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LARRY CRETUL  
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November 16, 2009

Anne Cole, Commission Clerk  
And Administrative Services  
Room 100, Easley Building  
Florida Public Service Commission  
2540 Shumard Oak Blvd.  
Tallahassee, FL 32399-0850

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Re: Docket Nos. 080677-EI and 090130-EI

Dear Ms. Cole:

Enclosed for filing in the above-referenced docket are the original and 15 copies of Citizens' Post-Hearing Statement of Positions and Post-Hearing Brief.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

Joseph A. McGlothlin  
Associate Public Counsel

JAM:bsr

COM \_\_\_\_\_  
APA 2  
ECR 2  
GCL 2  
RAD 2  
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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for rate increase by  
Florida Power & Light Company.

DOCKET NO. 080677-EI

In re: 2009 depreciation and dismantlement  
Study by Florida Power &

DOCKET NO. 090130-EI  
DATED: November 16, 2009

**CITIZENS' POST-HEARING STATEMENT OF POSITIONS  
AND POST-HEARING BRIEF**

Pursuant to Order Nos. PSC-09-0573-PCO-EI & PSC-09-0627-PHO-EI, the Citizens of the State of Florida, by and through the Office of Public Counsel ("OPC"), hereby submit their Post-Hearing Statement of Positions and Post-Hearing Brief.

**Preliminary Comment On Organization:** OPC has combined its Post-Hearing Statement of Positions and its Post-Hearing Brief into a single document. Each position statement will be set off with asterisks.

**STATEMENT OF BASIC POSITION**

FPL's petition-- in which FPL seeks authority to increase base rates and miscellaneous service charges by approximately \$1 billion annually in January of 2010, another \$240+ million annually in January 2011, and another \$180 million annually at the point in 2011 when its next generating unit comes on line-- exemplifies the reasons why it is necessary to restrain a monopoly's behavior through effective and ongoing regulatory oversight. FPL's overall request is a conglomeration of extreme positions and excessive demands—all of which FPL pursues at a time when customers are experiencing severe economic hardships. FPL proposes to use its extravagant 59% equity ratio for ratemaking purposes. This is far higher—and would be far more expensive to customers-- than the more reasonable common equity ratios of comparable electric utility companies. FPL's higher equity ratio lowers its risk, which must be reflected in its return on equity. FPL's request for a return on equity of 12.50% is detached from any credible consideration of current conditions in capital markets or FPL's low risk profile. FPL's proposal to increase depreciation expense at a time when it has over-collected depreciation by more than \$2 billion is inequitable and self-serving in the extreme. To address this severe

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intergenerational inequity, the Commission should require FPL to amortize \$1.25 billion of its depreciation reserve surplus back to customers over four years. FPL wants the Commission to vote now to allow FPL to increase base rates each time a future power plant enters commercial service, without any concurrent regulatory consideration of the ability of FPL's rates in effect at the time to absorb some or all of the costs without an increase. With this particular request FPL asks the Commission—not to exercise its ratemaking authority—but to abdicate it. Not content with the advantages associated with a projected test year, FPL pushes for a second increase in 2011 that would require the Commission to attempt to peer even farther into the future—at a time when the speculation inherent in doing so is exacerbated by the uncertainties accompanying a calamitous economic downturn. This is hardly the standard of accurate and reliable information to which bill-paying customers are entitled. At a time when customers are already paying for past storms and the Commission has shown its readiness to approve surcharges if and when warranted by future storm damage, FPL's proposal to increase base rates by \$150 million annually to add to its storm reserve is unwarranted and unfair on its face.

When these and other overreaching proposals are tempered by the application of the standards of fairness and reasonableness, it will become clear that FPL's outsized demands mask an overearnings situation. As OPC's evidentiary presentations will demonstrate, the Commission should reduce FPL's base rates, not increase them.

## **EXECUTIVE SUMMARY**

Because of the large number of complex issues raised in these consolidated dockets, and the resulting length of a brief that treats them in detail, OPC believes the following Executive Summary may be useful to the reader.

For the sake of brevity, OPC will address in this summary only certain major topics. Also, OPC will not replicate here all of the more detailed arguments that will be developed in following sections.

In its petition, FPL proposes to increase base rates by approximately \$1.4 billion annually over two years. An examination of the evidence will compel the conclusion that FPL's request for an increase is baseless, and indeed OPC's demand for a base rate *reduction* is warranted. In fact, adjustments designed to scale FPL's extreme proposals back to reasonable levels in only four major areas – capital structure, return on equity, depreciation, and storm damage reserve –

negate FPL's entire base rate request for 2010. Two more topics— the subsequent test year request and FPL's proposed "generation base rate adjustment" – demonstrate the extent to which FPL wants to inappropriately shift the risk of future uncertainty from shareholders to retail customers.

**CAPITAL STRUCTURE–OPC: Reduce FPL's Request By \$100 Million**

A utility raises capital from investors by borrowing money (debt) or selling stock (equity). Because debt is less risky to the investor than equity, debt costs the utility less than equity; but with debt comes financial risk (in the form of interest obligations). On the other hand, as the percentage of capital structure consisting of more expensive equity increases, the utility's revenue requirements increase and the rates that retail customers pay go up.

The electric utility industry has resolved the tradeoff between the financial risk that accompanies debt and the higher revenue requirements associated with more equity by settling on equity ratios in the 40% - 50% range. OPC witness Dr. Woolridge assembled a representative proxy group of 10 electric utilities; the average equity ratio for the group is 40%. FPL rate of return witness Dr. Avera also used a proxy group of utilities. The average equity ratio of his group is 47%.

FPL Group is the corporate owner of FPL. The equity ratio of FPL Group is in the low 40s.

In stark contrast, FPL's current equity ratio is 59.62%. This is an extravagant and overly expensive (to retail customers) level of equity.

FPL tried to make its extravagant and expensive equity ratio appear more reasonable than it is. Frequently, utilities argue that, because bond rating agency Standard & Poor's regards payments made by a utility to wholesale sellers under power purchase agreements as "debt-like," the utility should be permitted to counterbalance this "imputed debt" by adding an increment of "pretend equity" to its capital structure—increasing its revenue requirements in the process. The S&P adjustment is unwarranted in Florida, where the Commission has taken measures to assure cost recovery of PPA payments; in fact, the Commission rejected it in the recent TECO rate case. FPL's application of the adjustment is topsy-turvy—and even less warranted. FPL imputes \$950 million of debt it doesn't owe – not to justify an increment of fictitious equity and a higher equity ratio – but to ask the Commission to regard it as having a *lower* "actual adjusted equity ratio" of 55.8%. However, this artificially lower "actual adjusted equity ratio" is not the equity ratio that

FPL employed to calculate its revenue requirements. The sharp contrast between other electric utilities (and FPL's parent, for that matter) on the one hand, and FPL, on the other – as well as FPL's machinations to mask its extremely high equity ratio – prove an adjustment must be made to bring the equity ratio used for ratemaking purposes to a reasonable and appropriate level. OPC witness Dr. Woolridge used 54%, which in his view is still higher than is warranted by FPL's risk profile. The effect of OPC's adjustment to FPL's equity ratio is to reduce its claimed revenue deficiency by approximately \$100 million annually.

**RETURN ON EQUITY--OPC: Reduce FPL's request by \$400 million**

The authorized return to be applied to the utility's investment in plant (rate base) is the weighted average of its cost of acquiring capital, the investor – provided components of which are debt and equity. The cost of debt can be measured accurately and factually. The cost of equity is determined by the Commission. It requires judgment, informed by reasonable and credible information and opinion. FPL requests a return on equity of 12.5%, based on testimony of FPL witness Dr. Avera. OPC's witness, Dr. Woolridge, advocates a 9.5% return on equity. The difference translates into about \$400 million dollars of annual revenue requirements.

In his analyses, Dr. Avera relied heavily on forecasts of Wall Street analysts to develop key inputs to his models. Wall Street analysts are notorious for the upwards bias in their projections—a fact that OPC witness Dr. Woolridge documented by comparing the analysts' past projections with the materially lower actual results for the same period. In 2003 nine major brokerage firms agreed to pay a fine of \$1.5 billion to settle allegations that investment banks had pressured Wall Street analysts to publish rosy predictions of stock activity; since that time, the Wall Street analysts' projections have continued to be approximately twice as high as actual market results. The bias is evident in Dr. Avera's results. For example: To accept his 12.5% cost of equity recommendation, one must buy into Dr. Avera's assumption that in the future stocks will return 13.2% annually, and his assertion that investors require a risk premium (above the "riskless" interest rate of a long term Treasury bond) of 10% to place their money in equities. Because of the weakness of their analytical underpinnings, these conclusions simply have no credibility.

By contrast, OPC witness Dr. Woolridge employed a proxy group of utilities more representative of FPL; used both historical and projected data; and benchmarked his results against those of such entities as the Philadelphia Federal Reserve Bank and other major

institutions. His more thorough analysis led him to place the range of return required by equity investors as 9.25%-10.50%. Based on FPL's relatively low risk profile, Dr. Woolridge recommended a return of 9.50%.

As with the case of equity ratio, FPL's claimed cost of equity is extreme. Adjusting it back to a reasonable value that reflects a credible assessment of market conditions and its relatively low risk will reduce FPL's claimed revenue deficiency by about \$400 million.

**DEPRECIATION--OPC: Reduce FPL's request by \$240 million annually.**

Depreciation is the manner in which a utility recovers the cost of capitalized investments over time. The objective of depreciation policy is to match the period of recovery (service life) with the period during which the plant is in service, so that each "generation" of customers pays its fair share of the costs. Over time, no group of customers should subsidize another group of customers: each group should bear its proportionate share of the capital costs associated with plant.

The amount of annual depreciation expense associated with an item of plant is determined by the service life (in years), the salvage value, and the cost of removal. Because service lives are not known with precision until retirement, they are estimated periodically. Similarly, values for salvage and the cost of removing plant upon retirement are refined or updated periodically.

The Commission requires the use of straight line depreciation to recover depreciation expense ratably over its service life. Therefore, a shorter service life means higher annual depreciation expense. Salvage and cost of removal also affect annual depreciation expense.

OPC witness Jack Pous demonstrated that FPL's analyst, Mr. Clarke, consistently incorporated "aggressive" parameters (unreasonably short service lives, artificially low net salvage) that led him to overstate annual depreciation expense. An example is FPL's Scherer 4 coal unit. FPL proposes a 40 year service life for the unit; OPC recommends 60. During the hearing it was established that Georgia Power, who owns a coal unit on the same Scherer site, uses a 55 year service life.

When challenged regarding the reasonableness of its depreciation parameters, FPL frequently alluded to differences in location, climate, maintenance practices, and its intimate knowledge of its own plants. With respect to Scherer 4, FPL witness Hardy acknowledged that (1) Scherer 4 is one of four coal units on the site, all of which are similar in size, design, and

vintage; (2) Georgia Power constructed all four units, including Scherer 4; (3) Geographical location and climate differences do not explain the very different service lives; (4) Georgia Power operates and maintains Scherer 4 for FPL, so there is no difference in maintenance; (5) Scherer 4 even shares a single stack with another Scherer unit.

This is one example of numerous instances in which OPC witness Jack Pous identified FPL's aggressive, unrealistic parameters and provided more realistic alternatives. Applying OPC's more realistic values for service lives, salvage, and cost of removal values reveals that FPL has overstated the annual depreciation expense for 2010 by \$240 million.

**FPL'S DEPRECIATION RESERVE SURPLUS--OPC: Reduce FPL's revenue requirements by \$312 million**

The Commission rule governing depreciation requires electric utilities to perform depreciation studies at four year intervals. Once the study is complete, the rule also requires the utility to compare its "book reserve" (the amount of depreciation expense actually collected to date) with its "theoretical reserve" (the amount of depreciation expense it would have collected had the updated parameters been in effect at the outset). Ideally, under the matching principle there should be no difference. If the book reserve exceeds the theoretical reserve, the utility has overcollected. If the book reserve is less than the theoretical reserve, the utility has undercollected.

A difference between the book reserve and the theoretical reserve is called a reserve imbalance. A reserve imbalance is a violation of the matching principle. A material imbalance creates an intergenerational inequity. If the imbalance is a surplus, past and present customers are subsidizing future customers, who, absent corrective action, will pay less than their proportionate fair share. If it is a deficiency, then future customers will be required to bear an extra helping of cost responsibility.

The comparison of book and theoretical reserves is not merely informational. In normal circumstances, under the "remaining life" methodology the utility divides the remaining undepreciated balance of plant (into which is built any surplus or deficiency) by the plant's remaining life to calculate the annual depreciation expense going forward. In this way, any surplus is effectively returned to customers, and any deficiency is collected from customers, over the remaining life.

Whether the “business as usual” remaining life calculation addresses a reserve imbalance adequately depends on the severity of the imbalance and the time frame over which it would be corrected. The “remaining life” approach is woefully inadequate here. FPL calculates a reserve surplus of \$1.25 billion. Applying his more realistic and supportable parameters, OPC’s witness calculates it to be \$2.75 billion. Either figure reveals a massive intergenerational inequity. The remaining life is 22 years. Like other electric utilities, FPL experiences significant turnover in its customer base. To achieve a measure of intergenerational fairness in a time frame that will benefit the customers from whom FPL collected far too much depreciation expense, more must be done.

OPC witness Jack Pous recommended that \$1.25 billion of reserve surplus be amortized back to customers over four years. The 2010 portion of the amortization would reduce test year revenue requirements by \$312 million.

OPC witness Dan Lawton confirmed that this recommendation will not affect FPL’s financial integrity adversely. In fact, his Exhibit 442 demonstrates that, if the Commission adopts Mr. Pous’ proposed amortization *and all of OPC’s other rate case adjustments*, FPL’s financial metrics will continue to warrant its existing “A” rating by Standard & Poor’s. Further, because the amortization will affect only the timing of capital recovery, OPC’s proposal will not deny FPL recovery of any capital dollar, will not affect FPL’s earnings, and will not affect FPL’s rate of return.

FPL contends the Commission should adhere to the remaining life methodology and return the depreciation reserve surplus of \$1.25 billion-\$2.75 billion over 22 years. (At the same time, FPL asks the Commission to allow it to collect \$314 million of anticipated deficiencies in specific reserve accounts over 4 years. The lack of symmetry is revealing.) FPL observed that OPC’s proposed amortization will “add back” past depreciation to rate base, meaning that future rate base and revenue requirements will be higher. On cross-examination, FPL witnesses acknowledged that any increase in revenue requirements resulting from the “add back” would be mitigated by increases in sales growth between now and the next base rate proceeding, because the increase would be spread over a larger number of billing units. Also, FPL witness Davis acknowledged that he performed no analysis of the value of lower rates to customers that would result from OPC’s amortization. He agreed that, for instance, a customer currently paying 25% credit card interest would benefit more from lower bills (and the resulting ability to pay down

balances costing 25% interest) now, even if in the future FPL earns its authorized overall rate of return on the “add back” amount.

FPL witness Terry Deason testified that the objective of depreciation is simply to ensure 100% of cost recovery by the retirement date. He asserted that, if past customers were paying the rates intended and prescribed by the Commission, there is no intergenerational inequity in the \$1.25 billion - \$2.75 billion reserve surplus. His testimony is contradicted by his own decisions as a regulator. In a Gulf Power depreciation case in which Mr. Deason participated, the Commission observed that the intent of the matching principle is ensure that at any point of time customers benefitting from the plant will be bearing their appropriate share of depreciation expense.

Also, in Docket No.970410-EI, *FPL* asked for a departure from remaining life *explicitly to avoid an intergenerational inequity*, and the Commission – with Mr. Deason on the panel – agreed with FPL’s position. Further, in 2002 the Commission considered a settlement agreement that (among other things) permitted FPL to credit depreciation expense by \$125 million per year (thereby reducing FPL’s reserve surplus and increasing rate base by the amount of the credits). FPL’s then president described the provision as a valuable tool for addressing FPL’s “overdepreciated” condition, and Mr. Deason publicly took comfort in the idea that this non-remaining-life related measure would aid in restoring depreciation reserves to their appropriate levels. Mr. Deason acknowledged that the Commission has the authority and discretion to adopt OPC’s recommended amortization. OPC submits it is needed to restore a measure of fairness to a severely distorted and inequitable depreciation posture.

**STORM DAMAGE RESERVE-OPC--Reduce FPL’s request by \$150 million**

FPL proposes to add to its storm damage reserve in the amount of \$150 million per year. This amount is built into its 2010 request. The Commission already has rejected a similar request by FPL in its 2006 storm financing order. It should reject this request as well. The Commission has demonstrated it will act promptly to authorize a surcharge in the event of severe storm damage, so the risk of storm damage is already on customers. Besides, current customers are already paying the costs of past storms through the “securitization” surcharge representing reimbursement of past restoration costs. It would be unfair in the extreme to require these same customers to bear the costs of unknown future storms.

**GENERATION BASE RATE ADJUSTMENT—OPC: Deny outright**

In the proceeding on FPL's 2005 base rate increase request, FPL and intervenors negotiated a settlement agreement. The thrust of the agreement was to maintain base rates at their then present level, and restrict FPL's ability to increase them during the term of the agreement. One exception was the provision allowing FPL to add the revenue requirements of power plants for which FPL received a "determination of need" and which FPL placed into service during the term of the agreement.

FPL now says it wants to "continue" the "generation base rate adjustment," or GBRA; however, lifted from the original setting, in which it was a limited exception to a negotiated rate freeze, it makes no regulatory sense. Base rates are designed to recover a myriad of costs and investments. The relationship among investments, revenues, and expenses fluctuates, and base rates do not change unless and until, measured on the basis of the totality of operations, base rates are no longer reasonable. Plus, base rates are designed to yield a return that falls in a "range of reasonableness," not a specific point.

In other words, base rates are not appropriately the subject of "piecemeal regulation." A new cost standing alone does not warrant a surcharge, just as a new revenue source does not warrant a refund.

Most importantly: At any given point in time, base rates may be sufficient to absorb all or a portion of a new power plant. The proposed GBRA would instead increase rates by 100% of the new unit's revenue requirements. This means, necessarily, that at any time base rates could absorb a portion of the costs, the GBRA will result in total bills higher than necessary to support FPL's investment and yield a fair return.

In past years, FPL absorbed several power plants without increasing base rates. FPL's response is that today's economy is different. But FPL acknowledged that the future may look nothing like the present. FPL's West County 3 unit will have revenue requirements of \$180 million annually. In 1999 FPL reduced rates by \$350 million; in 2002, it reduced rates by \$250 million. Why would the Commission want to tie its hands and abdicate its responsibility to ensure customers pay no more than necessary by adopting FPL's GBRA? FPL argues that if the GBRA leads to unreasonably higher rates, the Commission can initiate a case to reduce rates. That idea would bypass the concept of FPL's burden of proof, and shift the risk from shareholders to customers. If FPL believes a new power plant will render base rates

unreasonable, it is free to file a base rate request and time it to coincide with the in-service date of the new unit.

### **2011 SUBSEQUENT TEST YEAR ADJUSTMENT—OPC: Deny outright**

In 2008, FPL formulated the projections for its 2009 budget, its 2010 test year, *and* its 2011 “subsequent test year.” As projections reach farther out in time, they become increasingly more speculative and less reliable. It’s no surprise that, in 2008, FPL made *monthly* projections for 2009, but only *annual* projections for 2010 and 2011. To protect customer’s interests, and to require FPL to meet its burden of proof, the Commission must demand reliable and accurate information prior to increasing the rates borne by customers. At hearing, FPL agreed that the future is uncertain. OPC submits that 2010 is as far into the future that the Commission can attempt to peer without inappropriately engaging in speculation and guesswork, rather than scrutiny and oversight. This is particularly true given the current recession and the uncertainty regarding future economic recovery. (FPL attempted, unpersuasively, to argue that its \$240 million subsequent year request would be warranted even if 2011 turns out to be a better year than FPL assumed in its projections.) To employ speculative projections as the basis for an increase in rates would be to allow FPL to bypass its burden of proof and shift the risk of future uncertainty from shareholders to customers.

## **ISSUES AND POSITIONS**

### **2010 PROPOSED TEST PERIOD**

**ISSUE 1: Does the Commission have the legal authority to approve a base rate increase using a 2010 projected test year?**

\*OPC has not contested the authority of the Commission to approve a base rate increase using a 2010 projected test year in this proceeding.\*

**ISSUE 2: Is FPL’s projected test period of the 12 months ending December 31, 2010, appropriate?**

\*While OPC believes that the 2010 projections are less reliable than the 2009 data, OPC will not object to the use of the 2010 Test Year in this proceeding.\*

**ISSUE 3: Are FPL's forecasts of customers, kWh, and kW by revenue and rate classes for the 2010 projected test year appropriate?**

\*No. FPL's correction to its load forecast for minimum use customers should be adjusted to reflect a 7.42% historical average and its re-anchoring adjustment should be removed. In 2010, FPL's revised net energy for load should be 111,299,656,865 and FPL's revenues should be increased by \$63.942 million. The net reduction in revenue requirements, including reallocation of revenue requirements, is \$63.587 million.\*

**ARGUMENT:** FPL developed its load forecast using a historical database covering January 1998 through October 2008. (TR-995). To develop its load forecast, FPL ran a regression model for the net energy load (NEL) that is expressed in use per customer. (TR-994). Inputs to the model incorporated multiple independent variables, including cooling degree hours, heating degree hours, Florida household disposable income, real price, February dummy variable, March 2003 dummy variable, and an autoregressive term to address auto correction. (TR-994-995, TR-2442).

As part of its modeling, witness Morley admitted making adjustments to the Florida household income database obtained from Global Insights, Inc. (TR-995-996). She further acknowledged that those adjustments were based upon assumptions about the economic recovery -- including the assumption that the sharpest percentage decline would be in April 2009. (TR 996). FPL modeled the changes in Florida household disposable income after the changes that occurred in the 1974 recession. (TR-996). Witness Morley testified that the real price forecast that FPL used came from its financial business unit and was developed in the last quarter of 2008. (TR-997).

Since FPL was forecasting the use per customer, the regression basically established the historical relationship between each of the variables and the historical per use customers, witness Morley testified. (TR-997, 998). In her Exhibit RM-9 (Exh 48), witness Morley acknowledged the exhibit showed a trend of declining use of energy use per customer starting around 2006. (TR-998). She agreed that this declining use of energy is reflected in the historical database of use per customer. (TR-998). She also agreed that at least part of reason for this reduction was due to the increase in minimum use accounts. (TR-998). Witness Morley further conceded that as customers convert from a regular use account to a minimum use account, the reduction in kWh usage affects the use per customer in the historical database. (TR-998, 999).

Witness Morley testified that after reviewing the forecast she determined it was necessary to make some out-of-model adjustments. (TR-999). She claimed that the model was

overforecasting between March 2008 and December 2008 by 3.3%, and that the over-forecasting was accelerating due to the increase in the number of empty homes (minimum use customers). (TR-999). She testified that her adjustments to the regression model included energy efficiency adjustments, adjustments for changes in wholesale load, the re-anchoring adjustment and the minimum use customer adjustment. (TR-1000). However, as OPC witness Brown noted, FPL had not shown that the model prior to the adjustments produced results outside the range of reasonableness. (TR-2444). In fact, witness Brown noted that FPL in its response to OPC Interrogatory No. 161 stated that:

“In-sample MAPE statistic value for the NEL model is 2.69% when calculated for the January 2008 through October 2008 period. This is slightly larger than 1.75%, the in-sample MAPE value calculated over the January 1998 through October 2008 period, but is still small and within the acceptable limits to deem a forecasting model to be a reliable forecasting model.”

(TR-2444, 2445). Witness Brown noted that with adjustments for energy efficiency and wholesale load, the error rate for 2008 was reduced to 1.29%, which was significantly less than the 2.69% determined to be reliable. (TR-2445).

In developing the re-anchoring adjustment, witness Morley testified that she first adjusted the net energy for load forecast by the energy efficiency and wholesale loads, then compared the revised net energy for load to the actual net energy for load for each month of 2008. (TR-1000, 1001). Based upon this analysis, witness Morley testified that the revised net energy for load was still higher than the actual net energy for load by an average of 1.29%. (TR-1001). She decided to adjust the forecast for 2009, 2010, and 2011 by the 1.29% which she termed a re-anchoring adjustment. (TR-1001). OPC witness Brown noted that the use of this re-anchoring adjustment plus the minimum use adjustment results in a duplicative adjustment. (TR-2445). Witness Brown explained that to the extent the number of minimum use customers has increased through the end of 2008, this reduction is already reflected in the use per customer and resulting NEL for that period. (TR-2445). In other words, since an increase in minimum use customers was already included in the actual NEL for 2008, the portion of the model error attributable to that increase in 2008 was already reflected in the overall model error of -1.29% calculated by FPL. If FPL had corrected for the decrease in NEL associated with the increase in minimum usage customers before calculating the overall model error, witness Brown noted, the error would have been reduced. Thus, she concluded that the application of the model error and

the increase in minimum usage accounts overstates the overall error and understates the NEL. (TR-2446).

In addition, FPL understated the average historical percentage of minimum use homes. Witness Morley testified that FPL assumed an average historical percentage of minimum use homes of 7% using 2003-2004 data. (TR-1002). She agreed that the minimum use homes in 2008 were above the 7% that FPL used, especially in later 2008. (TR-1002). Witness Brown testified that it was more appropriate to use the 7.42% for minimum use homes using the longer September 2002 through December 2007 database. (TR-2448, 2449, H.E. Revised SLB-9 Exh 231). This is in part responsible for the under-forecasting of the kWh of net energy load which thereby results in a higher revenue requirement.

Witness Morley acknowledged that, if a minimum use account adjustment had been made in 2008, the correction to the load forecast would be 0.77%. (TR-1003). Witness Morley conceded that if a minimum use accounts adjustment had been made, the revised net energy for load forecast (after the energy efficiency and wholesale adjustments) would have been lower. (TR-1003). Thus, the average percent difference would be less than the 1.29% re-anchoring adjustment that FPL calculated for 2008.

Witness Brown testified that, had a minimum use adjustment been made by FPL in its 2008 NEL calculation, the adjustment would be -0.64%. As witness Brown noted the resulting model error would be reduced from -1.29% to -0.075%. Based upon this analysis, witness Brown revised the re-anchoring adjustment for each test year: -0.62% for 2009, and -0.75% for 2010. Further, since FPL did not provide minimum use customer information for 2011, but simply divided the 2010 adjustment in half, witness Brown applied the same methodology for 2011 which results in a re-anchoring adjustment of -0.375%. (TR-2453). Since FPL's re-anchoring adjustment is not significant (even with double counting the minimum use customers), a re-anchoring adjustment is not warranted.

FPL's correction to its load forecast for minimum use customers should be adjusted to reflect a 7.42% historical average and its re-anchoring adjustment should be removed. In 2010, FPL's revised net energy for load should be 111,299,656,865 and FPL's revenues should be increased by \$63.942 million. The net reduction in revenue requirements, including reallocation of revenue requirements, is \$63.587 million. (See Exhibit 232-SLB-10 Revised, page 2 of 4 and 2010 MFR Schedule C-1, Exhibit 180)

## **2011 PROPOSED SUBSEQUENT YEAR TEST PERIOD**

### **ISSUE 4: Does the Commission have the legal authority to approve a subsequent year base rate adjustment using a 2011 projected test year?**

\*Especially in view of the uncertainties associated with the economic downturn, the predictions offered by FPL are too speculative to form a basis on which to fix rates for 2011. OPC asserts that an attempt by the Commission to do so would amount to an unlawful abuse of discretion.\*

### **ISSUE 5: Should the Commission approve in this docket FPL's request to adjust base rates in January 2011?**

\*No. The assumptions used in developing the 2011 revenue requirements reflect an unacceptable level of economic uncertainty. See OPC's position on Issues 4 and 6. \*

### **ISSUE 6: Is FPL's projected subsequent year test period of the 12 months ending December 31, 2011, appropriate?**

\*No. The 2011 test year, which FPL prepared in 2008, incorporates an unacceptable level of speculation. Rather than advancing and meeting a burden of proof, FPL wants to shift the risk of future uncertainty from the utility to FPL's customers. That is not the way regulation works.\*

**ARGUMENT:** Within its petition, FPL requests authority to increase its base rates to generate an additional \$240 million annually beginning in January 2011. The \$240 million annual increase would be incremental to the (approximate) \$1 billion annual increase that FPL requests, based upon its chosen test year period of calendar year 2010. FPL bases its additional \$240 million annual increase for 2011 on projections of financial results for calendar year 2011.

In this case, OPC has not objected to the concept of a subsequent test year on legal grounds *per se*. However, FPL has the burden of proof in this case. With respect to the proposed subsequent test year adjustment, this means FPL must support its request with competent, substantial evidence – which, in context, means accurate and reliable information demonstrating that it will experience a revenue deficiency of \$240 million in 2011. FPL could not and did not.

FPL prepared its projections of financial results for 2010 in November 2008. Calendar year 2010 is the 12 month period following the year (2009) for which FPL prepared its budget projections. Calendar year 2011, therefore, is two years removed from the budget for 2009, which was prepared in 2008.

At the outset of this docket, OPC favored 2009 as the more appropriate rate case test period, because of the proximity in time to FPL management's stringent review of department budgets for 2009. OPC subsequently decided to withdraw its objections to FPL's choice of a 2010 test period. However, OPC's view is that, for a case prepared in part in 2008 and filed in March 2009, 2010 is as far into the future that the Commission can attempt to peer without relieving FPL of its burden of proof – and without substituting utility-favoring guesswork for customer-protecting oversight and scrutiny.

OPC submits that no reasonable person – and no credible party – would dispute the proposition that, as one reaches farther into the future, predictions and projections of future economic conditions become less certain and more subject to the vagaries of changing variables. It is for good reason that the level of detail to which FPL aspired in its 2010 and 2011 projections was lower than that contained in its 2009 budget projections. For 2009, FPL prepared monthly data; for 2010 and 2011, it prepared only annual figures. (TR-1224). Despite FPL witness Barrett's bold words to the contrary, 2010 projections are less certain than 2009 projections, and 2011 projections are even more uncertain.

During the case, FPL alluded to the fact that it has not raised base rates in the past 20+ years, and has reduced base rates three times during that period. It is somewhat curious, in light of this history, to see FPL contend that conditions will deteriorate within 12 months of the full revenue requirements determination to such a degree that FPL will require two increases in consecutive years.

This is particularly true, given that for 2010 FPL projected results based upon the assumption of a “down economy,” and for 2011 projected results based upon a “down economy just beginning to recover.” (TR-5943, 5944).

It is in the area of assumptions regarding the status of the economy that the frailty of FPL's 2011 contention shows through. As FPL witness Barrett described it, FPL chose a 2011 scenario and proceeded to develop a request so “accurate” that FPL divided the risk of results better or worse than the assumptions equally between FPL and its customers. (TR-5922). The problem with Mr. Barrett's claim is that the very choice of a future scenario is speculative and subject to error. The strength and timing of future economic recovery is unknown. Will the recovery be U-shaped? V-shaped? W-shaped? Will it begin in January 2011, and pick up speed? Or April 2011 and promptly wane? Once FPL identifies a specific target, FPL can then

hit it with a rate proposal; however, the 2011 target FPL chose is only one of many possible future outcomes. As FPL's own Mr. Barrett agreed, the future is uncertain. (TR-5948).

