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Sent: Friday, September 21, 2012 4:49 PM
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Subject: E-filing (Dkt. No. 120015-EI)
Attachments: 120015 OPC's Post Hearing Statement of Positions and Post Hearing Brief (FPL).pdf

The attached filing is to replace the electronic filing made by OPC and confirmed by e-mail receipt at 4:37 p.m.
Electronic Filing

a. Person responsible for this electronic filing:

Joseph A. McGlothlin, Associate Public Counsel
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b. Docket No. 120015-EI

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

c. Document being filed on behalf of Office of Public Counsel

d. There are a total of 102 pages.

e. The document attached for electronic filing is a transmittal letter and the redacted version of the Citizens' Post-Hearing Statement of Positions and Post-Hearing Brief.

Thank you for your attention and cooperation to this request.

Brenda S. Roberts
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DEAN CANNON
Speaker of the
House of Representatives

September 21, 2012

Anne Cole
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd
Tallahassee, FL 32399

Re: Docket No: 120015; Citizens' redacted Post-Hearing Statement of Positions and Post-Hearing Brief

Dear Ms. Cole:

Enclosed for Electronic filing is a redacted copy the Citizens' Post-Hearing Statement of Positions and Post-Hearing Brief. Please note that a single paper copy of the Citizens' brief on Issue 30 is being filed separately on a confidential basis with the appropriate request for Confidential Classification being submitted by FPL. (See attached transmittal letter for the confidential document) The argument section related to that issue contains information from Hearing Exhibits 609-614 for which FPL has pending claims for confidential classification.

FPL and Parties who have executed non-disclosure agreements with FPL and who participated in the hearing as noted at Page 4304 of the Hearing transcript will receive -- by separate service – the document containing confidential Issue 30 argument, pending a full review of the document by FPL.

Once FPL reviews the document containing the argument on Issue 30 and makes a designation of confidentiality, if any, the Public Counsel will file and serve either an unredacted, complete brief (if FPL determines none of its content is confidential) or a redacted public version and a single copy of a complete confidential version (if FPL determines that any information is confidential).

The Citizens are utilizing this process as matter of expedience, understanding that the Commission staff needs to begin reviewing the briefs immediately. In doing so, we do not waive any objections we may have to any claim of confidentiality that FPL may assert.

Please feel free to contact me if you have any questions.

Sincerely,

Charles J. Rehwinkel
Deputy Public Counsel

cc: Parties of record (transmittal letters and redacted Brief only)

Enclosure

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company.	DOCKET NO. 120015-EI FILED: September 21, 2012

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

Pursuant to Order Nos. PSC-12-0143-PCO-EI and PSC-12-0428-PHO-EI, the Citizens of the State of Florida, by and through the Office of Public Counsel, hereby submit their Post-Hearing Statement of Positions and Post-Hearing Brief.

PRELIMINARY STATEMENT

The Office of Public Counsel 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. The issues on which Citizens take no positions or which were stipulated have not been reflected in the Brief. Within this Brief, the Office of Public Counsel will be shortened to "OPC." OPC will refer to Florida Power & Light Company as "FPL," and to its parent, NextEra Energy, Inc., as "NEE." The acronyms "DCF" and "CAPM" refer to the discounted cash flow and capital asset pricing model forms of financial analysis, respectively. OPC will refer to Standard & Poor's, the credit rating agency, as "S&P." Plant Held For Future Use accounts will be referred to as "PHFFU."

References to OPC's calculations of revenue requirements are based on OPC witness Ramas' Exhibits 270-273. Subsequent to the submission of those Exhibits, OPC accepted FPL-sponsored downward revisions to the cost rates of customer deposits and short-term debt. Also, based on rebuttal testimony, Ms. Ramas withdrew certain proposed adjustments to transmission-related PHFFU. (TR 2752-2754) These revisions would modify fall-out calculations slightly. OPC's positions on individual issues are as stated within this Brief.

EXECUTIVE SUMMARY OF ARGUMENT

As Counsel for OPC emphasized during opening statements, this is largely a cost of capital case. FPL hopes to marry an overreaching return on equity of 11.50% to an extravagantly high 59.62% equity ratio. In combination, the impact of these supersized components of FPL's request on the revenue requirements borne by customers is extreme. The adjustments necessary to bring the requested return on equity down to the reality of the current economic environment, and also to establish the properly risk-based relationship between return on equity and capital structure, are nearly sufficient by themselves to offset the large base rate increase that FPL wants to implement in January 2013. When adjustments to excessive operations and maintenance (O&M) expense levels and rate base are added, the resulting overall calculation discloses that FPL's current rates generate revenues in excess of the level required to yield a fair return on its investment.

OPC's primary recommendation is to authorize a return on equity capital (ROE) of 9% for FPL, based on an equity ratio of 50% for ratemaking purposes; and, based on these parameters and adjustments to excessive O&M expenditures that FPL has targeted for 2013, reduce FPL's revenues by $253.4 million per year as of January 1, 2013. In the event the Commission elects to approve FPL's requested 59.62% equity ratio, OPC advocates a return on equity of 8.50% and a reduction to FPL's revenues in the amount of $184.4 million annually. The increase that FPL wishes to implement at the time its Canaveral project enters service in June 2013 should be reduced from $173.9 million to either $121.4 million or $122.4 million, depending on whether the Commission adopts OPC's primary recommendation or its alternative recommendation. The adoption of either recommendation would leave FPL in a strong financial position – one that will continue to qualify FPL for its current "A" rating. In this Executive Summary, OPC will highlight, in condensed form, certain of the arguments that OPC will develop in greater depth in the main body of this Brief.

Equity Ratio – The debate over the appropriate equity ratio involves tens of millions of dollars annually. In its pre-settlement rate case decision in Docket No. 080677-EI, the Commission acknowledged the fundamental linkage between FPL's equity ratio and the return on equity that is commensurate with the company's overall risk profile. A prudently cost-conscious utility will employ a suitable amount of debt to "leverage" its capital dollars and to lower overall capital costs borne by customers. FPL's proposed equity ratio of 59.62% is extravagant and excessive, whether measured by reference to the broad utility industry (45%-47% equity ratio) or by the capital structure of its parent, NEE (39% equity ratio). NEE's capital structure is particularly important in the comparison because — regardless of the amount of equity that NEE places in FPL's capital structure — the *parent's* capital structure is the one that potential investors assess when evaluating whether to purchase stock in the entity that owns FPL.

FPL's extremely high equity ratio is illogical when compared to its low business risk (relative to its unregulated affiliates, whose operations are characterized by uncertainty and volatility), but NEE has an incentive to place 59.62% equity in FPL to maximize returns on the safest, most assured of its subsidiaries.

FPL avoids treating its proposed 59.62% equity ratio as having a downward effect on the return on equity that would be commensurate with the significantly lower risk profile engendered by its extreme high equity ratio. In FPL's presentation, the high equity ratio and high ROE become two separate and independent "solutions" to the "problem" of its claimed high business risk. It is as though FPL believes that the equity ratio can be placed on one end of a see-saw, the return on equity on the other end of the see-saw, and both ends can go up at the same time! However, the link between equity ratio and return on equity cannot be severed, and FPL cannot have it both ways. If the Commission adopts FPL's 59.62% equity ratio for ratemaking purposes, it must correspondingly reflect the lower risk of the capital structure in the ROE that it authorizes for FPL. OPC witness Dr. Woolridge quantified the difference in ROE that corresponds to the differential in the 50% and 59.62% equity ratios to be 50 basis points.

OPC recommends that the Commission employ a 50% equity ratio in this case for ratemaking purposes. The 50% equity ratio advocated by OPC witness Kevin O'Donnell is higher than the average equity ratios of the proxy groups examined by FPL witness Dr. Avera and OPC witness Dr. Woolridge; it is far higher than NEE's 39% equity ratio when viewed on a consolidated basis; and was chosen specifically to avoid the unduly onerous revenue impact that a transition all the way to NEE's consolidated capital structure would have on FPL in this case.

Return on Equity Capital — FPL's request for a 11.25% midpoint ROE is based on a false narrative regarding the Commission's 2010 rate case decision and an analysis of investors' current requirements that is built on patently unrealistic inputs and assumptions.

False narrative — FPL contends that the Commission's decision to authorize an ROE of 10% in 2010 was unjust, and that it disappointed Wall Street's expectations. FPL uses this theme in an attempt to persuade the Commission into believing it must placate Wall Street with a high ROE in this case. Yet, .in April 2010 — shortly after the Commission issued its "pre-settlement order," and long before the eventual settlement agreement was submitted to the

Commission — Moody's described the 10% ROE for FPL as consistent with contemporaneous decisions around the country. Further, in April 2012, Moody's referred to the 10% ROE decision of 2010 as "still adequate." As to the "disappointment" that FPL tries to exploit, a closer reading reveals that Moody's distinguished between the 10% ROE decision, which it did not criticize, and the small amount of revenue increase that the Commission awarded in 2010, which Moody's regarded as "adverse." However, subsequent to the 10% ROE ruling, FPL promptly issued debt on favorable terms, the price of NEE stock performed well, and – most importantly — FPL realized high earnings. These developments demonstrate that FPL's enormous $1.23 billion request was *unneeded and unjustified.* Any "expectations" of a significant increase in revenues clearly were unwarranted. FPL fueled baseless expectations of huge revenue increases through its meritless petition. It has only itself to blame for any equally baseless institutional "disappointment" that accompanied the Commission's decision.

Current environment — Since 2010, interest rates in the economy, which are the chief driver of the cost of capital, have declined by about 150 basis points. FPL tried to seize onto certain authorized returns of southeastern utilities that were established several years ago, some of which were dictated by statutory mandates, and claimed that these returns establish a "ratchet" below which the Commission — notwithstanding current economic realities – cannot set its own ROE now. To the extent the Commission pays attention to returns authorized elsewhere, the most current decisions are the ones that matter. In the second quarter of 2012, the average return on equity for electric utilities authorized by regulators was 9.92%, and those decisions were based on data of 2011 vintage. Very recently, the Public Utility Commission of Texas established Entergy of Texas' ROE to be 9.8%. Moreover, these recent decisions say nothing about the financial risk reflected in the utilities' respective equity ratios relative to that of FPL.

To calculate his DCF growth rate, FPL witness Dr. Avera employed a "proxy" group containing riskier, unregulated companies. He relied exclusively on long-term estimates of earnings per share by Wall Street analysts, a source which has been widely and thoroughly discredited as upwardly biased. To derive a CAPM value, Dr. Avera assumed facially unrealistic returns in the stock market (13.5% per year) and an over-the-top risk premium of 10.9%. Dr. Avera's unrealistic assumptions indict the conclusions of his work product. By comparison, Dr. Woolridge supported his DCF analysis with a proxy group of 28 utilities with characteristics similar to FPL. To develop his critical DCF growth rate, Dr. Woolridge employed a variety of measurements — earnings per share, book value per share, dividend growth, and growth in retained earnings – taken from numerous sources. The methodological soundness of Dr. Woolridge's DCF approach and the robustness of his analysis commend his recommendation of a 9% ROE (8.50% with a 59.62% equity ratio).

Proposed ROE Adder – FPL requested a "performance adder" of 25 basis points, which would increase its requested ratesetting point from 11.25% to 11.50%. The proposed adder would generate an additional $41 million of revenues annually. OPC's objection to the request is based, not on the Commission's lack of statutory authority to approve an ROE adder, but on the undesirable policy it would represent. FPL wants to accept the considerable benefits of Florida's regulatory scheme, and then set the bar for its performance very low, so that it can claim a bonus. To accept FPL's argument for a performance adder, it would be necessary to first accede to the premise that a regulated utility's "obligation to serve" demands little of the utility. The Commission's endorsement of FPL's concept would send an unhealthy policy message to watching utilities. OPC submits that a regulated utility's customers are entitled to the utility's best efforts to deliver high quality service at the lowest reasonable prices possible.

While OPC objects to the performance adder primarily on policy grounds, the evidence in this case does not adequately support FPL's claim of superior performance. For instance, during his benchmarking, FPL witness John Reed assigned a "best in class"– type grade to FPL, even when no other utility had values within the category being measured. In the "contest" for superior ratings that Mr. Reed conducted, FPL frequently did not even have to compete!

Another weakness in FPL's proposal is the linkage between the year-over-year continuation of the adder and the lowest residential rates in the state. Many factors that bear on relative residential rates – geography, demographics, density of population, vintage of plant – are not good measurements of management's performance. The Commission rejected FPL's plan to construct a tremendously expensive coal plant near the Everglades in 2007, and denied FPL's request to increase its revenues by $1.23 billion in 2010. Ironically, in FPL's distorted view of the landscape, these rejections of expensive proposals, which kept bills low, should now enhance its claim to an additional $41 million annually.

Amortization of Depreciation Reserve Surplus — FPL criticized the Commission's 2010 decision to require FPL to amortize $894 million of depreciation reserve surplus as a temporary means of reducing rates, and pointed to the related increase in rate base as a "driver" of the pending rate case. FPL grossly mischaracterized the Commission's action. The goal of depreciation accounting is to collect the cost of plant, through annual depreciation expense over the lives of the related assets, so each generation of customers pays equitably for the plant serving that generation. This is called the "matching principle." By the late 1990s, FPL had overcollected depreciation expense to the extent that the $1.2 billion surplus imbalance between its actual book reserve and the much smaller reserve it should have accumulated created a severe intergenerational inequity. In its 2010 order, the Commission required FPL to achieve intergenerational fairness by returning $894 million of reserve surplus over four years instead of the 18 year remaining life of the related assets. The more timely return of the reserve surplus was needed to ensure that many of the same customers who overpaid in prior years also received the benefit of the reversal. FPL points to the fact that the effect of reversing past entries to the depreciation reserve was to increase rate base. However, FPL fails to mention that the resulting rate base will be no higher than it would have been had FPL been applying depreciation rates that would have collected the appropriate amount of depreciation expense in the first place. Nor does the increased rate base attributable to the corrective action necessarily constitute a "driver" of a base rate increase. FPL's revenue requirements are a function of many variables, of which the amortization of reserve surplus is only one. As OPC witness Donna Ramas demonstrates, when all factors – *including* the impact of the amortization on rate base – are considered, FPL has an excessive level of revenues for the test year, not a deficiency.

O&M and Rate Base Adjustments – OPC will now briefly summarize several of its recommended adjustments to O&M expense and rate base. These and others will be detailed in the body of this Brief.

<u>*Hendry County Land (PHFFU) Accounts*</u> – OPC asks the Commission to disallow $112 million associated with a speculation, convoluted contingent transaction involving interests in 12,500 acres of land and water rights in Hendry County. FPL appears to have provided a possible or potential business partner with an unconscionable 167% profit of $25 million on the actual proposed power plant land site that far exceeds in size the Company's foreseeable need.

The transaction does not comport with Commission standards or policies for including land in PHFFU.

Payroll – OPC recommends that the Commission reduce FPL's projected payroll due to FPL's persistent and historical trend of hiring fewer employees than the headcount budget. The Commission made a similar adjustment in the prior case, and FPL subsequently hired a complement that was smaller than even the Commission-adjusted level. OPC witness Schultz documented this phenomenon and advanced a conservative adjustment to reduce the FPL test year complement by 387 employees, and to adjust associated payroll and benefit and tax costs by approximately $30 million.

Smart meters – In the last rate case, the Commission authorized FPL to add approximately $600 million in rate base as it deployed over 4 million smart meters. The Commission accepted FPL's estimate that the net savings attributable to smart meters would be approximately $20 million by 2013. When FPL filed its 2012 case, the rate base impact was on target at about $555 million. Tens of millions of dollars in savings were also projected. However, the rate base number is in the *test year*, while the savings are now projected to occur in *2014 and 2015*. In the test year, FPL shows net costs of $3.7 million, or nearly a $24 million negative swing in the savings figure that the Commission relied upon in FPL's last rate case. OPC proposes a simple solution: Give FPL the rate base impact, and hold FPL to the 2013 savings it projected in the last case. The Commission should set rates based on the $20 million savings that FPL projected and will quickly achieve as soon as the test year is over. This balances the interests of shareholders and ratepayers more equitably and reduces test year expense by $24 million.

2012 depreciation surplus amortization adjustment – OPC recommends that the Commission decrease test year revenue requirements by at least $60.55 million (plus recognize the reduced rate base effect of approximately $30.3 million) to account for FPL's overstated projection of the amount of surplus depreciation reserve that it would consume in 2012. FPL has recognized that its current forecast now calls for the Company to use approximately $506 million of the surplus in 2012 instead of the originally forecasted $526 million. This frees up an additional $20 million of the reserve surplus to reduce revenue requirements for rate setting purposes in 2013. Other forecast errors overstate expense such as payroll, tree trimming, pole inspections, uncollectible expense, employee benefits, and payroll taxes, and which reduce revenue requirements in the test year also have similar impacts in 2012. When these adjustments are made to the 2012 forecast, the net impact is to provide an additional $40.55 million of surplus depreciation for the reduction of test year revenue requirements. The total adjustment to the 2013 amortization credit is $60.55 million.

Affiliate transactions — Commission Rule 25-6.1351, F.A.C., imposes requirements on electric utilities that are intended to prevent ratepayers from subsidizing the unregulated activities of the utility's affiliates. In this case, the burden was on FPL to demonstrate affirmatively that it complies with this rule. Instead, the record reveals a dearth of the type of information that is needed to enable the Commission to gauge the reasonableness of FPL's affiliate-related costs and charges. Further, OPC witness Vondle documented nine discrete deficiencies in FPL's affiliate-related practices, including a failure to utilize bidding, an overreliance on sole source contracts, a failure to document the benefit of purchases from affiliates to customers, a biased general allocator, a failure to apply the asymmetric pricing required by the rule through analyses of market prices, the absence of service agreement-like contracts, the lack of a service company, a failure to use positive time reporting, and a failure to require compensation for the use of FPL's name. In light of FPL's failure to meet its burden of proof, the Commission should reduce test year O&M expense by $34.5 million which represents a 20% order of magnitude estimate of the impact of FPL's inadequate practices. In addition, the Commission should open an investigatory docket to more closely scrutinize FPL's transactions with affiliates.

