**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

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| **In re: Petition for Approval of Storm Cost Recovery Clause for Extraordinary Expenditures Related to Hurricanes Charles, Frances, Jeanne and Ivan** | Docket No. 041272-EI<br><br>Submitted for filing: February 28, 2005 |

# REBUTTAL TESTIMONY OF JAVIER J. PORTUONDO

## ON BEHALF OF PROGRESS ENERGY FLORIDA

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**FPSC DOCKET NO. 041272**

**IN RE: PETITION FOR APPROVAL OF STORM COST RECOVERY CLAUSE FOR EXTRAORDINARY EXPENDITURES RELATED TO HURRICANES CHARLEY, FRANCES, JEANNE AND IVAN**

**REBUTTAL TESTIMONY OF JAVIER J. PORTUONDO**

## I. Introduction

**Q. Please state your name, position, and address.**

A. My name is Javier J. Portuondo. I am the Director of Regulatory Services, Florida, for Progress Energy Florida. My business address is 100 Central Avenue, St. Petersburg, FL 33701.

**Q. Did you file direct testimony in this case?**

A. Yes, I did.

**Q. Have you reviewed the testimony filed by the witnesses testifying for the Office of Public Counsel ("OPC"), the Florida Industrial Power Users Group ("FIPUG"), and Buddy L. Hansen and the Sugarmill Woods Civic Association, Inc. (collectively, "Sugarmill Woods")?**

A. Yes, I have.

**Q. Do you agree with it?**

A. No, I do not. The testimony by each of these witnesses is fundamentally flawed for two reasons.

**Q. Please explain your areas of disagreement.**

A. These witnesses base their testimony on (1) a misunderstanding of the history of the regulatory treatment of storm cost recovery in Florida and (2) a misunderstanding of ratemaking principles and the rate stipulation among the parties currently in place.

## II. Regulatory Treatment of Storm Cost Recovery in Florida

**Q. Addressing these issues in turn, please explain why you believe the Intervener witnesses have misinterpreted the history of regulatory treatment of storm cost recovery in Florida.**

A. The Intervener witnesses rely on selected excerpts from prior Commission orders without taking into account what the Commission actually did, the circumstances before the Commission, and the context of the rulings. When you review prior Commission orders in their entirety and in context, it becomes clear that they support the relief we are requesting in this case.

**Q. Please explain why you believe you are proceeding in accordance with prior Commission orders and policy in this area.**

A. The starting point for analysis is the utilities' request in 1993 to convert from reliance on third-party insurance for storm damage to transmission and distribution ("T&D") facilities to a self-insurance program.

Up until November 1993, Florida Power Corporation ("FPC") maintained third-party T&D insurance in the amount of $85 million per occurrence, subject to a deductible of $10 million. Customers paid for insurance premiums and losses not covered through insurance through base rates. Specifically, the Company maintained a Commission-approved Storm and Property Insurance Reserve ("the Reserve") to cover the costs of storm-related losses not reimbursed through third-party insurance. The Company collected $1 million annually in base rates for T&D property damage not covered by insurance, and made annual contributions in this amount to the Reserve. This is documented in Commission Order No. PSC-93-1522-FOF-EI, dated October 15, 1993 ("1993 FPC Order").

After Hurricane Andrew, third-party T&D insurance became prohibitively expensive. Insurance rates increased 500-1500% over then-current rates, and deductibles increased 900%. Insurers demanded an up-front capital contribution, plus a potential retroactive premium. Further, insurers no longer offered insurance on a per occurrence basis. They agreed to insure only aggregate annual losses, which left utilities and their customers exposed to catastrophic uninsured losses in the event of multiple storm events. Other utilities faced the same untenable circumstances.

As a result of this change in market conditions, public utilities in Florida petitioned the Commission for approval of a self-insurance program. This is the genesis of the Commission's treatment of storm-cost recovery in Florida.

**Q. Please explain what the utilities proposed to the Commission.**

A. The utilities proposed that the Commission approve a self-insurance program that replicated the operation of third-party insurance.

**Q. Were the utilities proposing to fund T&D losses out of its shareholders' pockets?**

A. Absolutely not. FPC and other public utilities requesting this relief are cost-of-service regulated utilities. Under the regime of third-party insurance, these utilities recovered the cost of paying for insurance and uninsured T&D losses from their customers. They proposed replacing third-party insurance with a system of self-insurance not as a mechanism for shareholders to shoulder the costs of operating the business but based on the reasonable belief that the utilities otherwise would have to call upon ratepayers to pay exorbitant premiums for third-party insurance and to pay catastrophic uninsured T&D losses that third-party insurers were declining to cover.

**Q. Please explain what the utilities asked the Commission to approve, and how the Commission responded.**

A. The utilities proposed to increase their annual accrual and contributions to the Reserve to replace and replicate third-party insurance. For example, in 1993, the year of the request, FPC was contributing $1 million annually to the Reserve to cover premiums and uninsured T&D losses. As part of its self-insurance proposal, FPC proposed to increase its annual accrual and contribution to $3 million. The utility proposed, and the Commission explicitly acknowledged, that

"The reserve would be used to cover storm damage experience for all losses not covered by insurance, including T&D lines and deductibles associated with other property insurance." (1993 FPC Order) (emphasis ours). The Commission approved this approach as a reasonable alternative to continuing reliance on third-party insurance.

**Q. Did the utilities and the Commission contemplate the possibility that storm costs might exceed the amount accrued in the reserve?**

A. Yes, they did. This subject was discussed in the course of the proceedings. The Commission assured FPC that it would "expeditiously review any petition for deferral, amortization or recovery of prudently incurred costs in excess of the reserve." (1993 FPC Order).

**Q. Sugarmills Woods' witness Stephen A. Stewart points out that, prior to 1993, balances in the Storm and Property Insurance Reserves of certain utilities, including FPC, were occasionally depleted and subsequently replenished through base rates. He argues on this basis that the Commission favors base rate treatment of such losses rather than a surcharge on top of base rates. Do you agree with his conclusion?**

A. No, I do not. What he overlooks is that, prior to 1993, electric utilities in Florida did not operate on a self-insured basis. As I have explained, electric utilities maintained third-party T&D insurance sufficient to defray losses amounting to $85 million per occurrence. Electric utilities maintained reserves to cover normal,

recurring insurance premiums and occasional uninsured losses of a readily manageable magnitude. Before 1993, the utilities had no occasion to request, and the Commission had no occasion to consider, whether cost-recovery clauses or other similar mechanisms might be employed to recover costs for non-recurring, extremely volatile expenses like those incurred during this past hurricane season. Traditionally, the Commission has not employed base rates to cover such expenses. In fact, other Intervener witnesses in this docket recognize that the use of a surcharge to recover costs over a two-year period as we request serves the best interests of all stakeholders in this proceeding.

