BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

PETITION FOR INCREASE IN RATES BY PROGRESS ENERGY FLORIDA, INC. / DOCKET NO. 090079-EI

PETITION FOR LIMITED PROCEEDING TO INCLUDE BARTOW REPOWERING PROJECT IN BASE RATES, BY PROGRESS ENERGY FLORIDA, INC. / DOCKET NO. 090144-EI

PETITION FOR EXPEDITED APPROVAL OF THE DEFERRAL OF PENSION EXPENSES, AUTHORIZATION TO CHARGE STORM HARDENING EXPENSES TO THE STORM DAMAGE RESERVE, AND VARIANCE FROM OR WAIVER OF RULE 25-6.0143(1)(C), (D), AND (F), F. A. C., BY PROGRESS ENERGY FLORIDA, INC. / DOCKET NO. 090145-EU

VOLUME 15

Pages 2003 through 2207

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PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Friday, September 25, 2009

PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	LINDA BOLES, RPR, CRR Official FPSC Reporter (850) 413-6734
PARTICIPATING:	(As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
133	JP-Appendix A	2010	2205
134	JP-1	2010	2205
135	JP-2	2010	2205
136	JP-3	2010	2205
137	JP-4	2010	2205
138	JP-5	2010	2205
139	JP-6	2010	2205
140	JP-7	2010	2205
141	JP-8	2010	2205
142	JP-9	2010	2205
143	JP-10	2010	2205
144	JP-11	2010	2205
286	Late-Filed Deposition of Witness Pous	2174	2225

P R O C E E D I N G S

(Transcript follows in sequence from Volume 14.)

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

Mr. Rehwinkel, call your next witness.

MR. REHWINKEL: The Citizens of Florida call Jacob Pous to the stand.

Mr. Pous, were you sworn as a witness in this proceeding yet?

THE WITNESS: No.

CHAIRMAN CARTER: Mr. Pous, would you please stand and raise your right hand?

And if there are any other witnesses that will be testifying today that have not been sworn -- Mr. Larson -- Mr. Lawson is here.

Would you please raise your right hand?

(Witnesses collectively sworn.)

Thank you. Please be seated.

Mr. Rehwinkel.

MR. REHWINKEL: Thank you.

JACOB POUS

was called as a witness on behalf of the Office of Public Counsel and, having been duly sworn, testified as

follows:

DIRECT EXAMINATION

BY MR. REHWINKEL:

Q. Good morning, Mr. Pous. Could you state your name, employer and address for the record?

A. My name is Jacob Pous. That's P-O-U-S. My employer is Diversified Utility Consultants, Inc. My address is 1912 West Anderson Lane, Suite 202, Austin, Texas 78757.

CHAIRMAN CARTER: Excuse me, Mr. Rehwinkel. Let's back up for a second. Let's back up for a second.

I don't remember if we did the exhibits. Did we do the exhibits --

MR. REHWINKEL: I moved --

CHAIRMAN CARTER: -- for Mr. Schultz?

MR. REHWINKEL: -- 169 through 172.

CHAIRMAN CARTER: We did those? Let me be -- out of an abundance of caution here. Okay. I got it. Thank you.

MR. REHWINKEL: Yes, sir.

CHAIRMAN CARTER: You may proceed.

BY MR. REHWINKEL:

Q. And, Mr. Pous, on whose behalf are you testifying today?

A. The Office of Public Counsel.

Q. In that regard, did you cause to be prepared prefiled direct testimony in this docket consisting of 137 pages?

A. Yes.

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

A. Just one. Page 101.

Q. Okay.

A. Line 23, the parentheses says, "See Exhibit (EMR-2) page 2-227." It should have been 2-7. So you need to strike the number two at the end of the parentheses. That's it.

Q. Okay. With that correction, if I asked you the questions contained in your prefiled direct testimony, would your answers be the same?

A. Yes.

MR. REHWINKEL: Mr. Chairman, I would ask that Mr. Pous' prefiled direct testimony be admitted into the record.

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

BY MR. REHWINKEL:

Q. Mr. Pous, did you also prepare a series of exhibits to your testimony, consisting of JP-Appendix A

and JP-1 through JP-11, which have been identified as Exhibits, hearing Exhibits 133 through 144?

A. Yes.

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

A. No.

(Exhibits 133 through 144 marked for identification.)

DIRECT TESTIMONY

Of

JACOB POUS

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 090079-EI

SECTION I: INTRODUCTION

A. STATEMENT OF QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Jacob Pous. My business address is 1912 W Anderson Lane, Suite 202, Austin, Texas 78757.

Q. WHAT IS YOUR OCCUPATION?

A. I am a principal in the firm of Diversified Utility Consultants, Inc. ("DUCI"). A description of my qualifications appears as Exhibit__(JP-Appendix A).

Q. PLEASE DESCRIBE DIVERSIFIED UTILITY CONSULTANTS, INC.

A. DUCI is a consulting firm located in Austin, Texas. DUCI has an international client base. DUCI provides engineering, accounting, and financial services to clients. DUCI provides utility consulting services to municipal governments with utility systems, to end-users of utility services and to regulatory bodies such as state public service commissions. DUCI provides complete rate case analyses, expert testimony,

negotiation services and litigation support in electric, gas, telephone, water, and sewer utility matters.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN PUBLIC UTILITY PROCEEDINGS?

A. Yes. Exhibit___(JP-Appendix A) also includes a list of proceedings in which I have previously presented testimony. In addition, I have been involved in numerous utility rate proceedings that resulted in settlements before testimony was filed. In total, I have participated in well over 300 utility rate proceedings in the United States and Canada. I have testified on behalf of the staff of five different state regulatory commissions on subjects relating to appropriate depreciation rates.

Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?

A. I am a registered professional engineer. I am registered to practice as a Professional Engineer in the State of Florida, as well as numerous other states.

Q. ON WHOSE BEHALF ARE YOU PROVIDING THIS TESTIMONY?

A. Florida's Office of Public Counsel ("OPC") engaged me to address the depreciation study and the depreciation aspects of the revenue requirements request of Progress Energy Florida ("PEF" or "the Company") pending before Florida Public Service Commission (the "Commission" or "FSPC").

B. Overview

Q. CAN YOU PROVIDE A QUICK OVERVIEW OF THE RELATIVE SIGNIFICANCE OF DEPRECIATION-RELATED MATTERS IN THE CONTEXT OF PEF'S REQUESTED INCREASE IN REVENUES?

A. Yes. In terms of revenue impacts, the subject of depreciation is extremely significant in this proceeding. In my testimony, I will report the results of my account-by-account analysis of the depreciation study that PEF is sponsoring, the results of which are reflected in PEF's calculation of its revenue requirements. I will identify numerous examples in which PEF's witness overstates depreciation expense, and refute PEF's proposed treatment on the basis of the inappropriate assumptions and rationales that he employed. My approach is a "from the bottom up" type of analysis, in which I review the details of individual accounts and build up the individual adjustments into a total dollar recommendation. In the aggregate, my adjustments amount to $275 million of reduced depreciation expense annually based on plant as of December 31, 2009. Approximately $161million of this annual amount is intended to return to current customers a *portion* of a massive reserve excess that is the result of PEF's having over collected depreciation expense over time; the balance relates to my adjustments to PEF's calculation of annual depreciation expense that the utility should recognize "going forward." When applied to PEF's proposed increase, the impact of my $275 million recommendation is to reduce PEF's revenue requirements dollar for dollar. In other words, when PEF's overly aggressive depreciation practices and proposals, past and present, are modified to conform to available data and reasonable assumptions, the result is to offset a sizeable portion of PEF's half billion dollar rate increase request for 2010. At first blush, the magnitude of the overall

recommendation may be surprising. However, as I will show, the result is the sum of dozens of smaller individual adjustments, each of which is a "standalone" topic and each of which I will document, discuss, and support in detail in the course of my testimony.

Q. HOW HAVE YOU ORGANIZED YOUR TESTIMONY?

A. I will begin with an introductory background section, in which I will define and describe the basic nature and role of depreciation in the context of a regulated electric utility. Next, I will provide an "executive summary" of my analysis. I will then develop the issues that I have identified and my analysis of the appropriate disposition of those issues in detail.

C. General Background

Q. PLEASE BRIEFLY EXPLAIN THE CONCEPT OF DEPRECIATION AS IT APPLIES TO A REGULATED ELECTRIC UTILITY.

A. While the term "depreciation" is commonly used to describe a loss of value due to "wear and tear," it has a precise and specialized meaning as an accounting concept. Depreciation refers to the recoupment of a capital investment, less net salvage, over the useful life of the asset to which the investment relates.

Q. CAN YOU ILLUSTRATE THE MEANING OF THE TERM?

A. Yes. Perhaps the best way to explain the concept is to contrast an item that is depreciated with one that is not depreciated. As the example of an item that is not depreciated, let's use copier paper. Assume the utility purchases 1,000 reams of paper

for $5,000, and consumes all of the paper within the month in which it was purchased. The utility therefore "expenses" the full $5,000 in the period of the purchase. Assume the utility spends $250,000 on copier paper annually. The annual total cost of copier paper is recorded as a portion of operations and maintenance expense, which is deducted from operating revenues to calculate net income for the year in which the paper was purchased. Recognizing the full cost of the paper purchased in the year is appropriate from a matching standpoint, because the paper was consumed completely in the period in which it was purchased. Moreover, because rates are designed to recover operating costs and provide a return on investment, the annual cost of copier paper is embedded in the rates that the utility charges its customers, and $250,000 of overall revenues serves the purpose of recovering from customers the cost of copier paper consumed during the year.

Q. PLEASE CONTINUE.

A. Now, let's compare that situation with the example of an investment in copper conductor. Assume the conductor costs $100,000 to purchase and install, and the utility expects to use it in the business for forty years. At the end of forty years the utility expects to sell the copper for $30,000 but also anticipates it will incur $10,000 of cost in removing it from the system. This means that its net depreciable investment will be $80,000 ($100,000-$30,000+$10,000). To recognize the full $80,000 in a single year would be to distort the manner in which that investment in copper conductor is employed in the operation of the business. Said differently, the utility expects to "consume" the service value of the conductor—not within a year—but over forty years. Therefore, the investment is "capitalized" and added to rate base. Subsequently, each year 1/40th, or $2,000 of the capitalized cost is recognized

as depreciation expense associated with the conductor. Because depreciation expense is a component of the utility's overall cost of providing service, it is reflected in the design of rates that the utility charges customers. The $2,000 of annual depreciation expense associated with the conductor is accumulated with other depreciation and operating expenses and netted against operating revenues to determine net income for the period. Of the revenues collected during the year, $2,000 serves to recoup the portion of the capital investment that is applicable to the period. Accordingly, the utility will reduce its rate base by the annual amount of the $2,000 that it recouped from customers. It does so by recording $2,000 in an account called the accumulated provision for depreciation or reserve. The value of the rate base is calculated by subtracting the total of the accumulated provision by depreciation from the original depreciable value of the investment. Each year the utility incurs depreciation expense, it adds the amount of expense to the reserve, thereby reducing rate base by that amount.

Q. IN ADDITION TO THE BASIC DEFINITION, WHAT ELSE CAN BE GLEANED FROM YOUR EXAMPLES?

A. First, the examples illustrate a major difference between depreciation expense and other operating expenses. In the case of copier paper, the utility must make a cash outlay during each annual period. In the case of the conductor, there is an initial outlay of cash to purchase and install the conductor; thereafter, the recognition of the annual component of expense applicable to the period does not involve cash outlays. For this reason, depreciation is referred to as a "non-cash" expense. However, the dollars that are collected and applied to defray this non-cash expense are as real to the

utility and the customers who pay them through rates as the dollars that were expended to acquire the capital item or pay for the copier paper.

Q. DOES THE EXAMPLE OF THE CONDUCTOR ILLUSTRATE ANY OF THE ISSUES TO WHICH A DEPRECIATION STUDY MAY GIVE RISE?

A. Certainly. The example illustrates the determination of the appropriate useful life; the assumed salvage value upon retirement; and the projected cost of removing the item from service that the utility may incur to realize the salvage. While the analytical techniques, which may involve statistical measurements, actuarial analyses, and review of historical and comparative industry data, can become technical and involved, all of the debates surrounding the establishing of appropriate depreciation rates involve the interplay between and among service lives and related remaining lives, salvage values, and cost of removal. If the utility assumes too short a useful life, the total depreciation expense will be allocated over too few periods, and the expense recognized in a single period will be higher than it should be. If a utility understates expected salvage or overstates the cost of removing the item upon retirement, it will overstate the amount of depreciation expense that is allocated over the life of the asset. When in my testimony I observe that PEF has been overly aggressive in proposing depreciation rates, I mean that it continues to attempt to overstate depreciation expense currently through one or more of these means.

The example of the copper conductor also illustrates another important point. Depreciation practices applicable to assets that have long useful lives very quickly give rise to issues of intergenerational equity. For instance, if a utility has reason to believe that the conductor will be in service for forty years, but proposes to depreciate it over only five years, the utility would be calling on current customers to bear an

inordinate proportion of the cost of the investment, thereby subsidizing future customers, who will pay none of the depreciation cost of the asset providing service to them in the future.

There is another point that belongs in this introductory section. Setting depreciation rates necessarily involves the use of estimates and projections. If the estimates and projections are inaccurate, or if circumstances change such that estimates that were good at the time they were made are no longer valid, a utility's depreciation posture can require corrective action. Earlier I mentioned the reserve or the accumulated provision for depreciation, which serves to provide a "running total" of the extent to which individual assets or groups of assets have been depreciated. It is useful to compare the actual reserve to the "theoretical reserve," or the reserve that would be necessary to enable the utility to remain "on course" to recoup its investment ratably over the current estimate of life of the asset or assets in question at a given point in time. If a "reserve excess" or "reserve deficiency" is discovered in the course of a periodic depreciation study, corrective action can be devised. The time frame that is appropriate for addressing an excess or a deficiency is in part a function of the severity of the imbalance. If the degree to which the actual depreciation experience is ahead of or behind schedule is slight, the typical regulatory response is to devise modified depreciation rates that will cure the imbalance over the remaining life of the asset. However, if the imbalance is so severe that it amounts to unfair and inequitable treatment of customers or the utility, the regulators have the obligation and the means with which to require remedial action that is more direct and immediate. In my testimony, I will demonstrate that by over collecting depreciation expense in the past, PEF has built a massive depreciation reserve excess-- so massive that the

Commission should require PEF to return a portion of the excess to customers over a four year period.

Q. WHAT DO YOU MEAN BY "DEPRECIATION RATES"?

A. A depreciation rate differs from the tariff rates that are applied to a customer's usage to calculate a bill for service. In the above example, I noted that 1/40th of the investment in conductor cable would be quantified as depreciation expense for the annual period. This translates into a "depreciation rate" of 2.5% of the investment annually. However, this is only a step in the ratemaking process. The depreciation rate is applied to the original gross investment to calculate the annual depreciation expense that the utility should recognize on its books. When the Commission conducts a revenue requirements case, the total depreciation expense is rolled into the overall revenue requirement that retail rates are then designed to recover.

Q. DO YOU HAVE ANY ADDITIONAL OBSERVATIONS OF A GENERAL NATURE BEFORE YOU BEGIN THE PRESENTATION OF YOUR ANALYSIS OF PEF'S DEPRECIATION STUDY?

A. Yes. Generally speaking, it is in an electric utility's financial self-interest to collect more dollars from customers than fewer dollars, to collect those dollars sooner than later, and, once having collected dollars, to keep them rather than returning them to customers. This is true of depreciation practices. Because depreciation expense results in revenues that do not have a concurrent cash outlay associated with them, depreciation expense is a source of cash flow, and higher depreciation expense means greater cash flow. Plus, recouping more of an investment in early years than would be warranted by the comparison of actual and theoretical reserves would reduce the

risk of not recouping the investment in later years. Accordingly, even though issues of depreciation affect the timing of recoupment of capital investments rather than whether the utility should recover its claimed capital costs, a utility has an incentive to favor higher depreciation expense and higher depreciation reserves. The Commission therefore must scrutinize the utility's practices and studies to ensure that current customers are not called on to bear more than their appropriate share of the depreciation expense.

D. EXECUTIVE SUMMARY

Q. PLEASE PRESENT YOUR MAIN POINTS IN SUMMARY FASHION.

A. PEF's own depreciation study shows a reserve excess of $646 million. However, as I will show, the claimed excess of $646 million is an understatement. It reflects the result of inappropriate assumptions and rationales that PEF's depreciation witness Mr. Robinson employed in the course of his depreciation study. The real excess reserve is far greater than the $646 million that PEF claims. My analysis, based upon data, assumptions, and rationales that I develop and support in detail, reveals that PEF has a current reserve excess of $858 million. The excess reserve would be even higher were I to incorporate a more realistic useful life for combined cycle generators than the inadequate 30 year life that PEF's witness employs, or recognize the impact of other issues.

The massive reserve excess necessarily means that current and past customers have paid PEF far more than would be needed to enable PEF to be on track to recoup its investment in plant over the service lives of the plant. PEF proposes to correct the

reserve excess by modifying the amount of depreciation on a going forward basis over its claimed 21 years of remaining life. In view of the size of the excess that customers have paid, the size of its overall rate increase request and the resulting justification for remedying the situation, PEF's proposed response is unrealistic and unacceptable. PEF's proposal would be inadequate and unfair to current customers, even if the value of $646 million that it assigns to the excess reserve were near the appropriate amount. The corrected imbalance of $858 million has the effect of increasing the impetus to return the excess to customers more rapidly.

Bearing in mind that I have demonstrated a total reserve excess of at least $858 million, the Commission should at a minimum require PEF to amortize its identified $646 million of the excess reserve to customers over a period of four years. By returning only this portion to customers over a period more rapid than the remaining life, the Commission conservatively will leave PEF with a substantial cushion of excess in its reserve. Moreover, as OPC witness Dan Lawton testifies, requiring this more equitable treatment will not adversely affect PEF's strong, robust financial condition.

When the $646 million amount is amortized over four years, $161 million is available to reduce revenue requirements in each year, including the 2010 test period. The above measure is needed to address PEF's sizeable depreciation reserve excess, which is the result of past practices and over collections. I have also examined the appropriate amount of depreciation expense that PEF should be allowed to recognize annually on a going forward basis. I find that PEF has overstated its need for depreciation expense. The overstatement of overall depreciation expense results from

having employed inappropriate service lives, understating expected salvage, and overstating the projected cost of removing assets upon retirement. I have described the flaws in PEF's claims and have supported my proposed alternatives in the detailed discussion that follows. As a result of my detailed analysis, I recommend that the Commission reduce PEF's proposed annual depreciation expense by $113 million based on plant as of December 31, 2009 as reflected in the Company's depreciation study.

The overall impact of my recommendations in the areas of correcting the massive reserve excess and reducing future depreciation expense is to reduce PEF's claimed revenue requirements by $227 million for the 2010 test year. The resulting depreciation expense adjustment has been provided to OPC witness Bill Schultz.

Q. DOES YOUR RECOMMENDATION MEAN THAT PEF WILL NOT RECOVER ANY PART OF ITS CAPITAL INVESTMENT?

A. No, it does not mean that. In my testimony, I have not challenged or sought to disallow recovery of any of the investments in plant. My proposed adjustments affect only the timing of the collection. If the Commission adopts my recommendation, the portion of the reserve excess that is amortized over four years will be added back to rate base at the same time. Over time, PEF will recoup all of the capital investment that the Commission deems prudent and reasonable.

E. ANALYSIS

Q. PLEASE PROCEED WITH YOUR MORE DETAILED PRESENTATION.

A. The Company retained AUS Consultants to perform a new depreciation study, the results of which are sponsored by Mr. Robinson. The Company's depreciation analysis is based on estimated plant levels through the end of 2009. Based on the plant in service as projected through December 31, 2009 the Company proposes $445,613,594 of depreciation expense, which represents a $97,355,430 or 22% increase. (See Exhibit No. __ (EMR-2) page 2-8). After reviewing the Company's presentation, data, responses to discovery requests, and information in the public domain, I conclude that the Company's request is significantly overstated. In fact, rather than a proposed increase in depreciation expense as requested by the Company, a reduction of $113,112,961 to the requested level or a $15,757,531 reduction to existing depreciation expense is warranted as set forth on Exhibit_ (JP-1).

The Company's request for an increase in depreciation expense is inconsistent with the undisputed fact that customers have significantly overpaid depreciation expense historically, even prior to recognition that the depreciation parameters reflected in the Company's study are excessively aggressive and inappropriate. The acceleration of depreciation expense as proposed by the Company is not warranted and should be denied by the Commission. A brief discussion of the various issues I will address in detail later in my testimony follows.

- **Excess Reserve:** The Company, through its depreciation study, admits to a $646 million excess reserve. This level of excess reserve increases significantly when one applies to PEF's production and mass property accounts the different depreciation parameters I recommend and support in my analysis. Consistent with the Commission's prior decisions, it is appropriate to return to customers some portion of the

excess reserve over a period shorter than the remaining life. In order to remain conservative, I recommend returning the Company-identified $646 million amount over a 4-year period. Limiting the return of the excess reserve to the Company's identified amount rather than the full amount that results from my recommended adjustments leaves the Company with a substantial cushion of remaining excess reserve, which can be addressed in future depreciation studies. OPC witness Dan Lawton establishes in his testimony that limiting the amount to be amortized to $646 million, and accomplishing the amortization over four years, will assure that the adjustment leaves PEF with very strong financial integrity. The impact of my recommendation is a $161,451,136 annual depreciation expense credit, prior to jurisdictional allocation, for the next four years.

- **Production Plant Life Spans**: The Company proposes artificially short life spans (the time frame between when a unit goes into service and when it ultimately retires) for many of its steam generating units. The Company has also underestimated the reasonable life expectancy of its investment in combined cycle generation. As a first step toward correcting this situation, I recommend that the life spans for the Crystal River 4 and 5 coal-fired units be increased from the low 50-year range as proposed by the Company to 60 years as is now being recognized by other regulators and utilities. I further recommend that the minimum life span for the two large steam oil-fired generating units at Anclote be set at a minimum of 50 years. The approximate

impact of this recommendation is a $26 million reduction to the Company's depreciation expense based on plant as of December 31, 2009.

- **Interim Retirements**: Interim retirements are intended to represent limited downward adjustments to the life span for generating units due to items of investment that will retire and be replaced prior to the ultimate retirement date for a generating facility. The Company has proposed a method that is inappropriate for generation investment and which overstates depreciation expense by millions of dollars. The Company's proposed interim retirement results are excessively aggressive, even when measured against the interim retirement results that the Company's depreciation consultant, AUS Consultants, has proposed elsewhere. Correcting the method and level of interim retirements results in an approximate $45 million annual reduction in depreciation expense based on plant as of December 31, 2009.

- **Interim Production Net Salvage**: There are two types of production net salvage. The first is interim retirement net salvage associated with the interim retirements that are estimated to transpire prior to the final termination of a generating station or unit. The second type of production net salvage is terminal net salvage as reflected in the Company's request for dismantlement costs discussed elsewhere. Based on excessively negative net salvage estimates for interim retirements, and an excessive level of projected interim retirements,

the Company seeks in excess of $600 million of interim net salvage to be collected over the remaining life of its generating facilities. Correcting the Company's excessively negative levels of interim retirement related production net salvage results in a $30 million reduction to annual depreciation expense based on plant as of December 31, 2009.

- **Terminal Production Net Salvage**: The Company has presented dismantlement calculations for its various generating facilities. These studies represent a worst case scenario of the ultimate disposition of the investment. In addition to assuming the worst case scenario of having to completely remove each facility and restore the site, the Company's assumed approach to demolition is also the most costly option available. Moreover, the Company incorporates an unjustified level of contingencies as well as other costs that further inflate the overall demolition cost estimates artificially. The Company also erroneously calculated labor costs. It would be difficult to develop an alternative demolition estimate that would be higher than the Company's request. A review of the Company's proposal, as well as what has actually transpired with recent demolition of generating facilities, would support a reduction to the Company's request. However, rather than recommend a specific adjustment in costs, I recommend the Commission order the Company to develop more realistic and supportable demolition studies for its next rate case. At a minimum, such studies should rely on more cost effective demolition

approaches than the costly "reverse construction" approach that PEF presented in this case.

- **Mass Property Life Analysis**: Mass property consists of transmission, distribution and general plant. The Company has relied on its interpretation of actuarial results to propose life characteristics for its various accounts. The Company's proposals are not the best statistical results obtained from its actuarial analysis and fail to recognize other Company specific information which would result in longer average service lives ("ASL"). After reviewing the Company's proposals on an account by account basis, I recommend adjustments to 2 mass property accounts which result in a $13 million reduction to annual depreciation expense based on plant as of December 31, 2009.

- **Mass Property Salvage Analysis:** The Company performed an "interpretative" analysis. The Company failed to provide any specific support for its various proposals in theory derived from its "interpretative" analyses. Also, by failing to correct for "catastrophic" hurricane events or explain significant changes or unusual amounts or occurrences, PEF skewed its future net salvage proposals. Those proposals are not appropriate because they are not indicative of future expectations for the investment in each of the Company's plant accounts. After my review and investigation, I recommend adjustments to the proposed net salvage level for 15 mass property accounts. The standalone impact of these recommendations results in

a reduction of $29 million in annual depreciation expense based on plant as of December 31, 2009.

- **Combined Impact:** Due to the interaction of life and salvage parameters, life spans, and interim retirement levels, the combined impact of my various recommendations is not simply the summation of each standalone adjustment. As shown on Exhibit__(JP-1), the combined impact of all adjustments results in a $274,564,296 reduction to annual depreciation expense based on plant as of December 31, 2009. The recommended adjustment is reduced to $226.9 million when applied to 2010 test year plant balances and then allocated to the retail jurisdiction.

Q. ARE YOU AWARE OF THE MAGNITUDE OF YOUR RECOMMENDED ADJUSTMENT RELATIVE TO THE COMPANY'S REQUEST?

A. Yes. My recommendation must be viewed in two distinct categories: the return of a portion of excess reserve in the amount of $161 million for the next 4 years; and, $113 million in normal annual depreciation adjustments. The $113 million of annual normal depreciation adjustments represents approximately 25% of the Company's request for normal depreciation expense, but is only a 14% reduction to the existing level of depreciation rates. The Company's request represents a greater increase to existing rates than my recommended decrease represents, absent the reserve amortization.

To place my recommended adjustments in proper perspective, it is necessary to recognize that the Company has significantly over collected depreciation expense from prior and current customers. The intent underlying the concept of depreciation is that the Company should recover 100% of what it is due, no more and no less. If the Company over collects in earlier periods, then the remaining life approach to depreciation requires that a lower level of depreciation must be charged in the future in order to reach 100% recovery over the life of the investment. There can be no doubt that the Company has significantly over recovered depreciation expense from customers. However, as the Commission will see once it reviews the individual account and generating unit discussions contained in the balance of my testimony, the Company has proposed unrealistically short life spans or ASLs and excessively negative net salvage values in an apparent attempt to minimize the level of excess reserve it would present in its depreciation study.

To remain conservative in my level of adjustments, I have not proposed in this proceeding longer life spans for over a billion dollars of investment in new combined cycle generating facilities. The Company's proposal for 30-year life spans for this new investment is artificially short. Extending the assumption to 35-year life spans or longer for this type of generation would have resulted in substantial further reductions to the Company's request. In addition, the Company's terminal demolition cost estimates for its generating facilities are excessively high. Correcting the Company's request with a more realistic and reasonable scenario would further reduce the level of annual depreciation expense.

The Company did not reach this position of being in a significant excess reserve position overnight, and should not be required to correct it overnight. However, allowing the Company to correct its situation over the remaining life is simply unfair and unjust, as this Commission has determined in prior proceedings. While my recommendation represents a substantial reduction to the Company's depreciation expense, it is a fair and reasonable first step in a process that might take several rate cases. Delaying the beginning of the correction to the Company's huge over collection would only exacerbate the problem and continue an unreasonable level of intergenerational inequity.

SECTION II. DEPRECIATION

Q. PLEASE ELABORATE ON THE BASIC DEFINITION OF DEPRECIATION THAT YOU PROVIDED IN THE GENERAL BACKGROUND SECTION.

A. There are two commonly-cited definitions of depreciation. The first, from the Federal Energy Regulatory Commission ("FERC"), appears in Title 18 of the Code of Federal Regulation ("CFR"), Part 101:

> 'Depreciation', as applied to depreciable plant, means the loss in service value not restored by current maintenance, incurred in connection with the consumption or prospective retirement of electric plant in the course of service from causes which are known to be in current operation and against which the utility is not protected by insurance. Among the causes to be given consideration are wear and tear, decay, action of the elements,

> inadequacy, obsolescence, changes in the art, changes in demand and requirements of public authorities.