Overall Revenue Requirements — OPC's primary and alternative recommendations are to reduce FPL's annual revenues by $253.4 and $184.4 million annually, respectively. With all of OPC's adjustments, including those to O&M expense levels, FPL will continue to exhibit cash flow metrics and a debt-to-capitalization value that will qualify for its current "A" rating by Moody's and S&P.

Cash flow metrics — When gauging a utility's creditworthiness, S&P and Moody's measure the utility's cash flow relative to its total debt. OPC witness Dan Lawton calculated that, after applying all of OPC's adjustments, FPL would continue to exhibit cash flow metrics that fall within the ranges of these rating agencies' respective established criteria for an "A" rated utility, in both of OPC's recommended scenarios. Even after FPL witness Dewhurst modified Mr. Lawton's original schedule to account for an immaterial calculation error to add short-term debt to the financial parameters, and to give effect to the S&P "imputed debt" adjustment for power purchase contracts (an adjustment with which OPC does not agree), the financial profile resulting from OPC's primary recommendation continued to satisfy the cash flow criteria for an "A" rating established by S&P and Moody's for the utility industry.

In rebuttal testimony, FPL witness Dewhurst asserted that Moody's had indicated in an April 2012 report that its "A" criteria would be more limiting for FPL than those contained in its general "Ratings Methodology" document. In Moody's April 2012 report, Moody's said that a downgrade of FPL "could be considered" if FPL's metrics were to fall below the approximate *midpoint* of the wider ranges it established for the broad utility industry – including FPL – in the general "Ratings Methodology" document. Within the April 2012 report itself, Moody's continues to apply its global criteria to FPL's performance, and even concludes that, on this basis, some of FPL's recent scores satisfy higher Aaa and Aa ratings. Further, in a June 2012 report, Moody's referred to the more general criteria of its global "Ratings Methodology" document as being applicable to FPL, without mentioning the constraints that FPL wants to invoke. Significantly, in the pre-settlement order in Docket No. 080677-EI, the Commission explicitly applied the standard criteria of Moody's "Ratings Methodology" documents to FPL. Even if one were to take the truncated April 2012 criteria seriously, OPC's *alternative* recommendation (8.50% ROE; 59.62% equity ratio; $205.7 million revenue reduction) would satisfy even that dubious set of standards.

Debt to capitalization metrics – In addition to the above measurements of the adequacy of cash flow to service debt obligations, Moody's and S&P employ a metric called "debt to capitalization." At first blush, it would appear that OPC's recommended equity ratio of 50% would exceed Moody's debt to capitalization target range (for an "A" rating) of 35% to 45%. However, a closer examination demonstrates that the debt to capitalization metric is not the "flip" of the equity ratio terminology that OPC and other parties have employed liberally in this proceeding. For instance, a recent Moody's report recites that FPL's current debt to capitalization ratio is 33.8%.. We know that the amount of debt implicit in FPL's 59.62% equity ratio is 40.38% — which clearly does not correspond to the "debt to capitalization" figure of

33.8%. The apparent discrepancy is quickly resolved. The definition of "debt to capitalization" in Moody's Ratings Methodology document establishes that Moody's makes numerous technical adjustments to a utility's accounting and financial data when deriving its debt to capitalization value. With respect to Moody's "A" criteria, using the relationship between the current (33.8%) and maximum (45%) debt to capitalization values as a reference, one can approximate the upper boundary of debt as it is implicitly measured in the equity ratio. The relation becomes: 33.8% current debt/capitalization is to 45% maximum debt/capitalization as 40.38% current debt implied in FPL's equity ratio is to X. The answer places the value in the low fifties — which would accommodate either of OPC's primary and alternative positions.

It is important to bear in mind the nature of the scenarios to which Mr. Lawton applied the agencies' ratings criteria. OPC's primary recommendation is to *reduce FPL's current annual revenues* by $253.4 million. The alternative recommendation would *reduce FPL's current revenues* by $184.4 million. At these reduced revenue levels, and even after incorporating FPL's adjustments to Mr. Lawton's "primary recommendation" scenario, FPL would continue to satisfy the cash flow requirements of an "A" rating. Without abandoning its position that the Commission should reduce FPL's rates, OPC observes that injecting either $253.4 million or $184.4 million of annual revenues into Mr. Lawton's calculations of cash flow – hefty infusions of cash that correspond to increasing assumed revenues *back to the level of FPL's existing rates* – would significantly strengthen the already adequate cash flow metrics.

Conclusions: (1) Facts debunk the myth of the "unjust 10% ROE result" of FPL's last rate case, and events have proven that in 2010 the Commission properly rejected nearly all of FPL's mammoth, and mammothly unnecessary, $1.23 billion 2010 revenue request. The Commission should ignore FPL's effort to channel its decision through the insinuation that it must demonstrate to the investment community that regulation in Florida has been "reformed"; (2) FPL's cost of equity capital has declined since the Commission authorized a 10% ROE in the last rate case; (3) FPL's equity ratio and its ROE are interrelated moving parts, not separate, standalone decisions. An assessment of FPL's appropriate ROE must expressly consider the equity ratio that the Commission approves for FPL. FPL cannot have it both ways. If the Commission adopts FPL's extremely high equity ratio for ratemaking purposes, it must reflect the correspondingly low financial risk in the ROE that it approves; and (4) if all of OPC's adjustments are adopted and FPL's annual revenues are correspondingly reduced, FPL will still qualify for its current "A" rating. Leaving revenues where they are, with no increase in base rates, would bolster the metrics well beyond the already adequate levels of OPC's positions.

ISSUES AND POSITIONS

LEGAL ISSUES

ISSUE 1: Absent a stipulation of parties in this case, does the Commission possess legal authority to grant FPL's proposal to continue utilizing the storm cost recovery mechanism that was one of the terms of the settlement agreement that the Commission approved in Order No. PSC-11-0089-S-EI?

*No. The disposition of a request to recover storm-related costs through rate increases involves factual and policy determinations, such as the amount to be collected; the issue of whether the amount should be limited by the utility's earnings level; the time period over which any surcharge should be spread; and the appropriate level of the storm reserve. Chapter 120, F.S., gives affected parties the right to raise and litigate such issues. In Docket No. 080677-EI, parties entered a negotiated resolution of such issues as part of a larger global settlement. The settlement expires on December 31, 2012. At that time, parties will again have the right to identify issues, present evidence, cross-examine witnesses, and argue positions on all storm recovery requests. *Limiting* the scope of permissible inquiry and *prejudging* the amount and timeframe of future recovery, applicability of earnings levels to FPL's future requests, and level of reserve to be restored in the form of *predetermined* outcomes in the absence of a stipulation and settlement of those potential issues would violate parties' substantive and procedural due process rights.*

ARGUMENT:

Florida law provides guarantees of due process to parties who can show their substantial interests will be affected by agency action, and who raise disputed issues of material fact. Sections 120.569 and 120.57(1), Florida Statutes, require an agency that is subject to the Florida Administrative Procedure Act (such as the Commission) to afford an opportunity for parties to respond, to present evidence and argument, and to conduct cross-examination before it enters findings of fact and conclusions of law.

In addition, before the Commission sets rates, it must comply with the provisions of Chapter 366, Florida Statutes. Chapter 366 provides, among other things, that actions pursuant to the file-and-suspend ratemaking provisions must provide for a public hearing (Sections 366.06(2) and 366.07, Florida Statutes). Failure to comply with these statutory provisions would subject the Commission's order to remand on appeal. Sections 120.68(7)(a) and 120.68(7)(b), Florida Statutes.[1]

Only by stipulation can a party negotiate away the rights that these statutory provisions create and protect. In the negotiated settlement agreement that the Commission approved in Order No. PSC-10-0153-FOF-EI, OPC and other parties agreed to a provision establishing certain procedural and substantive storm cost-related terms, to be effective for a finite period of time. (The terms to which they agreed enabled FPL, among other things, to begin collecting storm-related costs within 60 days of filing a petition, and to do so without reference to its ability to absorb costs within its earnings, regardless of the magnitude of its earnings levels.) OPC agreed to these terms in the context of a give-and-take global compromise, in which each party agreed to accept individual provisions which it would otherwise contest, because the party believed the value it received through its participation in the entire stipulation more than offset the concessions it made in individual terms.

The settlement agreement, including the provision regarding storm cost recovery, will expire at the end of 2012. At that point, OPC and other parties who will be affected by Commission action in the areas that have been the subject of the settlement agreement will again have full rights of due process provided by law to dispute any aspect of FPL's request, unfettered by the obligations of expired contractual terms.

Inherent to a utility's request to recover costs of repairing storm damage are potential issues of material fact. Prior to the Commission's decision regarding the approval of a future storm cost recovery factor for FPL, OPC or other parties may wish to contest the utility's calculation of costs to be recovered, or contest the period of time over which the utility should collect costs, or dispute the magnitude of the storm reserve that FPL proposes, or contest the size of the cost recovery factor that FPL proposes to apply to customers' bills, or present evidence and argument supporting its view that the utility's earnings are such that it should absorb a portion of the storm costs in earnings before requiring customers to pay all of its storm-related

[1] Section 120.68(7)(b), Florida Statutes, specifically states that a remand shall occur when an agency's action depends on a fact "that is not supported by competent, substantial evidence in the record of a hearing" conducted pursuant to ss. 120.569 and 120.57, Florida Statutes. In this case, the only record evidence on the subject of storm cost recovery supports the Commission's established practice of combining a storm reserve, an appropriate accrual, and the ability of a utility to petition for a surcharge. By contrast, the only "support" offered in conjunction with FPL's request is that it was part of a negotiated agreement that will expire at the end of 2012. This does not pass muster with the requirements of Chapter 120, Florida Statutes.

costs. The particular circumstances of such future petitions by FPL may give rise to issues that cannot be anticipated in advance.

Each such issue will be a function of the specific factual circumstances attending each future storm event that leads FPL to petition for the recovery of storm-related costs. With the termination of the existing agreement, OPC (like other affected parties) will be able to avail itself of the rights guaranteed by Chapters 120 and 366, Florida Statutes.

FPL's proposal to lift the single provision of the storm cost recovery mechanism from the settlement agreement, and perpetuate it would, in the *absence* of a *new* stipulation on the subject, violate OPC's rights under these chapters of Florida Statutes. The violation would occur in the form of a preemptive prejudgment of the outcome of future issues and a predetermination of future ratemaking parameters (level and timing of recovery factor; exclusion of earnings from consideration) without providing OPC the opportunity to raise issues of material fact and to present evidence and arguments addressing the disputed facts at the time they arise.

In this case, FPL has offered nothing more than the fact that in the past OPC signed a negotiated agreement containing the storm cost recovery provision that FPL wants — a representation that, as OPC will develop in response to Issue 95, gives rise to serious contractual and policy problems of its own. FPL's effort to lift, preserve, and perpetuate a provision that reflects parties' willingness to forgo procedural and substantive rights only for a prescribed period of time, in the absence of either a new stipulation or supporting competent, substantial evidence, runs afoul of Chapters 120 and 366, Florida Statutes, and must be rejected.

<u>ISSUE 3</u>: Does Commission Rule 25-6.1351, "Cost Allocation and Affiliate Transactions," require FPL to implement and apply the criteria (greater of market price or fully allocated cost for charges to affiliates, lesser of market price or fully allocated cost for charges paid to affiliates) and related requirements of the rule to all affiliate transactions?

Yes. To prevent subsidization of unregulated affiliates by FPL's ratepayers, Rule 25-6.1351 requires FPL to demonstrate that it has charged the greater of market price or fully allocated cost to affiliates, or paid the lesser of market price or fully allocated cost for charges to affiliates, unless it documents how specific, individual departures from these criteria benefit ratepayers.

ARGUMENT:

Rule 25-6.1351, F.A.C., "Cost Allocation and Affiliate Transactions" (Affiliate Transaction Rule or Rule), implements the standard set forth in Section 366.05(9), Florida Statutes, as it relates to affiliate relationships and transactions. Section 366.05(9) states, in part, that "[t]he commission may also require such reports or other data necessary **to ensure that a utility's ratepayers do not subsidize nonutility activities.**" (Emphasis added.) (TR 2539) As OPC witness Vondle testified "[w]ith affiliate relationships, there is an opportunity for a company to allocate common or shared costs between a regulated utility, which recovers its allowed costs in regulated rates, and unregulated affiliates that have no limit on revenues and profits." Thus, he notes that there is a strong financial incentive to allocate more cost to the regulated utility which will be recovered in its revenue requirement and less costs to the affiliates which lowers their expenses and increases their profits. (TR 2541-2542) Due to this built-in incentive to cost-shift expenses onto a regulated utility and ultimately the ratepayers, the Commission implemented the Affiliate Transaction Rule to ensure that costs are being allocated to benefit the ratepayer or, at a minimum, that the ratepayer is not required to subsidize unregulated activities.

In pertinent part, Rule 25-6.1351(3)(b), regarding charges to affiliates states:

> **A utility must charge an affiliate the higher of fully allocated costs or market price for all non-tariffed services and products purchased by the affiliate from the utility.** Except, a utility may charge an affiliate less than fully allocated costs or market price if the charge is above incremental cost. If a utility charges less than fully allocated costs or market price, the utility must maintain documentation to support and justify how doing so benefits regulated operations. If a utility charges less than market price, the utility must notify the Division of Economic Regulation in writing within 30 days of the utility initiating, or changing any of the terms or conditions, for the provision of a product or service. (Emphasis added)

Section 3(c) of the Rule, relating to charges from affiliates to the utility, in pertinent part, states:

> **[w]hen a utility purchases services and products from an affiliate and applies the cost to regulated operations, the utility shall apportion to regulated operations the lesser of fully allocated costs or market price.** Except, a utility may apportion to regulated operations more than fully allocated costs if the charge is less than or equal to the market price. If a utility apportions to regulated operations more than fully allocated costs, the utility must maintain documentation to support and justify how doing so benefits regulated operations and would be based on prevailing price valuations. (Emphasis added)

Thus, as OPC witness Vondle noted, "[t]he rule applies to transactions between a utility and its affiliates, and also a utility's unregulated activities, with the intent that these affiliate and nonregulated transactions and activities not be subsidized by the utility ratepayer." (TR 2540)

While the Rule does allow for some instances where a utility may charge less than the greater of allocated costs or market price or be charged market price by an affiliate, the burden to document and justify this deviation from the standard lays squarely with the utility as discussed below.

The Rule also exempts certain kinds of affiliate transactions from the obligations to meet the standard costing requirements. The Rule specifically excludes affiliate transactions related to the purchase of fuel and fuel transportation recovered through the cost recovery proceedings. See, Rule 25-6.1351(1). Additional exemptions are set forth in Section (3)(a), which included exemptions for service costs between the utility and its parent company (NEE), or between the utility and its regulated affiliates, or to services received by a utility from an affiliate that exist solely to provide services to members of the utility's corporate families (service company). Even with the specific Section (3)(a) exemptions, the Rule states that "[a]ll affiliate transactions, however, are subject to regulatory review and approval." See, Rule 25-6.1351(3)(a). Further, as OPC witness Vondle noted in his testimony, the Commission has acknowledged the closer scrutiny warranted for affiliate transactions and the Court standard set forth in GTE Florida, Inc. v. Deason, 642 So.2d 545 (Fla. 1994). The Court in the GTE case stated that the standard for evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. See, Order No. PSC-01-1374-PAA-WS, issued June 27, 2001, in Docket Nos. 000737-WS and 010518-WS. Since both the Rule and the Court in the GTE case require that affiliate transactions be measured against market price, the general rule requires that the utility perform and/or support some kind of market analysis, market pricing study, or bids.

FPL witnesses Ousdahl and Flaherty acknowledged that the Affiliate Transaction Rule applies in Florida. (TR 1070, 3704) However, FPL witness Flaherty tried to cloud the standard for Affiliate Transactions regarding the need for establishing market prices. First, he inappropriately attempted to bring in the cost allocation principle for indirect cost under Section (4)(c) regarding the requirement that fully allocated costs be used. Next, he acknowledged on cross-examination that Section (3)(b) governing the non-tariffed affiliate transactions included the market pricing language. (TR 3705-3706) Further, he failed to consider that the remainder of Section (4)(c) provides an exception where indirect costs on an incremental or market basis can be used if the utility can demonstrate that the departure will benefit the ratepayers. A review of Sections (3)(b), (3)(c), and (4)(c) reveals no language that would negate the requirement that FPL must establish market pricing to comply with the rule. In addition, FPL witness Flaherty stated that he had no knowledge of FPL ever seeking a waiver of the Rule. (TR 3707)

Second, both FPL witnesses Ousdahl and Flaherty attempted to import the less strict standard allowed in FERC Rule 707 into the Florida scheme. (TR 3669, 3761) FPL witness Ousdahl testified that under the FERC Rule, for a company like FPL, they are only required to provide general administrative and management services at fully loaded cost. (TR 3761) Despite FPL witness Flaherty's attempt to import FERC Rule 707 language into the Florida scheme, he had to acknowledge that FPL has to comply with both regulatory schemes. (TR 3669, 3707) Witness Ousdahl also conceded that the FERC Rule 707 would not relieve FPL from having to comply with the Florida Affiliate Transaction Rule. (TR 3822-3823)

Notwithstanding FPL's attempts to confuse the standard regarding affiliate transactions in Florida, the Florida Affiliate Transaction Rule outlines the standards to be applied. As OPC witness Vondle succinctly states "FPL must charge affiliates the higher of fully allocated cost or market price and affiliates must charge FPL the lower of fully allocated cost or market price for non-tariffed products and services under most circumstances (asymmetrical cost allocation)." (TR 2540) Thus, to prevent subsidization of unregulated affiliates by FPL's ratepayers, Rule 25-6.1351 specifically requires FPL to demonstrate that it has charged the greater of market price or fully allocated cost to affiliates, or paid the lesser of market price or fully allocated cost for charges to affiliates, unless it documents how specific, individual departures from these criteria benefit ratepayers.

