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STEVE CRISAFULLI
Speaker of the House of Representatives

July 7, 2016

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

Re: Docket No. 160021, 160061-EI, 160062-EI and 160088-EI

Dear Ms. Stauffer:

Please find enclosed for filing in the above referenced docket the Direct Testimony and Exhibits of **Ralph Smith, CPA**. This filing is being made via the Florida Public Service Commission's Web Based Electronic Filing portal.

If you have any questions or concerns; please do not hesitate to contact me. Thank you for your assistance in this matter.

Sincerely,

Patricia A. Christensen
Associate Public Counsel

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by Florida Power Company	Docket No. 160021-EI
In re: Petition for approval of 2016-2018 storm hardening plan, by Florida Power & Light Company.	Docket No. 160061-EI
In re: 2016 depreciation and dismantlement study by Florida Power & Light Company.	Docket No. 160062-EI
In re: Petition for limited proceeding to modify and continue incentive mechanism, by Florida Power & Light Company.	Docket No. 160088-EI
______________________________/	Filed: July 07, 2016

DIRECT TESTIMONY

OF

RALPH SMITH, CPA

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

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TABLE OF CONTENTS

DIRECT TESTIMONY

OF

RALPH SMITH

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 160021-EI, et al (consolidated)

I. INTRODUCTION

Q. WHAT ARE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS?

A. My name is Ralph Smith. I am a Certified Public Accountant licensed in the State of Michigan and a senior regulatory consultant at the firm Larkin & Associates, PLLC, Certified Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan, 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC, ("Larkin") is a Certified Public Accounting and Regulatory Consulting Firm. The firm performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including numerous electric, water and wastewater, gas and telephone utility cases.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION?

A. Yes, I have testified before the Florida Public Service Commission ("FPSC" or "Commission") previously. I have also testified before several other state regulatory commissions.

Q. HAVE YOU PREPARED AN EXHIBIT DESCRIBING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Exhibit RCS-1, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Larkin & Associates, PLLC, was retained by the Florida Office of Public Counsel ("OPC") to review the rate request of Florida Power & Light Company ("FPL" or "Company"). Accordingly, I am appearing on behalf of the Citizens of the State of Florida ("Citizens").

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

A. I am presenting OPC's overall recommended revenue requirement in this case. I also sponsor some of the OPC's recommended adjustments to the Company's proposed rate base and operating income.

Q. ARE ANY ADDITIONAL WITNESSES APPEARING ON BEHALF OF THE FLORIDA OFFICE OF PUBLIC COUNSEL IN THIS CASE?

A. Yes. Helmuth W. Schultz, III, also of Larkin & Associates, PLLC ("Larkin"), is presenting testimony on storm hardening, payroll and several other issues, which impact the revenue requirement. Dr. David Dismukes is presenting testimony addressing FPL's sales forecasts for 2017 and 2018, which impact the revenue requirement in this case. Dr. Dismukes also presents information on forecasted inflation rates. Jacob Pous addresses FPL's request for new depreciation and amortization rates. Kevin O'Donnell's testimony addresses the appropriate capital structure for purposes of determining the revenue requirement of FPL in this case. Dr. Randall Woolridge presents Citizens' recommended rate of return on equity in this case using the recommended capital structure, as well as the appropriate rate of return on equity if the Commission adopts FPL's proposed capital structure. Daniel Lawton addresses FPL's request for an additional return on equity and financial ratios.

II. <u>FPL REQUESTED REVENUE INCREASES</u>

Q. WHAT ARE THE REVENUE ADJUSTMENTS THAT THE COMPANY IS PROPOSING?

A. The Company is proposing revenue adjustments over a four-year period. The Company is requesting a general base revenue adjustment of approximately $860 million effective in January 2017; a subsequent year adjustment of approximately $265 million effective in January 2018; and an adjustment of approximately $200 million effective in mid-2019 when the new Okeechobee Clean Energy Center enters service. There would be no base rate increase in 2020.

Q. FPL IS REQUESTING BOTH A BASE RATE INCREASE TO BE EFFECTIVE JANUARY 2, 2017, AND A SUBSEQUENT YEAR INCREASE FOR JANUARY 1, 2018, AND A LIMITED SCOPE ADJUSTMENT ON JUNE 1, 2019, CONCURRENT WITH THE COMMERCIAL IN-SERVICE DATES OF ITS OKEECHOBEE

CLEAN ENERGY CENTER. WILL YOU BE ADDRESSING EACH OF FPL'S THREE REQUESTED INCREASES TO BASE RATES?

A. Yes. In this testimony, I first address the base rate increase that FPL has proposed to be effective January 2, 2017 ("January 2017 Base Rates"). I then also address the proposed base rate adjustment for the Company's requested January 2018 Subsequent Year Increase and for the Company's requested Mid-2019 Limited Scope Adjustment (LSA) Increase for the Okeechobee Clean Energy Center.

III. <u>ORGANIZATION OF TESTIMONY</u>

Q. **HOW WILL YOUR TESTIMONY BE ORGANIZED?**

A. In Section IV, I present the overall financial summary for the base rate change to be effective January 2, 2017, showing the revenue requirement excess for the 2017 test year recommended by Citizens. In Section V, I discuss certain corrections that FPL has identified to its filing that affect the revenue requirement. In Section VI, I then discuss my proposed adjustments which impact the January 2017 Base Rates, and how the recommended sales forecast adjustment sponsored by OPC witness Dismukes and the new depreciation rates recommended by OPC witness Pous have been reflected. Where an adjustment affects both 2017 and 2018, I discuss the impact on both projected test years in Section VI. Exhibit RCS-2 presents the schedules and calculations in support of the 2017 revenue requirement and Exhibit RCS-3 presents the 2018 revenue requirement.

In Section VII, I address the January 2018 Subsequent Year Increase. Within this section, I present the OPC revenue requirement recommendation associated with the 2018 increase requested by FPL. The January 2018 revenue requirement calculations and adjustments impacting these calculations are presented in Exhibit RCS-3.

Finally, in Section VIII, I present the adjusted revenue requirement for FPL's requested Okeechobee Limited Scope Base Rate Change for the projected year ending May 31, 2020. Although an adjusted revenue requirement for the Okeechobee limited scope increase is presented on Exhibit RCS-4, I recommend that no increase for 2019 or 2020 be approved at this time.

IV. OVERALL FINANCIAL SUMMARY – JANUARY 2017 BASE RATE CHANGE

Q. WHAT IS THE JANUARY 2017 BASE RATE REVENUE REQUIREMENT DEFICIENCY OR EXCESS FOR FLORIDA POWER & LIGHT COMPANY?

A. As shown on Exhibit RCS-2, Schedule A-1, the OPC's recommended adjustments in this case result in a recommended revenue reduction for FPL in January 2017 of approximately $807.2 million. This is $1.674 billion less than the base rate revenue increase of $866.4 million requested by FPL in its filing.

Q. PLEASE DISCUSS THE EXHIBIT YOU PREPARED IN SUPPORT OF YOUR TESTIMONY AS IT PERTAINS TO THE JANUARY 2017 BASE RATE CHANGE.

A. Exhibit RCS-2, totaling 21 pages, consists of Schedules A-1, B-1 through B-2, C-1 through C-7, D, E, and F.

Q. WHAT IS SHOWN ON SCHEDULE A-1?

A. Schedule A-1 presents the revenue requirement calculation for the January 2017 Base Rate change, giving effect to all of the adjustments I am recommending in this testimony, along with the impacts of the recommendations made by Citizens' witnesses Schultz, Dismukes, Pous, O'Donnell, Lawton, and Woolridge.

Q. WHAT IS SHOWN ON SCHEDULE B-1 AND B-2?

A. Schedule B-1 presents OPC's adjusted rate base and identifies each of the adjustments impacting rate base that are recommended by Citizens' witnesses in this case. Schedule B-2 provides supporting calculations for the rate base adjustment for Plant Held for Future Use that I am sponsoring.

Q. WHAT IS SHOWN ON SCHEDULE C-1?

A. OPC's adjusted net operating income is shown on Schedule C-1, page 1. OPC's adjustments to net operating income are listed on Schedule C-1, page 2. Schedules C-2 through C-7 provide supporting calculations for the OPC adjustments to net operating income, which are presented on Schedule C-1.

Q. WOULD YOU PLEASE DISCUSS SCHEDULE D?

A. Schedule D presents Citizens' recommended capital structure and overall rate of return, based on the revisions to FPL's proposed debt-to-equity ratio recommended by Kevin O'Donnell and the rate of return on equity recommended by Dr. Randall Woolridge. The capital structure ratios for debt and common equity are based on the ratios recommended by Mr. O'Donnell. On Schedule D, I have applied the adjustments to the capital structure necessary to synchronize Citizens' recommended capital structure to the adjusted jurisdictional rate base. On Schedule D, I applied Dr. Woolridge's recommended return on equity, resulting in OPC's overall recommended rate of return of 5.05%.

Q. WHAT IS SHOWN ON SCHEDULES E AND F?

A. Schedules E and F show the incorporation of FPL's corrections to its application that affect the revenue requirement. In filings made on May 3, 2016 and June 16, 2016, FPL identified corrections and adjustments to its filing.[1]

V. <u>INCORPORATION OF FPL IDENTIFIED ADJUSTMENTS AND CORRECTIONS</u>

Q. AFTER FILING ITS MFRS, HAS FPL IDENTIFIED ANY ERRORS OR CORRECTIONS TO ITS FILING?

A. Yes. FPL so far has filed three notices of Identified Adjustments that impact the requested revenue requirement as detailed below. While I have included FPL's Identified Adjustments in my testimony, I have not had sufficient time to evaluate and form an opinion on the reasonableness of these adjustments.

Q. ON MAY 3, 2016, FPL FILED A NOTICE OF IDENTIFIED ADJUSTMENTS. WHAT DID THAT CONTAIN?

A. FPL's May 3, 2016 Notice of Identified Adjustments provided descriptions and estimated revenue requirement impacts for the corrections and adjustments that FPL had identified up to that point. FPL explained in its May 3, 2016 Notice that: "The Adjustments Affecting Revenue Requirements, if made, would net to an approximate net $9 million decrease in FPL's overall 2017 test year revenue requirements and a decrease of approximately $7 million for FPL's overall 2018 Subsequent Year revenue requirements." FPL stated further in its Notice that it would include all adjustments identified on Attachment 1 to its Notice in an exhibit of adjustments that it will file with rebuttal

[1] FPL made a third correction filing on June 30, 2016, which has not been incorporated at this time.

testimony, along with any other adjustments that may be identified between now and then. FPL indicates further that it had included similar exhibits with the rebuttal testimony of FPL witnesses in its 2009 and 2012 rate cases.