The second definition, from the American Institute of Certified Public Accountants ("AICPA"), is similar:

> Depreciation accounting is a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any) over the estimated useful life of the unit (which may be a group of assets) in a systematic and rational manner. It is a process of allocation, not of valuation. Depreciation for the year is a portion of the total charge under such a system that is allocated to the year. Although the allocation may properly take into account occurrences during the year, it is not intended to be a measurement of the effect of all such occurrences.

Q. WHAT ARE THE TWO GENERAL FORMULAS USED IN DETERMINING DEPRECIATION RATES?

A. The *whole life* and the *remaining life* techniques are the most commonly used formulas. The whole life technique is as follows:

$$\text{Depreciation Rate (\%)} = \left[\frac{\text{Original Cost} - \text{Net Salvage}}{\text{Average Service Life}} \right] \frac{}{\text{Original Cost}}$$

The remaining life technique is as follows:

$$\text{Depreciation Rate (\%)} = \left[\frac{\text{Original Cost-Accumulated Provision for Depreciation -- Net Salvage}}{\text{Average Service Life}} \right] \div \text{Original Cost}$$

The two formulas should equal each other when the difference between the theoretical reserve and the actual Accumulated Provision for Depreciation ("APFD") is recovered over the remaining life of the investment under the whole life formula.

Q. ARE THERE ADDITIONAL CONSIDERATIONS IN DEPRECIATION BEYOND THE DEFINITIONS?

A. Yes. The definitions provide only a general outline of the overall utility depreciation concept. In order to arrive at a depreciation-related revenue requirement in a rate proceeding, a depreciation system must be established.

Q. WHAT IS A DEPRECIATION SYSTEM?

A. A depreciation system constitutes the method, procedure, and technique employed in the development of depreciation rates.

Q. BRIEFLY DESCRIBE WHAT IS MEANT BY "METHOD".

A. Method identifies whether a straight-line, liberalized, compound interest, or other type of calculation is being performed. The straight-line method is normally employed for utility depreciation proceedings.

Q. BRIEFLY DESCRIBE WHAT IS MEANT BY "PROCEDURE".

A. "Procedure" identifies a calculation approach or grouping. For example, procedures can reflect the grouping of only a single item, items by vintage (year of addition), items by broad group or total grouping, and equal life groupings. The average life group ("ALG") procedure is used by the vast majority of utilities.

Q. PLEASE BRIEFLY DESCRIBE WHAT IS MEANT BY "TECHNIQUES".

A. There are two main categories of "techniques" with various sub-groupings: the whole life technique, and the remaining life technique. The whole life technique simply reflects the calculation of a depreciation rate based on the whole life (e.g., a ten-year life would imply a ten percent depreciation rate over the life of a plant using a straight-line depreciation method). The remaining life technique recognizes that depreciation is a forecast or estimation process that is never precisely accurate and requires true-ups in order to recover only 100% of what a utility is entitled to over the entire life of the investment. Therefore, as time passes, the remaining life technique attempts to recover the remaining unrecovered balance over the remaining life or other period of time. Most utilities rely on a remaining life technique in utility rate matters.

Q. DO THE METHODS, PROCEDURES, AND TECHNIQUES INTERACT WITH ONE ANOTHER?

A. Yes. Different depreciation rates will result depending on what combination of method, procedure, and technique is employed. Differences can occur even if the same average service life and net salvage values are employed at the outset.

Q. HOW ARE THE LIFE AND REMAINING LIFE DETERMINED?

A. The determination of the appropriate life to associate with production plant differs from the corresponding determination for mass property, which includes transmission, distribution and general plant. The estimation of production plant life relies on a life span method. The life span method requires an estimate of the probable future retirement date and the impact of interim additions, both of which are discussed in detail later in my testimony. The estimation of mass property plant life (average service life, or ASL) normally relies on an actuarial analysis. This approach recognizes a dispersion pattern of retirements in the life estimation process. The industry relies on a series of standardized dispersion patterns identified as Iowa Survivor curves to arrive at the appropriate ASL for a category of mass property. Exhibit__(JP-11) to my testimony provides additional detail regarding Iowa Survivor curves.

Once an overall life for production plant and an ASL for mass property have been determined, a remaining life can be calculated. The remaining life for mass property is dependent not only on the ASL, but also on the Iowa Survivor curve selected.

Q. WHAT IS NET SALVAGE?

A. Net salvage is the value obtained from retired property (the gross salvage) less the cost of removal. Net salvage can be either positive in cases where gross salvage

exceeds cost of removal, or negative in cases where cost of removal is greater than gross salvage.

Q. HOW DOES NET SALVAGE IMPACT THE CALCULATION OF DEPRECIATION?

A. The intent of the depreciation process is to allow the Company to recover 100% of investment less net salvage. Therefore, if net salvage is a positive 10%, then the utility should only recover 90% of its investment through annual depreciation charges, under the theory that it will recover the remaining 10% through net salvage at the time the asset retires (e.g., 90% + 10% = 100%). Alternatively, if net salvage is a negative 10%, then the utility should be allowed to recover 110% of its investment through annual depreciation charges so that the negative 10% net salvage that is expected to occur at the end of the property's life will still leave the utility whole (i.e., 110% - 10% = 100%).

Q. PLEASE IDENTIFY SOME OF THE MAJOR FACTORS THAT AFFECT A DEPRECIATION "SYSTEM."

A. The concept of depreciation utilized for utility ratemaking has evolved over time. Currently, there are still many different combinations of methods, procedures, and techniques employed in the development of utility depreciation rates. A depreciation system must, among other things, be systematic and rational. The regulator must further take into the account the quality, quantity, and timeliness of data relied upon, as well as the quality of the judgment employed by the depreciation analysts. Given the subjectivity involved in the various estimation processes, judgment plays an important role in establishing depreciation rates. While judgment is critical, that does

not mean that an analyst can simply refer to "judgment" as the basis for a proposal without providing meaningful factual support for that "judgment," nor can "judgment" serve as the basis for ignoring relevant facts.

Q. WHAT ARE THE KEY ELEMENTS OF THE DEPRECIATION FORMULA AT ISSUE IN THIS PROCEEDING?

A. The life parameters and net salvage for the mass property accounts in the above formula are at issue. Also, the treatment of the Company's excess reserve is at issue in this case.

SECTION: III RESERVE IMBALANCE

Q. WHAT IS THE FUNDAMENTAL PURPOSE OF DEPRECIATION?

A. As I have stated, depreciation is the recovery of invested capital less net salvage over the life of the investment. It is intended to match the recovery of the investment less net salvage with the periods of time in which the related asset is employed, thereby recouping the investment from all of the customers that received the benefit of the investment.

Q. IS THE RECOVERY OF CAPITAL THROUGH DEPRECIATION A PRECISE PROCESS?

A. No. The depreciation process for utility ratemaking relies on forecasting the future life and net salvage of the investment. As with any forecasting process, there are inherent inaccuracies that will exist whether due to inappropriate forecasts of mortality characteristics or real changes in life and salvage characteristics over time.

In recognition of the inherent inaccuracies, depreciation studies should be performed on a regular basis and should incorporate a true-up provision to address recognized excesses or deficiencies that are indentified.

Q. HOW ARE RESERVE EXCESSES OR DEFICIENCIES INDENTIFIED?

A. The normal process is to calculate what is called a theoretical reserve and compare that value to the actual book reserve of the utility. The theoretical reserve is the calculated balance that would be in the accumulated provision for depreciation (FERC Account 108), often called the reserve, at a point in time if current depreciation parameters (i.e., current life and salvage estimates) had been applied from the outset. The theoretical reserve measures the amount of depreciation expense a utility should have collected in order to be "on schedule" with respect to recovering its investment over the life of the depreciable asset. The book reserve reflects what *actually* has been collected or incurred. One can compare the book reserve to the theoretical reserve. If the book reserve is greater than the theoretical reserve, then the utility has collected more than is needed as of that point in time; it is ahead of schedule. The difference is a reserve excess. If the theoretical reserve is greater than the book reserve, the utility has under collected as of that point, it is behind schedule and a reserve deficiency exists.

Q. WHAT ARE THE GUIDING PRINCIPLES THAT SHOULD BE CONSIDERED IN DETERMINING THE CAPITAL RECOVERY PATTERN THROUGH DEPRECIATION OVER TIME?

A. In my opinion, the overriding considerations of fairness and equity that govern the utility ratemaking process mandate adherence to the matching principle. In other

words, the generation of customers that causes an expense or cost to be incurred should be the generation of customers that pays for such expense or cost through the rates charged for usage of the final product, in this case electricity. The matching principle attempts to achieve the goal of eliminating intergenerational inequities. Intergenerational inequities occur when one set or generation of customers pays too much or too little for its use of the investment necessary to provide electricity, and transfers either an undue benefit or undue burden to some future set of customers.

Q. HAS THIS COMMISSION HISTORICALLY RECOGNIZED THE MATCHING PRINCIPLE WHEN IT COMES TO CAPITAL RECOVERY THROUGH DEPRECIATION?

A. Yes. When capital recovery becomes materially imbalanced between generations of customers, as measured by the difference between the theoretical and book reserve, normally one of two industry options is employed. The two options for truing-up or correcting the imbalance are (1) to amortize the calculated differences over a short period of time, or (2) to simply implement new depreciation rates based on the remaining life technique where the recovery period is the remaining life. This Commission has established a long and identifiable policy of correcting material reserve imbalances by (1) reserve transfers, (2) one time reserve adjustments based on changes to revenue requirement areas other than depreciation, and (3) amortizing the reserve differences over periods much shorter than the remaining life of the investment. In addition to these practices, this Commission recently approved a settlement in Florida Power & Light Company ("FPL") last rate case that allowed FPL to reduce revenue requirements by $500 million over a four year period, or $125 million per year, through credits to depreciation expense. (See Exhibit CRC-1, page

69 in Docket No. 080677-EI). Rigid adherence to "remaining life" concepts would not have permitted this flexibility.

Q. CAN YOU PROVIDE EXAMPLES OF THIS COMMISSION'S LONG AND IDENTIFIABLE POLICIES TO WHICH YOU REFER?

A. Yes. In the area of implementing corrective reserve transferences, some examples of this Commission's previous actions are Gulf Power Company in Docket No. 880053-EI and Marianna Electric Division by Florida Public Utilities Company in Docket No. 010669-EI. These examples occurred during the time frame of the 1980s through the early 2000s. (See Order Nos.19901, PSC-01-2270-PAA-EI). An example of a Commission action to change the depreciation reserve due to revenue requirements from an area other than depreciation is Tampa Electric Company in Docket No. 860868-EI. (See Order No. 19438). Finally, examples of depreciation reserve differences that the Commission required to be amortized over periods shorter than the average remaining life are General Telephone Co. in Docket No. 840049-TL, City Gas Company in Docket No. 890203-GU, and FPL in Docket No. 970410-EI. (See Order Nos. 14929, 22115, PSC-97-0499-FIF-EI).

Q. WHAT HAS THE COMMISSION STATED AS ITS UNDERLYING POLICY OR BASIS WHEN ADDRESSING THE TREATMENT OF RESERVE DIFFERENCES OR INTERGENERATIONAL INEQUITIES?

A. The Commission has adopted the position that depreciation reserve differences "*should be recovered as fast as possible*, unless such recovery prevents the Company from earning a fair and reasonable return on its investments." (Emphasis added). (See Order No. PSC-93-1839-FOF-EI). In another case, the Commission adopted a

one-year write-off for a portion of a utility's reserve deficit by stating that "we believe that it [the deficit] should be *written off as quickly as possible.*" (Emphasis added). (See Order No. 13918). In yet another case, the Commission addressed the fairness issue as it relates to intergenerational inequity. In establishing a funded nuclear decommissioning reserve the Commission stated "[f]*airness dictates* that those receiving services and imposing costs be obligated to pay those costs, instead of placing the risk of recovery on other ratepayers who may not get service from the nuclear units." (Emphasis added). It went on to state, "that a further delay in changing rates to recognize the responsibility of current ratepayers to pay the full cost of operating the nuclear generators *simply continued an already unfair situation.* We determined that *it was unfair that current ratepayers were not paying their full share and could therefore properly change FP&L's and FPC's rates to alleviate unfair, unjust and unreasonable rates.*" (Emphasis added). (See Order No. 13427).

Q. IN THE CASES YOU CITED, DID THE AMOUNT OF THE RESERVE IMBALANCE THAT THE COMMISSION DECIDED TO CORRECT OVER A PERIOD SHORTER THAN THE REMAINING LIFE APPROACH HALF BILLION DOLLARS?

A. No.

Q. HOW HAVE YOU NORMALLY HANDLED RESERVE MATERIAL IMBALANCE SITUATIONS LIKE THIS?

A. Before this Commission in Docket No. 050078-EI, I recommended that PEF's $844 million of excess reserve above the $504 million of excess reserve PEF itself identified be amortized back to customers over a 4-year period. (See Mr. Pous' Direct Testimony at page 34 in Docket No. 050078-EI). That case settled prior to the

scheduled evidentiary hearing. Also in Docket No. 080677-EI, FPL's current case, I recommend a 4-year amortization of that company's identified $1.25 billion excess reserve. In other cases, utilities normally perform frequent depreciation studies and implement corrective measures so as not to get too far out of line with current depreciation expectations. In this case, PEF identifies over *$645 million* dollars of excess reserve based on its proposed depreciation parameters. (See Exhibit No.__ (EMR-2) page 2-79).

Rather than acting on such a significant and increasing level of excess with an immediate and meaningful response, the Company proposes "business as usual." That approach would attempt to correct the excess reserve situation over the average 21-year remaining life of all its current investment. (See Exhibit No. __ (EMR-2) page 2-22). Particularly in view of the fact that, as I will demonstrate later, the actual magnitude of the reserve excess is $858 million – in other words, about a third greater than the amount the Company identified, I do not believe this is an appropriate reaction to the facts and circumstance presented in this case. The magnitude of the intergenerational inequity compels an immediate and sizeable departure from the remaining life approach to mitigate the degree of unfairness that otherwise could be imposed on current customers.

Q. DOES THE EXCESS LEVEL OF RESERVE AFFECT REVENUE REQUIREMENTS?

A. Yes. The effect of the excess reserve imbalance on revenue requirements is significant, no matter the approach undertaken to correct this situation. The shorter the period utilized to return the excess to current customers, the greater the revenue

requirement impact in this case. For example, the Company-identified $645 million excess reserve is already reflected in the Company's filing and is partially responsible for the Company's recommended increase in depreciation expense of an amount less than $100 million annually. (See Exhibit No.__ (EMR-2) page 2-8). However, had the Company's calculated excess reserve been credited back to current customers over a period shorter than the remaining life utilized by the Company in its calculation, the overall revenue requirement impact could be a decrease in depreciation expense.

Q. SHOULD THE CORRECTIVE TREATMENT OF A RESERVE IMBALANCE DIFFER DEPENDING ON WHETHER IT IS MATERIAL EXCESSIVE OR MATERIAL DEFICIENT?

A. No. The identical rationale should be applied to either scenario. In this regard, it is important to note that under the depreciation process the utility will not be "harmed" by a corrective adjustment. The matter is one of the timing of recovery. On the other hand, imbalances have prejudicial impacts on certain customers.

Q. WHY DO YOU REFER TO *MATERIAL* IMBALANCES RATHER THAN IMBALANCES IN GENERAL?

A. Any process that involves estimates will result in actual values that differ from the predicted values. As previously noted, I do not believe most utilities allow identified imbalances of this magnitude to be created. Generally speaking, by revisiting the reserve situation with a comprehensive study every few years, one would reasonably expect the variance between the theoretical reserve and the book reserve to stay within reasonable bounds. When reserve imbalances occur, they are normally treated through the remaining life process. Not every discrepancy between theoretical and book reserves is so large as to require a departure from the method of recalculating

the accrual that will recover the asset over its remaining life. However, the greater the disparity in the reserve, the greater the level of intergenerational inequity that exists. The greater the level of intergenerational inequity, the more compelling becomes the corresponding rationale for addressing the imbalance over a shorter period.

Q. IS THERE ANY REASONABLE QUESTION IN THIS CASE WHETHER A SIGNIFICANT OR MATERIAL EXCESS IN THE DEPRECIATION RESERVE EXISTS?

A. No, in my view there is no room for argument on this question. The Company identifies a $645 million excess in its depreciation study. I submit that this level of excess must be considered material and significant by any reasonable measuring index. Moreover, the $645 million size of the reserve excess reported in PEF's depreciation study has been artificially *understated* by the effect of inappropriate net salvage and life estimates. When restated to adjust for the distortions created by the inappropriate net salvage and life assumptions, the reserve excess is not $645 million, but over $850 million as shown on Exhibit (JP-2). The magnitude of the excess is so huge, and the prejudicial impact of the imbalance on current customers is so great, that fairness compels a departure from PEF's "business as usual" remaining life approach so that current customers do not continue to subsidize future customers to such a large extent.

Q. WHAT IS THE BASIS FOR THE COMPANY'S TREATMENT OF THIS MATTER?

A. The Company's depreciation study is silent on this matter. However, Mr. Robinson made various comments regarding this matter in his rebuttal testimony in the last case that sheds light on the Company's position. First, Mr. Robinson stated that "the FPSC has no mandate for companies under their jurisdiction to provide any special treatment of the variance." (See Mr. Robinson's rebuttal testimony in Docket No. 050078-EI at page 5). In other words, unless the Commission orders it to correct the intergenerational inequity on a more expedited basis, the Company will rely on the remaining life approach.

Next, Mr. Robinson stated that if approval from the Nuclear Regulatory Commission is not received for the Crystal River life extension, then "a sizable portion of the reserve variance will instantaneously disappear." (See Mr. Robinson's rebuttal in Docket No. 050087-EI at page 6). Mr. Robinson went on to introduce additional concerns regarding the potential early shut down of Crystal River 3 and the additional investment that will be needed, which will have a shorter life span. All these unsubstantiated, generalized and unwarranted concerns were presented as support for the Company's position that unless the Commission orders it to correct the imbalance on an expedited basis, it will not do so, and will take advantage of such situation by increasing the level of excess as it has done since the last case.

Q. DOES THIS POSITION COMPORT WITH COMMISSION PRECIDENT?

A. As previously noted, the Commission often has employed the recovery of a reserve imbalance over periods shorter than the remaining life.

Q. DOES THIS POSITION TAKEN BY PEF ADEQUATELY ADDRESS THE INTERGENERATIONAL INEQUITY THAT EXISTS FOR CURRENT CUSTOMERS?

A. No. For example, the 20-year change in the number of residential customers on an actual and forecasted basis is 33%, as set forth on page 2-3 of the Company's Ten-Year Site Plan dated April 1, 2009. While this is a sizeable change in the customer base, it tells only part of the story. The 33% growth is a net number and does not identify how many customers left or will leave the system. Thus, the change in customers corresponding to the remaining life period employed by PEF for the return to customers of its prior acceleration of depreciation expense, at least for the residential class, could easily be over 40%. I submit that the current intergenerational inequity that exists due to the current excess of the depreciation reserve created by prior accelerated levels of depreciation (whether intentional or not) cannot reasonably be addressed or rectified by relying on a 21-year remaining life period.

Q. DOES MR. ROBINSON'S RELIANCE ON THE REMAINING LIFE APPROACH TO ADDRESS RESERVE IMBALANCES IN OTHER JURISDICTIONS DIMINISH THE NEED TO FOLLOW FPSC'S LONG AND IDENTIFIABLE PRECEDENT?

A. No. In my opinion it would be unfair to customers to deny them the *same treatment afforded utilities* by the FPSC when the situation was reversed. Inconsistent application of concepts in the rate setting process causes uncertainty. Needless uncertainty in the ratemaking process is not in the public interest and can result in higher rate case expenses and other higher costs in the future.

Q. IS THERE A VALID CONCERN REGARDING A POTENTIAL TURNAROUND OF THE EXCESS RESERVE IN THE NEAR TERM FUTURE?

A. No. While the excess reserve level identified by the Company is sizeable and has increased since the last case, I am confident that it will increase even further if the Company's proposed depreciation rates are adopted. Even with my recommended excess reserve amortization, which would amortize only $646 million of the $858 million identified excess more rapidly than the remaining life, the Company is well protected until the next depreciation study. Because I have purposely tempered my recommendation to be conservative, under the circumstances I believe there is no realistic scenario under which PEF could swing to a reserve deficiency prior to the next study. Certainly, that extremely remote prospect is more than outweighed by the prejudice to current customers if the Commission were to take no action to address the severe imbalance more rapidly than the remaining lives of the assets. My position is that there is no realistic basis or possibility that the excess reserve would turnaround and become a deficiency by the time the next depreciation study is completed in four years.

Q. WHAT IS YOUR SPECIFIC PROPOSAL REGARDING THE TREATMENT OF THE RESERVE EXCESS?

A. I recommend an approach that should satisfy all concerns if all or even a portion of my recommended adjustments to net salvage and life parameters are adopted. I recommend that the $645,805,342 Company identified excessive reserve be returned to customers over the next 4-years. The excess reserve associated with my

adjustments to net salvage and life parameters can be returned to customers over the remaining life of the assets in this case. This latter aspect provides a safety cushion for those that may believe that one is necessary, while providing the most representative generation of customers available the return of a significant portion of their prior overpaid depreciation expense. This approach addresses the matching principle as it relates to the intergenerational inequity problem, but not to the degree that this Commission has previously found appropriate in other cases. This approach also takes into account the need to gauge the impact of a shorter amortization period so as to protect the financial integrity of the Company. I have discussed the impact of my recommended adjustment with OPC's financial, policy and accounting witnesses, who confirmed that PEF can implement my recommendation *and* maintain the healthy coverage ratios adequate to access the capital markets on reasonable terms. Dan Lawton addresses this subject in detail.

Q. WHY DID YOU CHOOSE A 4-YEAR AMORTIZATION PERIOD?

A. The 4-year period is not only within the range of periods previously adopted by this Commission for other cases where a reserve deficiency was present, it also corrects the intergenerational equity situation in an effective but manageable manner. Further, the 4-year period provides sufficient time for the Company to gain additional experience and perform and present a new, complete and well-documented depreciation study within the normal cycle required by the Commission's rule on the mater. Finally, one must always recognize that the ratemaking process already disadvantages current customers in the intergenerational inequity scenario. Remember, those generations of customers nearer to the end of the useful life of an investment pay much less for service than do customers at the beginning of the useful

life. While future customers will not see a difference in the actual product (i.e., a kwh of energy or a Kw of capacity), a different price will be paid for specific assets. Payment for electricity near the end of the useful life of an investment is associated with heavily depreciated investment. Recognition of heavily depreciated investment results in a much smaller return on investment being required for that asset. Therefore, it is inappropriate to violate the strong and identifiable precedent employed by this Commission in the past by penalizing current customers for the benefit of future customers.

Q. WHAT IS THE IMPACT ON REVENUE REQUIREMENTS IF YOUR BIFURCATED APPROACH TO THE BILLION DOLLAR RESERVE EXCESS IS ADOPTED?

A. Amortizing the $645,805,342 excess reserve PEF has identified as of December 31, 2009 over a 4-year period results in a $161,456,336 reduction in annual depreciation expense, and a corresponding reduction to that amount in the Company's overall revenue requirements prior to the impact of jurisdictional allocation.

SECTION: IV PRODUCTION PLANT

A. INTRODUCTION

Q. PLEASE PROVIDE AN OVERVIEW OF THE COMPANY'S PRODUCTION PLANT RELATED DEPRECIATION REQUEST.

A. The Company has approximately $6.5 billion of generating investment reflected in its depreciation request. (See Exhibit No. ___ (EMR-2) page 2-2, 2-3, and 2-6).

Associated with this level of investment the Company seeks in excess of $238 million of annual depreciation expense based on plant as December 31, 2009.

Q. IS DEPRECIATION EXPENSE CALCULATED THE SAME FOR PRODUCTION PLANT AS IT IS FOR TRANSMISSION, DISTRIBUTION OR GENERAL PLANT?

A. No. The Company relies on a life span approach to depreciation for production plant. In addition, the Company also seeks recovery of costs associated with terminal dismantlement studies that estimate the cost to totally demolish existing generating facilities.

Q. ARE THESE THE ONLY DIFFERENCES?

A. No. For production plant, the Company has proposed the recognition of interim retirements. As discussed later, those interim retirements simply reflect individual items at a power station that are projected to retire before the final plant is retired. For transmission, distribution, and general plant analyses the concept of interim retirements does not exist.

Q. IS THERE ANOTHER DIFFERENCE BETWEEN PRODUCTION PLANT AND MASS PROPERTY DEPRECIATION?

A. Yes. For production plant, the Company must estimate a future expected retirement year or "Projected Year of Retirement" in conjunction with the life span method. Thus, if a generating unit was placed in service in the middle of 2000 with a 60-year life span it would be expected to retire in the middle of 2060. Again, the need to forecast a specific future retirement date is not an issue for mass property accounts.

Q. HAVE YOU REVIEWED THE VARIOUS COMPONENTS OF THE COMPANY'S PROPOSED PRODUCTION DEPRECIATION EXPENSE?

A. Yes. After a detailed review, I find that the Company's proposed production plant depreciation request is excessive and must be modified. The Company's proposed life and net salvage parameters can only be characterized as aggressive. In other words, based on available information, the Company's proposed life spans are artificially short, it proposed interim retirement method and results excessively reduce the remaining life for its generating units, its proposed interim net salvage is excessively negative, and its proposed terminal net salvage represents a high-side estimate of a worst case scenario.

Q. IS THE COMPANY'S NEED FOR AN INCREASE IN DEPRECIATION EXPENSE QUESTIONABLE GIVEN THE EXCESS RESERVE POSITION?

A. Yes. The Company proposes a remaining life technique for depreciation. The remaining life technique adjusts the depreciation expense for the future, taking into account whether the existing reserve is excessive or understated. If the existing reserve is excessive in comparison to the theoretical reserve based on the Company-proposed mortality characteristics, then the remaining life technique forces a reduction in annual depreciation expense from what would have been the level absent an excess in the reserve. In other words, if depreciation expense has been collected on an accelerated basis historically, whether intentionally or not, the rate of recovering the remaining level of expense must be decelerated over the remaining life so that only 100% of cost is recovered.

Q. DOES THE COMPANY ADMIT TO AN EXCESS RESERVE POSITION FOR ITS GENERATION-RELATED DEPRECIATION?

A. Yes. The Company claims a $472.5 million excess reserve position for production plant. (See Exhibit No. ___ (EMR-2) page 2-75 and 2-77).

Q. WHAT ARE THE MAJOR AREAS OF THE COMPANY'S PRODUCTION PLANT DEPRECIATION REQUEST THAT YOU WILL BE ADDRESSING?

A. I will address the Company's life span estimates for several of its steam and nuclear generating units, the Company's method and results for interim retirements, and the Company's over statement of negative net salvage.

B. PRODUCTION PLANT LIFE SPANS

Q. WHAT IS THE ISSUE IN THIS PORTION OF YOUR TESTIMONY?

A. This portion of my testimony will deal with limited modifications to the Company's proposed retirement dates for its steam-fired generating facilities.

Q. WHAT LIFE SPANS HAS THE COMPANY PROPOSED FOR ITS VARIOUS STEAM-FIRED GENERATORS AT THE THREE GENERATING STATIONS ACCOUNTED FOR IN STEAM PLANT ACCOUNTS 311 THROUGH 316?

A. The Company has proposed four different future retirement dates for the Company's steam production investment. For the Crystal River 1 and 2 coal-fired units, the Company proposes a retirement date in the middle of 2020. For the Crystal River 4 and 5 coal-fired generating units, the Company proposes a mid 2035 retirement date. For the Anclote units the Company proposes a mid 2022 retirement date, and for the

remaining 3 Suwannee generating units the Company proposes a mid 2013 retirement date, or only 3 ½ years beyond the end of the depreciation study period of 2009.