OPC witness Sheree Brown made this point when she testified that economic recovery may occur earlier and with more strength than FPL assumed. FPL's rebuttal to that point is revealing. Yes, said Mr. Barrett, it is possible that sales will rebound faster than we assumed when we put together our subsequent year adjustment – but that doesn't mean you should deny our \$240 million request! During cross-examination, Mr. Barrett acknowledged that the 2010 request is premised on the assumption of lower sales. OPC then asked him why an *increase* in sales beyond the level that FPL assumed in its request would not diminish the need for a revenue increase. Because, said Mr. Barrett, an increase in sales might be accompanied by an equal increase in costs. (TR-6003). One could argue as easily that a decrease in sales will be accompanied by a corresponding decrease in costs. While FPL claims the ability to dissect its preferred scenario with clinical precision, it claims to be unable to agree even that a more rapid recovery would be welcome news – if the acknowledgement would undermine its request for a base rate increase in 2011! It appears to OPC that FPL is determined to cling to its untenable position, even if the clinging requires it to abandon all credibility.

In the area of the subsequent test year adjustment, as with FPL's proposed generation base rate adjustment, FPL's approach is, "Give us the increase, and if it turns out we didn't need it you can bring us in for an adjustment in rates." The approach is a transparent effort to shift the risk associated with attempts to divine the future onto the backs of customers. The Commission should remind FPL that it has the burden of proof in this case. With respect to the requested subsequent year adjustment, FPL failed to meet its burden.

**ISSUE 7: Are FPL's forecasts of customers, kWh, and kW by revenue and rate classes for the 2011 projected test year appropriate?**

*\*No. (Note: OPC opposes FPL's request for a subsequent year adjustment in its entirety.)* FPL's correction to its load forecast for minimum use customers should be adjusted to reflect a 7.42% historical average and its re-anchoring adjustment should be removed. In 2011, FPL's revised net energy for load should be 112,835,431,286 and FPL's revenues should be increased by \$58.067 million. The net reduction in revenue requirements, including reallocation of revenue requirements, is \$57.706 million.\*

**ARGUMENT:** As discussed in Issue 3, FPL's forecast understates revenues by overcorrecting its NEL model. FPL understated the average historical percentage of minimum

use homes. Witness Morley testified that FPL assumed an average historical percentage of minimum use homes of 7% using 2003-2004 data. (TR-1002). She agreed that the minimum use homes in 2008 were above the 7% that FPL used, especially in later 2008. (TR-1002). Witness Brown testified that it was more appropriate to use the 7.42% for minimum use homes using the longer September 2002 through December 2007 database. (TR-2448, 2449, H.E. SLB-9, Exhibit 231). This is, in part, responsible for the under-forecasting of the kWh of net energy load which thereby results in a higher revenue requirement.

Witness Morley acknowledged that, if a minimum use account adjustment had been made in 2008, the correction to the load forecast would have been 0.77%. (TR-1003). Witness Morley conceded that if a minimum use accounts adjustment had been made, the revised net energy for load forecast (after the energy efficiency and wholesale adjustments) would have been lower. (TR-1003). Thus, the average percent difference would have been less than the 1.29% re-anchoring adjustment that FPL calculated for 2008.

Witness Brown testified that based upon her calculation had a minimum use adjustment in been made in FPL's 2008 NEL calculation, the adjustment would have been -0.64%. As witness Brown noted, the resulting model error would have been reduced from -1.29% to -.075%. Based upon this analysis, witness Brown revised the re-anchoring adjustment for each test year, 0.62% for 2009, and -0.75% for 2010. Further, since FPL did not provide minimum use customer information for 2011, but simply divided the 2010 adjustment in half, witness Brown applied the same methodology for 2011, which results in a re-anchoring adjustment of -0.375%. (TR-2453). Since FPL's re-anchoring adjustment is not significant (even with double counting the minimum use customers), a re-anchoring adjustment is not warranted.

As noted elsewhere, OPC opposes FPL's request for a subsequent year adjustment. The request would require the Commission to substitute speculative for burden of proof, and shift the risk of future uncertainty from FPL to its customers. However, if the Commission decides to entertain the request, FPL's correction to its load forecast for minimum use customers should be adjusted to reflect a 7.42% historical average and its re-anchoring adjustment should be removed. In 2011, FPL's revised net energy for load should be 112,835,431,286 and FPL's revenues should be increased by \$58.067 million. The net reduction in revenue requirements, including reallocation of revenue requirements, is \$57.706 million. (See Exhibit 232-SLB-10 Revised, page 4 of 4 and 2011 MFR Schedule C-1, Exhibit 180)

## GENERATION BASE RATE ADJUSTMENT

**ISSUE 8: Should the Commission approve a Generation Base Rate Adjustment (GBRA) mechanism which would authorize FPL to increase base rates for revenue requirements associated with new generating additions approved under the Power Plant Siting Act, at the time they enter commercial service?**

\*No. The requested GBRA mechanism would allow FPL to avoid regulatory oversight of its overall costs of service by providing an automatic base rate increase when new plant is added regardless of the achieved rate of return. With respect to any eligible power plant in the future, ratepayers would be forced to bear unwarranted increases in base rates if then existing earnings are sufficient to absorb some or all of the costs of the addition.\*

**ARGUMENT:** In 2005, parties to Docket No. 050045-EI, a proceeding to establish FPL's revenue requirements and base rates, negotiated a global settlement. Among other things, the parties agreed to keep base rates unchanged and to limit FPL's ability to increase base rates during the four year term of the settlement agreement. One of the limited and narrowly defined exceptions to the "freeze" on base rates to which parties agreed was FPL's ability to increase base rates to reflect the revenue requirements associated with power plants that (1) received affirmative "determinations of need" from the Commission and (2) were placed in service during the term of the settlement agreement.

Such was the origin of the "generation base rate adjustment," or GBRA. In the context of a negotiated freeze on base rates, it made regulatory sense. However, in this case, FPL wants to break the concept loose from its rate limitation moorings and use it in a manner altogether inconsistent with the settlement agreement. FPL contends that it is asking the Commission to "continue" the generation base rate adjustment, but this statement distorts the situation. Again, the generation base rate adjustment, or GBRA, was inextricably tied to related provisions that prevented FPL from raising base rates, even though the GBRA was designed by the parties in the middle of a proceeding on FPL's 2005 petition to increase base rates. If FPL truly was asking the Commission to "continue" the GBRA, it would mirror the provisions to which the GBRA was necessarily linked at the time it was agreed to. This means that FPL would agree to hold base rates at current levels now and commit to no increases to a period of time. Instead, FPL not only is not offering to limit base rate increases; in conjunction with the GBRA FPL wants to

increase base rates by approximately \$1 billion in 2010 and by another \$240 million in 2011. To call FPL's request a continuation of the GBRA would be laughable, if it did not expose customers to so much jeopardy.

FPL's proposal would add the full revenue requirements of eligible power plants to base rates without first considering whether existing rates are sufficient to absorb all or a portion of the costs of the plant and continue to yield FPL a fair rate of return. FPL supports its GBRA proposal in part with the argument that the GBRA, in and of itself, cannot lead to an overearnings situation. FPL's argument misses the fundamental point. The critical question should be – *not* whether the GBRA will result in overearnings – but whether the GBRA will result in total bills that are higher than necessary to support FPL's investment and yield a fair return. The pertinent truism is not that the GBRA could not cause FPL to exceed the ceiling of its authorized range of return. The pertinent truism is this mathematical certainty: *In every situation in which current rates generate earnings sufficient to absorb a portion of the incremental cost of a power plant, adding the full revenue requirements to base rates through the mechanism of the proposed GBRA (in which base rates remain unchanged and a full surcharge is added) will result in total collections from customers that are higher than would be the case if the Commission instead folded the new unit into a full revenue requirements case and set rates based on the totality of FPL's operations.*

A synopsis of the base rate "ratefixing" process proves the point. In a typical base rate proceeding, the regulator reviews the totality of the utility's operations, including the myriad of costs, capital investments, and revenues. The ratemaking formula identifies operating revenues, subtracts expenses to derive net operating income, and divides net operating income by the "rate base" (the undepreciated value of plant providing service) to calculate the rate of return. Once the fair rate of return is established, and compared with the rate of return that would be realized under current rates, the regulator can calculate the excess or deficiency of revenues and "fix" rates accordingly.

In a base rate proceeding a "test period" is used to quantify the investment, revenues, and expenses to be used in the ratemaking formula; however, parties and regulators understand that the test period is a snapshot of a particular point in time. After rates are set, the "mixture" of revenues, expenses, and investments will change. Some costs will increase; others may decrease, or, in the case of retirements or specified amortization periods, go away completely.

Similarly, revenues may increase or decrease. If the utility experiences an increase in revenues or a decrease in costs, the impact on the earned rate of return will be to increase it. If the utility experiences an increase in rate base and/or an increase in costs, the impact on the earned rate of return will be to decrease it.

The base rates serve the function of recovering a myriad of costs. Because of the dynamic nature of the utility's operations, in which relationships between costs, revenues, and rate base investments are constantly shifting, it would be impossible to design base rates to yield a specific, "single point" rate of return. For this reason, traditionally regulators identify a "range of reasonableness." If the relationship among expenses, revenues, and investments is such that the earned rate of return falls within the established range of reasonableness, then by definition the rates that generated the return are fair, just, and reasonable—even though the relationships may have shifted from the time the Commission examined a test period and established rates.

Assume that a regulatory agency establishes a "fair and reasonable" range for overall rate of return of 8% to 10%. A month later, the utility actually earns 9.3%. For regulatory purposes, the return is fair and reasonable. Assume that in subsequent months, the actual, earned rate of return fluctuates between 8.5% and 9.8% as costs, revenues, and investment levels (the inputs to the ratemaking formula) vary. Both the lower 8.5% and higher 9.8% earned rates of return fall within the authorized range. Therefore, one is as "fair and reasonable" as the other. In fact, 8% would be as "fair and reasonable" as 10% for regulatory purposes, because the target is a range, not a point. As a consequence, a single new revenue source that would have the effect, when viewed in isolation, of increasing earnings and rate of return does not justify a refund to customers; and a single new cost that would have the effect, viewed in isolation, of reducing earnings and rate of return is no occasion for an increase (or surcharge). This is because the reasonableness of rates must be assessed on an overall basis, and the effect of any individual component of the mix of revenues, expenses, and investments may be offset or absorbed by changes elsewhere in the mix, such that on an overall basis rates remain reasonable.

If the utility's earned rate of return is within the established fair and reasonable range, there is "room" for earnings to grow before the "ceiling" of the range of reasonableness is surpassed and the earned rate of return becomes unreasonably high ("overearnings").

Similarly, if the earned rate of return is within the established range, there is "room" within which (as a result of increased investment and costs, for instance) earnings and the

resulting earned rate of return can decrease before it falls below the lower end of the range and rates become unreasonably low (“underearnings”). Said differently, in this latter situation earnings within the range are sufficient to absorb additional costs and yield a fair rate of return without the necessity of a base rate increase (or surcharge, or adder). In short, rates are not established or changed based on a piecemeal approach to ratemaking.

Enter the proposed “generation base rate adjustment,” or GBRA. As its name denotes, *the GBRA would be a base rate increase*. In a situation in which earnings (revenues minus expenses) generated by existing base rates are sufficient to absorb all or some portion of the costs of the new power plant, the effect of the GBRA would be to preserve earnings at their existing level and increase total bills to a level higher than necessary to support FPL’s investment and yield a fair return. *See* testimony of OPC witness Sheree Brown, at (TR-2420-2421).

FPL’s witnesses refer to the proposed “generation base rate adjustment” as “efficient”. (TR-1245). “Efficiency” is in the eye of the beholder. FPL uses the term to describe its goal of a minimum of administrative proceedings, an absence of interveners, and a confining regulatory focus—regulatory “tunnel vision”—that ignores its total earnings picture. OPC submits the more appropriate meaning of “efficiency” is that degree of administrative oversight that results in the delivery of service, including any plant required to provide it, for the lowest overall cost consistent with providing FPL an opportunity to earn a fair return. The proposed “generation base rate adjustment” or GBRA flunks this test of efficiency.

FPL argues that the “generation base rate adjustment” would be fair and warranted because it would add the costs of owning and operating the plant to customers simultaneously with the timing of lower fuel costs that customers will receive due to the efficiency of new plants. (TR-1246). But, under the accounting system that the Commission prescribes for electric utilities subject to its jurisdiction, customers effectively begin bearing the costs of a new unit when it begins commercial operation, whether or not base rates are modified at the time. (TR-5955). In fact, and as FPL witness Barrett acknowledged (TR-5927), prior to the 2005 settlement agreement FPL “absorbed” (recognized, booked, accounted for in financial statements) the full cost of several new power plants when they entered service without seeking an increase in base rates. While base rates remained unchanged when this happened, the recognition of costs for accounting purposes (including earned rate of return) coincided with the timing of any and all benefits, including lower fuel costs, and – because earnings were sufficient

to absorb the costs of the new units – FPL continued to earn an adequate return. (TR-5956). Had a Commission- approved GBRA been in place at the time, base rates would have increased (by the amount of the GBRA adder) *unnecessarily*, and total bills would have increased *unnecessarily*, despite the obvious fact that FPL did not require additional revenues at the time.

FPL witness Barrett acknowledged that FPL absorbed new power plants in the past, but said that it could no longer afford to do so in today’s different economic environment. However, as Mr. Barrett acknowledged, FPL’s GBRA proposal is not limited to the next year, or the next two years. FPL wants to apply it to all future power plants that receive affirmative determinations of need. (TR-5962).

As Mr. Barrett acknowledged during cross-examination (TR-5963), future economic circumstances may look very different when compared to the present “down” economy. Just as those who predicted, when mortgage rates exceeded 15%, that we would never see another fixed rate mortgage badly misgauged the future, we who are currently mired in a recession cannot predict what the future holds. In coming years or decades—remember, FPL wants the Commission to make the proposed GBRA *permanent*--the economy may “take off” at some point. Paradigm shifts (plug-in electric cars? Population explosion? Relocation of power-intensive industry? Developments none of us can foresee?) may provide sales and profits that lead to overearnings. The first unit that would be the subject of FPL’s proposed GBRA, West County 3, is projected to have annual revenue requirements of \$180 million—and it is a very large, very expensive power plant. In 1999, FPL reduced rates by \$350 annually. In 2002, FPL reduced base rates by \$250 million annually. See Order No. PSC-99-0519-AS-EI, dated March 17, 1999, and Order No. PSC -02-0501-AS-EI, dated April 11, 2002. In each of these time frames, FPL could have absorbed 100% of the revenue requirements of West County 3 and customers would have been given back change. Who within FPL—who among the Commissioners—can guarantee today that the GBRA, if approved, will not have the effect of increasing bills when no increase is warranted or when the bills should be decreased? Who among the current Commissioners would want to tie his/her hands, much less the hands of future Commissioners, in the face of such possible eventualities? Instead of FPL’s proposed “piecemeal” approach to ratemaking, which can only benefit FPL, the Commission should express its determination to scrutinize the entirety of FPL’s operations to ensure that regulation accomplishes its objective of protecting the customers from monopoly excesses.

The same principles and mathematical relationships apply when FPL's earnings are sufficient to absorb a *portion* of a new plant. If current rates and current earnings are sufficient to absorb a portion of the cost of a new unit, such that the size of the base rate increase needed to assimilate the new power plant is less than the annual revenue requirements of the power plant when measured on a stand-alone basis, the effect of the proposed GBRA would be to secure all of the earnings for the benefit of shareholders and increase rates by 100% of the unit's revenue requirements. As a mathematical certainty, in this situation total customer bills would be higher than necessary to support FPL's investment and yield a fair return.

FPL may contend that the proposed "generation base rate adjustment" is needed to overcome the disincentive to make an investment that would reduce the utility's earned rate of return (or, said differently, to provide an incentive to spend the capital dollars associated with the new power plant). If FPL does so, the Commission should reject the argument. FPL (and other regulated electric utilities) are fond of reminding the Commission that the utilities have "an obligation to serve." FPL has such an obligation because the State of Florida has conferred on FPL an extraordinarily valuable monopoly on providing an essential service to all retail customers in its service areas. That monopoly service is regulated to ensure that quality of service is good, rates are fair and reasonable, and the utility is given an opportunity – as opposed to a guarantee – to earn a fair return on its investment. Since FPL has an obligation to serve, it has a corollary obligation to make all investments required to provide good service, as and when needed. A regulated utility cannot accept the fabulous advantage of possessing 100% of its market -- and then hold the Commission and customers up for "incentives" to do that which it is obligated to do. The very notion that FPL might withhold or delay investments needed to deliver quality service for the purpose of avoiding costs that would temporarily lower its earned rate of return would reveal that its commitment to the "obligation to serve" is secondary to short-term considerations of corporate profitability. Besides, at any point at which FPL believes that on overall basis, rates are inadequate to provide an opportunity to yield a fair return, it can file a base rate request. In fact, if it believes a new power plant will have the effect of rendering base rates unreasonable low, it can time the base rate request to coincide with the in-service-date of the new generating unit.

The proposed "generation base rate adjustment" also would violate the principle that regulation is to provide an opportunity, and not a guarantee, to earn a fair return. When power

plants are rolled into a general revenue requirements determination and base rates are set accordingly, the investments in power plants share the same financial, regulatory, and business risks as the rest of the utility's operation. The proposed GBRA would change that. The "adder" to base rates would be automatic. During the hearing FPL touted the "true-up" feature of the proposed GBRA mechanism, but the important aspect of the true-up is that it would ensure collection of 100% of the revenue requirements associated with the units--including return on investment. There is no similar guarantee with base rate -- related costs that are recovered through the traditional rate base process. To this point, the only items that are treated outside the base rate mechanism have been fuel, environmental costs, conservation costs, and certain preconstruction costs of nuclear units. The Commission authorized the fuel cost recovery charge because the volatility of fuel costs render them ill-suited for base rate treatment. The Florida Legislature directed the Commission to permit recovery of the other items through special cost recovery clauses. No such justification or authority exists to treat power plants rendering service as the subjects of a cost recovery clause. In fact, no investment could be more "base rate related" than generating units—they are the epitome of "fixed costs" that are properly and appropriately recovered through base rates. In the proposed GBRA, FPL has effectively fashioned a "quasi-cost recovery clause" within base rates for certain power plants. For the same reasons that led the Commission to keep them in base rates for decades, the Commission should reject FPL's effort to create a "power plant cost recovery clause" in disguise.

As with the proposed subsequent year adjustment, FPL supports its proposed "generation base rate adjustment" by arguing, purportedly on behalf of customers, that the mechanism would avoid the costs of a rate case. (TR-1246). The Commission must reject this argument with the others.

A rate case (or revenue requirements case) is the best -- in fact, the sole-means available to the Commission to get its arms around a utility's overall financial condition. Based upon the current case, we can anticipate that FPL will incur somewhere in the range of \$3.5 - \$5 million in rate case expense. That amount will be amortized over 4-5 years, meaning that base rates will include perhaps \$1.5 million annually of the rate case expense. By contrast, FPL calculates the revenue requirements of its next (2011) West County unit to be \$180 million *annually*. If by protesting the GBRA and litigating FPL's overall revenue requirement needs in a base rate proceeding Intervenor could demonstrate that, when all factors are taken into account, current

earnings could absorb even 5% - 10% of the plant's requirements, the rate case will have proven to be the most cost-effective expenditure the Intervenor ever incurred.

Finally, FPL says with respect to the proposed GBRA (as with other aspects of its request), "if we overearn, you can haul us in." Here, FPL does not merely shift the burden of proof—FPL tries to eliminate it completely. Rarely has anyone attempted to place so big a cart before the horse. Tell FPL: First comes proof that existing rates are inadequate—*then* comes the base rate increase. While FPL points to the economic analysis that it performs for the determination of need proceeding, that analysis relates solely to demonstrating that the proposed plant is a better choice than possible alternative generating additions. As Mr. Barrett admitted during cross-examination, the determination of need proceeding does not address whether base rates are or will be insufficient to pay for the identified plant when it enters service. (TR-5966). FPL's approach would shift the burden of proof. It is for FPL to demonstrate that on an overall basis, (then) current base rates are inadequate to yield a fair rate of return.

**ISSUE 9: If the Commission approves a GBRA mechanism for FPL, how should the cost of qualifying generating plant additions be determined?**

**\*(Note – OPC opposes FPL's proposed GBRA in its entirety.)** The cost of qualifying assets should be based on the most recently available information at the time that the request is made by FPL to adjust its rates, but should be limited to the bid made and accepted in the determination of need proceeding.\*

**ISSUE 10:** Intentionally Blank.

**ISSUE 11: If the Commission approves a GBRA mechanism for FPL, how should the GBRA be designed?**

**\*(Note – OPC opposes FPL's proposed GBRA in its entirety.)** The design should ensure that customers' bills are increased no higher than necessary to support overall rate base and provide a fair return. Affected parties should have a point of entry to be heard on this criterion.)\*

**ARGUMENT:** First, any base rate increase should be considered only when the addition of the prospective plant revenue requirements to the Company's most recent surveillance report will cause the company to earn less than the floor of its last authorized rate of return on equity. To make its request, the Company should be required to file minimum filing requirements similar to what Rule 25-30.445, FAC, requires for water and wastewater companies in order to file for a limited proceeding rate increase. The docketed proceeding should provide sufficient time for

staff to audit the proposed filing/increase and allow for a point of entry for parties to participate if necessary. In its filing, FPL should be required to make a showing similar to the interim statute for requested interim rate increases: revenue requirement calculations should be reflected with adjustments made consistent with its last rate case proceeding and by using the range of its last authorized rate of return on equity in determining the cost of capital. The amount of increase should be limited to that necessary to restore the company to the bottom of its authorized overall fair rate of return. Because the filing would be based on estimates, the rate increase should be held subject to refund pending the filing of actual amounts to protect customers in case the rate increase generated excess earnings.

**ISSUE 12: If the Commission approves a GBRA mechanism for FPL, should the maximum amount of the base rate adjustment associated with a qualifying generating facility be limited by a consideration of the impact of the new generating facility on FPL's earned rate of return ("earnings test")? If so, what are the appropriate financial parameters of the test, and how should the earnings test be applied?**

**\*(Note – OPC opposes FPL's proposed GBRA in its entirety.)** If the Commission approves a GBRA for FPL, any base rate increase should be considered only when the addition of the prospective plant revenue requirements to the Company's most recent surveillance report will cause the company to earn less than the floor of its last authorized rate of return on equity. The amount of the increase should be limited to that necessary to restore the company to the bottom of the range of its authorized overall rate of return. Also, see OPC's Position on Issue 11.\*

**ISSUE 13: If the Commission approves a GBRA mechanism for FPL, how should FPL be required to implement the GBRA?**

\*See OPC's position on Issue 11.\*

**ISSUE 14: If the Commission chooses not to approve the continuation of the GBRA mechanism, but approves the use of the subsequent year adjustment, what is the appropriate adjustment to FPL's rate request to incorporate the revenue requirements reflected in the West County Unit 3 MFR Schedules?**

\*The Commission should add back the adjustments made by FPL to remove WCEC3 from the 2011 revenue requirement Plant in service should be increased by \$465.616 million, depreciation expense should be increased by \$26.815 million (\$19.623 million with J. Pous adjustment), accumulated depreciation should be increased by \$8.250 million (\$6.540 million with J. Pous adjustment), and production O&M expenses should be increased by \$5.229 million.\*

## JURISDICTIONAL SEPARATION

**ISSUE 15: Does FPL's methodology of including its transmission-related investment, costs, and revenues of its non-jurisdictional customers when calculating retail revenue requirements properly and fairly identify the retail customers appropriate revenue responsibility for transmission investment? If no, then what adjustments are necessary?**

\*No. FPL's MFRs understated the revenue impact of allocating transmission service revenue which created a significant subsidy charged to the retail jurisdictional customers. FPL agrees with OPC's adjustment. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amounts are as follows:

Jurisdictional	2010	2011
Rate Base	(\$261,720,000)	(\$286,794,000)
NOI	(\$6,867,000)	(\$7,161,000)
Revenue Requirement	(\$22,975,000)	(\$26,615,000)

\*

**ARGUMENT:** FPL witness Ender agreed with the testimony of OPC witness Brown that FPL's MFRs did not reflect the appropriate adjustments and allocations to remove the related impacts of providing transmission service from the 2010 test year and subsequent year adjustment. (TR 4069). Exhibit JAE-11 (EXH 378) reflects the proper adjustments to be made to rate base, operating revenues and expenses.

**ISSUE 16:** \*See Issue 15.\*

## QUALITY OF SERVICE

**ISSUE 17:** \*No position.\*

## DEPRECIATION STUDY

**ISSUE 18:** INTENTIONALLY BLANK.

**ISSUE 19A:** What are the appropriate capital recovery schedules?

\*The appropriate recovery schedules should be revised consistent with the recommendations of OPC witness Jacob Pous, outlined in the following issues. Among other things, as discussed in detail under Issue 19F the proposed four year schedule to recover \$314 million associated with retirements at Cape Canaveral, Riviera and with meter changeouts should be denied, and the related deficiencies eliminated by transferring and applying a portion of FPL's huge depreciation reserve surplus.\*

**ISSUE 19B:** Is FPL's calculation of the average remaining life appropriate?

**Subissue - *Appropriate methodology*:** \*No. FPL's consultant departed from the appropriate methodologies in several respects.\*

**ARGUMENT:** First, FPL's consultant relied on a truncated Iowa Survivor curve approach for production assets. While reliance on these curves is appropriate for mass property assets, such reliance for production assets can and has resulted in unrealistic and inappropriate results. Second, FPL also artificially stops assigning future book accruals to vintage additions it believes are fully accrued. This approach defies logic as those vintages are still in service and are used to calculate the amount of depreciation that is to be booked currently and used until that vintage addition is retired. This process also distorts the calculated remaining life. In addition, FPL's analyst incorporated net salvage parameters as part of the remaining life calculation, rather than after the remaining life calculation. This means that a change in net salvage values would affect the remaining life – an illogical and inappropriate relationship. FPL's errors of methodology distort its remaining life calculations and its statement of its depreciation reserve excess.

**(Former Issue 26)**

**Subissue - *Appropriately calculated the remaining life*:** \*FPL incorrectly limits the allocated book reserve to the surviving balance of an individual vintage, adjusted for net salvage. This artificial limitation conflicts with reality and distorts the calculation of remaining life. Also, FPL's witness recognizes the impact of net salvage parameters within the remaining life calculation rather than after the remaining life calculation. A methodology under which a change in net salvage also changes the calculation of remaining life is illogical and inappropriate. These flaws affect the calculation of depreciation expense and also of the amount of FPL's excess reserve. OPC's witness corrects these flaws in his analysis.\* **(Former Issue 27A)**

**ISSUE 19C: What are the appropriate depreciation parameters (remaining life, net salvage percentage and reserve percentage) and resulting rates for each production unit (including but not limited to, coal, steam, combined-cycle, etc)?**

\*The appropriate depreciation parameters should be determined using the recommendations of OPC witness Pous regarding the appropriate life spans, remaining life calculations, the level of interim retirements, net salvage, and depreciation rates addressed in the subissues below:

***Subissue - Appropriate life spans by category* (Former Issue 25):**

\*Coal-fired- FPL's proposed 40 year life span is artificially short. Empirical evidence, treatment in other jurisdictions, and FPL's expectations, reflect a 60-year life span. Large steam Oil/Gas-fired – The actual 50+ years (and counting) experience of FPL's smaller units argue for OPC witness Pous' recommended 50-year life span. Combined Cycle – FPL's 25-year life span is

unrealistically short. At minimum, FPL should be directed to evaluate available information and develop a more appropriate life span in its next depreciation study. If the Commission decides to revise the life span for combined cycle units in this proceeding, it should set the minimum value at 35 years, consistent with the testimony of FIPUG witness Pollock.\*

**ARGUMENT: Coal-fired production units:** FPL attempted to support its unrealistically short (relative to other utilities) service lives on the basis of differences in geographical location, climate, maintenance practices, as well as the argument that FPL knows its units better than anyone else. With respect to FPL's ownership interest in the Scherer 4 coal unit, FPL's arguments fall flat. While FPL wants to apply a 40 year service life, the record establishes that Georgia Power, which owns a similar unit on the same Scherer site, employs a 55 year service life. (TR-3072). Shown an aerial photograph of the Scherer complex, including the single powerhouse that contains the boilers and turbines of Scherer Units 1, 2, 3, and 4, (Exhibit 531) FPL witness Hardy acknowledged that the four coal-fired units are similar in size, design, and vintage. Scherer 4 even shares a single stack with another Scherer unit. (TR-6282-6291). He agreed that location and climate do not explain the differences in service lives. Further, Georgia Power constructed all of the Scherer units, including Scherer 4. He acknowledged that Georgia Power operates and maintains all of the Scherer units (under contract to FPL and other owners). He acknowledged that Mr. Clarke, FPL's depreciation witness did not visit either Scherer 3 or St. Johns Power Park (FPL's other coal-fired generator). There simply is no support for FPL's out-of-step assumption that Scherer 4 (or St. Johns Power Park) will have a service life of only 40 years.

**Large steam oil or gas-fired generating facilities:** With respect to the service lives appropriate for FPL's large Martin and Manatee steam units, FPL proposes service lives ranging from 39 to 44 years. But FPL has already operated smaller oil and gas-fired units for more than 50 years, and has indicated its expectation that the smaller units will remain in service for 60 years. (TR 1848). That being the case, FPL's shorter lives for larger, more efficient and more valuable units make no sense. The Commission should accept OPC witness Pous' recommendation of 50-year life spans for the Martin and Manatee steam units.

NOTE: The impact of OPC's adjustments for coal-fired and large steam units is to decrease depreciation expense by \$32 million.

***Subissue - Level of interim retirements- production units (Former Issue 27):*** \*FPL relied on an inappropriately truncated actuarial analysis to estimate interim retirements. FPL

compounded its error when it applied a life-curve that was not a good fit to the data. The company's approach leads to demonstrably unrealistic results. OPC witness Pous used a standard method even used by FPL's witness for most of his career, and actual Company-specific information to develop interim retirement ratios. This better approach results in a \$54,916,074 reduction in depreciation expense. \*

***Subissue - Appropriate net salvage: interim retirements estimated to transpire prior to the final termination of a generating station or unit (Former Issue 28):*** \*FPL's request is overstated due to its approach to the quantification of interim retirements. FPL has proposed excessively negative levels of overall net salvage – the beginning point of the process – which then results in excessively negative interim retirement levels of net salvage. OPC's more appropriate results are based on investigation of the specific data within FPL's database. The individual adjustments (which reduce depreciation by \$74 million annually) are reflected in OPC's brief.\*

**ARGUMENT:** FPL's request is overstated due to its approach to the quantification of interim retirements. FPL has proposed excessively negative levels of overall net salvage – the beginning point of the process – which then results in excessively negative interim retirement levels of net salvage. OPC's more appropriate results are based on investigation of the specific data within FPL's database. The individual adjustments (which reduce depreciation by \$74 million annually) are reflected below:

- a. Account 311- Structures and Improvements: Adjust FPL's proposed negative 15% interim net salvage to negative 5%.
- b. Account 314 - Turbo Generator Units: Adjust FPL's proposed zero interim net salvage to 10% net salvage.
- c. Account 322 – Reactor Plant Equipment: Adjust FPL's proposed negative 5% net salvage to negative 4%.
- d. Account 324 – Accessory Electric – Equipment: Adjust FPL's proposed negative 20% to negative 2%.
- e. Account 341 – Other Production Structures: Adjust FPL's proposed negative 25% net salvage to zero net salvage.
- f. Account 342 – Other Production Fuel Holders: Adjust FPL's proposed negative 5% net salvage to zero net salvage.
- g. Account 343 – Other Production Prime Moves: Adjust FPL's proposed negative 10% net salvage to zero net salvage.

h. Account 344 – Other Production Generators: Adjust FPL’s proposed negative 100% net salvage to zero net salvage.

i. Account 345 – Other Production Accessory Electric Equipment: Adjust FPL’s proposed negative 10% net salvage to zero net salvage.