Q. **WHAT ADJUSTMENTS WERE IDENTIFIED IN FPL'S MAY 3, 2016 NOTICE?**

A. FPL's May 3, 2016 Notice in Attachment 1 identified 14 items that impact the revenue requirement, which are briefly summarized below[2] using FPL's descriptions:

> 1) **Deferred Pension Debit**. Deferred pension debit in FERC Account 186 was forecasted inconsistently with forecasted pension expense amounts reflected on MFR C-17. As such, rate base is overstated by approximately \$3.6M and \$8.9M for 2017 and 2018, respectively.
>
> 2) **West County Water Reclamation**. O&M expense for the servicing of the water reclamation bonds was double counted, resulting in an overstatement to O&M of \$4.2M for both 2017 and 2018.
>
> 3) **Outdoor Lighting Revenues**. An incorrect present rate was used for the "OL-1 Underground conductors excluding trenching (rate per foot)" in the 2018 revenue forecast. As shown on MFR E-13d page 13 of 21, line 19, column 5, the rate entered was "1.078" and the correct rate is "0.078." Adjusting this rate to reflect the correct value decreases 2018 revenues under present rates by approximately \$3.8M.
>
> 4) **Retail Base Revenues**. The long-term price of electricity for both 2017 and 2018 was calculated incorrectly as it included higher fuel expense than should have been forecasted. This underestimated the amount of usage by customers and results in less than 0.1% increase in the amount of megawatt hours sold for 2017 and less than 0.2% for 2018. This results in \$4.9M of additional retail base revenues for 2017 and \$9.3M for 2018.

[2] FPL's May 3, 2016 Notice also identified three additional adjustments/corrections without revenue requirement impact.

5) **Changes related to Forecast Revenues** including:

a) **<u>Late Payment Charges</u>**. Incorrect Late payment charges for 2017 and 2018 result in an understatement of revenues in 2017 and overstatement of revenues in 2018.

b) **<u>Returned Checks</u>**. Incorrect returned check charges for 2017 and 2018 result in an understatement of revenues in 2017 and overstatement of revenues in 2018.

c) **<u>Uncollectible Accounts Expense</u>**. Incorrect uncollectible accounts expense for 2017 and 2018 result in an understatement of O&M expense in 2017 and overstatement of O&M expense in 2018.

d) **<u>NOI Multiplier - Bad Debt Rate</u>**. Incorrect bad debt rate reflected on MFR C-44 for all periods should be 0.066% and the resulting NOI multiplier should be 1.63025.

6) **<u>Demand Side Management (DSM) Peaking Adjustment</u>**. FPL includes adjustments to Net Energy for Load (NEL) in its forecast for incremental DSM to account for DSM impacts not reflected in historical data; however, did not include comparable adjustments in its peak forecasts. Including the incremental DSM impact to its peak forecasts lowers the retail share of the system monthly coincident peak demand resulting in a reduction in production demand-based separation factors of 0.014% in 2017 and 0.018% in 2018. There is no impact on the allocation between the rate classes as a result of this adjustment.

7) **<u>Amortization of Gains - Aviation</u>**. Gain amortization related to the sale of aviation assets ceased in 2016 and should not have been included in 2017 or 2018. This results in an overstatement of the credit to FERC Account 407 by approximately $1.2M for both 2017 and 2018. FPL did not forecast any activity in the related regulatory liability (FERC Account 254); therefore, no adjustment to rate base is required.

8) **<u>Amortization of Gains - Mitigation Bank - Phase II</u>**. FPL included $25.1M as the estimated phase II mitigation bank gain on MFR C-29 and related amortization in 2018 in error. This benefit cannot be recognized until beyond 2020. This results in an overstatement of the credit to FERC Account 407 by approximately $5.0M for 2018.

9) **Company Adjustment - Fukushima**. Accumulated depreciation reserve for the Fukushima Company adjustment for 2018 contained a formula error for January 2018. The accumulated depreciation reserve adjustment was understated by $0.1M for 2018, with a resulting $7K impact on revenue requirements.

10) **Company Adjustment - Depreciation**. Company adjustment for base depreciation expense was not reflected in the correct distribution plant accounts. The majority of distribution plant accounts have a separation factor of 1; however, plant account 370 has a factor lower than 1. The retail jurisdictional amount for the credit to depreciation expense for the distribution function for both 2017 and 2018 was understated.

11) **Company Adjustment - Dismantlement**. Company adjustment dismantlement calculations for both 2017 and 2018 are as follows: (1) Useful life of the Okeechobee plant (currently 52 years, should be 40 years); (2) Alignment of forecasted dismantlement costs for Turkey Point and gas turbines with the study assumptions; and (3) Certain formula errors in the 2016 Dismantlement Study prepared by Burns & McDonnell. The impact of these adjustments results in an overstatement of FPL's dismantlement expense Company adjustment for 2017 and 2018 of $1.4M. Corrections to the 2016 Dismantlement Study will be filed in Docket No. 160062-EI.

Cost of Capital Impacts. FPL identified the following three adjustments as impacting on its proposed Cost of Capital:

12) **Company Adjustment - ADIT Proration**. ADIT proration company adjustment for 2017 and 2018 did not include the impact of bonus depreciation associated with FPL's Gas Reserves investment. In addition, 2018 was calculated incorrectly due to a formula error. The beginning balance for the 2018 13-month average company adjustment should have been zero, not the ending balance of the ADIT company adjustment for 2017. As such, the weighted average cost of capital for 2017 and 2018 should be 6.6080% and 6.7032%, respectively.

13) **Customer Deposits**. Amount of customer deposits for 2017 and 2018 was not updated for the final forecasted retail revenues from the sales of electricity. In addition, the amount of forecasted refunds for excess deposits on master accounts was input incorrectly. As such, the amount of total company per book customer deposits should increase $1.2M and $1.8M for 2017 and 2018, respectively, and all other classes of capital should be adjusted in order for rate base to reconcile to capital structure. The weighted average cost of capital for 2017 and 2018 should be 6.6071% and 6.7048%, respectively. Because the amounts of long term debt and common equity have changed based on these adjustments, the amount of long term debt and

common equity used in the calculation of the incremental cost of capital for the 2019 Okeechobee LSA requires an adjustment. Adjusting for these changes decreases the incremental cost of capital for the OK LSA by 0.000098%.

14) **Incremental Cost of Capital**. The calculation of the incremental cost of capital for the 2019 Okeechobee LSA was based on the jurisdictional adjusted capital structure amounts from 2018, which included an ADIT proration adjustment specific to 2018 forecasted activity. The ADIT proration adjustment for the 2019 Okeechobee LSA was already reflected in the calculation of deferred income taxes, which is a reduction to rate base. As such, incremental cost of capital should be based on the jurisdictional adjusted 2018 capital structure, less the 2018 ADIT proration adjustment. Adjusting for these changes decreases incremental cost of capital by 0.000002%.

Q. HOW HAVE YOU INCORPORATED THOSE ADJUSTMENTS IDENTIFIED BY FPL IN ITS MAY 3, 2016 NOTICE INTO THE CALCULATION OF THE REVENUE REQUIREMENT?

A. As noted above, the Notice filed by FPL on May 3, 2016 provided estimated revenue requirement impacts of its identified corrections and adjustments, but did not include detail on rate base or net operating income impacts. In Excel workpapers, FPL provided additional details showing the impacts on key rate base and net operating income components of its Identified Adjustments. I have utilized the information provided by FPL in response to that discovery to incorporate many FPL-identified adjustments to FPL's originally filed rate base and net operating income.

Q. PLEASE EXPLAIN HOW YOU HAVE REFLECTED THE FPL MAY 3, 2016 CORRECTIONS AFFECTING THE 2017 RATE BASE AND NET OPERATING INCOME.

A. On Exhibit RCS-2, Schedule B-1, page 1 of 2, which shows 2017 forecasted rate base, I have reflected the adjustments to rate base identified in FPL's May 3, 2016 Notice in column B.

Similarly, on Exhibit RCS-2, Schedule C-1, page 1 of 2, which shows 2017 forecasted net operating income, I have reflected the adjustments to net operating income that were identified in FPL's May 3, 2016 Notice in column B.

On Exhibit RCS-2, Schedule E, page 3, I have reproduced the FPL identified adjustment detail that was provided by the Company in its workpapers for impacts on the 2017 forecasted test year rate base and net operating income. Exhibit RCS-2, Schedule E, page 1, shows the reflection of FPL's May 3, 2016 adjustments on 2017 test year rate base. Exhibit RCS-2, Schedule E, page 2, shows the adjustments to 2017 test year net operating income components.

Q. HOW HAVE YOU INCORPORATED FPL'S CHANGES TO THE CAPITAL STRUCTURE AT THIS TIME?

A. As shown on Exhibit RCS-2, Schedule D, the reconciliation of the capital structure to the adjusted rate base includes the OPC rate base adjustments and the FPL identified rate base correction amounts. As described elsewhere in my testimony, OPC witness O'Donnell is recommending a different capital structure than FPL has proposed. The capital structure, cost rates, and overall cost of capital used to compute the revenue requirement for the 2017 forecasted test year is shown on Exhibit RCS-2, Schedule D.

Q. HAVE YOU INCORPORATED THE IMPACTS OF FPL'S MAY 3, 2016 NOTICE ON 2018 SUBSEQUENT YEAR RATE BASE AND NET OPERATING INCOME IN A SIMILAR MANNER?

A. Yes. I have reflected the impacts on the 2018 subsequent test year in a similar manner. Specifically, on Exhibit RCS-3, Schedule B-1, page 1 of 2, which shows 2018 forecasted rate base, I have reflected the adjustments to rate base identified in FPL's May 3, 2016 Notice in column B. On Exhibit RCS-3, Schedule C-1, page 1 of 2, which shows 2018 forecasted net operating income, I have reflected the adjustments to net operating income that were identified in FPL's May 3, 2016 Notice in column B.

On Exhibit RCS-3, Schedule E, page 3, I have reproduced the FPL identified adjustment detail that was provided by the Company in its Excel workpapers for impacts on the 2018 subsequent test year rate base and net operating income, which are shown on Schedule E, pages 1 and 2, respectively.

Q. HAS FPL FILED A SECOND NOTICE OF IDENTIFIED ADJUSTMENTS?

A. Yes. On June 16, 2016, FPL filed a Second Notice of Identified Adjustments. Similar to its May 3, 2016 Notice, in its June 16, 2016 Second Notice, FPL states they will include the adjustments identified on Attachment 1 to its Second Notice in an exhibit of adjustments that it will file with rebuttal testimony, along with any other adjustments that may be identified between now and then.