**Q. As part of the utilities' proposal to replace third-party insurance with a self-insurance program, did the utilities and Commission consider how to account for storm-related expenses?**

A. Yes. In fact, the Commission held open FPC's docket until it received and evaluated FPC's study discussing the Company's basis for accruing funds to the Reserve. The Commission treated other utility petitions the same way. In FPL's case, the Commission pointed out:

> We find that FPL shall submit a study indicating the appropriate amount that should be contributed to the fund annually. The study shall be filed three months from the date of the vote in this docket.
>
> . . . .
>
> From the record in this docket it is unclear what storm related expenses FPL intends [to] draw from the reserve fund. For example it is unclear whether normal salaries would be charged to the fund if employees worked on storm related tasks. In addition, employees repairing storm damage would be required to spend time away from their everyday work tasks which would result in "catch up" expense. It is unclear from the record whether FPL intends to draw "catch up" expense from the reserve fund. The record reflects that "catch up" expense is not

recoverable under FPL's current insurance policy. In addition it is unclear whether the cost of damaged assets would be accounted for at replacement cost or net book value. For example, if there were $100 million of net book value of assets that were destroyed and it took $200 million to replace those, what accounting entries would be made?

FPL shall address these questions in the company study discussed above. . . . FPL shall submit a study detailing what it believes the appropriate amount that should be annually accrued to the reserve. The company shall include in the study the costs it intends to charge to the reserve. The study shall be filed with the Commission no later than three months after the vote in this docket. Order No. PSC-93-0918-FOF-EI, pp. 3-4 ("1993 FPL Order").

**Q. Did the utilities submit the requested studies documenting the methodology they proposed to use in accounting for storm costs?**

A. Yes. I am attaching by way of example the studies submitted by FPC and FPL, as Exhibits ___ (JP-3) and ___ (JP-4).

**Q. Did these studies explain how the utilities proposed to account for storm-related costs?**

A. Yes, they did. In its study, FPC explained:

> The Company proposes to use a replacement cost approach for determining the appropriate amounts to be charged to the storm damage reserve. This approach is consistent with both the Company's prior coverage under traditional insurance for T&D lines as well as its current insurance coverage for other facilities. The damage to facilities currently covered through a self insurance program should be treated comparably. The replacement cost method represents by far the simplest approach and will transition well with any changes made in the Company's current insurance program for all facilities. The replacement cost approach assumes that the total cost of restoration and related activities will be charged against the storm damage reserve.
>
> . . . .
>
> Actual repair activities and those activities directly associated with storm damage and restoration activities would be charged to the reserve.

> Indirect costs would not be charged to the reserve. Direct costs would typically be payroll, transportation, materials and supplies, and other services necessary to locate and repair or replace damaged property. Payroll includes labor charges for those employees involved in actual repair activities as well as those in supporting roles such as customer service, engineering, storeroom and transportation personnel. See Exhibit Number 3 for a detailed list of the types of costs the Company believes would be directly associated with storm damage and restoration activities. (FPC Study, pp. 9-10) (emphasis in original).

The study continued to explain in great detail the accounting treatment the Company proposed to use in administering the Reserve and, by the same token, the accounting assumptions that formed the predicate for the Company's calculation of the amount of annual accrual for the Reserve.

Likewise, in the FPL study, FPL stated:

> The Company recommends that the actual restoration cost approach, without adjustment, be used. . . . Initially the incremental cost approach appears appropriate, however, after evaluating the result, and the numerous adjustments based on estimates and allocations that are required to arrive at incremental cost, we do not believe that the method provides a benefit when compared to use of the simple and more straightforward actual restoration cost approach. Under the actual restoration cost approach, without adjustment, the only review required would be for the necessity and reasonableness of the costs actually incurred and recorded on the Company's books. Further, since the actual restoration cost approach mirrors replacement cost insurance, this approach allows the company to switch easily from self-insurance to traditional insurance if and when it becomes available at reasonable rates. (FPL Study, p. 2)

FPL continued:

> We would define actual restoration costs to be those direct and indirect costs which are incurred to safely restore customer service, or to return plant and equipment to its original operating condition. In general, these costs include FPL payroll costs, costs associated with the use of vehicles and equipment, inventory costs, payments for outside services provided by contractors and other utilities, security services and crew support such as food, lodging, transportation and miscellaneous temporary subsistence costs. Development of a complete, detailed listing of all costs that could possibly be incurred as the result of a storm is neither practical or possible.

On pages 2 and 3 of **Attachment 1** we have provided representative examples of the types of activities and related costs that would fit the definition of actual restoration costs that can reasonably be expected to be incurred as a result of a storm.

. . . .

It is important to note that actual restoration costs charged to the storm work order(s) would not include all costs resulting from a storm. Specifically excluded would be costs which are an indirect result of the storm. In particular, overtime incurred by Company personnel in work areas not directly affected by the storm due to loss of some personnel to storm assignments (backfill work) and costs associated with work which must be postponed due to the urgency of the storm restoration and accomplished after the restoration is completed (catch-up work) would not be included. In addition, revenues lost by the Company due to the disruption of customer service or the disappearance of customers after the storm would not be included. . . . For Hurricane Andrew we believe these indirect costs to total approximately $48 million; however this is a rough estimate. While the actual restoration cost approach does not consider these indirect costs, the indirect costs are partially covered since there is also no adjustment to remove costs which would normally be incurred during the restoration period. In this way the use of the actual restoration cost approach to charge the Reserve when self insured would work much like replacement cost insurance. (FPL Study, pp. 8-9)

FPL elaborated on its consideration and rejection of the incremental cost

approach:

While it may seem reasonable in theory to charge only incremental costs resulting from a storm to the Reserve, we believe that there is not a clear benefit derived by attempting to quantify incremental cost. Both direct incremental and indirect incremental costs should be considered if an incremental cost approach is to be used. Recoverable incremental costs would exclude reasonably estimable and quantifiable costs that would be charged to expenses normally in the absence of a storm. We believe such charges to be straight time FPL employee payroll charged to the storm work order, appropriate loadings for pension, welfare, taxes and insurance applicable to the straight time payroll, and a representative level of normal Company vehicle use charges. If the incremental cost approach is to be used then all incremental costs should be considered, including backfill work, catch-up work and revenues lost by FPL as a result of the storm. While incremental cost can be calculated, it requires starting with actual restoration cost and making numerous adjustments which depend on estimates and allocations. The complexities are apparent when the

> incremental costs column on page 1 of **Attachment 1** is reviewed. . . . [T]he field accounting must remain simple and it would be unworkable to attempt to record only incremental costs to the storm work order. Furthermore, each storm can be expected to impact the Company in a unique way and the assumptions and the estimation and allocation techniques needed to calculate indirect incremental costs and non-incremental costs might need modification. We can envision extensive debate before the Commission over these calculations which could result in unnecessary delays. As is the case with the net book value adjustment, the incremental costs approach would be inconsistent with replacement cost insurance recovery when some level of insurance is obtained. In contrast we view the actual restoration cost approach as relatively simple and fair. (FPL Study, pp. 10-11).

**Q. How did the Commission respond to these studies?**

A. The Commission received them, approved them, closed the respective dockets in those proceedings, and has permitted the utilities to follow them ever since. The Commission discussed the FPL study, in particular, at some length in subsequent orders. In Order No. PSC-95-0264-FOF-EI, dated Feb. 27, 1995 ("Feb. 1995 FPL Order"), the Commission described that it had "required FPL to submit a study detailing the appropriate amount that should be annually accrued to the reserve and the costs it intends to charge to the Storm Fund." (Feb. 1995 Order, p. 2). In approving FPL's study, the Commission stated:

> FPL's study provided sufficient analysis to indicate the appropriate annual amount that should be contributed to the storm damage reserve fund at this time.
>
> In addition, the study addressed the issues raised in the [1993 FPL] order concerning the types of expenses that would be charged to the reserve. However, we have the authority to review any expenses charged to the reserve for reasonableness and prudence. FPL stated that it would use the actual restoration cost approach for determining the appropriate amounts to be charged to the reserve. This methodology is consistent with the manner in which replacement cost insurance works. (Feb. 1995 FPL Order, p. 4).