***Subissue - Appropriate depreciation rates (Former Issue 32):*** \*The Commission should adopt the depreciation rates as recommended by OPC witness Jacob Pous. The cumulative effect of his recommendation is to reduce annual depreciation expense from FPL’s requested \$1,065,623,140 to \$824,950,126, or a reduction of \$240,673,014. \*

**ISSUE 19D: What are the appropriate depreciation parameters (remaining life, net salvage percentage and reserve percentage) and resulting rates for each transmission, distribution, and general plant account?**

\*The appropriate depreciation parameters should be determined using the recommendations of OPC witness Jacob Pous regarding the appropriate life characteristics, remaining life calculations, the level of interim retirements, net salvage, and depreciation rates. The cumulative effect of his recommendations is to reduce annual depreciation expense from FPL’s requested \$1,065,623,140 to \$824,950,126, or a reduction of \$240,673,014. These positions are specifically addressed in the OPC’s brief. \*

***Subissue: Appropriate life characteristics and net salvage levels for transmission, distribution, and general plant (Former Issues 30 and 31):*** \*FPL proposes inappropriate life characteristics and excessive levels of negative net salvage. FPL overstates depreciation expense by the cumulative effect of adjustments to 22 different accounts, each of which requires a discrete decision.\*

a. Account 350.2 – Transmission Easements: Adjust FPL’s proposed 50 year ASL and S4 down curve to 95 S4 life-curve. This results in a \$2,432,236 reduction to depreciation expense.

**ARGUMENT:** FPL simply relies on suggestive industry data as the basis for its proposal to retain a 50 year ASL (Exhibit 15, page 481). The Company further admits that there are not many retirements historically and thus life analyses produce poor results (TR-2802). Alternatively, OPC recognizes that easements are difficult to obtain and that transmission facilities built on such easements will be replaced while still retaining the original easement. (TR-1897). In fact, FPL admits that it is its policy to retain such “perpetual rights” associated with such easements. (TR-1897). Further, FPL admits that it has no plans to retire any easements (Id). Therefore, OPC’s very conservative approach of relying on the approximate maximum life of one complete life cycle of the facilities that rest upon the easements is the only appropriate recommendation in this proceeding. Given the “not in my backyard” or “NIMBY”

syndrome that is prevalent throughout the country, the retention of existing right-of-ways is a logical conclusion. Therefore, OPC's recommended 95 year S4 life-curve combination represents a conservative approach, recognizing the specific facts and circumstances applicable to this account.

b. Account 353 – Transmission Station Equipment: Adjust FPL's 38 R1.5 life-curve combination to a 43 L1 combination. This results in a reduction of \$6,128,005 in depreciation expense. Also, Adjust FPL's proposed negative 10% net salvage to zero net salvage. The effect of this adjustment is to reduce annual depreciation expense by \$3,731,047.

**ARGUMENT:** FPL's 38 R1.5 life-curve combination proposal not only relies on a poor and inappropriate interpretation of the result of its actuarial analysis as support for its position, but further relies on an incorrect recognition of industry values. As shown in Exhibit 187, page 1 of 15, it is easy to see that the longer 43 year ASL proposed by OPC is a better fitting curve than is FPL's proposal. Moreover, FPL witness Clarke was incorrect when he relied on a 38 or 39 year life as being typical for the industry (Exhibit 115, page 495). The actual industry range reflected in Mr. Clarke's workpapers clearly establish that the more appropriate industry range is 45-50 years, and that a 38 or 39 year ASL would be "at the low end of the industry". (TR-1900). Moreover, Mr. Clarke recently recommended a 50 year ASL in his testimony in Nevada (Id). Finally, FPL's proposal fails to recognize that the actuarial analysis relied upon reflects only 15% of retirements being associated with transformers, structures and foundations, all of which are expected to have long ASLs, yet the investment in the account for these components is 33%. (TR-1901). Thus, the life analysis performed by the Company understates the expected ASL for the correct investment mix. An analysis of the actuarial results, confirmation from correct industry data, and recognition of the correct mix and type of investment in the account, demonstrates the Company's proposal for a 38-year ASL is artificially short and that OPC's proposed 43-year ASL is a more appropriate value.

The Company's proposal to dramatically change from an existing positive 5% net salvage to a negative 10% net salvage is inappropriate. The Company's claim that it relied on a trend in recent years fails to recognize that the trend is artificial and due only to unusual events. (TR-1944-1945). Indeed, the Company could not identify any given year's activity in its initial analysis. It failed to recognize that breakers and panels retired and included in the database

analyzed are double their investment level, while transformers, which are anticipated to provide positive gross salvage, were retired at only one-third of their investment level (Id). In other words, the historical data is artificially skewed towards more negative or less positive levels of net salvage than would be the case if a normalized mix of investment had retired during the database reviewed by the Company. (TR-1945). Finally, the Company's negative 10% net salvage, based in part on a comparison with industry data, fails to recognize the significant price increase in copper that has transpired and is expected to continue as the economies of China and India continue to expand. At a minimum, OPC's proposal of a zero net salvage level recognizes that a change from a positive 5% to a negative 10% is an excessively aggressive position taken by the Company that fails to recognize any form of gradualism. The Commission should adopt OPC's position of a 0% net salvage for this account.

- c. Account 353.1 – Transmission Station Equipment – Step-Up Transformers: Adjust FPL's proposed 33 R2 life-curve combination to a 44 S0.5 life-curve combination. This results in a reduction of \$42,281,178 in annual depreciation expense.

**ARGUMENT:** The Company's basis for its proposed 33 year ASL is that its study shows that 33 years "was a good average service life for this account" (Exhibit 115, page 504). The Company's approach to its analysis is simplistic and flawed. First, the retirement activity for this account is relatively minor, yet the limited level of retirement activity is still relied upon by the Company without further investigation. (TR-1902). Moreover, the Company's blind reliance on unusual activity is unacceptable. Indeed, one-fourth of the entire retirement activity was associated with an infant mortality that occurred at age 0 (Exhibit 115, page 506). Given that this account was established to segregate step-up transformers at generating stations from other station equipment, the concept of including a major transformer that failed immediately upon installation is not indicative of future expectations. Failure to normalize such atypical activity results in an artificial shortening of the ASL. (OPC Exhibit 187, pages 2 and 3). While the Company stated in rebuttal testimony that removing the infant mortality retirement did not impact the analysis, it failed to provide any support for its statement. Indeed, the statement clearly flies in the face of the evidence presented by OPC in Exhibit 187, pages 2 and 3 of 15. Finally, it is illogical and inconsistent with historical practices for the industry to assume that the ASL for step-up transformers will be appreciably shorter than the realistic life expectations for the Company's generating facilities, to which such transformers are specifically tied. (TR-1903).

Blind reliance on an inappropriate interpretation of an actuarial analysis that incorporates atypical events does not result in credible evidence in support of the Company's position. OPC submits that the only credible evidence is that presented by Mr. Pous, which is reflected in the observed life tables set forth in OPC Exhibit 187.

- d. Account 354 – Transmission Tower and Fixtures: Adjust FPL's proposed 45 R5 life-curve combination to a 60 R4 life-curve combination. This will reduce depreciation expense by \$3,192,653. Adjust FPL's proposed 15% negative net salvage to zero net salvage. The effect of the adjustment is to reduce depreciation expense by \$1,281,044.

**ARGUMENT:** FPL admits that there are very few additions and retirements for this account and that its actuarial analysis produces results that were "poor". (Exhibit 115, page 510). Moreover, the Company admits that towers are generally retired when transmission lines are rerouted or replaced and that replacement due to foundation decay also occurs (Id). Thus, the Company effectively relies on industry data for its proposal, which "suggests a 40 -70 year life." What FPL fails to state is that its 45-year life is based on Mr. Clarke's feelings that "there was not enough information to recommend a change at this time." (TR-2804). Alternatively, OPC proposed a 60-year R4 life-curve combination, which "is logically derived from Company-specific data, and is also reflective of what Mr. Clarke and his firm have recommended in other depreciation studies." (TR-1905). Indeed, OPC noted that surviving plant is already approaching "the maximum life expectancy that would be derived from the Company's proposal." Like the Company, OPC relied on industry data to some extent for its recommendation. However, as noted by OPC, FPL stated that industry database indicated that the "lowest ASL" was at 48 years "with most values at 65-70 years and an average of 63 years." (TR-1906). In other words, FPL's presentation that the industry ranges 40-70 years is clearly wrong, but was apparently necessary in order to encompass FPL's proposed 45 year ASL. Obviously, if the lowest industry value is 48 years and the average industry value is 63 years, the Company's proposed 45-year ASL is wrong on its face. OPC's recommended 60 year ASL is the only credible evidence in the record.

The Company's proposal for a negative 15% net salvage is based on its failure to properly analyze the data upon which it relied. The Company's historical database was significantly affected by the value reported for 2006, which represented 79% of the entire 22-year net salvage database. (TR-1948). However, only OPC analyzed the underlying data for this

unusual transaction year. When the analysis was performed, OPC identified unusual and unexplained data manipulations. In fact, the Company's own analysis identified the retirements in 2006 as outliers. Had such data been analyzed properly, it would have reduced the recorded negative 192% net salvage to only negative 4%. (TR-1949). Further analysis established that the 2006 retirement activity relied upon by the Company corresponded to the replacement of "12 cross braces of 500 KV structures." (TR-1949). In no way has the Company established or demonstrated that the removal activity associated with 12 cross beams at a single tower, where the tower itself was not retired, is representative of future retirement activity of this account. Moreover, it must be noted that cross beams represent only 8% of the investment in the account, while representing 33% of retirement activity. This clearly distorts the database relied upon by the Company for its proposal. Further, any reliance by the Company on the concept of "trends" conflicts with the Company's admission that the data is sporadic. (TR-2817). It is difficult to establish a reliable "trend" if the database is sporadic. OPC's proposal, which discounts the significant impact of the 2006 retirement of 12 cross beams, is the only credible evidence in the record.

- e. Account 355 - Transmission Poles & Fixtures: Adjust FPL's proposed negative 50% net salvage to negative 30% net salvage. The effect of the adjustment is to reduce depreciation expense by \$4,329,923.

**ARGUMENT:** The Company claims that its proposed negative 50% net salvage reflects the historical net salvage value for a 20-year and a 5-year band, as well as its expectation that cost of removal will increase for wood poles due to potentially changing regulations associated with preservatives used to treat wood poles. (Exhibit 115 at page 515). Upon investigation of the underlying data, OPC identified the fact that the Company had removed significant actual historical activity from its database. In particular, the removal of "reimbursed retirements" by the Company significantly changed resulting the net salvage values. In fact, inclusion of reimbursed retirements would result in a positive 4% net salvage for the historical band. (Tr-1952-1952). Reimbursed retirements should not be excluded as outliers, as they have occurred each and every year in the Company's historical database. By definition, such events are not outliers but are actual expected events. In addition, even the hurricane related activity the Company also removed experienced only a negative 26% net salvage -- or only approximately half the level the Company proposes for normal cost of removal. (TR-1951). The Company's

reliance on 5-year and 20-year historical bands failed to recognize the trend in recent data, a concept the Company relied upon in other accounts. For example, the result of the 3-year historical band yields only a negative 10% net salvage (Id). Yet, the Company chose to refer only to a 5-year band, with full knowledge that the fifth and oldest year in that 5-year band had the highest negative net salvage experienced by the Company's entire 22 year historical database. Moreover, the fourth year of the 5-year band reflected a negative gross salvage, which is a theoretically impossible value. The Company's inconsistent selection process skewed the results to a more negative net salvage value than is warranted. In fact, had the Company extended its 5-year band, and relied on a 7-year band in recognition of the unusual data that occurred in the 4<sup>th</sup> and 5<sup>th</sup> years, the results would have been a negative 32% net salvage -- or approximately the value recommended by OPC.

Yet another failure on the part of the Company is its failure to recognize the concept of economies of scale. During the most recent 3-year period, one in which the level of negative net salvage trended to less negative levels, the Company actually retired 48% more poles on an annual basis than it had retired in the 3-year period prior to 2005. (TR-1952-1953). Given that the level of poles retired during the most recent 3-year period is more indicative of the type of activity that is expected to be incurred by the Company in the future, it is clear that the Company's negative 50% net salvage proposal is excessively negative. Finally, while the Company referred to its expectation of more negative net salvage due to preservatives in wood poles, it admitted that the majority of transmission poles are concrete. (Tr-1953). Obviously, concrete poles are not treated with the preservatives that affect wood pole activity and a lesser level of negative net salvage is therefore appropriate. The only credible evidence in the record supports OPC's recommendation of a negative 30% net salvage.

- f. Account 356 – Transmission Overhead Conductor: Adjust FPL's proposed 47 R1.5 life-curve combination to 51 SO life-curve. This results in a reduction of \$1,618,285 to depreciation expense. Adjust FPL's proposed negative 50% net salvage to negative 40% net salvage. The effect of the adjustment is to reduce depreciation expense by \$1,506,549.\*

**ARGUMENT:** While FPL recognizes the need to increase the existing ASL, its proposed increase is inadequate. The Company relies on its interpretation of actuarial results, which yielded a 44-50 year ASL. (Exhibit 115, page 523). FPL states that the results of its actuarial results are consistent with the industry range when, in fact, its own witness Mr. Clarke testified

in Nevada recently to 50 and 55-year ASLs. (TR-1908). Even the Company's statements in rebuttal regarding wind loading and reconditioning are not credible, as they are unsupported and undocumented, and represent only vague and generalized comments. While the Company's proposal and OPC's 51 S0 life-curve combination are similar from an actuarial standpoint, OPC's recommended longer life represents a better fit at the top or "head" of the survivor curve, where exposures are much greater (Exhibit 187, page 4). Moreover, OPC's longer life is more representative given the fact that the Company admits it has reconditioned certain transmission lines in the past. This means that the higher voltage lines have a greater probability of lasting longer than lines that were previously retired due to reconditioning activity. (TR-1907). This is especially true given that the majority of the Company's investment in this account is already at a 500 KVA level. Finally, while the Company in rebuttal claimed that industry data should not be used for this account (even though it did refer to industry data in its direct case), it must be noted that the Company's witness Mr. Clarke did identify the industry average as being around 52 years in a recent proceeding in Nevada. (TR-1908). Therefore, industry data does confirm the need to lengthen the service life to the 51 year level proposed by OPC.

The Company's proposal to move to a more negative net salvage of negative 50% is unjustified. For this account, the Company chose to rely on historical data and industry ranges as a general basis for moving to a negative 50% net salvage. (Exhibit 115, page 523).. However, a review of the Company's actual historical database indicates significant data manipulation by the Company. In particular, the Company removed the impact of reimbursed retirements, on the grounds that such events were outliers. However, reimbursed retirements have occurred during each and every year of the Company's database, clearly demonstrating that they are not outliers. (TR-1954-1955). Had the Company incorporated, rather than excluded, the impact of reimbursed retirements, negative net salvage would have fallen to a negative 32% level and would be more in line with the negative 40% recommended by OPC. In addition, the Company elected to ignore the fact that it still has 5 million linear feet of copper conduit and copper conduit does produce gross salvage. Finally, the Company failed to consider the economies of scale, given that retirement levels are expected to double in the future compared to what was reflected in the last 10 years. The Company also failed to recognize that the industry average was negative 27%, again more in line with the less negative net salvage proposed by OPC. (TR-1954-1956).

g. Account 359 – Transmission Road and Trails: Adjust FPL’s proposed 50 SQ combination to 65 SQ. This reduces depreciation expense by \$699,372.

**ARGUMENT:** The Company admitted there were few retirements upon which to perform actuarial analyses and, as such, the actuarial results were not very good. (Exhibit 115, page 547). Further, the Company identified industry average as being between 50-70 years and concluded that the existing 50 year ASL should be retained. (Exhibit 115, page 547). OPC actually analyzed and took into account the type of investment reflected in the account. The investment in the account consists of roads, bridges, culverts, trails, and other types of investments that logically can and will last longer than 50 years. (TR-1909). Another consideration raised by OPC is the fact that there have been relatively few retirements for investments that have been in place for extended periods of time. This long life without retirement again indicates life expectancy greater than 50 years. (TR-1909-1910). Finally, the Company’s reliance on the fact that its proposed 50-year ASL is within the industry range fails to recognize that the industry range is 60 years and that Mr. Clarke, the Company’s witness, proposed 65 and 70-year ASLs in recent Nevada proceedings. (TR-1910). FPL’s proposal is excessively aggressive and must be increased to the more realistic 65-year level proposed by OPC.

h. Account 3623 – Distribution Station Equipment: Adjust FPL’s proposed 41 R1.5 combination to 48 SO. This reduces depreciation expense by \$5,860,004.

**ARGUMENT:** There has been considerable activity and the Company believes the results of its actuarial analysis indicate an ASL between 40-45 years. The Company also identified the industry average at 45 years, but recommends only a 41-year ASL. (Exhibit 115, page 560). Alternatively, OPC’s analysis of the data demonstrates that a longer life is justified, based on a more appropriate review of the actuarial analysis and recognition of the type of investment and retirement activity reflected in the historical data. (TR-1911). In particular, a longer ASL is warranted due to a better match at the top or “head” of the actuarial survivor curve, where the vast majority of exposures exist. The Company’s proposed 41-year curve pattern becomes a better fit when the exposure level is greatly diminished and cannot overcome the better matching portion of the curve for ages 0-30 years (Id). This recognition of a longer ASL is significant, given that transformers normally comprise the largest investment category of this account and are anticipated to have longer lives. The Company’s retirement activity that is reflected at the

end or “tail” of its survivor curve and the portion it attempts to match have not been shown to be indicative of transformer investment (Id). The Company’s presentation further suffers from being lower than the Company’s reported industry average of 45 years, but is even more underreported when the 21-year outlier reflected in the data is removed. At that point the industry data increases to 48 years, a full 7 years greater than the Company’s proposal. (TR-1912; 2806). The Company’s deviation from expected longer service lives is further highlighted by Mr. Clarke’s own recommendation of 50 years in recent Nevada cases, as well as recommendations of other utilities and utility commission staff in the upper 40-50 year range. (TR-1912). The Company’s problem of underreporting ASLs compared to what its own depreciation witness recommends elsewhere is not overcome by the Company’s simple rebuttal statement that circumstances differ completely from company to company. In fact, the Company had every opportunity to justify such differences, but failed to do so. (TR-2806). The evidence of record clearly establishes the need for the longer 48 year ASL that OPC proposed.

- i. Account 364 – Distribution Poles, Towers, and Fixtures: Adjust FPL’s proposed 37 R2 life-curve combination to a 41 R1.5 combination. This reduces depreciation expense by \$13,188,572. Adjust FPL’s proposed negative 125% net salvage to negative 60% net salvage. The effect of the adjustment is to reduce depreciation expense by \$23,451,436.

**ARGUMENT:** The Company’s support for its recommendation is limited at best. The Company begins its presentation by claiming incorrectly that most poles on the system are concrete when, they are not. (Exhibit 115 at page 569; TR-1913). From this erroneous position, the Company proceeds by stating its actuarial analysis suggests an ASL of 38-40 years and that the industry range is 35-55 years with an industry average of around 42 years. (Exhibit 115 at page 569). Indeed, if the Company’s own actuarial analyses indicated ASL between 38-40 years and the industry average is 42 years, it is hard to imagine why the Company would propose increasing the ASL to only 37 years (Id). The 37-year life is below the lowest range established by the Company’s own actuarial analysis, and is far below the industry average the Company has identified. The Company’s understatement of ASL becomes even harder to understand when the Company admits it has a program in place to replace certain wood poles with concrete poles that have longer lives. For those wood poles that are not being replaced with concrete poles, the Company is implementing a program to extend the lives of such wood poles. (Exhibit 115 at page 169). The real basis for the Company’s proposal appears to be the statement that Mr.

Clarke is already extending the life from 34 to 37 years and as such, everyone should be satisfied with his efforts. (TR-2806). Such statements do not rise to the level of credible evidence. Rather, as OPC points out on Exhibit 187 at page 6, a 41-year ASL is a better fit to the observed life table during almost all age brackets. Thus, from a statistical standpoint, a 41-year ASL is far superior than the Company's proposed 37-year ASL. Even a longer ASL should be warranted, given the Company's admission that it has implemented a program to extend the lives of wood poles that are not being replaced by concrete poles. Yet, such programs are not reflected or adequately reflected in the historical data. Finally, the Company's own witness proposed 45 and 50-year lives in recent Nevada cases, well above the industry average that he claims. The Company chose not to attempt to reconcile any differences between Mr. Clarke's recommendations in Nevada for much longer ASLs on the basis of differences between the several companies. OPC submits that its 41-year R1.5 life-curve combination is the recommendation supported better by the record.

The Company's net salvage recommendation represents the most aggressive depreciation practice presented by the Company. For this account, the Company proposes to change the existing negative 40% net salvage to a negative 125% net salvage, or more than a tripling of the existing negative net salvage values. (TR-1956). In support of this dramatic change, the Company presents the results of its 20 and 5-year historical averages and states that utilities are experiencing high cost of removal, with the industry range being between negative 10 and negative 135%. (Exhibit 115 at page 569). From these few items of information, the Company concludes that a negative 125% is appropriate. In rebuttal the Company desperately attempts to shore up its unsubstantiated proposal. It does so by first suggesting that negative net salvage, in one year, was as high as 193%. (TR-2820). In addition, Mr. Clarke claims in rebuttal that industry values, as previously reported, are being exceeded in recent, unidentified studies (Id). The Company continues to rely on and identify historical net salvage that excludes the impact of reimbursed retirements. It excluded reimbursed retirements because it treated such retirements are outliers. However, the Company fails to explain why such data are outliers if they have occurred in every single year in the historical database. This pattern and level of retirement activity clearly demonstrates that the data are not outliers, but must be recognized. In fact, if reimbursed retirements are recognized, the historical level of net salvage is reduced to a negative 62%. (TR-1958).

The Company fails is to recognize its own admission that wood poles are being replaced with concrete poles when possible. In the future, fewer dollars of investment associated with wood poles will be retired, incurring less costs of removal due to disposal of such wood poles that are chemically treated. The failure to recognize such facts creates a flaw in the Company's analysis: it relies on historical data, which it knows is not indicative of future expectations. Moreover, OPC's recommended negative 60% net salvage still provides the Company with more than 7 times the level of annual negative net salvage that it has experienced over the past 22 years and is 138% greater than the highest dollar value of negative net salvage that the Company has ever experienced. Thus, the Company is more than adequately protected by OPC's recommendations, while at the same time the OPC value will inappropriately punish customers with excessively negative net salvage. OPC's recommended negative 60% net salvage is the only justified net salvage value reflected in the record.

- j. Account 365 – Distribution overhead Conductors: Adjust FPL's proposed 40 SO life-curve combination to 43 SO. This reduces depreciation expense by \$5,026,679. Adjust FPL's proposed negative 100% negative net salvage to negative 50% net salvage. The effect of the adjustment is to reduce depreciation expense by \$19,714,964.

**ARGUMENT:** The Company claims that its actuarial analyses indicate a 35-45 year ASL, while industry suggests a 25 to 55-year ASL with an average of around 44 years (Exhibit 115 at page 577). OPC relied on trends exhibited by the actuarial results and the fact that even reliance on only the Company's review of the full band actuarial analysis results in a longer ASL than proposed by the Company. In fact, based on the Company's selected actuarial analysis, a 42-year ASL is a better fitting curve than the Company's proposal (Exhibit 187 at page 7). However, relying on a 20-year historical band, which provides trend indications in the life analyses, demonstrates that an even longer ASL, possibly up to 46 years, is more appropriate. The longer ASL recommended by the OPC is further justified by the fact that the industry average is 44 years and the fact that Mr. Clarke, the witness on behalf of the Company, recently recommended 50 and 55-year ASLs for investment in this account in another jurisdiction. (TR-1916). Therefore, from the standpoint of actual historical results derived from actuarial analyses, whether it is the sole analysis relied upon by the Company, or the trend analysis exhibited through the 20-year band, or through industry comparative data, or what Mr. Clarke is

recommending elsewhere, the only credible recommendation in the record is OPC's recommended 43-year ASL.

For an account in excess of a billion dollars in investment, the Company proposes a doubling of the negative net salvage from a negative 50% to a negative 100%. To justify such dramatic change, the Company simply refers to the results of 20 and 5-year historical averages, as well as recent 3-year rolling bands. It claims that industry data shows a range of net salvage for investment in this account from positive 5% to negative 75%. (Exhibit 115 at page 577). First, it is necessary to place the Company's request in proper perspective. The Company's request for this item has a \$40 million revenue requirements impact, which also reflects a \$20 million increase from existing rates. Next, it is important to note that even though the Company identified the industry as ranging from positive 5% to negative 75%, the Company's proposal is a negative 100% -- or 33% greater than the most negative value identified by the Company. (TR-1962). Next, the Company recognized but did not act on the fact that its recent trend analysis was skewed due to the inclusion of a theoretically impossible negative gross salvage in 2006. (TR-2823; 1961-1962). The Company's proposal further suffers from its continued manipulation of the data. For this account, the Company once again excluded reimbursed retirements due to its contention that they represent outliers, even though they again occurred in every single year of the Company's historical database. Recognition of reimbursed retirements in the Company's historical database would reduce the negative net salvage to a negative 42%. (TR-1962). The Company's simplistic analyses further fail to recognize that switches comprise 10% of the investment, but the retirement levels consistently exceed that level. In fact, in the 2 years since 1998 that reflect the highest percentage of retirement activity related to switches, the corresponding net salvage is a negative 178%, while the 2 years with the lowest level of retirements corresponding to switches yielded only a negative 99% net salvage. Thus, the disproportionate relationships of switches in the retirement activity compared to its investment level have distorted the overall salvage values to excessively negative levels. Turning to industry data, the Company's identification of a range from positive 5% to negative 75% also fails to adequately reflect reality. The range by itself is excessive, in that it does not identify average values. As OPC identified, the average salvage values reflected within this range are a mean of negative 27%, a median of negative 20%, and a dual mode of negative 10% and negative 20%. Thus, from the standpoint of a more thorough investigation of the Company's

historical database, industry comparisons, and recognition of the mix of investment compared to the retirement activity, the record clearly demonstrates that the Company's proposal of negative 100% is significantly excessive. The record further demonstrates that a negative 50% proposed by OPC is reasonable and appropriate. Finally, it must be noted that the Company's rebuttal is indicative of the lack of evidence that supports its position. In particular, when addressing reimbursed retirements, at (TR-2823) , Mr. Clarke states simply it did not manipulate the data because "any reimbursements that should have been excluded were properly excluded." The Company provided not a single shred of evidence regarding any basis for excluding any item of reimbursements in the record evidence. Simply saying it is right because the Company says its correct does not constitute credible evidence.

- k. Account 366.6 – Underground Conduit – Duct System: Adjust FPL's proposed negative 5% net salvage to zero net salvage. The effect of the adjustment is to reduce depreciation expense by \$1,073,994.

**ARGUMENT:** FPL's basis for its position is that the 20 and 5-year bands yielded negative 3% and 0% respectively. (Exhibit 115, page 585). FPL also noted that the 3-year rolling bands were going down and that the industry range was from 0 to negative 50%. While the Company recognizes the excessively negative level of existing negative 10% net salvage, its corrective action to a negative 5% is inadequate. Moreover, the Company fails to note that its most recent 3-year band resulted in a positive level of net salvage. (TR-1965). Thus, from the standpoint of the Company's actual, historical database, a positive value may be warranted, but no value less than zero is appropriate. For this account, the Company also manipulated the data to exclude reimbursed retirements, which, if recognized, would again result in a positive value for this account. Finally, the Company's rebuttal presents an inconsistent argument regarding the results of abandonment of investment and reimbursed retirements. In Mr. Clarke's rebuttal, he claims that there are many instances where underground conduit is removed and where the cost of removal exceeds gross salvage, as when a third party accidentally digs up an underground line. (TR-2824). What Mr. Clarke fails to note is when an outside party damages utility property, that party is responsible to reimburse the Company for such damage. However, under Mr. Clarke's rebuttal presentation, he excludes the reimbursement of those costs from the historical net salvage database, but claims that Mr. Pous is incorrect when he states there is no reason to dig up underground facilities versus abandonment in place. In other words, if the Company is not going

to abandon retired facilities in place, and is going to ignore reimbursed retirement activity, than the only reason to remove underground facilities is when the Company can receive a positive net salvage for the items being removed. The only credibly record evidence supports OPC's recommendation for a zero net salvage.

1. Account 367.6 – Underground Conductors: Adjust FPL's proposed 38 SO combination to 40 L1. The effect is to reduce depreciation expense by \$2,238,822. Adjust FPL's proposed negative 5% net salvage to zero net salvage. The effect of the adjustment is to reduce depreciation expense by \$2,225,291.

**ARGUMENT:** The Company proposes to retain the existing ASL because the current 38-year life "looks about right." (Exhibit 115, page 599). In addition, the Company identifies the industry average as being around 39 years, with a wide range from 28 years to 53 years (Id). OPC notes that its proposed 40-year ASL is a superior curve fit during the more meaningful portion of the observed life table. (TR-1917; Exhibit 187 at p. 19). In addition, while FPL identifies the industry average to be 39 years, it fails to note that the industry average appears to be around 50 years for those components in the industry that do not reflect the early generation problems associated with tree-retardant cable. While a 32-year ASL is more indicative of problematic older cable, considering that tree-retardant cable comprises over 22% of the investment in the account some recognition of a longer ASL is warranted. Recognition of a longer ASL due to growing investment in tree-retardant cable is not overcome by Mr. Clarke's rebuttal statement that he is "not aware that there has been an established life in the industry for tree-retardant cable that indicates a life longer than 38 years." (TR-2807). Mr. Clarke's failure to recognize or admit to this development does not refute evidence that longer life expectancy is appropriate for newer cable. The only credible evidence in the record is the 40-year ASL proposed by OPC.

The Company's initial presentation begins with the statement that industry data yields a positive 25% to a negative 40% level and that cost of removal is decreasing. (Exhibit 115 at page 599). From these two meager items of information, the Company concludes that recent trends in the data "suggest" net salvage is similar to the currently authorized negative 5%. What the Company failed to note is that its own historical data produced an overall negative 2% and that one would have to go back to a 1996-1998 3-year rolling band to get to a negative 5% level. (Exhibit 115 at pages 601-602). Moreover, if one considers reimbursed retirements to any extent

for inclusion in the historical data, then the analysis of history turns positive. (TR-1967). The Company's rebuttal attempts to downplay its own historical database by claiming that it is "heavily impacted by large final gross salvage amounts in 2006 and 2007 and that such gross salvage levels will not continue in the future." (TR-2825). However, the Company fails to provide any evidence to support this new unjustified and unsupported position, created in an attempt to salvage its unrealistic proposal. OPC's recommended zero net salvage is the only credible evidence in the record.

m. Account 367.7 – Distribution Underground Conductions and Devices – Direct Buried: Adjust FPL's proposed 35 R2 combination to a 43 SO.5 combination. This reduces depreciation expense by \$1,613,351.

**ARGUMENT:** The Company slightly increased the ASL from 34 to 35 years. It does so based on indications from its actuarial analysis and industry data, which suggests a 29-53 year ASL with an average of 39 years. (Exhibit 115 at page 605). Alternatively, OPC demonstrated that a 43-year ASL is a *better* curve fit than is the Company's presentation. (Exhibit 187 at page 10). OPC's presentation of a better curve fit was un rebutted. Rather, the Company chose to state that it expected that there would be an increase in retirement activity in the future, which may result in the ASL not increasing as far as current expectations reflected in the actuarial analyses. In fact, Mr. Clarke recommends "waiting to see if the level of retirements will return to historical levels." (TR-2808). This admission by the Company is clear support that it cannot justify, on any evidentiary basis, why its current proposal is artificially short. Moreover, Mr. Clarke recommended a 50-year ASL for the investment in this same account in a recent Nevada proceeding. (TR-1920). The record evidence is clear that OPC's recommended 43-year life is the only justified value for this account.

n. Account 368 – Distribution Line Transformers: Adjust FPL's proposed 32 L1.5 to a 34 L1.5 combination. This reduces depreciation expense by \$3,808,140. Adjust FPL's proposed negative 25% net salvage to negative 20% net salvage. The effect of the adjustment is to reduce depreciation expense by \$3,952,437.