Q. WHAT ARE THE OVERALL LIFE SPANS THAT CORRESPOND TO THESE RETIRMENT DATES?

A. The Company's mid 2020 retirement date for its investment in Crystal River 1 and 2 units equates to a 53.5 and 50.5-year life spans, respectively. The Company's mid 2022 retirement date for the Anclote 1 and 2 units yields 47.5 and 43.5-year life spans, respectively. The Company's proposed mid 2035 retirement date for the Crystal River 4 and 5 units results in 52.5 and 50.5-year life spans, respectively.

Q. DO ANY OF THE COMPANY'S PROPOSED RETIREMENT DATES FALL WITHIN THE PLANNING HORIZON OF THE COMPANY'S 10-YEAR SITE PLAN?

A. Yes. The most recent 10-year site plan for the Company encompasses a planning horizon only for the Suwannee plant.

Q. ARE THE COMPANY'S PROPOSED RETIREMENT DATES FOR ITS STEAM FIRED GENERATING FACILITIES REASONABLE?

A. No. The Company's proposed life spans for its newer large coal-fired and its large oil and gas-fired generating units are inadequate or short.

Q. ON WHAT DO YOU BASE YOUR STATEMENT THAT THE LIFE SPANS FOR THE COMPANY'S NEWER COAL AND LARGE OIL AND GAS-FIRE GENERATING FACILITIES ARE INADEQUATE OR SHORT?

A. There are various reasons, but the most compelling is the fact that the Company has demonstrated through actual operation that it can operate its other oil and gas fired generating facilities for more than 55 years. Moreover, the Company's expectation is that such facilities can operate in excess of 60 years. (See OPC's POD 7 No. 174, Attachment). If the Company has or expects to operate smaller less efficient generating facilities for 60 years or longer, estimated life spans for its newer, larger and costly generating facilities should not be limited to the low 50-year range. The Company's proposal is contrary to standard economic theory which dictates that large capital intensive investments should be operated to maximum levels in order to deliver the economic worth that such facilities are capable of obtaining.

Q. ARE THERE OTHER REASONS WHY THE COMPANY'S PROPOSED LIFE SPANS APPEAR TO BE UNREASONABLY SHORT?

A. Yes. I have been performing utility depreciation analyses for over 35 years. At the beginning of my career I did experience utilities proposing life spans for steam-fired generating facilities in the low to mid thirty year range. Those expectations were based on claims of typical design life and concerns about higher temperature and pressure operating characteristics of units being placed into service in the 1960s and early 1970s. At that time no empirical data existed to demonstrate that 30 to 35-year life spans were unreasonably short, even though older units operating at lower temperatures and pressures had operated for longer life spans.

As time progressed and more empirical data became available the life span issue changed from one where utilities would propose 30 to 35-year lives to where the utilities were proposing upper 30 to low 40-year lives. In other words, as time

progressed and it became obvious that units were operating for time periods approaching or exceeding the initially proposed 30 to 35 years of operation, coupled with the fact that there were no plans for retirement, utilities could no longer support the initial artificially short life spans. As additional years passed the life span discussion for steam-fired generation continued to change. Utilities began proposing 45 and 50-year life spans, again in recognition of reality. The process continues through today. In the last several years utilities and regulators are recognizing that 50 and 60-year life spans are more appropriate for steam-fired generating facilities.

Q. HAVE THERE BEEN RECENT CASES TO WHICH 60-YEAR LIFE SPANS HAVE BEEN ADOPTED FOR STEAM GENERATING FACILITIES?

A. Yes. For example, in a 2007 Oklahoma Corporation Commission ("OCC") ordered Public Service Company of Oklahoma ("PSO"), a member of the very large American Electric Power Company group, was ordered to rely on a 60-year life span for its coal-fired generating facilities. (See OCC Cause No. 200600285). In PSO's most recent case decided in early 2009, PSO did not challenge and even relied on a 60-year life span for its coal generating facilities. (See OCC Cause No. 200800144). In fact, the head of generation production for American Electric Power Corporation stated that based on its experience and expectation there was no reason why it could not operate generating facilities for a minimum of 60 years. PSO's life spans for its gas-fired generating facilities were not at issue as PSO was proposing 60-plus years for such facilities.

Q. CAN YOU PROVIDE OTHER EXAMPLES?

A. Yes. Another example is a recent Rocky Mountain Power Company case in the state of Utah. In that case, the regulatory staff of five states negotiated a settlement where that company's proposed life span for its coal-fired generating facilities was reduced to 61 years. (See Utah Public Service Commission Docket No. 07-035-13). In that case, the Company had actually proposed a longer life span for its coal-fired generating facilities.

Yet another very recent example is the settlement in the Southwestern Public Service Company ("SPS") case in Texas. (See Public Utility Commission of Texas Docket No. 35763). It should further be noted that SPS is part of the large Xcel holding company which has operations in numerous states across the country. In that case, SPS had proposed a 55-year life span for its coal-fired generating facilities, but settled and accepted a 60-year life span. It is worth noting that SPS is one of the utilities that for decades argued in rate cases that anything in excess of a 35-year life span was unrealistic and would not occur. Yet, in only a period of a decade or so SPS is now not only proposing 55-year life spans, but accepting 60-year life spans for its coal-fired generating facilities.

Q. DOES THE FEDERAL GOVERNMENT MAINTAIN INFORMATION THAT WOULD FURTHER SUPPORT LONGER LIFE SPANS FOR COMPANY'S GENERATING FACILITIES THAN THOSE THE COMPANY PROPOSES IN THIS PROCEEDING?

A. Yes. The Energy Information Administration of the Department of Energy maintains a listing of all generating facilities. I have reviewed such information numerous times in the past. The government's database clearly demonstrates that there is more than

adequate empirical data to support life spans much longer than what the Company proposes in this case for its coal-fired generation.

Q. IS THERE ANY QUESTION THAT FROM A PHYSICAL STANDPOINT THE COMPANY'S GENERATING FACILITIES CAN LAST FOR 50 TO 60 YEARS, OR LONGER?

A. No. From a physical standpoint there is nothing presented by the Company or the industry which can refute that coal, oil and gas-fired generating facilities can and have operated for longer periods of time.

Q. HAS THE COMPANY PRESENTED ANY ECONOMIC ANALYSIS WHICH CLEARLY DEMONSTRATES THAT THE ECONOMIC OPERATION OF ITS LARGE COAL, GAS OR OIL-FIRED FACILITIES CANNOT OPERATE FOR MUCH LONGER PERIODS THAN IT PROPOSES?

A. No. Not only am I not aware of any, I would question the validity of any assumptions which would support a life expectancy for such facilities being as short as 43 years as proposed by the Company for one of its Anclote units.

Q. IS THERE CONCERN REGARDING THE CARBON EMISSIONS FOR THE COMPANY'S VARIOUS GENERATING FACILITIES?

A. Yes. I think everyone is concerned regarding the carbon emissions of all fossil-fired generating facilities. However, that does not change the fact that based on what we know today, these large and efficient operating units can be expected to operate beyond the Company's proposed retirement dates. Moreover, other utilities and

regulators across the country are recognizing the longer realistic life spans for such units with full knowledge and concerns regarding carbon emissions.

Q. IS THERE ANY BASIS TO DENY LONGER LIFE SPANS ASSOCIATED WITH ANY POTENTIAL ARGUMENT ASSOCIATED WITH INTERIM ADDITIONS?

A. No. First, it must be noted that some utilities have claimed that longer life spans cannot be recognized for ratemaking purposes absent the recognition of interim additions. Interim additions simply mean certain unknown levels and timing of capital additions in the future to keep generating facilities operating for the expected life spans.

Q. WHY WOULD SUCH AN ARGUMENT NOT BE APPROPRIATE?

A. The interim addition issue has been an issue before regulators for an extended period of time. The FERC and other state jurisdictions have ruled, consistent with the National Association of Regulatory Utility Commissioners' ("NARUC") publication entitled "Public Utility Depreciation Practices," that interim additions are not appropriate for inclusion in depreciation analyses. Interim additions represent significant unknown timing and quantities. They should be recognized after the fact once they have occurred. Thus, any argument raised by the Company associated with interim additions should be dismissed as having no merit.

Q. WHAT DO YOU SPECIFICALLY RECOMMEND?

A. In order to present a conservative initial adjustment, I recommend the lengthening of life spans for Crystal River 4 and 5 coal-fired generating units, as well as the

Company's large Anclote oil-fired generating units. Specifically, I am recommending a 60-year life span for Crystal River 4 and 5 coal-fired generating units and a minimum 50-year life span for the Company's Anclote large oil-fired generating units.

Q. IS THE COMPANY'S PROPOSED LIFE SPAN FOR CRYSTAL RIVER 3 NUCLEAR PLAN ARTIFICIALLY SHORT?

A. Yes. Unlike steam generating units the Company's nuclear unit has a very specific license termination date. With the requested 20-year license extension, the license termination date is December 3, 2036. The Company has proposed a mid-2036 retirement date. Therefore, I recommend the remaining life for crystal River 3 be extended to recognize approximately 11/12ths of calendar year 2036.

Q. DO YOU BELIEVE THE PROPOSED LIFE SPANS FOR THE COMPANY'S REMAINING GENERATING FACILITIES ARE APPROPRIATE?

A. No. In particular, the Company's proposal for an approximate 30-year life span for combined cycle generating units is also understated. Other utilities and regulators are recommending longer life spans for combined cycle generating facilities. In this case, I recommend that the Commission order the Company to perform a detailed analysis demonstrating why its substantial investment in combined cycle generating facilities cannot be expected to reasonably operate for 35 years or longer, and present the study in its next depreciation filing. However, if the Commission were so inclined, it would be more than reasonable to increase the life span to 35 years as initial steps in this case. It is no longer reasonable to expect customers to overpay for decades for the

use of generating facilities that realistically should and can be expected to last longer than the Company's unsubstantiated 30-year life expectations.

Q. WHAT IS THE IMPACT OF YOUR ADJUSTMENT?

A. I have not made a precise quantification of the standalone impact of this adjustment due to the manner in which the Company has presented its data. However, a reasonable estimate of the impact on a standalone basis is a reduction to depreciation expense of $26 million annually.

C. INTERIM RETIREMENTS

Q. WHAT ISSUE DO YOU ADDRESS IN THIS PORTION OF YOUR TESTIMONY?

A. The issue in this portion of my testimony addresses the Company's choice for estimation of interim retirements and the ultimate interim retirement life-curve combinations proposed for production plant accounts.

Q. WHAT ARE INTERIM RETIREMENTS?

A. Interim retirements have been characterized as a fine tuning adjustment to the life span analysis. The life span method is used in estimating the retirement date for any large unit of property such as an entire generating unit. The theory behind interim retirement rates is that even though a large unit of property such as a generating unit might retire in 60 years, in the interim period many components have to be replaced in order to maintain the overall generating facility in operating condition. An analogy to this would be a car which might be anticipated to have a service life of 10 years.

During the 10-year life of the car, the owner might have to replace the battery, tires, alternator and other components in order to maintain the automobile in a safe and operable condition. Therefore, even though the automobile may have an overall 10-year life span, its dollar weighted adjusted life span may be 9.8 years due to the averaging of the automobile's overall life span with the average of the individual replaced components. In other words, the interim retirement rate would be a fine tuning factor used to reduce the service life from 10 years to 9.8 years.

Q. HAS THE COMPANY INCORPORATED THE IMPACT OF INTERIM RETIREMENTS IN ITS DEPRECIATION ANALYSIS?

A. Yes. The Company proposes to implement a calculation procedure for interim retirements based on truncated Iowa Survivor curves that are "designed" to recognize "anticipated" interim retirements. (See Exhibit No. __ (EMR-2) page 1-4).

Q. DO YOU AGREE WITH THE COMPANY'S POSITION?

A. While I agree with the Company that interim retirements should be included in the calculation of production plant depreciation rates, I do not agree with the Company's proposed process or results. I find the Company's proposal inappropriate and cumbersome for application in this proceeding.

Q. PLEASE EXPLAIN THE PROBLEMS WITH THE COMPANY'S PROPOSED METHOD.

A. The Company's approach relies on an actuarial analysis of the historical data to determine an interim retirement life-curve combination. Actuarial analyses are normally performed on more homogeneous-type investments that are not generally

dependent on one another, such as poles or wires. In particular, the varying types of investments within each of the major production plant accounts do not reasonably lend themselves to actuarial analyses. In other words, the retirement forces experienced by electric motor drives booked in Account 312 are noticeably different than the retirement forces on smoke stacks, also booked in Account 312. However, the Company's actuarial approach treats all items in the same account as one type of item for life estimation purposes.

The actuarial approach can also overreact to unusual activity or the timing of unusual activity. Indeed, the results of the Company's actuarial analysis are greatly affected by the unusual retirement activity that the Company booked during the past 4 years since its last depreciation study. For example, the Company's assumed "25O1" life-curve combination for Account 343 is based on unusual levels of infant mortality. (See Exhibit No.__(EMR-2), page 5-39 through 5-41). In order to properly recognize what has transpired since the Company's last depreciation study and the impact on the Company's current proposal, I have attached the equivalent analysis performed by Mr. Robinson in his last depreciation study as Exhibit (JP-3). In the last case Mr. Robinson proposed a 48R0.5 life-curve combination for Account 343. Therefore, his proposal in this proceeding basically cuts the average service life in half and dramatically changes the shape of dispersion pattern.

Q. DOES MR. ROBINSON'S SELECTION AND APPROACH FOR ACCOUNT 343 REPRESENT APPRORIATE DEPRECIATION ESTIMATION PRACTICES?

A. No. First, it must be noted that even Mr. Robinson states that "gradualism" is a concept he employs in the development of his depreciation studies. (See Mr. Robinson's rebuttal testimony in Docket No. 050078-EI at page 10). Given that Mr. Robinson's previously proposed average service life for interim retirement purposes for this account was 48 years, or approximately 100% higher than his current proposal, it appears he must have made an unexplained and unwarranted exception to his concept.

Next, Mr. Robinson chose not to explain why in the last case a zero level of retirements existed for the zero to one half year age interval, meaning no infant mortality, yet in this proceeding he relies on $46.5 million of infant mortality during the same age interval. Retirements of this magnitude at the time of installation of investment, an age of zero, is simply not realistic or practical for estimation purposes. Moreover, the claimed retirement activity between the Company's prior depreciation study and the current depreciation study for the first four age brackets increased by more than a 1,000%. Whether such activity represents true retirement activity experienced by the Company during the last 4 years, it cannot reasonably or realistically be assumed to be a repeating pattern in the future absent reliance on imprudent activity.

Q. WHAT IS THE PRACTICAL IMPACT OF MR. ROBINSON'S PROPOSED INTERIM RETIRMENT APPROACH FOR ACCOUNT 343?

A. The real practical impact of Mr. Robinson's method and assumptions are best described as it applies to the new combined cycle investment for Account 343 – Bartow combined cycle. Mr. Robinson proposes a 5.08% depreciation rate

corresponding to an estimated $632 million of new investment. (See Exhibit No.__(EMR-2), page 2-4). While the Company claims a 2039 Probable Year of Retirement date for this new investment (See OPC's POD 7-174, Attachment), which corresponds to a 30-year life span, Mr. Robinson reduces that value to only 20.7 years for remaining life purposes. (See Exhibit No.__(EMR-2), page 2-18, column (j)). In other words, Mr. Robinson's proposed interim retirement approach and resulting life-curve combination takes the 30-year life span proposed by the Company and cuts off a full 1/3rd of that life span due to the impact of his assumed interim retirement calculation. Such massive and artificial reduction in life spans due to Mr. Robinson's approach and quantification of interim retirements can only be characterized as an attempt to create and implement an accelerated form of depreciation. The annual revenue requirement impact of reducing a 30-year life span to a 20.7-year adjusted remaining life for this single account for this single generating unit is $9.8 million. It is precisely this type of activity that will result in an excess level of depreciation reserve in the future if the Company's proposal is adopted. This practice must be stopped now before it acerbates the current excess reserve situation.

Q. IS THERE ANOTHER ASPECT TO THE COMPANY'S INTERIM RETIREMENT PROPOSAL THAT HIGHLIGHTS ITS UNREASONABLE RESULTS?

A. Yes. In this case the Company proposes two types of net salvage for production plant: interim retirement net salvage and terminal net salvage. The interim retirement net salvage is associated only with the retirements that are estimated by employing the Company's proposed interim retirement life-curve combination approach. For

other production plant the Company calculated interim retirements as 47% of total investment as of December 31, 2009. (See Exhibit No.__(EMR-2) page 2-134).

The Company performed this analysis for interim net salvage in order to determine how to adjust its total proposed plant account net salvage values so that the adjusted value applied to total plant in service would be the equivalent of applying the net salvage only to interim retirements. For example, for Account 312 the Company proposes a total overall negative 50% net salvage estimate. However, the Company realized that it should not apply the negative 50% to the entire plant balance since the entire plant balance does not correspond to the level of "estimated" interim retirements prior to the final retirement of each generating unit. Therefore, the Company presented an approach which reduces its proposed total account net salvage level to a negative 21% in an attempt to make it equivalent to only the level of interim retirements. The significance of this example is that the Company's proposed interim retirement approach, which relies on a 48S0 truncated Iowa Survivor curve, projected that *$394 million* of plant would retire between January 1, 2010 and the projected 20-year remaining life for its boiler plant equipment. (See Exhibit No.__(EMR-2), pages 2-131 and 9-15).

Q. CAN YOU PLACE THE $394 MILLION OF PROJECTED INTERIM RETIREMENT ACTIVITY FOR BOILER PLANT EQUIPMENT INTO PROPER PERSPECTIVE?

A. Yes. The Company provided the annual historical boiler plant retirement activity for the period 1976 through 2007. (See Exhibit No._(EMR-2), pages 8-5 through 8-8). This time frame represents a 32-year period or 1.6 times the Company's projected remaining life for the existing boiler plant equipment. During the historical 32-year

period the Company reports retirements of approximately $60 million or $1.8 million per year. Thus, on a per year basis the Company's projected interim retirement values are more than *10 times* the historical annual retirement levels experienced by the Company for the same plant. There is no evidence that demonstrates that such a proposed expansion of interim retirements is reasonable or realistic.

Q. DOES INDUSTRY DATA CONFIRM THE REASONABLENESS OF THE COMPANY'S PROPOSAL?

A. No. A review of the electric industry data provided by the Company's depreciation consultant identifies longer lives than his proposal for Account 312 in this case. For example, Mr. Robinson's interim retirement values average over 60 years with half of his prior proposals at or above 70 years for Account 312. (See OPC's 5th Interrogatories No. 192, Attachment). Mr. Robinson's historical average represents a 28% increase above the value he proposed in this case. Thus, the method employed by Mr. Robinson for interim retirements produced results that vary to a significant extent and artificially reduce the remaining life of the production facilities to too great of an extent in this case.

Q. ARE YOU PROPOSING ANY ADJUSTMENTS TO THE LEVEL OF INTERIM RETIREMENTS REQUESTED BY THE COMPANY?

A. Yes. Given (1) the excessive level of interim retirements that are produced by the Company's approach, (2) the level of variance between what the Company proposed compared to what the Company's consultant has proposed in other proceedings for the same accounts, and (3) the unrealistic results that are a direct fallout of the Company's process, I recommend an alternative approach and values for interim retirements.

Q. WHAT DO YOU RECOMMEND?

A. I propose an interim retirement adjustment that is not based on truncated Iowa Survivor curves. In other words, I have replaced the actuarial component of the analysis, given that the plant analyzed is neither reasonably homogeneous nor independent from the life of the overall generating unit. The method I rely upon is one sponsored by the California Public Utilities Commission in its publication entitled "Determination of Straight – Line Remaining Life Depreciation Accruals Standard Practice U-4", and also recognized by the NARUC in its publication entitled "Public Utility Depreciation Practices." Thus, there can be no doubt that the method I recommend has been employed and adopted historically and currently by utilities and utility regulators.

Next, I developed interim retirement ratios for each of the plant accounts based on actual and realistic Company specific information. In other words, the interim retirement ratios utilized in my approach were developed from the historical reported levels of retirement activity by account for each of the steam, nuclear and other production accounts as also relied upon by the Company. (See Exhibit No.__(EMR-2), page 8-1 through 8-62). The resulting interim retirement ratios and the corresponding impact on remaining lives are set forth on Exhibit (JP-4).

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDED MODIFICATIONS TO THE APPROACH AND LEVEL OF INTERIM RETIREMENTS?

A. The adoption of my recommended approach for interim retirement ratios on a standalone basis results in an approximate $45 reduction to depreciation expense on a total Company basis.

D. INTERIM NET SALVAGE

Q. WHAT IS THE ISSUE IN THIS PORTION OF YOUR TESTIMONY?

A. This portion of my testimony addresses the Company's proposal for net salvage associated with interim retirements. The Company has proposed a wide array of values ranging from zero to a negative 50% for various production plant accounts.

Q. WHAT IS INTERIM NET SALVAGE?

A. The Company proposes two different types of net salvage for production plant, interim net salvage and terminal net salvage. Terminal net salvage corresponds to the estimated cost associated with the final retirement and disposition of a generating facility once it has been retired. Alternatively, interim net salvage reflects the cost the Company estimates it will incur when replacing components of the plant that retire between now until when the Company forecasts the unit will retire. In other words, interim net salvage corresponds to the interim retirements projected by the Company.

Q. HOW DID THE COMPANY DEVELOP ITS PROPOSED INTERIM NET SALVAGE LEVELS?

A. That is a good question; unfortunately, the Company provided no specifics that support the Company's proposals. Rather, the Company states that it relied on an "interpretive as opposed to an arithmetic approach." (See OPC's 2nd Interrogatories No. 64). The Company also states that the "level of interim net salvage of each property was based upon an account level analysis of historic data to date." (See Exhibit No._ (EMR-2), Section 4 pages 4-1 through 4-31). Mr. Robinson further stated that the interim net salvage "was based upon an analysis of the Company's

historical experience, consideration of the prepared net salvage forecast, plus current and perspective factors." (See Mr. Robinson's direct testimony at page 22). In other words, the Company admits that its presentation is based on some vague interpretation of a combination of historical data, considerations of Mr. Robinson's forecast approach to net savage, plus current and perspective "factors."

Q. DID MR. ROBINSON PRESENT AN ANALYSIS OF EACH ACCOUNT?

A. Yes, however, the mathematical analyses presented do not correspond to or verify the interim net salvage proposals made by Mr. Robinson. This lack of connection between numerical analysis and Mr. Robinson's proposed results are to be expected given his admission that his estimation process is an "interpretative as opposed to an arithmetic approach."

Q. DID YOU SEEK SPECIFICS REGARDING MR. ROBINSON'S RELIANCE ON JUDGMENT AND EXPERIENCE IN DETERMINING THE FINAL SELECTION OF NET SALVAGE SELECTIONS?

A. Yes. In fact, the Company was specifically requested to provide a "detailed narrative identifying and explaining each item of judgment and experience relied upon by account and/or subaccount in the estimation of life and net salvage values." (See OPC's 2nd Interrogatories No. 64, Subpart C). It is in response to this request that the Company admits for the first time that its process is interpretative as opposed to mathematical, yet both the Company and Mr. Robinson failed to provide any specifics as requested.

Q. HAVE YOU REVIEWED MR. ROBINSON'S NOTES TO DETERMINE IF HE PROVIDED INFORMATION THAT MIGHT RELATE TO CURRENT AND SPECIFIC FACTORS ASSOCIATED WITH HIS INTERIM NET SALVAGE PROPOSALS?

A. Yes. (See OPC's 2nd Interrogatories No. 99, Attachment). Mr. Robinson's notes shed no additional light on the specific proposal he presents and the Company relies upon for its depreciation request. His failure to provide any meaningful information by account regarding the current proposed factors is inappropriate given he also states that "input from management regarding its view of current and potential changes in coming years are considered in the process." (See OPC's 2nd Interrogatories No. 64). Mr. Robinson cannot be allowed to claim that his process is "interpretative" and relies on "input from management" and then not provide a single specific item of information regarding this process when requested to do so. The real issue is that Mr. Robinson and the Company failed to provide any specifics in the first place when the case was filed.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. Most of the Company's proposals are excessively negative. The Company's failure to investigate the underlying data other than through a faulty "forecast" process has caused it to inappropriately select excessively negative values which are not representative of the remaining investment in the account. Moreover, the Company fails to provide any specifics of how it arrived at its proposal, versus any other value, for each separate account. (See OPC's 2nd Interrogatories No. 64 and 5th Interrogatories No. 177). In fact, Mr. Robinson provided less specifics than he did in his last study.

Q. CAN YOU PROVIDE AN EXAMPLE OF THE COMPANY'S FAILURE TO PROVIDE ADEQUATE EXPLANATION AND SUPPORT FOR ITS PROPOSALS?

A. Yes. I will use steam production plant Account 312 – Boiler Plant Equipment for the example. For this account, the Company has proposed an overall negative 50% net salvage. When adjusted for the Company's claimed level of interim retirements the negative 50% net salvage is reduced to a negative 21%. (See Exhibit No.___(EMR-2) page 2-130). The Company's depreciation study and responses to interrogatories and document productions failed to identify how the initial negative 50% net salvage level was established. What the Company has provided is general statements that (1) it relied on an "interpretative" approach, (2) it reviewed historical data, (3) it did a "forecast" analysis, and (4) it relied on input from management. However, a review of the historical data and analyses, forecasted data and analyses, information from the Company's last study, Company notes, responses relating to input from management, etc., all fail to identify why a negative 50% net salvage was selected or why it was appropriate in the first place.

What the Company's information does identify is that the overall historical data indicates a negative 37% net salvage and that the Company's forecast analysis indicates a negative 130% net salvage. (See Exhibit No.__(EMR-2) page 4-3). Thus, the negative 50% proposed by the Company does not appear to be based on either the forecast or the historical information. Given that the Company failed to provide any specifics regarding the input, and the impact of such input, from any Company individual, renders its proposal completely void of any supporting evidence.

Q. HOW DOES THE COMPANY'S PROPOSAL COMPARE TO ITS PROPOSAL FOR THIS SAME ACCOUNT IN THE LAST CASE?

A. The two proposals are identical. However, the net salvage "forecast" in the last case was a negative 384%, while in this case it is only a negative 130%. Thus, while the forecasted amount has been reduced by 2/3rd there is no change in the Company's proposed negative 50% overall net salvage. Obviously, the "forecast" analysis played no meaningful role in the selection process. Turning to the historical data, the overall net salvage for this account in the last study was a negative 67%. In this study that value has changed to a negative 36%, yet the Company made no change in its proposed negative 50% overall net salvage. Obviously the Company's proposal is not based on any analysis or a review of historical data or trends in the data. Moreover, the ultimate interim retirement related net salvage as proposed by the Company in the last case was a negative 12.5%. However, in this case the Company now proposes a negative 21%. This proposal is made in spite of the fact that its own "forecast" analysis has been cut by 2/3rd and the overall historical data indicates approximately a 50% cut in negative net salvage. In spite of these contradictory movements between cases, Mr. Robinson and the Company elected to remain silent as to the basis for the proposal.

Q. PLEASE SUMMARIZE THE COMPANY'S PRESENTATION?

A. The Company presentation is less than vague, yet based on the depreciation study it still seeks approximately $33 million of annual revenue requirements based on plant as of December 31, 2009. (See Exhibit No._(EMR-2) pages 2-31, through 2-36). Rather than presenting any specific facts, considerations, documents, exhibits or even meaningful testimony in support of its various proposals, the Company simply places

such values within its 165 pages of summary numerical documentation identified as Section 2 of its depreciation study. There are no notes that explain the various proposals, there are no workpapers that explain the proposal, and there is no testimony that explains the proposal other than to indicate three potential approaches. Indeed, while the study identifies three very generalized basis for Mr. Robinson's proposals, the Company only admits in response to an interrogatory that the arithmetic approach reflected in the historical analysis and in the forecast analyses were not relied upon. Even when making such admission the Company and Mr. Robinson still fail to provide any support for the bases of its proposals. The Company's proposal should be denied since the Company has met no burden of proof associated with its interim net salvage request and has still not identified any credible support.

Q. WHAT DO YOU RECOMMEND?

A. While a zero level of net salvage would be a logical reaction to the Company's total failure to present and support its proposals, I have two recommendations. First, I recommend that the actual overall historic values reflected in the Company's depreciation study be utilized for interim retirement purposes, with one very conservative limitation. That limitation is that in each instance where the historical data for interim net salvage yields a positive value that the interim net salvage be set to zero. This limitation is conservative in favor of the Company. The second recommendation is that the Commission order the Company to perform a detailed, thorough and well documented depreciation study for its next proceeding. The presentation by the Company should clearly identify what was specifically relied upon by account and how the various items of information relied on result in

whatever proposal the Company makes in its next depreciation study. The Commission and customers should not be left hanging in the dark even after requesting information that was intended to elicit the clear basis and support for the Company's proposals.