<u>ISSUE 4</u>: With respect to amounts that FPL charges or pays to affiliates, who has the burden of proof in this proceeding to demonstrate the amounts comply with Commission Rule 25-6.1351 and should be allowed in the cost of service borne by customers?

FPL has the burden to prove it is entitled to collect from customers, through the ratemaking process, the expenses it includes in the test year "cost of service." One component of the test year expense calculation consists of payments to, and revenues from, affiliates. The appropriateness of those payments/revenues is governed by the criteria of Rule 25-6.1351, which applies to FPL. The burden of proof is therefore on FPL to demonstrate compliance with the rule.

ARGUMENT:

In Order No. PSC-01-1374-PAA-WS, the Commission stated that "[b]y their very nature, related party transactions require closer scrutiny. Although a transaction between related parties is not per se unreasonable, it is the utility's burden to prove that its costs are reasonable. Florida Power Corp. v. Cresse, 413 So.2d 1187, 1191 (Fla. 1982)." Order at p. 15. The Florida Supreme Court set forth the standard for evaluating affiliate transactions in the GTE case, as ". . . whether the transactions exceed the going market rate or are otherwise inherently unfair." Id. at 548. In the GTE case, the Court observed that the evidence supported that the affiliate costs were no greater than market, so not inherently unfair. Id. at 574-548. The Florida Supreme Court in Florida Power Corp. v. Cresse, 413 So.2d 1187, 1190(Fla. 1982), stated that the "[b]urden of proof in a commission proceeding is always on a utility seeking a rate change, and upon other parties seeking to change established rates," (i.e., when a utility files a petition for rate change versus another party filing a petition for rate change). Since FPL is the moving party who has filed for a change in its rates based on the data contained in its MFRs, pursuant to the Florida Power Corp. case, FPL clearly has the burden of proof. While some may challenge the idea that FPL is seeking to change its rates related to affiliate transactions, it is obvious that the newly requested rates in the March 2012 filing are based on changes in affiliate costs included in the MFRs that are different than those costs included in the last rate case. Therefore, it is not necessary that affiliate costs be a main driver for the requested change by FPL in the March 2012 rate increase petition.

Moreover, the Affiliate Transaction Rule also places the burden of proof on the utility. Sections (3)(b), (3)(c), and (4)(c) provide that any deviation from the asymmetrical pricing scheme requires the utility to maintain documentation to support and justify the benefits to the regulated operations (and thus the ratepayers). Further, practical implementation of the Rule's asymmetric pricing requirement requires the utility to be able to document the market for affiliate transactions. As OPC witness Vondle testified that "[t]he utility bears the burden of proof to ensure that its transactions with affiliates are fair, that they are priced appropriately at market price or fully allocated cost, and that they do not disadvantage the ratepayer." (TR 2541) FPL witness Ousdahl agreed that FPL has the burden of proof. (TR 1072-1073)

Regarding the burden of proof, OPC witness Vondle noted that the utility must account for affiliate transactions in a detailed, prescribed manner and must allocate costs according to the Rule. He also opined that if the utility does not meet its burden of proof or does not comply with the affiliate accounting and allocation rules, the affiliate charges should not be allowed. (TR 2541) Although OPC witness Vondle testified to the many deficiencies related to FPL's compliance with the Rule and the lack of documentation, he recommends only a relatively modest adjustment to the requested affiliate costs based on FPL's failure to meet its burden of proof. (TR 2569-2571)

In conclusion, FPL has the burden to prove that it is entitled to collect from customers the expenses it includes in the test year "cost of service." One component of the test year expense calculation consists of payments to, and revenues from, affiliates. The appropriateness of those payments/revenues is governed by the criteria of Rule 25-6.1351, which applies to FPL. The burden of proof is therefore on FPL to demonstrate compliance with the rule.

RATE BASE

ISSUE 17: Should FPL's adjustment to extend the amortization period of the new SAP general ledger system from 5 years to 20 years be approved?

Yes. At this time, OPC does not object to extending the amortization period of the new SAP general ledger system from 5 years to 20 years. However, OPC reserves the right to address the issue in future depreciation-related proceedings and to recommend a different amortization period based on any new evidence, facts, or other relevant information.

ISSUE 22: Is FPL's requested level of Plant in Service in the amount of $30,424,227,000 ($31,078,941,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of jurisdictional plant is $30,424,227,000.

ISSUE 24: Is FPL's requested level of Accumulated Depreciation in the amount of $11,901,711,000 ($12,970,028,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of jurisdictional accumulated depreciation is $11,921,986,000, which reflects an increase to the reserve of $20,275,000.

<u>ISSUE 27</u>: Is FPL's requested Construction Work in Progress in the amount of $501,676,000 ($514,978,000 system) for the 2013 projected test year appropriate?

No. CWIP should be reduced by $4,234,000 ($4,685,000 system) per EXH 64.

<u>ISSUE 30</u>: Should the Commission approve FPL's request to include the Fort Drum, McDaniel, and Hendry County proposed generation sites in Plant Held For Future Use?

*No. In its MFRs, FPL quietly increased PHFFU by $160 million from its last case. Much of the increase relates to FPL's proposal to have *alternative* "primary" and "secondary" sites (Hendry and Fort Drum) totaling 15,367 acres for future base load generation in the "other production" category. In the aggregate, all six potential generators require no more than 1,000 acres. Moreover, the Hendry tract is the subject of a speculative and convoluted transaction involving sensational profits to the seller (with whom FPL appears to also have a business relationship) during a time of weak land prices, title disputes, rezoning that is the subject of litigation, unexercised options, vague commitment to purchase, potential loss of future resale proceeds, options for large acreage to be acquired solely for water rights (with FPL having uncertain occupancy rights), and possible plans for a currently non-cost-effective solar farm. In discovery responses, FPL indicated no specific plans for the property. The attempted justifications appearing suddenly in FPL's rebuttal testimony do not meet the requirements of Commission policy concerning prudence and reasonableness.*

ARGUMENT:

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ISSUE 31: Should the Commission approve FPL's request to include nine proposed transmission line sites for which projected in-service dates are either 2022-2023 or indeterminate ("TBA") within Plant Held For Future Use?

No. FPL has not demonstrated that 6 of the sites warrant inclusion in rate base – either because their projected in-service dates fall outside the Ten-Year Site Plan horizon or because they have no announced in-service date. Property Held For Future Use should be reduced by $5,337,000 ($5,905,000 system).

ARGUMENT:

OPC also urges that the Commission remove the sites identified by OPC witness Ramas as being beyond the next ten years. Prior to hearing, FPL belatedly identified three of the questioned sites as finally having an in-service date. (TR 1378-1379) Ms. Ramas removed these from her recommended disallowances. (TR 2752-2753, 2833-2834) The identification of the in-service dates provides a contrast to the remaining sites that have no date and for which there has been no date for many years. The Company claims that NERC requirements and the studies to meet them drive the property purchase. The problem with this is that the purchases of these sites date from 1977, 1978, 1988, 1993, 1996, with only one recent purchase (2008). (EXH 44) The NERC requirements that the Company speaks of in discovery and testimony are more recent than all but the 2008 purchase. FPL's response to discovery below is indicative:

> On an annual basis, FPL conducts planning studies to determine what facilities will be needed over the next ten years in order to meet NERC reliability standards. Typically, projects resulting from these studies require FPL to purchase property, which can require zoning, permitting or lengthy eminent domain proceedings. Large projects, such as Bobwhite-Manatee, are subject to the Transmission Line Siting Act which can add several years to the process. All of these processes dictate that the property is purchased ahead of the projected in-service date. Changes to

> the load growth forecast can result in modification to the transmission expansion plans and associated property in-service dates.
>
> (TR 2768, EXH 72)

FPL's inclusion of the plant sites with expected in-service dates of "TBA" (4 sites), or 2021 (1 site), or 2022-2023 (1 site) should not warrant consideration for inclusion in PHFFU even on the criteria the company advances. Given that the in-service dates for all sites are indeterminate or far in the future and not likely to have been purchased or held for meeting NERC requirements, and considering the fact that the Company was able to conjure up three definite in-service dates for other sites on the eve of the hearing, at least the 5 pre-2008 purchases should be removed from PHFFU.

ISSUE 32: Is FPL's requested level of Property Held for Future Use in the amount of $230,192,000 ($237,400,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

No. FPL's Property Held for Future Use balance should be reduced by $110,142,000 ($114,857,000 system) pursuant to the adjustments recommended in Issues 30 and 31.

ISSUE 34: Should unamortized rate case expense be included in Working Capital?

No. Commission policy is to exclude unamortized rate case expense from rate base for rate setting purposes. FPL has not demonstrated why this long-standing policy should not be followed. Rate base should be reduced by $4,826,000 (jurisdictional and system).

ARGUMENT:

The Commission should follow its long-standing policy in electric cases of not allowing inclusion of the unamortized rate case expense in rate base. OPC witness Ramas testified that consistent with the Commission's findings in the most recent rate cases for Progress Energy Florida, Gulf Power Company, and FPL's last rate case, it is unfair for customers to pay a return on unamortized rate case expense when those costs are being used to increase customer rates. OPC witness Ramas removed the full amount of the unamortized balance of rate case expense from working capital, thus reducing rate base by $4.826 million. (TR 2789, EXH 269 [DR-2, Sch. B-1, pg. 2])

ISSUE 35: Should Account 143, Other Accounts Receivable, be included in working capital for the 2013 test year?

No, not in its entirety. The Commission should exclude 65.10% of the amounts FPL proposes to include in projected test year working capital due to the lack of demonstration that the amounts included relate to providing current service to customers. Working capital should be reduced by $88,680,327 ($90,116,880 system).

ARGUMENT:

OPC witness Schultz testified that FPL projects other accounts receivable on a total account basis not on individual receivables, thus making it impossible to analyze the details or reasonableness of the receivables projected. Without supporting detail, Mr. Schultz was unable to determine whether the receivables related to providing retail electric service or the appropriateness of including the amounts in working capital. With the lack of test year support, he identified 65.10% of 2011 receivables with subaccount descriptions that did not appear necessary to provide utility service. OPC witness Schultz then, as a proxy, applied this percentage to the 2013 test year balance of Other Accounts Receivable balance, recommending a reduction of $88,680,327 ($90,116,880 system). (TR 2678-2679, EXH 268) Because FPL failed to sufficiently explain and justify the components of its projected balance, Mr. Schultz' adjustment should therefore be made.

FPL witness Ousdahl dismissed Mr. Schultz' testimony by stating that all of the accounts relating to utility service are in compliance with the Uniform System of Accounts and were audited by Commission staff. (TR 3744) Ms. Ousdahl had the opportunity to provide the support requested by OPC's discovery and testimony; however, she chose only to provide broad descriptions with no supporting documentation. Thus, FPL failed to meet its burden to justify its requested balances for other accounts receivables and Mr. Schultz' adjustment should be approved.

<u>ISSUE 36</u>: Should an adjustment be made to the amount of Account 182.3, Other Regulatory Assets, included in working capital for the 2013 test year?

Yes. FPL has failed to meet its burden to demonstrate that the amounts it proposes to include in projected test year working capital relate to providing current service to customers. Working capital should be reduced by $266,850,000 ($271,365,000 system).

ARGUMENT:

OPC requested in Interrogatory 249 that FPL provide a breakdown of the amounts included in other regulatory assets for the test year and to provide references of where the Commission allowed such amounts to be included in working capital. In its response, FPL provided the subaccount balances but no further support. In its explanation of where the Commission allowed recovery of the balances in working capital, FPL stated broad guidance as to which accounts are included in the calculation and not why those specific subaccounts should be included. (EXH 78) OPC witness Schultz testified that because of the lack of support provided, he removed $266,850,000 ($271,365,000 system) for those account balances which did not have descriptions to indicate how they were related to providing utility service. Mr. Schultz opined that until FPL fully explains the benefits to ratepayers those account balances should be removed from working capital. (TR 2680-2681) Thus, FPL did not meet its burden to justify its requested balances.

<u>ISSUE 37</u>: Should an adjustment be made to the amount of Account 186, Miscellaneous Deferred Debits, included in working capital for the 2013 test year?

Yes. FPL has failed to meet its burden to demonstrate that the amounts it proposes to include in projected test year working capital relate to providing current service to customers. Working capital should be reduced by $3,836,435 ($3,896,171 system).

ARGUMENT:

OPC witness Schultz testified that FPL failed to meet its burden to show that balances included in Miscellaneous Deferred Debits were utility related and reasonable to include in the working capital balance. When asked by OPC in discovery to provide explanations on the components for the March 2012 13-month average balances, FPL responded with a generic statement that the Commission had authorized the use of the balance sheet approach; however, FPL did not discuss the individual account balances. Mr. Schultz stated that because FPL did not provide a similar analysis for the test year, it was reasonable to assume that similar items and amounts for the test year would be inadequately supported as well. As a surrogate, OPC witness Schultz removed $3,896,171 of the balances from working capital until the company could provide an explanation to justify the amounts. (TR 2681-2683)

In her rebuttal, FPL witness Ousdahl again relied on a blanket statement that because the balance sheet approach is used, the balances in the account should be included without any additional documentation or justification needed from FPL. Ms. Ousdahl also relied on the testimony of Staff witness Welch's audit of FPL's records as support for the underlying account balances and dismisses OPC witness Schultz' use of a surrogate adjustment. (TR 3747-3749) Ms. Ousdahl's reliance on the 2011 historical year staff audit to support the amounts for the projected 2013 test year is flawed. If you use 2011 to justify the 2013 amounts, why is it unreasonable to use the most recent actual amounts compared to the projected 2013 amounts as a surrogate? The bottom line remains that FPL did not justify its balances that it wishes to include and has not justified why working capital increased so dramatically from the last rate case to the current test year. (TR 2674)

<u>ISSUE 39</u>: Has FPL adhered to the Commission's policy of including net clause over-recoveries and excluding net clause under-recoveries in its calculation of working capital? If not, what adjustments should be made?

FPL has the burden of proof to demonstrate that it has adhered to Commission policy of excluding clause over-recoveries and including clause under-recoveries in its calculation of working capital under the balance sheet approach, to the extent it is used in this case. The Commission should hold the company to this burden.

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 accurately as possible and to avoid large over-recoveries. The Commission should treat the over and under-recoveries projected in this docket consistent with its prior practice.[5]

<u>ISSUE 40</u>: What is the appropriate methodology for calculating FPL's Working Capital for the 2013 projected test year?

*FPL has presented its test year working capital using the balance sheet approach. If the Commission continues to use this approach, FPL must demonstrate that it applied the method

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[5] 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.

correctly and that the projected working capital on which it seeks to recover a return from customers accurately reflects the actual working capital required to provide utility service to customers.*

<u>ISSUE 41</u>: **If FPL's balance sheet approach methodology for calculating its Working Capital is adopted, what adjustments, if any, should be made to FPL's proposed Working Capital?**

The Commission should adjust working capital when using the balance sheet approach for the adjustments recommended by OPC witness Schultz in the amount of $359,366,762 ($365,378,051 system). Additionally, working capital should be reduced $4,826,000 (jurisdictional and system) to remove unamortized rate case expense pursuant to Commission policy as recommended by OPC witness Ramas in Issue 34.

<u>ISSUE 42</u>: **Are FPL's adjustments to the Asset Retirement Obligation (ARO) revenue neutral as required by Commission rule?**

FPL has not met its burden of demonstrating that it is in compliance with Commission Rule 25-14.014, F.A.C., and that the ARO adjustment is revenue neutral in its implementation.

ARGUMENT:

Rule 25-14.014, F.A.C., entitled Accounting for Asset Retirement Obligations (ARO), states that under Statement of Financial Accounting Standards 143, the implementation of the accounting for AROs shall be revenue neutral in the ratemaking process. Subsection 9 of the rule states that each utility shall keep records supporting the calculation and the assumptions used in the determination of the ARO and the related Asset Retirement Cost and the related Regulatory Assets and Regulatory Liabilities established in accordance with this rule and the implementation of SFAS 143. OPC witness Schultz testified that there were significant differences in the debit and credit balances in working capital related to the ARO and that it was not clear the result was revenue neutral, as required by the Commission's rule. While Mr. Schultz did not recommend an adjustment, he stated that FPL did not clearly explain all of the components related to the ARO. OPC witness Schultz also testified that the Commission should require the Company to fully explain the impacts of the ARO, the net effect on the Company's rate base, and why ratepayers should pay a rate of return related to the net balance of these adjustments. (TR 2674-2678)

FPL witness Ousdahl did provide an explanation and calculation showing that the ARO liability was revenue neutral. (TR 3742 and EXH 397) OPC argues that this showing should have been made up-front in the Company's testimony and filing rather than presented at the end of the case as part of rebuttal, and that such a showing should be required in FPL's future rate case proceedings.

<u>ISSUE 43</u>: Should the nuclear maintenance reserve be modified to reflect post-paid reserve accounting in lieu of pre-paid reserve accounting?

Agree with SFHHA.

<u>ISSUE 44</u>: Is FPL's requested level of Working Capital in the amount of $1,217,209,000 ($2,032,805,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

No. As set out in Issues 33-37, the Commission should allow FPL working capital of no more than $853,016,238 if the balance sheet approach is used.

<u>ISSUE 45</u>: Is FPL's requested rate base in the amount of $21,036,823,000 ($21,470,413,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate rate base should be $20,537,979,000 on a jurisdictional basis.

<u>COST OF CAPITAL</u>

<u>ISSUE 46</u>: What is the appropriate amount of accumulated deferred taxes to include in the capital structure?

The appropriate amount of accumulated deferred income taxes prior to reconciliation should be $4,365,176,000. After the pro rata reconciliation to rate base, the amount of deferred income taxes should be $4,261,665,000.

<u>ISSUE 47</u>: What is the appropriate amount and cost rate of the unamortized investment tax credits to include in the capital structure?