Later that same year, the Commission commented again that it had required FPL to "submit a study detailing what it believed to be the appropriate amount that should be accrued annually to the reserve and what costs it intended to charge to the storm fund," and that the Commission had "found the storm damage study submitted by FPL to be adequate." Order No. PSC-95-1588-FOF-EI, dated December 27, 1995.

In 1998, the Commission had occasion to rule upon an FPL request to increase the annual accrual to its Reserve. Order No. PSC-98-0953-FOF-EI, dated July 14, 1998. Discussing the history of the utility's self-insurance program, the Commission noted again that it had previously approved FPL's 1993 Study. In fact, the Commission pointed out that "[b]ased upon the study," the Commission had authorized a prior increase in FPL's accrual amount. Order, p. 2. The Commission denied FPL's request to increase the accrual further, however, based upon its view that the then-current accrual amount should be sufficient to cover most storms. In capping the accrual at then-current levels, the Commission assured FPL that the Commission understood that "the costs of storm damage incurred over and above the balance in the reserve and the costs of the use of the lines of credit [to finance out-of-pocket storm costs] would still have to be recovered from the ratepayers." (Order, p. 5). In this regard, the Commission stressed that, "In the event FPL experiences catastrophic losses, it is not unreasonable or anticipated that the reserve could reach a negative balance. . . . In cases of catastrophic loss, FPL continues to be able to petition the

Commission for emergency relief, as reflected in Order No. PSC-95-1588-FOF-EI." (Order, p. 5).

Finally, in discussing the state of FPL's Reserve, the Commission recognized the fact that the determination of the amount then in the Reserve, and how long it should take for the Reserve to reach the targeted amount, was based upon a "calculation [that] includes a reduction to the reserve of $14.5 million in charges associated with the 1998 'Groundhog Day' storm." (Order, p. 4). FPL, of course, was then administering the Reserve in the manner described in its 1993 Commission-approved Study. Despite the fact that the Commission was explicitly considering the adequacy of the Reserve and making decisions about accrual to the Reserve based upon FPL's implementation of its 1993 Study, the Commission voiced absolutely no objection to FPL's use of funds in the Reserve in the manner prescribed in the 1993 FPL Study. To the contrary, as I have described, the Commission specifically noted that it had previously found that the Study was acceptable.

**Q. How have you interpreted these orders in administering the Reserve and in accounting for storm costs arising out of the catastrophic hurricanes in 2004?**

A. I believe the Commission's orders and the context in which they were rendered are quite clear. For the last ten years, the electric utilities and the Commission have shared a common understanding that the Reserve would be administered to replicate and mirror replacement cost insurance and that the electric utilities would account for storm-related costs to achieve that objective in the manner

detailed in the studies we submitted in 1993. Over the last ten years, the utilities in this state have consistently booked storm costs and administered the Reserve in the manner described, in full view of the public and the Commission. In fact, FPC applied the Reserve in the same manner we now propose for storm costs directly associated with Hurricanes Erin, Floyd, and Gabrielle. The Commission, its staff, and various parties in various rate proceedings have had countless opportunities to review these actions. Until now, no one has questioned the propriety or integrity of this approach. Progress Energy Florida faithfully implemented this consistent understanding going into the hurricane season last year and in its filing in this docket, and the Company's submissions should be recognized as consistent with long-standing Commission policy.

I believe that the Intervener witnesses are completely disregarding the context, purpose, and meaning of the prior actions of the Commission and the utilities to recommend an approach that turns the Commission's prior actions on their head.

**Q. Does the long-standing approach to these issues in Florida make sense in the context of a catastrophic season like 2004?**

A. Absolutely. It is important to keep in mind that this policy was forged in a catastrophic season, as a direct result of the horrendous impact that Hurricane Andrew had on this State. Andrew not only wreaked a tremendous amount of damage in Florida, but it induced insurance companies to adjust rates and coverage in unprecedented ways, forcing utilities to replicate third-party insurance

through a self-insurance program. Accordingly, when the Commission conducted proceedings on these issues and requested and received studies and analyses addressing the very issues the Interveners seek to raise in these proceedings, it was not an academic exercise. The Commission and the electric utilities had seen and experienced firsthand how catastrophic storms might impact this State.

**Q. The Intervener witnesses argue that the Commission has made reference from time to time to the relationship between storm-cost recovery and the utility's earnings. On the basis of these statements, the Intervener witnesses argue that PEF should absorb all storm costs that would not push PEF's earnings below a 10% ROE. Do you agree with this contention?**

A. No. This leads me to a discussion of the Intervener's misunderstanding of ratemaking and the current stipulation among the parties to PEF's last rate proceeding.

## III. The Interveners Base their Case on a Misunderstanding of Ratemaking Principles and the Parties' Stipulation in PEF's 2001 Rate Proceeding

**Q. Please explain how the Intervener witnesses are missing the mark in suggesting that PEF must absorb any expenses that will not force the Company to experience an ROE below 10%.**

A. As an initial matter, it is important to understand how base rates are set. Traditionally, base rate proceedings have not been designed to capture non-

recurring, volatile expenses like catastrophic storm losses. Indeed, FIPUG witness Sheree Brown concedes this much. She acknowledges that "if PEF had just booked the [storm-related] expenses to O&M and filed for a rate increase, it would have had to absorb the total costs." (Brown, p. 7) (emphasis ours). She explains that this would have occurred because "rates are implemented on a prospective basis" and "any non-recurring expenses, such as the storm damage losses, would typically be removed through pro-forma adjustments. This would have eliminated PEF's recovery of the costs in a future rate period." (Id.) (emphasis ours).

This is a significant concession, but Ms. Brown does not appear to recognize the importance of what she has acknowledged. It is an important concession because it recognizes that base rates do not contemplate extraordinary expenses like the catastrophic storm costs at issue in this case. Base rates are not set with such costs in mind. Base rates are set to defray other normal, recurring costs of running the utility. After those rates are set, the utility may do better or worse in managing those other functions than anticipated. And the utility's earnings will benefit or suffer depending upon how well the utility does in managing those costs. But it is untenable and unfair for Interveners to suggest that PEF must use its base rate revenues to absorb all or part of the costs of volatile, non-recurring expenses that base rates were never intended to recover in the first place.

Typically, the Commission has employed different mechanisms to ensure that electric utilities are able to recover non-recurring, volatile costs. In this

regard, as we discussed in our direct testimony, the Commission recently authorized the use of a cost-recovery clause to permit utilities to recover extraordinary security costs resulting from the 9/11 terrorist attack.