Q. WHAT SPECIFIC INTERIM NET SALVAGE VALUES RESULT FROM YOUR RECOMMENDATION?

A. Exhibit (JP-5) presents a listing of the overall net salvage and interim net salvage by account for production plant as proposed by the Company and as I recommend based on actual Company specific data.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in an approximate $30 million reduction to annual depreciation expense based on plant as of December 31, 2009.

E. Inconsistent Interim Net Salvage Analyses

Q. IS THERE INTERNAL INCONSISTENCY IN THE COMPANY'S PRESENTATION FOR INTERIM NET SALVAGE?

A. Yes. Once the Company establishes the overall proposal for net salvage for an account it then adjusts the proposed value downward to reflect the fact that it will be applied to total plant, yet intended to have the effect of only being applicable to interim retirements. Unfortunately, the Company calculates the modification to its proposed overall net salvage value based on data as of December 31, 2007. While this portion of the depreciation analysis is based on data as of December 31, 2007, the

Company specifically carries forward additions and retirements through the end of 2009 in all other portions of its study. The Company takes such projected additions and retirements into account in calculating the remaining life for the overall depreciation expense and resulting rates, but fails to update the applicable level of interim retirements due in part to its reliance on a truncated Iowa Survivor curve approach in establishing the level of interim retirements.

Q. CAN SUCH INTERNAL INCONSISTENCY HAVE A SIGNIFICANT IMPACT IN THE FINAL RESULT?

A. Yes. For example, Account 322 – Nuclear Plant Equipment represents one such instance. A review of Exhibit No._ (EMR-2) pages 7-49 and 7-50, which reflects data as of December 31, 2007, and page 9-39, which reflects plant data as of December 31, 2009, establishes that substantial additions and retirements are projected to occur to this account. In particular, the plant balance increased from $267 million at the end of 2007 to approximately $516 million as of the end of 2009. A close comparison of these pages identifies that the Company projected additions of $311,892,596.74 during calendar year 2008 and 2009. However, when these additions are added to the 2007 plant balance set forth on page 7-50 it yields a difference of $62.8 million. This is precisely the amount the Company estimated would retire during 2008 and 2009. The $62.8 million of retirements are interim retirements. The significant additions of over $311 million and the $62.8 million of retirements have a dramatic impact on the average age of the investment that should be reflected in the depreciation study in order to be consistent.

Q. WHAT AGE DID THE COMPANY RELY UPON IN PERFORMING ITS STUDY?

A. As set forth only in the Company's electronic workpapers provided during discovery, the Company relied on a 19.5 year average age as of December 31, 2007 for this account. This value can be duplicated by multiplying the original cost set forth on Exhibit No. __ (EMR-2) pages 7-49 and 7-50 beginning with 0.5 year of age corresponding to 2007 and increasing the age by one year as values move back in time to 1951, and dividing the sum of the weighted dollars by the total original cost. When the same calculation is performed on the values on page 9-39, which reflects the substantial new additions in 2008 and 2009, the average age drops to 8 years. The age for this account that Mr. Robinson used in one portion of his study is 2.4 times the age of the investment relied on in a different portion of his study.

Q. WHAT DIFFERENCE DOES THE AVERAGE AGE HAVE IN THE CALCULATION PRESENTED BY THE COMPANY?

A. The Company's calculation of age was used to establish the 48-year average age for the Projected Year of Retirement on Table 2 – a, set forth at page 2-131 of the Company's depreciation study. The 48-year value was calculated by adding the age of 19.5 years to the remaining life for this unit of 28.5 years. This 48-year average age was divided by the 40-year average service life reflected in the Company's proposed 40-R0.5 life-curve combination in its interim retirement approach. That calculation yields a value of 120% of the average service life as set forth on Table 2 – a, page 2-131 of the Company's study. The Company then identified a 62% value for the level of plant retired on an interim basis from standard Iowa Survivor tables for a 40R0.5 at 48 years of age. This 62% value is critical as it represents the Company's

assumed level of interim retirements and was applied to the negative 20% net salvage value estimated on an overall basis for the account. Multiplying 62% times the proposed negative 20% net salvage yields the Company's proposed interim retirement net salvage level of negative 12.4%. Also set forth on page 2-131 of the Company's study, the Company relied on the negative 12.4% interim net salvage proposal for calculating the ultimate depreciation rate it proposed.

Q. WOULD THE SIGNIFICANT CHANGE IN THE AGE PROPOSED BY MR. ROBINSON EFFECT THE PROPOSED LEVEL OF INTERIM RETIREMENTS?

A. Absolutely. Reducing the 19.5-year age to 8 years of age relied upon and proposed by the Company through the end of 2009 results in a 36.5-year average age for the investment in this account at the Projected Year of Retirement versus the 48-year value relied upon by Mr. Robinson. Performing the same calculations as the Company did in its study results in a 91% percent of average service life value compared to the Company's 120% value. The final percentage retirements corresponding to the level of interim retirements that should have been utilized drops to 42% compared to the Company's proposed 62%, or a full 20 percentage point reduction.

Even assuming the Company's proposed overall negative 20% net salvage for this account was appropriate, which it is not, the resulting negative net salvage applicable to interim retirements would have declined to a negative 8.4% compared to the Company's proposed 12.4%. In other words, the Company's proposed value is approximately 50% higher than it should have been had the Company calculated its

interim net salvage process on a consistent basis. This single change for this single account reduces the Company's claimed depreciation expense by $929,000. The Company has performed this calculation on over 150 entries corresponding to different accounts by generating units. While there is no impact in those instances where the Company did not project additions or retirements for a given account for a generating unit, the Company has proposed additions and retirements for the vast majority of the 150 plus entries.

Q. HAVE YOU CORRECTED EACH OF THE COMPANY'S ERRORS?

A. By relying upon my recommended approach to calculating and quantifying interim retirements, I have effectively corrected the Company's errors due to inconsistent recognition of plant additions and retirements. I have not recalculated the impact of the Company's errors relying on its inappropriate approach to interim retirements.

F. TERMINAL NET SALVAGE

Q. WHAT ISSUE DO YOU ADDRESS IN THIS PORTION OF YOUR TESTIMONY?

A. This portion of my testimony will address the Company's dismantlement study for its various generating facilities.

Q. HAVE YOU REVIEWED THE COMPANY'S DISMANTLEMENT STUDY?

A. Yes. I have reviewed the study, as well as the information provided by the Company in support of such study.

Q. DOES THE COMPANY'S PRESENTATION JUSTIFY ITS REQUEST?

A. No. There are two separate levels from which to review the Company's request. The first level of review relates to how the Company's request compares to the various options available to the Company associated with final retirement of the generating facilities under utility regulation. The second level of review for the Company's presentation occurs once the option associated with the final retirement from utility operation is selected. This review addresses the quantification of the cost of removal within the retirement process selected.

Q. WHAT OPTIONS ASSOCIATED WITH THE RETIREMENT OF A GENERATING FACILITY ARE AVAILABLE TO A UTILITY?

A. The range of options available to a utility range from total dismantlement and site restoration to the sale of the facility. The cost to the utility and thus the cost to the customers vary dramatically depending on the option selected. For example, if any form of sale of the facility occurs, substantial levels of gross salvage can be expected to be obtained and positive net salvage is a realistic result. Positive net salvage means that the Company needs to recover less than 100% of its costs through depreciation, as the balance of the cost is obtained through sale proceeds. On the other end of the spectrum is the full dismantlement and site restoration approach. This approach normally results in cost of removal exceeding gross salvage, and thus an overall negative net salvage is required.

Basically, the options available to the Company range from the worst case scenario of total dismantlement and site restoration, to the best case scenario corresponding to the sale of the facility at an amount significantly above net book value. Since ratemaking

is an attempt to charge expected average costs, some weighting of future probabilities associated with each potential option should be recognized.

Q. HAS THE COMPANY RECOGNIZED ANY WEIGHTING OF DIFFERENT OPTIONS ASSOCIATED WITH THE RETIREMENT COSTS FOR ITS GENERATING FACILITIES?

A. No. The Company has assumed a 100% probability of the worst case scenario, that being full demolition and site restoration. This assumption by the Company is unreasonable and inappropriate for ratemaking purposes.

Q. ARE YOU AWARE OF GENERATING FACILITIES THAT HAVE BEEN SOLD RATHER THAN DEMOLISHED AT THE TIME THEY WERE RETIRED FROM UTILITY OPERATIONS?

A. Yes. Approximately 1,000 generating units have sold in the United States since the late 1990s. The vast majority of such sales are associated with areas that became deregulated for electric generation purposes. In those instances even very old, small, and inefficient generating facilities sold at prices substantially above net book value.

Q. IS PEF SUBJECT TO ELECTRIC DEREGULATION?

A. No, not at this time. However, the possibility always exists that the situation could occur in the future.

Q. ABSENT DEREGULATION, DO ELECTRIC UTILITIES EVER SELL GENERATING FACILITIES?

A. Yes. While such situations are far less frequent, there have been sales of generating facilities that were still in operation at price levels above net book value. Thus, the Company's total exclusion of any possible approach to cost recovery other than assuming full facility dismantlement and site restoration is unreasonable and results in excessive costs to customers.

Q. DID THE COMPANY PROPOSE ANY LESSER COST FORM OF DISMANTLEMENT?

A. No. Even though the Company is not legally required to dismantle and restore the site to a greenfield condition, it has elected to charge customers for that scenario.

Q. IS THIS APPROACH REASONABLE?

A. No. First, generating sites and facilities are valuable resources. The plant normally will have access to water, adequate zoning for industrial usage, if applicable, and most important, access to transmission corridors necessary to connect to the transmission grid. In fact, the Company has used many of its existing generating plant sites for new generation. The need to charge customers for returning such sites to a greenfield status is unrealistic and quite excessive.

Q. HOW WOULD YOU CHARACTERIZE THE COMPANY'S REQUEST AS IT PERTAINS TO THE FIRST LEVEL OF REVIEW YOU HAVE ADDRESSED?

A. The Company's demolition approach must be categorized as a worst case scenario. Charges to customers should not be set on presentations associated with worst case scenario revenue requirements, especially when other less expensive options are more realistic.

Q. PLEASE DISCUSS THE SECOND LEVEL OF REVIEW ASSOCIATED WITH DEMOLITION COST ESTIMATES.

A. The second level of review comes into play after the approach to generation retirement has been established. As previously noted, the Company has proposed a worst case site demolition and greenfielding of the location. Once this decision is made, the second level of review addresses how such activities are to be performed.

Q. WHAT APPROACH HAS THE COMPANY PROPOSED?

A. The Company's approach is in effect what the industry identifies as "reverse construction." The Company's approach assumes that it will take down the generating facility piece by piece, and then break up foundations and remove underground piping.

Q. WHY IS THIS SIGNIFICANT?

A. The approach proposed by the Company is again the worst case scenario for the dismantlement option. A good example to depict what is at issue is the dismantlement of a tall smoke stack at a power plant. In a recent case in Oklahoma, the demolition cost estimator projected a cost of $2 million to demolish a 600 foot tall smoke stack. The estimate was predicated on a process that began at the top of the smoke stack and knocked off sections of the smoke stack, tumbling the debris into the stack. This process was to continue from the 600 foot elevation down to the base. Once the rubble had been accumulated in a large cone at the bottom of the base, the utility would remove it and dispose of it. This approach is very costly in comparison to the available alternative of demolition, which involves exploding the smoke stack base and allowing the stack to topple and break apart along a predefined "fall line".

Once the stack has been broken apart by gravity as it falls and smashes to the ground, the rubble can be gathered and disposed of more easily and more cheaply.

Q. ARE YOU AWARE OF SIGNIFICANT COST DIFFERENCES IN THE TWO DIFFERENT TYPES OF APPROACHES?

A. Yes. In another recent case in Nevada, another major engineering estimator projected the cost of performing a reverse construction approach for generating facilities. Shortly thereafter, Nevada Power Company actually entered into a contract with a demolition firm to demolish the plant. The contractor employed explosive demolition and controlled toppling of the facilities rather than the reverse construction approach. The cost differential between the engineering firm's cost estimate based on a reverse construction approach and the actual demolition based on explosive charges and toppling the facility to the ground was about 30 cents on the dollar. In other words, the estimate for reverse construction approach was approximately 3 times greater than the cost that the utility incurred to employ the explosive demolition method.

Q. TURNING TO THE COMPANY'S COST ESTIMATES, CAN YOU PROVIDE A BRIEF OVERVIEW OF THE CRITICAL COMPONENTS OF A DEMOLITION STUDY?

A. Yes. To make a "reverse construction" demolition cost estimate, it is necessary to have three key items of information. Those three key items are (1) the quantity of material to be removed by type of materials (2) the labor rates and corresponding crew sizes and mix (i.e., how many laborers, welders, supervisors, etc.), and (3) the productivity factors or the rate at which the labor crew can perform activities.

Q. HAVE YOU REVIEWED NUMEROUS DEMOLITION COST ESTIMATES?

A. Yes.

Q. WHAT IS THE GENERAL PROBLEM YOU FIND WITH SUCH ESTIMATES?

A. Of the three main categories of variables, the quantity of material to be removed is generally not a major issue. However, the labor costs and productivity factors are normally major issues. In addition, such studies normally include excessive levels of indirect costs and contingency factors.

Q. IN THIS CASE WAS THE COMPANY ABLE TO PROVIDE THE UNDERLYING PRODUCTIVITY FACTORS?

A. No. The Company hired Burns & McDonnell ("BM") as its new cost estimating firm for this case. The Company then had BM rely on the crew mix, man-hours and associated productivity factors that were developed by a different cost estimating firm that performed a prior demolition cost estimate study as a starting point for this case. (See OPC's Fifth Interrogatories No. 204). Thus, the Company does not have an adequate underlying basis for the productivity factors that it employs in its demolition cost estimates.

Q. HAS THE COMPANY ALSO INCLUDED A CONTINGENCY FACTOR ON TOP OF WHAT APPEARS TO BE A HIGH SIDE COST ESTIMATE FOR DEMOLISHING POWER PLANTS?

A. Yes. The Company states that a 20% "contingency was included because they "are expected to be expended." (See Exhibit No._(EMR-2) page 4-3).

Q. IS THE COMPANY'S USE OF A 20% CONTIGENCY FACTOR REASONABLE AND NECESSARY?

A. No. The 20% contingency factor is excessive given the dismantlement approach proposed. In other words, if an estimate is based on a low side cost estimates --one that assumes very efficient operation, no weather related delays, etc. -- then a positive contingency might be warranted. However, if the cost estimate is based on a "reverse construction" approach then a *negative* contingency may be warranted.

Q. WHAT TYPE OF APPROACH HAS THE COMPANY PROPOSED?

A. As previously noted, the Company has proposed a very high side cost estimate. This is precisely the type of situation that I referenced earlier when discussing the situation in Nevada. The cost to pre-cut members, beams, piping etc., high above the ground and carefully lowering them, rather than blowing the support beams and toppling the facility, produces an excessively high cost estimate. Therefore, to the extent any contingency should be considered in this case, it should be a negative contingency. In fact, under the right circumstances demolition contractors will actually pay a positive value for the right to demolish a power plant.

Q. ARE YOU SAYING THAT IT IS POSSIBLE THAT, EVEN WITHOUT SELLING THE GENERATING FACILITIES AS ONGOING OPERATING STATIONS, THE COMPANY COULD POSSIBLY OBTAIN POSITIVE SALVAGE?

A. Yes. In fact, recently the Fort Pierce Florida Utilities Authority employed a contractor to demolish the King generating plant. The demolition contractor actually

paid Fort Pierce approximately $1 million for the right to demolish the plant and sell the resulting scrap.

Q. CAN SUCH SITUATIONS REASONABLY BE ANTICIPATED TO OCCUR IN ALL INSTANCES?

A. No, not necessarily. At the time of the Fort Pierce transaction, scrap metal prices had reached their all time high. Since that time, prices have fallen noticeably. However, it is reasonable to expect that the economies of China and India will again begin to grow at substantial rates. At that time the scrap metal market will experience higher prices. The key point to be taken from this is that the theory that the Company operates under is neither accurate nor economically efficient. Customers should not be subject to worst case scenarios and inappropriate procedures, approaches and cost estimates.

Q. IS THERE ANOTHER PROBLEM WITH THE COMPANY'S DEMOLITION STUDIES?

A. Yes. The Company has made an error in its calculation of labor costs.

Q. WHAT IS THE ERROR?

A. The Company claims that for "the study an average of these two wage rates was utilized." The two wage rates referenced are local union wage rates and the pay scales listed in the 2008 RS Means Heavy Construction Cost Data, 22nd Annual Edition. (See OPC's Fifth Interrogatories No. 189).

Q. IS THE COMPANY'S STATEMENT ACCURATE?

A. No. A review of the fully loaded labor rates demonstrates that rather than using the average of union and RS Means pay scales, the Company's study actually relies on only the higher union labor rates.

This error can be seen by review of the Iron Worker labor rate of $67.98 per hour employed by the Company. (See OPC's Fifth Interrogatories No. 200, Attachment at bate stamp 3). This fully loaded labor rate starts with the union only labor rate for an iron worker of $37.58. (See OPC's Fifth Interrogatories No. 200, Attachment bate stamp page 1for iron worker at the Anclote plant). The calculation ignores a $33.96 hourly rate for the same iron worker as reported in the RS Means publication. Increasing the $37.58 base labor rate by the 30% contractor burden, an additional 10% to cover overtime, and finally by the 26.499% proposed additional "mark up" precisely yields the previously referenced $67.98 labor rate. (See OPC's Fifth Interrogatories No. 200, the attachment identified as "PROGRESS FLORIDA mark up.pdf at bate stamp 8). In other words, the Company has overstated labor costs for this category of workers by a minimum of over 5% prior to the impact of the Company's additional 10% mark up for indirect costs and the 20% mark up for contingencies. The value is initially overstated by 11% when comparing union versus non union base labor rates.

Q. GIVEN THE VARIOUS PROBLEMS YOU HAVE IDENTIFIED, WHAT DO YOU RECOMMEND?

A. Given the significant level of adjustments that I recommend elsewhere in the area of depreciation, I have elected not to propose an additional adjustment to the Company's requested level of demolition cost revenue requirements. However, I do recommend

that the Commission order the Company to perform detailed and well documented analyses of the different approaches and probabilities of end of life termination for generating facilities. I further recommend that the Commission also order the Company to develop and fully justify the most cost efficient manner for any actual demolition cost approach that it determines to be appropriate. This study, with all analyses, work papers, etc., should be provided to the Commission no later than the Company's next depreciation or rate proceeding. However, if the Commission finds that it is appropriate to modify or adjust the Company's request in this proceeding, I would recommend that it reduce the Company's requested costs by 60%.

Q. WHAT IS YOUR BASIS FOR A 60% REDUCTION?

A. The 60% reduction is based on the approximate relationship experienced by Nevada Power Company between the reverse construction cost estimate approach to demolishing power plants and what an actual demolition contractor charged to tear down the facilities. The actual differential was greater than 60%, so the 60% estimate is conservative. Moreover, when one recognizes the likelihood of reusing generating sites for future generation, and the fact that substantial costs are included in the Company's estimate for site restoration, a reduction of only 60% of the Company's cost estimate would be conservative in favor of the Company.

SECTION V: MASS PROPERTY LIFE ANALYSES

A. INTRODUCTION

Q. WHAT IS THE PURPOSE OF THE LIFE PORTION OF A DEPRECIATION ANALYSIS?

A. The purpose of a life analysis is to determine the "average service life" or ASL, the dispersion pattern and remaining life for each account or subaccount. This information is necessary to properly perform the depreciation calculation. A longer ASL results in a longer remaining life and therefore a lower depreciation expense. Alternatively, a shorter ASL will reduce the remaining life and increase depreciation expense. The dispersion pattern is important, as it is critical in the overall selection process of the best fitting results. The same ASL with different Iowa Survivor curves also results in different remaining lives, due to the remaining expected pattern of retirements.

Q. WHAT ARE THE MAIN TOOLS UTILIZED IN PERFORMING LIFE ANALYSIS?

A. Life analysis is normally performed through the use of actuarial or semi-actuarial analyses. Actuarial analyses rely on aged data. In other words, when an item of property is retired, the age at retirement is known. This is the type of analysis performed by insurance companies when developing life tables in order to establish premiums. Semi-actuarial analyses are performed in instances in which the age of retired plant is not known.

Q. PLEASE PROVIDE MORE INFORMATION REGARDING HOW A DEPRECIATION ANALYST PERFORMS A LIFE ANALYSIS THAT RELIES ON AN ACTUARIAL APPROACH.

A. Aged data is gathered and analyzed. Aged data means that when an asset retires in 2007 we know that it originally went in service in 1967, and was 40 years old at the time of retirement. When all the aged data in a group is statistically analyzed by actuarial techniques, a resulting Observed Life Table or OLT is developed that depicts the rate of retirement over the life of the group. The OLT starts at 100% surviving and declines from there as each year of age is obtained and retirements occur. Naturally, not all units retire at once; instead, the retirement dates are dispersed through time, creating a "dispersion pattern." In order to permit testing of the results some standard or index must be used. The principal tool that a depreciation analyst uses for this aspect of the study is a set of "survivor curves." The industry standard and most extensively used curves are called the Iowa Survivor Curves. The name is derived from the fact that they were developed at Iowa State College in the 1930s.

Most often, and as is the case for many of PEF accounts, the data analyzed does not yield a complete OLT, one that fully declines to 0% surviving. This means that the data set will produce an incomplete OLT or a "stub curve." Also, the limited data base may include atypical or abnormal events not reasonably anticipated to occur again or at the same magnitude during the remaining life.

The Iowa Survivor Curves are based on empirical studies of retirement "behavior" of physical property. They are designed to predict the retirement patterns of the property under study based on detailed past observations. The Iowa Survivor Curves make the calculation of the average service life far more manageable and comparable; instead of making and weighting a myriad of individual calculations that include each data point in the universe, the analyst measures the area below the curve and uses an

established equation or standard curve to "solve" for the average service life. And, even if the data set is incomplete—which is often the case —by properly choosing a closely fitting curve to the known data, the analyst can better predict the behavior of the entire universe and calculate the average service life with reasonable statistical accuracy, if a meaningful "stub curve" exists. The result of any estimation is more reliable if 70% of an OLT is known and only 30% must be assumed, than if only 10% of the OLT is known and 90% must be assumed.

Not surprisingly, choosing the survivor curve that provides the best fit to the data is critical to the accuracy of the analysis. When fitting the curves to the OLT the analyst must bear in mind that some data points—those that occur on the points of the graph that reflect the most significant level of plant exposed to retirement events-- are more important to the determination of the ASL and dispersion pattern than others. Further, the analyst cannot use the curves in isolation of other considerations. The analyst must incorporate such things as knowledge of the nature of the property being studied, an understanding of the causes of unusual events, recognition of changes or trends, and judgment when using the curves. Also, the nature of survivor curves limits their usefulness. For instance, they are best suited to studies of homogeneous items that, because of their physical similarity and common exposure to retirement forces, can be expected to share common retirement characteristics. (By analogy: When an insurance actuary performs a mortality/longevity study for life insurance purposes, the actuary does not combine people and horses in the universe of data). It is for that reason that I criticized PEF's analyst for inappropriately applying the Iowa Survivor Curves to interim retirements for generation plant. The items of generation plant involved in interim retirements frequently are far from homogeneous.

Q. HAVE YOU REVIEWED THE COMPANY'S LIFE ANALYSES?

A. Yes, I have reviewed the Company's life analyses. The main problem with the analyses is that for two accounts Mr. Robinson proposes ASLs with corresponding Iowa Survivor curves that are significantly out of line with realistic expectations and fail to properly evaluate factors that directly impact the OLT. Mr. Robinson's selections for these two accounts reflect a bias toward artificially short ASLs. Mr. Robinson fails to provide support for his questionable practice.

Q. BASED ON YOUR REVIEW OF THE COMPANY'S LIFE ANALYSES, ARE YOU RECOMMENDING ADJUSTMENTS?

A. Yes. I recommend adjustments to 2 accounts. The two accounts are 364 – Distribution Poles and Fixtures and 368 – Distribution Line Transformers.

The combined impact of the two adjustments I recommend result in a standalone impact of a $13,977,196 reduction to annual depreciation expense, based on plant as of December 31, 2009.

Q. WHAT IS THE RESULT OR OUTPUT OF AN ACTUARIAL ANALYSIS?

A. The output of an actuarial analysis is called an observed life table or OLT. This OLT output includes a graphical depiction of the remaining surviving level at each progressive age of the plant. In other words, all plant additions start at "100% surviving" when first placed into service. As plant ages and items of plant begin to retire, the initial 100% survivor level decreases until it reaches zero, if it has completed a full life cycle.

Q. DO MOST OF THE COMPANY'S OBSERVED LIFE TABLES REFLECT A COMPLETE LIFE CYCLE?

A. No. Many of the OLTs decline to 20% or 30% surviving, while others decline to only 40%, 50%, or higher values.

Q. HOW ARE THE ULTIMATE LIFE-CURVE SELECTIONS MADE?

A. The best fitting life-curve selections are made by visually matching the OLT to standardized Iowa Survivor Curves.

Q. IN THE VISUAL MATCH PROCESS, ARE ALL POINTS OF COMPARISON EQUAL?

A. No. Many of the points of comparison for an OLT may reflect dollar levels of exposures that differ by *a factor of 10,000 or more*.

Q. IN THE CURVE FITTING PROCESS, IS IT MORE IMPORTANT TO MATCH THE POINTS ON THE OLT THAT REFLECT LARGER DOLLAR LEVELS OF EXPOSURES THAN THOSE POINTS WHERE THE DOLLAR LEVEL IS MUCH LOWER?

A. Yes. It would be foolish to accept the results of a standardized life-curve that better fits the results of the end or "tail" of the OLT rather than a life-curve combination that is a better fit near the "head" or top of the OLT. While it is desirable to have close fitting results all along the OLT, this unfortunately does not occur for many accounts. Therefore, recognition of the dollar level of exposures at different points of the OLT is critical.

This is significant, since as each additional year of plant activity transpires the OLT can and usually does change. However, the future changes will not occur equally to all portions of the OLT. In fact, it is highly unlikely, given the level of exposures near the "head" or top of the OLT, that the few years between depreciation studies would result in any appreciable movement of that portion of the OLT. The same cannot be said of the "tail" portion of the OLT, and potentially even the mid portion of the curve. If larger retirements transpire in older age intervals, or more dollars of exposures filter further down in the OLT without corresponding retirements, the mid portion or tail of the OLT can move significantly based on only a few years of additional data. That is precisely why matching the "head" of the observed life table is more important than matching the "tail."

Q. DID MR. ROBINSON FOLLOW THIS PRACTICE IN HIS CURVE FITTING PROCESS?

A. No, not to the extent he should have. As will be discussed in the Account Specific portion of my testimony, Mr. Robinson did not perform appropriate curve fitting practices in conjunction with evaluation of projected levels of retirement recognized elsewhere in his depreciation study. As a result, he understated the appropriate ASL or chose an Iowa Survivor curve that is not the best fit to the OLT.

B. ACCOUNT SPECIFIC

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 364 – DISTRIBUTION POLES, TOWERS AND FIXTURES?

A. The Company proposes a 29-year ASL with a corresponding R4 Iowa Survivor curve. This proposal represents a 1-year change from the Company's last depreciation study and a modification from an L4 to a R4 Iowa Survivor curve. The existing ASL is a result of a settlement in the last case.

Q. WHAT IS THE COMPANY'S BASIS FOR ITS PROPOSAL?

A. From a narrative standpoint, the Company is silent as to the basis for its proposal. The Company performed actuarial analyses and presented the full band results, 1957 through 2007. (See Exhibit No.___ (EMR-2) page 5-92). Therefore, the Company's basis can only be characterized as Mr. Robinson's interpretation of the full band actuarial analysis.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal reflects an ASL significantly shorter than any ASL Mr. Robinson has presented for investment in this account during the past 10 years. The shortest ASL Mr. Robinson has proposed during the past 10 years is 35 years, while the average of his proposals was 42 years. (See OPC's Fifth Interrogatories No. 192, Attachment). The obviously short ASL on its face should have caused Mr. Robinson to further investigate or explain in detail why such an artificially short life is reasonable for the Company. As previously noted, no such explanation or analysis has been provided. I recommend a 35-year ASL with a corresponding R3 Iowa Survivor curve.

Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?

A. First, my recommendation corresponds to the shortest ASL Mr. Robinson has proposed for any other electric utility during the past 10 years and is still 7 years below the average ASL Mr. Robinson proposed during that period. The 35-year ASL recommendation is also equivalent to what Mr. Robinson proposed for Progress Energy Carolina, a sister company.

Unlike Mr. Robinson, I investigated further into the base data in an effort to identify the underlying cause for such a short ASL. The underlying cause indication can be identified on Exhibit No._(EMR-2) at page 5-92. There the values for age interval 24.5 to 25.5 years and the following two subsequent years drive the observed life table appreciably downward at a steep rate of decline. These particular data points appear to be the driving factor to which Mr. Robinson reacted in order to propose his artificially short ASL.

Q. DOES THE MAGNITUDE OF THE RETIREMENTS IN RELATIONSHIP TO THE EXPOSURES FOR THESE THREE AGE INTERVALS APPEAR REASONABLE?

A. No. For example, the average retirement ratio (the ratio of dollars retired in an age interval divided by the dollars exposed to retirement at the beginning of the age interval) for the three years in question is 0.12226. The equivalent ratio for the prior three age intervals is only 0.02115. Thus, the retirement ratio during the unusual period is six times the average retirement ratio experienced during the three age intervals immediately prior to that period. Indeed, the period in question is also four times the level of the retirement ratio for the three age intervals immediately following the period in question. Moreover, one age interval, 24.5 to 25.5 years of

age, reflects a dollar level of retirements that is approximately two to eight times the dollar level of retirement activity in the 3-year brackets proceeding or following that particular age interval. This single unusual year of activity caused over a 14% drop in the observed life table.

Q. IS THIS PARTICULAR YEAR SIGNIFICANT?

A. Yes. Given the manner in which observed life tables are calculated, dollar retirement levels of such magnitude can have an artificial impact for a period of time. However, if the underlying events are more atypical than normal, the impact of such event over time will diminish. For example, in the Company's last depreciation study the same significant level of retirement activity that occurred during the 24.5 to 25.5 year age interval yielded a 0.21646 retirement ratio. (See Docket No. 050078-EI 2005 Depreciation Study at page 5-75). The impact of this single age interval declined by approximately 1/3rd since the last depreciation study (0.21646 versus 0.14496). This decline since the last study is due to more dollars being exposed to retirements during the age interval. In the last case, the unusually high dollar level of retirement activity for the 24.5 to 25.5 age interval was associated with $64 million of exposures. In this case, because four more years of exposures have passed through this age interval, the level increased to $97 million. In other words, because the actual retirements during the last 4 years for this age interval increased only by 1%, yet the dollar level of exposures in the last 4 years increased by 51%, the resulting retirement ratio declined dramatically.

Exhibit __ (JP-6) sets forth the observed life table for this account for both the current and prior depreciation studies. As can be seen, there is relatively little movement

between the two studies at early ages, but the difference becomes more pronounced once an age of approximately 20 years is reached. The unusual activity that occurred during the 24.5 to 25.5 year and the two subsequent age intervals are not repeated as 4 additional years of history experienced. The middle portion of the observed life table moves upward over time to reflect this reality. Mr. Robinson failed to recognize the unusual nature of this portion of the observed life table and the dynamic upward movement in the shape of the observed life table over time as the impact of some prior unusual events diminishes.

Q. DO YOU EXPECT THE OBSERVED LIFE TABLE TO CONTINUE TO MOVE UPWARD BY THE TIME OF THE NEXT DEPRECIATION STUDY?

A. Yes. For example, the Company projected retirement activity for this account through 2009 of approximately $5 million, or $2.5 million per year. (See Exhibit No._(EMR-2) pages 2-44 and 2-51). The Company has not projected any retirement activity corresponding to the age intervals of concern. Assuming this pattern continues for the years 2010 and 2011, the dollar level of exposures corresponding to the 24.5 to 25.5 age interval can be estimated to increase to approximately $150 million. A $150 million level of exposures corresponds to an approximate 50% increase in exposures ($150/$97). If no additional retirements occur for this age interval during 2010 and 2011, the new retirement ratio would drop to approximately 0.093, which represents another 35% reduction by the time of the next depreciation study. This new reduction in the retirement ratio would again have the affect of raising the middle portion of the survivor curve indicating a longer ASL than the 29-year level proposed by Mr. Robinson.

Q. HAVE YOU ANALYSED THE COMPANY'S PROPOSED OBSERVED LIFE TABLE?

A. Yes. Exhibit __ (JP-7) sets forth my comparative analysis. As can be seen, the Company's proposal versus my recommended 35R3 life-curve combination are approximately equal matches through the first 21 years of age. However, my recommendation is a better fit to the actual data through approximately 25 years of age. At that point, the observed life table is impacted by the major retirements that occurred during the 24.5 to 25.5 age interval as previously discussed. While subsequent to that age the Company's proposal is a better match than my recommendation, that is precisely the portion of the curve that will change to the greatest extent by the next depreciation study. As previously noted we are already 2 years into the 4 year period between depreciation studies. The Company's presentation for those 2 years 2008 and 2009, do not continue the unusual retirement activity reflected in the 24.5 to 25.5 age interval. The survivor curve that I currently recommend will be a much better fit to the observed life table in the next proceeding as the impact of the unusual historical event is diminished due to substantial more exposures. Therefore, from a knowledge based life-curve combination matching process, my recommendation is superior to the artificially short ASL proposal by Mr. Robinson. Moreover, unlike Mr. Robinson's proposal, my recommendation reflects proper evaluation of historical data in order to make appropriate estimates of future expectations.

Q. ARE THERE OTHER CONSIDERATIONS WHY A LONGER ASL IS WARRANTED AT THIS TIME?

A. Yes. Recall that depreciation is a projection of anticipated events in the future. Historical analyses are a starting point for future expectations. With this in mind, there are additional facts that further support increasing the ASL at this time. First, the Company notes that it has implemented a "program to inspect poles on an ongoing basis." (See Exhibit No._ (EMR-2) at page 4-54). Based on this inspection program the Company has become more proactive in maximizing the life expectancy for its investment. Due to the inspection program the Company now reinforces poles, which permits poles to achieve a longer service life due to such reinforcement. Another consideration is the fact that the Company now chemically treats wood poles with preservatives. Again, the purpose of such actions is to lengthen the life expectancy of poles compared to historical time frames. These are precisely the type of considerations that a depreciation analyst should take into account when making recommendations. Mr. Robinson failed to account for such considerations, which helps explain why he is proposing an artificially short ASL for this account.

Q. DID FP&L EXPERIENCE THE SAME HIGH LEVELS OF RETIREMENT RATIOS FOR THIS ACCOUNT?

A. No. I just recently reviewed FP&L's life analyses for this account in Docket No. 080677-EI). Exhibit No. __ (JP-8) sets forth FP&L's observed life table for this account. During the first 38.5 year of age FP&L did not experience a retirement ratio anywhere near what PEF experienced during the mid 20-year age intervals, the period during, which Mr. Robinson reacted as the basis for his proposal.

Q. PLEASE SUMMARIZE YOUR ADJUSTMENT?

A. A longer ASL is warranted for this account given (1) both Mr. Robinson and the industry sponsor longer service lives for investment in this account, (2) the Company has not explained why it significantly deviates from industry expectations, including those of its sister utility, (3) Mr. Robinson failed to investigate unusual historical retirement activity which significantly impacts the shape of the observed life table, (4) Mr. Robinson failed to recognize the limited level of retirement activity he has projected elsewhere in the depreciation study for 2008 and 2009 that would force the observed life table to move upward from what he relied upon and (5) Mr. Robinson failed to take into account the new inspection program and the Company's practice of chemically treating poles with preservatives in order to lengthen the life expectancy compared to prior periods. Therefore, the Commission should adopt my 35-year R3 life-curve combination as a conservative estimate of the life characteristics for this account. The Commission should further order the Company to fully investigate and substantiate whether the unusual historical retirement activity during the mid 20 year age intervals is representative of the future, and present its results in the next depreciation study.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation results in a $8,451,288 reduction to annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 368 – DISTRIBUTION LINE TRANSFORMERS?

A. The Company proposes a 27-year ASL with a corresponding R2 Iowa Survivor curve. This proposal represents a 1-year change from the Company's last depreciation study

and a modification from an R2.5 to a R2 Iowa Survivor curve. The existing ASL is a result of a settlement in the last case.

Q. WHAT IS THE COMPANY'S BASIS FOR ITS PROPOSAL?

A. From a narrative standpoint, the Company is again silent as to the basis for its proposal. The Company performed actuarial analyses and presented the full band results, 1957 through 2007. (See Exhibit No.___ (EMR-2) page 5-105). Therefore, the Company's basis can only be characterized as Mr. Robinson's interpretation of the full band actuarial analysis.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal reflects an ASL significantly shorter than any ASL Mr. Robinson has presented for investment in this account during the past 10 years. The shortest ASL Mr. Robinson has proposed during the past 10 years is 34 years, while the average of his proposal was 40 years. (See OPC's Fifth Interrogatories No. 192, Attachment). The obviously short ASL on its face should have caused Mr. Robinson to further investigate or explain in detail why such an artificially short life is reasonable for the Company. As previously noted, no such explanation or analysis has been provided. I recommend a 33-year ASL with a corresponding S0.5 Iowa Survivor curve.

Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION?

A. First, my recommendation corresponds to basically the shortest ASL Mr. Robinson has proposed for any other electric utility during the past 10 years and is still 7 years below the average ASL Mr. Robinson proposed during that period. The 33-year ASL

recommendation is 2 years less than what Mr. Robinson proposed for Progress Energy Carolina, a sister company.

Unlike Mr. Robinson, I investigated further into the base data in an effort to identify the underlying cause for such a short ASL indication. The underlying cause for such a short ASL indication can be identified on Exhibit No.__ (EMR-2) at page 5-105. There the values for age intervals 26.5 to 27.5 years and the following year drive the observed life table appreciably downward at a steep rate of decline. These particular data points appear to be the driving factor to which Mr. Robinson reacted in order to propose his artificially short ASL.

Q. DOES THE MAGNITUDE OF THE RETIREMENTS IN RELATIONSHIP TO THE EXPOSURES FOR THESE TWO AGE INTERVALS APPEAR REASONABLE?

A. No. For example, the average retirement ratio for the two years in question is 0.14232. The equivalent ratio for the prior two age intervals is only 0.05608. Thus, the retirement ratio during the unusual period is 2.5 times the average retirement ratio experienced during the two age intervals immediately prior to that period. Moreover, one age interval, 26.5 to 27.5 years of age, reflects a dollar level of retirements that is approximately two to three times the dollar level of retirement activity in the 2-year brackets preceding that particular age interval. This single unusual year of activity caused over a 15% drop in the observed life table.

Q. IS THIS PARTICULAR YEAR SIGNIFICANT?

A. Yes. Given the manner in which observed life tables are calculated, dollar retirement levels of such magnitude can have an artificial impact for a period of time. However, if the underlying events are more atypical than normal, the impact of such event over time will diminish. For example, in the Company's last depreciation study the same significant level of retirement activity that occurred during the 26.5 to 27.5 year age interval yielded a 0.19179 retirement ratio. (See Docket No. 050078-EI 2005 Depreciation Study at page 5-87). The impact of this single age interval declined by approximately 25% since the last depreciation study (0.19179 versus 0.14665). This decline since the last study is due to more dollars being exposed to retirements during the age interval. In the last case, the unusually high dollar level of retirement activity for the 26.5 to 27.5 age interval was associated with $50 million of exposures. In this case, because four more years of exposures have passed through this age interval, the level increased to $90 million. In other words, because the actual retirements during the last 4 years for this age interval increased only by 16%, yet the dollar level of exposures in the last 4 years increased by 80%, the resulting retirement ratio declined dramatically. The unusual activity that occurred during the 26.5 to 27.5 year age interval is not repeated as 4 additional years of history was experienced. The middle portion of the observed life table moves upward over time to reflect this reality. Mr. Robinson has failed to recognize the unusual nature of this portion of the observed life table and the dynamic upward movement in the shape of the observed life table over time as the impact of some prior unusual events diminishes.

Q. DO YOU EXPECT THE OBSERVED LIFE TABLE TO CONTINUE TO MOVE UPWARD BY THE TIME OF THE NEXT DEPRECIATION STUDY?

A. Yes. For example, the Company projected retirement activity for this account through 2009 of approximately $5 million, or $2.5 million per year. (See Exhibit No.__ (EMR-2), pages 2-44 and 2-51). The Company has not projected any retirement activity corresponding to the age intervals of concern. Assuming this pattern continues for the years 2010 and 2011, the dollar level of exposures corresponding to the 26.5 to 27.5 age interval can be estimated to increase to approximately $140 million. A $140 million level of exposures would correspond to an approximate 55% increase in exposures ($140/$90). If no additional retirements occur for this age interval during 2010 and 2011, the new retirement ratio would drop to approximately 0.0943, which represents another 35% reduction by the time of the next depreciation study. This new reduction in the retirement ratio would again have the affect of raising the middle portion of the survivor curve indicating a longer ASL than the 27-year level proposed by Mr. Robinson.

Q. HAVE YOU ANALYSED THE COMPANY PROPOSED OBSERVED LIFE TABLE?

A. Yes. Exhibit __ (JP-9) sets forth my comparative analysis. As can be seen, the Company's proposal versus my recommended 33S0.5 life-curve combination is approximately equal matches through the first 17 years of age. However, my recommendation is a better fit to the actual data from 22 through approximately 27 years of age. At that point, the observed life table is impacted by the major retirements that occurred during the 26.5 to 27.5 age interval as previously discussed. While subsequent to that age the Company's proposal is a better match than my recommendation, that is the portion of the curve that will change to the greatest extent by the next depreciation study. As previously noted we are already 2 years into

the 4 year period between depreciation studies. The Company's presentation for those 2 years, 2008 and 2009, does not continue the unusual retirement activity reflected in the 26.5 to 27.5 age interval. The survivor curve that I currently recommend will be a much better fit to the observed life table in the next proceeding as the impact of the unusual historical event is diminished due to more exposures.

Another consideration is the level of dollars exposed to retirement forces at each age interval. Mr. Robinson's efforts to match the observed life table at ages beginning at 28.5 years is misguided. The beginning level of exposures for this account is $636 million. (See Exhibit No.__ (EMR-2) page 5-105). The exposures at the 28.5 age bracket are $56 million, or only 9% of the original level. The exposure relationship falls swiftly at older ages and is only 5% of the original level by 31.5 years of age. The minimal levels of exposures should be given little weight in the matching process since they can change significantly from year to year. Therefore, from a knowledge based life-curve combination matching process, my recommendation is superior to the artificially short ASL proposal by Mr. Robinson.

Q. ARE THERE OTHER CONSIDERATIONS WHY A LONGER ASL IS WARRANTED AT THIS TIME?

A. Yes. Recall that depreciation is a projection of anticipated events in the future. Historical analyses are a starting point for future expectations. With this in mind, there is an additional fact that further supports increasing the ASL at this time. The Company notes that it has implemented an inspection program for pad mounted underground service transformers. (See Exhibit No._ (EMR-2) at page 4-62). Based on this inspection program the Company has become more proactive in maximizing

the life expectancy for its pad mounted underground service transformers. The inspection program will yield a longer life expectancy for the investment in the future. This program is significant since the majority of the investment in this account relates to underground service transformers. (See OPC's Second Interrogatories No.96, Attachment). This is precisely the type of consideration that a depreciation analyst should take into account when making recommendations. Mr. Robinson failed to account for such consideration, which helps explain why he is proposing an artificially short ASL for this account.

Q. PLEASE SUMMARIZE YOUR ADJUSTMENT?

A. A longer ASL is warranted for this account given (1) both Mr. Robinson and the industry sponsor longer service lives for investment in this account, (2) the Company has not explained why it significantly deviates from industry expectations, including those of its sister utility, (3) Mr. Robinson failed to investigate unusual historical retirement activity which significantly impacts the shape of the observed life table, (4) Mr. Robinson failed to recognize the limited level of retirement activity he has projected elsewhere in the depreciation study for 2008 and 2009 that would force the observed life table to move upward movement from what he relied upon, (5) Mr. Robinson failed to recognize the limited level of plant exposure at older ages where he attempted to match the observed life table while sacrificing better curve matches at ages with more meaningful levels of exposures, and (6) Mr. Robinson failed to take into account the new inspection program that will result in longer life expectancy compared to prior periods. Therefore, the Commission should adopt my 33-year S0.5 life-curve combination as a conservative estimate of the life characteristics for this account.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation results in a $5,525,908 reduction to annual depreciation expense based on plant as of December 31, 2009.

SECTION VI: MASS PROPERTY NET SALVAGE ANALYSES

A. General

Q. WHAT IS NET SALVAGE?

A. FERC's Uniform System of Accounts ("USOA") defines various salvage related terms as follows:

"Salvage value" means the amount received for property retired, less any expenses incurred in connection with the sale or in preparing the property for sale; or, if retained, the amount at which the material is recoverable is chargeable to Materials and Supplies, or other appropriate amount.

"Cost of removal" means the cost of demolishing, dismantling, tearing down or otherwise removing electric plant including the cost of transportation and handling incidental thereto.

One additional definition is required order to properly follow the USOA Electric Plant Instructions. That definition is for "Replacing" or "replacement," and is as follows:

> "Replacing" or "replacement," when not otherwise indicated in the context, means the *construction or installation* of electric plant in

place of property retired, *together with the removal of the property retired.*" (Emphasis added).

In other words, "net salvage" is simply the value received for the sale, reuse, or reimbursement of retired property (gross salvage), less the cost of retiring such property (cost of removal), whether the retirement reflects demolition of the item of plant or only the accounting transaction for retiring an item of property in place (abandonment). Limited or no costs of removal should occur with replacement activity. This situation conforms to USOA Electric Plant Instructions 10B(2). That instruction recognizes cost of removal being "appropriate" when not accompanied by replacement activity. However, the crediting of the plant account for the retirement shall occur, with or without replacement.

Q. CAN YOU ILLUSTRATE "NET SALVAGE" USING AN ACTUAL FPL EXAMPLE?

A. Yes. For Account 364, Distribution Poles and Fixtures, the Company has requested a negative 50% net salvage. This means PEF assumes that removing a pole will impose a net cost on the system that equals 50% of the original cost of buying and installing the pole. Given the plant balance of $506 million, the Company's proposed net salvage figure would result in approximately $253 million of depreciation expense over the life of the investment *above* the recovery of the original $506 million investment. (See Exhibit __ (EMR-2) page 2-13). The proposed annual depreciation rate for this account to recover all proposed amounts, both investment and net salvage, is 5.91%. (See Exhibit (EMR-2) page ~~2-27~~ 2-7). If one assumes the scrap value of the pole at retirement is exactly offset by the cost of removing it, in other words a zero level of net salvage, the annual depreciation rate falls to only

3.29%. The difference in rates that would be applied to the $506 million plant balance corresponding to the different net salvage assumption results in over $13 million of additional annual revenue requirements for this account alone.

Q. WHAT PERIOD HAS THE COMPANY CHOSEN TO ANALYZE TO DERIVE ITS NET SALVAGEVALUES?

A. The Company has analyzed a 32-year period, 1976 through 2007. (See Exhibit No.___(EMR-2) Section 8).

Q. HAVE *YOU* REVIEWED ALL OF THE INFORMATION PRESENTED BY THE COMPANY IN SUPPORT OF ITS NET SALVAGE REQUEST?

A. Yes. The information provided is inadequate to support or demonstrate the appropriateness of its request for an overall *negative 22%* net salvage for electric transmission, distribution and general property. (See Exhibit No. __ (EMR-2) pages 2-27, 30, 37 and 38). PEF's request includes $1.2 billion for negative net salvage related to electric mass property over the life of the investment. PEF's requested negative net salvage requires over $43 million of annual revenue requirements as compared to a zero (0) level of net salvage.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION CONCERNING PROPOSED NET SALVAGE VALUES FOR MASS PROPERTY.

A. PEF's proposed net salvage reflected in the 2007 Study is flawed and insufficiently substantiated. As a result, it proposes excessive levels of negative net salvage. I recommend a reduction to PEF's depreciation expense based on adjustments to its proposed net salvage level for 15 accounts as summarized on Exhibit__ (JP-10). The

standalone impact of my net salvage recommendations is a reduction of $29,041,861 in annual depreciation expense.

Q. WHY DO YOU BELIEVE PEF'S PROPOSED NET SALVAGE LEVELS ARE INAPPROPRIATE?

There are numerous problems with PEF's proposals. For example, (the following is not intended to be a comprehensive listing):

- Mr. Robinson relies on data that incorporates "catastrophic circumstances" related to hurricane events.
- Mr. Robinson calculates a forecasted future level of cost of removal that attempts to only recognize estimated future inflation.
- Mr. Robinson makes no meaningful effort to actually identify and understand what is reflected in PEF's historical retirement database from a net salvage standpoint.
- Mr. Robinson fails to investigate the reasonableness of unusually high levels of cost of removal in the historical database.
- Mr. Robinson fails to investigate or explain significant changes in net salvage values between the existing and proposed levels, including swings that exceed $200 million of net salvage (i.e., Account 364).
- Mr. Robinson fails to explain the underlying reasons for changes that cause revenue requirements to increase by more than $10 million annually for an individual account.

- The Company fails to comply with NARUC Interpretation No. 67 as it relates to reimbursed retirements.

- Mr. Robinson fails to adequately recognize, or recognize at all, the impact that economies of scale will have in the future.

In summary, when the Company's net salvage proposals seek over *$40 million of annual revenue requirements*, the Commission and customers are entitled to a *qualitative* presentation of the basis for net salvage proposals adequate to support the request. PEF has not met this standard with its study and in fact has reduced the narrative explanation for its proposals when compared to its prior study. I recommend that the Commission order the Company to develop and present --not just a depreciation study supported by substantial *quantities of paper* -- but a study that is substantiated by *meaningful levels of explanations and analyses* of what caused the retirements and related net salvage, and to determine whether such historical causes and relationships are indicative of future expectations. Mr. Robinson's approach of simply claiming that costs have increased can no longer be an acceptable basis for seeking such increases in annual revenue requirements. The concern I raise is the same concern that was raised at the Annual NARUC meeting this year. I submit that if it is reasonable for the Commission to have previously required substantial documentation and support for assumptions when reviewing forecasts for future resources and loads, then it should demand no less for projections of future net salvage when such net salvage requests seek over $1 billion from customers over the life of the assets. The Company's presentation in this case, even though backed by significant quantities of paper, does not meet the standard. It is important to

distinguish quantity from quality of information. Mr. Robinson completely failed to explain and substantiate his interpretation and blending of the results of an inappropriate "forecast" with his review of different portions of historical data that results in a proposal that falls outside the range of results is unacceptable (e.g., Account 369.1). (See Exhibit __ (EMR-2) page 4-64). Mr. Robinson's presentation does not constitute a reasonable and appropriate basis upon which to set such substantial levels of revenue requirements.

B. REIMBURSED RETIREMENTS

Q. WHAT ARE REIMBURSED RETIREMENTS?

A. I define reimbursed retirements as a situation in which a third party reimburses the Company for the retirement of plant.

Q. DOES MR. ROBINSON STATE THAT REIMBURSED RETIREMENTS ARE AN APPROPRIATE COMPONENT OF NET SALVAGE?

A. Yes.

Q. DOES MR. ROBINSON'S STATED POSITION COMPLY WITH GUIDELINES?

A. Yes. In NARUC Interpretation No. 67, NARUC has identified how such amounts are to be treated. In particular, for any amount received from a third party to be considered as a contribution in aid of construction, it must specifically be designated as such on a *contractual basis.*

Q. WHAT DOES NARUC INTERPRETATION NO. 67 SPECIFICALLY STATE?

A. NARUC Interpretation No. 67 states the following:

> The cost of plant retirements should be accounted for in accordance with the rules applicable thereto. The cost of new plant should include in the appropriate plant accounts at actual cost of construction. The reimbursement received shall be accounted for (a) by crediting operation and maintenance expenses to the extent of actual expenses occasioned by the pant changes and (b) crediting the remainder to the reserve for depreciation, unless contractual terms definitely characterize residual or specific amounts as applicable to the cost of replacement. In the latter event, appropriate credits should be entered in the plant accounts.

Q. IS THE COMPANY'S DATABASE RELIED UPON BY MR. ROBINSON CONSISTENT WITH NARUC'S INTERPERTATION?

A. No. As discussed later, the Company has inappropriately assigned a portion of amounts received from third parties as contributions in aid of construction.

C. ECONOMIES OF SCALE

Q. IS PEF'S HISTORICAL NET SALVAGE DATABASE REPRESENTATIVE OF WHAT CAN REASONABLY BE ANTICIPATED IN THE FUTURE?

A. No. The Company's historical database, as it applies to net salvage, reflects a situation in which relatively few retirement dollars have occurred compared to the

level of retirement activity that will occur in the future on an annual basis. In other words, in future years, as a greater level of the Company's investment approaches its ASL, a larger number of investments will retire on an annual basis. The greater level of annual retirements should result in a reduction to the per unit cost of removal as economies of scale are realized. Recognition of this concept belongs in the proper technique to be utilized in any depreciation analysis. By contrast, the Company's approach is more reflective of an analysis of historical data without proper evaluation of future expectations.

Q. ARE YOU AWARE OF ANY SOURCES WHICH CONCUR WITH YOUR CONCEPT OF ECONOMIES OF SCALE?

A. Yes. In its publication "*Public Utility Depreciation Practices*" NARUC indicates, among other things that while future cost of removal logically may be higher than past costs, this premise does not necessarily indicate that the percentage cost of removal will increase over time. Moreover, the publication acknowledges that as labor costs increase over time, so do the number of items to be removed, thus making it more economical in many cases to invest in special tools, which may actually result in an overall decrease in cost of removal per item removed. This rationale reflects the appropriate depreciation rates to be utilized in the future better. Moreover, the NARUC stated concept and my reference of the concept does not rely on a concept "similar to a production line" approach as Mr. Robinson incorrectly referenced in his rebuttal testimony at page 11 in the prior case.

D. ACCOUNT SPECIFIC

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 353.1 – TRANSMISSION STATION EQUIPMENT?

A. The Company proposes a zero level of net salvage for this account. The Company's specific basis is not presented. The Company only notes the results of its most recent 3-year rolling bands as well as the 5, 10, 15, 20 and full band historical analyses. (See Exhibit No.__ (EMR-2), page 4-36). The Company also identifies a forecasted net salvage value of a negative 42%.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal at best is unsubstantiated. Moreover, it appears that the Company's proposal reacts to a limited level of recent negative net salvage occurrences. (See Exhibit No._ (EMR-2), pages 8-71 through 8-74). Therefore, I recommend a *positive* 5% net salvage.

My recommended positive 5% net salvage is based on several factors. First, the Company's summary for this account is wrong when it identifies a zero level of net salvage for its 1975 through 2007 full depth band analysis. The Company sets forth the correct value later in its study as a positive 20%. (See Exhibit No._(EMR-2), pages 8-71 through 8-74). Next, it is important to note that the Company cannot identify the mix of investment in this account or the mix of retirements that are reflected in its historical retirement activity. (See OPC's Second Interrogatories No. 78 and 79). This situation is in contrast to what Mr. Robinson stated in completing his prior depreciation analyses that "consideration is given to the range and level of historic activity (gross salvage and cost of removal), *the content of the account*, and the likely and/or potential for generating gross salvage at the end of the property's useful life." (Emphasis added). (See Mr. Robinson's rebuttal testimony in Docket

No. 050078-EI at page 29). Taking Mr. Robinson at his word and the Company's responses to interrogatories, it is clear that he could not have taken into account the mix of investment within the account nor the mix of retirements.

Q. WHY IS THIS IMPORTANT?

A. This account normally reflects transformers as the largest single investment. However, the account normally contains substantial amounts for breakers, switches, foundations and other investment. If the historical retirement data in recent years reflects negative net salvage corresponding to retirements that excluded large transformers or reflected a disproportionately lower level of transformer investment, then the negative values provide false indications of the overall net salvage potential for this account. This was precisely the situation for FP&L, a utility that does identify the investment and retirement mix unlike PEF. (See Docket No. 050078-EI, Mr. Pous' direct testimony pages 148-151).