The appropriate amount of unamortized investment tax credits prior to reconciliation should be $923,000. After the pro rata reconciliation to rate base, the amount of investment tax credits should be $901,000.

<u>ISSUE 49</u>: What is the appropriate cost rate for long-term debt for the 2013 projected test year?

OPC does not take issue with FPL's long-term debt cost rate of 5.18%, as addressed by FPL witness Dewhurst in his rebuttal testimony.

ISSUE 51: What is the appropriate equity ratio that should be used for FPL for ratemaking purposes in this case?

Equity costs more than debt. Debt is employed to leverage capital dollars. An excessively high equity ratio burdens ratepayers unnecessarily. Investors interested in owning FPL through shares of NEE evaluate NEE's overall, consolidated 39% equity ratio. To manage overall risk, NEE logically should place more debt in low-risk FPL and less in its riskier, unregulated affiliates. Instead, NEE overloads its equity investment in FPL, where returns are more certain, with an extravagant 59.62% equity ratio. The Commission should impute a lower equity ratio for FPL. Alternatively, it must reflect the much lower financial risk of a capital structure containing inordinately high equity in a commensurately lower authorized ROE. For ratemaking purposes, OPC proposes a 50% equity ratio, which is higher than the overall equity ratios of NEE (39%), Avera's proxy group (47.3%), and Woolridge's proxy group (45%). OPC's recommended 9% ROE is tied to OPC's 50% equity ratio recommendation. If the Commission approves FPL's 59.62% equity ratio, it should lower ROE to 8.50%. Failure to make one adjustment or the other would saddle customers with a significantly overstated revenue requirement.

ARGUMENT:

In terms of the impact on FPL's revenue request, determining the appropriate level of equity that should be included in FPL's capital structure for ratemaking purposes constitutes one of the major decisions that the Commission will make in this docket. Treating ROE as a non-variable — which is what FPL essentially wants the Commission to do — makes the point effectively. If all other variables (including FPL's requested 11.50% ROE) are held constant and the equity ratio is changed from 59.62% to 50%, the revenue difference becomes $214 million annually. (TR 2457) In its pre-settlement rate case decision in Docket No. 080677-EI, the Commission recognized the fundamental linkage between a utility's capital structure and the return on equity that is commensurate with that company's overall risk profile. (Order No. PSC-10-0153-FOF-EI, at page 132) In this case, OPC witness Dr. Woolridge translated the difference in risk between FPL's 59.62% equity ratio and OPC's recommended equity ratio of 50% as being worth 50 basis points on the return on equity. Using the combinations of equity ratio and ROE within OPC's alternative recommendations as a frame of reference, the difference in OPC's primary position (50% equity ratio and 9% ROE) and its alternative position (59.62% equity ratio and 8.5% ROE) is about $69 million annually.

To invest in ownership shares, investors require a premium over the cost of debt, which has a superior claim to a company's earnings. Also, unlike interest payments on debt, returns on equity are not deductible for tax purposes. As a result, in terms of the revenue requirements that ratepayers bear, equity capital is significantly more expensive than debt. (TR 2318) A prudently cost conscious utility will employ a suitable amount of debt to "leverage" its capital dollars and to lower overall capital costs borne by customers. (TR 2318) FPL's proposed equity ratio of 59.62% is extravagant and excessive, whether measured by reference to the broad utility industry (45%-47% equity ratio) or the capital structure of its parent, NEE (39% equity ratio) (TR 2446-47) NEE's capital structure is particularly important in the comparison because — regardless of the amount of equity that NEE places in FPL's capital structure — the *parent's* capital structure is the one that potential investors assess when deciding whether to purchase stock in the entity that owns FPL. (TR 2450, 2455) It is for that reason that OPC witness Dr. Woolridge reviewed the equity ratios — not of subsidiary utility operating companies — but of the holding companies that own all of the utilities' stock. The amount of capital that a holding company places in its utility subsidiary is a "holding company decision," not one that is driven by the market. FPL's extremely high equity ratio is illogical when compared to its low business risk (relative to its unregulated affiliates, whose operations are characterized by uncertainty and volatility); however, NEE has an incentive to place 59.62% equity in FPL to maximize returns on the safest, most assured of its subsidiaries. (TR 2449)

When assessing FPL's argument that the proper comparison of equity ratios is between FPL and operating subsidiaries of other holding companies, one must consider that the equity ratios of *those* operating subsidiaries represent holding company decisions too. Like NEE, those holding companies have non-market-based motivations to increase the equity in their subsidiary utilities to levels that contradict the relationship between business risk and capital structure and exceed the equity ratios of their consolidated capital structures. As is the case with NEE, the holding companies in the witnesses' proxy groups court investors with their consolidated capital structures, not the capital structures of their wholly owned, regulated subsidiaries.

In an effort to portray FPL's equity ratio as less extreme FPL witness Dr. Avera alluded to S&P's methodology for evaluating power purchase agreements. S&P regards a portion of the capacity payment obligations of power purchase agreements as the equivalent of debt. In one of its reports on FPL, S&P treated 25% of FPL's total capacity payment obligations as "debt-like." Based on this "S&P methodology," Dr. Avera sponsored an exhibit showing the effect of adding $949 million of "imputed" debt on capital structure ratios to argue that FPL's 59.62% equity ratio is only about 53% in S&P's eyes. (TR 2356; EXH 206)

When appraising the equity ratio issue, the Commission should ignore FPL witness Dr. Avera's S&P-based assertions. First, S&P's adjustment is unrelated to generally accepted accounting principles (GAAP), and does not appear on FPL's financial statements. The adjustment is not "seen" by investors in accounting statements and reports that FPL files. (TR 2358) Next, of the several major rating agencies, only S&P employs this controversial adjustment. Others recognize that the positive benefits that a utility secures through power purchase agreements (PPAs) can offset or outweigh any perceived negatives. For instance, if a utility recovers PPA payments through a cost recovery clause, Moody's more reasonably regards such payments as normal operating costs, not debt. (TR 2357; EXH 638, Appendix H) In other words, where cost recovery is provided adequately, Moody's treatment of PPA payments has no negative ratings implications – for capital structure or otherwise.

Given the high degree of certainty that is associated with the Commission's capacity cost recovery clause, S&P's vague and arbitrary 25% "risk factor" is unreasonable on its face. Indeed, because the Commission allows FPL to "true up" any discrepancy between projected and actual payments annually, PPA payments are actually *less* risky, and cost recovery is *more* certain, than FPL's base rate-related costs. In comparison to the PPA payments that are the subject of S&P's adjustments, base rate-related costs are not trued up. These costs are "reset" only during rate cases that typically occur several years (or more) apart. (TR 2357-58) S&P distorts the Commission's treatment of PPAs by cramming it into a mold (the assumption of uncertainty of cost recovery) that it does not fit. When a Wall Street rating agency – whose sole constituency consists of investors — promulgates "adjustments" to decisional parameters that are unwarranted and do not accurately reflect Florida's regulatory framework, the Commission should protect its jurisdiction. The choice is between adhering to and articulating the Commission's policy decision or abdicating the Commission's oversight role by defaulting to a single Wall Street entity's "adjustments." The Commission should not permit S&P (or its surrogate, FPL witness Dr. Avera) to influence its decision on the issue of the appropriate equity ratio on the basis of FPL's PPAs.

In a separate effort to defend FPL's overreaching 59.62% equity ratio, Dr. Avera compared his proxy group's market value-based ratios to FPL's book value-based equity ratio. Plainly, Dr. Avera's use of market value-based ratios is an inappropriate "apples to oranges" comparison. FPL's rates are set based on book value capital structure data. Dr. Avera's departure from book value data is a transparent effort to artificially stretch the equity ratios of his proxy group toward the extreme reaches of FPL's proposal. (TR 2359)

In its presentations, FPL avoids acknowledging – directly or indirectly – that its proposed 59.62% equity ratio would have a downward effect on the return on equity that would be commensurate with the significantly lower risk profile engendered by its extreme high equity ratio. Instead of "lower financial risk," FPL prefers such phrases as "strong balance sheet" and "financial strength." (TR 1863, 1890, and many others) In FPL's presentation, the high equity ratio and high ROE that it desires become two separate and independent "solutions" to the "problem" of its claimed high business risk. (TR 1897) It is as though FPL believes that the equity ratio can be placed on one end of a see-saw, the authorized return on equity on the other end of the see-saw, and both ends can go up at the same time! However, the link between equity ratio and return on equity cannot be severed, and FPL cannot have it both ways. If the Commission adopts FPL's 59.62% equity ratio for ratemaking purposes, it must reflect the correspondingly low financial risk in FPL's authorized ROE. As noted earlier, OPC witness Dr. Woolridge quantified the difference in ROE that corresponds to the 50-59.62% range on equity ratio to be 50 basis points. (TR 2353)

OPC recommends that the Commission employ a 50% equity ratio in this case for ratemaking purposes. The 50% equity ratio advocated by OPC witness Kevin O'Donnell is higher than the average equity ratios of the proxy groups examined by Drs. Avera (47.3%) and Woolridge (45%); it is far higher than the 39% overall, consolidated equity ratio of NEE; and it was chosen specifically to avoid the unduly onerous revenue impact that a transition all the way to NextEra's consolidated capital structure would have on FPL in this case. (TR 2456-2457)

<u>ISSUE 54</u>: Should FPL's request for a 25 basis point performance adder to the authorized return on equity and proposed annual review mechanism be approved?

No. FPL enjoys a protected retail market; numerous cost recovery mechanisms; the ability to request rate increases; and other risk-reducing, revenue-enhancing benefits. After accepting those benefits, FPL would set its required obligation bar low, so that it can claim a "bonus." Acceding to FPL's "low bar" proposition would signal that indifferent mediocrity is acceptable — an undesirable policy. In return for its privileged monopoly, and the opportunity to earn a fair return (including the incentive to earn the increment of return above the midpoint of the authorized range), customers rightfully expect FPL to fulfill its obligation by providing the best possible service at the lowest reasonable costs. Besides, holes in its "benchmarking evidence" undermine FPL's claim. Finally, the relative levels of rates among utilities are affected by type and vintage of generating equipment, customer mix, density of development, and other factors that are not measurements of management performance. The differentials between FPL's rates and those of other Florida utilities are due in part to the Commission's past rejections of an unnecessary $1.2 billion rate request and an extraordinarily expensive coal plant.

ARGUMENT:

FPL requested a "performance adder" of 25 basis points, which would increase its requested ratesetting point from 11.25% to 11.50%. The proposed adder would generate $41 million of additional revenues annually — about $15 million of which FPL would pay in taxes. (TR 2913) OPC's objection to the request is based — not on the Commission's lack of authority to approve an ROE adder — but on the undesirable policy it would represent. (TR 2910) (Referring to orders that reach back as far as 1968, FPL found two historical examples of ROE adders in Florida. Two adders in a span of 44 years do not a policy make.) (TR 2900, 2914) FPL enjoys the benefits of cost recovery mechanisms that operate outside base rates and enable FPL to collect the costs of fuel, power purchase contracts, conservation programs, and environmental compliance on a current basis, subject to annual true-ups. FPL collects approximately 61% of its total revenues from such flow-through mechanisms. FPL may petition for an adjustment in rates, and within the related proceeding request an interim increase; thus, Florida Statutes also reduce regulatory lag. Yet, FPL would have the Commission believe that, in return for protection from competition and a myriad of advantageous, risk-reducing statutory and regulatory mechanisms, customers should expect to receive (absent a bonus!) only a half-hearted, mediocre level of performance from their regulated electric utility. In other words, FPL wants to accept the considerable benefits of the regulatory regime, and then set the bar for its performance very low. The Commission should consider very carefully the message it would send to all regulated utilities if it were to accede in this case to FPL's proposition that a utility's "obligation to serve" is met by a mediocre standard of performance. OPC submits that a regulated utility's customers are entitled to the utility's best efforts to deliver high quality service at the lowest reasonable prices possible.

While OPC objects to the performance adder primarily on policy grounds, the record in this case does not prove FPL's claim of superior performance adequately to warrant a $41 million annual increase on customers' bills in any event. If one peers beneath the veneer of FPL witness Reed's conclusions, one sees that during his benchmarking Mr. Reed assigned a "best in class" – type grade to FPL, even when no other utility had values within the category being measured. In the "contest" for superior ratings that Mr. Reed conducted, FPL frequently did not even have to compete! (TR 272-275) Even if the Commission were to entertain the type of adder that FPL seeks, a reward of an additional $41 million annually should rest on a stronger body of proof of outstanding performance than that which FPL presented. Significantly, FPL witness Dewhurst, who was among the witnesses who touted FPL's management when pursuing the $41 million ROE adder, did not cite strong management as a distinguishing business risk feature when describing FPL's risk profile. Either Mr. Dewhurst's support for the adder was insincere, or the strong management to which he refers also serves to lower FPL's business risk profile and the return on equity that is commensurate with FPL's overall risk. Again, FPL cannot have it both ways.[6] (TR 4835-38)

Another weakness in FPL's proposal is the linkage between the year-over-year continuation of the adder and the lowest residential rates in the state. Many factors that bear on relative residential rates – geography, demographics, density of population, vintage of plant – are largely unrelated to management's performance. (TR 2863) The Commission rejected FPL's plan to construct a tremendously expensive coal plant near the Everglades in 2007, and denied its unwarranted request to increase its revenues by $1.23 billion in 2010. (TR 2863) Yet, when viewed through the special lens through which FPL surveys the regulatory landscape, these rejections of expensive proposals, which kept bills low, should now enhance its claim to an

[6] When pointed to this inconsistency, FPL witness Dewhurst replied, "I will concede the point immaterially." (TR 4838) At another juncture, when shown that the cash flow metrics calculated by OPC witness Lawton satisfied the (dubious) criteria that Mr. Dewhurst advocated, he said, "I'm not willing to accept" Mr. Lawton's calculations. (TR 4864) In this adversarial proceeding before a regulatory forum, neither FPL (the petitioner in this case) nor one of its witnesses is the arbiter of what is "material" and what will be "accepted."

additional $41 million annually! The Commission should emphatically reject FPL's proposed "performance adder" to ROE.

<u>ISSUE 58</u>: What is the appropriate authorized return on equity (ROE) to use in establishing FPL's revenue requirement?

*FPL pins its overreaching 11.50% ROE hopes on a false narrative of past "unfair" treatment and skewed analyses of investors' current requirements. In April 2010, long before FPL's rate case settlement, Moody's described the Commission's 10% ROE decision as consistent with other, contemporaneous rulings. Since 2010, interest rates and investors' expectations have fallen further. Based on a methodologically sound application of DCF that drew from a robust variety of sources and factors (dividends, retained earnings, book value, earnings per share) for his DCF growth rate component, OPC witness Woolridge derived a current ROE for FPL of 9% (assuming 50% equity ratio) or 8.5% (59.62% equity ratio) Even FPL witness Avera's exhibit of his (disputed) "corrections" to Dr. Woolridge's inputs shows an average ROE of only 9.7%.

Witness Avera's own analyses are skewed by his exclusive reliance on upwardly biased analysts' projections of EPS for his DCF and CAPM exercises, and his unrealistic CAPM assumptions of a 13.5% forever annual stock market return and exaggerated 10.9% risk premium. Witness Avera's implausible inputs produced a grossly overstated ROE value.*

ARGUMENT:

<u>The last rate case.</u> FPL tied its presentation on the issue of the appropriate return on equity to what it described as an unfair ruling on the same subject in the 2010 rate case, Docket No. 080677-EI. Because FPL insinuated that investors are anticipating that the Commission will "rectify" the last decision to placate Wall Street analysts, OPC will begin its treatment of the ROE issue with a consideration of the "merits" of FPL's description of its alleged mistreatment.

FPL chants the following mantra: the panel that heard FPL's last rate case made a "poor" ROE decision that "disappointed" and "shocked" the investment community; FPL and parties executed a settlement agreement that served as a temporary "bridge" until the Commission could "revisit" its unjust 10% ROE decision; investors have calmed in response to the settlement and their belief that the current panel of Commissioners is in the process of correcting the "perceived politicization" of the environment of the last case; and the Commission should not "aggravate" past perceptions of "less than constructive" regulation by its decision in the current case. (TR 1891, 1893) In an attempt to exact an undeservedly high ROE from the Commission, FPL has constructed a false narrative. The Commissioners should see through it, and not be swayed by FPL's attempt to rewrite history — much less FPL's effort to pressure the Commission.