This only makes sense. PEF is a regulated cost-of-service utility. It is entitled to recover reasonable and prudent expenses as a statutory and constitutional entitlement. It follows that, if the Company cannot recover reasonable and prudent storm-related costs through a base-rate proceeding, then it must be able to recover those costs through a cost-recovery mechanism, surcharge, or some other means. This is why the Commission has repeatedly invited the electric utilities to petition the Commission to recover reasonable and prudent storm costs in excess of amounts accrued in the Reserve.

Indeed, Ms. Brown and OPC witness Michael J. Majoros, Jr. both concede that a two-year recovery by means of a surcharge makes sense for part of PEF's storm-related costs. It is neither fair nor sensible, however, to force PEF to employ base rates to absorb the substantial balance of those costs when everybody appears to agree that base rates were not set in the first place with those costs in mind.

The circumstances of this very case make clear that the Commission's long-standing policy makes perfect sense when applied to catastrophic events like these. By all accounts, the hurricanes of last season were unanticipated and unprecedented. Never in recorded history has Florida experienced hurricane activity of that magnitude. Had the hurricanes never occurred, PEF had plenty to do to run the Company. When the hurricanes struck, the Company had to divert

employees and other resources to the monumental task of coping with back-to-back highly destructive storms and restoring power to customers, no questions asked. By no means did these events excuse the Company from other work that it had to perform to operate the utility. The Company still had to hook up new customers and terminate old ones, it had to continue its work on capital projects, it had to compute customer bills, it had to operate and maintain plant and equipment.

As FPL explained in its 1993 Study, dislocation like this forces a utility to incur significant backlogged work that must often be performed at higher than "normal" costs. PEF experienced this problem after the last hurricane season because the Company had to commit virtually all of its resources for a substantial period of time to storm restoration. Also, the Company lost substantial revenues and numerous customers as a result of the storms.

PEF is not seeking to transfer these indirect storm-related risks to its customers. But PEF is seeking to enforce the understanding reached and followed since 1993 concerning how it must account and recover for direct storm-related expenses. The Commission may rest assured that the Company will use the base rates previously approved to perform the activities and services contemplated by the Company in its Minimum Filing Requirements in the last rate case. But it cannot be expected to use those rates to absorb costs that were most definitely not contemplated during the last rate case.

**Q. But Ms. Brown contends that PEF is "gaming" the system by "shifting" what should be seen as normal labor costs covered by base rates to storm costs reimbursable through a special cost-recovery clause, and that this will result in "double dipping." Do you agree with her characterizations?**

A. No. I believe that her argument and pejorative characterizations are unfair. PEF is not "gaming" anything. As I have explained, the Company is complying with the accounting methodology that the utilities proposed and discussed extensively in their 1993 Studies. The extraordinary costs in excess of the Reserve that the Company has booked to the storm accounts were not "normal" in any sense and, by definition, were not contemplated at the time base rates were established.

Ms. Brown reaches her conclusion that we have engaged in "cost shifting" by looking at only part of the picture. The premise of her argument is that we recovered base rates to pay for O&M and other activities during this period and that we used our resources to deal with storm-related activities instead of performing these "normal" demands. What this completely ignores is the fact that the Company's "normal" demands did not go away during the storms. The Company was forced to deploy its resources to cope with the devastating hurricanes in addition to meeting its commitment to perform other "normal" projects and responsibilities. After the storms, the Company faced the significant backlog of "normal" activities that I just discussed.

**Q. The Intervener witnesses argue that the 10% ROE trigger in the parties' Stipulation must be used as the operative measure of the amount of losses the Company must absorb with base rates. Do you agree?**

A. No, I do not agree. This argument reflects a misunderstanding of the background, structure, and meaning of the Stipulation. First, the Intervener witnesses ignore important considerations that went into the Stipulation. At the time of the last rate case, the Company had just completed a merger. As a direct result of that merger, the Company had been able to achieve tremendous savings in O&M expenses, through a reduction in headcount and other measures. The parties arrived at a Stipulation, in part, as a means to share the benefits of those savings. For its part, the Company agreed to provide rate relief in the staggering amount of $125 million. What the Company received in return included in part the elimination of the use of an ROE limitation on earnings.

Traditionally, the Commission has set rates tied to an authorized ROE. The Commission establishes a "midpoint," say 12%, and then creates a band around that midpoint of 100 basis points on either side. The Commission has used this band to determine whether it is appropriate to initiate a rate proceeding either to increase or decrease rates.

In the case of the parties' Stipulation in the last rate case, the Commission and the parties did not establish a midpoint ROE, representing a target rate of return. Nor did the Commission establish an upper limit on a band around the midpoint, which might be used to determine whether the Company was "over earning." Instead, the Commission approved a revenue sharing mechanism to

allow both the Company's shareholders and its customers to benefit from greater-than-anticipated revenues.

It is true that the Commission approved a 10% ROE as a trigger for determining whether PEF could initiate a request to increase rates. But this must be understood in context also. The parties essentially agreed to a base rate freeze for five years. To ensure that PEF would not return to the Commission before that time to argue that its base rates were too low in view of the substantial base rate "give up," the parties agreed that PEF would be bound to adhere to the base rates it accepted unless the parties seriously miscalculated the amount of base rate revenues that the Company would require to meet its anticipated costs. The ROE of 10% serves as that trip point, and it was purposely set at a low number to prevent PEF from seeking an adjustment in base rates absent a serious miscalculation.

It would be a complete misreading of the Stipulation to contend that the Stipulation requires PEF to absorb expenses that, by Ms. Brown's own admission, are not typically addressed through base rates so long as PEF would not earn less than a 10% ROE.

**Q. The Intervener witnesses insist that the Commission's prior orders on storm costs mean that the Company must be driven down to the 10% trigger point. Are they correct?**

A. No, they are not. To the contrary, the Commission's orders unmistakably foreclose that reading. Time and time again, the Commission has invited utilities

to petition the Commission for recovery of storm costs in excess of the Reserve. If the Interveners were correct, the Commission would have instructed the utilities to petition only for relief from costs that would cause the utilities' earnings to reach 100 basis points below its authorized midpoint ROE.

Further, it makes no sense to focus on the bottom end of any approved ROE range, as the Interveners do. The Commission has not sought to drive utilities to the bottom end of an approved range to cover storm costs, even in circumstances where the utility has operated under such a range. In a case involving Gulf Power, for example, the Commission permitted Gulf Power to apply excess earnings, exceeding 12.75%, to augment its Reserve. The Commission concluded: "[W]e find it appropriate to allow the Company the flexibility to increase its annual accrual to the accumulated provision account when the Company believes it is in a position, from an earnings standpoint, to do so." Order No. PSC-96-0023-FOF-EI, dated Jan. 8, 1996 ("1996 Gulf Order"), p. 4. Although the Commission had approved a Reserve balance that Gulf had not then achieved, the Commission did not order Gulf to fund that balance out of base rate revenues forthwith up until the point where funding would depress the utility's earnings below the bottom end of its authorized ROE range.

In the same vein, the Commission approved a request by FPC to cap its 1994 earnings at a 12.5% ROE, at a time when it had a 12% midpoint and a range extending from 11% to 13%, by applying any earnings above the utility's proposed cap to increase its storm damage accrual to $6,000,000. Again, despite the Commission's finding that "an increase above the current $3,000,000 annual

accrual is needed," the Commission did not direct the Company to augment its Reserve so long as this did not depress earnings below 11%.