Q. WHAT ADJUSTMENTS WERE INCLUDED IN THAT SECOND NOTICE?

A. FPL's Second Notice identified the following three adjustments, along with FPL's explanations:

1) **Supplement to 2016 Depreciation Study**. As filed, FPL's 2016 depreciation study developed service lives and net salvage characteristics based on historical data through year-end 2014. Those parameters were then applied to estimated plant and reserve balances brought forward to year-end 2017. Because the primary test year in FPL's base rate case is 2017, FPL considered year-end 2017 estimated plant and reserve balances as best representing FPL's depreciable plant during the test year. Discovery to date from Staff and others has raised questions about whether using year-end 2016 balances would be more appropriate and consistent with past Commission practice. FPL continues to believe that the use of year-end 2017 balances would provide a good match with FPL's 2017 Test Year and 2018 Subsequent Year, but has no objection to using results for year-end 2016 balances for the purpose of setting depreciation rates and determining FPL's base rates in this proceeding and accordingly is proposing the adjustment described. ... [in its Second Notice].

2) **Economic Development Rider**. In responding to discovery, FPL determined that its projection of test period revenues for customers taking service under the Economic Development Rider and the Existing Facility Economic Development Rider did not take into account the base rate discounts provided under those riders and thus test period revenues were overstated by the amount of the discounts. At the same time, FPL determined that it needed to correct the five percent of economic development expenses (i.e., rate reductions and O&M expenses) from test period revenue requirements that is contemplated by Rule 25-6.0426, Florida Administrative Code. These two corrections partially offset and result in increases in revenue requirements of approximately $700,000 in 2017 and $800,000 in 2018, as shown on Attachment 1.

3) **SJRPP Dismantlement Costs**. In responding to discovery, FPL determined that it had not correctly forecast the dismantlement costs that are to be accrued for the 30% of SJRPP output that FPL purchases from JEA under a PPA. As shown on Attachment 1, this correction results in decreases in revenue requirements of approximately $70,000 in 2017 and $85,000 in 2018.

Q. HOW HAVE YOU INCORPORATED THE ADJUSTMENTS AND CORRECTIONS NOTED BY FPL IN ITS JUNE 16, 2016 SECOND NOTICE OF IDENTIFIED ADJUSTMENTS IN THE REVENUE REQUIREMENT DETERMINATION?

A. I have incorporated those June 16, 2016 FPL adjustments in a similar manner to FPL's May 3, 2016 adjustments. An Excel file containing detail of the additional FPL-identified adjustments was obtained and reproduced on Exhibit RCS-2, Schedule F, page 3, for 2017, and on Exhibit RCS-3, Schedule F, page 3, for 2018. That FPL-provided information was used to incorporate the rate base and net operating impact of those adjustments into the revenue requirement determination in the following manner.

On Exhibit RCS-2, Schedule B-1, page 1 of 2, which shows 2017 forecasted rate base, I have reflected the adjustments to rate base identified in FPL's June 16, 2016 Second Notice in column C. Similarly, on Exhibit RCS-2, Schedule C-1, page 1 of 2, which shows 2017 forecasted net operating income, I have reflected the adjustments to net operating income that were identified in FPL's June 16, 2016 Second Notice in column C.

On Exhibit RCS-2, Schedule F, page 3, I have reproduced the FPL identified adjustment detail that was provided by the Company in an Excel file that was provided to OPC after FPL filed its Second Notice. Schedule F, pages 1 and 2 summarizes the impacts on the 2017 forecasted test year rate base and net operating income, respectively, of the additional adjustments FPL identified in its Second Notice.

Q. **HAVE YOU REFLECTED THE IMPACTS OF FPL'S JUNE 16, 2016 SECOND NOTICE OF ADJUSTMENTS ON THE 2018 SUBSEQUENT TEST YEAR IN A SIMILAR MANNER?**

A. Yes. I have reflected the impacts on the 2018 subsequent test year in a similar manner. Specifically, on Exhibit RCS-3, Schedule B-1, page 1 of 2, which shows 2018 forecasted rate base, I have reflected the adjustments to rate base identified in FPL's June 16, 2016

Notice in column C. Similarly, on Exhibit RCS-3, Schedule C-1, page 1 of 2, which shows 2018 forecasted net operating income, I have reflected the adjustments to net operating income that were identified in FPL's June 16, 2016 Second Notice in column C.

On Exhibit RCS-3, Schedule F, page 3, I have reproduced the FPL identified adjustment detail that was provided by the Company in an Excel file for impacts of adjustments described in FPL's Second Notice on the 2018 subsequent test year rate base and net operating income. Exhibit RCS-3, Schedule F, pages 1 and 2, shows the incorporation of those FPL adjustments to 2018 rate base and net operating income, respectively.

Q. DID FPL FILE A THIRD NOTICE OF IDENTIFIED ADJUSTMENTS?

A. Yes, on June 30, 2016, FPL filed a Third Notice of Identified Adjustments.

Q. WHAT WAS CONTAINED IN FPL'S THIRD NOTICE?

A. FPL's June 30, 2016 Notice provided the following explanation, describing how it was implementing the Florida Supreme Court's May 19, 2016 Citizens v. Graham decision that reversed the Commission's orders approving cost recovery for the Woodford gas reserves project. In its filing, FPL stated:

> In January 2015, the Commission issued Order No. PSC-15-0038-FOF-EI approving Fuel Clause recovery for the costs associated with FPL's owning and operating the Woodford gas reserves project. In July 2015, the Commission issued Order No. PSC-15-0284-FOF-EJ approving guidelines for FPL investments in future gas reserves projects. Based on those orders, FPL included both the Woodford project and estimates of additional gas reserves projects in developing its Total Company financial forecast underlying the rate case filing in this docket. Because the costs for gas reserves projects were to be recovered through the Fuel Clause, FPL then made Commission adjustments to remove the costs of those projects from the test period base rate revenue requirements calculations, consistent with the Commission's Earnings Surveillance Report ("ESR") and MFR practice for clause-recoverable activities.

> On May 19, 2016, the Florida Supreme Court reversed Order No. PSC-15-0038-FOF-EI and two companion orders, finding that the Commission does not have authority to allow FPL to recover costs associated with the Woodford gas reserves project from customers. While the Court's May 19 order directly addressed only the Woodford project, its rationale would apply to future gas reserves projects as well. On June 15, 2016, the Commission and all parties to the appeal of Order No. PSC-15-0284-FOF-EI filed a joint motion for the Court to relinquish jurisdiction over that order so that the Commission may vacate it. The Court granted the joint motion on June 28, 2016.
>
> In light of the May 19 order, Staff held an informal meeting with FPL and parties to discuss removing the impact of gas reserves projects from the Fuel Clause and rate case filings. Following that meeting, FPL has rerun its financial forecasts for the 2017 Test Year, 2018 Subsequent Year and the 2019 Okeechobee LSA as if (1) there had been no Woodford investments historically and thus no sale of Woodford gas production to FPL and (2) no additional gas reserves investments would be made in the rate effective years.[3] As noted above, FPL had already made a Commission adjustment to remove gas reserves costs from base rate revenue requirements consistent with the Commission's ESR and MFR practice for clause-recoverable activities. However, for the reasons discussed in Attachment 1 to this Notice, there are some minor differences in the revenue requirements calculation when the financial forecasts assume no gas reserves projects rather than assuming that there will be gas reserves projects with a Commission adjustment to treat them as clause-recoverable. The net effect of those differences is a modest reduction in revenue requirements for the 2017 Test Year and 2018 Subsequent Year, with a negligible impact on the 2019 Okeechobee LSA.

Q. DID FPL'S THIRD NOTICE IDENTIFY ESTIMATED REVENUE REQUIREMENT IMPACTS?

A. Yes. FPL's June 30, 2016 Third Notice identified a $7.3 million decrease in its 2017 revenue deficiency, a $1.6 million increase to its 2018 revenue deficiency, and a negligible $65,000 increase in its claimed Okeechobee revenue requirement.

[3] In its actual/estimated true-up filing in Docket No. 160001-EI on August 4, 2016, FPL will include a refund calculation for the difference between the amounts it is collecting for the Woodford project in the Fuel Clause, versus the market price of the gas produced from that project.

Q. HAVE YOU INCORPORATED FPL'S THIRD NOTICE INTO THE OPC'S REVENUE REQUIREMENT COLUMN?

A. No. Due to the timing of when it was received, I have not incorporated impacts from FPL's Third Notice. I will reserve the option to amend my testimony and schedules to incorporate these impacts.

VI. RECOMMENDED ADJUSTMENTS TO RATE BASE AND NET OPERATING INCOME

Q. WOULD YOU PLEASE DISCUSS EACH OF YOUR SPONSORED ADJUSTMENTS TO FPL'S FILING?

A. Yes, I will address each adjustment I am sponsoring below.

Plant Held For Future Use

Q. PLEASE EXPLAIN THE LEVEL OF PLANT HELD FOR FUTURE USE THAT FPL HAS REFLECTED IN ITS 13-MONTH AVERAGE RATE BASE.

A. As shown on MFR Schedule B-1, FPL shows Plant Held For Future Use ("PHFFU") of $247,614,000 on a total Company 13-month average basis. FPL provided a breakout of this amount by category in MFR Schedule B-15, which is reproduced in the table below:

Description	13 Month Avg. 2017 Test Year Amount	2017 Test Year Jurisdictional Amount
Gas Reserves Future Use	$ 1,369,000	$ 1,297,000
Other Production Future Use	$ 95,089,000	$ 90,391,000
Transmission Future Use	$ 72,952,000	$ 65,820,000
Distribution Future Use	$ 44,398,000	$ 44,398,000
General Plant Future Use	$ 33,806,000	$ 32,706,000
Total PHFFU	$ 247,614,000	$ 234,612,000

Q. HAS FPL REMOVED ANY PHFFU FROM RATE BASE?

A. Yes. FPL removed the $1.369 million for Gas Reserves (jurisdictional amount of $1.297 million) from rate base. Per a footnote on MFR Schedule B-15, FPL had intended to seek recovery of that amount through the Fuel and Purchased Power Recovery Clause.

Q. DID YOU REVIEW THE DETAIL OF FPL'S REQUEST FOR RATE BASE INCLUSION OF PHFFU?

A. Yes. In OPC's Second Set Interrogatory No. 105, OPC requested that the Company provide the following information for each item of PHFFU included in the $247.614 million: (a) a description of the property; (b) purchase dates and related amounts; (c) the date originally recorded in account 105; (d) the current anticipated in-service date; and (e) documentation for system planning supporting the expected in-service dates. In response to OPC's 2nd Set of Interrogatories, Interrogatory No. 105, FPL provided a detailed listing of each item included in PHFFU.