**ARGUMENT:** The Company supports its proposed 32-year ASL based on its claim that the actuarial analysis "suggests an ASL life around 32 years." (Exhibit 115 at page 613). In addition, the Company relies on its belief that the industry values range from 26 to 45 years, with an average of 36 years. OPC demonstrated that its interpretation of actuarial analyses resulted in

a *better* fit through the first 24.5 years of age, which represents the vast majority of exposures associated with this investment. (TR-12922; Exhibit 187 at page 11). OPC's better fit corresponds with a 34-year ASL. In addition, OPC identified unreasonable levels of infant mortality reflected in the Company's database that the Company failed to investigate (TR-1922-1923). Eliminating or placing less weight on unusual infant mortalities in the Company's database would increase the ASL. The only rebuttal to OPC's position was that FPL "has not identified any unusual events that would make an impact on its analyses." (TR-2808). Unfortunately, the Company chose not to present any evidence of any analysis it performed to substantiate its claim. This unsubstantiated claim is made in spite of the fact that specific infant mortality events were identified by OPC in direct testimony. Finally, OPC not only emphasized that the industry average was 36 years, or 4 years longer than FPL's proposal, but that Mr. Clarke had recommended 38 and 45-year ASLs in recent Nevada proceedings, and all the studies relied upon for industry purposes performed during the past 5 years yielded an average of 40 years. (TR-1923). All such values are substantially longer than the 32-year ASL proposed by the Company. The record evidence supports the 34-year ASL proposed by OPC.

The Company recognizes that the existing negative 35% net salvage is excessively negative and adjusts its proposal to a negative 25%. (Exhibit 115 at page 613). The Company bases its proposal on the simple resulting averages from the 20-year and 5-year historical database. The Company further identifies the industry range from a positive 5% to a negative 20% and states that removal cost is decreasing and salvage is less than 0. The Company concludes by recognizing that its proposal is more highly negative than the industry; however, the analysis shows that net salvage is decreasing. The Company's conclusion is meaningless on its face. Simply stating that the removal cost is decreasing does not identify a particular value; rather, it identifies a trend. OPC agrees the trend is to a less negative value; however, the Company's reaction falls short of reasonable levels. First, only one of the most recent 3-year rolling bands reflects a value more negative than a negative 25% (Exhibit 115 at page 618). In addition, the trend in the data from the overall database to the 5-year average referenced by the Company is to a less negative value and, as such, the trend would indicate that a minimal movement would be to a negative 20%, as recommended by OPC. In addition, the historical analysis performed by the Company is based on modified data that removed reimbursed retirements. As previously discussed, the Company has not and cannot demonstrate that its

arbitrary decision to remove reimbursed retirements is justified. Further, the Company admits in rebuttal that it did rely on some negative gross salvage amounts, which, as previously noted, are theoretically impossible (an asset cannot be worth less than zero in place) and overstate the negative level of net salvage in the historical data. Finally, the Company has provided absolutely no evidence to demonstrate why its proposal is more negative than all other values it can identify in the industry. Therefore, OPC's recommendation of a negative 20% net salvage for this account is the only credible evidence in the record.

- o. Account 369.1 - Distribution Services – Overhead: Adjust FPL's proposed negative 125% net salvage to negative 85% net salvage. The effect of the adjustment is to decrease depreciation expense by \$1,968,596.

**ARGUMENT:** The Company proposes a dramatic change from the existing negative 60% net salvage to a negative 125% net salvage. The Company's proposal is approximately 50% more negative than the most negative value identified in the industry by the Company. The Company bases its proposal on a review of its historical database, without any consideration of what causes it to be so much more negative than the industry (Exhibit 115 at page 6 21). OPC has analyzed the data and believes that the Company's accounting practices may be at issue. (TR-1969-1971). In particular, the cost of removal that has been increasing so dramatically on a historical basis is not a value derived by actual activity, but rather is established by an *allocation* process of amounts booked into replacement work orders. The Company has not demonstrated that its internal and arbitrary decision as to what constitutes the proper allocation of cost of removal is appropriate (Id). Alternatively, the Company rebuttal takes the position that its own practices are just that, its own practices, and somehow justifies whatever value is determined from such practice (Clarke's rebuttal, page 68). The Company makes a declaratory statement that it follows proper methodology for accounting, yet provides no support or justification for such declarative statement (Id). OPC submits that if the Company's values are so much different than the rest of the industry, it is the Company's responsibility to provide some basis or support for its position other than this is the way we do it. (TR-1970-1971). OPC's recommendation is that a negative 85% is conservative and provides the Company more than adequate coverage until it can justify its position as an outlier, as compared to the rest of the industry, in its next depreciation study. OPC's presentation is the only reasonable conclusion that can be drawn from the information provided by the Company and its admission that there was "no analyses performed to determine

why the net salvage percentage for this account are higher at Florida Power & Light than the industry statistics used in this study” (Id). OPC’s recommendation is the only reasonable recommendation in the record, as the Company has not met any reasonable burden of proof to establish a negative 125% net salvage for the investment in this account.

- p. Account 369.7 – Distribution Services – Underground: Adjust FPL’s proposed 34 R2 life-curve combination to 41 SO.5. This reduces depreciation expenses by \$4,160,079. Adjust FPL’s proposed 10% net salvage to negative 5% net salvage.

**ARGUMENT:** The Company proposes to retain the existing 44-year ASL even though its actuarial analysis “show very long lives.” (Exhibit 115 at page 629). The Company further identifies the industry range as being from 30-45 years. OPC further pointed out that the industry average was 39 years and that for those studies performed within the last 5 years resulted in the industry average of a 41-year ASL. In other words, the trend in the industry is to even longer ASLs. (TR-1925). From these items of information, the Company concludes that it will “ignore the extremely long lives from the analyses” and retain the existing 34-year ASL. (Exhibit 115, page 629). OPC reviewed the historical actuarial analyses and found that a longer ASL was warranted. (TR-1924-1925; Exhibit 187 at page 12). While the observed life table for this account does not decline to a great extent from 100%, it indicates a longer life is warranted. Further, the Company admits in rebuttal that 90% of the investment is still surviving after 50 years. (TR-2809). This admission demands a longer ASL than the retention of existing 34-year life. In fact, one has to question how the existing 34-year life was established in the first place, given that the current analysis contains more data to analyze than any prior analyses could have contained and thus calls into question the validity of the existing 34-year ASL. The Company’s rebuttal is also incorrect in attempting to categorize OPC’s recommended 41-year ASL as being justified by industry averages. Rather, the longer life recommended by OPC is justified by review of the actuarial results and are only *confirmed* through industry data. Therefore, the only credible evidence in the record is that a longer ASL than the existing 34-year ASL is warranted, and OPC’s recommendation is the most appropriate value.

The Company’s proposal for retaining the existing negative 10% net salvage is based on its review of the 20-year and 5-year historical salvage values. (Exhibit 115 at page 629). However, the results from those 20 and 5-year bands were a negative 3% and a negative 7% respectively (Id). These values do not justify a negative 10%, as proposed by the Company. The

Company also admits that salvage values vary from year to year. When salvage values vary, as admitted to by the Company, one would expect reliance on longer historical bands to smooth out the annual variances in order to obtain a more appropriate conclusion. The 20-year band yields a negative 3% net salvage, more in line with OPC's proposed negative 5% value. In addition, the Company's 5-year value of negative 7% includes a theoretically *impossible negative gross salvage*, thus skewing the value to a more negative value than is warranted. (OPC Exhibit 180 at page 177). The Company fails to rebut OPC's position that 18 of the 22 years of historical data were less negative than a negative 10%, and that 17 of those years yielded less negative values than negative 5% (Id). The Company also fails to rebut OPC's finding that the Company's basis for the negative gross salvage was due to reversals of corrected Hurricane Jeanne transactions. As pointed out in OPC's testimony, no such reversals occurred in the years in question. (TR-1973). Further, rather than addressing the issue of *economies of scale* as raised by OPC in its testimony, Mr. Clarke simply stated that he was not sure what point was trying to be made. OPC understands Mr. Clarke rebuttal position, given that any recognition of economies of scale would be detrimental to FPL's position. Finally, unlike the Company, OPC analyzed the type of investment in the account and identified the Company's practice of abandoning in place certain direct buried cable, once such cable was retired. Abandonment in place results in minimal or zero levels of cost of removal. Moreover, when abandonment is not relied upon, a positive gross salvage would occur since the Company has not identified a reason to remove such retirements unless there is an economic benefit for such action. (TR-1974). The Company's only response in rebuttal to this observation was that it is looking at retirements of the entire account, not just a small piece, in an attempt to minimize the point raised by OPC. Unfortunately, the Company chose not to identify whether the amount of abandonment is small. Thus, the Company provides no credible rebuttal evidence on this issue. In total, the Company has not met its burden of proof, and the only credible evidence in the records supports OPC's position for a negative 5% net salvage.

- q. Account 370 – Distribution Meters: Adjust FPL's proposed 36 R2.5 combination to 38 S1.5. This reduces depreciation expense by \$41,504,782. Adjust FPL's proposed negative 55% net salvage to negative 10% net salvage. The effect of the adjustment is to reduce depreciation expense by \$4,306,357.

**ARGUMENT:** The Company conducted actuarial analysis for its meters that are not AMI meters, the results of which the Company believes yielded ASLs ranging from 35-39 years. (Exhibit 115, page 635). The Company further identified the industry range for this type of meters as 20-43 years, with an average of 30 years (Id). The Company relied on its actuarial results in order to propose its 36-year ASL. OPC reviewed the actuarial analysis and determined that, while the Company's curve fit was good, it was not the *best* fitting life-curve combination available. (TR-1926). OPC presented its recommendation of a 38-year ASL and demonstrated that it was, in fact, a better fitting life-curve combination than the Company's 36-year ASL. (Exhibit 187 at page 13). This presentation by OPC was unrebutted, since the Company's rebuttal only reaffirmed that its proposal was a *good* fit, not the *best* fit, of the historical data. (TR-2809). The Company's rebuttal is also incorrect when it claims that OPC's curve fitting is better only by relying on the earlier years of retirements, as shown on Exhibit 187 at page 13. OPC's curve fit is identifiably better during earlier years, but is still an equal or better fitting curve for the remaining portion of the age period presented. Thus, OPC's position is effectively unrebutted and represents the best evidence.

The Company's proposal for a significant change from a negative 30% to a negative 55% net salvage is based on only the past five years of reported data. (Exhibit 115 at page 635). The Company has not established that the activity during the most recent 5-year period is indicative of what will transpire in the future, especially since it deviates significantly from the net salvage experience prior to that period. OPC established that an efficient cost of replacement for these meters will result in a negative 10% net salvage. (TR-1976-1977). OPC's established efficient level of replacement is unrebutted and represents the best evidence of realistic net salvage values for the remaining investment in this account.

- r. Account 370.1 - Distribution Meters – AMI: Adjust FPL's proposed 55% negative net salvage to negative 10% net salvage. The effect of the adjustment is to reduce depreciation expense by \$711,992.

**ARGUMENT:** The Company proposes the same negative 55% net salvage for AMI meters as it did for the remaining meters set forth in Account 370.0. (Exhibit 115 at page 642). The Company further admits it has no historical information available for the investment in the sub-account. The Company claims that it also based its proposal on "field studies," but failed to produce or substantiate that field studies did, in fact, produce a 55% net salvage. OPC

demonstrated that efficient removal or replacement activity for meters results in an approximate negative 10% net salvage. (TR-1976-1978). Thus, OPC's position is unrebutted and constitutes the best evidence in the record and therefore should be adopted.

- s. Account 373 - Distribution Street Lighting and Signal Systems: Adjust FPL's proposed 30 RO.5 combination to a 35 LO combination. This reduces depreciation expense by \$751,011.

**ARGUMENT:** The Company proposed a 30-year ASL based on its actuarial analysis, which indicated a 30 to 35-year ASL. (Exhibit 115 at page 653). The Company also identified the industry range for investment in this account being from 22-45 years, with an average of 22 years (Id). Obviously, the average cannot be equal to the lowest point of the range, a fact that was admitted by Mr. Clarke in his rebuttal. (TR-2810). Alternatively, OPC first demonstrated a 40-year ASL is a *superior* curve fit to the Company's proposed 35-year ASL. (TR-1928; Exhibit 187 at page 14). OPC further analyzed the 20-year historical actuarial band analyses and determined that an even longer ASL was warranted. (TR-1928). For this account, it is important to review more current trend analyses for actuarial purposes given the changing technology associated with the investment. If only the full-length band is analyzed, then retirement characteristics due to incandescent and mercury vapor bulbs that have been changed out due to technological advancements disproportionately affect the results. The Company failed to consider the technological changes that occurred to the investment in this account, but did attempt to downplay such impact in rebuttal by simply stating that Mr. Clarke did not believe such analysis establishes a valid basis for making future predictions. (TR-2810). Simply stating it does not believe such a position is a valid basis for predictions is, in effect, no rebuttal at all, and should be given no weight. The credible evidence in the record clearly establishes that OPC's proposed 35-year ASL is a superior fit, not only during the early ages but through the remaining portion of the observed life table where it is either equal or superior to the Company's curve fitting proposal.

- t. Account 390 – General Plant Structures: Adjust FPL's proposed 50 R1.5 combination to 56 SO. This reduces depreciation expense by \$1,022,803. Adjust FPL's proposed negative 10% net salvage to positive 25% net salvage. The effect of the adjustment is to decrease depreciation expense by \$3,828,186.

**ARGUMENT:** The Company proposes a 50-year ASL for buildings based on current actuarial analysis and reference to industry values ranging from 40-50 years. (Exhibit 115 at page 661). The Company's interpretation of its actuarial analysis is inadequate, as better fitting curves exist -- as set forth in Exhibit 187 at page 15, where OPC demonstrates that a 56-year ASL is a *better* fitting curve to the historical observed life table. Unlike the Company, OPC further investigated the investment in the account. 40% of the investment is associated with two new buildings. (TR-1930). Given the level of investment for these newer buildings, OPC determined it was appropriate to also review the 20-year actuarial band analyses, which further confirmed a longer ASL is warranted. Further investigation into the type of investment into the account identifies that 66% of the investment is associated with the 10 largest buildings owned by the Company. It is unreasonable for the Company to limit the ASL, when 40% of the investment is associated with the 2 new buildings that are constructed with concrete and can be expected to live much longer than the Company's 50-year ASL. OPC's recommendation to increase the ASL to 56 years is conservative, given the type and amount of investment at issue. FPL's proposal for a 50-year life understates the life of the larger dollar items of investment, and focuses on interim retirements or components of buildings rather than the sizable investment in the buildings. The only credible evidence in the record supports OPC's longer 56-year ASL.

The Company proposes to change from the current 0% net salvage to a negative 10% net salvage for this account based on increases in cost of removal in recent years, which the Company believes is typical for buildings. The Company also references to industry data which shows a negative 5% to a negative 15% net salvage. (Exhibit 115 at page 661). The Company's proposal is based on acceptance of historical results, with little or no thought as to the underlying assets. (TR-1978). The Company's reliance on recent activity reflects replacement of components of a building rather than the retirement of buildings. This is significant given that 64% of the investment in the account is tied to the 10 largest buildings owned by the Company. Large, modern office buildings constructed of pre-cast concrete can, and do, last for well over 50 years. In fact, real estate normally appreciates in value rather than depreciates in value, contrary to the Company's proposition in this case. OPC's recommendation for a positive 25% net salvage represents the first step towards proper recognition of significant value of the Company's office buildings and service centers. In fact, the Company ignores its own appraisal performed for its Juno Beach headquarters, which supports OPC's position that the investment in its

buildings has appreciated rather than depreciated (Id). The Company has met no reasonable burden of proof nor presented any credible evidence that a negative 10% net salvage is appropriate for more than a million square feet of office space located within pre-cast concrete buildings. The only credible evidence in the record is the recognition of an initial first step towards recognizing the value of such facilities of a positive 25% as recommended by OPC.

- u. Account 392.01 – General Plant Aircraft – Fixed Wing: Adjust FPL’s proposed 7 SQ life-curve combination to 9 R5. This reduces depreciation expense by \$372,741.

**ARGUMENT:** The Company chose not to perform an actuarial analysis for the investment in this account. The Company states that a 7-year life as currently employed “appears reasonable after discussion with company personnel.” (Exhibit 115 at page 669). The Company’s statement in support of its position is not borne out by a review of the underlying data. In fact, OPC points out that the oldest of the 3 vintage additions was placed into service in 1999. (TR-1931-1932). For the Company’s 7-year estimate to be credible, such investment should have already been retired in 2006, yet it has not retired even after 2007. Indeed, OPC pointed out that the 2<sup>nd</sup> and 3<sup>rd</sup> vintage additions out of the 3 total vintage additions for this account are already at 7 years of age, thus demonstrating the fallacy of the Company’s position that a 7-year life appears reasonable. In rebuttal, the Company admits that its one jet aircraft is already over 7 years old, but says that it will be retired next year. (TR-2811). The admission demonstrates a life in excess of 10 years for the oldest and largest vintage addition of the three vintage editions reflected in this account. Moreover, the only rebuttal to OPC’s proposed longer service life is a hollow statement that “on the whole, their [FPL] helicopters and airplanes last about 7 years.” (TR-2811). OPC submits that no matter how many times the Company states that they want a 7-year life for this investment, the reality is that the investment has and will continue to last longer than 7 years. The only credible evidence in the record is OPC’s recommended 9-year ASL.

- v. Account 392.02 – General Plant Aircraft – Rotary Wing: Adjust FPL’s proposed 7 SQ life-curve combination to a 9 R5 life-curve combination. This reduces annual depreciation expense by \$178,226.

**ARGUMENT:** The Company again did not perform an actuarial analysis for the investment in this account and, again, relies on the existing 7-year ASL as being reasonable. This contention is supported only by undisclosed discussions with company personnel. (Exhibit 115 at page 672).

For this account the Company was specifically requested to provide all support and justification for its life-curve combination, yet responded by only referencing undocumented discussions with unidentified Company personnel and their *belief* that the 7-year proposal is proper. (TR-1933). The Company could not provide any additional information, because the Company's actual experience corresponds to its last retirement of a rotary wing aircraft with a 10-year lifespan (Id). Thus, the actual experience is different than the Company's *discussions* with Mr. Clarke. The Company's credibility is greatly called into question when it continues in rebuttal to rely on undisclosed and unidentified discussions that are clearly contrary to the actual data provided by the Company applicable to the investment in this account. The only credible evidence in the record is OPC's recommendation for a 9-year ASL.

**ISSUE 19E: Based on the application of the depreciation parameters that the Commission has deemed appropriate to FPL's data, and a comparison of the theoretical reserves to the book reserves, what are the resulting imbalances?**

\*FPL currently has a depreciation reserve excess of \$2.7 billion. This amount is based on acceptance of OPC witness Jacob Pous' adjustments to FPL's depreciation study. It does not take into account OPC's and Mr. Pous' position that the life spans that FPL assigns to combined cycle units are too short; modifying those values to more realistic life spans in this proceeding would increase the size of FPL's depreciation reserve excess.\* **(Former Issue 33)**

**ISSUE 19F: What, if any, corrective reserve measures should be taken with respect to the imbalances identified in Issue 19E?**

*Subissue: Corrective reserve measures with respect to the theoretical reserve imbalances - **(Former Issue 34):** \*FPL's enormous depreciation reserve excess means it has over-collected depreciation expense from current customers. Its \$2.7 billion surplus constitutes a massive intergenerational inequity. The Commission should rectify this cumulative inequity to the extent consistent with the dual objectives of achieving fairness to current customers while maintaining FPL's financial integrity. FPL's proposal to return the excess over a remaining plant life of about 22 years is woefully inadequate to address the severity of the inequity. OPC estimates that there will be a 50% turnover in residential customers during that period. FPL should be required to amortize \$1.25 billion of its reserve excess back to customers over a period of four years. Limiting the amount of the overall \$2.7 billion excess to be amortized to \$1.25 billion will leave a thick "cushion" of reserve excess that will protect FPL until the next study.\**

*Subissue: Considerations and criteria when evaluating time frame for amortization of the depreciation reserve imbalances **(Former Issue 36):** \*The Commission should consider the extent to which it can reverse the pattern of overcollection of depreciation expense while maintaining FPL's strong financial integrity. It should also consider the timing of FPL's next*

depreciation study. The period of four years, when coupled with identifying \$1.25 billion as the amount to be amortized, satisfies these criteria. See also OPC's position on Subissue 34.\*

***Subissue: Impact of proposal with respect to the treatment of the depreciation reserve imbalances on FPL's financial integrity (Former Issue 37):*** \*If the Commission adopts all of OPC's recommendations in these consolidated dockets, including the recommendation to amortize \$1.25 billion of FPL's reserve excess over four years and OPC's overall recommendation to reduce base rates by \$364 million annually, FPL would continue to exhibit strong financial integrity. In his testimony and exhibits, OPC witness Daniel J. Lawton demonstrates that FPL would continue to display the financial parameters and indicators typical of an "A" rated electric utility.\*

**ARGUMENT:** Before analyzing what should be done with FPL's massive depreciation reserve surplus, OPC believes it would be useful to recap the nature and purpose of the concept of depreciation, and to articulate succinctly the policies underlying depreciation practices.

If a utility purchases an item and consumes it within the same accounting period in which it was purchased (gasoline for trucks; paper for copiers), for accounting purposes the utility fully "expenses" the item. That is to say, the full costs are booked and netted with other expenses against revenues to derive the net operating income for the period.

If, on the other hand, the item is going to be used to provide service for more than a year, the related investment is capitalized, and the investment is recovered over the service life of the asset through "depreciation expense."

Obviously, with respect to a capitalized asset, the related cash expenditure has already occurred; therefore, the annual depreciation expense relating to the asset does not reflect an additional outlay of cash. For this reason, depreciation is called a "non-cash expense." However, it is included as an item of cost in calculating the utility's total cost of service that rates are designed to recover through the revenues they generate. In that manner, a portion of revenues serves to reimburse the utility for the portion of capital costs attributable to that period of the asset's service life.

Clearly, a utility cannot continue to earn a return on the portion of the capital investment that it has recovered from customers. Each annual installment of depreciation expense is recorded in a manner that offsets or reduces the amount of rate base investment on which the utility is permitted to earn a return. The annual installments are recorded as "accumulated provision for depreciation" or "depreciation reserve". In the simplest scenario, an asset having a service life of 10 years would result in annual depreciation expense equal to 1/10 of depreciable

investment; the depreciation expense would be built into the overall cost of providing service recovered through base rates; the original rate base investment would be offset by an annually increasing “depreciation reserve” that reduces the amount of undepreciated investment on which a return is calculated ratably over its 10 year life; and the plant would be retired at the end of the 10 years.

The amount of “depreciable investment” takes into account the fact that, upon retirement, the plant will have a salvage value (positive or negative), and, in order to remove the plant from service and realize its salvage value, the utility may incur costs of removal. The net salvage value (that is, salvage reduced by removal costs) is an offset to the amount of original cost the utility can recover through depreciation.

The rationale underlying the practice of matching the period of time over which the utility collects depreciation expense with the service life of the asset is one of straightforward fairness: The customers who benefit from an item of plant should be the same customers who pay for the plant. This is referred to as the “matching principle.” (TR-1826).

Implicit in the matching principle is the proposition that it would be unfair for some customers to receive an undue benefit as a consequence of other customers being required to bear a disproportionate share of the costs of an item of plant. Said differently, one of the basic principles of depreciation policy and practice is that, with respect to the utility’s recovery of capital investments, current customers should not subsidize future customers, and future customers should not subsidize current customers. (TR-1826).

The appropriate depreciation rate, then, is a function of the capital investment, the net salvage (salvage minus cost of removal), and the service life of the asset. These are the depreciation parameters, or inputs, used to derive appropriate depreciation rates. The capital investment is known. Salvage, cost of removal and service life, however, will not be established finally and definitively until the plant is retired. Accordingly, estimates and assumptions regarding retirement date, salvage and cost of removal are used in quantifying annual depreciation expense. These estimates are revised periodically, based upon updated information. The Commission’s depreciation rules require electric utilities to prepare and file depreciation studies every four years. Rule 25-6.043(8)(a), F.A.C.

Rule 25-6.043(6)(d), F.A.C. provides that, once the revised parameters are determined, the utility must calculate the amount of depreciation expense it would have collected from

customers over time, had the updated service lives and net salvage values been in effect from “day one.” This is called the theoretical reserve. The utility compares the theoretical reserve to the book reserve, also called the accumulated reserve for depreciation, which represents the actual amounts of depreciation expense that the utility has recorded over time. If the book (actual) reserve is larger than the theoretical reserve, the utility has collected more than it needed to collect by that point in time, and a “reserve surplus” exists. If a reserve deficiency exists, it has undercollected depreciation expense.

The exercise of comparing book and theoretical reserves to quantify any positive or negative imbalance is more than informational in nature. Under the “remaining life” methodology that the Commission has adopted by rule, any reserve surplus (or reserve deficiency) is reflected in the undepreciated balance of an asset, which is divided by the remaining life of the plant to quantify the amount of annual depreciation expense to be collected going forward. In this manner, any reserve surplus will be returned to customers over the remaining lives; similarly, any reserve deficiency will be “made up” over the remaining lives. In this sense, the remaining life methodology can be said to be self-correcting over time. However, the “correction” takes place very gradually, over the remaining lives of the utility’s plant assets. In this case, on a composite basis that works out to be about 22 years. (TR-1833).

An imbalance between the book reserve and the theoretical reserve represents a violation of the matching principle, and, absent corrective action, requires one group of customers to bear costs that should be paid by another group. Whether the corrective feature of the remaining life calculation methodology addresses the unfairness inherent in departures from the matching principle adequately depends on the severity of the imbalance and the extent of the subsidization. (TR-1805).

FPL’s testimony is replete with references to FPL’s “*theoretical* reserve surplus.” Significantly, the word “theoretical” does not appear in the Commission’s definition of a reserve surplus:

(i) Reserve Surplus—An excess in the reserve of a category as evidenced by a comparison of that reserve indicated as necessary under current projections of life and salvage with that reserve historically accrued. The latter figure may be available from the utility[s] records or may require retrospective calculation.

Rule 26-6.0436(1)(i), F.A.C.

Perhaps FPL hopes having its witnesses add the word “theoretical” to the term may give the Commission the impression that the existence of a large surplus is less meaningful than it is. Don’t be misled. The Commission’s definition correctly treats it as highly significant. The Commission’s definition describes reserve surplus as an “excess” – without qualifying that excess as “theoretical.” By requiring a utility to divide the remaining un-depreciated balance (which reflects the effect of any surplus or deficiency) by the remaining life, the rule effectively directs utilities to incorporate the “reserve surplus” that FPL witnesses characterize as “theoretical” into the calculation of future depreciation rates, with the objective of eliminating the excess. There is nothing “theoretical” about the manner in which a reserve surplus (or deficiency) reduces (or increases) annual depreciation expense and resulting depreciation rates.

As it is required to do by rule, FPL prepared its periodic depreciation study and filed it in Docket No. 090130-EI. Based upon the service lives and net salvage parameters developed by its consultant, FPL quantified an overall depreciation reserve surplus in the amount of \$1.25 billion. FPL applied the depreciation rates that its depreciation consultant proposed when quantifying the 2010 test period revenue requirements. With respect to the \$1.25 billion reserve surplus identified by its consultant, FPL proposed to flow the surplus back to customers over the next 22 years via the standard remaining life methodology.

OPC engaged depreciation expert Jacob Pous to evaluate FPL’s depreciation study and depreciation-related rate case proposals. Mr. Pous’ review disclosed that Mr. Clarke, FPL’s depreciation consultant, was consistently aggressive when identifying the service lives, salvage values, and cost of removal for FPL’s plant. Aggressive in this context means FPL’s witness chose unrealistically short service lives, low salvage values and high cost of removal assumptions. (TR-1804). Parameters based upon aggressive assumptions increase annual depreciation expense relative to more realistic and supportable values.

Mr. Pous performed an independent review that resulted in alternative values for many plant items. He substituted his more appropriate depreciation parameters for those advocated by FPL’s witness to calculate FPL’s theoretical reserve. When he compared his calculation of FPL’s theoretical reserve with FPL’s book reserve, Mr. Pous determined that FPL has a current reserve surplus of \$2.75 billion – considerably higher than the \$1.25 billion sponsored by FPL’s witness. (TR-1807). Moreover, the \$2.75 billion figure is conservative, in that Mr. Pous identified certain areas in which FPL understated service lives (thereby overstating depreciation

expense) or overstated cost of removal (which understated net salvage and thereby overstated depreciation expense); however, Mr. Pous did not substitute alternative values for them in this case. Had he done so, the reserve surplus he identified would have been larger than \$2.75 billion. These areas include the appropriate service lives of combined cycle units (FPL uses 25 years) and the methodology that FPL employs to quantify dismantlement costs of fossil units (FPL assumes a need in all instances to perform a “reverse construction” approach and to restore the site to Greenfield status). OPC identified these as areas as issues on which the Commission should focus in the future, either when FPL files its next depreciation study, in the case of its combined cycle units, or in a separate docket, in the case of the dismantlement methodology.

The question, then, is: What should be done with a depreciation reserve surplus that FPL’s witness Clarke (using aggressive assumptions) quantifies to be \$1.25 billion, and that OPC’s Jack Pous measures to be \$2.75 billion? FPL’s answer is to roll \$1.25 billion into the “remaining life” calculation. This would mean reducing the total capital costs to be collected by the book reserve (which includes the surplus) and dividing the result by the 22 years remaining to quantify the annual credit that current customers would see in the measurement of FPL’s 2010 revenue requirements. Given the enormity of the reserve surplus, OPC asserts this approach is wholly inadequate to restore a meaningful degree of “depreciation fairness” to customers. If FPL served a single customer or group of customers who remain on the system from start to finish, the remaining life approach might be more appropriate to the circumstances. However, that is not the case. As is the case with other utilities, customers come and go frequently on FPL’s system. (TR-1834).

That being the case, the extent of subsidization (i.e., “intergenerational inequity”) increases with the size of the imbalance and the length of the correction period. Here, an amortization period far shorter than the 22 years remaining life period is required to return the reserve excess to the same customers (to the extent possible considering customer turnover) whose rates resulted in a depreciation reserve surplus. As explained in detail below, “to the extent possible” also means to the degree that can be accomplished while maintaining FPL’s financial integrity.

Far more than FPL’s proposal must be done to mitigate the gross intergenerational inequity occasioned by the fact that future customers would benefit unfairly by the disproportionately larger share of capital costs that has been borne by current and past customers.

Consistent with the testimony of Mr. Pous, OPC recommends that \$1.25 billion of the \$2.75 billion reserve surplus be amortized over four years. If the Commission adopts OPC's recommendation, ¼ of \$1.25 billion, or \$312 million, would appear in FPL's 2010 test period revenue requirements as a credit (offset or reduction) to depreciation expense. This means that FPL's overall revenue requirements for 2010 would be reduced by \$312 million. The portion of the reserve surplus above \$1.25 billion, which OPC's expert measures to be \$1.5 billion, would be left in place so as to avoid too big an impact on FPL's cash flow and to leave a cushion of excess reserves pending the completion of FPL's next depreciation docket. The Commission will revisit the status of depreciation reserves and depreciation rates in four years, when FPL submits its next depreciation study.

OPC submits this approach represents the best and most appropriate remedy to the huge reserve surplus that is available to the Commission. It will provide a significant first step toward eliminating the intergenerational inequity created by the enormous surplus.