Indeed, during the 1993 proceedings, when FPL had just encountered catastrophic losses as a result of Hurricane Andrew, nowhere did the Commission direct that FPL must absorb those losses up until the point where FPL's earnings reached the bottom end of its authorized range. To the contrary, the Commission anticipated that those losses would be covered by replacement insurance and the previously-approved Reserve and approved a mechanism for future accruals using the very means of accounting employed by PEF in this case.

**Q. The Interveners argue, nonetheless, that PEF will be over earning unless the Company is made to absorb a substantial share of the storm costs. Do you agree?**

A. No. This argument makes less sense in this case than it might have in prior cases because PEF has no cap on earnings under the current Stipulation. The Interveners are, in essence, seeking to re-write the Stipulation to include some kind of cap on ROE. The parties agreed to a revenue sharing arrangement in lieu of a cap. The 10% figure that Interveners use has no relationship to that revenue sharing mechanism, and it certainly does not constitute an upper limit on earnings. But that is exactly how the Intervener witnesses are using it.

The fact is, before the storms, PEF was targeting earnings in excess of 13%. It had every right to do this under the Stipulation. In addition, the Company was enjoying revenues in an amount sufficient to trigger the

Stipulation's revenue sharing mechanism. So the Company's customers were benefiting, too.

There can be no question that the Company's revenues were impaired below what they would have been but for the storms. What the Company seeks to achieve by this proceeding is not to obtain any windfall, but to recover no more or less than the direct costs that it incurred as a result of these catastrophic storms, based on the accounting the Commission has long accepted.

**Q. Would it be either fair or appropriate to change the rules for accounting for storm costs after the fact?**

A. No. A regulated utility depends upon predictable and reasonable regulation in running its business. Investors and analysts require and expect this, too. Changing rules after the fact is neither predictable nor reasonable. In fact, in the context of the regulation of cost recovery, it amounts to impermissible retroactive ratemaking.

This is not an academic issue. Knowing the rules in advance allows a regulated utility to make reasonable and prudent decisions about how to run the business. This is especially important in the context of emergency response, when the utility simply does not have the time or opportunity to consult with regulators first to determine whether change may be in the air.

Every business has choices about how to handle any situation confronting the company. Regulated utilities are no different. As the Commission has recognized time and time again, utilities may exercise prudent judgment to

balance the needs and interests of their customers and their shareholders. The Commission has never required electric utilities to subvert the interests of their shareholders to favor the short-term financial interests of customers because experienced regulators know that this will only hurt ratepayers in the long run by raising the utility's cost of capital.

In the case of these hurricanes, relying on the rules in place, the Company deployed all of its resources to get power back in service, knowing that this would create a substantial backlog of normal work assignments that might have to be completed under difficult circumstances at a higher cost, at the Company's expense. If the Company had known that its shareholders would have to bear a substantial portion of direct labor costs and other direct expenses associated with the storm response effort, the Company may well have opted prudently to keep its employees on task, tending to their normal, recurring responsibilities, while relying more heavily on contract labor to manage storm response and restoration. But this likely would have resulted in higher costs to the customer than the relief PEF is now seeking.

Having faith that the Commission would "do the right thing" by adhering to long-standing policy if the Company "did the right thing" by applying all of its resources to storm response and repair, the Company plunged ahead to return customers to service at the earliest practicable time and the lowest practicable cost. In this proceeding, PEF is not asking for any favorable change in Commission policy. Rather, PEF is simply asking the Commission to apply the

tools that have been used for the last 10 years to account for and recognize the Company's storm-related efforts.

As for the assertion by Intervener witness James Rothschild that our shareholders should be satisfied so long as the Company receives a 10% ROE, this is completely unrealistic and divorces the 10% figure from the context in which it was used in the Stipulation. As I have explained, the 10% ROE figure in the parties' Stipulation is not a cap on the Company's earnings; nor is it a target earnings rate. The Company can and does target earnings above that level, and its investors know that. The rate agreement set forth in the parties' Stipulation represents the level of base rates that the parties have agreed should be sufficient to enable the Company to meet its normal, recurring expenses. As I have explained, the parties' Stipulation does not contemplate the recovery of non-recurring, volatile costs. Nor was the 10% trigger point set with such costs in mind. Thus, Mr. Rothschild is mixing apples and oranges by trying to apply the trigger point in the Stipulation to cost recovery that should occur outside the contours of that Stipulation.

To be sure, our investors may be expected to be familiar with the Stipulation in place at this time. But it is unrealistic to assert that our investors must treat as a normal part of PEF's "risk profile" the occurrence of a string of four catastrophic hurricanes, never before seen in the State of Florida. Further, there is no basis to assert that our investors should expect that the current Stipulation contemplated this extraordinary event when the assumptions going into that Stipulation were radically different. Finally, our investors must be

deemed to be familiar with the Commission's long-standing policy relating to the accounting for storm costs, and the Commission's repeated assurances that the electric utilities in Florida should be able to seek recovery of reasonable and prudently incurred storm costs in excess of the Reserve, notwithstanding the fact that these costs are not the kind of costs typically covered in base rates.

**Q. The Intervener witnesses contend that, in view of the fact that PEF has initiated a full requirements rate case that will take place later this year, the Commission should act upon PEF's request for recovery of storm-related expenses as part of its examination of the Company's overall finances and operations. Do you agree?**

A. No, I do not. This argument amounts to reliance on coincidence rather than sound regulatory policy. In addition, it reflects a misunderstanding of ratemaking principles and the ratemaking process.

Catastrophic storms can occur at any time. It is mere happenstance that Hurricanes Charley, Frances, Ivan, and Jeanne struck last year, the second-to-last year before expiration of the current rate Stipulation. The Commission's response to events like these should not depend upon proximity to the utility's next full requirements rate proceeding. Rather, the Commission should respond by taking action best suited to the nature of PEF's request.

In this connection, the Commission has never treated the utilities' actions in drawing upon funds in the Reserve, or petitioning the Commission for recovery of excess storm costs, as an exercise in the setting of base rates. It is important to

remember that the current approach to storm response was conceived as a replacement for third-party T&D insurance. Insurance benefits are payable upon occurrence of the loss, not upon completion of a utility rate case. Certainly, if the current Reserve were sufficient to cover the amount of the recently incurred storm-related losses, nobody would argue that the utility would have to undergo a rate case before drawing upon the Reserve to satisfy those losses. By the same token, the Commission has repeatedly invited utilities to petition for relief from excess storm costs, and has repeatedly assured utilities that any such petition would be processed expeditiously. Either folding this proceeding into a rate case, or – even worse – converting this proceeding into a rate case by putting on the table all aspects of the utility's finances and operations would be completely at odds with the way the Commission and the utilities have treated this issue over the years.

Equally fundamental, the Interveners' arguments do not recognize the limitations on the upcoming rate case. As Ms. Brown herself points out, rate case proceedings are designed to set base rates prospectively. They are not used, and may not properly be used, to provide cost recovery for non-recurring past events or to change the rules of cost recovery retroactively. Although PEF has charged storm expenses to the Reserve and has thus not expensed these costs to date, PEF incurred the costs last year, and all the issues that Interveners want to examine – namely, the impact of storm response on "normal" workload during 2004 or budgeted O&M and capital items for 2004 and 2005 – occurred last year or will occur this year. The Commission will set PEF's base rates in the upcoming

proceeding based upon its examination of a future test year – 2006 – not based on one-time events in the past.