Q. DO YOU AGREE THAT EVERY PROPERTY INCLUDED IN FPL'S 2017 TEST YEAR PHFFU BALANCE SHOULD BE INCLUDED IN RATE BASE IN THIS PROCEEDING?

A. No, I do not. Upon reviewing the detail associated with the Company's requested level of PHFFU provided in response to OPC's 2nd Set of Interrogatories, Interrogatory No. 105, I have determined that several items should be removed and not included in rate base at this time. Sites with a projected in-service date of more than ten years beyond the test year planning horizon should be excluded from rate base, resulting in an overall PHFFU reduction of $14.681 million on a total Company basis, or $14.238 million after jurisdictional allocation.

Q. WHY DO YOU RECOMMEND THAT PHFFU WITH EXPECTED IN-SERVICE DATES OF BEYOND 2026 BE REMOVED FROM FPL'S RATE BASE?

A. Ratepayers should not be required to pay a return to FPL's shareholders for the costs of sites that have an expected in-service date that is beyond the 10-year planning horizon because it is not used and useful to current customer and will not be used within a reasonable timeframe in future. The statute states: "The commission shall investigate and determine the actual legitimate costs of the property of each utility company, <u>actually used and useful in the public service</u>, and shall keep a current record of the net investment of each public utility company in such property which value, as determined by the commission, shall be used for ratemaking purposes and shall be the money honestly and prudently invested by the public utility company in such property <u>used and useful in serving the public</u>, ..." Section 366.06, Florida Statutes. (Emphasis added.) Property held for future use that is beyond the ten-year planning horizon is not used and useful in providing service to ratepayers. Thus, it is not reasonable to expect ratepayers to pay a return on the costs of that property held for future use on an annual recurring basis. The detail that was provided in the response to OPC Interrogatory No. 105 listed several properties under the Transmission and Distribution Future Use categories, where the expected in-service dates are beyond 2026. Additionally, eight of the sites have been on FPL's books for many years prior to 2000, ranging from 1967 to 1994, and 11 sites were added between 2000 and 2010. Exhibit RCS-2, Schedule B-2, pages 2 and 3, lists those PHFFU sites with expected in-service dates of beyond 2026, i.e., beyond the next ten years. I recommend that the cost of these sites be removed from the 2017 test year PHFFU balance that is included in rate base.

Q. DOES THE COMMISSION HAVE A STANDARD THAT IT HAS APPLIED TO DETERMINE WHETHER SPECIFIC FUTURE USE PROPERTIES SHOULD BE INCLUDED IN RATE BASE?

A. FPL offered a standard in the 2012 rate case that is useful and can be followed since they agreed to it. As addressed in his rebuttal testimony in FPL's last rate case, former PSC Commissioner Terry Deason offered the following as a standard (at page 14, lines 1 to 11):

> The Commission's standard is one of reasonableness or what amount of PHFU is reasonably needed to cost-effectively provide reliable service to existing and future customers. Applying this standard requires a review of specific properties to determine whether their acquisition and retention are reasonable to provide service over an adequate planning horizon. The Commission's reasonableness standard cannot be determined by arbitrary and rigid time limitations on the properties' ultimate use. To do so would be contrary to Commission policy and ultimately work to the disadvantage of utilities' customers.

Q. HAS FPL IN THIS DOCKET MADE ANY SHOWING THAT THE SPECIFIC PROPERTIES ARE REASONABLY NEEDED TO COST-EFFECTIVELY PROVIDE RELIABLE SERVICE TO EXISTING AND FUTURE CUSTOMERS OR WHAT TIMEFRAME IS AN ADEQUATE PLANNING HORIZON?

A. No, it has not. FPL has made no showing why the projects that have been in rate base for more than 10, and some more than 40 years, which are not expected to provide service for more than 10 years after the test year, are reasonably needed to provide reliable service to existing and future customers. Customers should not be required to continue to provide FPL with a rate base return, including shareholder profits, on these projects when FPL has failed to show why these properties were needed. Further, it has failed to explain why a 40 to 50-year planning horizon is reasonable for identifying assets to be included in rate base as used and useful plant.

Q. WHAT COSTS DID FPL ASSIGN TO PHFFU SITES WITH EXPECTED IN-SERVICE DATES BEYOND 2026?

A. A description of the PHFFU sites and their associated costs, which total $14.681 million on a 13-month average basis (per OPC Interrogatory No. 105), are summarized on Exhibit RCS-2, Schedule B-2.

Q. PLEASE SUMMARIZE YOUR OVERALL ADJUSTMENT TO PHFFU FOR THE 2017 FUTURE TEST YEAR RATE BASE.

A. As shown on Exhibit RCS-2, Schedule B-2, my adjustment removes the PHFFU in the 2017 future test year in the amount of $14.681 million total ($14.228 million jurisdictional) for sites with estimated in-service dates beyond 2026.

Q. IS THERE A SIMILAR ADJUSTMENT TO THE 2018 FUTURE TEST YEAR RATE BASE?

A. Yes. As shown on Exhibit RCS-3, Schedule B-2, for the 2018 future test year, the jurisdictional adjustment decreases average 2018 jurisdictional rate base by $14.234 million.

<u>Construction Work in Progress</u>

Q. HAS FPL INCLUDED CONSTRUCTION WORK IN PROGRESS ("CWIP") IN ITS RATE BASE REQUEST?

A. Yes. For the 2017 test year, MFR Schedule B-1 shows that $747,987,000 has been included in rate base for CWIP.

Q. SHOULD THE COMMISSION ALLOW THE NON-INTEREST-BEARING CWIP TO BE INCLUDED IN RATE BASE AS PROPOSED BY FPL?

A. No. It is my opinion that CWIP should not be afforded rate base treatment. CWIP, by its very nature, is plant that is not completed and is not providing service to customers. More specifically, and in reference to this proceeding, CWIP is not used or useful in delivering electricity to FPL's customers. Under the ratemaking process, utilities are permitted to earn a return on the assets that are used and useful in providing service to a utility's customers. Assets that are still undergoing construction clearly are not used in providing service to customers during the construction period. Because of this, the ratemaking process in some jurisdictions excludes CWIP from rate base, requiring that assets be classified as used and useful in serving customers prior to earning a return on those assets being recovered from ratepayers. Therefore, as a general regulatory principle, CWIP should be excluded from rate base and from costs being charged to customers until such time as it is providing service to those customers.

However, it is my understanding that the Commission has consistently allowed the inclusion of non-interest-bearing CWIP projects for electric utilities in rate base. This understanding was affirmed in the Commission's Order No. PSC-12-0179-FOF-EI, issued April 3, 2012, in Docket No. 110138-EI in a Gulf Power Company general rate case proceeding. In that order, at page 20, the Commission reaffirmed that: "the inclusion of CWIP (not eligible for AFUDC) in rate base is consistent with our practice." In acknowledgement of the Commission's practice and its recent affirmation thereof, I have not removed the non-interest-bearing CWIP from rate base for purposes of determining OPC's recommended revenue requirement in this case. However, the fact that the removal has not been reflected in OPC's revenue requirement calculations in this case should not be interpreted to mean that OPC's position on this issue has changed, or that OPC will not pursue this important policy issue in this rate case or future proceedings.

Rate Case Expense

Q. PLEASE EXPLAIN THE COMPANY'S ADJUSTMENT TO RATE CASE EXPENSE.

A. As discussed in the direct testimony of Company witness Kim Ousdahl, FPL has estimated rate case expenses totaling $4,925,000, which it proposes to amortize over a four-year period beginning in 2017. In its response to SFHHA Fourth Set of Interrogatories, Interrogatory No. 106, Attachment 1, FPL provided the breakdown of its projected $4.925 million of rate case expense for this case. In response to OPC Production of Documents No. 1, FPL provided detail for C-10, its rate case budget. That detail is included in the table below, which provides a breakdown of the estimated cost into categories:

Summary Table - FPL Requested Rate Case Expense	
Component	Totals
INCREMENTAL FPL Labor - Non-Exempt OT	$82,100
INCREMENTAL FPL Labor - Related Overhead	$19,992
Employee Related Travel Total	$505,800
Outside Services - Security	$24,000
Outside Services - Legal Fees Subtotal	$750,000
Outside Services - IM & Accounting Subtotal	$8,500
Outside Services - Temporary Labor Subtotal	$832,400
Outside Services - Professional Subtotal	$2,363,400
Outside Services - Other Subtotal	$86,000
Office & Facilities Administration Total	$181,808
Office & Facilities Administration Total	$71,000
Total	$4,925,000

As shown on MFR Schedule C-10, using the four-year amortization period, FPL proposes to include $1,231,250 for test year rate case expense amortization. In addition, as shown on MFR Schedule B-2, page 3 of 8, at line 23, FPL proposes to include the 13-month average unamortized balance of rate case expense associated with this proceeding of $4.309 million in the working capital component of its proposed 2017 test year rate base.

Q. DO YOU AGREE THAT THE COMPANY'S PROJECTED RATE CASE EXPENSE OF $4.925 MILLION IS REASONABLE?

A. No. The Company's projected rate case expense appears significantly overstated and should be reduced. The FPL labor costs should be removed. The $505,800 in employee related travel should be reduced, as should the amounts for temporary labor and professional.