When in Docket No. 080677-EI the Commission authorized a return on equity of 10% for FPL, it explicitly took into account both the economic conditions which prevailed at the time and FPL's extremely high equity ratio. In a report published in April 2010, months before the eventual settlement agreement was submitted to the Commission, Moody's referred to the Commission's 10% ROE decision as consistent with decisions involving other utilities in different areas of the country. (EXH 574) In April 2012, shortly after FPL filed its *pending* base rate petition, Moody's characterized the currently authorized 10% ROE midpoint that the Commission established for FPL in Docket No. 080677-EI as "still adequate." (EXH 636) During the period between these pronouncements of the adequacy of the Commission's 10% ROE decision by a major Wall Street rating agency, FPL issued debt on favorable terms (EXH 112, Late-filed EXH 1; EXH 634), and its parent's stock price fared well. NEE's stock price performed so well in July 2010, in fact, that FPL witness Dr. Avera, anxious to explain all developments subsequent to the "pre-settlement order" in terms of the "FPL narrative," conjectured wildly from the witness stand that news of negotiations toward a settlement agreement must have permeated the stock market. (TR 1840-1841)

If a major rating agency such as Moody's regarded the Commission's 10% ROE decision as adequate in 2010, and continues to do so now, what explains the "disappointment" to which FPL refers? A close reading of the documents reveals that is necessary to distinguish between the 10% ROE, which was regarded as adequate, and the small amount of the 2010 overall revenue increase, which Moody's and Value Line described in negative terms — but which subsequent events proved to be the absolutely correct disposition of FPL's overreaching 2010 request. In its presentation to the Commission in this case, FPL referred only to the alleged unfairness of its 10% authorized ROE. FPL asserts that the 2010 settlement agreement quieted the capital markets — which, FPL said, had been roiled by the 2010 rate case decision — by assuring that FPL could earn 11% (the ceiling of the same return on equity that the Commission authorized in the pre-settlement order) consistently during its term. (TR 1894)

Without agreeing to FPL's premise that an ROE of 11% represented equity investors' requirement at the time, OPC observes that the difference between 10% ROE and 11% ROE is only $160 million in annual revenues. In its petition in the last case, FPL requested authority to increase revenues annually by *$1.23 billion*! (TR 4850) Further, FPL's revenue request was based on a proposed ROE of 12.5% – which is 125 basis points higher than the level that FPL now contends was representative of investors' expectations. (TR 4849) Of the $1.044 billion increase that FPL sought to place into effect in 2010, the Commission denied $969 million, approved $75 million, and designed rates based on an ROE midpoint of 10%. In 2010, FPL pursued all of its capital projects. (TR 4850) It incurred actual operating expenses higher than the level that the Commission approved for the 2010 test year in its pre-settlement order. (TR 4853-4854; EXH 635) The fractionally smaller $75 million increase did not take effect until March 2010. Yet, FPL proceeded to *actually* earn 11% ROE – the ceiling of its authorized range – in 2010 without resorting to the "earnings flexibility" portion of the settlement agreement.[7] (TR 4854) When one considers the impact that the $969 million portion of FPL's request that the Commission denied would have had on FPL's already high earned rate of return, it is clear that the Commission rightly rejected FPL's last, massively overreaching revenue request.

Exhibit 636, which is the report that Moody's published on April 10, 2012, helps to make this point. Within a single page of this document, Moody's alludes both to the "adverse" outcome of the 2010 rate case, on the one hand, and to the 10% ROE that was typical for the period and is "still adequate," on the other – as well as to "some of the stronger financial performance measures and cash flow coverage ratios in the industry. . ."[8] A closer examination of this document shows how Moody's defined "adverse outcome." At page 2 of 4, Moody's recites that the outcome was "*substantially less than the company had requested.*" (emphasis provided) Inasmuch as Moody's regarded the 10% ROE as "adequate," Moody's necessarily was referring to the small size of the revenue increase. However, as the above discussion demonstrates, and as Moody's 2012 references to some of the "stronger financial performance measures and cash flow coverage ratios in the industry" proves, FPL *did not need* the enormous revenue increase that it requested. (FPL's sterling post-decision performance that Moody's chronicles in its report disproves its "adverse" characterization of the 2010 revenue decision!)

[7] FPL likes to "caveat" the 2010 earnings by noting that its service area experienced abnormal weather. First, FPL erroneously assumes that the 11% ROE was the "norm" or the standard against which operations should be judged. The Commission established a range of 9-11%, with a midpoint of 10%, which a major investment analyst judged to be consistent with other decisions around the country and adequate during the period between the last and current rate cases. Actual earnings anywhere within the 9%-11% range would by definition be fair and reasonable. While OPC does not agree that the "weather adjusted" data is the correct way to view FPL's surveillance reports from an achieved earnings standpoint, even that calculation shows earnings solidly within the authorized range (EXH 635) Second, after a test year is constructed and rates have been set, the assumptions of the test year always give way to actual circumstances that differ from those assumptions. As FPL witness Barrett testified, many times the changes in those variables — including weather — cancel each other out over a year's time. (TR 1155)

[8] Moody's reference to FPL's currently strong cash flow coverage ratios is particularly important, in light of FPL's many complaints that the amortization of the depreciation reserve surplus substitutes non-cash earnings for cash.

The necessary conclusion is that while entities such as Value Line and Moody's employ detailed and sophisticated metrics for other purposes, they appear eager to embrace a simplistic and superficial comparison of the amount of revenue that the utility requested and the amount it received when reacting initially to whether a decision was "favorable" or "adverse." However, to the extent that "news" of a huge revenue *request* led to investor expectations that, as it turned out, were unrealistic because the increase was unjustified and undeserved, any "disappointment" should have been directed at the utility, not the Commission.[9]

The ROE that is appropriate for FPL in today's environment. In 2010, the Commission established a range of 9-11% ROE, with a ratesetting midpoint of 10%, as appropriate for FPL. Since that time, interest rates in the economy, which are the chief driver of the cost of capital, have declined by about 150 basis points. All ROE witnesses who testified in the 2009-10 case, including FPL's Dr. Avera, testified in the current case to lower ROE values than those that they sponsored in Docket No. 080677-EI. During this case, FPL appeared to long for the "good old days" of higher authorized ROE's — harkening, perhaps wistfully, in its testimony and exhibits as far back as the 1960s, 1970s, and 1980s, when economic conditions bearing on the appropriate return on equity were far, far different than they are today. FPL also tried to latch onto certain authorized returns of southeastern utilities that were established several years ago, all of which were set during very different economic circumstances, and some of which were dictated by statutory mandates, and claim that they establish a "ratchet" below which the Commission – notwithstanding current economic realities – cannot set its own ROE now. (EXH 451) Of course, both arguments are silly. To the extent the Commission pays attention to returns authorized elsewhere, the most current decisions are the ones that matter. In the second quarter of 2012, the average return on equity for electric utilities authorized by regulators was 9.92%, and those decisions were based on data of 2011 vintage. (TR 2421-2422) Very recently, the Public Utility Commission of Texas approved a return on equity capital of 9.8% for Entergy of Texas. (TR 2980) Moreover, these recent decisions say nothing about the financial risk reflected in the utilities' respective equity ratios relative to that of FPL.

[9] If the pre-downgrade ratings were dependent upon Wall Street's presumption that FPL would receive a large increase in revenues from the Commission simply because it asked for one, the downward adjustments to the midrange of the "A" category — which is still stronger than almost all other electric utilities — is not to be mourned. The evidence indicates that the cost to ratepayers, in the form of additional revenue requirements, of maintaining the higher rating would have far outdistanced — by tens of millions of dollars annually – any related benefits stemming from lower interest rates. This is the case whether one assumes the differential in interest rates would be 28 basis points, as indicated by Dr. Avera's EXH 198, or 44 basis points, as assumed in EXH 555. See also Dr. Woolridge's EXH 239, p. 2, which indicates the differential in interest rates associated with a downgrade to be approximately 25 basis points.

In support of the 11.25% ROE advocated by Dr. Avera, FPL witness Dewhurst attempted to paint a portrait of high business risk. FPL's description flies in the face of the opinion of its allies, the credit reporting agencies, who frequently and uniformly depict FPL as having an attractive business profile. Besides, the comparison between FPL and several Florida utilities that Mr. Dewhurst presented takes place within a low risk universe of regulated entities that receive numerous, risk-reducing cost recovery advantages.

Nor was Mr. Dewhurst's list of business risk factors complete. He omitted several that work to FPL's advantage. They include size and scale, low rates, its stable residential customer base, and strong management.

To calculate his discounted cash flow growth rate, Dr. Avera employed a "proxy" group containing riskier, unregulated companies. He relied exclusively on long-term estimates of earnings per share by Wall Street analysts, a source which has been widely and thoroughly discredited as upwardly biased. (TR 2339; EXH 237) To derive a CAPM value, Dr. Avera assumed facially unrealistic growth rates in the stock market (13.5% per year) and produced an over-the-top risk premium assumption of 10.9%. Dr. Avera's unrealistic, overreaching assumptions indict the conclusions of his work product. By comparison, Dr. Woolridge supported his DCF analysis with a proxy group of 28 utilities having characteristics similar to FPL. While Dr. Avera looked only at predictions of earnings per share, Dr. Woolridge employed a variety of measurements — earnings per share, book value per share, dividend growth, growth in retained earnings — taken from numerous sources.

Dr. Avera's upward adjustment to ROE to account for flotation costs is unwarranted. First, FPL has identified no specific flotation costs. Next, to the extent flotation costs are intended to prevent dilution of existing stockholders' investment, the healthy margin of the stock price above book value shows that flotation costs adjustments are unnecessary. Finally, flotation costs take the form of market transaction costs, and as such, do not belong in a determination of a company's cost of equity. If a company were to include such transaction costs in a DCF analysis, the higher effective stock prices would lead to lower dividend yields and lower DCF-derived equity cost rates. (TR 2374-2375)

The robustness of Dr. Woolridge's analysis contrasts his approach from that of Dr. Avera and supports the credibility of Dr. Woolridge's recommendation. Dr. Woolridge recommends a

9% ROE if the Commission adopts the 50% equity ratio advocated by OPC witness Kevin O'Donnell. Dr. Woolridge testified that if the Commission approves FPL's proposed 59.62% equity ratio, the difference in risk translates into a reduction of 50 basis points, or a return of 8.50%. [10]

<u>ISSUE 59</u>: What is the appropriate capital structure that should be used by FPL for ratemaking purposes in this case?

Using OPC's recommended 50% equity ratio, the appropriate capital structure is 36.49% long-term debt, 2.12% short-term debt, 38.61% common equity, 2.03% customer deposits; 20.75% deferred taxes; and 0.00% ITCs. If the Commission approves FPL's 59.62% equity ratio, the appropriate capital structure is 29.47% long-term debt, 1.71% short-term debt, 46.03% common equity, 2.03% customer deposits; 20.75% deferred taxes; and 0.00% ITCs.

<u>ISSUE 60</u>: Is the combination of regulatory ROE, debt costs, capital structure and performance adder (if any) appropriate?

See position on issues 54, 58, 59 and 61.

<u>ISSUE 61</u>: What is the appropriate weighted average cost of capital?

Using OPC's primary capital structure that includes a 50% equity ratio and a 9% ROE, the appropriate cost of capital should be 5.45%. Using OPC's alternate capital structure (FPL's requested equity ratio and an 8.5% ROE), the appropriate cost of capital should be 5.52%. Both the primary and alternate OPC positions have been adjusted for the reductions to the cost of long-term debt and customer deposits as addressed in Issues 49 and 50.

<u>NET OPERATING INCOME</u>

<u>ISSUE 62</u>: Has FPL maximized the sources of net jurisdictional revenue that are projected to be reasonably available and technically viable for the 2013 test year? If not, what action, if any, should the Commission take in setting FPL's rates in this case? (For purposes of this issue, "net jurisdictional revenue" may include net revenue related to the supply of CO2 captured from an FPL facility.)

FPL should take reasonable and cost-effective steps to offset test year revenue requirements. However, the Commission should not require or allow FPL to pursue revenue opportunities where such pursuit would not be in the best interests of the customers.

[10] In rebuttal testimony, Dr. Avera purported to "correct" Dr. Woolridge's DCF study by excluding data points from Dr. Woolridge's proxy group that he considered "too high" or "too low." Dr. Avera excluded *twenty-two actual* values on the grounds that they were unrealistically low. He excluded *zero* values on the grounds that they were too high. Among the values he left undisturbed was a 14.0% actual return for a Hawaiian utility. Yet, after excluding twenty-two data points, Dr. Avera arrived at a "corrected" Woolridge DCF showing an average ROE of only 9.7%.

<u>ISSUE 63</u>: Does FPL properly account for revenues received from FPL Fibernet and other telecommunications companies for utilizing long-haul fiber optic facilities hosted by FPL's electric transmission system?

See OPC's positions on Issues 64 and 79.

<u>ISSUE 65</u>: Is FPL's projected level of Total Operating Revenues of $4,407,253,000 ($4,505,007,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of Total Operating Revenues is $4,407,253,000 on a jurisdictional basis.

<u>ISSUE 67</u>: Should an adjustment be made to transfer incremental security costs from the Capacity Cost Recovery Clause to base rates?

Yes. As a general matter, and absent any countervailing consideration that would be to the detriment of customers, OPC favors placing normal recurring operating expenses such as security costs in base rates rather than in cost recovery clauses. Including the incremental security costs in base rates is consistent with how these costs are treated for each of the other IOUs.

ARGUMENT:

FPL has presented no compelling evidence to show why the incremental security costs should continue to be recovered in the capacity cost recovery clause. It has been 11 years since September 11, 2001, the events that precipitated the need to incur increased security costs. FPL witness Ousdahl testified that when the original request to recover incremental security cost was approved, FPL used outside contractors. However, as the years progressed, FPL used it own employees to perform this function. (TR 1028) Plant security labor and other security costs are normal recurring operating expenses and are not even remotely related to plant capacity or fuel costs.

FPL's responses to Staff's Fourth Set of Interrogatories, Nos. 117 and 118, state that FPL believes that, due to the volatility of post-9/11 power plant security costs, the Capacity Clause continues to be the appropriate recovery mechanism. Yet, all of the other electric utilities recover security costs through base rates. (EXH 41) Given that most of FPL's security services are provided by in-house labor or relate to capital costs, FPL maintains control over the annual level of costs, which obviates any purported volatility.[11] The Commission has previously ordered that the manner of recovery for incremental security costs would be reassessed to determine whether clause recovery remained appropriate as opposed to the traditional practice of base rate recovery.[12] OPC believes that it is well past the time that recovery of incremental security costs returns to base rates.

<u>ISSUE 68</u>: If incremental security costs continue to be recovered in the Capacity Cost Recovery Clause, should the Commission approve FPL's adjustment to transfer incremental security payroll loadings from base rates to the Capacity Cost Recovery Clause?

No. As a general matter, and absent any countervailing consideration that would be to the detriment of customers, OPC favors placing normal recurring operating expenses such as security costs and related payroll loadings in base rates rather than in cost recovery clauses. This is consistent with how security costs are treated for each of the other IOUs.

ARGUMENT:

In its last rate case, FPL requested that the Commission allow the incremental payroll loadings associated with payroll costs that are recovered through several clauses. The Commission denied this request stating that the request would shift more cost to recovery clauses and that the Company had presented no compelling reason to shift the costs from base rate to clause recovery.[13] Consistent with the Commission's decision in FPL's last rate case, OPC believes that the request should be denied.

<u>ISSUE 73</u>: Should FPL's adjustment to remove ECCR clause related payroll loadings of $1,815,000 for FICA and unemployment taxes from base rates and include them in the Energy Conservation Cost Recovery Clause be approved?

No. As a general matter, and absent any countervailing consideration that would be to the detriment of customers, OPC favors placing normal recurring operating expenses such as payroll loadings in base rates rather than in cost recovery clauses.

ARGUMENT:

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[11] Order No. 14546, issued December1985, in Docket No. 850001-EI, is the source of Commission practice that states: "Prudently incurred fossil fuel-related expenses which are subject to volatile changes should be recovered through the fuel clause.... All other fossil fuel-related cost should be recovered through base rates."
[12] See Order No. PSC-01-2516-FOF-EI, issued December 26, 2001, in Docket No. 010001-EI, at 4; and Order No. PSC-02-1761-FOF-EI, issued December 13, 2002 in Docket No. 020001-EI, at 3.
[13] See Order No. PSC-10-0153-FOF-EI, in Docket Nos. 080677-EI and 090130-EI, issued March 17, 2010, at page 154.

In its last rate case, FPL requested that the Commission allow the incremental payroll loadings associated with payroll costs that are recovered through several clauses. The Commission denied this request stating that the request would shift more cost to recovery clauses and that the Company had presented no compelling reason to shift the costs from base rate to clause recovery.[14] Consistent with the Commission's decision in FPL's last rate case, OPC believes that the request should be denied.

ISSUE 74: Has FPL made the appropriate adjustments to remove all non-utility activities from operating revenues and operating expenses for the 2013 projected test year?

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers.

ARGUMENT:

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers as outlined in Issues 3, 4, 79, and 80.

ISSUE 75: Is the percentage value (or other assignment value or methodology basis) used to allocate NextEra Energy, Inc. corporate costs and/or expenses to FPL appropriate?

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers.

ARGUMENT:

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC

[14] See Order No. PSC-10-0153-FOF-EI, in Docket Nos. 080677-EI and 090130-EI, issued March 17, 2010, at page 154.

witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers as outlined in Issues 3, 4, 79, and 80.

ISSUE 76: Should the percentage value (or other assignment value or methodology basis) of NextEra Energy, Inc. corporate costs and/or expenses allocated to FPL be equal to the percentage value(or other assignment value or methodology basis) of NextEra Energy, Inc. corporate costs and/or expenses allocated to NextEra Energy Resources, LLC?

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers.

ARGUMENT:

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers as outlined in Issues 3, 4, 79, and 80.

ISSUE 77: Are the amounts of the NextEra Energy, Inc. corporate costs and/or expenses (including executive compensation and benefits) allocated to FPL fair, just, and reasonable?

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers.

ARGUMENT:

FPL has the burden of demonstrating that all non-utility activities and costs attributable to its affiliates are not included in its filing. In addition to adjustments warranted by the totality of evidence taken in this case, the Commission should make the adjustments recommended by OPC witness Vondle to ensure that FPL's transactions with its affiliates do not impose inappropriate costs on its customers as outlined in Issues 3, 4, 79, and 80.

<u>ISSUE 79</u>: Should any adjustments be made to FPL's operating revenues or operating expenses for the effects of transactions with affiliated companies for the 2013 projected test year?

Yes. To demonstrate its customers are not subsidizing affiliates, and to support its test year request in this case, FPL should employ such measures as bidding for services, service agreements between FPL and its affiliates, analyses of market prices, the creation of a virtual service company, and positive time reporting. Instead, the record reveals severe deficiencies in the manner in which FPL accounts for affiliate transactions, and a resulting dearth of the type of information necessary to enable the Commission to determine the reasonableness of affiliate-related amounts in this case. Further, FPL applies a "general allocator" to some expenses that, because of its emphasis on revenues, steers a disproportionate amount of costs to FPL. Based on FPL's abject failure to meet its burden of proof, a case could be made that the Commission should disallow all affiliate-related expenses. Instead, OPC witness Vondle recommends the Commission reduce payments to affiliates and increase revenues from affiliates by 20%, as an order of magnitude proxy for proof missing from FPL's presentation. OPC's adjustment reduces test year O&M expenses by $34.5 million.