Q. DID THE COMPANY RECENTLY EXPERIENCE ITS LARGEST DOLLAR LEVEL OF RETIREMENT ACTIVITY?

A. Yes. In 2007 the Company reported approximately $11.7 million of retirement activity for this account. (See Exhibit No._(EMR-2), page 8-72). Normally when large retirement activity occurs, one anticipates that large transformers are reflected in such activity. The corresponding net salvage experienced by the Company yielded a positive 5% net salvage. In 2006, the year before the large positive net salvage corresponding to the large retirement activity, the Company retired only $2 million. In that year the Company experienced the largest negative net salvage percent in its entire database. This event, in part, appears to be the activity that the Company relied

upon to change from a positive 10% net salvage last approved by the Commission in a fully litigated proceeding to the Company's proposed zero level, which corresponds to its most recent settled proceeding.

Another consideration is the fact that transformers and other scrap material have increased in value during the last several years. For example, copper prices hit a peak of over $4 in the scrap metal market during 2008, or approximately 10 times the level experienced earlier in the 2000's. While the level of scrap metal prices has declined from the peak during 2008 it is anticipated that they will again increase as the economies of China and India eventually again ramp back up. The Company's depreciation analysis fails to take into account the trend in gross salvage values contrary to its actions relating to its fossil-fired dismantlement study also part of this case. (See Staff's 6th Interrogatories No. 12).

Q. DOES YOUR RECOMMENDATION ALSO CORRESPOND WITH MR. ROBINSON'S STATED GOAL OF GRADUALISM?

A. Yes. Mr. Robinson's reaction to the recent negative net salvage values, which represent a relatively small component of the overall database, is contrary to his stated principal of relying on gradualism. Mr. Robinson has previously stated that "it is prudent not to move all at once to the results indicated by the analysis." (See Mr. Robinson's rebuttal testimony in Docket no. 050078-EI at page 10). According to Mr. Robinson, if movement is to transpire, it should be done so in a step wise manner.

Mr. Robinson's failure to recognize the significant increase in scrap metal prices that have transpired since the early 2000's is contrary to his position that

recommendations should not be "based upon the Company's historical experience with no consideration of anticipated future costs incorporated into future net salvage estimates." (See Mr. Robinson's rebuttal Docket No. 050078-EI at page 14).

Q. DID THE COMPANY RECOMMEND A POSITIVE 10% NET SALVAGE IN ITS 2002 DEPRECIATION STUDY?

A. Yes. While Mr. Robinson has attempted to distance the Company from its own recommendation in its 2002 depreciation study by referencing what has been identified as "abnormal" net salvage, the fact is the Company did recognize and recommended results predicated on what was labeled as "abnormal" net salvage. (See Docket No. 050078-EI Mr. Robinson's rebuttal testimony at Exhibit No._(EMR-2)). In other words, while the Company employed the term "abnormal" for reuse and reimbursed retirements, it appropriately did recognize that such amounts represent real and ongoing gross salvage amounts.

Q. PLEASE SUMMARIZE THE BASIS FOR YOUR RECOMMENDATION?

A. The Company's failure to present adequate support for its position should not be allowed to default to the concept that the Commission should accept its proposal. The Company recognizes the importance of knowing what is in the account but fails to investigate the investment mix and retirement mix to see if the historical data is representative of current expectations. Review of the historical data does indicate that when the largest level of retirement activity occurs a positive net salvage can normally be expected. In addition, the Company's historical database is predicated on low levels of scrap metal prices, which understates the realistic level of gross salvage that can and will be experienced in the future. Mr. Robinson has over reacted to recent negative net salvage occurrences that correspond to hurricane time frames.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a $647,102 reduction to the Company's request based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 355 – TRANSMISSION, POLES AND FIXTURES?

A. The Company proposes a negative 50% net salvage. The proposed value represents a doubling of the existing negative 25% net salvage that was a result of a settlement in the last case. It also represents a 67% increase from the Company's negative 30% established in the Company's last litigated rate proceeding. (See Docket No. 050078-EI, Exhibit No._ (EMR-2)).

Neither the Company's written narrative in its depreciation study nor in Mr. Robinson's testimony sheds light on the Company's significant movement towards a more a negative value. The only information provided that represents any basis for the Company's significant movement is the actual negative net salvage recorded during the last several years. (See Exhibit No._ (EMR-2) at pages 8-82 through 8-85).

Q. DOES THE COMPANY'S PROPOSAL IN THIS CASE VIOLATE MR. ROBINSON'S PREVIOUSLY STATED CONCEPT OF GRADUALISM?

A. Yes. The Company's presentation in this proceeding is a significant movement both from the existing level of negative net salvage as well as the last Commission approved level set in a fully litigated proceeding.

Q. WHAT DO YOU RECOMMEND?

A. I recommend a negative 25% net salvage. The recommendation does not react to the unexplained 5 to 10 fold increase in cost of removal experienced by the Company during the last several years. This is significant given the hurricane related activity associated with this time frame. The Company admits that its replacement activity for this account occurred "under catastrophic circumstances." (See Staff's 15th Interrogatories No. 169). Modifying future net salvage parameters based on "catastrophic circumstances" is inappropriate and should be denied. Moreover, only one year out of the past 4 years since the Company's last depreciation study reflects any level of gross salvage. (See Exhibit No.__ (EMR-2) at page 8-83). This contrasts significantly with the average 36% gross salvage associated with the Company's entire historical database. Thus, the combination of dramatic increases in cost of removal, elimination of gross salvage and Mr. Robinson's stated policy of gradualism would all contradict the Company's movement to a *negative 50% net* salvage.

Another consideration is the fact that the Company is replacing wood poles with steel poles. (See Exhibit (EMR-2) at page 4-42). Consideration of future expectations rather than reliance on history would indicate that scrap value for steel poles will be recognized in the future contrary to what the Company has experienced since the last depreciation study. In summary, the Company has not substantiated any valid basis upon which to base its substantial change in net salvage absent reaction to catastrophic occurrences during the past several years. The Commission should order the Company to investigate and substantiate the dramatic change in cost of removal

and gross salvage values since the last depreciation study and present such findings in the Company's next depreciation study.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a $3,612,647 reduction to annual depreciation and expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 356 – TRANSMISSION OVERHEAD CONDUCTORS AND DEVICES?

A. The Company proposes a negative 30% net salvage. This value is equivalent to the existing rate as adopted in the Company's last proceeding, which reflected a settlement, but is more negative than the negative 20% approved by the Commission in the Company's last fully litigated case.

Unlike the Company's last depreciation study, the Company provides no explanative narrative in support of its proposal. It appears the Company's proposal is predicated on some combination of the full depth analysis of historical data, which yields a negative 10%, and the very high negative net salvage values experienced during recent years that incorporates the impact of hurricanes. (See Exhibit No.__ (EMR-2) at page 4-44).

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is excessively negative and not justified. I recommend a negative 10% net salvage.

The negative 10% net salvage recognizes that prior to the impact of the recent hurricanes the Company had almost exclusively experienced positive net salvage for

this account. (See Exhibit No.__ (EMR-2) at page 8-86 and 8-87). The Company appears to be overreacting to the excessive level of negative net salvage incurred in association with various projects that are heavily weighted to hurricane activity. The 3-year rolling bands relied upon by the Company that encompass the 2004 through 2007 hurricane related time frames range from a negative 63% to a high of a negative 209%. In contrast the comparable four 3-year rolling bands immediately prior to the 2004 hurricane period yield a range from a low of a positive 9% to a positive 127%. Therefore, the Company's proposal is not supported by what can reasonably be expected absent significant hurricane activity.

Q. IS THERE ANOTHER PROBLEM WITH THE COMPANY'S PROPOSAL?

A. Yes. The Company was requested to provide information regarding retirement activity for this account, including copies of work orders relating to more than 1 linear mile of overhead conductor billing retired during the past 10 years. (See OPC's 2nd Interrogatories No. 92). A review of the limited number of work orders provided clearly establishes that the Company's database reflected in its depreciation study is erroneous. For example, in 2005 the Company provided 5 separate work orders that produced a total level of gross salvage of approximately $250,000. Yet, the Company's reported value in its deprecation study is zero. Further, even if one were to assume that the work order may actually encompass other accounts such as Account 354 or 355, a review of the gross salvage for 2005 for those accounts also indicates a zero level of gross salvage. This concept of zero level of gross salvage when significant levels of retirement activity have occurred is inconsistent with the Company's previously stated history. It is only during the hurricane related time frame that the Company for the first time begins to report zero levels of gross salvage

compared to all prior years where the Company reported substantial levels of gross salvage.

The Company's depreciation related net salvage database relied upon by Mr. Robinson differs from actual work order reported values. Therefore, it appears Mr. Robinson has relied on data which has overstated the level of negative net salvage appropriate for this account.

Q. IS THERE ANOTHER CONCERN REGARDING THE COMPANY'S PROPOSAL?

A. Yes. Review of work orders corresponding to instances where the Company retired more than the one linear mile of transmission lines sets forth projects where the Company received reimbursement for the retirement activity. When that situation occurred the Company reported a zero level for gross salvage and over $50,000 for cost of removal, yet assigned the entire reimbursement as a contribution in aide of construction. This particular accounting is inappropriate and in conflict with NARUC Interpretation No. 67 as previously discussed. This situation further calls into question the underlying negative net salvage reflected in the Company's historical data, which Mr. Robinson relied for his proposal.

Given the questionable accounting employed by the Company and relied upon by Mr. Robinson, I recommend that the Commission order the Company to further analyze its historical data and correct such situations so as to properly report gross salvage and present such data in a fully documented and explained manner in the Company's next depreciation study. Until that time, the Commission should deny the Company's

request and adopt my recommendation which reflects a blending of both the overall historical data as well as partial recognition of the negative net salvage activity that has occurred during the hurricane time frame.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a $1,555,815 reduction to annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 358 – TRANSMISSION UNDERGROUND CONDUCTORS AND DEVICES?

A. The Company proposes a negative 3% net salvage. This proposal represents a change from the zero level of net salvage last approved by the Commission in a fully litigated case for the Company, but is equivalent to the net salvage adopted in the settlement in the Company's last rate proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal lacks support and is excessively negative. Therefore, I recommend a zero level of net salvage equivalent to what the Commission adopted in the Company's last fully litigated rate proceeding.

Given that the Company failed to provide any narrative explanation for its proposal, and that the proposal is equivalent to the same proposal made by the Company in its last depreciation study, a review of the last case provides insight into the Company's reasoning. In the last depreciation study the Company stated that its forecasted level of net salvage "is not anticipated for all the current property investments,

nevertheless, some modest amount of negative net salvage *is anticipated* in conjunction with future retirements. *Based upon the limited size of the amount of the property* in the account, net salvage is estimated at negative three (3) percent." (Emphasis added). (See Docket No.050078-EI 2005 Depreciation Study at page 4-32). The only basis Company can establish for its proposal is that it is "anticipated", as well as reference to the limited size of the amount of the property. Neither of these generalized statements rise to the level of a credible basis for the Company's proposal.

The actual history for this account indicates retirements in only 4 years over the past 31 years. (See Exhibit No. __ (EMR-2) page 8-94 and 8-95). While the overall net salvage for this account is a negative 0.27%, the overall retirement activity is less than one half of one percent of the existing balance over the entire 31-year period. Therefore, from a materiality, frequency, or pattern standpoint set forth in historical data, there is no basis for the Company's proposed expectations or anticipation. A zero level of net salvage is the only appropriate value based on available information.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a $287,862 reduction to annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 362 – DISTRIBUTION STATION EQUIPMENT?

A. The Company proposes a negative 15% net salvage, this represents a significant change from the Company last fully litigated case where a *positive* 15% level was

adopted. A negative 15% does correspond to the level adopted in the Company's last rate case, which was based on a settlement.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is excessively negative and unsubstantiated. I recommend a zero net salvage be adopted.

Given the Company's failure to provide any narrative basis for its proposal in its current depreciation study, a review of the Company's prior depreciation study provides limited yet some information. In the last depreciation study where the Company proposes the same negative 15% net salvage, Mr. Robinson stated that:

> "the Company's experienced net salvage has historically averaged approximated twenty-five (25) percent. However, the historically experienced net salvage has principally occurred as a result of the relocation and reuse of existing transformers and is not generally the product of final salvage generated from the disposal of property at the final end of life. Furthermore, positive net salvage has been declining during recent years and has turned negative. The forecast of the historical net salvage experience indicates future net salvage of negative thirty (30) percent. Giving consideration to the recent experience and anticipated higher future cost of removal, future net salvage is estimated at negative fifteen (15) percent." (Emphasis added). (See Docket No. 050078-EI 2005 Depreciation Study at pages 4-35 and 4-36).

(See Docket No. 050078-EI 2005 Depreciation Study at pages 4-35 and 4-36). The Company's statement that its historical activity is principally a result of relocation and reuse of existing transformers is questionable given the Company's inability to

provide the categorization of investment or retirement activity when requested to do so. (See OPC's 2nd Interrogatories Nos. 78 and 79). Next, the Company's reliance on its "forecast" of net salvage provides no support or evidence as even Mr. Robinson makes it a practice to heavily discount or ignore his own forecast given the excessively high negative net salvage levels that are normally produced. Finally, the Company's "anticipated higher future cost of removal" also is without support or basis. Thus, the Company's significant swing from a positive 15% to a negative 15% in the last proceeding and its attempt to continue such position into this case are unsupported.

The net salvage experienced by the Company since the last depreciation study also calls into question its current proposal. While the retirement activity from 2004 to 2007 produced a negative net salvage, it reflects retirements that were "significantly impacted by a group of devastating hurricanes." (See Staff's 15th Interrogatories No. 175). A review of the historical data demonstrates a dramatic shift from prior history to the period encompassed by hurricane activity. To base a negative net salvage proposal on unusual activity which reflects higher costs of removal than would be anticipated during more normal operation should not be relied upon for establishing long term net salvage expectations.

Another consideration is the higher scrap metal prices that currently exist and can reasonably be anticipated to increase as the economies of China and India again gain momentum. This is significant since transformers normally comprise a significant component of the investment in this account. Transformers also contain significant quantities of copper. Copper prices had previously increased by a factor of approximately 10 prior to the recent world wide economic downturn. However,

current copper prices are still over 5 times the level they were in the late 90s and early 2000s.

Another consideration is the fact that the Company has proposed a zero level of net salvage for transmission station equipment. This represents a significant difference from the Company's negative 15% proposed for this account. Moreover, as previously noted I recommend a positive 5% for transmission station equipment. Therefore, a zero level of net salvage for this account at this time is a reasonable and realistic level to be utilized for ratemaking purposes. The zero value I recommend is still conservative in favor of the Company given the historical data, includes the events during the hurricane period I recommend yields an overall positive 10% net salvage overall.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a standalone impact of $1,521,831 reduction to annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 364 – DISTRIBUTION POLES, TOWERS AND FIXTURES?

A. The Company proposes a negative 50% net salvage. This level represents a 100% increase in the level of negative net salvage previously approved by the Commission in the Company's last fully litigated proceeding. It also represents a 43% increase from the negative 35% value adopted as part of the settlement in the last proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is still excessively negative, just as it was in the Company's last proceeding. In the Company's last proceeding Mr. Robinson proposed a negative 90% for this account. (See Mr. Robinson's rebuttal testimony in Docket No. 050078-EI, Exhibit No. (EMR-2)). While Mr. Robinson now recognizes his proposal in the last proceeding for a negative 90% net salvage was extremely unreasonable, his proposal for a negative 50% in this proceeding is still excessively negative and unreasonable.

I recommend a negative 35% net salvage as a reasonable yet still conservative value in favor of the Company. While the Company relied on values that it admitted in the last proceeding were "bogus" (See Mr. Robinson's deposition in Docket No. 050078-EI at page 141), Mr. Robinson again attempts to rely on data that the Company admits occurred "under catastrophic circumstances". (See Staff's 15th Interrogatories No. 177). In fact, even during the catastrophic circumstances that occurred in association with hurricanes subsequent to the last depreciation study, the level of negative net salvage was less negative than the negative 50% Mr. Robinson proposes this proceeding. In other words, even in association with catastrophic events, the Company did not sustain an overall level of a negative 50% net salvage for the investment in this account.

My recommendation for a negative 35% net salvage still provides the Company with over $11 million of annual negative net salvage for this account based on plant as of December 31, 2009. This amount is over 12.5 times the level the Company experienced on average during the past 10 years, including the "bogus" value Mr. Robinson admits to. Moreover, the negative 35% provides the Company with 3.7

times the highest level it has ever experienced, the value Mr. Robinson identified as being "bogus." Therefore, my recommendation is very conservative while providing additional time to determine how net salvage levels settle once the impacts of catastrophic circumstances associated with hurricane activity subside.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation results in a $4,774,199 reduction to annual depreciation expense based on plant in service of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 365 – DISTRIBUTION OVERHEAD CONDUCTORS AND DEVICES?

A. The Company proposes a negative 45% net salvage. This proposal is approximately 30% more negative than the negative 35% last approved by the Commission in a fully litigated case, and is 3 times the existing level of net salvage as established in the last case, which was settled.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is excessively negative and unsupported. Therefore, I recommend a negative 20% net salvage.

My recommendation reflects historical experience of the Company with less weight placed on the more recent activities since the last case. Placing less weight on recent events is due in part to the Company's admission that it failed to report gross salvage for the years 2003 through 2006. Another consideration is the Company's admission that cost of removal increased since the Company's last depreciation study "due to the affect of the 2004/2005 hurricanes." (See Staff's 15th Interrogatories No. 179).

Thus, the Company's proposal, which results in a significantly more negative level of net salvage for this account, appears to be in reaction to hurricane related activity. Reactions to hurricane related activity artificially skews the results from what can reasonably anticipated for the investment in the future. In addition, my recommendation of a negative 20% net salvage is more in line with Mr. Robinson's previously stated basis for his proposal in the last depreciation study. There Mr. Robinson stated his proposal was in part "based upon the Company's overall experience." (See Docket No. 050078-EI 2005 Depreciation Study at page 4-38). Had Mr. Robinson been consistent between studies he would have recognized a negative 20% net salvage for the overall level of this account. (See Exhibit No.__ (EMR-2) at page 8-117).

My recommendation is also conservative given that there are still substantial quantities of copper wire in the system, and the price of copper can reasonably be expected to increase as the economies of the world return to higher growth rates than reflected in the current economic situation. (See OPC's 2nd Interrogatories No. 94, Attachment). In addition, my recommendation still provides the Company with $5.1 million of annual negative net salvage. This level of negative net salvage is almost 9 times the average level experienced historically and higher than every year in the Company's database with the exception of 2005, which reflects hurricane related activity. Thus, the Company is more than adequately protected until its next depreciation study where it can demonstrate, absent hurricane related activities, what a more realistic level of net salvage for this account might be.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation on a standalone basis results in a $5,100,267 reduction to annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 366 – DISTRIBUTION UNDERGROUND CONDUIT?

A. The Company proposes a negative 10% net salvage. This compares to the zero level of negative net salvage that it proposed in the last case as well as the zero level approved by the Commission in the Company's last fully litigated proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is again excessively negative and not indicative of the underlying facts. Therefore, I recommend a zero level of net salvage for this account.

My recommendation takes into account several factors. First, it is common practice in the industry to abandon in place investment in this account whenever possible. Plant abandoned in place normally does not incur any appreciable level of negative net salvage. Another consideration is that if plant is removed rather than abandoned, normally some level of gross salvage should be experienced. However, just as was the situation for Account 365, the Company reported a zero level of gross salvage for the years 2004 through 2006 representing the only years in the Company's entire 33-year database with zero salvage values. (See Exhibit No._ (EMR-2) at pages 8-118 and 8-119). Another consideration is the excessive level of cost of removal the Company experienced during the recent hurricanes.

It is also significant that the Company itself proposed a zero level of net salvage for this account in its last depreciation study. In fact, while Mr. Robinson failed to

provide any narrative supporting his proposal in this proceeding, in the last proceeding he stated that "little or no salvage is expected to be achieved in conjunction with future retirements. Based upon the experience and future expectations, future net salvage is estimated at zero (0) percentage." (See Docket No. 050078-EI 2005 Depreciation Study at page 4-39). Thus, without any explanation, Mr. Robinson proposes a significant movement in net salvage for this account based on impacts of hurricane related activity. There is no support for Mr. Robinson's unsubstantiated position.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of relying on a zero level of net salvage for this account reduces annual depreciation expense by $375,423 based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 367 – DISTRIBUTION UNDERGROUND CONDUCTORS AND DEVICES?

A. The Company proposes a negative 10% net salvage. This proposed value compares to the zero level of net salvage found appropriate by the Commission in the Company's last fully litigated case, and the existing negative 5% net salvage adopted by settlement in the Company's last rate proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. Again, the Company failed to present any narrative basis for its proposed level of negative net salvage. The Company apparently believes sole reliance on unidentified portions of the historical data or reference to a "forecasted" value that Mr. Robinson

heavily discounted, if not totally ignored, is adequate support for its proposal. I recommend a negative 5% net salvage.

In the last proceeding, Mr. Robinson did provide a limited narrative identifying that his then proposed negative 15% net salvage was "based upon the Company's experience and expectations." (See Docket No. 050078-EI 2005 Depreciation Study at page 4-40). One can only assume that in this case Mr. Robinson again relied on historic experience and a changing expectation of the future. In any instance, the Company's negative 10% net salvage is still too negative.

The Company's recent experience subsequent to its last depreciation study encompasses the significant impact associated with hurricane activity. In fact, absent the resulting excessive levels of negative net salvage associated with calendar years 2004 and 2005 the Company would actually be in a *positive* historical net salvage position. (See Exhibit No. (EMR-2) at page 8-123). Thus, from the standpoint of the Company's normalized experience, a positive net salvage might be warranted. Another consideration is the fact that the Company admits that it has a "policy to retire the investment in this account in place when possible." (See OPC's 2nd Interrogatories No. 95). Thus, while the Company obviously does not retire all of its investment in this account in a manner where such investment is abandoned in place, one can expect a significant component of the retirement activity to be retired without being removed. Moreover, in instances where the Company actually removes conductor, such conductor should have a gross salvage associated with it. In summary, the Company has not justified movement to a more negative net salvage then a negative 5%. Moreover, a negative 5% may also be excessively negative.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation results in a $1,052,091 annual reduction in depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 368 – DISTRIBUTION LINE TRANSFORMERS?

A. The Company proposes a negative 15% net salvage. This represents a level equal to what the Commission last approved to the Company's most recently fully litigated case, but is more negative than the existing negative 5% adopted by settlement in the Company's last proceeding. Further, the negative 15% proposal is more negative than Mr. Robinson's proposed negative 10% in the Company's last proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is again unsubstantiated and excessively negative. I recommend a negative 5% net salvage for this account.

The historical data relied upon by the Company since the last depreciation study contains excessively negative aspects associated with hurricane activities. (See Staff's 15th Interrogatories No. 181). In addition, the Company admits to reassessing its salvage potential and reported a true-up of increased gross salvage in 2007 offsetting zero values in 2004 and 2005, as well as possibly understating 2006. The historic understatement of salvage during 2004 through potentially 2006 appears to be part of the cause of the Company's decision to propose a more negative net salvage. Alternatively, a consideration that the Company apparently did not take into account is the fact that during 2005 and 2006 it retired a significantly higher percentage of

pole mounted transformers rather than pad mounted transformers. This relationship is opposite the dollar level of investment for this account where pad mounted transformers represent 56% of the investment. (See OPC's 2nd Interrogatories No. 96, Attachment).

Another consideration demonstrating why the Company's proposal is excessive is the fact that excluding the hurricane related activity the Company did not report a single annual occurrence as negative as it proposes in this case during the past 10 years. (See Exhibit No. (EMR-2) at pages 8-126 and 8-127). During this period the Company reported positive values in three years and reported values less negative than the negative 5% that I am recommending in six of those years. Thus, when Mr. Robinson states that a "negative five (5) percent to negative fifteen (15) percent identified through an analysis of the Company's historical experience and future expectations" is the basis for his net salvage proposal, (See Mr. Robinson's direct testimony at page 25) it becomes clear that his proposal is based on an inappropriate encompassing of hurricane related activity as a normal ongoing expectation. Excluding hurricane related activity, my recommended negative 5% net salvage is a conservative value at this time.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation results in an annual $3,026,237 reduction to depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 369.1 – DISTRIBUTION SERVICES – OVERHEAD?

A. The Company proposes a negative 50% net salvage. This compares to the same level of net salvage approved by the Commission in the Company's last fully litigated case and is the level adopted by settlement in the last proceeding. However, the proposed value is noticeably less negative than the negative 75% Mr. Robinson proposed in the last case.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is unsupported and excessively negative. I recommend a normal reduction to a negative 40% net salvage.

In the last case, Mr. Robinson had no problem with claiming that "based upon the Company's experience and expectations and anticipated level of increased retirement activity at progressively higher retirement cost, future net salvage is estimated at negative seventy-five (75) percent." (See Docket No. 050078-EI 2005 Depreciation Study at page 4-42). Now, Mr. Robinson recognizes that his previously proposed negative 75% net salvage was severely excessive. However, he still fails to recognize the updated data, including the impact of hurricane related activity, yields a positive level of net salvage. In fact, reliance on data during the last 5 to 10 years would indicate a positive net salvage to no more than a negative 5% to 10% net salvage would be warranted. However, in recognition of the concept of gradualism I am only recommending a change to a negative 40% net salvage for this account. It is further worth noting that even if the gross salvage reported in 2004 were totally eliminated, the negative net salvage during the past 10 years would still not exceed a negative 10%. Therefore, I recommend a minimum 10 percentage point reduction to the Company's proposal, which results in a negative 40% net salvage for this account.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation on a standalone basis results in a $516,263 reduction in annual depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 369.2 – DISTRIBUTION SERVICES – UNDERGROUND?

A. The Company proposes a negative 15% net salvage. This value compares to the value approved by the Commission in the Company's last fully litigated case, but is significantly more negative than the zero level reflected in the Company's most recent case, which was settled. The value is also less negative than the negative 25% Mr. Robinson proposed in the Company's last rate proceeding.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal again appears to react to a major cost of removal reported during 2005 corresponding to hurricane related activity. Based on my review of the information I recommend a zero level of net salvage for this account.

Since Mr. Robinson failed to provide any narrative explanation for his proposal, a review of the narrative he did provide in the last depreciation study provides insight to his approach. In the last study, Mr. Robinson stated that "the Company has routinely experienced negative net salvage in conjunction with Underground Service retirements. The three year rolling band analysis shows net salvage has varied between a positive and negative salvage and averaged approximately four (4) percent. Future net salvage is forecasted to [be] in excess of negative thirty (30) percent. Based upon the Company's experience and expectations and anticipated level of

increase of retirement activity at progressively higher retirement costs, future net salvage is estimated at negative twenty-five (25) percent." (See Docket No. 050078-EI 2005 Depreciation Study at page 4-43). In other words, the Company reviewed historical averages, specifically recent rolling bands, performed its "forecast" analysis of inflating values into the future, and then made a proposal based on historical experience, its expectation and anticipation of higher levels of negative net salvage. Assuming that Mr. Robinson was consistent between his last study and this study, one can identify that the "forecasted" future net salvage is still approximately negative 30%. Therefore, that portion of the two different analyses is basically identical. That leaves actual Company experiences apparently as the driving factor. The four years in between studies, even after the inclusion of hurricane related activity, yields only a negative 11.5% level of net salvage. This would explain why Mr. Robinson elected to propose a negative 15% in this proceeding rather than the negative 25% he proposed in the last study, but leaves the undefined and unsubstantiated "anticipation and expectation" of the future still as a basis for Mr. Robinson's artificial increase in negative net salvage.

Mr. Robinson apparently again failed to recognize the unusual and negative aspect of hurricane related activity. Had Mr. Robinson eliminated both the retirement and the significant level of negative net salvage that occurred in 2005 associated with hurricane activity, the overall results for over the last 10 years would generally be between zero and a negative 4%, with trends towards zero. Mr. Robinson's failure to compensate in any manner for the unusual storm related activity during the last several years is incorrect and unacceptable.