Q. WHY SHOULD THE FPL LABOR COST BE REMOVED?

A. As indicated previously, FPL has included $82,100 for "Labor Non-Exempt OT" and $19,982 in "FPL Labor-Related Overhead". This category includes current fiscal year costs such as overtime. Because FPL's labor costs are already included in current base rates, these are labor expenses that FPL is incurring in 2016. FPL is proposing to add these 2016 labor costs to rate case expense that will be amortized in 2017 even if FPL's earnings in 2016 are adequate. The Commission has previously found that it is inappropriate for FPL to include additional pay or labor costs as part of the rate case expense to be recovered from ratepayers in future periods. In Order No. PSC-10-0153-FOF-EI, issued March 17, 2010, Docket No. 080677-EI, at page 163, in the 2008 FPL rate case, the Commission stated the following with respect to FPL including overtime labor in its projected rate case expense:

> FPL included $450,000 for overtime and or bonuses for salaried employees in its original total rate case expense filing. We have historically disallowed recovery of additional pay or bonuses as part of rate case expense. In Order No. PSC-08-0327-FOF-EI, we stated "Salaried Overtime Pay for Extraordinary Work Load" shall be disallowed because these employees and managers are paid a salary, not an hourly wage. Salaried employees are

usually expected to work the hours required to complete their job duties without extra compensation. (Footnote omitted)

Q. WHAT IS INCLUDED IN THE "EMPLOYEE RELATED TRAVEL" AMOUNT?

A. For the "Employee Related Travel" category, FPL's workpaper provides a breakdown of the total costs of $505,800, as follows:

Employee Related Travel	Amount
Hotel and Lodging	$244,300
Business Meals	$148,200
Airline Travel	$42,000
Vehicle - Car Rental	$33,800
Travel Expense	$16,700
Vehicle - Occasional	$20,800
Employee Related Travel Total	$505,800

FPL projects that $421,500 of this would be incurred in September 2016 alone:

Monthly Employee Travel Expense Components	JAN 2016	FEB 2016	MAR 2016	APR 2016	MAY 2016	JUN 2016	JUL 2016	AUG 2016	SEP 2016	OCT 2016	NOV 2016	DEC 2016	TOTAL
Hotel and Lodging	$300	$1,000	$3,000	$5,000	$2,000	$2,000	$2,000	$5,000	$215,000	$5,000	$3,000	$1,000	$244,300
Business Meals	$200	$500	$2,000	$3,000	$1,500	$1,500	$1,500	$3,000	$130,000	$3,000	$1,500	$500	$148,200
Airline Travel	$0	$0	$0	$0	$0	$3,000	$3,000	$3,000	$20,000	$10,000	$2,000	$1,000	$42,000
Vehicle - Car Rental	$100	$200	$400	$600	$600	$600	$600	$2,000	$25,000	$3,000	$500	$200	$33,800
Travel Expense	$50	$100	$200	$200	$200	$200	$200	$1,000	$14,000	$300	$200	$50	$16,700
Vehicle - Occasional	$100	$100	$200	$250	$250	$250	$250	$1,200	$17,500	$400	$200	$100	$20,800
TOTALS	$750	$1,900	$5,800	$9,050	$4,550	$7,550	$7,550	$15,200	$421,500	$21,700	$7,400	$2,850	$505,800

The hearings for this proceeding are scheduled for August 22 to September 2, 2016, with the post-hearing briefs due to be filed by the parties on September 16, 2016. Even with a two-week hearing, $421,500 of cost in September 2016 appears excessive. For example, if you take the hotel and lodging amounts for September of $215,000 and divide it by 12 days for the 10-day hearing, it equates to almost $18,000 per day. If you assume a $150 per night hotel group rate, which we could assume FPL could easily secure, that relates to over 120 employees staying in Tallahassee each night. Similarly, the amount for business meals over the same 12-day period equates to almost $11,000 per day or almost $100 a day per employee. Based on these estimates, clearly the lodging and meal estimates are excessive.

I would point out that these are the travel costs for employees and do not include the travel costs for the outside professional consultants that will attend the hearing.

Q. ARE THERE OTHER CATEGORIES OF COSTS THAT APPEAR TO BE OVERPROJECTED OR UNSUPPORTED?

A. Yes. Several of the cost estimates included in the Professional Services category appear to be either excessive or questionable. For example, $400,000 was included for "Concentric Energy, Advisors, Inc., Reed", yet only $58,190 is shown as paid through March 2016. The Company also included $40,000 for "William Feaster," yet no direct testimony was filed by Mr. Feaster. An amount of $250,000 is shown for "Sussex Consulting, Hevert" of which $73,295 is shown as paid through March 2016. That appears excessive for a return on equity witness, especially in comparison to OPC's rate of return and capital structure witnesses of less than $100,000 in total. In addition, the Company has included costs for additional potential rebuttal witnesses totaling $993,400.

Q. IS THE COMPLEXITY OF FPL'S FILING RESULTING IN INCREASED RATE CASE EXPENSE, AND WHO SHOULD BEAR THAT?

A. It appears that the complexity of FPL's filing, with two forecasted test years and an additional 2019 step increase, has increased rate case expense. These costs are not reasonable and should not be borne by ratepayers.

Q. WHAT IS YOUR RECOMMENDED AMOUNT TO BE ALLOWED FOR RATE CASE EXPENSE IN THIS CASE?

A. My recommended adjustment is presented on Exhibit RCS-2, Schedule C-2. Because several of the projected costs are inappropriate for inclusion in rate case expense, and other costs appear excessive, I recommend that the costs in this case be limited to the amount of rate case expense allowed by the Commission in FPL's 2008 rate case, adjusted for inflation. In FPL's prior 2008 rate case, Order No. PSC-10-0153-FOF-EI, the Commission authorized a rate case expense recovery of $3,207,000[4]. I escalated the allowed level from the prior docket using the O&M multiplier for CPI[5] of 1.072066 to 2013 and by 1.05300 for 2014 to the 2017[6] test year to determine the recommended amount of rate case expense. As shown on Exhibit DR-2, Schedule C-2, this adjustment results in an overall rate case expense of $3.620 million, or $1.305 million less than the Company's requested amount of $4,925,000. The annual amortization of these costs, using FPL's proposed four-year amortization period, is approximately $905,000, or $326,000 less than the amount proposed by FPL. Thus, the test year amortization expense requested by FPL should be reduced by approximately $326,000.

<u>Unamortized Rate Case Expense</u>

Q. HAS THE COMPANY INCLUDED THE PROJECTED TEST YEAR BALANCE OF UNAMORTIZED RATE CASE EXPENSE IN ITS WORKING CAPITAL REQUEST IN THIS CASE?

A. Yes. As noted above, the working capital component of rate base for the 2017 test year includes $4.309 million for FPL's projected unamortized rate case expense associated with this case. As noted in FPL's response to Staff First Set of Interrogatories, No. 52, FPL also reflected a $1.9 million deferred tax liability:

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[4] The Final Order in FPL's 2008 rate case in Docket No. 080677-EI was issued March 17, 2010.

[5] See MFR Schedule C-40 from FPL's filing in Docket No. 120015-EI.

[6] As shown on Exhibit RCS-2, Schedule C-2, this incorporates the recommendation of OPC witness Dismukes to use an inflation rate for 2016 of 1.44% instead of 2.00% and an inflation rate for 2017 of 2.0% instead of the 2.5% for 2017 listed on FPL's MFR Schedule C-40.

> FPL has included a $1.9 million deferred tax liability on line 6, column 2 on MFR D-1a in its Company per book forecast related to the total amount of deferred rate case expenses for this proceeding of $4.9 million (refer to MFR C-10). The Company adjustment associated with the amortization of deferred rate case expenses is removed from capital structure pro rata over all sources of capital, which is consistent with the treatment of Company adjustments in prior FPL base rate proceedings.

Q. SHOULD FPL BE PERMITTED TO INCREASE RATE BASE FOR THE UNAMORTIZED RATE CASE EXPENSE BALANCE?

A. No, it should not. The Commission has disallowed the inclusion of unamortized rate case expense in working capital in several prior decisions. This long-standing Commission policy was reaffirmed in Order No. PSC-10-0131-FOF-EI, issued March 5, 2010, involving Progress Energy Florida. At pages 71 to 72 of that Order, the Commission stated the following with regard to unamortized rate case expense:

> We have a long-standing policy in electric and gas rate cases of excluding unamortized rate expense from working capital, as demonstrated in a number of prior cases. The rationale for this position was that ratepayers and shareholders should share the cost of a rate case: i.e., the cost of the rate case would be included in the O&M expenses, but the unamortized portion would be removed from working capital. It espouses the belief that customers should not be required to pay a return on funds expended to increase their rates.
>
> While this is the approach that has been used in electric and gas cases, water and wastewater cases have included unamortized rate case expense in working capital. The difference stems from a statutory requirement that water and wastewater rates be reduced at the end of the amortization period (Section 367.0816, F.S.). While unamortized rate case expense is not allowed to earn a return in working capital for electric and gas companies, it is offset by the fact that rates are not reduced after the amortization period ends.
>
> We agree with the long-standing policy that the cost of the rate case should be shared, and therefore find that the unamortized rate case expense amount of $2,787,000 shall be removed from working capital. (Footnote omitted)

In a footnote on page 71 of the Order, the Commission identified the following cases that confirm and validate its long-standing policy of excluding the unamortized rate case expense from working capital in electric and gas cases:

> Order No. 23573, issued October 3, 1990, in Docket No. 891345-EI, In re: Application of Gulf Power Company for a rate increase; Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, in Docket No. 080317-EI, In re: Petition for rate increase by Tampa Electric Company; Order No. PSC-09-0375-PAA-GU, issued May 27, 2009, in Docket No. PSC-09-0375-PAA-GU [080366-GU], In re: Petition for rate increase by Florida Public Utilities Company.

In addition, in Order No. PSC-10-0153-FOF-EI, which was issued pursuant to FPL's last litigated rate case in Docket No. 080677-EI, at page 164, the Commission stated in part:

> We do not agree with the Company that the unamortized balance of rate case expense should be included in rate base. Historically, the unamortized balance of rate case expense has been excluded from rate base to reflect a sharing of the rate case cost between the ratepayers and the shareholders. Rate case expenses are recovered from ratepayers through the amortization process as a cost of doing business in a regulated environment. However, the unamortized balance of rate case expense has been excluded from rate base to reflect that an increase in rates is a benefit to the shareholders. (Footnote omitted)

This policy was also affirmed in Commission Order No. PSC-12-0179-FOF-EI, issued April 3, 2012, in Docket No. 110138-EI, involving Gulf Power Company, where the Commission stated at pages 30 and 31:

> [W]e have a long-standing practice in electric and gas rate cases of excluding unamortized rate case expense from working capital, as demonstrated in a number of prior cases. The rationale for this position is that ratepayers and shareholders should share the cost of a rate case; i.e., the cost of the rate case would be included in O&M expense, but the unamortized portion would be removed from working capital. This practice underscores the belief that customers should not be required to pay a return on funds spent to increase their rates.
>
> * * *
>
> For the foregoing reasons, we find that the unamortized rate case expense of $2,450,000 shall be removed from working capital consistent with our long standing practice.

In a footnote on page 30 of the Gulf Power Order, the Commission identified the same cases referenced in the footnote of the Progress Energy Florida Order discussed above.