ARGUMENT:

As discussed in Issues 3 and 4, FPL has the burden to prove that its affiliate transactions meet the requirements of the Affiliate Transactions Rule. Under the Rule, FPL must demonstrate that it has charged the greater of market price or fully allocated cost to affiliates, or paid the lesser of market price or fully allocated cost for charges to affiliates, unless it documents how specific, individual departures from these criteria benefit ratepayers.

OPC witness Vondle not only reviewed the data submitted by FPL in its MFRs as support for its March 2012 petition, but also requested and reviewed extensive discovery related to its requested affiliate costs. (TR 2539) Based on his review, Mr. Vondle testified that FPL failed to ensure the reasonableness of the affiliate transaction amounts included in the filing and how the methods FPL employs actually skew costs in the direction of FPL and the ratepayers. (TR 2542)

Based on FPL MFR Schedule C-30, FPL included eight affiliate relationships in the 2013 projected test year. However, in response to OPC Interrogatory No. 165, there are approximately 238 separate affiliate relationships that have been rolled up into the eight affiliate relationships reported on MFR Schedule C-30. (TR 2543) In the projected 2013 test year, charges from FPL to its affiliates are projected to be $150.6 million and charges from affiliates to FPL are projected to be $22 million. (TR 2542)

Despite the many affiliated companies under NEE's umbrella, there is no separate service company. (TR 2543-2545) Since FPL is NEE's only regulated utility and serves only one state, NEE was not required to form a service company. Nevertheless, OPC witness Vondle noted that in his experience utility companies of the scale of NEE and FPL generally have multi-state utility operations and therefore have a separate service company that provides common and, thus, shared services. (TR 2545) However, FPL provides the common and shared services to itself, its parent and to the unregulated affiliates that would typically be provided by a service company in other companies of FPL's scale. (TR 2545) Mr. Vondle stated that a service company would make common support services more transparent for cost control as well as cost accuracy. (TR 2603)

FPL charges affiliates using three types of methods. Direct charges are based on the resources used exclusively to provide services for the benefit of one company and are charged to that company. Service fees are charged monthly for many of the fleet support operations (i.e., Nuclear, and Energy, Markets and Trading). The affiliate management fee (50% of the affiliate transactions) are either collected in cost pools and allocated on cost drivers such as the number of employees, square feet, or work stations (40% of the AMF) or allocated using a general allocation formula, the Massachusetts Formula (60% of the AMF). (TR 2545-2546)

Based on his review of FPL's affiliate structure and charging methodologies, OPC witness Vondle identified nine deficiencies. (TR 2569) First, he identified the lack of a separate legal entity service company that would encompass the common and support services provided by both FPL and NextEra Energy Resources (NEER). (TR 2569) The lack of a service company adds opacity and a layer of complexity. (TR 2547-2548) This lack of transparency makes it easier for FPL to retain more cost in its operation and shift those costs away from the affiliate, thereby ultimately increasing cost to ratepayers. While OPC witness Vondle's suggests that a service company is preferable, he explained that a "virtual" service company could serve the same purpose. His definition of a "virtual" service company includes a separate division or department within FPL where FPL employees are assigned to work for multiple affiliates. (TR 2549) FPL witness Flaherty claims that FPL has a virtual service company now, even though he acknowledged that there is no separate department or division that houses all the FPL employees that work for the multiple affiliates. (TR 3695-3696)

The next deficiency that OPC witness Vondle identified was the lack of service agreement-like contracts. As he testified, FPL had only two service agreement-type contracts despite the hundreds of affiliate transactions. (TR 2569) FPL witness Flaherty claimed that the Cost Allocation Manual (CAM) acts like a service level agreement. (TR 3666) Despite his proposition that service agreements are unnecessary in light of the CAM, FPL witness Flaherty conceded that even service level agreements are a good business practice. (TR 3703) Unlike FPL witness Flaherty, who is confident that the CAM is all that is necessary (TR 3702-3703), OPC witness Vondle asserted that service agreements are good regulatory practice to ensure compliance with the affiliate rules and regulations, as well as providing a starting point for any audits of affiliate transactions. (TR 2566-2567)

OPC witness Vondle also noted that FPL failed to use asymmetric pricing for all of its affiliate transactions for goods and services. (TR 2569) As witness Vondle testified based on FPL's discovery responses, FPL only produced three examples of any effort remotely related to addressing market pricings for the hundreds of affiliate transactions. (TR 2558) Essentially, FPL's response to the lack of market studies or pricing boils down to that it is too difficult to do them or that the Rule does not require them. (TR 3668-3672) However, FPL witness Flaherty had to concede that the Rule does use the wording "market price" and that he was unaware of FPL ever seeking a waiver of the Rule. He also acknowledged that Florida's Affiliate Transaction Rule is an asymmetrical pricing scheme. (TR 3706-3707)

Next, OPC witness Vondle observed that FPL used direct charging, the preferred allocation methodology, too little and used the less preferred general allocator too much. (TR 2569) The direct charges attach cost to the cost causer at the finest granularity possible and should be used whenever possible. (TR 2551) The general allocator is used as the catch-all when direct charging or when an acceptable cost driver cannot be used. (TR 2552) FPL witness Flaherty's analysis of the different types of allocation methodologies shows that the use of direct charging has decreased by 10% and the use of the general allocator has increased by 9% from 2008-2011. (EXH 594)

In addition, FPL's use of exception time reporting rather than positive time reporting for direct charges and cost pools is a deficiency that OPC witness Vondle identified. As he noted, exception time reporting requires a fixed time allocation employee to first identify that he or she is spending time differently than the fixed allocation, and then to take steps to report the exception. (TR 2553) FPL witness Flaherty acknowledged that with exception time reporting the default cost allocation is that the utility is charged. (TR 3697) In positive time reporting, an employee would charge each work hour to a specific client, work order, or activity. OPC witness Vondle testified that real-time positive time reporting is more accurate regarding how the time is actually spent than the fixed allocations used with exception time reporting. He noted that exception time reporting is "highly suspect" in its accuracy in reporting how the time was spent versus the fixed allocation of time. (TR 2552-2553) FPL witness Flaherty acknowledged that he did not address OPC witness Vondle's criticism regarding FPL's use of exception time reporting. (TR 3695)

OPC witness Vondle criticized FPL's use of the Massachusetts Formula as the general allocator. He noted that because of the incentive to overcharge regulated utilities and undercharge unregulated affiliates, great care must be taken to select a general allocation formula that is clearly fair to the utility. (TR 2552) He also noted that the Massachusetts Formula overemphasizes size more associated with the electric utility and underemphasizes growth and change more closely associated with unregulated affiliates. (TR 2569) FPL witness Flaherty acknowledged that the Massachusetts Formula allocates cost based on size, but makes the claim that essentially the growth and change bias are not problematic. (TR 3677) However, this rebuttal does not fully address OPC witness Vondle's criticism that in reality the growth and change of developing unregulated affiliates command proportionately more management attention and service than a stable, steady regulated utility. (TR 2554-2555) Moreover, FPL witnesses Ousdahl and Flaherty conceded that FPL could have chosen to use a general allocator with different factors. (TR 1073, 3712-3713)

FPL has also failed to document the benefit of purchases of goods and services to FPL from affiliates and did not assure that the affiliates' fully allocated cost calculations were accurate. (TR 2572) FPL witness Flaherty acknowledged OPC witness Vondle's criticism that he did not address the lack of FPL documentation of ratepayer benefits. (TR 3694-3695) FPL witness Ousdahl tried to blur the lack of documentation by citing to compliance with SEC SOX requirements and how that ensures that ratepayers are protected and that they benefit. (TR 3764) However, Ms. Ousdahl acknowledged on cross-examination that the SEC rules do not include the same requirement as the terms of the Affiliate Transaction Rule. (TR 3820) Further, OPC witness Vondle testified that he found several instances of FPL being inadequately compensated for the use of FPL's organizational resources in developing and operating the unregulated affiliates, such as payments from FPL Energy Services, Inc. (FPLES) for services and the use of the FPL name by affiliates. (TR 2560, 2562)

The next deficiency that OPC witness Vondle discussed is that FPL inappropriately utilized sole source contracts when the goods or services involved are readily available in the marketplace. (TR 2570) Mr. Vondle identified items that FPL listed as sole source contracts, which are often bid to unaffiliated suppliers such as receivable financing, emergency generators, switchyard upgrades, Future Enterprise Network Architecture, and insurance. (TR 2564-2565) FPL witness Ousdahl suggested that all of the sole source contracts were justified and again relies on the SEC/SOX processes. (TR 3765) However, OPC witness Vondle noted that, in response to discovery, FPL only provided partial documentation for two of the nine new affiliate contractual relationships. He further asserts that sole source contracting does not comply with the Affiliate Transaction Rule. Bidding by non-affiliate suppliers is the ideal way to establish market prices. (TR 2564-2565) FPL witnesses Ousdahl and Flaherty conceded that FPL could hire outside contractors if it so desired. (TR 3709-3710, 3822)

The final deficiency that OPC witness Vondle identified was the failure of affiliates to pay for the value of using the FPL name. (TR 2570) FPL witness Ousdahl testified that it would be difficult to assess any real value for the FPL name. She also claims that because there is no value that FPL could derive, there is no subsidization. (TR 3791, 3793) However, OPC witness Vondle noted in his testimony that the FPL brand has value for which FPL should be charging market value. (TR 2567) In its audit of FPLES, the Commission staff noted that FPL customers may think that FPLES is a regulated company because the name includes FPL. The Commission audit staff further noted that FPLES is receiving the benefit of being connected to a customer of FPL, and FPLES would have to spend considerably more time and money to obtain the same level of benefit. (TR 3825-3826, EXH 576)

In conclusion, to demonstrate that its customers are not subsidizing affiliates, and to support its test year request in this case, FPL should employ such measures as bidding for services, service agreements between FPL and its affiliates, analyses of market prices, the creation of a virtual service company, and positive time reporting. Instead, the record reveals severe deficiencies in the manner in which FPL accounts for affiliate transactions, and a resulting dearth of the type of information necessary to enable the Commission to determine the reasonableness of affiliate-related amounts in this case. Further, FPL applies a "general allocator" to some expenses that, because of its emphasis on revenues, steers a disproportionate amount of costs to FPL. Based on FPL's abject failure to meet its burden of proof, a case could be made that the Commission should disallow all affiliate-related expenses. Instead, OPC witness Vondle recommends that the Commission reduce payments to affiliates and increase revenues from affiliates by 20%, representing an order of magnitude estimate of the overcharges that should be associated with FPL's inadequate practices. Overall, OPC's adjustment reduces test year O&M expenses by $34.5 million.

<u>ISSUE 80</u>: What additional action (including, but not limited to, establishing a separate investigatory docket), if any, should the Commission take related to affiliate transactions as a result of the evidence taken in this docket?

The Commission should open an investigatory docket to examine FPL's affiliate transactions. The proceeding should, at a minimum, address the nine areas of deficiency identified by OPC witness Vondle: the lack of full or virtual service company, deficiencies in service agreements, asymmetric pricing, allocation methodologies, positive time reporting, general allocator, proof of benefit of purchases from FPL affiliates to ratepayers, plus absence of competitive bidding and compensation to ratepayers for use of FPL's name.

ARGUMENT:

Having identified nine deficiencies that relate to FPL's affiliate transactions, OPC witness Vondle recommended that the Commission require that FPL address these deficiencies before the next rate case. (TR 2570) He further recommended that the Commission establish an investigatory docket to address these deficiencies: the lack of a full or virtual service company, deficiencies in service agreements, asymmetric pricing, allocation methodologies, positive time reporting, general allocator, proof of benefit of purchases from FPL affiliates to ratepayers, and the absence of competitive bidding and compensation to ratepayers for use of FPL's name. (TR 2571-2572)

In addition to an investigation of these nine deficiencies generally, OPC witness Vondle suggested that the Commission investigate specific actions. First, he recommended the formation of a virtual service company within FPL (if NEE does not form the preferable actual service company) by assigning employees who materially serve more than one company assigned to it. (TR 2571-2572) Mr. Vondle recommended that: (1) service agreements be required at the corporate level between FPL and its affiliates; (2) FPL be required to use positive time reporting for all service company professional services-type functions; (3) the deficiency of the Massachusetts Formula be addressed; (4) FPL be required to develop a better general allocator; and (5) FPL be required to charter an independent appraisal of the value of using the FPL name and then to charge all the FPL-named affiliates the appropriate royalty fees. (TR 2572-2573)

Unsurprisingly, neither FPL witness (Ousdahl or Flaherty) believes that there is a need to investigate FPL affiliate transactions or to address any of OPC witness Vondle's recommendations. (TR 3683, 3770-3771) FPL witness Ousdahl refers to the Commissions' audit regarding the FPL and FPLES affiliate relationship. (TR 3766) She uses this limited audit in an attempt to infer that the Commission previously found no problems with FPL's affiliate relationships. Yet, when the Commission's audit staff attempted to verify that FPL was charging the higher of cost or market by identifying the rates FPLES' call center charges other vendors for each completed sale to compare what FPLES was paying FPL for completed sales, FPL declined to provide the information. (EXH 518) FPL witness Ousdahl admitted she was not aware that FPL declined to provide a market study because it believed it was inappropriate. (TR 3824) In its response to the audit, FPL suggested that it was not relevant because FPL did not provide that exact same type of service to any outside contractor. (EXH 518) However, the fact that FPL chose not to provide such service to an outside contractor does not relieve it of the obligation to establish the market price. FPL's failure to provide any market information underscores the need for the Commission to open an investigatory docket.

<u>ISSUE 87</u>: What is the appropriate amount of FPL's tree trimming expense for the 2013 projected test year?

FPL's tree trimming expense should be reduced by $9,236,000 ($9,240,000 system) to reflect the company's historical pattern of under-spending its budgeted tree trimming expense by an average of 13%.

ARGUMENT:

In reviewing FPL's response to Staff Interrogatory No. 235, OPC witness Schultz noted that several reliability-related expenses were historically below budget for the years 2008-2010. Based on OPC witness Schultz's analysis, it is appropriate to make an adjustment to reflect the expected and normal level of vegetation management/hardening expense. (EXH 43 and TR 2662)

In contrast, and during cross-examination by the SFHHA, FPL witness Hardy stated that the Company under-budgeted its 2012 vegetation management budget. This issue was discussed as follows:

Q Do you agree with the response that distribution knew at the moment that FPL approved a 2012 budget that distribution's vegetation maintenance budget was underforecast?

A Where are you speaking specifically?

Q In the answer under item number 2.

A Yes. We realized it was underbudgeted when it was approved. That's correct. (EXH 525 and TR 1330-1331).

During cross-examination by FPL, OPC witness Schultz testified about FPL's pattern of under-spending as it relates to the trimming of laterals and feeders and underscored the impact that those decisions have on ratepayers:

Q All right. In terms of the analysis that you've done here, it sounds like you don't disagree that FPL should be trimming the laterals and the feeders; you simply disagree with the per-mile cost that it would require to do that, correct?

A No. What I'm disagreeing with is the total cost not on a per-mile basis or whatever. I'm just saying historically the company has budgeted X, they spent less than that budget. And if we ignore that, then you're going to have too much money in rates because that's something that's historically happened. And, again, as your co-counsel indicated, those who ignore history are doomed to repeat it. (TR 2724-2725)

OPC witness Schultz also noted that FPL's proposed vegetation management spending for 2012 is less than the actual amount spent in 2011, even though more total miles are projected to be cut. Spending for vegetation management can vary from year to year, depending on the condition of the planned area for trimming, contractual pricing, and the actual miles trimmed. (TR 2663)

Ultimately, FPL's estimate in 2012 is just that: an estimate. And, based on the historical trend reviewed by OPC witness Schultz, FPL has been consistently high with its estimates when a comparison to actual is made. Because of these reasons, Mr. Schultz calculated a reduction to vegetation management/hardening expense of $7.929 million ($7.925 million jurisdictional) by applying the historical variance rate to FPL's estimate. (TR 2672; EXH 267, Page 5)

Likewise, the level of costs for 2013 is also an estimate because it is not known what the actual cost will ultimately be. The difference between OPC witness Schultz' recommendation and FPL's request is that Mr. Schultz applied a known and measurable factor to the estimate. The known and measurable factor is that FPL spent 13.94% less on vegetation management and hardening than it originally estimated from 2008 to 2010. (TR 2663-2664) In addition, during cross-examination by the SFHHA, FPL witness Hardy confirmed FPL's lack of having an approved long-term vegetation management plan, even though the Commission has mandated trimming cycles for laterals and feeders:

> **Q.** Approved FPL vegetation management plans and costs beyond 2013 are not available. Is that correct?
>
> **A.** That's correct.

(TR 1351)

Overall, OPC witness Schultz recommends a reduction of $9.240 million ($9.236 million jurisdictional) to the Company's latest estimate for 2013. This adjustment was determined by multiplying FPL's latest request of $71,400,621 by the budget-to-actual variance of 87.06% for the years 2008-2010 and then subtracting the result from the amount requested. (TR 2663, EXH 263)

<u>ISSUE 88</u>: What is the appropriate amount of FPL's pole inspection expense for the 2013 projected test year?

FPL's pole inspection expense should be reduced by $2,733,000 ($2,734,000 system) to account for the company's historical pattern of under-spending its budgeted pole inspection expense by an average of 19.51%.

ARGUMENT:

In reviewing FPL's response to Staff Interrogatory No. 235, OPC witness Schultz noted that actual pole inspection expenses were below budget for the years 2008-2010. (EXH 43 and TR 2664) Based on OPC witness Schultz' analysis, it is appropriate to make an adjustment to reflect the expected and normal level of pole inspection expense.