Importantly, FPL can afford to implement this measure. First, OPC's proposed amortization will not deny FPL recovery of any capital dollars. The amortization will affect only the timing of the collection of those dollars – by repositioning a portion of the recovery into future periods so that future customers will pay more of their fair share.

Next, OPC's proposed amortization would affect neither FPL's earnings nor FPL's earned rate of return. When total revenue requirements borne by rates are reduced by the amount that test year depreciation expense is reduced, rates are correspondingly lower; however, earnings and earned rate of return do not change.

OPC recognizes that, just as too-high depreciation expense in past periods enhanced cash flow, a credit to depreciation expense will reduce cash flow. Like other utilities, FPL must generate enough cash to cover its expenses, including debt service. The "coverage ratios" (the number of times FPL's cash flow that it generates "covers" debt service) are an important indication of financial integrity. When selecting the portion of the reserve surplus to be amortized and the length of the amortization period, Mr. Pous coordinated with OPC witnesses Dr. Randall Woolridge, Sheree Brown, and Dan Lawton to ensure that the amortization he proposed would not negatively impact FPL's financial integrity. In his Exhibit 442 (supplement to DL-6), OPC's Dan Lawton demonstrated that, if the Commission were to adopt Mr. Pous' recommended amortization of \$1.25 billion of FPL's reserve surplus *and all other OPC rate*

*case adjustments*, FPL's financial indicators would continue to be in the range that would warrant an "A" rating by Standard & Poor's. This conclusion holds true, regardless of whether the S&P criteria that Mr. Lawton employed or the more current S&P criteria are examined. (TR-2343-2345).

This bears repeating. In the aggregate, all of OPC's recommendations – including the recommendation to amortize \$1.25 billion of FPL's reserve surplus over four years – would lead to a base rate reduction of \$354 million annually. FPL's financial strength is such that FPL's cash flow will be sufficient, even after all of OPC's rate case adjustments are made, to amortize \$1.25 billion of the \$2.75 billion reserve excess identified by Mr. Pous and continue to show coverage ratios that warrant its current A rating by Standard & Poor's.

It is time to consider the arguments that FPL advanced in opposition to OPC's proposed four year amortization. The first FPL argument is that the Commission should look to the remaining life methodology, basically because it is the way the Commission deals with reserve imbalances. However, the remaining life calculation is not the only way the Commission has addressed depreciation practices over time.

In many past proceedings to set depreciation rates, the Commission distinguished between the portion of the reserve imbalance attributable to past insufficient parameters, on the one hand, and the deficiencies that would occur in the future absent a change in depreciation rates, on the other. In those cases, the Commission directed the utility to recover the former amount over a period of time far shorter than the remaining life. One example among many is Order No. 12866, issued on December 14, 1984, in Docket No. 830268-TP, In re: Petition of Indiantown Telephone System, Inc. for revision of depreciation rates:

Because we have determined that new depreciation rates are important, we must also provide for the recovery of the difference between the current reserve levels and what the reserve levels should be using the new depreciation rates. . . . We are ordering two amortization schedules for use in recovering the reserve deficit. That portion of the deficit that is attributable to changes in prospective life and salvage values is to be amortized over the composite remaining life of the embedded plant, which is estimated to be 15 years. That portion of the deficit that is attributable to past incorrect estimates of life and salvage factors and technological changes and growth should be recovered over a shorter period. Therefore, we are ordering a 5-year amortization period for this portion of the deficit. (at pages 1-2)

Another method the Commission has used to eliminate imbalances is to transfer surpluses from some reserve accounts to offset deficiencies in others. See Order No. 16963, issued on December 16, 1986 in Docket No. 851110-TL, Application of Central Telephone Company of Florida for New depreciation Rates. Another method that the Commission has used frequently to address reserve imbalances is to identify individual accounts that have reserve surpluses and transfer some or all of the surplus to accounts (within the same functional area, so as to avoid any distortion that might result from transfers between functions) that have reserve deficiencies. OPC has identified literally dozens of instances in which the Commission addressed imbalances in this other-than-remaining-life method; OPC cited twelve of them in its Request for Official Recognition, dated September 4, 2009.

One example of such orders is Order No. 941199, dated September 30, 1994. In that order the Commission stated, “One aspect of a depreciation study is the review of the reserve status of all production sites and all transmission, distribution and general plant accounts to determine the need for corrective reserve transfers.” Among other things, the Commission reallocated the reserve surplus at Riviera Units 3 and 4, and Ft. Myers Unit 1 to recover reserve deficiencies associated with asbestos abatement and a pre-1994 major overhaul. In Order No. 990073, issued on January 8, 1999, the Commission directed FPL to apply specific reserve surpluses to eliminate reserve deficiencies. The Commission stated: “Therefore, as of January 1, 1999, the company’s total generation reserves were equal to their theoretical reserves based on the most recent study by the company.” Similarly, in Docket No. 970410, the Commission ordered that the first priority would be the “Correction of any depreciation reserve deficiency resulting from an approved depreciation study order.”

In fact, Commission Rule 25-6.043(7)(b), F.A.C., states, “The possibility of corrective reserve transfers shall be investigated by the Commission prior to changing depreciation rates.” The application of this rule is significant in this case because FPL’s depreciation study presents a clear opportunity to apply a portion of the reserve surplus in this manner to lower FPL’s claimed revenue deficiency — an opportunity that FPL chose not to propose. Part of FPL’s overall claimed revenue deficiency is related to FPL’s desire to recover some \$314 million of undepreciated costs associated with imminent retirements at its Riviera and Cape Canaveral plants, its nuclear uprate projects, and the first of the meters to be replaced with the “AMI meter” project, over four years by the application of a special capital recovery schedule. The proposal

comprises about \$78 million of FPL's total annual revenue request for 2010. In other words, at the same time FPL proposes to return a surplus in the range of \$1.5 billion - \$2.7 billion to customers over a period of 22 years — thereby hanging onto that money as long as possible — FPL wants to increase depreciation expense by \$78 million per year for four years to recover what will be a deficiency in certain accounts when the identified retirements occur.

In light of the above precedent and the Commission's rule on the subject, FPL's proposal is particularly wayward. OPC witness Pous established, and FPL witness Davis did not dispute, that when FPL requested a capital recovery schedule designed to collect the deficiency of \$44.9 million due to early retirements at Cape Canaveral and Riviera generating stations, its books showed \$410 million of reserve excess in "steam production" investment. When it sought similar rapid collection of the \$168 million pending deficiencies due to retirements occasioned by nuclear uprate activities, FPL's books showed a reserve surplus of \$377.5 million in nuclear production investment. When FPL sought to include \$101 million of unrecovered costs associated with phasing out existing residential meters, FPL had \$340 million of reserve excess in the distribution function. (TR-6415). Yet, in his testimony FPL witness Davis vigorously defended the four year capital recovery schedule and opposed Mr. Pous' recommendation to apply a portion of the \$1.25 billion surplus to eliminate it. (TR-6416-6417).

OPC believes the disparity of treatment between the \$2.7 billion surplus, on the one hand (return over 22 years) and the request to collect a specific \$314 million deficiency, on the other (collect over 4 years) buttresses Mr. Pous' observation that a utility has an incentive to collect as much depreciation expense as possible, then keep as much of it as possible. (TR-1806). This is FPL's version of symmetry and fairness. In his recommendation, Mr. Pous proposes to apply the first \$78 million of his \$312 million annual amortization to eliminate the deficiency that will be related to the specific retirement events and the corresponding need for a capital recovery schedule.

Interestingly, over time FPL has received the benefits of some of the Commission's significant departures from "remaining life." In the 1990s, the Commission allowed FPL to accelerate its collection of depreciation expense by approximately \$1 *billion* in preparation for potential deregulation and competition by applying a specified increment of revenues to write down assets. The measure had nothing to do with the remaining life methodology. See Order No. PSC-97-0499-FOF-EI. Subsequently, when the potential for deregulation had dissipated and

FPL had “overdepreciated” its plant (FPL’s President’s term)<sup>1</sup>, the Commission approved two settlements pursuant to which FPL credited depreciation expense (thereby reducing its reserve surplus) by \$125 million per year for eight years. In approving the settlements, the Commission approved and adopted measures other than the remaining life methodology to address reserve imbalances.

These are not the only examples of the Commission’s use of approaches other than remaining life to address imbalances. During the hearing, OPC asked the Commission to take official recognition of 31 separate orders in which the Commission treated reserve imbalances by means that departed from the strict remaining life methodology. Most of the orders involved reserve deficiencies, not surpluses, but that is because – prior to recent cases involving FPL and Progress Energy Florida – those were the circumstances that utilities presented to the Commission most frequently.

In almost all of its other arguments opposing OPC’s proposed amortization, FPL expresses concern for its customers’ well being. The chief such argument is that, because the annual amortization would have the effect of returning past depreciation to rate base, OPC’s recommendation will increase customer’s rates several years from now. When supporting FPL’s pending request for a billion dollar + rate increase, representing (over 2 years) a 30% increase in base rates. FPL witness Michael Davis worried aloud about future “rate shock” associated with Mr. Pous’ recommendation -- which, said Mr. Davis, could cause future rates to increase by 3.8%. (TR-6399). Aside from the fact that as a result of its petition FPL has no credibility when it expresses concern over rate shock, there are several things wrong with FPL’s argument.

First, it overlooks that past customers have paid too much in depreciation expense, so FPL’s current rate base is artificially below the level that would be associated with the matching principle. Next, while it is true that Mr. Pous’ recommendation would increase rate base each year by the amount of the amortization, it is equally true that in each of those years the continued application of FPL’s depreciation rates will increase the reserve for accumulated depreciation (thereby reducing rate base) in each of those years. (TR-6472-6473). Perhaps more significantly, to the extent that FPL adds customers and increases sales between now and the next base rate proceeding, the revenue requirements associated with the rate base “add-back” will be spread over a higher level of kilowatts of demand and more kilowatt hours of energy sold

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<sup>1</sup> Exhibit 539, at page 32.

than are included in the 2010 test period. Spreading the increase over a higher number of these billing determinants will mitigate the impact of the “add-back” by lowering the amount of rate increase per unit of consumption<sup>2</sup>, thereby lessening the impact on individual bills. (TR-6473).

Finally, whether the increased revenue requirements associated with the “add-back” would be seen as a net plus or minus by a customer would depend on that customer’s individual discount rate, or time value of money. After lowering its base rates to reflect the \$312 million annual amortization, FPL would earn approximately 8.5% on the amount of depreciation credits added back to rate base over time. To the many customers currently financing their household circumstances with credit cards that charge as much as 25% interest, a 4 year amortization that would lower their rates and free up cash with which to pay down those 25% interest rates credit card balances *now* would be economically very appealing – even if the tradeoff is an addition to rate base that earns 8.5% when rates are next calculated. When arguing on behalf its customers, FPL ignored this crucial aspect of the consequences of the amortization proposed by OPC in its direct testimony, and did not challenge or dispute this point when OPC raised it during cross examination. (TR-6474)

Next, FPL’s witnesses attempted to trivialize, distort, or deny the intergenerational inequity that the massive reserve surplus presents. FPL’s depreciation analyst, Mr. Clarke, used the term “intergenerational inequity” in connection with a reserve deficiency; however, he tried to limit its applicability to an underrecovery:

Q. Take a moment and review Lines 18 through 22. Mr. Clarke, beginning at Line 18 you refer to certain proposals by Mr. Pous and Mr. Pollock, and you assert that the suggested changes would result in a significantly understating FPL’s true depreciation requirements, and thus improperly skew recovery of asset value toward the future, saddling future customers with a burden that is disproportionate to their use of the assets in question. Do you see that?

A. Yes, I do.

Q. And the next statement says this has significant adverse consequences for intergenerational equity. Do you see that?

A. Yes, I do.

Q. Do I understand, sir, that you oppose those measures that would place a burden on customers that is disproportionate to their use of the assets in question?

A. In this instance, yes.

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<sup>2</sup> To illustrate: If a \$25 million increase in revenue requirements is to be spread over 50 million gigawatt hours (GWH), the increase will be \$0.50 per GWH. If it is instead spread over 60 million GWH, the increase is only \$0.446 per GWH. For the same level of consumption, an individual customer’s bill will be lower if the increase is spread over the larger level of system sales.

Q. And do I understand correctly that is your position that intergenerational equity is a consideration that the Commission should take into account as it evaluates the depreciation issues in this case?

A. No, I don't.

Q. Well, you do say at Line 21 with respect to your observation that some customers would be placed with a disproportionate burden and that this has significant adverse consequences for intergenerational equity, do you not?

A. Yes, I do.

(TR-2841-2843).

This witness' bias is as unsupportable as it is blatant and stark.. Mr. Clarke cannot have it one way. Surpluses and deficiencies alike violate the matching principle that underlies depreciation practices. Each represents the formation of a subsidy. Both are to be avoided or, once formed, eliminated.

FPL witness Michael Davis used the term "intergenerational inequity" to describe, inappropriately, the benefits that current customers will receive as a result of increasing future customers' obligation to bear capital costs:

Q. Would the intervenor witness' proposals to amortize the theoretical reserve surplus reduce or eliminate intergenerational inequities as suggested?

A. No. In fact, the effect is the opposite of what is suggested. A rapid amortization will create intergenerational inequities by providing customers during the next four years with an artificial benefit while requiring customers in future periods to pay significantly higher costs solely as a result of the short-term benefit have been provided. ...

(TR-6404).

Mr. Davis even asserted that, with Mr. Pous' proposal, customers on the system during the next four years would receive a "windfall"! (TR-6419). Mr. Davis' characterization is based upon a self-servingly myopic view of the customers' circumstances. Only by ignoring the history of the reserve surplus, treating 2009 as the beginning point of pertinent circumstances, *and* pretending that in 2009 a fair cost collection equilibrium exists among current and future customers, could Mr. Davis portray current customers as receiving an undue advantage, and future customers as receiving an unfair burden, from OPC's proposal. He ignored the fact that the explicit purpose of the amortization proposed by OPC is to turn around a portion of the amount that current and past customers have overpaid in past years, so as to reduce the subsidy that future customers otherwise would enjoy at their expense. Mr. Davis' truncated view of the

situation is particularly ironic, in that in other portions of his testimony he argued that OPC's approach fails to take history into account. (TR-6402; 6407-6408; 6410).

Terry Deason, FPL's last witness, maintained that if past customers paid the rates deemed appropriate at the time, the fact of a reserve surplus (or by implication, a reserve deficiency) does not mean an intergenerational inequity exists. (TR-6754)<sup>3</sup>. Accordingly, he denied that the current \$1.25 billion reserve surplus involves an intergenerational inequity. Further, he contended that the paramount objective of depreciation policy is – not fairness to customers over time – but more simply to ensure that the final period of collection coincides with the retirement date of the related asset. (TR-6724; 6754-6755). Under Mr. Deason's premise, the remaining life methodology should be employed in all situations where there is "adequate time" to eliminate an imbalance over the remaining life.

With respect to Mr. Deason's emphasis on examining whether the remaining life methodology will satisfy his objective of ensuring that the utility will collect 100% of its capital costs by the retirement date, this question arises: – *When would it not?* Assume an item of plant has an undisputed service life of 50 years. Assume that in year 10, the utility has collected 90% of the depreciable capital costs. According to the view that Mr. Deason expressed, the Commission should apply the remaining life methodology and permit future customers to pay only 10% of capital costs over 80% of the service life. He would reach this conclusion because there is "adequate time" for the remaining life methodology to correlate the period of collection with the retirement date.

Clearly, ascertaining whether the remaining life methodology will match the collection period to the retirement date is a poor means of distinguishing among situations, because the methodology is constructed to *always* match the period of collections with the retirement date. The consideration missing from Mr. Deason's premise is the purpose underlying the policy of matching the collection period to the service life of the asset. The fundamental purpose of depreciation policy is to achieve fairness among customers: Those customers who are served by the asset should be the customers who pay for it. In the above example, in which customers paid 90% of depreciable costs in the first 20% of the service life, Mr. Deason would assert that, as long as they were paying the depreciation rates deemed appropriate at the time, the 90/20

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<sup>3</sup> His testimony contradicted that of FPL witnesses Clarke and Davis, who, though they severely distorted its application, implicitly acknowledged the validity of the *concept* of intergenerational inequity.

situation presented no intergenerational inequity. This view is at odds with the theory underlying prescribed depreciation practices.

Essentially, Mr. Deason tried to deny that any linkage exists between the objective of matching the cost collection period with the service life, on the one hand, and the concept of accomplishing fairness to customers, on the other. *It cannot be done.* The matching principle is not simply a matter of accomplishing a neat and tidy confluence of accounting events for its own sake. The matching principle is not so sterile a concept. It springs from, and is permeated with, the principle that customers should pay their fair share of the costs of the plant that serves them – no more and no less – so that they neither subsidize other generations of customers nor are subsidized by them.

Mr. Deason's denial of this fundamental relationship is at odds with the view the Commission has expressed in its orders. *In fact*, Mr. Deason's testimony on this point is directly contradicted by an order in which Mr. Deason participated when he was a Commissioner. In Docket No. 930221-EI, a panel consisting of then Chairman Deason and Commissioners Clark, Johnson, and Laredo ruled on depreciation rates proposed by Gulf Power Company. At page 7 of Order No. PSC-93-1808-FOF-EI, issued on December 20, 1993, the Commission stated:

Finally, Gulf has taken issue with the presumption that unrecovered costs—if significant—should be fully recovered by the time the assets are retired since it is unable to find any such requirement in the Florida Administrative Code or the FERC USOA. However, depreciation, as defined by any book or publication, is to provide a systematic recovery of invested capital over the period the assets represented by that capital are serving the public. *The intent is that customers benefitting from the plant at any point of time will be bearing their appropriate share of the depreciation expense. The matching of expenses to consumption is the goal.* (emphasis provided)

In this order, the Commission – with Mr. Deason participating - articulated well the principle that Mr. Deason now resists in his testimony. The quoted passage applies with equal force to both a capital recovery schedule, as was involved in the Gulf case, and an enormous midcourse reserve surplus, which this case presents.

Mr. Deason also participated in a decision in which the Commission embraced the proposition that a failure to match the recovery of costs of plant with benefits results in an intergenerational inequity. In Docket No. 970410-EI, the Commission considered a request by FPL to allow FPL to apply designated increments of revenues toward eliminating reserve

deficiencies. The Commission's order is revealing, in that all of the arguments that have been advanced in this case were made then. However, in the 1997 case FPL and Mr. Deason were on the other side of them! In the case, FPL's witness, Mr. Gower, testified that eliminating deficiencies more rapidly than the remaining life would cure the intergenerational inequity associated with placing on future ratepayers more than their fair share of the burden of plant used to serve past and future customers. Here is how the Commission summarized Mr. Gower's testimony for FPL:

Mr. Gower further testified that correction of the nuclear decommissioning and fossil dismantlement reserve deficiencies over a time period shorter than the remaining life of the associated plants is consistent with this Commission's prior actions. . . .

Because the reserve deficiencies represent costs that should have been recovered in prior years, intergenerational equity suggests that these deficiencies be recovered quickly so that future ratepayers are not burdened with an unfair share. The primary purpose of the proposed Plan is to correct past deficiencies. This correction is not an acceleration of expenses appropriately attributable to future periods but, in fact, is remedial because it addresses expenses appropriately attributable to prior years and therefore corrects intergenerational inequities. The intergenerational inequity has already occurred and, if not corrected by the proposed Plan, will only be exacerbated. (Order No. PSC-98-0027-FOF-EI at pages 6-7)

In that case, (Intervener) Ameristeel witness Cicchetti rehearsed for FPL the argument that FPL is presenting in this case, by advocating the use of the remaining life method to deal with the reserve deficiency:

Witness Cicchetti submitted that FPL's nuclear decommissioning accrual prescribed in 1995 was designed to correct any deficiencies over the remaining life of the nuclear units. . . .Witness Cicchetti submitted that there is no indication that periodically adjusting the decommissioning and dismantlement annual accruals will not adequately ensure recovery over the remaining lives of the associated units. (Id, at page 8)

Mr. Cicchetti also foreshadowed the argument being made by FPL witness Davis in the instant case, to the effect that correcting an imbalance more rapidly than over the "remaining life" creates an inequity rather than righting one:

Witnesses Cicchetti and DeWard argued that correction of the deficiencies as quickly as economically practicable exacerbates an intergenerational unfairness to the (future) ratepayers of 1998 and 1999. (Id at page 14)

Ameristeel witness Cicchetti even attempted to argue that timely recovery, not fairness to customers, should be the Commission's sole focus --which is the argument Mr. Deason is advancing on behalf of FPL in this case:

Witness Cicchetti testified that he believes adjustments of existing or future overearnings to make up material past deficiencies and depreciation accruals may or may not be appropriate accounting from a regulatory perspective. He stated that the important thing is that the Company recovers its total cost; he further stated that there is nothing to indicate that any of the items or the amounts listed in the proposed Plan are in jeopardy of not being recovered. . . . He contended that the period of recovery of the depreciation reserve balance is not as important as ensuring that the imbalance is recovered in total by the end of its useful life. (Id at page 13)

Having considered the competing arguments, the Commission, with Mr. Deason participating, agreed with FPL's witness Gower:

The remaining threshold is whether the record demonstrates that correcting a reserve deficiency over a shorter period of time is more reasonable or fair than correcting the reserve deficiency over the remaining life. *The record evidence demonstrates that the tenet of intergenerational equity dictates that, in this docket, correcting reserve deficiencies over a shorter period of time is more reasonable or fair than correcting the reserve deficiency over the remaining life.*

At page 15 (emphasis supplied)

The Commission should take careful note, not only of the conclusion — which is consistent with OPC's position in this case — but of the dramatic pivots in positions made by FPL between the 1997 docket, which involved a reserve deficiency, and this case, which involves a massive reserve surplus. In the above order, FPL contended an approach that cured an imbalance more rapidly than would remaining life was needed to cure intergenerational inequities. The Commission, with Mr. Deason participating, rejected competing contentions and granted the shorter periods specifically to address the intergenerational inequity identified by FPL. In this case, FPL is opposing the application of the principle of intergenerational equity that it advocated in Docket No. 970410-EI. In his capacity as witness for FPL, Mr. Deason is advancing the very proposition ("all that matters is 100% recovery by retirement") that Ameristeel argued and that he effectively rejected in Order No. PSC-98-0027-FOF-EI.

Mr. Deason's emphasis on treating the remaining life methodology as the near-exclusive means of addressing reserve imbalances is also at odds with other actions that he took as a regulator. On the witness stand, Mr. Deason acknowledged that he (and other Commissioners)

voted to allow FPL to depreciate assets rapidly in preparation for potential deregulation. As has been shown, that program was a significant departure from the remaining life methodology. A billion dollars of accelerated depreciation later, the potential for deregulation had passed and FPL's president, Mr. Evanson, was describing FPL as "overdepreciated." Mr. Deason (as did FPL's president) saw in the provision of the 2002 settlement that permitted FPL to credit depreciation expense \$125 million per year during the four years of the settlement a means of correcting the depreciation reserves to their proper status over 4 years – a matter he publicly deemed important in this excerpt from the transcript of the special agenda conference held in Docket No. 001148-EI (Exhibit 539):

Commission Deason: Okay. The, the other question I have, I guess this is probably more appropriately addressed to the company, and it has to do with the ability of the company to, to book credit amounts to the depreciation expense up to \$125 million per year. And we got, just got clarification as to how that would work during the, during the duration of this agreement.

I, I can understand the necessity for this. It gives the company some, some flexibility. This agreement is over a number of years and you cannot look into a crystal ball and know exactly what's going to transpire during that period of time. I guess it gives the company some ability to have some consistency and stabilize earnings, if necessary.

I guess my question. I guess I'm looking for some assurance from the company, is that this provision will not be utilized unnecessarily. . . .  
(Transcript, p. 30, lines 1 through 16)

Mr. Evanson: Well, Commissioner Deason, we certainly intend to continue to operate the company in the same efficient manner we have in the past and we certainly will be making every effort to improve operational efficiency and productivity.  
(Docket No. 001148-EI, Special Agenda Conference Transcript, p. 30-31, lines 23-25; 1-2)

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

So we've done a lot to do that, we've changed a lot of policies, and I think perhaps we've gone too far in that area. We did, as you know, in the '90s under the depreciation, special depreciation program approved by the Commission take perhaps an additional billion dollars of special depreciation secondly. And then when we go back and look at the remaining book value of our assets, they are

extremely low and extremely low compared to industry averages. The fossil is about, I think it's almost a fourth of what the industry average is; the nuclear is about the same order of magnitude. So in a sense we've significantly – it appeared to me relative to industry and also relative to market value, those assets have been very highly depreciated. . . .  
(Transcript, pgs. 31-32, lines 5-25, 1)

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

So it serves a few purposes, but I think it certainly would serve the purpose of bringing our depreciation more in-line. And I think after we've taken that, to the extent that we take the full \$125 million, we actually will be in-line with peer groups.  
(Transcript, p. 32, lines 8-18)

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

MR. EVANSON; Well, I think there are two aspects. That's clearly one, and I think one that otherwise is overlooked. But the second is certainly it helps, it does cushion the earnings impact to the company on, from a \$250 million rate cut.

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

We know that if, if we underdepreciate or overdepreciate, there has to be corrective measures taken after the next study. And my effort, I mean, my concern is try – I want the depreciation reserves to be as accurate as possible. I want to hopefully avoid though erratic changes in depreciation rates. And I know that this agreement keeps rates frozen, depreciation rates frozen during the entire period. I would hope that after the conclusion of this settlement, if it is approved, that we would not find ourselves in a situation where depreciation reserves are way out of balance from where they should, theoretically should be. And you've given me the indication that you think this is a step in the right direction to get those, actually to get those, as a positive thing to get the reserves where they should be.

MR. EVANSON: Right.  
(Transcript, pgs. 33 through 35, lines 23-25; 1-25; 1-6).

Mr. Deason's testimony in the instant case was internally inconsistent in another respect. On the one hand, Mr. Deason agreed that ideally the utility would collect depreciation expense ratably over the service life, such that at a given point there is neither a reserve surplus nor a reserve deficiency. (TR-6723). At the same time, Mr. Deason resisted OPC's proposal to address the large imbalance on the grounds that to do so would deprive customers of the benefit of the surplus. (TR-6739). Mr. Deason and Mr. Davis argued that the Commission should allow FPL to maintain the large reserve surplus because it has the effect of reducing rate base and revenue requirements relative to a reserve that has no surplus. (TR-6745).

However, Mr. Deason agreed during cross-examination that the "overdepreciated" system described by then FPL president Evanson meant FPL had a depreciation reserve surplus at the time. (TR-6738). The prospect of "depriving customers of the benefit of the surplus" did not bother Mr. Deason at the time; to the contrary, he was openly comforted by the knowledge that one effect of the settlement would be to reduce or eliminate the reserve surplus. One can only infer that, at the time he believed his belief that the objective of restoring reserves to their proper levels was more important than any perceived "benefits" created by the "overdepreciation." Besides, if requiring past or current customers to overpay so as to permit future ratepayers to enjoy lower rates were the appropriate policy, depreciation policy would be to create surpluses, not eliminate them. It is always possible to lower carrying costs by buying down the amount being financed. One could lower revenue requirements even more by requiring utilities to expense their investments in plant in the first year and placing the entire investment on the backs of the customers who are taking service then. Again, this might have more appeal if the same customers took service from the plant throughout its life. However, that is not the case. Through adoption of the matching principle, the Commission has appropriately made the policy decision to emphasize fairness among customers. A surplus is as much a deviation from that policy as is a deficiency.

In response to questions from Commissioner Skop, Mr. Deason acknowledged that the Commission has the authority and discretion to address depreciation issues by means other than the remaining life methodology, including the type of amortization proposed by OPC. But he contended that this case does not present an occasion for doing so. (TR-6738). To the contrary, the evidence indicates that after eight years of \$125 million annual credits to depreciation, the chief value of which Mr. Deason believed at the time to be a remedy to the overdepreciation of

the 1990s, have not put more than a smallish dent in the surplus created by the accelerated depreciation program of that period. In 2002, the reserve surplus (as measured by FPL's depreciation study) that FPL's president publicly decried was \$1.6 billion; presently, it lies between \$1.25 billion (FPL's figure) and \$2.75 billion (OPC's analysis). The severe intergenerational inequity associated with the overdepreciated assets has persisted, and will continue to persist unless the Commission adopts OPC's recommendation to amortize a significant portion of the surplus over the near term<sup>4</sup>.

**ISSUE 19G: What should be the implementation date for revised depreciation rates, capital recovery schedules, and amortization schedules?**

\*January 1, 2010.\*

**ISSUE 19- 39:** Intentionally Blank.

**FOSSIL DISMANTLEMENT COST STUDY**

**ISSUE 40: Should the currently approved annual dismantlement provision be revised?**

\*Yes. FPL's quantification represents a worst case scenario for terminal net salvage. The Commission should substitute the more reasonable value proposed by OPC. At a minimum, the Commission should revisit the extreme assumptions that drove FPL's estimate in the next study or in a general proceeding.\*

**ARGUMENT:** FPL's request fails to recognize any potential of full or partial sale of the site or facilities. FPL's request also fails to recognize the possibility of reuse of a site, which has already occurred. In addition, FPL's reliance on the "reverse construction" approach fails to recognize less costly means of demolition that have already been employed elsewhere. At a minimum, the Commission should direct FPL to propose a more realistic approach and cost level to terminal net salvage in its next depreciation study. If the Commission is inclined to change the terminal net salvage level in this proceeding, it should use 40% of FPL's request. The 40% level represents the approximate level actually obtained for generation demolition in comparison to similar "reverse construction" cost estimate.

**ISSUES 41-43:** \*See Issue 40.\*

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<sup>4</sup> To be clear, OPC's proposal to amortize \$1.25 billion of FPL's reserve surplus is based upon the magnitude and resulting unfairness of the imbalance, and is not dependent on the source or cause of the imbalance.

**ISSUE 44: In future dismantlement studies filed with the Commission, should FPL consider alternative demolition approaches?**

\*Yes. See Issue 40.\*

**RATE BASE**

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent year adjustment.)

**ISSUE 45: Intentionally Blank.**

**ISSUE 46: Should the net over-recovery/under-recovery of fuel, capacity, conservation, and environmental cost recovery clause expenses be included in the calculation of working capital allowance for FPL? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Consistent with Commission practice, clause over-recoveries are included (as a reduction) and under-recoveries are excluded from working capital. Over-recoveries represent funds the Company owes customers that if excluded from working capital, customers would be providing interest the Company returned in the clause. In the clause, under-recoveries are collected from customers at the commercial paper rate. If clause under-recoveries are included in base rates, the company would receive a double return on the under-recovery.\*

**ARGUMENT:** The Commission's long-standing practice has been to exclude clause under-recoveries, which are assets, from working capital, and to include over-recoveries, which are liabilities. The rationale for including over-recoveries as a reduction to working capital is to provide the Company with an incentive to make its projections for the cost recovery clause as accurate as possible and avoid large over-recoveries. The Commission should treat the over and under-recoveries projected in this docket consistent with its prior practice<sup>5</sup>. OPC's opposes the subsequent test year adjustment in its entirety.

**ISSUE 47: \*No position.\***

**ISSUE 50: Are FPL's requested levels of Plant in Service appropriate? A. For the 2010 projected test year in the amount of \$28,288,080,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$29,599,965,000?**

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<sup>5</sup> See Order No. PSC-08-0327-FOF-EI, issued May 19, 2008 in Docket Nos. 070300-EI and 070304-EI, In re: Review of 2007 Electric Infrastructure Storm Hardening Plan filed pursuant to Rule 25-6.0342, F.A.C., submitted by Florida Public Utilities Company; and In re: Petition for rate increase by Florida Public Utilities Company. pp. 30-31; Order No. 12663, issued November 7, 1983, in Docket No. 830012-EU, In re: Petition of Tampa Electric Company for an increase in rates and charges and approval of a fair and reasonable rate of return. pp. 14-15; and Order No. PSC-93-0165-FOF-EI, issued March 29, 1993, In re: Application for a rate increase by Tampa Electric Company, p.38.