Q. HAS FPL CITED ANY CASES IN WHICH A PORTION OF A UTILITY RATE CASE EXPENSE WAS ALLOWED TO BE INCLUDED IN RATE BASE?

A. Yes. In response to FIPUG's First Set of Interrogatories, Interrogatory No. 32(b), FPL states that:

> Rate case expenses are a necessary cost for any regulated public utility, just like any other cost included in FPL's revenue requirement calculation. Because the rate case expenses are recovered over a period of years, the unamortized rate case balance must be included in rate base in the Test Year in order to avoid an implicit disallowance of these deferred costs. Commission Order No. **PSC-08-0327-FOF-EI, issued on May 19, 2008,** allowed Florida Public Utilities Company [FPUC] to include one half of their unamortized rate case expense balance in working capital. Additionally, FPL requested to include unamortized rate case expenses in rate base in its last rate case (Docket No. 120015-EI) and is currently applying this treatment pursuant to Order No. PSC-13-0023-S-EI. (Emphasis added)

Similarly, in response to SFHHA's Fourth Set of Interrogatories, Interrogatory No. 107, FPL stated that:

> Rate case expenses are legitimate expenses incurred by the Company to prepare and present a case before the Commission in order to obtain rate relief. FPL requested a four year amortization of rate case expenses and the inclusion of unamortized rate case expenses in rate base beginning in its 2013 Test Year in Docket No. 120015-EI. The Commission approved a stipulation and settlement agreement in this docket **in Order No. PSC-13-0023-S-EI,** which authorized this recovery. (Emphasis added)

However, the Commission specifically stated in Order No. PSC-09-0375-PAA-GU, issued May 27, 2009, in Docket No. 080366-GU, at pages 21-22, in the FPUC rate case that "[t]he inclusion of unamortized rate case expense in working capital in FPUC's case is an exception to our long-standing policy." FPUC has had this exception since 1993. <u>Id</u>. at

22. In this order, the Commission explained that "[w]hile unamortized rate case expense is not allowed to earn a return in working capital for electric and gas companies, it is offset by the fact that rates are not reduced after the amortization period ends." Id. at p. 21. The other order FPL refers to in its discovery response is the order approving its non-unanimous settlement in its last rate case proceeding. The Settlement specifically states that "[n]o party will assert in any proceeding before the Commission that this Agreement or any of the terms in the Agreement shall have any precedential value." Order No. PSC-13-0023-S-EI, issued January 14, 2013, in Docket No. 120015-EI, at page 26. Neither order supports a change in the Commission's long-standing policy of disallowing rate case expense in rate base.

Q. DO YOU RECOMMEND THAT THE UNAMORTIZED RATE CASE EXPENSE BE EXCLUDED FROM RATE BASE IN THIS CASE?

A. Yes, I recommend that the Commission follow its long-standing policy in electric cases of not allowing inclusion of the unamortized rate case expense in rate base. Consistent with the Commission's findings in the most recent Progress Energy Florida base rate cases, and the Gulf Power Company base rate case cited above, and FPL's 2010 rate case, it would be unfair for customers to pay a return on the costs incurred by the Company in this case when these are being used to increase customer rates. On Exhibit RCS-2, Schedule B-1, page 2, I have removed the full amount of the unamortized balance of rate case expense from working capital in this case, thus reducing rate base by $4.309 million.

Q. DO YOU AGREE THAT ADIT IN THE CAPITAL STRUCTURE SHOULD BE ADJUSTED TO SYNCHRONIZE WITH THE RATE BASE ADJUSTMENT?

A. Yes. A related adjustment to remove the related $1.9 million ADIT from the ADIT that is reflected in the capital structure should also be made. The reconciliation of the rate base with the capital structure is shown on Exhibit RCS-2, Schedule D.

Q. IS THERE A RATE BASE ADJUSTMENT FOR THE 2018 FUTURE TEST YEAR?

A. Yes. As shown on Exhibit RCS-3, Schedule B-1, line 24, FPL's requested amount of $3.078 million is removed from the 2018 future test year rate base. It would also be appropriate to adjust the 2018 capital structure for related ADIT.

<u>Generation Overhaul Expense</u>

Q. ARE YOU AWARE OF ANY COST PROJECTIONS INCORPORATED IN THE TEST YEAR THAT ARE NOT REPRESENTATIVE OF A NORMAL ANNUAL COST LEVEL?

A. Yes. FPL is projecting a significant increase in generation overhaul expense in the 2017 test year. Generation facilities are not overhauled on an annual basis. Additionally, the amount of overhaul expense incurred varies depending on the type of overhaul and the type of work needed during the overhaul. Test year generation overhaul expenses are significantly higher than a normalized cost level. The changes to base rates resulting from this case will likely be in effect longer than a one-year period. Thus, in setting rates, the costs should be based on a normalized cost level.

Q. HOW DO YOU RECOMMEND A NORMALIZED COST LEVEL BE DETERMINED?

A. I recommend that the normalized costs to be included in rates be based on a four-year average cost level. I recommend the four-year average be based on the actual costs for 2014 and 2015 and FPL's projected costs for 2016 and 2017.

Q. **WHAT ADJUSTMENT DO YOU RECOMMEND TO NORMALIZE TEST YEAR OVERHAUL EXPENSE?**

A. My recommended adjustment is presented on Exhibit RCS-2, Schedule C-3. As shown on the schedule, the adjustment is based on the average of the actual 2014 and 2015 as well as the projected 2016 and 2017 generation overhaul expenses. I inflated the costs to 2017 levels based on the inflation rates recommended by OPC witness Dismukes. As shown on Exhibit RCS-2, Schedule C-3, FPL's projected 2017 test year jurisdictional generation overhaul expenses should be reduced by $3.603 million. This allows for the non-unit specific costs incorporated in FPL's filing (i.e., the "Central Maintenance" expenses) on a four-year average basis, as well as a normalized cost level for the unit specific costs.

Q. **IS THERE A SIMILAR ADJUSTMENT FOR 2018?**

A. Yes. The similar adjustment for 2018 is shown on Exhibit RCS-3, Schedule C-3, and reduces jurisdictional O&M expense by $8.562 million. Five-year normalized overhaul expense (based upon 2014 – 2018) is also presented on Exhibit RCS-3, Schedule C-3, and would produce an adjustment to reduce jurisdictional 2018 O&M expense by $9.082 million. For purposes of reflecting this adjustment, the $8.562 million has been used by carrying that amount to the OPC net operating income adjustments on Exhibit RCS-3, Schedule C-1, page 2.

Income Tax Expense

Q. HAVE YOU ADJUSTED 2017 TEST YEAR INCOME TAX EXPENSE TO REFLECT THE IMPACT OF THE ADJUSTMENTS SPONSORED BY CITIZENS' WITNESSES TO NET OPERATING INCOME?

A. Yes. On Exhibit RCS-2, Schedule C-4, I calculate the impact of federal and state income tax expenses resulting from the recommended adjustments to operating expenses. The result is carried forward to the Net Operating Income Summary on Exhibit RCS-2, Schedule C-1, page 2.

Q. IS THERE A SIMILAR ADJUSTMENT FOR 2018?

A. Yes. The similar adjustment for 2018 is shown on Exhibit RCS-3, Schedule C-4.

Interest Synchronization

Q. WHAT IS THE PURPOSE OF YOUR 2017 TEST YEAR INTEREST SYNCHRONIZATION ADJUSTMENT ON EXHIBIT RCS-2, SCHEDULE C-5?

A. The interest synchronization adjustment allows the adjusted rate base and cost of debt to coincide with the income tax calculation. Since interest expense is deductible for income tax purposes, any revisions to the rate base or to the weighted cost of debt will impact the test year income tax expense. OPC's proposed rate base and weighted cost of debt differ from the Company's proposed amounts. Thus, OPC's recommended interest deduction for determining the 2017 test year income tax expense will differ from the interest deduction used by FPL in its filing. Consequently, OPC's recommended debt ratio increase in this case will lead to a greater interest deduction in the income tax calculation, which will in turn result in a reduction to income tax expense.

Q. IS THERE A SIMILAR INTEREST SYNCHRONIZATION ADJUSTMENT FOR THE 2018 FUTURE TEST YEAR?

A. Yes. The similar interest synchronization adjustment for the 2018 test year is shown on Exhibit RCS-3, Schedule C-5.

Q. IS THERE AN INTEREST SYNCHRONIZATION ADJUSTMENT FOR THE OKEECHOBEE STEP INCREASE?

A. Yes. The interest synchronization adjustment for the Okeechobee step increase is shown on Exhibit RCS-4, Schedule C-2.

Revenue At Current Rates - Sales Forecast

Q. PLEASE EXPLAIN THE ADJUSTMENT FOR REVENUE AT CURRENT RATES - SALES FORECAST.

A. OPC witness David Dismukes has reviewed FPL's sales forecast for the 2017 and 2018 projected future test years. Dr. Dismukes has determined that FPL's sales forecasts understate the level of metered retail sales (MWh). Accordingly, Dr. Dismukes is recommending a revision to the FPL sales forecasts. Dr. Dismukes provided me with the additional amounts of Revenue at Current Rates of $206.5 million for 2017 and $259.5 million for 2018. I have reflected the corresponding adjustments on Exhibit RCS-2, Schedule C-6 for 2017 and on Exhibit RCS-3, Schedule C-6 for 2018. Those schedules also show the related increase to Uncollectibles Expense, using FPL's corrected uncollectibles factor of 0.00066 (or 0.066%) from FPL's May 3, 2016 Notice of Identified Adjustments item 5, "NOI Multiplier - Bad Debt Rate."

The amount of adjustment for Revenue at Current Rates shown on Exhibit RCS-2, Schedule C-6 for 2017 and on Exhibit RCS-3, Schedule C-6 for 2018 has been netted against the revenue related to sales associated with the net operating income adjustment amounts of $4.9 million for 2017 and $9.338 million that FPL identified in its May 3, 2016 Notice of Identified Adjustments item 4, which have already been incorporated into OPC's revenue requirement calculation. OPC's incorporation of the adjustments that were identified by FPL in the Company's May 3, 2016 Notice of Identified Adjustments are discussed in a previous section of my testimony.

<u>Depreciation Expense - New Depreciation Rates</u>

Q. PLEASE EXPLAIN THE ADJUSTMENT TO DEPRECIATION EXPENSE FOR NEW DEPRECIATION RATES.

A. In the current rate case, FPL has proposed new depreciation rates for 2017. In its application, at Exhibit NWA-1, page 7 of 762 (FPL's 2017 Depreciation Study) the Company shows that on its projected December 31, 2017 Plant, at current depreciation rates, annual depreciation accruals would total to approximately $1.433 billion. At FPL's proposed depreciation rates, the annual depreciation accruals would total to approximately $1.654 billion, for an annual increase in depreciation accruals of approximately $221.3 million. In its application, at MFR Schedule C-2 for Projected Test Year Ended 12/31/17, page 3 of 3, line 15, FPL reflected an adjustment to increase 2017 projected test year jurisdictional Depreciation Expense by approximately $195.1 million.