In addition, even Mr. Robinson recognizes that "much, if not most of underground services will be abandoned in place." (See Docket No. 050078-EI, Mr. Robinson's rebuttal testimony at page 46). While some level of cost of removal may be incurred in association with abandonment, there may also be gross salvage in instances where third party reimbursements occur or scrap metal maybe salvaged when services are in fact removed. Given these facts, a negative 15% net salvage does not rise to an acceptable level of reasonableness. As can clearly be seen by a review of the Company's historical data during the past 10 years, with the exclusion of the single hurricane event in 2005, a zero level net salvage is reasonable and appropriate at this time.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation results in a $1,692,112 reduction in depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 370 – DISTRIBUTION METERS?

A. The Company proposes a negative 10% net salvage. This compares to the same level approved by the Commission in the Company's last fully litigated case, but represents a slight change from the negative 8% reflected in the Company's last rate proceeding, which was based on a settlement.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal to move from a negative 8% to a negative 10% is inappropriate given the Company's actual information and other industry information. Therefore, I recommend a negative 6% net salvage.

The Company retired $82 million of investment in this account during 2006. The resulting net salvage was a negative 6%. In addition, Oncor Delivery Company, the largest utility in Texas just went through a similar significant concentrated change out of meters and testified that a $5.63 cost of removal per meters was reasonable. While I recognize that labor rates between Florida and Texas may be different, relying on a $5.63 per cost of removal for retiring meters would also yield an approximate negative 6%, based on the Company's number of meters. (See Staff's 4th Interrogatories No. 71). Therefore, a negative 6% net salvage would appear to be a reasonable and appropriate value at this time.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation on a standalone basis results in a $359,623 reduction to depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 373 – DISTRIBUTION STREET LIGHTING AND SIGNALS?

A. The Company proposes a negative 20% net salvage. This compares to the negative 10% net salvage last approved by the Commission in a litigated case and the existing zero level which was established by means of settlement in the Company's last proceeding. The Company again provides no narrative basis for its position.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is excessively negative. Had Mr. Robinson remained consistent with his statements in the last case where his proposal was "based on the trend of recent experience and future expectations" (See Docket No. 050078-EI 2005 Depreciation Study at page 4-46), he would have proposed a zero to negative 5% net salvage in this case, exclusive of the impact of the hurricane event during 2005. In fact, the most recent data indicates a positive 3% net salvage. (See Exhibit No.__(EMR-2) at page 8-147).

Street lighting investment poses a somewhat different situation from many other accounts. The Company can go years without selling a street lighting system and then incur a significant positive salvage associated with a sale. To assume that the Company will not sell any street lighting systems in the future has not been established as reasonable and would be contrary to historical activity. Such an assumption also fails to recognize that the overall net salvage for this account is a positive 8%. However, in order to remain conservative, I am recommending a negative 5% net salvage based on historical data exclusive of the hurricane related activity recorded during 2005. The negative 5% is both reasonable and appropriate, but does not give adequate weight to the potential of selling future street lighting systems. Therefore, my recommendation is conservative in favor of the Company.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. The standalone impact of my recommendation is a $3,520,001 reduction to depreciation expense based on plant as of December 31, 2009.

Q. WHAT DOES THE COMPANY PROPOSE FOR ACCOUNT 390 – GENERAL STRUCTURES AND IMPROVEMENTS?

A. The Company proposes a negative 5% net salvage. This compares to the zero level established in the Company's last rate proceeding which was based on a settlement.

Q. DO YOU AGREE WITH THE COMPANY'S PROPOSAL?

A. No. The Company's proposal is unrealistic and inappropriate. Buildings can be anticipated to appreciate rather than depreciate in value over the useful life proposed by the Company. Therefore, as a first step in the proper recognition of future positive salvage for the Company's investment I am recommending a positive 15% net salvage.

Mr. Robinson yet again remains silent on the basis for his proposal in this case. In the prior case Mr. Robinson recognized that there was a 6% overall positive level of net salvage, but that he "anticipated" an increase in cost of removal as interim retirements occurred due to renovations at the Company's various properties and estimated a zero level of net salvage overall. (See Docket No. 050078-EI 2005 Depreciation Study at page 4-47 and 4-48). This is yet another account where review of historic data may not be adequate given the nature of the investment in the account.

In particular, approximately 20% of investment in the account is associated with the Company's ten largest general plant structures and improvements. (See OPC's 2nd Interrogatories No. 80). The Company has recently expended over $20 million for block and concrete or metal buildings to house various distribution operation centers, garages etc. Moreover, the Company has proposed only a 24-year ASL for the

investment in this account. (See Exhibit No.__(EMR-2), page 4-72). It is unreasonable and unrealistic to believe that block and concrete buildings, or metal buildings, after only 24 years or even 30 years would require demolition and the removal rather than a sale or reuse. As a standard practice throughout the United States, commercial buildings are expected to increase in value not decline in value over time. A building can obviously sell for more than 100% net salvage after extended periods of time. Failure to properly recognize the type of investment at issue and its significant potential for positive net salvage results in the Company's proposal being inaccurate and inappropriate. Some form of positive salvage is appropriate. Therefore, as a first step in the right direction I recommend the Commission adopt a positive 15% net salvage for this account.

Q. WHAT IS THE IMPACT OF YOUR RECOMMENDATION?

A. My recommendation on a standalone basis would result in a $1,218,203 reduction to depreciation expense based on plant in service as of December 31, 2009.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes; however, to the extent I have not addressed a method, value, issue, etc., it should not be assumed that I am accepting or endorsing that method, value, or issue.

BY MR. REHWINKEL:

Q. Mr. Pous, do you have a summary of your prefiled direct testimony prepared?

A. Yes.

Q. And mindful of the five-minute limitation by the Commission, can you give that summary to the Commission now?

A. Yes.

Depreciation is a very large dollar issue in this case. PEF's aggressive depreciation practices and proposals are the direct cause of its excessive request. PEF's aggressive depreciation proposals reflect unusual short estimates of service lives for certain accounts and certainly low projections of net salvage that are often skewed by recent hurricane impacts. Collecting the cost of plant over too short a period of time and underestimating the net salvage value has the effect of increasing annual depreciation expense above the appropriate amount.

In my testimony and exhibits I identify PEF's inappropriate service lives and net salvage parameters, explain with specificity why they are inappropriate, and then develop and support my recommended alternatives in detail on an account-by-account basis.

My recommendations and presentations are

superior to that of the company, as it failed to provide the actual substantiating factors in its study as required by the Commission rules. While my resulting total adjustments are large, they are the result of a detailed approach that examines and adjusts numerous individual accounts.

My adjustments to PEF's overly aggressive depreciation parameters has two effects. First, they reduce the amount of annual depreciation expense by 113 million, thereby reducing test year expenses and reducing PEF's claimed revenue deficiency. Second, a periodic depreciation study is also used to compare the amounts of depreciation that would have been collected using the updated depreciation parameters, theoretical reserve, with what was actually collected, the book reserve.

The existence of a reserve and balance, either positive or negative, indicates that past customers have paid either too much or too little. Once the surplus or deficiency in the reserve is identified, a decision can be made as to whether to simply roll the difference into the amount to be collected over the remaining life of the plant or whether the discrepancy is so material and the inequity so great that another option of eliminating the surplus of reserve should be adopted.

In the area of reserve and balance, the company admits to a $646 million excess. Moreover, the level of the excess reserve has increased since the last case and will continue to increase if PEF's proposals are adopted. Based on more appropriate life and salvage parameters than those developed in the company's depreciation study, I calculate the company's reserve excess to be $858 million.

Under either calculation of excess reserve, the surplus level is massive and imposes an unreasonable and unacceptable level of intergenerational inequity on current customers who have paid far more for their use of the plant to date than was either appropriate or equitable. The magnitude of the imbalance calls for a departure from the company's proposed remaining life approach to curing imbalances.

A reserve surplus is as inequitable as a reserve deficiency. I contend that equity requires that the approach to rectifying material imbalances, positive or negative, to be symmetrical. I recognize that it's not possible to rectify PEF's 858 million surplus overnight. I recommend that 646 million of the 858 million surplus be amortized back to customers over four years. The result is an annual amortization in the amount of $161 million.

OPC witness Dan Lawton has examined the impact of this proposal on PEF's financial conditions. He will testify that PEF can accomplish the four-year amortization that I recommend and continue to possess strong financial integrity.

In summary, my adjustments to PEF's depreciation parameters would reduce annual depreciation expense by 113 million. Adopting my proposal to amortize 646 million over four years would lower depreciation expense by an additional 161 million per year. When combined, my proposal to amortize a portion of PEF's reserve surplus over four years and to reduce its proposed depreciation rates would be to reduce its expense by approximately $275 million prior to the impact of special riders.

I have every expectation that even after my adjustments PEF will still be in an excess reserve position when it performs its next depreciation study.

MR. REHWINKEL: Mr. Pous is tendered for cross-examination.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel.

Ms. Bradley.

CROSS EXAMINATION

BY MS. BRADLEY:

Q. Mr. Pous, could you explain -- you used the

term "intergenerational inequity." Can you explain what that is?

A. Yes. In the area of depreciation, intergenerational inequity implies that one group of, or generation of customers is paid more than its fair share or less than its fair share. In an example, if you assume that an item of plant will last ten years, and you're five years into the analysis and customers have paid for half of the use of the plant, at least what they thought, and then we find out that the life analysis really should have been 15 years, so we have an additional ten years of life, well, customers up to that point have paid half of it, yet the remaining two-thirds of the life of the investment is still out there. That means future ratepayers have gotten a benefit because historic ratepayers have paid more than their fair share. That's inequitable. That's what's considered intergenerational inequity.

MS. BRADLEY: No further questions.

CHAIRMAN CARTER: Thank you, Ms. Bradley. Ms. Kaufman.

MS. KAUFMAN: I have no questions, Mr. Chairman.

CHAIRMAN CARTER: Ms. Armstrong -- Ms. Alexander.

MS. ALEXANDER: No questions.

CHAIRMAN CARTER: Sorry about that, Ms. Alexander.

Mr. Lavia.

MR. LAVIA: No questions, Mr. Chairman.

CHAIRMAN CARTER: Mr. Walls.

CROSS EXAMINATION

BY MR. WALLS:

Q. Good morning, Mr. Pous.

A. How are you today?

Q. I'm doing fine. How are you?

A. I'm alive.

(Laughter.)

Q. Mr. Pous, you're an engineer; correct?

A. Among other things.

Q. You have no degree in accounting; correct?

A. Correct.

Q. And you don't practice as a CPA or anything like that; right?

A. I don't practice as a CPA, but I do testify on accounting matters and financial matters before regulatory bodies throughout the United States.

Q. Okay. I want to talk a minute about the variance between the depreciation book reserve and the theoretical reserve. Okay?

A. Fine.

Q. Your proposal is to pay $161 million a year out of the depreciation book reserve back to customers; correct?

A. Yes.

Q. And so at the end of the four years the depreciation book reserve would have to be restated to reflect that annual $161 million adjustment; correct?

A. Yes. It would be $646 million lower than it would be absent any of the amortization that I propose.

Q. And you determined the amount by going to the company's calculation of the theoretical versus book of the $646 million in the depreciation study, and that's the amount that you recommend to be amortized over four years; correct?

A. Yes. I chose the lower of the amounts that were available to be amortized back to customers at this point.

Q. And could you turn to Page 30, Line 7 to 11 of your testimony?

A. You said Line 7 to 11?

Q. Yes.

A. Okay.

Q. Are you there?

A. I am there now, yes.

Q. Okay. And you say there, quote, at, beginning at Line 7, "The theoretical reserve is the calculated balance that would be in the accumulated provision for depreciation (FERC account 108), often called the reserve, at a point in time if current depreciation parameters (i.e., current life and salvage estimates) had been applied from the outset." Did I read that correctly?

A. Yes.

Q. And what you do with the theoretical calculation is from the outset you assume that those proposed parameters that are recommended to the Commission that they use have always been in effect since the Commission -- commencement of the operation of the assets; correct?

A. Yes and no.

Q. Do you have your deposition with you?

A. No.

(Document given to witness.)

Q. If you could turn to Page 82, Lines 19 to 25, and Page 83, Lines 1 to 2 of your deposition, and I asked you the following question.

"Question: And what you do with the theoretical calculation is from the outset you assume that those proposed parameters you're recommending to

the Commission that they use have always been in effect since the commencement of operation of the assets; correct?

"Answer: It would create the theoretical level.

"Question: So the answer to my question is yes?

"Answer: Yes."

Did I read that accurately?

A. Yes.

Q. Okay.

A. But you failed to note elsewhere in the deposition, such as on Page 82, that I also say it's a forward-looking concept. You have to understand the actual calculation of the theoretical reserve and how it's interactive. It is theoretically correct going forward, but it is also theoretically going backwards under certain conditions. Historically, you would have to have the same level of plant that we have today, which we know we don't have. So a historical review of the rates in the past would not get you to the theoretical reserve that you would have today. That's why it's a prospective-looking theoretical reserve calculation, as required by this Commission.

Q. Mr. Pous, could you answer my questions,

please?

A. I believe I did. I expanded on it.

Q. I only asked you if I read that correctly; right? And you said yes.

A. And I was pointing out that you left out other aspects of the deposition.

Q. Well, if you would like for other aspects of your deposition to be read, I'm sure Mr. Rehwinkel can handle it on redirect. But would you kindly answer my questions, please?

A. I definitely will.

Q. Thank you.

MR. REHWINKEL: Mr. Chairman, I want to object to this. I think it's argumentative with the witness, and it's contrary to the Commission's practice of allowing for each and every question that a yes and no be required, which Mr. Pous did do, with the opportunity for explication, which he did do.

CHAIRMAN CARTER: Okay. It's too far from lunch for you guys to get antsy, so let's kind of dial it back a little bit. The witness can answer the question yes or no or I don't know, and then they'll be entitled to respond or explain their answer. Let's proceed.

BY MR. WALLS:

Q. So, Mr. Pous, will you agree with me the theoretical calculation, under the theoretical calculation you're taking your proposed rates and applying them over the historical plant activity; correct?

A. That's one way you can do it with a number of assumptions. The correct way, which will get you to the same answer, is what is required by this Commission as a prospective-looking analysis. If you're looking to simply take the historic depreciation rates and apply them to the history, you don't have the same level of plant we have today when the calculation is made on a historical basis.

Q. Mr. Pous, could you turn to Page 84 of your deposition?

A. I'm there.

Q. Lines 20 to 24, where I ask you the following question, you gave me the following answer.

"Right, because to do the theoretical calculation, you're taking your proposed rates and applying them over the historical plant activity; correct?

"Answer: Yes."

Did I read that accurately?

A. Yes, you did.

Q. Thank you. And that assumption has to be made in order to do the theoretical calculation, in order to compare the theoretical to the book reserve; right?

A. No. In Florida it is a prospective-looking theoretical reserve. You can still do it historically, but you have to make a lot more assumptions.

Q. Could you turn to Page 85 of your deposition, Lines 4 to 8?

A. I'm there.

Q. Where I asked you the following question and you gave me the following answer.

"Question: Right. But that assumption has to be made in order to do the theoretical calculation in order to compare it to the book; right?

"Answer: To establish one of the two points in the analysis, the theoretical portion of the analysis."

Did I read that accurately?

A. Yes. And there is still many other places in the deposition where I explain to you very clearly that it's a prospective-looking theoretical reserve analysis. You can still do it historically, but there are different assumptions.

Q. Mr. Pous, we know that over the entire time

period of the historic time period that there were depreciation rates in effect; correct?

A. Absolutely.

Q. And you would agree that the customers paid the legal rate adopted by the Commission in the past; right?

A. I haven't audited it, but I would be surprised otherwise.

Q. And when you do the theoretical to book calculation, it's a snapshot, right, taken when you quantify the theoretical reserve and subtract it from book reserve and get an imbalance as of a point in time; correct?

A. Correct.

Q. And when you do that calculation, you're using rates that are proposed to be in effect, because they haven't even been approved, and they're proposed to be in effect from that point forward and that point backwards; right?

A. Not that point backwards.

Q. Could you turn --

A. Unless you make certain additional assumptions.

Q. Could you turn to Page 124, Lines 3 to 8 of your deposition, where I asked you the following

question and you gave me the following answer?

"Right. And when you do that calculation, you're using rates that are proposed to be in effect because they haven't even been approved, right, yet they're proposed to be in effect from that point forward?

"Answer: And that point backwards."

Did I read that correctly?

MR. REHWINKEL: Mr. -- before he answers that question, I want to object. I think there was a, a, and I could be mistaken, but I think there was a, an illustrative diagram that Mr. Walls was drawing on that this answer was related to, if I'm not correct (sic.).

MR. WALLS: Yes. And I just read the answer that he gave, and I'd like him to answer if that's the answer he gave me in the deposition.

MR. REHWINKEL: Well, I don't think -- I'm sorry. I don't think the answer can be given or that -- I mean, what Mr. Walls is trying to do is impeach the witness, live testimony based on statements he gave in his deposition. And I think he's entitled, since this answer was given with Mr. Walls standing it (phonetic) on a table, drawing on a piece of paper, and that piece of paper was made an exhibit to this deposition. I think he's entitled to see that and look at the full

context of the question and answer.

CHAIRMAN CARTER: Here's the plan, before we go -- I'm not going to rule on the objection. I'm just going to give a caution. If you can answer the question yes or no, answer it yes or no first, or I don't know. Then you can explain your answer. He's entitled to do that. And as you get to the page, if you say, hey, I said yes, but here's why I said that. Okay?

THE WITNESS: No problem.

CHAIRMAN CARTER: We can do that. So let's move forward, gentlemen. Mr. Walls.

MR. WALLS: Okay. And if it would help, I mean, I, I would --

CHAIRMAN CARTER: Let's proceed. Let's proceed. Let's proceed.

BY MR. WALLS:

Q. I'll go back to the question I had asked you, Mr. Pous, at Lines 124, 3 to 8, I asked you the following question and you gave the following answer.

"And when you do that calculation, you're using rates that are proposed to be in effect because they haven't even been approved; right? They're proposed to be in effect from that point forward.

"Answer: And that point backwards."

Did I read that correctly?

A. Yes.

Q. And that's the answer you gave me; right?

A. That's the answer I gave you based on the limited question you provided.

Q. Could you please turn to Pages 33 and 34 of your testimony, your direct testimony?

A. I'm there.

Q. And do you see at the bottom of Page 33, carrying over to 34, where you say how you've normally handled reserve material imbalance in situations like this?

A. Yes.

Q. Okay. And in answering this question the only example you give is the prior rate proceeding involving Progress Energy Florida; correct?

A. Yes.

Q. And outside of Florida Power & Light and Progress Energy in their current rate proceedings and Progress Energy Florida in the 2005 proceeding, you have not made a similar reserve and balance adjustment recommendation in any other proceeding; correct?

A. I don't recall any.

Q. And as a result I cannot go out and find in any other commission around this country where you made a certain reserve imbalance adjustment proposal and the

commission has ruled on that proposal; correct?

A. I don't believe you can.

Q. Okay. And in fact you testify at Page 35, Lines 23 to 24 of your direct testimony, that when reserve imbalances occur, they are normally treated through the remaining life process; correct?

A. Correct.

Q. And by normally treated, you mean by utilities and regulatory commissions; correct?

A. Yes.

Q. And you could proceed by establishing depreciation rates on a going-forward basis using a remaining life technique without doing the calculation of the theoretical versus book reserve; correct?

A. Correct.

Q. And in fact you are using the average remaining life technique in your recommendations as well apart from this amortization; correct?

A. Yes.

Q. Now you're asking the Commission to take $646 million out of the company's book depreciation reserve and pay it back to customers over four years, and you cannot show me in your direct testimony or at your deposition any Commission order approving a proposal like that that resulted in depletion of the

book reserve to pay customers back money out of the reserve or a period shorter than average remaining life that was calculated based on a theoretical to book reserve variance calculation without stipulations or settlements; correct?

MR. REHWINKEL: I want to object to the word "depletion." It's vague and I think it assumes facts not in evidence.

CHAIRMAN CARTER: Rephrase.

MR. WALLS: Well, it's the same question I asked at the depo and he didn't object.

MR. REHWINKEL: Well --

CHAIRMAN CARTER: Rephrase. Rephrase. Rephrase. Let's move it.

BY MR. WALLS:

Q. You're asking the Commission to take 646 million out of the company's book depreciation reserve and pay that back to customers over four years, and you cannot show me in your direct testimony or at your deposition any Commission order approving a proposal like that that used money out of the reserve over a period shorter than the average remaining life that was calculated based on a theoretical to book reserve variance calculation without stipulations or settlements; correct?

A. You want to tell me what page of the deposition you're talking about?

Q. Yes. Page --

CHAIRMAN CARTER: That was a long, convoluted question. If you could break it down, that'd be helpful.

BY MR. WALLS:

Q. If you would turn to Page 109, Lines 8 to 23 of your deposition.

A. 109, what lines?

Q. Lines 13 --

A. Okay.

Q. Or, I'm sorry, Lines 8 to --

CHAIRMAN CARTER: Mr. Walls, Mr. Walls, not that there's any law against long, convoluted questions, but we usually get those late at night.

MR. WALLS: I'm sorry.

CHAIRMAN CARTER: You may proceed.

MR. WALLS: There was a lot that had to be included. I apologize.

CHAIRMAN CARTER: You may proceed.

BY MR. WALLS:

Q. Lines 8 through 23, do you see that, where I asked you this same question?

A. Yes.

Q. And you answered, "With that list of caveats I can't do that today, but I can't say that there's not one at this point." Correct?

A. That's what it says.

Q. Thank you. Now you acknowledge that the average remaining life recognizes that depreciation is a forecast or estimation process; correct?

A. I don't think the average remaining life itself does it, but it takes it into account.

Q. And depreciation is a forecast estimation process; right?

A. Yes.

Q. And you would agree that any process that involves estimates, which depreciation does, will result in actual values differing from predicted values; correct?

A. Normally that will occur.

Q. And that means that no one, including yourself, is entirely accurate; correct?

A. I think I said in my deposition something like I'm not that lucky.

Q. Yes. That's pretty close. You would agree that the utility system is going to change daily, monthly, yearly; correct?

A. Yes, you would expect it to. If not -- it

doesn't necessarily have to, but you would expect it to.

Q. And if we reran the theoretical calculation and do the estimate again, even the estimates may be different; correct?

A. You would expect that's a distinct possibility. Yes.

Q. And even your estimates of the additional variance that you calculated could turn out to be different than what you estimated; correct?

A. Yes. And I would expect they would. As I stated in my testimony, that I did not make adjustments for the combined cycle short lives that the company has proposed. I haven't made adjustments for the terminal net salvage studies that the company has proposed, which are excessive. So I would expect that my reserve that I calculate would understate the actual excess reserve that exists.

Q. Under GAAP, isn't it true that depreciation changes in estimates, service lives, net salvage are applied prospectively?

A. I think GAAP does say that. But you also are aware that GAAP doesn't dictate ratemaking.

Q. Under your proposal, the company's book depreciation reserve will decrease by $161 million for four years; correct?

A. Per year. Yes.

Q. And that $160 million would be subtracted from current depreciation expense under your proposal; right?

A. Yes.

Q. And you would agree that's a reduction in cash flow to the company; right?

A. Yes.

Q. And you did not look at the impact of reducing the company's depreciation expense by $161 million a year on the company's net income in the test year; correct?

A. That is correct. That's why I brought the matter up with my client, had them get a conference call together with the accounting witness, the rate of return witness, and the financial witness in order to apprise them of the magnitude of the adjustment I was proposing and have them come back and tell me whether it was doable and not harming the company's financial position.

Q. You would agree with me your recommendation -- if, if your recommendation is accepted, the rate base will increase by at least $161 million each year starting in 2010; correct?

A. Correct.

Q. And the company is certainly entitled to an opportunity to earn a return on that higher rate base;

right?

A. They're entitled to the opportunity to earn that. But you always have to bear in mind, this is one component of the overall cost of service. The company may under recover in theory one component of a cost of service and overrecover in another area and choose not to come in for a rate proceeding because it may still be overearning in total.

Q. Mr. Pous, and you have not done anything in your testimony or analysis that you can show me in your testimony or exhibits where you performed any calculations showing the impact of that $161 million reduction in the reserve over four years on rate base and the increase in return on rate base; correct?

A. Correct.

Q. And you also did not adjust the depreciation rates going forward to take into account the impact of your proposal to amortize the variance between the theoretical and book on depreciation rates; correct?

A. Correct.

Q. Okay. I want to turn briefly to another topic, the service lives for CR-4 and 5. As I understand your testimony, you proposed 60 years for Crystal River Units 4 and 5, the coal units, but no change for CR-1 and 2; correct?

A. That is correct.

Q. And when I took your deposition, you could not recall if you were aware at the time you filed your testimony that PEF had extended the life of Crystal River Units 4 and 5 14 years from their last study to the present one; correct?

A. That's correct. I didn't remember it was 14 years.

Q. Okay. And part of the basis of your recommendation regarding the service lives of the coal plant extending 60 years, you rely on someone else who actually operates a coal plant for a different company in a different part of the country; correct?

A. I said in part, if I remember correctly.

Q. Yes, you did. And I said in part.

A. Okay.

Q. Did you undertake to compare the manufacturer of the units at Crystal River Units 4 and 5 to the units that you recommended with respect to your 60-year service lives?

A. No, I did not. But based on past experience of having looked at the manufacturers at other plants and not being able to discern any difference in the projected service lives due to the manufacturer, I didn't think that was appropriate or necessary.

Q. And you also didn't compare capital expenditures at the units that you identified in your testimony compared to Crystal River Units 4 and 5; correct?

A. No, I did not. But, again, when you're looking at a plant that has a probable retirement date 20 or more years in the future, you're not going to have any capital expenditures known today that are going to be applicable for that period into the future, so it's meaningless.

Q. And you didn't compare O&M costs at Crystal River Units 4 and 5 against the units from these other jurisdictions, did you?

A. Again -- I did not. But, again, when you're looking at probable retirement dates decades into the future, you don't know what those O&M costs will be decades into the future for each of the units. So I couldn't have compared them if I wanted to.

Q. And you agree that it would be foolish for a depreciation manual to include a statement that says coal plants have to have 60-year service lives; correct?

A. I don't think there's any manual that tells you that.

Q. Okay. A few questions about net salvage, Mr. Pous.

You made recommended changes to 15 mass property accounts, and you didn't make modifications to the other mass property accounts; correct?

A. I didn't take a position on the other ones.

Q. And you focused on the transmission and distribution mass property counts that had the most value; right?

A. I haven't gone back and looked, but I wouldn't be surprised. I would expect that to be the case.

Q. And you would agree with me that you've recommended lower net salvage parameters in every single account of these 15 accounts that you address; correct?

A. Yes. And that's in reaction to the very specific data that was applicable to the company that I reviewed and analyzed.

Q. And you would also agree with me that net salvage parameters are also estimates; correct?

A. Yes.

Q. And therefore even your proposals are estimates; right?

A. Absolutely.

Q. And will you agree with me then as well that this estimate is not going to be absolutely the same in the future; right? That would be sheer coincidence.

A. That would be coincidence, but you have

different levels of estimation. You have, let's say, the universe of opportunity to elect a number. The company's approach, as you heard during Mr. Robinson's cross-examination, was he performs a forecast analysis. If you look at the individual account forecast analysis that he performs, it proposes a number that's so high that it creates a value of hundreds of percent that he can choose within.

I am of the opinion you can't create a range of values that is so ridiculously wide that you can choose anything in between and say that's appropriate. The data that you can analyze can define a range, and if you're within that range, it's fine. But you cannot make the range too wide and have it have credibility.

That's why, yes, I do forecast in the future. Yes, the company does forecast in the future. I implore you to look at the forecasting methods that are employed, the discussions, the underlying basis, the premises, and determine if one is more of a pluck a number out of a very, very wide range and another one is a more detailed explanation of why I narrowed the range and why the value I chose is more realistic.

Q. Are you finished?

A. Yes.

Q. Thank you. You would also agree with me that

you should not just take a pure mathematical calculation to arrive at net salvage; right? Judgment has to be exercised; correct?

A. Yes. And it has to be good judgment.

Q. And if that's all true, there's a range of reasonableness, right, in these net salvage estimates; correct?

A. I think I stated that before. But you can't have the range of reasonableness, reasonableness be, for example, 0 to 400 percent negative net salvage. That's not a reasonable range.

Q. Mr. Pous, you also agreed looking at the depreciation experience for other Florida utilities gives you an additional data point; correct?