FPL's cost-per-pole fluctuated from 2007 through 2011, with 2011 being an extraordinarily high year. FPL estimated the cost for 2012 and 2013 at different rates, and at a rate lower than 2011. (EXH 264) The Company-proposed spending levels for both 2012 and 2013 are less than the actual amount spent in 2011. Likewise, FPL's request for 2013 is also an estimate because it is not known what the actual cost will ultimately be. As with the vegetation management estimate, the only difference between OPC witness Schultz' recommendation and FPL's request is that Mr. Schultz applied a known and measurable factor to the estimate. The known and measurable factor is that FPL spent 19.51% less on pole inspections than it originally estimated from 2008 to 2010. (TR 2665)

In his analysis of the information relevant to pole inspections, witness Schultz calculated a $2.842 million ($2.840 million jurisdictional) reduction to the Company's 2012 estimated expense of $14.566 million. Consistent with the recommendation for 2013, OPC witness Schultz applied the historical variance rate to FPL's estimate to determine his recommended expense level. (TR 2672; EXH 267, Page 6)

Overall, OPC witness Schultz recommends a reduction of $2.734 million ($2.733 million jurisdictional) to the Company's latest estimate for 2013. OPC witness Schultz calculated this adjustment by multiplying FPL's latest request of $14,014,888 by the budget-to-actual variance of 80.49% for the years 2008-2010 and then subtracting the result from the amount requested. (TR 2664, EXH 264)

<u>ISSUE 89</u>: What is the appropriate amount of FPL's production plant O&M expense for the 2013 projected test year?

O&M production plant generation overhaul expense should be based on the normalized costs of generation overhaul costs using a four-year average cost level that is based on the actual and projected costs for 2010 through 2013, as modified to remove retired units and to add new units. These costs should be inflated to 2013 levels based on the CPI-U compound multiplier. FPL's projected test year generation overhaul expenses should be reduced by $9,000,000 ($9,177,000 system).

ARGUMENT:

Following a number of revisions needed to determine the four-year average normalized cost level (i.e., Port Everglades, Cape Canaveral, and West County Unit 3), OPC witness Ramas recommends an adjustment to O&M production plant generation overhaul expense based on the average of the actual 2010 and 2011 and the projected 2012 and 2013 generation overhaul expenses. (EXH 270)

The revisions needed to determine the four-year average normalized cost level are as follows:

Port Everglades: the actual steam plant overhaul expenses for the Port Everglades Units need to be removed from the 2010 and 2011 amounts as these units will be retired January 2013. The modernized Port Everglades combined cycle units are not projected to go into service until mid-2016;

Cape Canaveral: in its response to OPC's Fourteenth Set of Interrogatories, No. 264, FPL included $862,000 for overhaul expense for the Cape Canaveral Modernized Unit. Since the Canaveral costs are removed from the January 2013 Base Rate Change calculations by FPL, OPC witness Ramas has removed the costs in determining the four-year normalized cost level. However, FPL will still recover costs associated with Canaveral overhaul expenses as the Canaveral Step Increase request includes $3 million for maintenance expense in Account 553; and

West County Unit 3: the final revision is for the West County Unit 3. There was no overhaul expense associated with the new unit in 2010 and 2011. For purposes of normalizing the costs, OPC witness Ramas increased the 2010 and 2011 other production plant overhaul expenses by the average 2012 and 2013 projected costs for overhauls of this unit. (TR 2780-2781)

Consistent with the FPSC's benchmarking analysis methodology, OPC witness Ramas inflated the costs to 2013 levels based on the CPI-U compound multiplier. As shown on DR-2, Schedule C-3, FPL's projected test year generation overhaul expenses specific to the generation units should be reduced by $9,177,000, which would allow for the non-unit specific costs incorporated in FPL's filing (i.e., the Central Maintenance expenses), and a normalized cost level for the unit-specific costs. (TR 2781, EXH 270)

OPC witness Ramas used a four-year average normalized cost level because a higher, one-year level is not reflective of typical expenditures. The amount of overhauls and type of work done as part of the overhauls vary from year to year. Accordingly, OPC witness Ramas testified that the normalized costs to be included in rates should be based on a more representative four-year average cost level. Given the retirement of several steam units and the addition of several other production plants in recent years, OPC witness Ramas recommends that the four-year average be based on the actual costs for 2010 and 2011 and FPL's projected costs for 2012 and 2013, as adjusted to account for the retirements and additions addressed above. (TR 2780) FPL already provided the necessary information to calculate the normalized cost level in its response to OPC's Fourteenth Set of Interrogatories, Nos. 264-267. More specifically, FPL's response included the actual 2010 and 2011 and the projected 2012 and 2013 generation overhaul expenses on a unit-by-unit basis. (TR 2779-2780)

Overall, FPL is projecting a significant increase in generation overhaul expense in the 2013 test year. Based on the workpapers provided by FPL in response to OPC's Second Request for Production of Documents, POD 12, at Bates Stamp OPC 294683, test year expenses include $15,034,000 for steam generation overhauls and $53,309,000 for other generation plant overhauls. These amounts are broken out on a unit-by-unit basis in the workpapers. In addition to the projected costs on a per-unit basis is $1,265,000 of "Central Maintenance" expense associated with overhauls. The workpaper also shows that the test year total generation overhaul expenses of $69,609,000 exceed the 2013 benchmark by $11,718,000, with the steam generation overhauls at $18.8 million below the benchmark, while other generation overhauls are $30.2 million above the benchmark. (TR 2778-2779)

Some of the variance-to-benchmark is explained by the retirement of several steam generation facilities and the addition of the combined cycle units. However, the projected test year overhaul expense is still significantly higher than the projected 2012 expense due largely to the timing of planned overhauls. The response to SFHHA's First Set of Interrogatories, No. 87, indicates that the company has "...identified a higher level of planned maintenance (overhaul) work for the combined cycle fleet in 2013, increasing planned maintenance costs over 2012 by $17.4 million." (TR 2779, EXH 92)

Also, generation facilities are not overhauled on an annual basis. Additionally, the amount of overhaul expense incurred varies depending on the type of overhaul and the type of work needed during the overhaul. For example, the response to Staff's Seventh Set of Interrogatories, No. 284, indicates that combined cycle unit outages are scheduled based on the life of combustion turbine parts. This response indicates that most of the General Electric 7FA combustion turbine units have 24,000-hour combustion parts requiring a Hot Gas Path outage in three years. The response also indicates that at year 6, additional work is done with a Major Inspection. (TR 2779, EXH 44)

Test year generation overhaul expenses are significantly higher than a normalized cost level. The changes to base rates resulting from this case will likely be in effect longer than a one-year period. Thus, in setting rates, the costs should be based on a normalized cost level. (TR 2779).

Overall, OPC witness Ramas recommends that the amount set in base rates (which will likely be in effect for numerous years) be based on a normalized cost level because of the nature of overhaul expenses and the nature of how they are incurred. (TR 2836). In addition, OPC witness Ramas recommends that FPL's projected test year generation overhaul expenses be reduced by $9,000,000 ($9,177,000 system).

ISSUE 90: What is the appropriate amount of FPL's transmission O&M expense for the 2013 projected test year?

See OPC's positions on Issues 87 and 88.

ISSUE 91: What is the appropriate amount of FPL's distribution O&M expense for the 2013 projected test year?

See OPC's positions on Issues 87 and 88.

ISSUE 95: If in its resolution of Legal Issue 1 the Commission determines it has legal authority to do so, should it approve FPL's proposed storm cost recovery mechanism?

No. As a matter of policy the Commission should not endorse FPL's misuse of a settlement agreement. Nor should it foreclose parties' opportunities to address future storm-related requests, or peremptorily exclude consideration of earnings from storm cost recovery metrics, or limit its own discretion to tailor future responses to specific factual circumstances. History demonstrates that the combination of a reserve and the ability to seek post-storm surcharges provides FPL adequate remedies for storm cost recovery.

ARGUMENT:

In lieu of proposing an adjustment to the $200 million storm reserve or to the current accrual of zero dollars annually, FPL proposes to brazenly "lift" a negotiated provision out of a settlement and ask this Commission to approve it in lieu of taking competent substantial evidence that would support a ratemaking provision. FPL's proposal is a flat-out violation of Chapters 366 and 120, Florida Statutes.

Legalities aside, the Commission should deny the proposal. Unlike the Commission's established practice and policy, adopting FPL's proposal would place the Commission's imprimatur on FPL's effort to unilaterally exploit a settlement agreement. It would also needlessly limit the Commission's discretion to hear from affected parties regarding all aspects of the situation, and fashion a response to a petition to recover storm-related costs that is specific to the factual circumstances that exist at the time.

The Commission can set rates in this proceeding only pursuant to the provisions of Sections 366.06(2) (file-and-suspend rate setting must be pursuant to a public hearing), 366.07 (rate adjustments must be pursuant to a public hearing), and 366.072 (rate adjustments are required to be in the final written order), Florida Statutes. Any rate setting decision by the Commission – including a decision establishing rates to be collected *in advance* (with no hearing) in the event of a costly storm – must be made pursuant to the provisions of Sections 120.569 and 120.57(1)(b), Florida Statutes. These core administrative due process provisions require that agency decisions be made only after the agency affords parties (such as the ratepayers), who have substantial interests and who have raised disputed issues of material fact, the opportunity to respond, to present evidence and argument, and to conduct cross-examination before then making findings of fact and conclusions of law supporting a change in rates. Otherwise, Sections 120.68(7) (a) and (b), Florida Statutes, provide that a reviewing court "shall remand a case to the agency when it finds that:"

> (a) There has been no hearing prior to agency action and the reviewing court finds that the validity of the action depends upon disputed facts;
>
> (b) The agency's action depends upon any finding of fact that is not supported by competent, substantial evidence in the record of a hearing conducted pursuant to ss. 120.569 and 120.57...

These provisions apply to the Commission's decisions affecting substantial interests in this case.

Against this legal backdrop, FPL asks that the Commission perpetuate its current storm mechanism that exists only because it was contained in a negotiated stipulation and settlement that contained many other provisions. FPL witness Dewhurst unilaterally proposed that the Commission "lift" the limited duration provision from the existing settlement agreement that was approved in 2010 (see Order No PSC-11-0089-S-EI, issued February 1, 2011 (2010 Stipulation Order)) and that it be continued indefinitely. (TR 1911, 4761-4762, 4814, 4816) That provision, contained in Paragraph 3 of the settlement agreement, allowed FPL to raise customer rates up to $4/month (100kWh) for as long as 12 months with no prior hearing and with no earnings test, no consideration of depreciation surplus, or any other "rate case type" proceeding (which ostensibly could consider cost offsets like Advanced Metering Infrastructure (AMI)) savings or other credits in the income statement). (See, 2010 Stipulation Order at 13-14). The provision represented a substantial concession that OPC (and other signatories) were willing to make only in the context of a global compromise of multiple issues.

The stipulation clearly and directly prohibits a party from advocating any provision of the stipulation as a precedent in any administrative proceeding. (2010 Stipulation Order at 22). Yet, in prefiled testimony, FPL witness Dewhurst said: "FPL proposes for the immediate future to continue to recover prudently incurred storm costs under the framework prescribed by the 2010 rate Settlement." (TR 1908) Under cross-examination, Mr. Dewhurst acknowledged that the approval of all provisions of the stipulation were required for any single provision to be effective. He also conceded that he understood that the stipulation was an "all or nothing" proposition. (TR 4816, 4818) In prefiled rebuttal testimony, FPL witness Dewhurst referred to ". . .the need to have some recovery mechanism clearly spelled out in advance, such *as the one previously supported by OPC and the SFHHA, among others,* and which FPL is proposing to continue in this instance. (TR 4765) (Emphasis provided) Yet, he denied having violated the term of the stipulation that prohibits FPL from attempting to use a portion of the settlement as precedent. (TR 4824-4825) When asked how, in light of the limiting language of the stipulation, he could represent in testimony that OPC had supported the storm provision he wished to lift from the 2010 settlement, his only answer was that – while he acknowledged it "as an integral part of the settlement agreement" (TR 4816) – OPC signed the stipulation. This acknowledgement further compounded the evidence of FPL witness Dewhurst's intent to use the

2010 compromise as precedent in an adversarial proceeding, in defiance of the express prohibition within the agreement.

Perhaps this approach by FPL is just a further indication of the contempt and disdain that FPL holds for the stipulation process. After all, this is not the first time FPL has been caught with its hand in the candy store cookie jar. In the last rate case, FPL attempted to similarly "lift" a GBRA (Generation Base Rate Adjustment) provision from a prior (2005) global settlement agreement and have it adopted in similar fashion. OPC and other parties objected, and the Commission rightly rejected the attempt. (See Order No. PSC-10-0153-FOF-EI, at 13-16.) In that order, the Commission acknowledged that the GBRA was a product of a compromise that included many other provisions, including a base rate freeze. The Commission also noted that the GBRA provision in the stipulation was time-limited, while the version that FPL sought to have the Commission "lift" and approve would be in effect indefinitely. For these and other reasons, the Commission rejected FPL's attempt to abuse the stipulation process in the last rate case.

Apparently, for FPL a stipulation is not a true bi-lateral agreement between parties having equal interests. Instead, it is a candy store from which to pick and choose the sweeter goodies FPL wants to have or to dole out, while leaving the bitter tasting items behind. FPL witness Dewhurst was not advocating the "continuing" existing base rates or the existing ROE midpoint and range (2010 Stipulation Order at 12, 20). The only thing FPL wanted to "lift" out of a settlement that was a compromise was the (time-limited) storm recovery mechanism. Tellingly, FPL offered zero evidence to support the actual rate setting provisions and the number in the storm cost recovery provision. FPL witness Dewhurst conceded that there was no evidence offered by anyone from FPL to support the substantive provisions. (TR 4821-4824) Denials notwithstanding, clearly the only basis offered was its embedded status in a stipulation accompanied by a misleading representation that OPC supported it.[15]

OPC witness Schultz concisely presented the OPC position of the storm reserve and storm cost recovery. He testified that after the stipulation expires on December 31, 2012, storm cost recovery should follow the Commission's established practice for addressing the adequacy

[15] This does not amount to the competent, substantial evidence that the law requires. Section 120.68(7)(b), Florida Statutes.

of FPL's storm reserve and the recovery of storm costs. He pointed out that the Commission's past practice, which allows utilities to seek recovery of costs that go beyond the storm reserve, is sufficient to protect FPL if a storm of that magnitude were to occur. Allowing an automatic storm-related adjustment in the absence of a stipulation by the parties would negate the need for a reserve that is intended to cover storms that are not as financially severe as those that occurred in the 2004/2005 timeframe. The reserve is available to cover the costs of major storms, and the provision for storm recovery that would exceed the reserve is a sufficient mechanism to protect FPL if significant damage were to occur. (TR 2685)[16] Clearly, Mr. Schultz laid to rest any notion that OPC "supported" the storm cost recovery provision that FPL proposes.

The Commission should refuse FPL's ill-conceived invitation to adopt the storm cost recovery mechanism of the expiring settlement agreement on the record in this case, as it would be unlawful and would subject the final order to automatic remand by a reviewing court. Perhaps more importantly, the Commission should not endorse unilateral efforts to leverage terms of negotiated settlements. Instead, it should send a strong message quashing the spurious notion that a party can unilaterally pirate a term from a stipulation that was negotiated in the context of a comprehensive and global context, and propose it in a manner that violates express provisions prohibiting the advocacy of the term as precedent. The very viability of alternative dispute resolution through genuine stipulations of issues in dispute is at stake. By advancing a provision of the 2010 agreement and citing the fact that OPC was a signatory as a reason for adopting it in this case, FPL wishes to deprive OPC, and perhaps other parties, of the benefit of the bargain they gained by ***compromise***. If this practice is allowed, and if limiting provisions of a stipulation are allowed to be ignored and individual terms are used in such a cannibalized fashion, FPL's maneuver and the Commission's action in approving it will have a chilling effect on the willingness of parties to compromise in the future.

ISSUE 96: What is the appropriate annual storm damage accrual and storm damage reserve for the 2013 projected test period?

*OPC submits that FPL's current storm reserve, which currently is greater than $200 million, is adequate in light of the availability of timely post-storm surcharges upon the requisite showing.

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[16] In Order NO. PSC-10-0153-FOF-EI, when denying FPL's effort to create an ongoing GBRA from a settlement agreement, the Commission said, "Approving a GBRA for FPL on a permanent basis would constitute a significant change in our general ratemaking policies." Similarly, the Commission's established policy of combining reserves, accruals where needed, and the ability to petition for a surcharge should not give way to FPL's attempt to parlay one term from a negotiated agreement into on ongoing fixture.

Therefore, no increase in the reserve is warranted. Similarly, no annual accrual is needed, and it should remain at zero.*

<u>ISSUE 100</u>: Should an adjustment be made to FPL's level of non-executive compensation for the 2013 projected test year?

Yes. Non-executive incentive compensation should be reduced $22,371,000 ($22,726,000 system) to properly allocate the benefits of non-executive incentive compensation between shareholders and ratepayers on a 50/50 basis consistent with the allocation for executive incentive compensation as ordered in the last FPL rate case.

ARGUMENT:

OPC witness Schultz testified that in the last rate case, the Commission decided that 100% of executive incentive compensation should be excluded from rates and "that 50 percent of the *non-executive incentive* compensation" shall be excluded from O&M expense borne by ratepayers. Mr. Schultz also noted that the justification for disallowing 50% (instead of the 100% disallowed for executives) was that the Commission was "hesitant to conclude that one hundred percent of the non-executive incentive compensation benefited only shareholders."

The problem identified by Mr. Schultz – and the basis for the OPC's recommended adjustment – is that the Commission may have inadvertently not adjusted the full scope of non-executive compensation that was described in the last order. As he testified, the full range of executive incentive compensation was allocated to shareholders. However, only a portion of the corresponding non-executive compensation was covered by the aspect of the Commission's order that allocated 50% of the non-executive compensation to shareholders. The sole aspect of incentive compensation that is addressed here is the portion of non-executive incentive compensation that was left allocated 100% to ratepayers. (TR 2652)

As OPC witness Schultz notes, there was an apparent inadvertent oversight in the Commission's order regarding what should have been included as part of the adjustment in that proceeding. The testimony of OPC's witness in the last case on that issue was entitled "Non-Executive Incentive Compensation" and the questions discussed issues related to "Non-Executive Incentive Compensation;" however; the testimony dealt only with non-executive long-term incentive compensation. This was a different plan than the more costly, general non-executive-type compensation plan. The Commission order also refers repeatedly to non-executive incentive compensation, which suggests that the Commission was also under the impression that the OPC witness' recommended adjustment was similar to the executive incentive compensation cost adjustment recommendation that consisted of both cash-based incentives and stock-based incentives.