OPC witness Jacob Pous is recommending new depreciation rates that differ from those proposed by FPL. As shown on Exhibit RCS-2, Schedule C-7, column 2, applying the new depreciation rates recommended by OPC witness Pous to FPL's December 31, 2017 Plant produces annual depreciation accruals of approximately $1.351 billion. As shown on Schedule C-7 in column 3, that is approximately $302.8 million less than the annual depreciation accruals computed by FPL in its Exhibit NWA-1, at page 7 of 762. OPC witness Pous also recommends amortizing a $923 million depreciation reserve excess over 4 years, for an annual reduction to depreciation expense of $230.8 million annually, as shown on Schedule C-7 in columns 4 and 5.

Q. HOW DID YOU ADJUST THE DEPRECIATION EXPENSE IN FPL'S 2017 TEST YEAR FOR THE IMPACT OF OPC WITNESS POUS' RECOMMENDED NEW DEPRECIATION RATES?

A. As shown on Exhibit RCS-2, Schedule C-7, OPC witness Pous' recommendation for new depreciation rates had two impacts. The first was a reduction to depreciation expense of approximately $303 million (calculated based on December 31, 2017 plant), as shown on Schedule C-7 in column 3. The second is the ratable flow-back over a four-year period of a depreciation reserve excess of approximately $923.1 million, as shown on Schedule C-7 in column 4. The annual impact of that flow back further reduces depreciation expense by approximately $230.8 million per year, as shown on Schedule C-7, in columns 5 and 10.

Q. WHAT IS SHOWN ON EXHIBIT RCS-2, SCHEDULE C-7, IN COLUMNS G THROUGH K?

A. Exhibit RCS-2, Schedule C-7, in column G shows FPL's total 2017 depreciation expense adjustment of $221.3 million by plant function that relates to the new depreciation rates being proposed by FPL. Column H shows FPL's exclusion of depreciation expense for amounts that are included in adjustment Clauses, and not in base rates. Column I shows FPL's depreciation expense amount for base rates that relates to the new depreciation rates being proposed by FPL of approximately $206 million. Column J shows the jurisdictional factors FPL applied for 2017 for its depreciation rates adjustment, and column K shows FPL's jurisdictional adjustment to depreciation expense in base rates for its new proposed depreciation rates of $195.1 million.

Q. HOW DID YOU UTILIZE THAT INFORMATION TO DERIVE THE OPC'S ADJUSTMENT TO DEPRECIATION EXPENSE FOR NEW DEPRECIATION RATES THAT IS REFLECTED IN OPERATING EXPENSES FOR THE 2017 TEST YEAR?

A. As shown on Exhibit RCS-2, Schedule C-7, in columns 3 and 7, the depreciation rates part of OPC witness Pous' recommendation (exclusive of the excess depreciation reserve flow-back) decreases FPL's depreciation expense by approximately $303 million. Column 8 shows the percentages of base rate to total FPL depreciation expense adjustment, based on the ratio of the FPL amounts in columns I (base rates) and G (total FPL new depreciation rates expense adjustment). Exhibit RCS-2, Schedule C-7, column 9, shows that after excluding the depreciation expense identified by FPL for Clauses (i.e., the amounts not sought by the Company to be recovered in base rates), the adjustment to depreciation expense for new depreciation rates is approximately $292.6 million. Column 10 shows the first year of the four-year amortization of the excess depreciation reserve recommended by OPC witness Pous, which reduces annual depreciation expense by approximately $230.8 million. Column 11 shows the sum of the two components, the $292.6 million and the $230.8 million, which total $523.4 million, before applying FPL's 2017 jurisdictional factors. After applying the jurisdictional factors, the adjustment shown on Exhibit RCS-2, Schedule C-7, in column 13 reduces FPL's requested 2017 depreciation expense in base rates by approximately $501.3 million. The amounts shown on Exhibit RCS-2, Schedule

C-7, column 13, are carried forward to Exhibit RCS-2, Schedule C-1, page 2, and reflected in the derivation of OPC's adjusted net operating income.

Q. IS THERE A RELATED ADJUSTMENT TO RATE BASE?

A. Yes. As shown on Exhibit RCS-2, Schedule B-1, page 2, there are related adjustments which decrease accumulated depreciation (and increase rate base). The impacts on 2017 rate base were derived by taking one-half of the annual depreciation expense adjustment.

Q. DID YOU COMPUTE THE ADJUSTMENT TO DEPRECIATION EXPENSE FOR THE 2018 FUTURE TEST YEAR IN A SIMILAR MANNER?

A. Yes. The adjustment to depreciation expense for the 2018 future test year in a similar manner on Exhibit RCS-3, Schedule C-7. As shown there, FPL's requested 2018 depreciation expense for base rate inclusion is reduced by approximately $495.2 million.

Q. IS THERE A RELATED IMPACT ON 2018 RATE BASE?

A. Yes. As shown on Exhibit RCS-3, Schedule B-1, page 2, the related impact on 2018 rate base is comprised of three components: (1) one-half of the 2018 depreciation rates expense adjustment, (2) a full year of the flow back in 2017 of the depreciation reserve excess, and (3) a half year (i.e., average) impact of the flow back in 2018 of the depreciation reserve excess.

Q. WERE YOU ABLE TO FULLY INTEGRATE THE OPC'S NEW DEPRECIATION RATES RECOMMENDATION WITH THE COMPANY'S ANNOUNCED FILING ADJUSTMENTS?

A. No. One of FPL's June 16, 2016 Second Notice adjustments was an adjustment to depreciation expense. FPL provided an Excel file showing an Updated Exhibit KF-2 (4 pages) showing its filing correction adjustments to 2017 and 2018 depreciation expense and accumulated depreciation. Those FPL filing corrections reduced the Company's proposed 2017 depreciation expense by $22.794 million (from FPL's as-filed amount of $206.023 million to its updated amount of $183.229 million) and reduced its proposed 2018 depreciation expense by $24.564 million (from the as-filed $208.865 million amount to the corrected amount of $184.302 million), along with related adjustments to accumulated depreciation. FPL's explanation of that adjustment described it as an update to its 2016 Depreciation Study, stating, among other things that:

> Because the primary test year in FPL's base rate case is 2017, FPL considered year-end 2017 estimated plant and reserve balances as best representing FPL's depreciable plant during the test year. Discovery to date from Staff and others has raised questions about whether using year-end 2016 balances would be more appropriate and consistent with past Commission practice. FPL continues to believe that the use of year-end 2017 balances would provide a good match with FPL's 2017 Test Year and 2018 Subsequent Year, but has no objection to using results for year-end 2016 balances for the purpose of setting depreciation rates and determining FPL's base rates in this proceeding and accordingly is proposing the adjustment described...

I am unclear as to how to integrate Mr. Pous' new depreciation rate recommendations with this FPL update adjustment. If the Commission should decide to use year-end 2016 balances for the purpose of setting FPL's depreciation rates and determining FPL's base rates in this proceeding, this FPL update would need to be integrated with the OPC's depreciation rate recommendations. If the Commission should decide not to use year-end 2016 balances for such purposes, the impact of this FPL filing update may need to be reversed.

VII. <u>OVERALL FINANCIAL SUMMARY – JANUARY 2018 SUBSEQUENT YEAR RATE CHANGE</u>

Q. WHAT IS THE JANUARY 2018 BASE RATE REVENUE REQUIREMENT DEFICIENCY OR EXCESS FOR FLORIDA POWER & LIGHT COMPANY?

A. As shown on Exhibit RCS-3, Schedule A-1, the OPC's recommended adjustments in this case result in a recommended revenue reduction for FPL in January 2018 of approximately $604 million. The $1.134 billion revenue increase requested by FPL for the 2018 projected future test year is presented in the Company's filing as an additional $262.3 million after the additional 2017 rate increase revenues of $871.3 million that FPL has requested. The OPC's recommendation of a revenue excess of approximately $604 million for the 2018 future test year is $1.737 billion lower than FPL's request of $1.134 billion.

Q: DO YOU BELIEVE THAT THE 2018 SUBSEQUENT TEST YEAR REQUEST IS NECESSARY OR GOOD POLICY.

A. No, I do not think that a subsequent test year is necessary or good policy. The test year is supposed to be representative of rates on a going-forward basis. If the test year is chosen appropriately, there should be no reason for another rate adjustment so shortly after original test year. As the Commission noted in Order No. PSC-10-0153-FOF-EI, at page 9, "[i]f the test year is truly representative of the future, then the utility should earn a return within the allowed range for at least the first 12 months of new rates." As the Commission noted, these types of back-to-back rate cases deprive the Commission and ratepayers of twelve months of actual economic data and operating history of the Company. <u>Id</u>. The Commission further stated that "[w]e believe that back-to-back rate increases should be allowed only in extraordinary circumstances." <u>Id.</u> The Company has shown no extraordinary need for the subsequent test year. In fact, OPC recommendation is for a reduction of approximately $807 million based on 2017 ($812 million with growth in 2018) and an overall revenue reduction of approximately $604 million for 2018.

Q. ARE YOUR SCHEDULES IN EXHIBIT RCS-3 FOR THE 2018 SUBSEQUENT TEST YEAR ORGANIZED IN A SIMILAR MANNER TO YOUR ABOVE-DESCRIBED PRESENTATION FOR 2017?

A. Yes.

VIII. OKEECHOBEE LIMITED SCOPE ADJUSTMENT (LSA OR STEP INCREASE) – JUNE 1, 2019

Q. COULD YOU PLEASE BRIEFLY DESCRIBE FPL'S REQUEST AS IT PERTAINS TO THE OKEECHOBEE LIMITED SCOPE STEP INCREASE?

A. FPL projects that the Okeechobee Clean Energy Center will be completed and placed into service in mid-2019. FPL is requesting that the project be included in a Step Increase that would go into effect on June 1, 2019, when the project is projected to be placed into service and begins serving customers. FPL's stated purpose of treating this as a step increase in base rates is so that base rates will reflect an annual level of the Okeechobee Project costs, beginning with the date the project is used to serve FPL customers. Thus, the costs associated with the Okeechobee Project under FPL's request would be treated as a base rate step increase after project completion based on an annualized cost level.

FPL provided the calculation of the requested Okeechobee Project LSA in a separate set of MFRs that are specific to the project. These MFRs show a projected annualized rate base of $1.063 billion, a requested 8.87% overall rate of return applied to the rate base, and a projected net operating income (loss) associated with the project of $33,868,000.

Altogether, these amounts result in FPL's projected first year annualized revenue requirement for the Okeechobee Project of $209,024,000.