It is true that PEF will propose an increase in accrual to the Reserve for predictably higher, future storm costs. But this is a function of estimating costs that are likely to recur in the future, not a process of obtaining recovery for costs already incurred. Therefore, it would be wrong to use the upcoming rate proceeding to review the storm costs incurred in 2004 and to provide a cost recovery mechanism for those costs.

**Q. Mr. Rothschild contends that, in acting upon PEF's petition, the Commission may wish to examine whether 10% would constitute a reasonable ROE under current market conditions. Is this a proper inquiry?**

A. No, it is not. We disagree with Mr. Rothschild's views about what would be a reasonable ROE in today's circumstances. But more importantly, we suggest that this discussion is totally out of place in this proceeding, and therefore we do not agree that it is appropriate to engage in this debate in the current docket. Again, Mr. Rothschild confuses a program that was conceived to replicate third-party insurance with a base rate proceeding. While it is appropriate to examine the ranges of reasonable returns on equity in a base rate proceeding, PEF has not petitioned in this case to re-set base rates. That matter is resolved definitively for the time being by the parties' rate Stipulation. In seeking to reopen this matter before January 2006, it is Mr. Rothschild, not PEF, who is arguing for a departure from a binding Stipulation.

Further, under that Stipulation, the parties and the Commission have not established a framework revolving around an authorized ROE. Rather, the Commission has approved a revenue sharing mechanism as the device to control over-earning by the utility. Accordingly, Mr. Rothschild's suggestion not only fails to come to terms with the fact that PEF is calling upon the Commission to take action on what is fundamentally a self-insurance, not base rate, issue. But his suggestion is out of alignment with the parties' current base rate Stipulation.

## IV. Miscellaneous Issues

**Q. FIPUG's witness, Sheree Brown, contends that PEF is proposing to use the wrong rate design for storm cost recovery. Should PEF be required to modify its rate design in its GSD, CS, and IS rates in order to recover the storm damage costs through a demand charge rather than an energy charge?**

A. No. The Company has used an energy charge rate design consistently for these rates in all of its recovery clauses including (i) Fuel Cost (ii) Energy Conservation, (iii) Capacity Cost, and (iv) Environmental Cost. Much like storm damage costs, the majority of the costs recovered by these clauses, with the exception of the Fuel Cost, are demand-related. The rate design recognizes the demand-related classification of these costs in determining each rate class's cost responsibility. Within a rate class, it has been the practice to recover the rate class's cost on the energy usage of that class.

**Q. If the Company were required to modify its rate design in its GSD, CS, and IS rates for the storm damage costs to be recovered through a demand charge, do you agree with the calculations presented by FIPUG in their testimony?**

A. No, I do not. FIPUG has not determined its charges as it pertains to voltage level customers in the same manner as voltage level differences are recognized in the Company's ratemaking practices. The Company's base rate charges reflect service to the lowest delivery voltage (distribution secondary). Where customers take service at higher delivery voltages, the customer's billing is adjusted by two factors. First, metering quantities or rate charges need to be adjusted to recognize lesser losses responsibility of 1% for distribution primary delivery and 2% for transmission delivery. Second, the higher delivery voltage customer is credited an amount for the avoidance of transformation facilities that have been incorporated in the secondary delivery charges.

The calculations performed by FIPUG do not appear to have been performed in the manner described. Nor do the results appear to be reasonable. FIPUG's calculations show greater charges should be assessed for the higher delivery voltage customers than that for the distribution secondary delivery customers. This is contrary to the nature of higher voltage service costs. Since the transformation credits have been fixed in base rates, the additional charges by voltage level, whether recovered on an energy basis

or a demand basis, should result in primary delivery charges of 1% less and transmission delivery of 2% less than that for secondary delivery charges.

**Q. OPC witness Michael Majoros contends that PEF retains enough flexibility in its budgeting process to absorb backup work pushed into 2005. Do you agree?**

A. I do not agree that this is a valid argument. It is built on a mistaken premise. The Company has made a commitment to the Commission and its customers to improve customer satisfaction and system reliability as part of its Commitment to Excellence. In order to fulfill this commitment, the Company was on track to perform a number of activities that got interrupted by the hurricanes. The Company will not lessen its efforts or commitment to improve customer satisfaction and system reliability now that the hurricanes have passed. The fact is that PEF faces a substantial backlog of work that it must perform to run its system. That work was not made easier or cheaper by the advent of the hurricanes. To the contrary, the Company will in many instances face greater costs in performing this backlog of projects. The Company will incur greater than normal costs for performing "normal" utility functions. Whether or not the Company meets or exceeds budget in doing so is completely irrelevant. The Company's budgets are projections. If the Company manages to meet budget in 2005 despite its backlog of work from the hurricane season, it will nonetheless incur greater costs for this period than it otherwise would have. There is no way around that.

**Q. Ms. Brown argues that the storm repairs will likely reduce future O&M requirements. Do you agree?**

A. No. We have no way to predict that this will occur or to quantify it if it does occur. Based on what we now know, we do not expect this to be the case. Given the urgency of the storm-related repairs, and the haste with which they had to be made, we may as readily speculate that we will encounter greater, not lesser O&M expenses in the future.

**Q. Ms. Brown also argues that the Company should have credited to the Reserve all revenues that it received from other utilities when employees were lent to assist those utilities with their storm-repair work. Do you agree?**

A. No, I do not. Again, Ms. Brown ignores the fact that PEF employees who were diverted from their "normal" activities had to return to those demands after they completed their service for other utilities. The services they performed outside our service territory did not benefit our customers; nor did our customers pay for those services. We used the base rates we collected from our customers to pay for the "normal" work that these employees were expected to perform before and after their out-of-state assignment. At the same time, we used the revenues collected from other utilities to defray the cost of the services these employees provided outside our system. This is all symmetrical. By contrast, it would make no sense to credit our customers

with revenues collected outside our system for work that benefited other customers, as Ms. Brown suggests.

**Q. Ms. Brown and Mr. Majoros suggest that PEF has been accruing as part of depreciation expense the cost of removal of T&D equipment and that none of the accrued cost removal was applied to the storm damage. Is this a fair criticism?**

A. No, it is not, for two reasons. First, PEF has always maintained that any removal cost incurred, as a direct result of the storms, will be charged to the accumulated reserve for depreciation and not to the storm reserve. Second, if we end up over-collecting or under-collecting in depreciation expense, we will correct for that by adjusting depreciation rates in our next depreciation study to collect less (or more) on a yearly basis. So any discrepancy that may be created in depreciation expense as a result of the storms will be corrected in our next depreciation study by adjusting what we collect.

**Q. Mr. Majoros claims that PEF did not provide documentation that OPC requested to back up the Company's representations about its accounting procedures. Is this true?**

A. No. We provided everything OPC requested.

**Q. Sugarmill Woods witness Stewart argues that the Commission should treat storm-cost recovery in the same manner that it treated the 1986 Federal Income Tax rate change. Do you agree?**

A. No. That tax rate change affected an item of cost of service that was included in the rate making process as a normal, recurring cost. Therefore, when the Federal Government changed the rate, it was logical and appropriate that the Commission would adjust base rates on a going forward basis to allow FPC to achieve its midpoint in light of this reduction in income tax expense.