\*Adjustments are appropriate regarding the appropriate jurisdictional factors in Issue 16. As reflected on Exhibit 248 SLB-26 Revised, jurisdictional plant for each year is as follows: A.2010: \$27,914,655,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$29,667,845,000.\*

**ISSUE 51: Are FPL's requested levels of accumulated depreciation appropriate? A. For the 2010 projected test year in the amount of \$12,590,521,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$13,306,984,000?**

\*Corresponding adjustments are appropriate as a result of the recommended adjustments in Issues 18-39 (depreciation) and Issue 50 (plant). As reflected on Exhibit 248 SLB-26 Revised, jurisdictional accumulated depreciation for each year is as follows: A.2010: \$12,175,597,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$12,321,306,000.\*

**ISSUE 52:** \*No position.\*

**ISSUES 53-54:** Approved.

**ISSUE 55: Are FPL's requested levels of Construction Work in Progress (CWIP) appropriate? A. For the 2010 projected test year in the amount of \$707,530,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$772,484,000?**

\*No. As reflected on Exhibit 248 SLB-26 Revised, adjustments are necessary to reflect the appropriate jurisdictional factors as addressed in Issue 16. The appropriate jurisdictional amounts are as follows: A. 2010: \$692,754,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$750,081,000.\*

**ISSUE 56: Are FPL's requested levels of Property Held for Future Use appropriate? A. For the 2010 projected test year in the amount of \$74,502,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$71,452,000?**

\*No. As reflected on Exhibit 248 SLB-26 Revised, adjustments are necessary to reflect the appropriate jurisdictional factors as addressed in Issue 16. The appropriate jurisdictional amounts are as follows: A. 2010: \$70,432,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$67,725,000.\*

**ISSUE 57:** Approved.

**ISSUE 58: Is FPL's proposed accrual of Nuclear End of Life Material and Supplies and Last Core Nuclear Fuel appropriate? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. FPL's current accrual for end-of-life materials and supplies and last core nuclear fuel should be suspended with no increase allowed. FPL's over-funded decommissioning funds

should be available to reimburse FPL for its end-of-life materials and supplies and last core nuclear fuel amortization should be discontinued and the 12/31/09 balance transferred to the end-of-life materials and supplies and last core reserves. Revenue impact: \$4.9 million in 2010, \$4.3 million in 2011. \*

**ARGUMENT:** OPC witness Brown testified that FPL's nuclear decommissioning funds are significantly over-funded by amounts far in excess of the amounts needed to cover the end-of-life materials and supplies and nuclear fuel (EOLMS/NF). While these are legitimate costs, based on the latest cost estimates provided by FPL<sup>6</sup>, the funds remaining at the end of the license lives will be over \$5.4 billion. See Exhibit 245 (SLB-23).

Ms. Brown stated that FPL could accrue interest on its EOLMS/NF balances from the beginning of decommissioning until the completion of decommissioning, when all funds should be released. Given the magnitude of the excess decommissioning funding, the Commission should require FPL to investigate its options for utilizing the unrestricted, non-qualified funds at an earlier point in time. She added that the Commission should also determine whether the EOLMS/NF balances can be classified as decommissioning costs and, thus, provide legitimate deductions against the funds at the end of the license lives. Lastly, a portion of the future decommissioning costs covered by anticipated tax deductions will be received in years where costs are charged to the non-qualified decommissioning funds. Ms. Brown stated that FPL should determine whether the full decommissioning costs could be covered by the qualified and non-qualified funds, while the tax savings are used to fund the EOLMS/NF. If the EOLMS/NF are taken out of the non-qualified fund balance, the qualified fund balance would be more than sufficient to cover the remaining decommissioning costs, with a remaining excess of \$4.7 billion at the end of decommissioning.

Ms. Brown testified that although the Commission has previously determined that EOLMS/NF should be kept separately from decommissioning, current circumstances justify a departure from the Commission's previous decision. The Commission previously was not faced with such tremendous excess decommissioning funds of over \$476 million. If current ratepayers are made to continue funding the EOLMS/NF inventories, in addition to the current excess decommissioning funds, the resulting generational inequities will be aggravated and thus it is reasonable to suspend any further accruals. Ms. Brown concluded that the Commission could

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<sup>6</sup> Based on FPL's last filed decommissioning study (2005)

require FPL to transfer the previously authorized<sup>7</sup> annual \$6.955 million in nuclear amortization (total accrued at December, 2009 of \$45.345 million) to the EOLMS/NF reserve. This will reduce the remaining costs that will be needed from the excess decommissioning funds. The resulting revenue impact is \$4.9 million for 2010, and \$4.3 million for 2011. [(TR-2473-2478) Exhibit 245(SLB-23 p 5 & 6)].

**ISSUE 59:** \*No position.\*

**ISSUE 60:** Are FPL's requested levels of Nuclear Fuel appropriate A. For the 2010 projected test year in the amount of \$374,733,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$408,125,000?

\*No. As reflected on Exhibit 248 SLB-26 Revised, adjustments are necessary to reflect the appropriate jurisdictional factors as addressed in Issue 16. The appropriate jurisdictional amounts are as follows: A. 2010: \$374,772,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$408,163,000.\*

**ISSUE 61:** \*No position.\*

**ISSUE 62:** Are FPL's requested levels of Working Capital appropriate? A. For the 2010 projected test year in the amount of \$209,262,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$335,360,000?

\*No. As reflected on Exhibit 248 SLB-26 Revised, adjustments are necessary to reflect the appropriate jurisdictional factors as addressed in Issue 16 and further adjustments may be necessary pending the resolution of other working capital issues. The appropriate jurisdictional amounts for working capital are as follows: A.2010: \$167,502,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$306,905,000.\*

**ISSUE 63:** Is FPL's requested rate base appropriate? A. For the 2010 projected test year in the amount of \$17,063,586,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$17,880,402,000?

\*No. As reflected on SLB-26 Revision 2, adjustments are necessary to reflect the appropriate jurisdictional factors as addressed in Issue 16 and further adjustments are necessary pending the resolution of other rate base issues. The appropriate jurisdictional amounts for rate base are as follows: A: 2010: \$17,044,518,000; B: OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$18,879,413,000.\*

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<sup>7</sup> Order No. PSC-02-0055-PAA-EI

### **COST OF CAPITAL**

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent year adjustment.)

**ISSUE 64: What is the appropriate amount of accumulated deferred taxes to include in the capital structure? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Corresponding adjustments are appropriate to reflect plant, depreciation and other adjustments that impact the amount of deferred taxes expense during the test year, including the proper jurisdictional allocations. See Exhibit 248 SLB-26 Revised, deferred taxes should be as follows: A. 2010: \$3,445,529,000 after an adjustment of \$93,598,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$3,737,349,000, after an increase of \$319,741,000.\*

**ISSUE 66: What is the appropriate amount and cost rate of the unamortized investment tax credits to include in the capital structure? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*The appropriate cost rate should reflect the weighted average cost rate of investor sources of capital (long and short-term debt, equity). Corresponding adjustments are appropriate to reflect the proper jurisdictional allocation factors. Based on OPC witness Brown's Exhibit SLB-26-Revision 2, unamortized ITCs should be as follows: A. 2010: \$63,939,000 at 7.41%. B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$191,748,000 at 7.40%.\*

**ISSUE 67: What is the appropriate cost rate for short-term debt? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*The appropriate cost of short-term debt is as follows: A. 2010: 2.27%. B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is 2.27%.\*

**ARGUMENT:** OPC witness Dr. Woolridge testified that the appropriate short-term debt cost rate for the 2010 test year should be based on the Company's projected for 2009 cost rate. These figures reflect current market interest rates and are not based on speculative forecasts of interest rates. The short-term debt cost rate of 2.27% is based on company provided figures. (TR-3210) This rate is favorably comparable to the average rate for both 2010 and 2011 as reflected on FPL witness Pimentel's rebuttal exhibit AP-16. (Exh 372)

**ISSUE 68: What is the appropriate cost rate for long-term debt? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*The appropriate cost of long-term debt is as follows: A. 2010: 5.14%. B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is 5.14%.\*

**ARGUMENT:** OPC Witness Woolridge stated that the long-term debt cost rate should be based on current market interest rates, not based on speculative forecasts of interest rates. The appropriate long-term debt cost rate for FPL the 2010 projected test year should be 5.14%, which is based on company provided figures. Notwithstanding OPC's opposition on the grounds that the proposed subsequent test period is speculative and unnecessary, if the Commission allows this rate adjustment, 5.14% should also be used as the projected cost of long-term debt. (TR 3210)

**ISSUE 69: Have rate base and capital structure been reconciled appropriately? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. Specific Adjustments should be made to customer deposits, ADIT and ITC based on corresponding rate base adjustments. No further prorata adjustments to these accounts should be made to reconcile the Company's capital structure to rate base.\*

**ISSUE 70: Has FPL appropriately described the actual 59.6% equity ratio that it proposes to use for ratemaking purposes as an "adjusted 55.8% equity ratio" on the basis of imputed debt associated with FPL's purchased power contracts?**

\*No. Typically, when electric utilities attempt to invoke the "S&P methodology" to adjust the capital structure to reflect S&P's treatment of power purchase agreements (PPAs), they seek to add an increment of "pretend equity" that they don't have on their books. FPL's actual equity ratio is so extravagantly high that it asks the Commission to pretend its actual 59% equity ratio is lower than it really is. FPL argues imputing \$949 million of additional debt associated with PPAs would yield an "adjusted actual equity ratio" of 55.8%. The argument is misleading, in that FPL proposes to use its actual ratio for ratemaking purposes. The adjustment is unwarranted in any event. The Commission assures FPL of recovery of PPA costs through a cost recovery clause, so there is no risk of non-recovery that warrants FPL's argument. Besides, not every rating agency regards PPAs as risky: Moody's views them as potentially positive.\*

**ARGUMENT:** See OPC's response to Issue 71.

**ISSUE 71: What is the appropriate equity ratio that should be used for FPL for ratemaking purposes in this case? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*FPL proposes to use its actual 59% equity ratio. This is far too high, given FPL's low risk profile and the responsibility of an electric utility to minimize revenue requirements borne by customers by employing a reasonable amount of debt leverage in its capital structure. FPL's proposal is far higher than typical electric utilities, who maintain equity ratios in the mid- to

high-40s. It is far higher than the equity ratio of FPL's parent, FPL Group, even though FPL Group is considered riskier than FPL. It is also higher than the level FPL projects to carry in the near future. Based on FPL's projections OPC witness Dr. Woolridge uses 54%, but cautions that this figure too is higher than FPL's risk profile would warrant, meaning that the Commission should adjust the allowed return on equity downward to reflect the relatively low financial risk associated with a 54% equity ratio. \*

**ARGUMENT:** Regulated utilities such as FPL finance their capital expenditure requirements with a mixture of debt and equity sources of capital. Because owners of debt instruments have an enforceable contractual commitment from the utility to pay the stated rate of interest, and purchasers of shares of stock do not have a corresponding contractual obligation with respect to the return they will receive on their investment, from an investor's standpoint debt is less risky than equity. Accordingly, the interest rates on a regulated utility's debt will be lower than the return on equity necessary to attract equity investors. (TR-3205). Because debt payments are deductible for tax purposes and payments to stockholders are not, a higher equity ratio also increases revenue requirements by increasing the utility's tax liability. (TR-3206)/

It follows that, with a given outlay, a utility can acquire more capital dollars by issuing debt than by selling stock (equity). (TR-3205-3206). This is the concept of debt leverage. However, as the proportion of debt in a utility's capital structure increases, its contractual obligations to pay interest increase, thereby signaling to investors that its financial risk is higher (the possibility that it may default on debt service). A utility must balance the advantages of debt's lower cost with the financial risk associated with issuing debt. The balance struck by the utility industry is reflected in the proxy group of ten representative utilities that OPC expert Dr. Randall Woolridge selected for analysis. The average capital structure in the group includes 40% equity. (TR-3204). Dr. Woolridge testified that this is consistent with typical industry experience, which ranges from 40 to 50%. (TR-3207). Significantly, the percentage of equity in the capital structure of FPL Group, FPL's corporate parent, is in the low 40s. (Exhibit 212).

By contrast, FPL's actual equity ratio is 59.62%. (TR-3190). Given that (on the basis of such factors as bond ratings and business risk profiles) FPL is less risky than the utilities in Dr. Woolridge's proxy group, a 59% equity ratio is extravagantly and expensively high.

The terms "extravagantly" and "expensively" fit. Because the cost of equity is higher than the cost of debt, and the weighted average cost of capital is applied to the utility's rate base

to calculate the return component of the overall revenue requirements borne by customers through the rates they pay, a higher equity ratio translates directly into higher rates.

In this case, FPL is attempting to mask its extravagantly and expensively high equity ratio. Throughout his testimony, FPL witness Pimentel referred to FPL's "actual adjusted" equity ratio of 55.8%. The seemingly self-contradictory nature of the term "actual adjusted" is only the beginning of the confusion that FPL created on the subject, which was misleading in its effect. While Mr. Pimentel referred to the actual adjusted equity ratio of 55.8%, he acknowledged during cross-examination that the actual adjusted 55.8% equity ratio was *not* the equity ratio that FPL employed when it calculated its claimed revenue deficiency. (TR-5148-5153).

FPL's "per books" equity ratio is 59.62%. The "per books" figures are the amounts of equity and debt alone, prior to regulatory adjustments, which investors would see on FPL's financial statements. In testimony, FPL asserts that the Commission should regard its actual "per books" equity ratio as 55.8%. FPL reaches this figure by imputing \$950 million of fictitious debt (debt that it has not issued<sup>8</sup> and therefore does not owe). In support of its actual adjusted equity ratio of 55.8%, FPL tries to invoke its peculiar version of the so-called Standard & Poor's ("S&P") methodology for treating obligations under power purchase agreements ("PPA"). The rationale underlying this methodology is that, when formulating its rating of a utility, S&P views a utility's obligations to make capacity payments to sellers of wholesale power as "debt-like." FPL argues that the \$950 million reflects the 25% risk factor that S&P would attach to its PPA obligations when calculating the "debt-like" nature of the contracts. When one takes the \$950 million of imputed debt into account, says FPL, its 59% equity ratio would be only 55.8%.

When pointing out the many problems with FPL's claimed actual adjusted equity ratio, it is difficult to decide where to begin. The first thing the Commission must understand is that *FPL does not ask the Commission to use its so-called actual adjusted equity ratio of 55.8% to calculate its revenue requirements.* As FPL acknowledged, FPL did not incorporate the \$950 million of imputed debt on any MFR schedule. This means the higher "per books" equity ratio

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<sup>8</sup> When one "imputes" non-existent debt and adds it to the actual debt when depicting FPL's capital structure, the percentage of the resulting fictitious capital structure that consists of equity decreases, relative to the proportion it occupies of the actual or real capital structure. In this case, the measure would decrease equity from 59% to 55.8%.

of was used to calculate FPL's revenue requirements, and the imputed debt was added to testimony solely to make the equity ratio appear lower (therefore less expensive and more reasonable) than the equity ratio FPL wants the Commission to use for ratemaking purposes. This is misleading.

Next, FPL's application of the imputed debt adjustment is a quirky misapplication of S&P's ratings methodology. To be clear, because the manner in which the Commission provides for cost recovery of approved wholesale power agreements disproves the rationale for the generic S&P methodology, OPC opposes the methodology as it relates to any regulated electric utility subject to the Commission's jurisdiction. The adjustment stemming from FPL's version of the methodology is even less warranted. Typically, the S&P methodology is used by utilities to argue that the equity ratio used to set their rates should be *higher* than the actual ratios. "Since S&P regards a percentage of our PPA obligations as debt," goes the utility's argument, "for ratemaking purposes we should pretend that we have issued more equity than we actually have on the books and apply the artificially higher equity ratio to calculate a higher revenue requirement." (TECO tried this argument in Docket No. 080317-EI, and the Commission rejected it. See PSC Order No. PSC-09-0283-FOF-EI, at pages 34-36.) FPL does not seek to invoke the S&P methodology to artificially *increase* its equity ratio. FPL's *actual* equity ratio is so high that FPL instead eliminates the "pretend equity" step, and uses the imputed (pretend) debt to give the appearance that its equity ratio is *lower* than it actually is.

Next, by focusing solely on S&P's methodology, (that is, FPL's aberrant version of it) FPL omitted evidence demonstrating that other ratings agencies view PPAs very differently than does S&P. For instance, where the regulatory authority has in place an effective cost recovery mechanism specifically applicable to PPA payments, Moody's and Fitch — with whom FPL also contracts for ratings services — regard PPA payments as ordinary operating costs, therefore, having no implication for capital structure. (Exhibits 508, 509). Such is the case here. FPL could have included the different approaches the other ratings agencies take toward PPAs in its testimony; however, that would not have supported FPL's desire to portray its equity ratio as being lower than that shown on its books and used for ratemaking purposes.

By any reasonable standard — the average of Dr. Wooldridge's proxy group, Dr. Avera's proxy group, and the equity ratio maintained by FPL's parent, FPL Group — FPL's equity ratio is unusually and expensively high. Shareholders, not customers, should bear the unwarranted costs

of FPL's high equity ratio. That being the case, according to Dr. Woolridge the Commission has two options. The first option is to assume a lower equity ratio for ratemaking purposes. The other option is to take into account the downward effect that the lower financial risk afforded by FPL's very high equity ratio would have on FPL's required cost of equity capital. Dr. Woolridge took the latter route. The risk-lowering impact of FPL's high actual equity ratio is reflected in his 9.5% return on equity recommendation.

**ISSUE 73: What is the appropriate capital structure for FPL for the purpose of setting rates in this docket? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*A. For regulatory purposes, the appropriate 2010 capital structure is 43.64% common equity (Dr. Woolridge's 54%, after certain separate regulatory items are added to capital structure); 33.51% Long-term Debt; 3.00% Customer Deposits; 3.02% Short-term Debt; 16.52% Deferred Income Taxes; 0.31% ITCs. B. If the strenuously opposed subsequent 2011 adjustment is considered, the appropriate capital structure is 42.68% common equity; 34.25% Long-term Debt; 2.93% Customer Deposits; 2.60% Short-term Debt; 16.69% Deferred Income Taxes; 0.86% ITCs. \*

**ISSUE 80: What return on common equity should the Commission authorize in this case? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*FPL's request grossly overstates the return on equity currently required to attract equity investors. Taking into consideration the proper application of a discounted cash flow analysis, a reasonable and credible premium above current risk-free rates required by equity investors, and FPL's low risk—as exemplified by its high equity ratio and the 61% of revenues through cost recovery clauses, a fair and reasonable return on equity for FPL is 9.5%. \*

**ARGUMENT:** The cost of a regulated utility's debt capital is a matter of contract terms that can be determined accurately and "factually" from empirical evidence. A regulated utility's cost of acquiring equity capital, by contrast, requires the exercise of opinion and judgment--informed by market data. OPC witness Dr. Randall Woolridge developed and presented a comprehensive analysis of FPL's cost of equity. At the outset of his testimony, Dr. Woolridge provided useful insight into the impact of the 2007-2008 financial crisis and the current recessionary environment on capital markets in general and FPL's cost of capital in particular. He explained that initially the crisis led to a "flight to quality" by investors, whose increased demand for safe Treasury bonds resulted in historically low yields on Treasuries. (TR-3193).

Simultaneously, the tightening credit market produced very high yields on corporate bonds. The result was a period of wide spreads between Treasury yields and corporate bond yields that have moderated as investors gain confidence that the threat presented by the crisis has lessened. (TR-3194).

Generally, an investor’s required return on investment is a function of the time value of money and the risk that the investor associates with the investment. (TR-3211, 3217) Analysts have developed models to quantify these factors. Dr. Woolridge applied two specific approaches – a discounted cash flow analysis and a risk premium analysis – to derive his recommended cost of equity capital for FPL. Both techniques involve examining data for a proxy group of companies similar to FPL, then adjusting the results to take into account FPL’s specific risk characteristics.

A discounted cash flow analysis proceeds from the proposition that the price an investor is willing to pay for a share of stock represents the present value of all of the current and future dividends that the investor expects to receive while owning the stock. It follows that the rate at which the investor discounts the future stream of dividends back to present value constitutes that investor’s required return on investment. The current price of the stock is known. The current dividend is known. The future payment stream consists of, not only the current dividend, but expected growth in dividends that corresponds to the investor’s expectations of the corporation’s business prospects. Once one supplies values for the price, dividend, and growth inputs, one can solve an algebraic equation for the discount rate. The formulas are:

$$\begin{aligned}
 \text{Price} &= \frac{\text{Dividend}}{\text{cost of equity} - \text{growth rate}} \\
 \text{Cost of equity} &= \frac{\text{Dividend}}{\text{Price}} + \text{growth rate}
 \end{aligned}$$

(TR-3221).

Dr. Woolridge explained that, while analysts sometimes use a “three stage” DCF model to account for the growth, transitional, and “steady state” characteristics of a firm as it develops its business over time, the mature, stable nature of the regulated utility business lends itself well to a “single stage” DCF application. (TR-3221).

To develop his analysis, Dr. Woolridge first analyzed a proxy group of ten regulated electric utilities. The criteria he established for inclusion in the proxy group included (1) a

requirement that the company receive a minimum of 70% of its total revenues from electric utility operations; (2) revenues of more than \$5 billion; and (3) an investment grade bond rating. (TR-3201). The average bond rating for the proxy group was lower than FPL's bond rating. (TR-3202). The lower bond rating of Dr. Woolridge's proxy group indicates that the group is riskier than FPL.

Because dividend yields tend to fluctuate over time, for his purposes Dr. Woolridge averaged the actual dividend yields of the proxy companies for a six month period and for July 2009. This provided a proxy dividend yield of 4.7%.

As for the projected growth rate, Dr. Woolridge explained that investors take into account both historical growth rates, which are readily available; expectations of "internal growth" (retention of earnings); and long term growth rate expectations. (TR-3226). Giving attention to the observable upward bias in the projections of Wall Street analysts (TR-3227), and taking into account internal growth expectations, Dr. Woolridge developed for his proxy group a growth rate value of 5.5%. Plugging the dividend yield (adjusted to reflect 1/2 the expected annual growth) and the proxy growth rate into the DCF equation set forth above, he concluded that, on the basis of discounted cash flow analysis, the equity cost rate for his proxy group of ten electric utilities is 10.33%.

Dr. Woolridge also performed a capital asset pricing model ("CAPM") analysis to inform his recommendation. The CAPM approach holds that a firm's cost of equity is equal to the sum of the risk-free interest rate, represented by the interest that can be earned on a long term U.S. Treasury bond, and the incremental return, or "premium," that an investor requires to invest in a corporation's equity instead of the riskless Treasury. (TR-3230). When quantifying the incremental return to add to the risk-free rate, the analyst first identifies an overall market equity premium, then adjusts that overall market premium to take into account the riskiness (measured in terms of share price volatility) of the company being analyzed relative to that of the overall market. The factor used to quantify the relative riskiness of the individual firm is called "Beta." (By observing historical patterns of general market movements and comparing them to the concurrent price activity of individual stocks, it is possible to build data bases of "Beta" values for specific companies.) The general market is assigned a Beta value of unity, or one. A Beta of less than one indicates the company is less risky than the overall market. A Beta greater than one means the company's stock is more volatile, and therefore riskier, than the market.

The CAPM equation, then, is:

Required rate of return on equity for a company= risk-free rate + (Beta of company) (market risk premium)

For the risk-free rate, Dr. Woolridge reviewed July 2009 data for 10-year and 30-year Treasuries. For the individual Beta values for the ten companies in his proxy group, he utilized Betas compiled by the *Value Line Investment Survey*. The average Beta for Dr. Woolridges's proxy group is 0.70, meaning that as a group the companies show 70% of the price volatility of the S&P 500.

The remaining component of the CAPM equation is the overall market risk premium—that is, the additional return an investor requires to place money in the stock market instead of purchasing a risk-free bond. Dr. Woolridge's process for quantifying the market risk premium was particularly thorough. He described the "Ibbotson" approach of comparing historical differences between bond and stock market returns, which indicates a past premium ranging from 5 to 7%, but cautioned that using solely historical data would ignore the influence of changing market conditions on future returns. (TR-3235). He then described studies that attempt to estimate the current, "ex ante" market risk premium using market data, (TR-3235), as well as a hybrid "Building Block" approach that employs elements of both the historic and ex ante models (TR-3235). The "Building Block" approach, the origin of which he attributed to a study published in 2003 by Ibbotson and Chen, relates the "fundamentals" that affect returns (inflation, growth in earnings per share, return on equity, price-earnings ratios) to decades of data for compounded historical returns: "By relating the fundamental factors to the ex post historical returns, the methodology bridges the gap between the ex post and ex ante equity risk premiums." (TR-3237). Using this approach, an analyst can break down ("decompose") past overall market returns into components representing the individual "contributions" of inflation, dividend yield, real earnings growth, and the effect of higher future P/E ratios, then employ current values for those components of the required return to estimate investors' current return expectations.

By supplying current inputs to these Building Block categories, Dr. Woolridge calculated the current market return expectation to be:

Inflation	2.60%
Dividend yield	2.50%
Real earnings growth	<u>2.50%</u>
Current expected market return	7.60%

Significantly, Dr. Woolridge's expected market return of 7.60% is in line with forecasts by the Federal Reserve Bank of Philadelphia (6.62%), and a survey of corporate chief financial officers conducted by Duke University and CFO Magazine (7.31%). Subtracting the risk-free rate of 4.38% (30 year Treasury bond) from this calculation of the expected market return yields an equity risk premium of 3.22%. Dr. Woolridge melded the results of his individual exercise into a composite of thirty separate studies that he examined. They included, in addition to his own "Building Block" analysis, studies that focused on historical data; studies that emphasized predictions of future results; and hybrids. In his CAPM analysis he employed the average market risk premium of the overall group of studies, which is 4.36%. (TR-3243). This value of 4.36% is consistent with equity risk premiums developed by CFOs, professional forecasters, and leading consulting firms. (TR-3244). These companies include McKinsey & Co., widely recognized as the leading management consulting firm in the world, which estimates the equity risk premium to be in the range of 3.5% to 4%. (TR-3245).

The quantification of the market risk premium provides the last input needed to solve the CAPM equation for Dr. Woolridge's proxy group of electric utilities. Again, the equation is: (TR-3246)

$$\text{Equity cost rate} + \text{risk free rate} = (\text{Beta}) (\text{market equity risk premium})$$

$$\text{Equity cost rate} = 4.50\% + (0.70) (4.36\%) = 7.6\%$$

Dr. Woolridge's CAPM and DCF analyses for his proxy group lead him to conclude the cost of equity for the group lies in the range of 7.6% to 10.3%. He attributed the wide range to the unusual degree of uncertainty and volatility in current capital markets. He also testified the current degree of volatility and uncertainty justifies using the upper end of the range, or 9.50 to 10.25%. (TR-3246). He also testified that the DCF analysis should be given more weight than the CAPM, as it is in his opinion better suited to the task of calculating the required return on equity for a regulated utility. (TR-3218). Given FPL's lower risk profile, and specifically taking into account FPL's very high equity ratio (and very low financial risk), Dr. Woolridge opined that the Commission should authorize 9.50% as a fair and reasonable return on FPL's equity.

Throughout his testimony, Dr. Woolridge demonstrated the reliability of his data and sources, the appropriateness of his proxy group, and his meticulous, disciplined application of

the DCF and CAPM approaches. He also demonstrated, at various steps, that the results of his analyses are within the mainstream of credible, professional analyses. By contrast, the recommendation of 12% - 13% ROE submitted by FPL witness Dr. Avera is based on inappropriate data, incorporates unrealistic assumptions, and results in a recommendation that is wholly lacking in credibility.

For instance, Dr. Avera selected a “proxy group” of electric utilities, but included companies having electric revenues comprising as little as 10%, 4%, and 22% of total revenues. (TR-3253, Exh 220 JRW-13). Dr. Avera also assembled a “proxy group” of unregulated companies. Because their business lines differ dramatically from that of an electric utility, and because they are not highly regulated, the information regarding this group has no value for determining the appropriate return on equity for FPL. (TR-3254)<sup>9</sup>.

Dr. Avera’s DCF exercise suffers from his exclusive reliance on the overly optimistic and upwardly biased growth rates projected by Wall Street analysts and Value Line. (TR-3255-3256). Dr. Woolridge exposed this upward bias by comparing historical market growth rates (growth in earnings per share) to the overly optimistic growth rates that the Wall Street analysts had projected for the same 20 year period. Over time, the analysts’ forecast errors were predominantly positive, meaning they were biased upward. The projections of Wall Street analysts notoriously are affected by their conflicts of interest. In fact, in 2003 the SEC, the New York Stock Exchange, the National Association of Securities Dealers, and nine major brokerage firms reached a “global settlement” of allegations that investment banks had pressured stock analysts to make rosy predictions. As part of the settlement, the nine brokerage firms agreed to pay a total fine of \$1.5 billion, (TR-3257). Notwithstanding that settlement, Wall Street analysts’ predictions have remained at levels that are twice as high as historical levels. (TR-3259). Given the known bias of Wall Street’s predictions, no serious investor would use these projections to the exclusion of historical information. (TR-3255).

Dr. Avera also employed a CAPM approach. It, too, is infused with overly optimistic assumptions that led him to an incredible conclusion. To recount briefly, the CAPM calculates a return on equity by adding the risk –free rate and the “equity risk premium” demanded by investors. The incredible conclusion reached by Dr. Avera is that investors require an equity risk premium of *10% above and beyond the risk-free rate.* ) To arrive at his risk premium of 10%,

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<sup>9</sup> Among other things, the Beta for the unregulated group is significantly dissimilar to the Beta for the utility group.

Dr. Avera had to estimate a value representing expected stock market returns. His value of 13.2% is the sum of a divided yield of 3.4% *and an expected EPS growth rate of 9.6%*. The 9.6% growth rate is a pure reflection of Dr. Avera's exclusive use of Wall Street's upwardly biased projection. Dr Avera based his conclusion on a single analysis that he personally prepared. His 9.6% growth rate focused exclusively on projections of Wall Street analysts. (This compares to Dr. Woolridge's 4.36% risk premium, which is the average of his study *and* 30 studies encompassing historical emphases, ex ante predictions, and hybrid approaches. (TR-3246).

The unrealistic, wildly optimistic, and incredible nature of Dr. Avera's assumptions is demonstrated well in Dr. Woolridge's testimony. Referring to historical data that show a long-term growth rate of 6% -7% is appropriate for U.S. companies, Dr. Woolridge addressed Dr. Avera's assumption of a 9.6% growth rate for purposes of his CAPM:

These results offer compelling evidence that a long-run growth rates of in (sic) the 6% - 7% is appropriate for companies in the U.S. By comparison, Dr. Avera's long-run growth rate projection of 9.6% is clearly not realistic. These estimates suggest that companies in the U.S. would be expected to: (1) increase their growth rates of EPS by 50% in the future and (2) maintain that growth indefinitely in an economy that is expected to grow at about one half his projected growth rates. Such a scenario is not economically feasible or reasonable. (TR-3264-3265).

Dr. Avera also attempted to support his 12% - 13% recommended range with what he referred to as an "expected earnings" analysis. Here, Dr. Avera simply used the returns on equity that Value Line estimated for the companies in his utility proxy group. Necessarily, those estimates incorporate predicted earnings for unregulated operations, which are significant portions of the overall businesses for several companies. Further, the relationship between a return on equity and the company's market-to-book ratio is such that the estimate is overstated if the market-to-book ratio is greater than one. (TR-3266,3267). Dr. Avera provided no evidence of the relationships between Value Line's predicted return and the firms' market-to-book ratings. Absent the market-to book correlation, no valid judgment can be made based on the estimates provided. (TR-3266, 3267).