Q. DO YOU HAVE A PRIMARY RECOMMENDATION AS TO WHETHER THE COMMISSION SHOULD APPROVE FPL'S REQUESTED LSA INCREASE?

A. Yes. I recommend that the Okeechobee June 1, 2019 LSA increase request by FPL not be approved at this time. This is primarily because of my previous recommendations addressed in my testimony reflecting substantial revenue excesses for both 2017 and 2018. I am also skeptical of the accuracy and reasonableness of FPL's 2019-2020 projections, given that they are three years out in the future.

Q. IF THE COMMISSION WERE TO APPROVE THE LSA, ARE YOU RECOMMENDING ANY REVISIONS TO THE AMOUNT OF THE REVENUE INCREASE ASSOCIATE WITH THE OKEECHOBEE PROJECT REQUESTED BY FPL?

A. Yes. If the step increase is to be considered, the following contingent adjustments to FPL's request should be made. First, I recommend that the rate of return the Commission will apply to the projected rate base should be based on OPC's overall recommended 2018 rate of return. Next, I recommend that the projected amount of rate base and operating costs associated with the project be updated based on more recent forecasts, which should be presented by FPL in 2019 prior to approval of the project. Additionally, I recommend that the start-up costs included in FPL's projections be removed so that base rates established at the time of the proposed step increase are based on normalized costs and exclude one-time non-recurring charges.

Q. HAVE YOU PREPARED AN EXHIBIT PRESENTING OPC'S RECOMMENDED REVENUE REQUIREMENT AS IT PERTAINS TO THE OKEECHOBEE PROJECT STEP INCREASE TO BASE RATES?

A. Yes. I have prepared Exhibit RCS-4, consisting of Schedules A-1, B-1, C-1, C-2, and D. Each of these schedules is specific to the calculation of OPC's revenue requirement calculation for the June 1, 2019 Step Increase.

Q. IN CALCULATING THE CONTINGENT REVENUE REQUIREMENT FOR THE OKEECHOBEE STEP INCREASE, DID YOU USE THE COMPANY'S PROPOSED RATE OF RETURN?

A. No, I did not. In calculating the contingent revenue requirement for the June 1, 2019 Step Increase, the Company based its calculation of the increase on an overall rate of return of 8.87%. As reproduced on Exhibit RCS-4, Schedule D, the determination of this 8.87% overall rate of return was based on the following hypothetical capital ratio for the Okeechobee Project: 39.61% for long-term debt, 60.39% for equity, a 4.87% rate for long-term debt, and an 11.50% rate of return on equity. FPL did not include any deferred income taxes in its cost of capital for the LSA, nor did it include customer deposits or investment tax credits. In my opinion, it is not appropriate to use a different capital structure and overall rate of return to calculate the revenue requirement associated with FPL's requested step increase. I would note that FPL did not provide the projected amounts for the total cost of capital as of June 2019 in its MFRs for the Okeechobee LSA. As such, I do not have a reasonable basis to determine or project the amounts necessary to calculate the overall cost of capital to use. In lieu of a reasonably projected cost of capital for 2019, I believe that it is appropriate to use the OPC's adjusted 2018 cost of capital as a proxy rate of return. The resultant overall cost of capital is 5.17%, as shown on Exhibit RCS-4, Schedule D. This is the same cost of capital I have reflected on Exhibit RCS-3, Schedule D.

Q. DID FPL EXPLAIN WHY IT USED A DIFFERENT CAPITAL STRUCTURE AND OVERALL RATE OF RETURN FOR THE OKEECHOBEE STEP INCREASE CALCULATIONS?

A. A footnote at the bottom of MFR Schedule D-1a – June 2019 Step Increase states that "The capital structure reflects incremental sources of capital consistent with the analysis submitted in connection with its need determination proceeding."

Q. DOES THIS EXPLANATION SUPPORT THE USE OF A RATE OF RETURN THAT DIFFERS FROM THE RATE OF RETURN TO BE USED FOR CALCULATING THE JANUARY 2018 BASE RATE CHANGE?

A. No, it does not. Additionally, it is my understanding that the Commission has based prior approved step increases associated with certain major capital projects on the authorized overall rate of return found to be appropriate for determining the change to base rates in a rate case proceeding. An example of this can be found in Order No. PSC-12-0179-FOF-EI, issued April 3, 2012. That decision, at page 143, shows that the Commission applied its authorized overall rate of return that it found appropriate for purposes of determining the base rate increase for Gulf Power Company in its calculation of the January 2013 step increase associated with the annualization of the Crist Units 6 & 7 turbine upgrade projects.

Similarly, in Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, the Commission applied its authorized overall rate of return it found appropriate for determining the base rate increase for Tampa Electric Company in its calculation of the January 1, 2010 step increase associated with five combustion turbine units being placed into service. This is demonstrated at pages 138 and 139 of the Order, on Schedules 5 and 6.

Q. COULD FPL'S REQUESTED OKEECHOBEE LSA TREATMENT OF ACCUMULATED DEFERRED INCOME TAXES POTENTIALLY VIOLATE THE INTERNAL REVENUE CODE NORMALIZATION REQUIREMENTS?

A. Yes. In Staff's Interrogatory No. 233, Staff asked FPL to explain why FPL chose to include the Deferred Income Taxes-Net in Operating Expenses rather than include the amount in the capital structure or use the amount to reduce the rate base for the Okeechobee Clean Energy Center Limited Scope Adjustment. In its response, while not answering the question asked, FPL stated:

> FPL has included jurisdictional deferred income tax expenses as a component of Net Operating Income of $124,436,000 and $4,758,000 on Lines 23 and 24, respectively, on Page 2 of 2 on Schedule C-4 for the 2019 Okeechobee Limited Scope Adjustment. In addition, FPL has reflected the jurisdictional 13-month average of accumulated deferred income taxes associated with the first year of operations of the Okeechobee plant of ($81,359,000) on Line 27, Page 1 of 1 on Schedule B-6 for the 2019 Okeechobee Limited Scope Adjustment as a reduction to rate base. Both sides of the accounting entry must be considered when determining revenue requirements in order to properly reflect deferred income taxes for ratemaking purposes.

By reflecting one year's deferred tax expense in operating expenses and the 13-month average balance of the accumulated deferred income taxes (ADIT) as a reduction to rate base and excluding the total Company balance of deferred income taxes in the capital structure for determining a rate increase could violate normalization requirements. By not including the balance of deferred income taxes, the utility has not only overstated the rate of return but has also removed the benefits to ratepayers for the Company's use of tax timing differences in its income tax expense charged to ratepayers. Making an incremental reduction for ADITs for this project in rate base and removing the ADITs from the cost of capital does not cure this problem. If the Commission were to accept FPL's argument that its adjusted rate base and cost of capital would not violate normalization requirements, FPL should be required to provide detailed supporting calculations that no violation will occur. These calculations should include a showing that using an incremental cost of capital, with an incremental reduction to rate base for deferred income taxes results in a revenue neutral method of calculating the revenue requirement compared to setting rates using the Commission practice of including all deferred income taxes in the overall costs of capital.

Q. DO YOU HAVE AN ESTIMATE OF THE REVENUE IMPACT OF USING AN INCREMENTAL COST OF CAPITAL COMPARED TO USING THE FULL COST OF CAPITAL?

A. Yes. For illustration purposes, if I add back the Company's $81.359 million reduction to rate base for the ADITs equals an adjusted rate base of 1.144 billion. Multiplying that rate base times FPL's requested 2018 rate of return of 6.71% (using an 11.50% ROE and 60% equity ratio) results in jurisdictional income required of $76.807 million. As I have reflected on Exhibit No. RCS-4, Schedule A-1, FPL's requested jurisdictional income required for the LSA is $94.348 million. That alone is an increase of $17.541 million and that is before taxes. After taxes, the increase for using an incremental capital structure is $28.596 million. Based on this, FPL's own numbers show that its incremental cost of capital impact is certainly not revenue neutral and results in a substantial increase in the revenue requirement.

Q. **YOU STATED THAT THE PROJECTED AMOUNT OF RATE BASE AND OPERATING COSTS ASSOCIATED WITH THE OKEECHOBEE PROJECT SHOULD BE UPDATED BASED ON MORE RECENT FORECASTS. PLEASE EXPLAIN.**

A. In 2019, prior to approval of any limited purpose step increase, updated estimates should be presented by FPL. This would apply only if the Commission determines that a mid-2019 step increase is needed. OPC's primary recommendation, as noted above, is that the Commission reject the 2019 step increase because OPC shows significant revenue excesses for 2017 and 2018 and FPL has not demonstrated that a mid-2019 increase would be necessary to keep FPL from falling below the low point of its authorized ROE range. Approval of a projected mid-2019 step increase would be premature.

Q. **PREVIOUSLY, YOU INDICATED THAT YOU WOULD RECOMMEND REMOVAL OF THE PROJECTED START-UP COSTS. WOULD YOU PLEASE ELABORATE?**

A. Yes. Start-up costs that FPL projects to expense in the twelve-month period ending May 31, 2020 are one-time, non-recurring expenses that should not be incorporated in the June 2019 Step Increase.

Q. **ARE THERE ANY ADDITIONAL ADJUSTMENTS THAT NEED TO BE MADE FOR PURPOSES OF CALCULATING THE REVENUE REQUIREMENT ASSOCIATED WITH FPL'S REQUESTED OKEECHOBEE STEP INCREASE?**

A. Yes. As addressed previously in this testimony, OPC's recommended revision to the capital structure results in the weighted cost of debt being different than the amount incorporated in the Company's filing. This difference in the weighted cost of debt impacts the calculation of the interest deduction in the income tax calculations (i.e., the interest synchronization adjustment). On Exhibit RCS-4, Schedule C-2, I provide the calculation of the adjustment that needs to be made to FPL's updated income tax expense amount to reflect the impact of the interest synchronization adjustment, which increases the income tax expense by $360,000.

Q. WHAT IS THE RESULTING REVENUE REQUIREMENT ASSOCIATED WITH FPL'S REQUESTED OKEECHOBEE STEP INCREASE RECOMMENDED BY THE OPC IN THIS CASE?

A. As noted above, OPC is recommending that no mid-2019 step increase be granted. As shown on OPC Exhibit RCS-4, Schedule A-1, OPC's recommended adjustments discussed above, should the Commission consider this step increase, result in a June 2019 Step Increase for FPL of $145 million, which is $64 million less than the $209 million June 2019 Step Increase requested by FPL in its original filing. As I addressed earlier, this calculation is based on OPC's adjusted overall cost of capital of 5.17%.

Q. DOES THIS COMPLETE YOUR PREFILED TESTIMONY?

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Direct Testimony of Ralph Smith has been furnished by electronic mail on this 7th day of July, 2016, to the following:

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