**Q. Do you agree with Ms. Brown's suggestion that PEF should provide an offset for the income tax benefits that PEF receives by expensing the storm damage costs for tax purposes?**

A. No. This argument misapprehends the income tax effect of the 2004 hurricane season on PEF. I am submitting as Exhibit ___ (JP-5), a schedule that demonstrates that PEF should not be required to offset the storm recovery by the "temporary" tax benefit that it recognized in 2004. You can see from the schedule that, although for tax purposes PEF is allowed to take a casualty loss as well as a current period deduction for the storm damage cost, it is all a temporary timing difference.

Line 5 of the schedule shows that, over the life of the assets installed, PEF will recognize the tax depreciation, offset by Line 8, which represents the book revenue requirement collected for depreciation expense on those assets. The difference represents the above normal cost of installation that is

capitalized for tax purposes but expensed to the Reserve for book purposes. We will also recognize this amount of extraordinary costs over the life of the tax capital investment, but this will be offset by the taxable income created by the cost recovery clause.

This leads to consideration of the casualty loss, which witness Brown may believe is a permanent difference and thus a benefit for PEF. In fact, it is not a permanent difference but rather a timing difference. The casualty loss reduces the tax basis of current year additions. PEF will recognize the amount as taxable income over the tax life of the investment placed into service due to the storms. It is evident from the attached exhibit that, over time, PEF will not be advantaged by the tax impact of the storms.

| **PROGRESS ENERGY FLORIDA** | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Federal and State Income Tax** | | | | | | | | | | | |
| **Retail Analysis of Storm Impact** | | | | | | | | | | | |
| | | | | | | | | | | | |
| ***(Tax Deduction) / Taxable Income*** | | **(A)** | **(B)** | **(C)** | **(D)** | **(E)** | **(F)** | **(G)** | **(H)** | **(I)** | **(J)** |
| Line No. | **Description** | **Impact** | **PY's** | **Carry-back 2003** | **2004** | **2005** | **2006** | **2007** | **2008** | **2009 - End of Life** | **total** |
| 1 | Tax Casualty Loss | $ (107.8) | | (94.7) | (13.1) | | | | | | $ (107.80) |
| 2 | Tax O&M and Cost of Removal | $ (298.0) | | | (298.0) | | | | | | $ (297.97) |
| 3 | Recovery through Storm Reserve at 12/04 | $ 46.9 | 34.9 | 6.0 | 6.0 | | | | | | $ 46.90 |
| 4 | Recovery of COR through Bk Depr in PY | $ 1.87 | $ 1.87 | | | | | | | | $ 1.87 |
| 5 | Capital portion for Tax | $ (66.7) | | | (3.3) | (3.3) | (3.34) | (3.34) | (3.34) | (50.03) | $ (66.70) |
| 6 | Reversal of Tax Casualty Loss | $ 107.8 | | | 5.39 | 5.39 | 5.39 | 5.39 | 5.39 | 80.85 | $ 107.80 |
| 7 | Recovery through Clause | $ 256.8 | | | | 64.20 | 128.40 | 64.20 | | | $ 256.80 |
| 8 | Book Depreciation on Storm Capital | $ 47.0 | | | 1.6 | 1.6 | 1.6 | 1.6 | 1.6 | 39.17 | $ 47.00 |
| 9 | Remove wholesale | $ 12.1 | | | 12.1 | | | | | | $ 12.10 |
| 10 | | | $ 36.77 | $ (88.66) | $ (289.39) | $ 67.82 | $ 132.02 | $ 67.82 | $ 3.62 | $ 69.99 | $ (0.00) |
| 11 | | | | | | | | | | | |
| 12 | | | | | | | | | | | |
| 13 | **O&M Recovery per tax Calc** | | | | **Casualty Calculated as** | | | | | | |
| 14 | Total Storm Cost Estimate | $ 385.8 | 337.0 | | Total O&M Costs | | | 337.00 | | | |
| 15 | Less Capital | 48.8 | | | Less Storm Res | | | 46.9 | | | |
| 16 | Less Storm Reserve | 46.9 | | | Less Wholesale | | | 12.1 | | | |
| 17 | Less Amount credited to capital per tax | 21.2 | | | | | | | | | |
| 18 | Less Wholesale | 12.1 | | | Recovery for Casualty Loss | | | $ 278.0 | | | |
| 19 | | $ 256.8 | | | | | | | | | |
| 20 | | | | | Total Costs | | | 385.8 | | | |
| 21 | | | | | Less Recovery for Cas. Loss | | | 278.0 | | | |
| 22 | | | | | | | | 107.80 | | | |
| | | | | | | | | | | | |

**Q. You have addressed a number of issues in your rebuttal testimony but may not have touched on each specific point the Interveners raise. Just to be clear, do you accept any of the Intervener witnesses' criticisms?**

A. No. I believe that I have addressed all of their concerns directly or indirectly in this rebuttal testimony. Lest there be any doubt, I do not accept any of their adjustments or criticisms of our submission. They are based on the faulty premise that the Commission should conduct a rate-case type inquiry of the Company's cost-recovery proposal when, in fact, we are talking about volatile, non-recurring costs that are not suitable for rate-case treatment.

PEF has accounted for the storm costs it incurred exactly in the manner described in the utilities' Commission-approved studies following Hurricane Andrew, and this has the virtue of treating extraordinary events in a straightforward and fundamentally just manner. The Intervener witnesses want to "back out" of those numbers any expense that they can conceivably attribute to "normal" demands without allowing full credit for all of the direct and indirect impacts on the utility caused by these unprecedented storms, including the fact that the utilities are not excused from performing their backlog of "normal" activities, in less-than-normal circumstances.

The Interveners want to do this by forcing the Commission and the utility to undergo a full-blown rate-case type inquiry, lasting for many months or more, conceivably every time we experience an extraordinary weather event. At the same time, of course, the Interveners, assume, and undoubtedly would insist, that the utilities in this state must continue to proceed at their

peril, no questions asked, to expend every resource, as we did this past hurricane season, to get the Interveners' constituencies back in service immediately after catastrophe strikes, and take their chances that they will eventually receive fair treatment by the Commission after the fact and following protracted regulatory hearings.

Finally, the Interveners want to define what is "fair" based on the minimum return that the Interveners can argue the utilities may receive without creating economic hardship. Sound regulatory policy, however, should recognize that utilities should be rewarded, not penalized, for rising to an occasion such as this, working tirelessly to restore power to millions of customers struck by devastating storms. In circumstances such as these, electric utilities should not be forced to earn a lower return than "normal." If anything, their extraordinary efforts should be rewarded with an extraordinary return. In fact, it is quite astonishing that the Interveners should argue that PEF should be forced to earn the most minimal ROE defensible under the parties' current rate Stipulation just because the utility dropped everything to work day and night, week after week, often at great personal sacrifice and even peril to the employees involved, to deal with an unprecedented natural disaster so that the Company's customers would suffer the least loss and inconvenience possible under the circumstances.