Finally, Dr. Avera contends that the authorized return should be increased to take "flotation costs" into account. Based on Dr. Woolridge's observations on the matter, OPC strongly disagrees. First and perhaps most fundamentally, neither Dr. Avera nor his client

proved any flotation costs in this proceeding. (TR-3267). Next, one justification offered for the adjustment is that the issuance of stock should not dilute existing shareholders' equity. The fact that shares of an electric utility's stock sell at market-to-book ratios considerably greater than 1.0 belie the notion that flotation costs (if any exist) dilute current stockholders' equity. This is because sales at prices above book value necessarily increase the book value of existing shareholder's shares. Finally, regulation is designed to enable the utility to recover from customers its reasonable out-of pocket expenses plus a fair return on its investment. Flotation costs do not fall into either category. Flotation costs represent the difference between the price the investment banker receives from investors and the price the investment banker pays the utility. (TR-3268). The fact that the investment bank marks up the stock it sells to investors does not prove that FPL incurs a cost to be borne by customers. Instead, the "spread" is a "transaction cost" in the market - one of many for which retail customers are not responsible. (TR-3268).

For all of these reasons, the Commission should reject Dr. Avera's formulations and accept the recommendation of 9.5% return on equity supported by Dr. Woolridge's testimony.

**ISSUE 81: What is the appropriate weighted average cost of capital including the proper components, amounts and cost rates associated with the capital structure? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*The appropriate weighted average cost of capital for each respective test year is 6.14% for 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate cost of capital should be 6.11%. The associated components, amounts and cost rates are reflected in Exhibit 248, Revised Exhibit SLB-26.\*

#### **NET OPERATING INCOME**

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent year adjustment.)

**ISSUE 82:** \*No position.\*

**ISSUE 83: Should FPL's proposal to transfer capacity charges and capacity-related revenue associated with the St. John's River Power Park from base rates to the Capacity Cost Recovery Clause be approved? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. The net capacity charges should continue to be recovered in base rates and should not be moved to the CCRC.\*

**ISSUES 84-88:**        \*No position.\*

**ISSUE 89:** Is an adjustment appropriate to FPL's Late Payment Fee Revenues if the minimum Late Payment Charge is approved in Issue? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\*Yes. Late payment revenue should be increased to eliminate FPL's 30% behavior adjustment and 2% write-off; to average 2007/2008 late payments on percentage to total bills for behavior modifications; and reduce revenues for customers not subject to the minimum fee to reflect lower anticipated revenues for 2010. Revenues should be increased \$25,024,251 for 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$26,034,753.\*

**ARGUMENT:**        In its MFRs, FPL requested to increase the late payment fees by adding a minimum \$10 fee to its existing fee of 1.5% of the late payment. FPL's proposal will impact all late-paying customers with bills that are less than or equal to \$667. OPC witness Brown testified that FPL has understated the revenue impact of this requested change. First, FPL ignored the recent trend of increases in late payment fees and assumed that the 2010 test year percentage of fees would remain at the same levels as 2008. Second, FPL offset the increased late payment fees by a 2% bad debt write-off rate. Because write-offs included in FPL's bad debt expense are reported in total, the test year projected bad debt expense already incorporates any write-offs of late payment revenues. Third, FPL offset the late payment fee revenue increase by a 30% "behavior change" associated with accounts subjected to the minimum charge. FPL based this behavior change assumption solely on an unsupported assumption that the higher charge would cause 30% of these customers to modify their behavior and pay their bills on time. While witness Brown agreed that there might be some behavior modification, the level projected by FPL is unreasonable and not supported. Witness Brown removed both the 2% write-off adjustment already incorporated into bad debt expense and the 30% behavior modification adjustment. In place of the behavior modification, she used a 2007/2008 average of late payments as a percentage of total bills. Using this methodology, she estimated 20% of customer bills are assumed to be paid late which recognizes the high growth in late payments experienced over the past few years. This adjustment also fully offsets any increases in historical late payment experience that would be expected including the economic factors FPL proposed throughout its application. Ms. Brown concluded that late payment fees should be increased by \$25,024,251 for 2010 and \$26,034,753 for 2011, as reflected on Exhibit 229 (SLB-7). (TR-2436-2440)

While FPL witness Santos disagreed with Ms. Brown's adjustment to late payment revenues regarding the 2% write-off rate and the 30% behavior change. Ms. Santos dismissed the fact that the historical level of late payment fees increased at an increasing rate. Further, Ms. Santos argued that the use of a historical late payment rate is not founded on a price change behavioral response and that Ms. Brown's reasoning to equate a growth trend in late payment charges with a price altering behavior change is "quite a stretch". Other than stating that the historical trend ignores the potential impact of behavior change, Ms. Santos does not dispute that the historical rate of late fees has increased. (TR-6056) Further, Ms. Santos ineffectively adds only theoretical assumptions that include a comparison of elasticity of demand in an attempt to support the proposed 30% behavior change. Ms. Santos concluded that if FPL's 30% behavior change is not accepted by the Commission, FPL would withdraw its proposal to change the current late payment fee structure. (TR-6059) This threatened withdrawal of its requested fee increase clearly shows that FPL has no evidentiary support for this behavior change. To request an increase in a customer charge but understate the impact in the rate setting equation is unfair and inappropriate. OPC recommends that Ms. Brown's adjustments are appropriate and should be made to the revenue requirement calculation.

**ISSUE 90: Are any adjustments necessary to FPL's Revenue Forecast? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes. Revenues should be increased by \$46,500,182 in 2010 and \$40,351,388 in 2011. See Issues 3 and 7. \*

**ISSUE 91: Are FPL's projected levels of Total Operating Revenues appropriate? A. For the 2010 projected test year in the amount of \$4,114,727,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$4,175,024,000?**

\*No. Revenues should be increased by \$46,500,182 in 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate 2011 amount is \$40,351,388. See OPC's positions on Issues 3 and 7.\*

**ISSUE 92: \*No position .\***

**ISSUE 93: Should an adjustment be made to remove FPL's contributions recorded above the line for the historical museum? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes. Test year expenses should be reduced by \$45,470 in 2010 and \$46,764 in 2011 for contributions FPL made to the Historical Museum consistent with Commission practice. \*

**ARGUMENT:** The museum is a not-for-profit affiliate of FPL which maintains records and artifacts concerning the electric industry. (TR-2120). FPL pays the operating costs of the museum; however, the museum records these amounts as contributions. *Id.* The company's description of the affiliates' activities include "maintaining records and artifacts associated with the company's long history in the state of Florida" and "preservation of historically significant information about the company and industry from its beginning in the early 20<sup>th</sup> century until today." (TR- 3703 – 3704). These factors are consistent with what is customarily considered a museum.

Contributions by FPL to a not-for-profit affiliate -- which is a museum -- should be treated as charitable contributions. Charitable contributions were treated as below-the-line items in the company's last rate cases, and the Commission's policy concerning charitable contributions has not changed since that time. (TR- 2120 – 2122). Accordingly, these amounts should be taken below-the-line in this case.

**ISSUE 94-95:** \*No position.\*

**ISSUE 96:** What is the appropriate level of Bad Debt Expense? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\* 2010 Bad debt expense (BDE) is \$19,751,466. BDE is overstated by: FPL's bad debt regression analysis included higher revenue projections than load and revenue forecast; revenue collection/assistance enhanced without savings considered; reduced net write-offs by automatic bill payment impacts and avoided write-offs; and net write-off percentage should be applied to test year revenues using adjusted 12/1/2008 model. OPC strenuously opposes the subsequent 2011 test year. If 2011 test year is considered, BDE is \$15,565,771.\*

**ARGUMENT:** OPC witness Brown testified that FPL included bad debt expense of \$26.325 million for 2010 and \$21.730 million for 2011. As part of this proceeding, FPL has requested that a large portion of its bad debt expense be transferred to clause recovery. The net amount of bad debt expense requested for base rate recovery is \$9.432 million for 2010 and \$7.855 million for 2011. Ms. Brown stated that FPL used a regression analysis to forecast bad debt expense using historical and projected data such as the real price of electricity, kWh sales, and unemployment. She had two significant concerns with FPL's methodology. First, the

regression model assumptions were made prior to the use of economic changes for other rate case components, which overstated bad debt expense. One crucial error was FPL's use of much higher revenues in its bad debt regression analysis which was inconsistent with the sales and revenues on which the test year revenues were based. If later estimates of real prices and sales had been used, the bad debt calculated from the regression analysis would have been reduced. Based on FPL's updated revenue and bad debt projections, the revenue expectations decreased, with a corresponding decrease in the expected write-off percentage.

Second, FPL included increased costs for enhanced collection and assistance programs, but failed to include a sufficient level of write-off savings. FPL witness Santos testified that FPL has aggressively sought to reduce uncollectibles through numerous programs, including social agency assistance, customer donations, increased automatic bill payments, and energy conservation programs. While the combination of these programs has reduced net write-offs, Ms. Santos focused more on the \$4.1 million increase in customer service costs from 2006 to 2008 and minimized the impact of the cost savings. Had FPL considered the increasing impact of automatic bill pay based on its management goals in reducing its net write-offs, bad debt expense would correspondingly be reduced.

Additionally, Ms. Brown testified that the Commission should reduce the net write-offs by FPL's projected savings associated with its deployment of the AMI meter installations and its Remote Connect Switch (RCS) write-offs on an incremental basis from 2010 to 2014. FPL's inclining deployment rate for this program starts with 4% in 2010, 30% in 2011, escalating to the full 100% in 2014. FPL projected the lower savings levels in its 2010 and 2011 write-off projections. Ms. Brown testified that a greater portion of the RCS avoided write-off savings *should be included in the test years by assuming an earlier deployment of RCS avoided write-offs*. She recommended a 5-year straight amortization of the expected RCS savings.

Witness Brown concluded that after adjusting FPL's updated net write-off forecast from December 1, 2008, the 2010 and 2011 test year net write-offs should then be reduced by the impacts of additional automatic bill payments and the incremental RCS savings. Exhibit 227 (Revised SLB-5) shows the calculations of the additional automatic bill payments and the incremental avoided write-offs. After calculating the bad debt expense from the December 1, 2008 model, as adjusted, the net write-off percentage calculated from the higher revenues on which the forecast was based should be applied to the Test Year revenues. As shown on Exhibit

228 (SLB-6), the net impact of these adjustments reduces the base rate revenue requirement by \$2.869 million in 2010 and \$2.495 million in 2011. The impact includes both the change to the uncollectible accounts expense for the test years at present rates and the change to the revenue expansion factor on Schedule C-44. (TR-2429-2436).

**ISSUE 97: Should an adjustment be made to remove the portion of Bad Debt Expense associated with clause revenue that is currently being recovered in base rates and include them as recoverable expenses in the respective recovery clauses? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No, bad debt expense should continue to be recovered through base rates. Based on the OPC amount of bad debt expense in Issue 96, the base rate recovery of bad debt expense should be increased by \$7,228,561 for 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$5,688,649. \*

**ARGUMENT:** OPC witness Brown testified that FPL has proposed that the portion of the bad debt expense that is clause-related should be removed from base rates and collected through the various clauses. This requested treatment creates additional regulatory oversight and adjustments as FPL would need to develop separate write-off rates and establish separate accrual provisions for each clause due to the variability of the uncollectible accounts. Thus far, FPL has not proposed a reliable process for recognizing the uncollectible accounts expenses through the various clauses. Further, transferring yet another base rate expense to clause recovery serves to drive an ever increasing proportion of FPL's revenue through cost recovery clauses instead of base rates. Additionally, FPL requested increased base O&M costs to incorporate additional revenue collection costs. If 61% of the uncollectible accounts are simply passed through a clause that feature a "true up" mechanism, FPL's incentive to continue its efforts to reduce uncollectible accounts is reduced. (TR-2435-2436). This continuing trend to move more and more costs to clause recovery should be stopped.

**ISSUE 98-99:** Approved.

**ISSUE 100: Are any adjustments necessary to FPL's payroll to reflect the historical average level of unfilled positions and jurisdictional overtime?**

\*Jurisdictional payroll expenses should be reduced by \$12.507 million in 2010 to recognize the historical average of unfilled positions. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate reduction for unfilled positions is \$13.068 million in 2011. Jurisdictional payroll expenses should be increased by \$3.262 million in 2010

and, if considered, \$3.414 million in 2011 to recognize additional overtime requirements as a result of the unfilled positions.\*

**ARGUMENT:** FPL forecasts positions for 11,111 employees in 2010 and 11,157 employees in 2011. However, the company typically has unfilled positions each year, as shown in exhibit SLB-12. During the five years ending 2008, FPL's actual number of employees ranged from a low of 1.7% below target in 2004 to a high of 2.48% below target in 2007, with an average of 2.08% below target over a five year period. Brown, Tr. 2454 – 2455. Based upon this history, FPL will not fill its targeted number of positions in the test years. (TR- 2498).

FPL concedes that it historically does not fill its targeted number of employees, but that the lower costs from having fewer employees forecasted is offset by a variety of other factors, such as (1) employees working excessive overtime to make up for the work from unfilled positions which makes the employees less productive; and (2) employees working excessive overtime also make them less efficient, and the increased stress of increased work demands leading to increased health care and benefit costs. (TR-5575). This rationale is unpersuasive, because these costs would have been incurred during all of the previous years when there were unfilled positions, and those costs should have been included in the forecasts for those categories of costs in the test years. In essence, the company conceded that they are unlikely to fill the targeted number of positions, but then claims those costs will be offset by unspecified, unquantified costs elsewhere in the forecasts. Clearly, such vague assertions do not meet the burden of proof the company bears to prove that it will incur the employee costs included in its forecasts. Accordingly, the Commission should adopt the adjustments proposed by Ms. Brown to adjust downward the forecasted compensation expenses based upon the actual, historical experience of the company not filling all of its forecasted positions.

**ISSUE 101-102:** \*No position.\*

**ISSUE 103:** **Should an adjustment be made to FPL's requested level of Salaries and Employee Benefits? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Jurisdictional executive salaries should be decreased by \$27.509 million in 2010 to remove half of executive compensation, which benefits shareholders, and the portion of executive salaries which exceeds target compensation levels. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate reduction is \$29.4 million in 2011.\*  
**(Former Issue 104).**

\*Jurisdictional non-executive salaries should be decreased by \$5.661 million in 2010 to remove half of non-executive compensation, which benefits shareholders, and the portion of non-executive salaries which exceeds target compensation levels. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate reduction is \$6.64 million in 2011.\* **(Former Issue 105)**.

**Argument:** FPL forecasts that it will have 11,111 employees in the forecasted 2010 test year. Approximately 5,000 of the employees are salaried, or "exempt," employees. Another 2,628 are hourly, or "non-exempt," and 3,540 are categorized as union employees. (TR-5624).

In addition to receiving a base salary, all salaried employees of FPL are entitled to participate in both a short-term incentive compensation plan and a long-term incentive compensation plan. The short-term incentive plan provides a cash bonus at the end of each year, while the long-term incentive plan provides compensation in the form of an award of equity in the company. The equity compensation is provided either as restricted stock, for which length of employment is the sole criteria for vesting, or as performance shares. (TR-5626 – 5627).

Performance shares are set for employees at the beginning of a three year period, and at the end of the three year term, the actual shares are paid to the employee based upon the performance of the company. The same performance factors are used in short-term and long-term incentive compensation plans. (TR-5629 – 5630).

In addition to these common performance factors, individual employees have other performance factors which are also considered when determining the amount of the incentive compensation the employee will receive. These factors include individual goals and business unit goals, in addition to the corporate goals. (TR-5632 – 5633). All told, FPL projects executive compensation to account for 4.5% of total company gross pay in 2010, and this percentage grows to 4.7% in 2011. (TR-2457).

*Incentive compensation is heavily weighted toward shareholder benefit*

The fundamental objective of FPL Group's executive compensation program is to support the creation of long-term shareholder value. (TR-2458; Ex. 515, pg. 37). It is not surprising, therefore, that many of the metrics permitted to be included in the executive compensation plan reflect performance criteria that benefit shareholders, such as return on equity and net income. (TR-553 – 2554). The proxy statement lists a large number of variations on this same theme of rewarding behavior which benefits shareholders, such as adjusted earnings, earnings per share

growth, base earnings per common share, diluted earnings per common share, adjusted earnings per common share, adjusted earnings before interest and taxes, earnings before interest, taxes, depreciation and amortization, total shareholder return, and operating income. (Ex. 515, pg. 12).

Perhaps the best example of incentive compensation being weighted toward shareholder benefit is the inclusion of rate case performance as a factor to be considered when setting incentive compensation. Higher rates are a detriment to customers, particularly in today's economic environment, yet the company intends to reward employees for obtaining higher rates. The satisfactory outcome of the rate case accounts for 25% of the incentive compensation award. (TR-5657). If the company truly wished to benefit customers through its incentive compensation plan, it should reward employees for reducing rates, not increasing them. The rate case, return on equity, and net income factors together account for 45% of the incentive compensation award. (TR-5669 – 5670). All of these factors are intended to benefit shareholders.

*The highest ranking employees receive the lion's share of long term incentive compensation*

Out of approximately 4,900 salaried employees eligible to participate in the long term incentive plan, approximately 700, or one seventh of those eligible, actually receive awards of long-term incentive compensation. (TR-5639 – 5640). Even so, the vast majority of the stock compensation is slated for the 42 officers of FPL. The company's response to the Attorney General's Interrogatory 76 provides a breakdown of the amount of incentive compensation projected to be paid to different classes of employees. Of the long-term stock compensation expected to be awarded, \$43.8 million will go to the 42 officers of FPL, while all other salaried employees will get \$9.2 million. (TR-5644 – 5645).

Even the lop-sided amount of long-term incentive compensation to be paid to the 42 officers is heavily weighted toward the highest ranking officers of the corporation. Exhibit 521 shows the portion of the amounts shown in the response to the Attorney General's Interrogatory 76 which are designated for the top 12 executive officers. For example, 73% of the performance equity shares allocated to the 42 officers will go to the top 12. (TR-5647). A further comparison of the two exhibits shows that 60% of the cash bonuses set aside for the 42 officers will go to the top 12, and 53% of the restricted stock will go to the top 12.

*There is insufficient incentive to control compensation costs if shareholders are not partly at risk*

Commissioner Argenziano noted that the company would have a greater incentive to control incentive compensation costs if the shareholders had something at risk, rather than being able to simply pass the entire cost through the ratepayers. (TR-5824 – 5828). In a similar vein, Commissioner Skop questioned whether it would be more appropriate for executive compensation above a certain level to be the responsibility of shareholders. (TR-5785 – 5786).

OPC Witness Brown proposed that shareholders bear responsibility for a portion of executive incentive compensation. Since a significant portion of executive incentive compensation is dependent on financial performance, this proposal can be viewed as a form of profit sharing. If the financial performance benefits shareholders, executives share in that benefit through the incentive program. (TR-2467). Since the determination of executive incentive compensation is tied to increasing shareholder value, it should be funded at least in part by those who benefit from attainment of that goal. (TR-2461 – 2462). This also allows the executive incentive compensation to be, in effect, self-funded. Rates are set based upon a projected level of revenue and O&M expense, among other things. If the company attains greater earnings due to greater revenues or expense containment which exceeds forecasts, then the higher earnings have been somewhat self-funded by ratepayers. (TR-2550).

*Other states require shareholders to bear some responsibility for incentive compensation*

In at least 20 cases decided since June 2007, a state regulatory commission limited the amount of executive compensation included in the development of rates. Exhibit 241 reflects a wide variety of decisions; however, most of the findings were based upon the conclusion that the excluded incentive compensation did not benefit ratepayers. (TR-2468). Some examples are exclusion of 50% of management incentive compensation (Arizona), disallowance of all incentives tied to stock performance and 50% of incentives tied to financial performance (Arizona), exclusion of long term incentive compensation (California), exclusion of annual incentive compensation and executive officer bonuses (Massachusetts), exclusion of incentive compensation and bonuses (Michigan), limiting annual incentive compensation to 15% of base pay (Minnesota), denial of the cost of long-term incentive compensation based upon measures of financial return (Missouri), denial of 50% of annual incentive compensation and 100% of long-term incentive compensation (Oklahoma), denial of 50% of executive incentive compensation (Maryland), and disallowance of the cost of all stock awards (Vermont).

*Shareholders should be responsible for all payments above the company's target*

FPL sets targets for annual and long-term incentive compensation; however, in this rate case, the company is asking to recover from ratepayers amounts which exceed the targets. For executives, it is asking customers to pay for payouts set at 1.4 times the target for executives and at 1.3 times the target for non-executives. (TR-2465). In 2010, the portion of executive incentives related to exceeding the targets is \$12.3 million, and in 2011 the portion is \$13.2 million. (TR-2466). For non-executives, the portion is \$5.7 million in 2010 and \$6.7 million in 2011. (TR-2469).

Shareholders should be responsible for all amounts in excess of target levels for both executives and non-executives. This is a reasonable assumption to make for a future test period during a bad economic environment and during a time when the company is seeking a steep increase in base rates. (TR-2468).

*FPL's last minute concession on compensation doesn't go far enough*

During the hearings, FPL announced that it was reducing its O&M expense request by \$17.2 million in 2010 and \$19.3 million in 2011, which it said was equivalent to 50% of all executive incentive compensation and equivalent to eliminating all executive raises in 2010 and 2011. FPL claimed that this action accommodated the views of OPC. (TR-5530). Later, it clarified this statement by stating that an "accommodation" was not the same as adopting OPC's position. (TR-5609). A worksheet calculating the amounts of the concession was marked as exhibit 514 for identification. (TR-5610).

The worksheet shows that part of the amount claimed by FPL as reductions to revenue requirement were actually amounts included in capital, and FPL witness Slattery conceded that this mistake overstated the claimed revenue requirement reduction resulting from FPL's accommodation. (TR-5622, 5624). In addition, the concession does not include the reduction of allocated salaries of \$7.9 million proposed by OPC witness Dismukes, nor does it include the reduction proposed by OPC witness Brown to reduce incentive compensation for amounts above the targets related to both executive and non-executive incentive compensation. (TR- 5621).

**ISSUE 106:** \*No position.\*

**ISSUE 107: Is a test year adjustment necessary to reflect FPL's receipt of an environmental insurance refund in 2008? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes. Test year expenses should be reduced by \$8.686 million (jurisdictional) in both 2010 and 2011, reflecting a 5-year amortization of the environmental insurance refund. The unamortized balance should be treated as a regulatory liability and included as an offset to rate base in the amount of \$39.086 million in 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$30.400 million.\*

**ARGUMENT:** OPC witness Brown testified that FPL received a \$43,817,952 refund in October, 2008 due to the termination of an environmental insurance policy and did not include any portion of this refund in the test year. Since the insurance costs have not been recovered through the ECRC, the Commission should require the refund to be deferred and amortized over a five-year period beginning on January 1, 2010, (\$8.686 million, jurisdictional) through base rates. This treatment is consistent with the Commission's recent deferral to the current rate case of discontinued costs associated with FPL's Glades Power Park (FGPP). The unamortized balance should also be included in rate base as a regulatory liability. (TR-2472-2473 Exhibit 244 [SLB-22]).

FPL witness Ousdahl argued that because the original policy was purchased in a non-base rate setting year (1998) and was not included in FPL's Environmental Cost Recovery Clause (ECRC) that the cost of the policy never had any direct impact on rates customers pay. She acknowledged that transactions such as these that result in increases or decreases in period operating expenses outside of a test year are reflected in surveillance reporting, and may result in a higher or lower return than authorized. She also argued that the deferral of FGPP is not a proper analogy for the deferral and amortization of the environmental refund because it was the Commission's action that gave rise to this regulatory asset. Without the amortization of the FGPP coal investment, Ms. Ousdahl stated that the Company would have been prohibited any opportunity to recover its investment in future generating plant necessary to fulfill its obligation to serve customers. (TR-3661-3664). Many utilities continue to make this unpersuasive argument that the Commission should reach back or forward to spread out of test year costs but not look back for decreases or refunds. This lopsided regulatory theory should be rejected outright.

**ISSUE 108: Is a test year adjustment appropriate to reflect the expected settlement received from the Department of Energy? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes, pursuant to FPL witness Ousdahl Exhibit KO-16. For 2010, rate base should be reduced by \$26,759,000 and NOI reduced by \$7,022,000. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, rate base should be reduced by \$53,205,000 and NOI reduced by \$7,892,000.\*

**ARGUMENT:** OPC witness Brown agreed with the adjustment made by FPL witness Ousdahl for anticipated operating expenses expected to be reimbursed by the DOE pursuant to the nuclear spent fuel settlement agreement. (TR-2538 and Exhibit 358 [KO-16 Items 3 and 4])

**ISSUE 109: Should adjustments be made for the net operating income effects of transactions with affiliated companies for FPL?**

\*Yes. As addressed in Issue 18, the total operating income impact of affiliate adjustments is \$13,844,866 (total company) for 2010 and \$17,992,038 (total company) for 2011. The specific adjustments are discussed below:

***Subissue: Allocation factor for FPL Group's executive costs (Former Issue 110)***

\*To address the problems associated with the size-based nature of the allocation factor and the significant benefits the non-regulated affiliates derive from their association with FPL and FPL Group, the Commission should distribute shared executive costs of FPL Group between FPL and the non-regulated affiliates with 50% assigned to each. This results in a reduction to test year expenses of \$7,935,976 in 2010 and \$7,906,276 in 2011, if the strenuously opposed subsequent year is considered.\*

**ARGUMENT:** FPL allocates the costs of common executives at FPL Group using an allocator called the Massachusetts Formula, which allocates the costs on the weighted average of three statistics: payroll, revenues, and average gross property plant and equipment. (TR-2092). This results in an allocation of approximately two-thirds of the costs to FPL and one third to the unregulated affiliates. Using this allocation factor fails to recognize the fact that the benefits received by each affiliate for these executive functions are not necessarily proportional to the size of each company. For example, Mr. Pimentel is Chief Financial Officer of FPL Group. He is responsible for overseeing the reporting for over 500 separate legal entities, a vast majority of which are unregulated companies. However, no study has been performed to ascertain the impacts of the specific reporting requirements of each legal entity on the proper allocation of Mr.

Pimental's compensation. (TR- 3827). FPL's allocation method also ignores the possibility that relatively new competitive companies, such as NextEra, benefit disproportionately from the corporate functions provided by FPL. (TR-2099). Not only are the Company's allocations suspect, but the Commission must question the diligence the Company takes in ensuring that costs are representative of the duties performed. Ms. Santos served as vice president of FPL's Customer Service and president of FPL Energy Services, among others. In March 2009, Ms. Santos was replaced by Eric Silagy as president of FPL Energy Services. (TR-1577-1578). Even with the shift of presidency, Ms. Santos' compensation was not changed. (TR-1581). Many questions remain unanswered. For example, are these costs now assigned 100% to FPL? If so, why? Certainly, if Ms. Santos no longer acts in the capacity of President of FPL Energy Services, the compensation she was paid for performing those services should be removed from expenses. However, how these costs have been treated is unclear at best.

The services provided by the FPL Group executives are generally more strategic in nature and benefit the regulated and non-regulated groups as a whole. For example, the FPL Group Proxy Statement lists certain challenges facing FPL and NextEra to justify the compensation paid to the executives. For FPL, the challenges are to "manage regulatory, environmental, and weather-related challenge." For NextEra, the challenges are to "manage growth, intense competition, changing technologies, environmental and market rules and regulations, the complexity of the various types of generation it operates and the use of derivatives of risk management." (Ex. 515, p. 39 (bate stamp FPL 096781)). The challenges facing NextEra listed in the Proxy Statement are more numerous and more complex than those facing FPL, yet the Massachusetts formula allocates approximately two thirds of the common executives' costs to the utility based upon its size compared to the unregulated companies.

Ms. Dismukes described other factors affecting the appropriate allocation of management's time. These factors include the fact that the unregulated operations are more diverse, they are growing, they are not regulated, they operate throughout the United States, they own hundreds of companies and they are complex. (TR-2083, 2145, 2150). All of these factors require management to devote more effort to the nonregulated companies. Consequently, if anything, it would be more appropriate to allocate two thirds of the common executive expense to the unregulated companies than to the regulated utility – just the opposite of the allocation proposed by FPL. The relative proportions of revenue for property, plant and equipment

between the utility and the unregulated affiliates do not reflect the substantial benefits the nonregulated affiliates receive from these executives.

A report by Citi Group also shows that that the unregulated affiliates -- particularly NextEra -- receive far greater benefits than are indicated by the Massachusetts formula used by FPL. Citi Group forecasts a share price of \$58 a share for FPL in 2010. It associates \$29 of that value with FPL and \$28.57 with NextEra -- virtually identical with the 50/50 allocation proposed by Ms. Dismukes. (TR-2149 -- 2150). The value of the stock of each company is derived from many factors, yet the level of top executives devoted to each group would tend to be commensurate with each company's earnings level and potential.

Ms. Dismukes' recommendation is based upon the value/benefit the regulated versus nonregulated companies receive from the FPL Group's executives. In the absence of adequate timekeeping which is devoid by upper management, it is certainly more appropriate to assign these costs on the benefits received. (TR-2110-2). In fact, the Company used the exact same rationale when changing its methodology for allocating nuclear fleet costs. (TR-2111 and 2146). Prior to 2008, the Company allocated this on the basis of the megawatts owned by FPL versus NextEra. However, it changed this methodology to allocate the charges based upon the number of nuclear units as opposed to megawatts. Its logic for the change was that the size was not determinative of benefits received and that an increase in megawatts would not change the level of service provided. (*Id.*)

In summary, a multitude of factors shows that a 50-50 allocation factor is eminently more reasonable than the size-based allocation factors proposed by FPL. These factors are:

- that the Company's nonregulated operations obtain significant benefits from their association with FPL and FPL Group;
- that NextEra has operations all over the United States;
- that the nonregulated operations are more diverse;
- that the nonregulated operations are more complex;
- that the nonregulated operations are growing;
- that NextEra owns hundreds of unregulated companies;
- that the Company failed to submit any evidence in the form of time records or otherwise that demonstrate the executives in question spend more time on the regulated operations than the nonregulated operations;
- that the services provided by FPL Group executives are generally more strategic in nature and benefit the regulated and unregulated groups as a whole;
- that size alone does not reflect the substantial benefit the unregulated affiliates receive from these executives;

- that the Company used a similar logic when allocating its nuclear fleet costs.

Given these facts, the Commissions should reject the size-based Massachusetts formula allocation factor and, instead, allocate the shared executive costs of FPL Group on a 50/50 basis between FPL and the unregulated affiliates. (TR- 2110). As shown on KHD-11 [Exhibit 201], this results in adjustments of \$7.9 million in 2010 and 2011.

**Subissue: *Affiliate Management Fee Cost Driver allocation factors* (Former Issue 111):**

\*The megawatts used to allocate the Power Generation Fee should be updated consistent with the Company's disclosures in its 2008 annual report and testimony filed in this proceeding. Cost drivers for which the Company projected no growth should be updated using the average growth in recent years. Test year expenses should be reduced by \$1,577,060 in 2010 and \$2,881,721 in 2011, if the strenuously opposed subsequent test year adjustment is considered.\*

**ARGUMENT:** FPL used stale data to compute several specific drivers which allocate shared costs. In several cases, the Company projected no change in allocation factors from 2008 to 2010, and there was even one instance where the allocation factor remained unchanged since 2006. The use of this stale data fails to reflect the growth that has taken place during 2008, much less the growth anticipated in the 2009, 2010, and 2011 projected test years. (TR-2093-2094).