A. Yes.

Q. But you did not look at other Florida utilities' net salvage parameters; correct?

A. That is correct. Well, I looked at Florida Power & Light I think is what I told you in my deposition.

Q. Okay. And, Mr. Pous, the method that you're following for the mass property accounts in identifying an average remaining life in an Iowa curve to correspond to the retirement history and experience is the same methodology that was followed by the company's witness

in preparing the depreciation study in 2009 and in 2005; correct?

A. The mathematical calculations are. The interpretation of the data is different.

Q. And with respect to PEF's calculation of the average remaining life, you don't have a problem with the company's mass property remaining life calculation. In fact, you believe you duplicated it precisely; correct?

A. That is correct. That's the mathematical components. We did have a problem in the FP&L case where the number cannot be duplicated in the normal standard calculation approach.

MR. WALLS: That's all the questions I have. Thank you, Mr. Pous. Always a pleasure.

THE WITNESS: Yes, it is.

CHAIRMAN CARTER: Thank you, Mr. walls. Staff.

MR. YOUNG: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. YOUNG:

Q. Good morning, Mr. Pous. How are you?

A. I'm alive still.

(Laughter.)

Q. My name is Keino Young. I'm with the

Commission staff. I have several questions for you this morning.

MR. YOUNG: But before we begin that, Mr. Chairman, just a point of information. Last night staff handed out the staff composite exhibit for Mr. Pous, and these are consistent of late-filed deposition exhibits that have been agreed to by all the parties. And this will need to be numbered. We're about to hand it out right now.

CHAIRMAN CARTER: Let's hand it out and then I'll give you a number, and the number will be 286. Number 286.

MR. YOUNG: Yes, sir. And a short title will be Late-Filed Deposition of Pous, Numbers 4, 9 and 10.

CHAIRMAN CARTER: How about just Late-Filed Deposition of Witness Pous? Will that work for you?

MR. YOUNG: That's fine too, sir.

CHAIRMAN CARTER: Okay. Good deal.

(Exhibit 286 marked for identification.)

MR. YOUNG: And at your pleasure, Mr. Chairman, we can either move it in now or we can move it in at the end of Mr. Pous.

CHAIRMAN CARTER: I'd rather do it at the end, and that way we can finish cross and redirect and we'll deal with that when we deal with the exhibits.

MR. YOUNG: Thank you, sir.

CHAIRMAN CARTER: Okay. Does all the parties have a copy?

Mr. Rehwinkel, do you have one?

MR. REHWINKEL: Yes, sir. Thank you.

CHAIRMAN CARTER: Okay. You may proceed, Mr. Young.

MR. YOUNG: Thank you, sir.

BY MR. YOUNG:

Q. Mr. Pous, are you aware of the PSC's Review of Commission Depreciation Practice published in 1992?

A. I read it about a month ago.

Q. Okay. Are you aware that the, that this publication contained a summary of the Commission's depreciation practices?

A. I believe that was the indication in the publication, or in the document.

Q. All right. Are you aware that one of the practices discussed in this document is capital recovery schedules?

A. Yes.

Q. Are you aware that the use of capital recovery schedules have been the practice of, of this Commission for many years?

A. I believe that's correct.

Q. Also, Mr. Pous, are you aware that the use of the reserve transfer has also been a practice of the Commission for many years?

A. Yes. I've read that in a number of decisions.

Q. All right. Depreciation -- moving to depreciation study rules. Are you aware of the Commission depreciation study rule, Rule 25-6.0436, *Florida Administrative Code?*

A. Yes.

Q. Is it your understanding, Mr. Pous, that this rule requires a prospective theoretical reserve calculation rather than a retrospective calculation?

A. Yes. And I just will reiterate, it's a 100 percent calculation. If you do it on a prospective basis and it says 30 percent needs to be recovered, then in theory you could go back and calculate historically that 70 percent has been recovered. You don't exceed 100 percent. But the proper calculation is a prospective-looking analysis, but it still can be done historically with many additional assumptions.

Q. Mr. Pous, are you familiar with the National Association of Regulatory Commission publication entitled Public Utilities Depreciation Practices?

A. Yes, I am.

Q. Mr. Pous, are you aware that the National

Association of Regulatory Commission suggests that the use of an annual amortization over a short period of time is a common option for eliminating a material reserve, material reserve imbalance?

A. I believe I can recall that.

Q. Mr. Pous, do you consider the publication as an authoritative, as authoritative in the area of utility depreciation?

A. Parts of it I would say yes. I can't say the whole portion. It's a good primer. It gives good information. It wouldn't be at the level that you would expect to be authoritative in rate proceedings based on the unique issues and the way they're raised in cases.

Q. Do you consider this publication as setting forth generally accepted depreciation principles?

A. I think that's a fair characterization.

Q. Looking at the matching concept, the concept of matching depreciation expense, expenses to the life of the property is called a matching principle; is this correct?

A. I would agree with that.

Q. If depreciation is matched to the economic climate, would this be a conflict with the matching principle?

A. Can you repeat the question, please?

Q. If depreciation is matched to the economic climate, would this be in conflict with depreciation, with the matching principle?

A. I'm not sure I completely understand the question. If you match depreciation to the economic climate, did you say?

Q. Yes, sir.

A. So if you're saying the economic climate shortens the life, then I would agree. If the economic climate doesn't shorten the life, then I wouldn't agree.

Q. All right. Do you consider PEF's calculation reserve variance to be material?

A. Yes.

Q. How would you define "material" in this circumstance?

A. Well, there is no absolute number. The only jurisdiction that I'm aware of that has a value for reserve amortization is the Alberta, Canada province. And they say that if your reserve imbalance is 5 percent or more, you take that into account and you put, build that into your depreciation rates. If it's less than 5 percent, you leave it alone. You expect there will be some variance in your reserve between the theoretical and the actual book, you accept some of it. They have a 5 percent level. I don't hold necessarily to that

level, but that's the only one I'm aware of specifically.

In this case we're talking about $646 million, as admitted to by the company. I believe that is substantial and significant and material in anybody's book. I've quantified it at 858 million, and I believe it's actually higher than that because of the other adjustments I have proposed.

So under all those criteria I believe it is significant and material.

Q. Okay. Looking at the study requirements, based on your review of PEF's depreciation study, does the study contain specific information regarding PEF's load management, load demand? Excuse me.

A. Repeat that again.

Q. Based on your review of PEF's depreciation study, does the study contain specific information with regards to PEF's load, PEF's load demand?

A. No.

Q. Does the study contain specific information with respect to conditions of generating plants?

A. No.

Q. Does the study contain specific information with regards to PEF's experience with the operating of its generating units?

A. No.

Q. Does the study contain specific information with respect to PEF's experience with, with the maintenance of these units?

A. No.

Q. Does the study contain specific information substantiating PEF's unique load demand on the operating conditions?

A. No.

Q. Does the study contain specific information substantiating PEF's unique load demand under environmental conditions?

A. No.

Q. Does the study contain specific, contain specific information substantiating PEF's unique load demand under regulatory conditions?

A. No.

Q. Does the study contain specific information regarding -- excuse me. Does the study contain specific information regarding this, the current economic conditions of the generating units and how this impacts on the lifespan?

A. No.

Q. Does the, does the study contain specific information regarding update, updates, change, recon,

reconfigurations made at each plant and how each plant affects the lifespan?

A. No.

Q. Does the study contain specific information with respect to the complexity of the operation and maintenance and long-term validity of the generating units?

A. No.

Q. Does the study contain specific information regarding the impact of operating subtropical conditions of the lifespan of its units, generating units?

A. No.

Q. Does the study contain specific information with respect to the impact that climate change may have a, may have on the lifespan of PEF's generating units?

A. No.

Q. And does the study contain specific information regarding the impact of renewable, renewable energy requirements that have a lifespan on the generating facilities?

A. No.

MR. YOUNG: Thank you, Mr. Chairman. No further questions.

CHAIRMAN CARTER: Thank you.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman. Good morning, sir.

THE WITNESS: Good morning.

COMMISSIONER SKOP: I just wanted to ask a few follow-up questions. You previously stated that you're not an accountant; correct?

THE WITNESS: I'm not by education, but I do testify on accounting issues.

COMMISSIONER SKOP: Okay. And so you'd be familiar with the accounting concept of the true-up; correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay.

THE WITNESS: Well, it's more than just an accounting concept.

COMMISSIONER SKOP: I understand.

THE WITNESS: Okay.

COMMISSIONER SKOP: In that regard, do you believe that a full rate case should essentially function as the ultimate true-up for all regulatory accounts?

THE WITNESS: Are we talking the realm of depreciation or overall?

COMMISSIONER SKOP: Overall, but specifically to depreciation.

THE WITNESS: The answer is in theory you would like that to be the case. It doesn't always happen because there aren't always the adequate presentation or facts presented in the case for each of the issues. Estimates still have to be made, but the intention is yes.

COMMISSIONER SKOP: All right. Thank you. On Page 16 of your prefiled testimony, Line 21. Are you there?

THE WITNESS: Yes. I'm sorry.

COMMISSIONER SKOP: And you state that the company has admitted to a $646 million excess reserve for depreciation; is that correct?

THE WITNESS: Correct.

COMMISSIONER SKOP: Okay. And following on Page 17 of your prefiled testimony, Lines 11 through 13, you signify the, that your recommendation is an annual depreciation credit expense in the amount of $161.4 million that would be amortized over the next four years; is that correct?

THE WITNESS: Correct.

COMMISSIONER SKOP: Okay. And that's not -- that just represents the four-year amortization of the $646 million excess reserve that the company stated; correct?

THE WITNESS: Correct.

COMMISSIONER SKOP: Not, not the higher amount that you came to the conclusion.

THE WITNESS: That's right. I left the cushion of over 200 million in addition to the additional issues. I did not make the adjustments for those other areas as combined cycles. And when you consider the massive level of investment the company has in combined cycles and the short life, I assure you a proper study in the future would show significantly additional excess reserves being created by that process.

COMMISSIONER SKOP: Okay. So I think that, subject to check, and please correct me, I think that the number that you mentioned that you would have used based on your calculations was excess reserve -- or excuse me -- yeah, excess reserve of approximately 858 million; is that correct?

THE WITNESS: That sounds correct.

COMMISSIONER SKOP: Okay. All right. But you're taking a more conservative approach and just using the company's number; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. All right. If I could next turn your attention to Page 21 of your

prefiled testimony, please.

THE WITNESS: I'm there.

COMMISSIONER SKOP: Okay. Generally Lines 14 through 20. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. On, beginning on Line 17 you speak of the four-year amortization of 161 million. And you also speak on Line 18 about 113 million in normal annual depreciation adjustments. Can you briefly explain that 113 million to me, please?

THE WITNESS: Those are the adjustments to net salvage for 15 accounts; adjustment to net salvage for mass property accounts. I'm sorry. That's transmission distribution, general and plant. Adjustments to the life analysis for two distribution accounts; adjustments to the production plant for the lives of the Crystal River 4 and 5 units; the Anclote 2 units; River Bend -- not River Bend. I'm sorry. Crystal River 3, small adjustment for life; adjustments for interim retirements in the application of calculation of production plant; the adjustment to the interim net salvage levels for production plant also. It's a combination of all those adjustments would total $113 million of annual impact.

COMMISSIONER SKOP: Okay. And so that's additional adjustments on top of the four-year

amortization that you've recommended; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. How does that relate in any way to the company's proposal to increase depreciation amounts by approximately, subject to check, $96 million per year?

THE WITNESS: I thought it was around 97, but that's pretty close. My $113 million would wipe that $99 million increase out and reduce it by approximately, I guess that would be a hundred -- by $16 million.

COMMISSIONER SKOP: Okay. So essentially not only would you resolve the issue of the stated excess reserve by crediting, you'd also make further reductions that would not only deny the company's request for additional depreciation, but make further reductions in terms of credits that would be passed on to ratepayers; is that correct?

THE WITNESS: Yes. And that makes perfect sense when you consider the level of the excess reserve that exists already. They got there for a reason, higher aggressive depreciation practices in the past, and you'd want to correct for that. The company's reaction to the excess reserve is to ask for even more depreciation expense in the future, which is illogical given the level of the excess reserve that exists.

COMMISSIONER SKOP: Okay. And in terms of it's been, been stated by the company that depreciation is a noncash item, so making those credits obviously -- what impact might that have on the company, notwithstanding the fact that it would clearly benefit the ratepayer in terms of either making credits, or would that impact cash flows, or how would the company deal with those issues in terms of implementing your recommendations?

THE WITNESS: It would obviously reduce revenue requirements, it would reduce expenses. But it would have an impact on cash flow, and that would potentially impact the company's financial operations, and that's what Mr. Lawton is addressing.

COMMISSIONER SKOP: Okay. Very well. If I could next turn your attention to Page 30 of your prefiled testimony, please.

THE WITNESS: I'm there.

COMMISSIONER SKOP: Okay. And generally on Lines 5 through 19, do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Beginning at Line 12 through 17 you discuss the theoretical reserve and the book reserve. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And so essentially, beginning on Line 15, if the book reserve is greater than the theoretical reserve, the utility has collected more than is needed to that point and is ahead of schedule. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. And you characterize that difference on Line 17 as a reserve excess; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. So essentially what you're saying is that the book reserve in this case is clearly greater than the theoretical reserve, and the company has overcollected as far as its depreciation requirements are, are, are such.

THE WITNESS: Yes. Based on the proposed parameters by the company, and I limited it to the company's basis, which is the 646 million, the company has overcollected and we have an excess reserve position.

COMMISSIONER SKOP: Okay. The word I was searching for was overcollected on its depreciation requirements, but my tongue got tied there. So I'll accept your answer as responsive to my question.

If I could next turn your attention to Page 31

of your prefiled testimony, continuing on to -- let me see where it went. Give me one second, please.

THE WITNESS: No problem.

COMMISSIONER SKOP: Okay. It would be Line, I mean, Page 31 of your prefiled testimony, continuing on to the bottom of Page 33. But in, on Page 31, beginning with Lines 9 through 25, generally, you speak to how the Commission has dealt with truing up or correcting the material imbalance between the generation of customers. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Lines 22 through 25 specifically you talk about the settlement in the FPL case where FPL reduced revenue requirements by 500 million over a four-year period, or 125 million per year through credits to depreciation expense. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: And that was through a settlement; correct?

THE WITNESS: Correct.

COMMISSIONER SKOP: Okay. And as you previously stated, to your knowledge, this Commission or other commissions, absent the two settlements that you cited, one of which we'll get to in a second, has never

done a true-up for correcting a depreciation imbalance; is that correct?

THE WITNESS: I think they have done adjustments for correcting imbalances.

COMMISSIONER SKOP: Okay.

THE WITNESS: What I said, I think the question was effectively have I seen where other commissions have addressed an excess reserve that wasn't done through a settlement, and I said I don't know if I could find that. But I believe this Commission has historically on numerous occasions made modifications to the reserve to make, account for reserve transfers within functions, within accounts to take care of technological changes to address the imbalance.

And in fact there's a stated policy in one of the Commission orders that specifically says it's the policy of the Commission to reverse or eliminate reserve imbalances as quickly as possible.

COMMISSIONER SKOP: Okay. So that notion of truing up imbalances is consistent with a full rate case functioning as essentially a true-up mechanism for all regulatory accounts; is that correct?

THE WITNESS: Normally I would think you'd want to do it in a rate case.

COMMISSIONER SKOP: Okay.

THE WITNESS: It doesn't have to be, but normally I would expect it to be in a rate case.

COMMISSIONER SKOP: Okay. And then just finally on Page 33 at the bottom of the page, Lines 21 through 25. Do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: I think that you mentioned the settlement for the prior Progress case as the other citation for the authority of where the Commission has done adjustments to depreciation expense; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. But outside of those two settlements, to your knowledge, this Commission has never made adjustment to depreciation, or outside of a settlement context there's no, you're not able to cite specific authority?

THE WITNESS: I'm trying to remember. I think the previous Florida Power & Light case prior to the 2005 one -- I think in 2001 is another case where there was a reserve adjustment. I believe that was a settled case though also.

COMMISSIONER SKOP: Okay. And the reason I'm exploring that is, again, the issue was raised, I believe, on cross by one of the parties to the nature

of, I believe it was Mr. Walls with respect to the reasons for why that might have been done in the context of a settlement where there's negotiation, give and take, and stipulation of certain issues versus just taking the approach, as you mentioned, of correcting the imbalance, which generally in rate cases is a good thing to do, I would imagine, based on your testimony.

THE WITNESS: Yes. But even in a settlement I, and I would assume you would agree that commissions normally act in the best interest of the public, in meeting the public interest. So if they accept a concept in the settlement, I got to believe that they're accepting the concept as being reasonable, accurate, legal and so forth. So I'm not sure the great distinction between a settlement case where the settlement is brought to the Commission, and I've seen other commissions in the country that have seen portions of settlements and say, I can't live with this, and they've denied the settlement entirely.

But if you accept the settlement, not being you personally, but a commission accepts it, they're indicating, yes, we've looked at the various aspects, we think it's overall in the public interest, we don't find anything illegal in it, it's acceptable.

COMMISSIONER SKOP: Okay. And just one final

question. I guess Mr. Young had asked you a series of questions on cross from staff relating to considerations that may have been made or not made in a depreciation study.

Just generally speaking, why should this Commission give more credence to your proposals and recommendations over the depreciation study that the company performed?

THE WITNESS: Let me give you the best answer on that one. I defy you or anybody else to go to the company's depreciation study and find the basis for their proposals. Not only is it not in there, it's not in his work papers, it's not in responses to data requests where I asked for this type of information. I have basically numerical analysis that the company has presented. I have a data response that says it's not an arithmetic process, it's an interpretive process, which means we set aside the arithmetic, which is what they presented. They didn't provide any other basis, narrative, explanations.

And, in fact, if you go back to the 2005 study by the same company witness, he actually put a narrative. So in this study he's reversed what he did before. He's given you less information.

So why would you believe my presentation over

the company's? At least I gave you reasons. I set forth parameters, gave you information, cited to documents. I defy you again to go back to the company's study and find any of that information. We have generalized statements at best. They're vague at best. There's no documentation. And the company truly has the burden of proof in the process.

So from that standpoint, I don't think there's any comparison regarding the presentation and the credibility of the results between what the company presented and what I have presented.

COMMISSIONER SKOP: Okay. Very well. And then just, again, in summary, and one final question. Based on your analysis of not only the company's depreciation study and their testimony on that issue, but your own independent analysis, that you would recommend $161 million be basically credited back to depreciation expense over the next four years; is that correct?

THE WITNESS: Yes. And that the company come back and perform a thorough detailed analysis study, including new theoretical reserve. There will still be cushion left over at that time, and you can make final determinations as to whether further adjustments need to be made at that time or not.

COMMISSIONER SKOP: All right. Thank you.

THE WITNESS: You're welcome.

CHAIRMAN CARTER: Thank you.

Mr. Pous, just one question.

Commissioners, I'll come back to the bench in a moment. I want to get this out before I forget it.

You've testified in cases, I think over 300 cases in the United States and Canada; is that correct?

THE WITNESS: Probably over 400 by now.

CHAIRMAN CARTER: About 400? Has it been your experience, particularly within the last 20 years or so, has most, have most of the cases, particularly rate cases, have they gone to full decision by the commission or gone to the process where the commissions were presented with stipulations by the parties? Is there any way to quantify that?

THE WITNESS: All right. Can you maybe explain that a little bit better to me?

CHAIRMAN CARTER: Okay. A case can go, a full-blown rate case can go all the way through where the commission --

THE WITNESS: Fully litigated.

CHAIRMAN CARTER: Fully litigated. The commission makes a decision. A full-blown rate case, at

any point in time during the proceedings the parties can get together and stipulate and then bring that stipulation to the Commission and the Commission accepts that.

THE WITNESS: Yes.

CHAIRMAN CARTER: My question to you is that, if you know, is there a way to quantify how many of those that actually went to the full-blown rate hearing or those that were in the context of a full-blown rate hearing that actually entered into a stipulation and that stipulation was presented to the commission? Do you understand it now?

THE WITNESS: I think I do. I don't have hard numbers, but given my experience, probably we settle 60 to 70 percent of the cases we're in. We don't go through a full litigated proceeding. As far as demarking what percentage of that entered into a proceeding before we got to the settlement, usually if there's a settlement, we get there before the hearing actually starts. It's relatively infrequent, but it does happen that a settlement occurs after a hearing has started but before the commission makes a final determination or closes the record.

CHAIRMAN CARTER: So most of them are primarily you say before you get to --

THE WITNESS: To what we're doing right now.

CHAIRMAN CARTER: I appreciate that. It has nothing to do with your testimony. I just wanted to ask you that question and --

THE WITNESS: No problem.

CHAIRMAN CARTER: -- take advantage of your experience on that and kind of get some feel.

Has that been within the context of -- and I was trying to ask that within the context of the last 20 years or so. But based upon your experience, that's --

THE WITNESS: There are more settlements now than there were 20 years ago.

CHAIRMAN CARTER: Oh, really?

THE WITNESS: Yes. But bear in mind, there's a lot more rate cases now than there were 20 years ago.

CHAIRMAN CARTER: And that, that --

THE WITNESS: And I'm talking about energy companies. I'm not talking about telephones.

CHAIRMAN CARTER: Right. That's what I'm talking about too.

THE WITNESS: Okay.

CHAIRMAN CARTER: And is, in that context is that they usually settle and come with the stipulation to the commissions prior to going into the, what, as you say in your words, what we're doing today?

THE WITNESS: Yes. This process affords a lot of uncertainty to both sides, to all sides, and there's give and take that occurs in order to gain certainty that you know what the final result is without leaving it up to the knowledgeable hands of commissioners.

CHAIRMAN CARTER: Well, I sincerely appreciate your, your, your thoughts on that. I just wanted to -- I've been, you know, I've been thinking about that, and I said let me just ask the next witness. So it was you.

Commissioner Skop.

COMMISSIONER SKOP: Thank you, Mr. Chairman. Just one final question for the witness.

If I could turn your attention to Page 40 of your prefiled testimony.

THE WITNESS: Is that 4-0?

COMMISSIONER SKOP: 40. Yes.

THE WITNESS: I'm there.

COMMISSIONER SKOP: Okay. Generally on Lines 15 through 25 on that page; do you see that?

THE WITNESS: Yes.

COMMISSIONER SKOP: All right. And on that, in that passage you discuss your rationale for why a four-year amortization period was appropriate; is that correct?

THE WITNESS: There, and I believe I also made

reference earlier to the concept of if you do the remaining life, it's a 20-, 21-year period, and that customers, there's -- at least under the company's own projections there'd be a 33 percent turnover in customers on a net basis. And on a gross basis I estimated that to be over 40 percent of customers being turned over.

So in order to repay the most representative group of customers, you'd want to do it as quickly as possible.

COMMISSIONER SKOP: Okay. And specifically on Line 18 of Page 40, do you see that?

THE WITNESS: Yes. I'm there.

COMMISSIONER SKOP: Okay. And you state basically that the four-year amortization period, that it would essentially correct the intergenerational equity situation in an effective but manageable manner; is that correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. Now obviously I think you previously mentioned that any time you would have to do such a credit, obviously there would be a cash flow issue on the company's financials; correct?

THE WITNESS: Yes.

COMMISSIONER SKOP: Okay. So doing that in a

shorter period of time or a shorter amortization period might present a substantial hardship on the company; is that correct?

THE WITNESS: It would have an impact. That's again why, you know, I brought this to the attention of the client so that he could bring together the financial, the accounting, the rate of return persons to discuss this and determine is it feasible. If it wasn't, if they would have came back and said, you need to do this over six years, I would have agreed to that, you know, because of the financial consideration of harm on the company.

COMMISSIONER SKOP: Okay. All right. So just in a nutshell then, if the Commission were to adopt your recommendations and move forward with what you've proposed, the appropriate period in your mind would be a four-year amortization period?

THE WITNESS: And it also affords you the ability to come back four years later when they're supposed to do another depreciation study and take another snapshot and see where you stand at that point in time.

COMMISSIONER SKOP: Okay. Very well. Thank you.

THE WITNESS: You're welcome.

CHAIRMAN CARTER: Thank you.

One second, Mr. Rehwinkel. I'm still on my train of thought.

This is not within the scope of your testimony or anything like that.

THE WITNESS: I always love those.

CHAIRMAN CARTER: I'm just trying, I'm just trying to take advantage of your experience over the years and all like that. You said that there are a lot more rate cases now.

THE WITNESS: Yes.

CHAIRMAN CARTER: And a lot more of them are settling now. Let me ask you this, if you know, is that -- and this is probably an unfair question and you can say it's unfair, and I'm not --

THE WITNESS: Shall I say it first?

CHAIRMAN CARTER: No. No. Don't say it first. Give me some hope.

THE WITNESS: Okay.

CHAIRMAN CARTER: Has there been any, within the confines of people in your industry, you know, expert witnesses both for the companies, against the companies, or just within the milieu of professional experts, have there been in your experience any kind of overlay of that, that process of all of these

settlements in the context of the financial markets? I mean from a global standpoint, that you know of. If you don't, don't worry about it.

THE WITNESS: Well, companies raise the financial markets in their basis for asking for rate cases. When we get to settlements, it still comes up sometimes, but rarely. I hate to say it, but usually the cry of wolf that we can't, we won't have access to the capital markets without much higher costs is for your consumption.

In the settlement process I think they're realizing they're dealing with people that may not buy the argument to the same extent others would, and so they don't raise it.

There have been some instances where they said, you know, we need to settle, we need to have at least this amount of money because of our financial considerations, and we take that into account in our settlement process.

But, you know, we do analysis still to determine the validity of their statements. We vet the statements by looking at the financial information. And if we agree with it, then we're more inclined to come up in a settlement mode than otherwise.

CHAIRMAN CARTER: Thank you.

Mr. Rehwinkel, I know that was not within the confines of your witness's expertise, but I just, I just wanted to ask him a question from an opinion standpoint.

MR. REHWINKEL: I appreciate that.

CHAIRMAN CARTER: Commissioners, anything further from the bench?

Mr. Rehwinkel, redirect.

MR. REHWINKEL: Yes. Briefly, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. REHWINKEL:

Q. Mr. Pous, you were asked a couple of times about whether you were an accountant. I just want to make sure I understand. You are not an accountant, but have you been accepted as an expert in regulatory accounting related to depreciation?

A. Not just depreciation. On other matters too.

Q. And in how many states would you say?

A. Excuse me?

Q. In how many states would you say?

A. I've probably testified in 15 to 20 different states, maybe more.

Q. Okay. The company study, was it performed by an accountant?

A. No. Mr. Robinson to my knowledge does not even have a college degree.

Q. Okay.

A. A full four-year college degree.

Q. I think you, in response to a question from Mr. Walls in reference to your deposition on Page 109, you were asked about whether you could point him to any Commission orders that approved a proposal like yours. Is that, is that how you understood the question?

A. It's been a while, but it's something along that line, yes.

Q. Are you aware of, of orders by not only other commissions but this Commission where depreciation surpluses have been returned to the customers in less than the remaining life period?

A. Yes. And I believe I filed a late-filed exhibit in this case that provided a list of those.

Q. Is that, is that list of orders contained in staff Exhibit 286, which looks to be very near the end, OPC-LFE-POUS-000092?

A. The only reason I'm hesitating is I thought I added one more case to this, and that was the Progress Energy docket in 2001, which I don't see here.

Q. Is this the list though that you provided?

A. Yes.

MR. REHWINKEL: Okay. Mr. Chairman, those are all the questions I have on redirect.

CHAIRMAN CARTER: Thank you, Mr. Rehwinkel. Exhibits?

MR. REHWINKEL: I would move Mr. Pous' exhibits.

CHAIRMAN CARTER: On Page, start on Page 36. That would be 133 through 144, I believe it is.

MR. REHWINKEL: Yes, sir. 133 through 144.

CHAIRMAN CARTER: Are there any objections?

MR. WALLS: No.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibits 133 through 144 admitted into the record.)

Staff, you're recognized.

MR. YOUNG: Mr. Chairman, at this time we'd move Exhibit 286.

CHAIRMAN CARTER: Are there any objections?

MR. WALLS: No objection.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 286 admitted into the record.)

Anything further for this witness?

MR. REHWINKEL: Just to ask if he and Mr. Schultz may be excused.

CHAIRMAN CARTER: Absolutely. Have a great

day. TGIF.

THE WITNESS: Thank you very much. You too.

(Transcript continues in sequence in Volume 16.)

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, CRR, Official Commission Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 30th day of September, 2009.

Linda Boles

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