In sum, the Interveners' position is neither consistent with past Commission treatment of storm costs, nor does it make sound regulatory policy. Rather, sound regulatory policy, consistent with the Commission's

prior orders dealing with storm costs, requires the adoption of the Storm Cost Recovery Clause proposed by the Company to recover from its customers all of its extraordinary, direct storm costs from Hurricanes Charley, Frances, Ivan, and Jeanne over a two-year period. This two-year recovery mechanism benefits both the Company and its customers by ensuring a timely recovery of all reasonably incurred direct costs to prepare for, respond to, and recover from the 2004 hurricanes in a reasonable amount of time that also more closely matches the recovery to the incurrence of the costs to ensure that customers paying the storm costs are more likely the same ones who benefited from the restoration efforts. Moreover, a recovery clause over two years reduces the financial impact to customers from additional financing costs, returns on working capital on negative storm reserve balances, and possibly additional severe storm costs if the recovery period is extended over a longer period of time.

## V. Staff's Testimony and Audit Contain the Same Fundamental Flaws that are Found in the Interveners' Testimony and Further Fail to Appreciate the Import of Auditing our Estimate of Storm Costs

**Q. Have you reviewed the Direct Testimony of Jocelyn Y. Stephens on behalf of Staff and the Audit Report identified as Exhibit ___ (JYS-1)?**

A. Yes, I have. Ms. Stephens' direct testimony simply reiterates the findings in the audit report that she has filed as an exhibit to her testimony.

**Q. Did the Company respond to the Staff audit report?**

A. Yes, it did. I responded to the audit on behalf of the Company on February 11, 2005. A copy of the Company's response to the Staff audit is attached to my rebuttal testimony as Exhibit ___ (JP-6).

**Q. Do you agree with all of the findings in the Staff audit?**

A. No, I do not. As I explained in greater detail in the response to the Staff audit in Exhibit ___ (JP-6), some of the findings in the audit report, in particular audit disclosures number 1 and number 3, reflect the fact that the Company is still working with estimates because not all invoices for the Company's storm costs have come in and been audited by the Company to ensure that they are properly charged to the storm damage reserve. Until that process is completed there will not be a final accounting of the storm-related capital and O&M costs and an allocation of those costs to capital to be deferred to the next base rate proceeding and to O&M to be included in the storm damage reserve and our request for cost recovery under a clause.

Other findings in the audit report are simply wrong. For example, Ms. Stephens states in the second point of audit disclosure number 2 that exempt employees, who are not eligible for overtime pay, received overtime pay. This statement is inaccurate. Certain, eligible exempt employees receive extended pay, not overtime pay, under the Company's Extended Policy provision that has been in place since the early 1990's. The Extended Policy provision is used for special projects, including storms and outages, where employees are required to work long hours for extended periods of time. The

Policy provides for extended pay only for time worked in excess of 40 hours per week with a maximum of 72 hours of extended pay. Extended pay is paid at a straight hourly rate under the Policy and, thus, is not overtime.

Finally, the findings in audit disclosures numbers 2 and 4 reflect the fact that the Company has properly charged all of its direct costs to prepare for, respond to, and recover from the four hurricanes to the storm damage reserve, subject only to the allocation of the total installation costs under normal operating conditions of the replacement facilities in the storms to capital to be carried by the Company until the next base rate proceeding. This replacement-cost insurance approach is consistent with the regulatory treatment of storm cost recovery in Florida and sound regulatory policy, as I explain in detail above in response to the interveners' testimony in this proceeding, and is, therefore, fully supported by the Commission's policy and prior decisions.

**Q. Are the findings in audit disclosures numbers 2 and 4 in the Staff audit consistent with Staff audits of other utilities' 2004 storm-related costs?**

A. No, they are not. Staff's "opinion" in the Staff audit report of the 2004 storm costs incurred by Florida Power and Light Company ("FPL") was that FPL had recorded items included in base rates, such as regular, overtime, and overhead costs for payroll employees who were assigned to the hurricane restoration, consistent with FPL's 1993 Study and the Commission's 1995 Order. This "opinion" is found on page 18 of the Staff audit in audit

disclosure number 6 addressing items included in base rates. Audit disclosure number 6 is similar to audit disclosures numbers 2 and 4 in the Staff audit of PEF's storm costs. I have attached as Exhibit ___ (JP-7) to my testimony the Direct Testimony of Iliana H. Piedra on behalf of Commission Staff in Docket No. 041291-EI, together with page 18 of the audit report she prepared with respect FPL's petition for authority to recover prudently incurred storm restoration costs related to the 2004 hurricane season.

Ms. Piedra reviewed the FPL study filed in 1993 in Docket No. 930405-EI and Commission Order No. PSC-95-0264-FOF-EI dated February 27, 1995 as part of her audit of FPL's storm costs. She correctly notes that FPL was required to file this Study by the Commission to describe for the Commission how FPL would record hurricane related costs to the storm reserve. She concedes that the FPL said that it would use the actual restoration cost approach to determine the appropriate amounts to be charged to the reserve in its Study, that the Commission understood this was the approach FPL selected as the most reasonable and prudent methodology, and that the Commission concluded that the actual restoration cost approach was consistent with the manner in which replacement cost insurance works in Commission Order No. PSC-95-0264-FOF-EI.

Staff's findings that FPL's storm-related costs have been recorded in accordance with its Commission-approved Study should be similarly and consistently applied to the Staff audit of PEF's 2004 storm-related costs. As I explained in detail above, PEF filed its own Study adopting the same, actual

restoration cost approach consistent with replacement cost insurance that FPL adopted, that Study was approved by the Commission, and PEF has followed the approach approved in that Study on a regular basis consistent with the sound regulatory policy that it represents.

**Q. What about audit disclosure number 5 where Ms. Stephens singles out one claim out of a number of damages claims arising from the storms and recommends that this item be removed from the Company's storm cost estimate. Do you agree with that finding?**

A. No, I do not. This is not an audit finding. Ms. Stephens is improperly drawing conclusions on issues of negligence that will be determined as part of a legal, not an auditing, process. There is no basis for Ms. Stephens to assume, in her position as a Staff auditor, that this damage claim should not be included as a regular cost of doing business. Any damage claim by one of our customers is undesirable and unfortunate, but to suggest that the Company is somehow negligent to a degree that would remove this particular claim from treatment as a cost of doing business like any other damage claim, when it arose during the crisis situation of responding to literally hundreds of thousands of calls and attempting to promptly restore power during and following a hurricane, is both baseless and inappropriate. Ms. Stephens is judging the conduct of an individual employee using the standard of care under ordinary circumstances. Under normal conditions notice of a downed power line, once or even twice, would be a significant event and the

appropriate standard of care would require prompt attention. The same notice of a downed power line, once or even twice, when there are hundreds of other power lines down, each one having the potential of causing serious bodily injury or property damage is an entirely different matter. While the failure to timely address the downed power line that Ms. Stephens is referring to is regrettable, it is a function of the extreme conditions that were present and is not the product of gross negligence. PEF could allocate its resources to make it less likely that this event would occur but it would do so at the increased cost of slowing restoration and increasing manpower costs.

## VI. Conclusion

**Q. Does this conclude your rebuttal testimony?**

A. Yes, it does.