Ms. Dismukes updated these drivers to reflect the most recent information available. (TR-2106). Specifically, she used more recent data regarding the installed megawatts affecting the Power Generation Division fee, NextEra capacity, and she used past trends to update data where other information was unavailable. (TR- 2107 – 2108).

At the hearing, even FPL witness Ousdahl realized her data underlying the allocation factors was stale, and she updated it to 2009. However, Ms. Ousdahl's update still results in a significant mismatch between the test years of 2010 and 2011 and the underlying data used to allocate costs reflected in those test years. In contrast to Ms. Ousdahl's mismatched data, Ms. Dismukes' allocation factors bring the factors to 2010 and 2011 levels so that there is a match between the factors and the test years. (TR-2154). The updates are backed by strong indications that NextEra will continue to grow, such as NextEra's plans to add 2,000 megawatts of wind power in the next two years. *Id.*

The updates recommended by Ms. Dismukes should be adopted by the Commission in order to avoid allocation factor data which would be mismatched with the test year data. Therefore, the Commission should approve Ms. Dismukes' recommendations and reduce test

year expenses by \$1.5 million in 2010 and \$2.9 million in 2011, as shown on page 2 of Ms. Dismukes' Revised Exhibit KHD-11 [Exhibit 201]. (TR-2107-2108).

**Subissue: Affiliate Management Fee Massachusetts Formula allocation factors (Former Issue 112)**

\*The Company did not provide adequate support for its projections of the Massachusetts Formula components for 2010 and 2011. Ms. Dismukes performed an analysis of the growth of each component from 2008 to 2010. This was then compared to the Company's 2011 projections. In instances where the Company's 2011 projections lacked sufficient support and were not years where the growth appeared abnormal, the average growth from 2008 to 2010 was used.\*

**ARGUMENT:** See the argument relating to the preceding subissue. The Company did not provide adequate support for its projections of the Massachusetts Formula components for 2010 and 2011. An examination of the allocation factors for the Massachusetts Formula from year to year shows the Company's projections for 2010 and 2011 are understated relative to previous years. For example, there are instances where the Company projects no additional Plant, Property and Equipment for its unregulated affiliates. It is unrealistic to assume these entities will not experience any additions to plant in service over the next two years. Not only is the "no growth" assumption questionable, but the lack of budgeting any increase in plant in service calls into question the use of a 2011 test year. (TR-2093-2096).

Ms. Dismukes also examined the revenue and payroll components of the Massachusetts Formula. There are instances where the projected revenue and payroll components for the unregulated companies are understated relative to previous years.

To correct problems encountered in the Massachusetts Formula, in instances where the Company's 2011 projections lacked sufficient support and were not years where the growth appeared abnormal, the average growth from 2008 to 2010 was used. Using Ms Dismukes' approach, a reduction to 2011 test year expenses of \$1,393,000 should be made. (TR-2108 – 2110).

**Subissue: Costs charged to FPL by FiberNet (Former Issue 113)**

\*The Commission should reduce the return on investment used in the determination of charges to FPL from FPL FiberNet to the return allowed for FPL. There is no need for FPL FiberNet to earn

a return in excess of the return allowed for FPL. Using the rate of return recommended by Dr. Woolridge, test year expenses should be reduced by \$1,182,224 in 2010 and 2011.\*

**ARGUMENT:** Costs allocated from Fibernet were allocated using fiber miles, fiber capacity, and DS3 capacity. A large portion of the costs allocated to FPL were based upon the return on the assets used by FPL. FPL used a return on investment claimed to be confidential. Ms. Dismukes modified the return to match the overall cost of capital recommended by Dr. Woolridge. Given the fact that the calculations used to determine the costs charged to FPL essentially guarantee that FiberNet will earn the rate of return included in its charges, there is limited, if any, risk associated with earning this return.

The use of FPL's authorized rate of return provides a generous return for an investment which is essentially risk-free. Therefore, the Commission should adopt the recommendations of Ms. Dismukes and use the overall cost of capital recommended by Dr. Woolridge, or the return ultimately found reasonable by the Commission. This more appropriate return on investment resulted in a reduction to test year expenses of \$1,182,224 for each test year. (TR-2112 – 2113).

***Subissue: Benefit of FPLES margins on gas sales as a result of the sale of FPL's gas contracts to FPLES (Former Issue 114)***

\*FPL failed to demonstrate the reasonableness of moving the gas margin revenues to its non-regulated affiliate and whether the gas contracts were sold at the higher of cost or market. Therefore, FPL's 2010 and 2011 test year revenues should each be increased as reflected on Exhibit KHD-13 [Exhibit 203] to reflect these margins as belonging to FPL.\*

**ARGUMENT:** FPL removed a profitable revenue producing segment from its regulated operations and moved it to a nonregulated affiliate at the expense of ratepayers. Prior to the sale, the margin earned on the sale of gas to FPL electric customers was recorded on FPL's books. Even today, FPL procures gas on behalf of FPL and transfers it to FPLES at cost. (TR-2115-2116).

The transaction between FPL and FPLES is riddled with problems. On January 1, 2006, FPL sold to FPLES the natural gas business of FPL. Prior to the sale, the margin for the natural gas business was distributed between FPL and FPLES based upon whether the customer was located in FPL's service territory or located outside its territory. (TR-2115). The in-territory customers of FPL (through its electric business) represented 70% of this total business associated with the sale of natural gas. (TR-2017).

The value of the contracts being sold was determined by FPLES – the unregulated entity actually purchasing the contracts. Had this been an arms-length transaction, the purchasing company would not have performed the evaluation which resulted in the actual sale price of just \$611,295. (TR-2170 and 2117). What buyer wouldn't like to determine the price of its purchase? In this case, the unregulated affiliate, FPLES, used a series of biased assumptions to determine an unrealistically low purchase price of the contracts from FPL.

As Ms. Dismukes testified, the Commission should seriously question why there was no independent unaffiliated company used to make a determination of the value of the contracts sold to FPLES. When FPLES valued the contracts, it assumed that the contracts would never be renewed – even though approximately 95 percent of the contracts had an evergreen provision. In addition, if a contract ended in February 2006, the valuation only assumed two months on margin. The FPLES valuation did not go beyond a one-year period, and it completely ignored the fact that the contracts would most likely be renewed. (TR-2159-2160).

If better assumptions had been used, such as assuming that the contracts would renew for the remainder of the year of purchase, the equivalent sales price would have been \$1.2 million, or about twice what was paid. Assuming that those contracts with evergreen provisions would renew for a full five years, the sales price would have been between \$4 and \$5 million dollars, or approximately 6.5 to 8 times more than what FPL was actually paid by its affiliate.

The above facts and circumstances clearly demonstrate the need for the Commission to closely examine affiliate transactions. In addition, the Company failed to produce any evidence that the sale of these gas contracts was done at the higher of cost or market, or that the sale price was reasonable. (TR-2117). The Commission has rules governing the conduct of marketers of gas utilities, but not of electric utilities. (Exhibit 431). Ms. Dismukes agreed with Staff that there should be similar rules for the conduct of marketers of gas by electric utilities as well. (TR-2164).

Given the fact that the Company utterly failed to demonstrate that the price for the sale of the gas contracts was reasonable, the Commission should adopt the recommendations of Ms. Dismukes and act as if the contracts did not change hands. Accordingly, the Commission should flow the gross margins through to FPL's ratepayers as if the sale had not taken place. The amount is confidential. (TR-2118).

***Subissue: Recognize compensation for the services that FPL provides to FPLES for billing on FPL's electric bills (Former Issue 115)***

\*FPLES should compensate FPL at market rates for the use of its personnel, billing systems, collection system, postage, paper and any other costs associated with billing the customer.\*

**ARGUMENT:** FPL includes charges from FPLES on its customers' bills and charges FPLES for this service. The cost of the bill is allocated based upon the number of lines. (TR-1584). However, the Commission's affiliate transactions rules require that charges from FPL to its affiliate be at the higher of cost of market unless certain conditions are met. Ms. Santos agreed that it would be more beneficial for the utility to charge the affiliate a market price for this service. (TR-1586). However, according to Ms. Santos, a market for this service does not exist and therefore no market price can be developed. (TR-1587). This is an excuse that should fall on deaf ears — as there are numerous companies that provide billing services. Moreover, FPLES offered billing to *The Miami Herald*, as well as other related services. Although these billing services have been discontinued, it could have been examined as a surrogate for an unaffiliated transaction. Moreover, Ms. Santos agreed that FPL could have charged the Miami Herald a "market price." (TR-1590-91). While the record is not clear as to what price FPL charged FPLES for the billing services provided to *The Miami Herald*, it is clear that FPL did not provide these billing services to FPLES at "market price."

OPC recommends that the Commission open an investigation to determine the appropriateness of the charges between FPL and FPLES for billing and related services that are provided by FPL to FPLES. This investigation should encompass all aspects of services provided by FPL to FPLES, including billing and any other services, such as referrals for appliance and surge protection, water lines and electric line protection, and One Plug. (TR-2113-14).

***Subissue: Compensation for the services that FPL provides to FPLES to the extent that FPL service representatives provide referrals or perform similar functions for FPLES (Former Issue 116)***

\*To the extent that FPL service representatives provide referrals or perform similar functions for FPLES, FPL should be compensated for this invaluable service. The amount of the adjustment is pending further development of the record.\*

**ARGUMENT:** See the argument relating to the preceding subissue. OPC recommends the Commission initiate an investigation regarding the appropriateness of compensation FPLES should provide FPL for referral services performed.

**Subissue: *Increase power monitoring revenue for services provided by FPL to allow customers to monitor their power and voltage conditions (Former Issue 117)***

\*Test year revenues should be increased by \$236,336 for 2010 to reflect the amount of power monitoring revenue projected by the Company. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate increase to revenues is \$267,885 for 2011.\*

**ARGUMENT:** Power monitoring revenue results from a service provided by FPL to commercial and industrial customers that allows them to monitor their power and record their voltage condition. FPL provided conflicting responses concerning the projected revenue from this service. Ms. Dismukes made an adjustment of \$236,336 for 2010 and \$267,885 for 2011 to reflect the higher revenue figures, which ensures that customers get sufficient credit for power monitoring revenues. (TR-2124).

**ISSUE 116a: Is an adjustment necessary to reflect the gains on sale of utility assets sold to FPL's non-regulated affiliates?**

\*Yes. Consistent with Commission practice, the gain on sales of utility assets should be passed onto customers and amortized over five years. This increases test year revenue by \$1,090,753 for 2010. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the same increase to test year revenues is appropriate for 2011. \*

**ARGUMENT:** During 2007 and 2008, FPL sold several assets to affiliates which resulted in gains on sale. In 2007, for example, FPL made a sale of a combustion turbine rotor to FPL Group which resulted in a gain of \$4.5 million. In 2008, FPL sold a transformer to Calhoun Company I, LLC (an affiliated company) which resulted in a gain of \$872,974. (TR-2122 – 2123).

The Commission routinely amortizes gains on sale over five years. (TR-2123). By attempting to recognize all of the gains in 2007 and 2008, FPL denied customers the amortization of the gains during the test years. The Commission should adopt the recommendations of Ms. Dismukes to amortize the gains over five years which results in adjustments to reduce test year expenses by \$1.1 million each for 2010 and 2011. (TR-2124).

**ISSUE 118:** Issue 118 is intentionally blank.

**ISSUE 119:** Should the Commission order notification requirements to report the future transfer of the FPL-NED assets from FPL to a separate company under FPL Group Capital?

\*Yes. The Commission should ensure that at the time of the transfer of FPL-NED assets to a separate company under FPL Group Capital the assets are transferred at the higher of cost or market as required by its affiliate transaction rules. The Commission should also order an independent appraisal as required by Rule 25-6.1351(d). \*

**ARGUMENT:** FPL-NED is a division of FPL created to hold the transmission substation assets of Seabrook, located in New Hampshire. In late 2009, the Commission expressed serious concerns about FPL owning assets in the state of New Hampshire when it requested \$30 million in financing for FPL-NED. (TR-2125). FPL withdrew its application before the Florida PSC and petitioned the New Hampshire Commission for approval of the financing. (TR-2125 -2126). FPL is taking steps to reorganize its structure so that FPL-NED will become a subsidiary of FPL Group Capital. (TR-2127).

FPL-NED and its subsequent owner receive numerous benefits from being a part of FPL. (TR-2128). As noted during questions from Commissioner Skop, the assets of FPL-NED were placed into the regulated entity for the convenience of an unregulated affiliate. (TR-2167). Consistent with the Commission's affiliate transactions rules, at the time the FPL-NED assets are transferred to a separate company, the Commission should ensure the assets are transferred at the higher of cost or market, and it should order an independent appraisal be prepared as to the fair market value of these assets. Any gain should inure to the benefit of ratepayers. (TR-2128).

**ISSUE 120:** Should an adjustment be made to FPL's requested storm damage reserve, annual accrual of \$150 million, and target level of \$650 million? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\*Yes. The accrual should be eliminated for 2010 and the target level of the reserve is \$200 million. Current customers are already paying for past storms and should not be doubly burdened by unknown future storms. To charge current customers for both historical and projected storms would actually cause an inequity to current ratepayers. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate accrual is zero.\*

**ARGUMENT:** OPC witness Brown testified that the Commission should deny FPL's request to charge \$150 million a year to ratepayers to build up the storm damage reserve. It is

extremely important in this case to balance the generational ratepayer interests. Given the tough economic times that exist, it is not reasonable or feasible for FPL's customers to pay \$150 million for an annual storm accrual that represents over 14% of FPL's requested 27% increase in base rates. Ratepayers are already paying a substantial amount to cover past storms, as well as replenishment of the storm reserve fund to over \$200 million (\$93.957 million projected in 2010). Ms. Brown added that pre-funding of storm costs is not necessary to provide for reasonable levels of generational sharing of costs as other recovery mechanisms such as deferred cost recovery or securitization are available for use by utilities in the event it incurs substantial storm damage.

Based on past Commission policy, Ms. Brown testified that the risk associated with the level of storm damages covered by the reserve falls to the ratepayers. The Commission recognized this in Order No. PSC-06-0464-FOF-EI, Section 57, where it stated:

FPL proposed that its Reserve be replenished to a level of \$650 million to be financed through storm-recovery bonds authorized in this proceeding. Intervenors support funding the Reserve to a level of between \$0 and \$200 million. The record clearly establishes that the level of FPL's Reserve has no impact on FPL's exposure to storms. Further, under the current approach to the recovery of storm restoration costs, the risk associated with a lower reserve level (i.e., the possibility of storm restoration costs exceeding the Reserve, leading to subsequent customer charges) and the risk associated with a higher reserve level (i.e., paying charges now for storm restoration costs that do not materialize) is completely borne by FPL's customers. The customers represented in this proceeding have made clear that they would rather pay to fund the Reserve to a lower level now and risk future rate volatility than pay to fund the Reserve to a higher level before future storm restoration costs have been incurred.

In the current case, according to Ms. Brown, the risks are still borne by the ratepayers. Given the burden already placed on ratepayers to cover previous storm damages and reserve replenishment, it is reasonable to accept the risk of future storm damage. Further, denying FPL's requested storm accrual will not create unreasonable generation inequities as current customers today are already paying for past storms and should not be doubly burdened by unknown future storms. Conversely, to increase the expense to current customers for both historical and projected storms would cause an inequity to current ratepayers. Based on the above, FPL's proposed storm damage accrual increase of \$148.667 million should be denied. (TR-2469-2472).

SFHHA witness Kollen added several other pertinent points supporting why the Commission should deny FPL's requested storm accrual in base rates. First, the surcharge approach avoids the need to speculate as to what level of storm damage expense is appropriate to include in base rates. Second, the most sophisticated models, including the model employed by FPL witness Harris, cannot possibly predict the magnitude or the timing of actual storm damage costs accurately. Finally, the surcharge approach in conjunction with securitization financing is the least cost and most economically efficient approach. Recovery by securitization removes tax penalties, allows the use of lower cost debt and minimizes ratepayer investment; whereas prefunded base rate accruals do the opposite.

Mr. Kollen opined that FPL's requested storm expense is "wildly excessive" and the accrual should be \$0. However, if the Commission does deem it appropriate to reconsider a storm accrual in this proceeding, the analysis of the amount should not be based on an insurance-type probabilistic model of risk exposure and replacement property damage. This analysis, while perhaps appropriate for the insurance industry, does not reflect the proper regulatory accounting and ratemaking process.

Further, Mr. Kollen stated FPL witness Harris' analysis provides a gross damages estimate (previously twice rejected<sup>10</sup>), not the "incremental" cost for which the Commission allows recovery, and the \$650 million storm reserve target is therefore overstated. The Commission previously rejected FPL's requested \$650 million target amount and instead found that a \$200 million reserve surplus was reasonable. Mr. Kollen concluded that there is no valid reason for the Commission to revisit the reserve target in this case. (TR-3148-3151).

**ISSUE 121: What adjustment, if any, should be made to the fossil dismantlement accrual?**

\*FPL's quantification is unreasonable, in that it represents a worst case scenario for terminal net salvage.\*

**ARGUMENT:** FPL's request fails to recognize any potential of full or partial sale of the site or facilities. FPL's request also fails to recognize the possibility of reuse of a site, which has already occurred. In addition, FPL's reliance on the "reverse construction" approach fails to

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<sup>10</sup> See Order No. PSC-06-0464-FOF-EI, in Docket No. 060038-EI, In re: Petition for Issuance of Storm Recovery Financing Order by Florida Power & Light Company; and Order No. PSC-05-0937-FOF-EI, in Docket No. 041291-EI, In re: Petition For Authority To Recover Prudently Incurred Storm Restoration Costs Related to 2004 Storm Season That Exceed Storm Reserve Balance, by Florida Power & Light Company.

recognize less costly means of demolition that have already been employed elsewhere. At a minimum, the Commission should direct FPL to propose a more realistic approach and cost level to terminal net salvage in its next depreciation study. If the Commission is inclined to change the terminal net salvage level in this proceeding, it should use 40% of FPL's request. The 40% level represents the approximate level actually obtained for generation demolition in comparison to similar "reverse construction" cost.

**ISSUE 122: What is the appropriate amount and amortization period of Rate Case Expense? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Rate case expense should be reduced to disallow recovery of rate case expense associated with the subsequent year rate increase and GBRA; overtime or bonuses for salaried employees to work on this rate case; external audit fees of aviation flight logs and cellular phone fees. A five-year amortization period is appropriate, the time period since FPL's last rate case.\*

**ARGUMENT:** Several adjustments are appropriate to FPL's requested rate case expense. First, OPC witness Brown testified that the Commission should deny FPL's requested subsequent year rate increase and the GBRA. Both represent meritless attempts to shift the risk of future uncertainty from FPL to customers. FPL witness Davis testified that had the company not requested these two rate increase adjustments that rate case expense would not have been as high as the amount incurred. (TR-6513).

Second, FPL in its response to Staff's Fourth Set of Interrogatories No. 35, projected \$450,000 to paid in overtime or bonuses for salaried employees to work on this rate case. (TR-6518-6520) The Commission has historically disallowed recovery of additional pay or bonuses as a part of rate case expense. See Order No. PSC-08-0327-FOF-EI, issued May 19, 2008, in Docket No. 070300-EI, In re: Review of 2007 Electric Infrastructure Storm Hardening Plan filed pursuant to Rule 25-6.0342, F.A.C., submitted by Florida Public Utilities Company and Docket No. 070304-EI, In re: Petition for rate increase by Florida Public Utilities Company. Pursuant to the Order, the Commission stated that "Salaried Overtime Pay for Extraordinary Work Load" shall be disallowed because these employees and managers are paid a salary, not an hourly wage. Salaried employees are usually expected to work the hours required to complete their job duties without extra compensation.

Other costs that should be disallowed as rate case expense are the audit fees associated with the External Review of Aviation Flight Logs for corporate airplane usage and cellular telephone service. The audit fees of the flight logs should be removed as the corporate aviation fees were removed by FPL. (TR-6521-6522). The cellular phone fees are clearly normal recurring costs that should not be specifically recovered as rate case expense. (TR-6523-6527), (Exhibit 536)

Additionally, rate case expense should be amortized over five years. Given the amount of time that has elapsed since FPL's last base rate case in which rates were changed, five years is certainly reasonable.

**ISSUE 123:** Approved.

**ISSUE 124:** Should FPL's request to move payroll loading associated with the Energy Conservation Cost Recovery Clause (ECCR) payroll currently recovered in base rates to the ECCR be approved? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\*No. These costs are appropriately recovered in base rates and should not be transferred to the ECRC.\*

**ISSUE 125:** Should an adjustment be made to remove payroll loadings on incremental security costs that are currently included in base rates and include them in the Capacity Cost Recovery Clause? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\*No. These costs are appropriately recovered in base rates and should not be transferred to the CCRC.\*

**ISSUE 126:** Should an adjustment be made to move the incremental hedging costs that are currently being recovered through the Fuel Cost Recovery Clause to base rates? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?

\*No. The Commission should deny FPL's request and continue to review the prudence and reasonableness of FPL's hedging costs during the annual Fuel Clause proceeding.\*

**ISSUE 127:** Approved.

**ISSUE 128:** Is FPL's requested level of O&M Expense appropriate? A. For the 2010 projected test year in the amount of \$1,694,367,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$1,781,961,000?

\*No. The appropriate amount of O&M Expenses for each respective test year should be as follows: A. 2010: \$1,508,754,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate 2011 amount is \$1,594,688,000.\*

**ISSUE 129: Should FPL be permitted to collect depreciation expense for its new Customer Information System prior to its implementation date?**

\*No. Depreciation of this system should commence upon the implementation date. As such, depreciation expense is overstated by \$0.5 million in 2010 and rate base is understated due to the accumulated depreciation in 2010 by \$0.2 million. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, depreciation expense should be reduced by \$4.9 million and rate base increased by \$2.3 million.\*

**ARGUMENT:** FPL has agreed to the above adjustments. See Exhibit 358, Exhibit KO-16, Items 11 & 12.

**ISSUE 130:** \*No position.\*

**ISSUE 131: Should any adjustment be made to Depreciation Expense? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. The appropriate amount of depreciation expense for each respective test year should be as follows: A. 2010: \$513,606,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$570,447,000.\*

**ISSUE 132: Should an adjustment be made to Taxes Other Than Income Taxes for the 2010 and 2011 projected test years? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes. The appropriate amount of Taxes Other Than Income Taxes for the respective test years is as follows: A. 2010: \$350,217,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$392,887,000.\*

**ISSUE 133:** \*No position\*

**ISSUE 134: Should an adjustment be made to Income Tax expense? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*Yes. Adjustments are appropriate to income taxes as a result of OPC's recommended adjustments to rate base, capital structure and operating income. The appropriate amounts for income taxes per year are as follows: A. 2010: \$545,476,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$476,151,000.\*

**ISSUE 135: Is FPL's projected Net Operating Income appropriate? A. For the 2010 projected test year in the amount of \$725,883,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$662,776,000?**

\*No. The appropriate net operating income is as follows: A: 2010: \$1,202,417,000; B. OPC strenuously opposes the subsequent 2011 test year. If the 2011 test year is considered, the appropriate amount is \$1,138,864,000.\*

**REVENUE REQUIREMENTS**

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL’s request for a subsequent year adjustment.)

**ISSUE 136: What are the appropriate revenue expansion factors and the appropriate net operating Income multipliers, including the appropriate elements and rates, for FPL? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*The appropriate NOI multiplier for the 2010 test year is shown below. OPC strenuously opposes the subsequent 2011 test year. If considered, the 2011 amounts are also shown.

<u>OPC Recommended</u>	<u>2010</u>	<u>2011</u>
Revenue Requirement	100.0000%	100.0000%
Regulatory Assessment Rate	0.0720%	0.0720%
Bad Debt Rate	0.1930%	0.150%
Additional Late Payments	-0.0866%	-0.0866%
Net before Income Taxes	99.82158%	99.8649%
State Income Taxes	5.4902%	5.49257%
Federal Income Taxes	33.0160%	33.03032%
Revenue Requirement	61.3154%	61.3420%
NOI Multiplier	1.630911	1.63020

\*

**ARGUMENT:** OPC witness Brown testified that two adjustments are necessary to FPL’s revenue expansion factor. First, FPL failed to include the impact of its requested increase in late fee revenues when it calculated its revenue expansion factor. (See Issue 89) Since FPL has requested that a portion of the late payment fees (in excess of the requested \$10 minimum fee) will still be calculated as 1.5% of the late payment, Ms. Brown believes it is reasonable to assume that any base rate increase in revenues will result in increased late payment fees. As with the bad debt factor application to the revenue expansion factor, it is appropriate to include an offset to the revenue expansion factor for this additional revenue. Based on FPL’s payment history for the period October, 2007 through September, 2008, FPL received late payment

revenues of \$10,028,545 from customers that would be in excess of the requested \$10 minimum fee. Ms. Brown grossed this amount up using the 1.5% late fee to equal gross revenue of \$668,569,666 that would pay late fees above the minimum. During that same period of time, FPL recorded total revenues of \$11,582,744,853. Dividing the late fee revenues above the minimum by the total revenues reflects that 5.7721% of revenue was subject to a late fee at 1.5%. Multiplying this percentage by the 1.5% late fee results in a factor of .08658% that should be applied to revenue expansion factor. See Exhibit 230 (SLB-8). Incorporating this offset to the revenue expansion factor reduces the 2010 and 2011 test year revenue requirements by \$905,000 and \$1,132,000, respectively. (TR-2440).

The second adjustment to the revenue expansion factor relates to the recommended change to bad debt expense. Consistent with Ms. Brown's recommended reduction to bad debt expense in Issue 96, the bad debt factor should be 0.00183 for 2010 and 0.00146 for 2011.

**ISSUE 137: Is FPL's requested annual operating revenue increase appropriate? A. For the 2010 projected test year in the amount of \$1,043,535,000? B. If applicable, for the 2011 subsequent projected test year in the amount of \$247,367,000?**

\*No. Not only is no revenue increase warranted, base rate revenues should be decreased as shown below. OPC strenuously opposes the subsequent 2011 test year. If considered, the 2011 amounts are also shown.

<u>OPC Recommended</u>	<u>2010</u>	<u>2011</u>
Revenue Reduction at Proposed Return	(\$1,298,043)	(\$1,281,546)
Less Increase in Miscellaneous Service Fees	\$25,024	\$26,035
Revenue Reduction for Sales Revenues	(\$1,323,067)	(\$1,307,581)

\*

**ISSUE 138: INTENTIONALLY BLANK.**

**COST OF SERVICE AND RATE DESIGN ISSUES**

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent year adjustment.)

**ISSUE 139: Has FPL correctly calculated revenues at current rates for the 2010 and 2011 projected test year? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. See OPC's position on Issues 3 and 7.\*

**ISSUES 140 to 168: \*No position.\***

**ISSUE 170: Should FPL evaluate the merits of a prepayment option in lieu of monthly billing for those customers who can benefit from such an alternative? If so, how?**

\*Yes, FPL should be required to provide a study evaluating the merits of a prepayment option in lieu of monthly billing within a month of the agenda conference. Interested persons should have a right to address the study and any recommendations from the study in a separate, subsequent proceeding and agenda conference as a PAA matter.\*

**Argument:** At the Ft. Myers service hearing, Mr. Frank Balogh and Mr. Don Morgan advanced a straight-forward proposition: allow customers to prepay their electric bills and receive a discount on the prepayment equal to the company's overall cost of capital. In other words, the customers would provide financing to FPL. The details would have to be worked out and a tariff submitted by FPL; however, the concept is clear.

The proposal by Mr. Balogh and Mr. Morgan gained support from a number of large usage customers of FPL. The Bank of America stated that they loved the idea. (TR-68). Collier County could save approximately \$1 million, and Lee County could save approximately \$950,000 using the prepayment option. Ft. Myers, Tr. 69.<sup>11</sup> Jim Delony, the Public Utilities Administrator for Collier County Public Utilities, strongly supported a prepayment option. The electric bill for Collier County's water/wastewater treatment plant alone is about \$1 million per year. (TR-49 – 61). A prepay option is available in some form in a number of other states, including Pennsylvania, Oklahoma, Utah, and Arizona. (TR-70).

FPL's response is that it will study the issue – and take close to a year to do so. Two months after the Ft. Myers service hearing, the company had created a team to look at the issue and to “understand the concepts;” however, it has not done much else. (TR-1592 – 1594). The Commission should require more from FPL. FPL should be required to provide a study evaluating the merits of a prepayment option within a month of the conclusion of the agenda conferences in this case. A subsequent proposed agency action or workshop by the Commission would allow interested persons to provide input.

**ISSUE 172:** Approved.

**OTHER ISSUES**

**ISSUE 173: Should an adjustment be made in base rates to include FPL's nuclear uprates being placed into service during the projected test years if any portion of prudently**

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<sup>11</sup> In 2008, Collier County's bill for electricity was \$13.3 million. Ft. Myers, Tr. 72.

**incurred NCRC recovery is denied? A. For the 2010 projected test year? B. If applicable, for the 2011 subsequent projected test year?**

\*No. These issues should not be addressed in this docket.\*

**ISSUE 173A: Should FPL evaluate the merits of an LED street lighting alternative to its conventional street lighting rate and, if so, how?**

\*Yes, FPL should be required to provide a study evaluating the merits of an LED street lighting alternative within a month of the conclusion of the agenda conferences in this case. Interested persons should have a right to address the study and any recommendations from the study either in a workshop or in a separate, subsequent proceeding and agenda conference as a PAA matter.\*

**Argument:** At the Plantation service hearing, Lauderhill Mayor Richard Kaplan testified that his city received an energy block grant fund of \$595,200 from the federal government to reduce energy consumption. (TR-50). Federal regulations governing use of the funds place a high priority on replacing conventional street lights with LED lights; however, under the existing tariff with FPL, the city would continue to pay the same rate even if it replaced existing lights with LED lights. According to Mayor Kaplan, energy usage can be reduced from 40% to 60% through the use of LED street lighting. Mayor Kaplan requested the PSC to look at the issue because of the difficulty he encountered trying to work with FPL on conservation programs.

FPL responded to the issue by stating that it wished to conduct a year-long study of 8 LED lights in its parking lot at Juno Beach before making a proposal. FPL does not appear to see any urgency to the issue, notwithstanding the potential of LED street lighting to save a great deal of energy. The City of Lauderhill has 3,000 street lights, and Mayor Kaplan sees an opportunity to save energy usage by reducing consumption by 40% to 60% on these lights. (TR-50). At the hearing held in Tallahassee, FPL's designated expert on this issue, Mr. Spoor, wasn't familiar with the results of tests of LED street lighting conducted by other companies (TR-2218, 2220), even though cities other than Lauderhill have expressed an interest in this lighting.

In view of the potential benefits of conserving energy through the use of LED street lighting, this issue should move forward more quickly than proposed by FPL. FPL began its pilot test of eight LED street lights in March of this year. At a minimum, the Commission should require FPL to provide a study evaluating the merits of an LED street lighting alternative within a month of the conclusion of the agenda conferences in this case and require FPL to provide that report to every city which has expressed to FPL an interest in LED lighting.

Interested persons should have a right to address the study and any recommendations from the study either in a workshop or in a separate, subsequent proceeding and agenda conference as a PAA matter.

**ISSUE 174: INTENTIONALLY BLANK.**

**ISSUE 176: No factual dispute; approved. TR 35.**

**ISSUE 177: \*No position.\***

### CONCLUSION

For the reasons stated herein, the Commission should deny FPL's request for a rate increase, and instead order FPL to reduce retail base rates by \$354 million annually.

Respectfully submitted,

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**DOCKET NOS. 080677-EI & 090130-EI**  
**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a copy of the foregoing CITIZENS' POST-HEARING STATEMENT OF POSITIONS AND POST-HEARING BRIEF has been furnished by U.S.

Mail to the following parties on this 16th day of November, 2009.

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