In the current case, Mr. Schultz testified that the inadvertent omission of the cash-based portion of the non-executive incentive compensation from the non-executive compensation adjustment in Docket No. 080677-EI is manifested in a significant difference, which arises when the non-executive adjustment is compared to the mechanics of the overall executive incentive compensation adjustment. The difference on a total Company basis in Docket No. 080677-EI amounted to approximately $52.966 million. The corresponding amount of non-executive incentive compensation in this docket, according to the response to SFHHA Interrogatory No. 262 (EXH 95) is $59.873 million. (TR 2652) This incentive compensation includes $53.667 million of cash incentives and $6.205 million of Performance Dollar Incentive Program costs. Id.

This difference forms the sole basis for the proposed incentive compensation adjustment. If the Commission concurs that an oversight occurred, the allocation of the 50% to shareholders results in a reduction to test year expense in the amount of $22.726 million ($22.371 million jurisdictional). (TR 2649)

OPC believes that the adjustment should not be based solely on whether the Commission inadvertently omitted the balance of non-executive incentive compensation. The primary factor is that the premise for adjusting non-executive incentive compensation is that the enhanced performance generated from a properly designed plan should benefit shareholders and ratepayers equally; therefore, the cost of that plan should be shared equally as well. (TR 2654) OPC witness Schultz also testified that the adjustment will not result in any elimination of the incentive compensation in the future. His testimony supports the prior adjustments in Progress Energy Florida rate case (Docket No. 090079-EI) and counters the often made – but never implemented – threat that incentive compensation will be eliminated in the face of sharing related disallowances and that base pay will be increased. As he testified the real question is whether it is probable that this change could take place. Mr. Schultz further pointed out that in three decades of analyzing rate cases, this has been a fairly common response by companies; however, he has never seen it happen. He also notes that this was a claim made by the company in the last case and, true to form, the threat was not carried out. (TR 2655-2656. 3547-3548, 3551)

<u>ISSUE 102</u>: Is FPL's projected level of employee positions for the 2013 projected test year appropriate?

No. The Commission should reduce the number of forecasted positions in the 2013 test year from 10,147 to 9,766 based on FPL's historical pattern of not filling the forecasted or budgeted complement. This reduction in employees reduces total payroll (capitalized and expensed), excluding incentive compensation, by $34,866,000, resulting in a reduction in payroll expense for ratemaking purposes of $24,578,000 ($24,968,000 system). Benefits Expense should also be reduced by $4,814,000 ($4,886,000 system).

ARGUMENT:

This issue is fairly straightforward. FPL has a documented history of not filling its budgeted complement of employees. OPC witness Schultz documents the historical and persistent under-run in the budgeted headcount used to set the rates that customers pay for future years. This ongoing pattern continues in this case. OPC has proposed a conservative adjustment to provide some protection to customers from paying excessive rates based on an inflated headcount.

As shown on the table below excerpted from Exhibit 259, FPL has a documented history of not filling the number of its authorized/budgeted positions. Specifically, the concern is that there has been a recent increase in the variance between authorized and filled positions. Given this historical pattern and the Company's request to set rates based on a projected complement of 10,147 employees when the current FPL headcount is 9,961, it is clear that FPL has significantly overstated the projected number of employees in its rate request.

	Actual	Budget
2004	10,107	10,338
2005	10,225	10,408
2006	10,390	10,552
2007	10,557	10,768
2008	10,711	10,994
2009	10,627	11,072

2010	10,195	10,627
2011	9,961	10,250

Based on the historical trend and the trending analysis used in the most recent FPL decision, Mr. Schultz calculated an average variance from the most recently available actuals (the 3.76% average variance from the test year projected complement is based on the five months ending May 2012). This yields a reduction in the number of projected positions in the 2013 test year of 381, from 10,147 to 9,766. As a consequence, total payroll, excluding incentive compensation, should be reduced by $34.866 million.

OPC's recommended adjustment is simple and straightforward. FPL's anemic response to the hard facts is to claim that OPC witness Schultz has ignored overtime and/or temporary workers. FPL is mistaken. Clearly, Mr. Schultz not only considered overtime in his analysis, but also in his adjustment. The testimony at hearing reinforced that the Company was hiding behind the coined phrase "optimal staffing" to mask the fact that they once again would be unable to maintain the projected full compliment. FPL witness Slattery acknowledged that they had failed to fill their budgeted positions year after year, blaming the gap on "housing conditions, and inability to hire qualified employees while at the same time joining the chorus of voices bragging about the Company's superior performance meriting an ROE adder. (TR 3514) Optimal staffing meant that FPL was staffing temporarily for uprates (which are recovered separately in the NCRC proceeding and which costs assumedly should be excluded from base rate revenue requirements) and which uprate activities and projects are going away beginning in 2012 and carrying into 2013.

FPL's own witnesses on this issue (Slattery and Barrett) conceded that the budgeting process was the same in past years as it is for the test year. (TR 3556; EXH 109, pp. 12-13) This concession demonstrates that the same under-run is likely to occur in the test year as in the prior years upon which rates have been set. There is nothing exceptional about the overtime and temporary staffing levels showing that FPL has finally stopped wildly overbudgeting the employee headcount. The Commission should keep in mind the very recent history that OPC witness Schultz pointed out, and which the Company did not rebut. Case in point: the projected 11,111 positions claimed to be *required* for 2010 in the last rate case, which significantly exceeded the 10,195 <u>actual</u> average employment level for 2010. The projected 11,157 positions claimed to be *required* for 2011 (subsequent year test year) in the last rate case significantly exceeded the 9,961 actual average employment level for 2011. With a variance of 916 positions in 2010 and 1,196 positions in 2011, any request for a significant increase by FPL should be viewed with skepticism. As Mr. Schultz reminded the Company attorneys seeking to discredit him, "those who fail to recognize history will repeat it." (TR 2711)

To remedy the seemingly inescapable difficulty that its history poses, FPL sought to inflate its request by using a projection built on a projection. OPC witness Schultz bases his adjustment on actual data as it relates to the Company's less-than-accurate historical forecasts. In preparing the filing it made in March 2012, FPL estimated that there would be 10,348 employees as of May 2012. From this starting point, FPL factored in and assumed that the employee complement would be reduced by 201 positions (10,348 – 10,147). This results in a projected average test year complement of 10,147 employees.

In contrast, OPC witness Schultz developed his recommendation using the actual employee complement of 9,921 as of May 2012, essentially eliminating FPL's erroneous May 2012 guesstimate from the equation. As noted above, Mr. Schultz developed the variance factor to apply to the actual May 2012 number to determine that the need is 9,766 employees in the projected 2013 test year. His reduction of 155 positions (9,921 – 9,766) to the 2012 actual employee complement is comparable to the Company's assumed reduction of 201 positions from actual 2012 to average 2013. The difference is that FPL's starting point was based on a projected, but highly unrealistic and imaginary May 2012 figure of 10,348.

Despite FPL's claims that OPC witness Schultz did not take the overtime into account, the facts are that his analysis appropriately considered overtime in his adjustment. As far as overtime affecting the budgeted headcount is concerned, FPL was careful not to advance the notion that overtime levels would not be reduced as the test year progressed. In fact, overtime levels are budgeted to decline. (TR 2714, 2734) FPL witness Slattery conceded that the levels of overtime and temporary workers were likely explained by the nuclear uprates and the scheduled outages that were to conclude in 2013. Ms. Slattery also indicated that those projects were "ramping down" in 2012 and 2013. (TR 1610; EXH 111, p. 70)

Assumedly, the payroll dollars for which FPL is seeking recovery in this case are appropriately separated between base rate and clause recovery. To the extent that the nuclear uprate/outage projects are driving overtime and the temporary worker dollars in 2012 and 2013, the true measure for analysis is the full-time headcount excluding overtime and temporary workers. Under cross-examination, OPC witness Schultz pointed out that FPL should budget the headcount it actually will fill and then budget overtime as needed. (TR 2714) Unfortunately, FPL has not done this and will clearly underachieve the projected headcount once again. Given FPL's history and the pattern discussed in Mr. Schultz' testimony and documented in the prior rate case, plus the fact that FPL's own 2010 and 2011 actuals under-ran not only the Commission's authorized level of employees but also FPL's subsequently lower revised budget amounts for those years, the adjustment proposed by OPC witness Schultz is fair and relatively conservative. In the end, the Commission cannot ignore the actual headcount under-runs that have persisted, even as the budget is assembled year after year through the same "rigorous" process that the test year forecast used. (EXH 109, pp. 12-13) Customers should not once again be forced to pay for phantom employees.

OPC's payroll and benefits adjustments are also conservative because OPC is not proposing an escalation adjustment on top of the headcount and the incentive compensation adjustment. As Mr. Schultz noted, the per employee benefit cost, excluding pension and Other Post-Employment Benefits (OPEB) costs, increased by 13.5% in 2012 and by 8.6% in 2013. In addition, the 2011 comparable cost per employee of $12,655 was less than the 2010 cost per employee of $13,387, which was also less than the 2009 cost per employee of $14,490. The sudden large increase in cost per employee after years of declining costs raises doubts in the ratemaking context. Mr. Schultz further noted that in the last FPL rate case, FPL witness Slattery testified that the benefit cost would be $198.355 million and $231.752 million in 2010 and 2011, respectively. However, in the 2013 test year in this case, MFR Schedule C-35 shows the 2010 and 2011 actual costs to be $173.893 million and $168.017 million, respectively. (TR 2659) These significant differences from FPL's prior projections lend great credibility to OPC's adjustment based on the budget under-runs in the payroll area. Without such an adjustment, the company has the ability – whether by design or historically consistent happenstance – to generate shareholder margin between rate cases.

ISSUE 104: What is the appropriate amount of FPL's requested level of Salaries and Employee Benefits for the 2013 projected test year? (Fallout Issue)

In addition to the adjustments described in Issues 99-103, the Commission should reduce FPL's benefits expense by $9,957,000 ($10,106,000 system). FPL has failed to meet its burden of demonstrating that its proposed O&M expense factor of 82.1% should be used for benefit costs instead of the historical average of 75.47%. Altogether, Salaries and Employee Benefits expense should be reduced by at least $61,720,000 ($62,686,000 system) as reflected on OPC witness Schultz's Exhibits HWS-2-4.

ARGUMENT:

OPC recommends a two-pronged adjustment under this issue of overall Salaries and Employee Benefits. To the extent that the Commission makes an adjustment under Issue 102 to recognize FPL's historical pattern of under-running the headcount budget and reduces the test year projected employee complement by 381, OPC witness Schultz has provided the supporting calculations for adjusting the corresponding average benefits and payroll taxes. (TR 2658-2662, EXH 261 and 262) He also recommends an adjustment to the Company's use of an excessive O&M expense factor. The benefits and excessive O&M factor adjustments combined generate an additional reduction in test year compensation-related expenses totaling $14.992 million ($14.771 million jurisdictional). The corresponding payroll tax expense adjustment to all payroll expense-affecting adjustments recommended by OPC is $1.601 million ($1.577 million jurisdictional). (TR 2661-2662, EXH 262)

Mr. Schultz describes his headcount at related benefits reduction (TR 2659-2660) and shows the calculation (EXH 261). Test year benefits expense should be reduced by $4.886 million.

The adjustment related to the excessive O&M expense allocation is required because OPC witness Schultz' analysis demonstrates that although historically FPL has expensed approximately 75% of benefit costs, and that for the first three months of 2012 the Company also expensed approximately 75%, the projected 2012 and 2013 expense factors are 80.69% and 82.1%, respectively. Based on his expertise and experience, Mr. Schultz described the projected costs and expense allocation as excessive, given the historical trend and the level of construction projected by the Company. (TR 2660; EXH 261, p. 2 of 2)

To adjust for this excessive allocation, OPC witness Schultz developed an adjustment that remedies the excessive allocation with respect to the O&M expenses (TR 2661; EXH 261, Page 1 of 2, Lines 11-13) This adjustment reduces expenses by $10.106 million.

ISSUE 106: Should an adjustment be made to the amount of the Directors and Officers Liability Insurance expense that FPL included in the 2013 projected test year?

Yes. The Commission should reduce Directors and Officers Liability Insurance expense by $1,369,000 ($1,391,000 system) consistent with Commission precedent that allocates the cost evenly between shareholders and ratepayers.

ARGUMENT:

In its response to OPC Interrogatory No. 60, FPL has included $2,781,173 of expense in Account 925 for Directors and Officers Liability ("DOL") insurance. (EXH 68) OPC's position is that ratepayers and shareholders should share DOL insurance premium costs equally ($1.391 million system and $1.369 million jurisdictional each) for the following reasons:

The cost associated with acquiring DOL insurance is a necessary business expense designed to protect shareholders from the decisions they made when they selected the Company's Board of Directors and when the Board of Directors hired the officers of the Company. The questions in this case are whether this cost (which FPL elected to incur) is for the benefit of shareholders and/or ratepayers, and who should be responsible for the costs associated with acquiring this coverage. Even though shareholders are the primary beneficiaries, OPC witness Schultz recommends that this business expense be shared equally between shareholders and ratepayers. (TR 2665)

In the recent Gulf Power Company rate case (Docket No. 110138-EI), the Commission determined that the cost of DOL insurance should be shared equally between shareholders and ratepayers. In addition, in the 2009 Progress Energy Florida rate case (Docket No. 090079-EI),[17] the Commission observed that other jurisdictions make an adjustment for DOL insurance and that it has disallowed DOL insurance in wastewater cases. In the Progress Energy case, the Commission allowed the utility to place one-half the cost of DOL insurance in test year expenses. Therefore, as a result of its decisions in the Gulf and Progress Energy cases the

[17] See Order No. PSC-10-0131-FOF-EI, issued March 5, 2010, in Docket No. 090079-EI, In re: Petition for increase in rates by Progress Energy Florida, Inc.

Commission has recognized that, while DOL insurance is a legitimate business expense, this expense is unique in that it is designed primarily to protect shareholders from their past decisions. (TR 2666-2667)

Further, even if DOL insurance costs had not been ordered shared in the Gulf and Progress Energy cases, OPC witness Schultz would still recommend an equal sharing approach for two reasons. First, the cost associated with DOL insurance benefits shareholders and they also are the ones who receive the insurance proceeds in any judgment or settlement. Second, these utilities are regulated entities subject to certain criteria for cost recovery, such as prudence and benefit. In ratemaking, a prudent cost should follow the benefit. However, the reason for incurring that prudent cost is often to protect shareholders from imprudent decision-making by directors and officers. The benefit of this insurance clearly inures primarily to shareholders; some of whom generally are the parties initiating any suit against the directors and officers. The Commission's decisions on this issue in the Gulf and Progress Energy rate case dockets were fair, and should be followed in this Docket. (TR 2667)

Because of these reasons, OPC witness Schultz recommends a 50% reduction to Account 925 of $1.391 million ($1.369 million jurisdictional). (TR 2666, EXH 265)

<u>ISSUE 108</u>: What is the appropriate amount and amortization period for Rate Case Expense for the 2013 projected test year?

The appropriate amount of rate case expense should be $3,438,116 amortized over 4 years to reflect annual amortization of $859,529. Excessive projected expenses should be reduced by $2,076,884, which reasonably limits FPL's rate case expense to the amount authorized in the 2009 rate case plus an allowance for inflation.

ARGUMENT:

OPC witness Ramas testified that FPL's requested $5.5 million in rate case expense is overstated because several projected costs are inappropriate and other costs appear excessive. FPL's estimate includes excessive costs for "Employee Related" travel and additional costs for legal, contractual, and other expenses. FPL has neither demonstrated why it expects to incur expenses related to this proceeding during 2013 (with some estimated costs occurring more than a year after the filing of the Post-Hearing Briefs), nor explained why costs incurred after this case is fully processed and the new rates are in effect should be recovered as rate case expense.

Ms. Ramas testified that no projected 2013 costs should be included in FPL's projected rate case expense. (TR 2782-2784)

Additionally, FPL included some employee salary costs which are included in salaries for base rate recovery. Therefore, including these labor costs as part of the rate case expense would result in double recovery of costs charged to ratepayers and should be disallowed consistent with the Commission's decision in the last FPL rate case. Further, FPL's projected rate case expense included $3.9 million collectively for temporary payroll, data processing, non-professional outside services, security costs, "company forms," and professional services. OPC witness Ramas testified that many of these costs also appeared either excessive or questionable. She cites as examples expense projections for two witnesses who did not file testimony, and costs included for additional rebuttal witnesses that began several months prior to the filing deadline for intervenor testimony. (TR 2785-2786)

Because several of the projected costs are inappropriate or appear excessive for inclusion in rate case expense, OPC witness Ramas recommended that rate case expense in this docket be limited to the amount allowed by the Commission in FPL's prior rate case, escalated for inflation. Using the prior authorized balance of $3,207,000 and a CPI escalation multiplier of 1.072066, Ms. Ramas recommended an overall rate case expense of $3,438,116, or $2,076,884 less than the Company's requested amount. (EXH 269 [DR-2, Sch. C-2]) Using FPL's proposed four-year amortization period, the annual amortization of rate case expense should be $859,529, or $519,221 less than the amount proposed by FPL. (TR 2786-2787)

While FPL witness Ousdahl agreed that FPL had lowered its rate case expense estimate to $3,925,000 (TR 1095), the Company still has the burden to show that its revised requested rate case expense is appropriate.

<u>ISSUE 109</u>: What is the appropriate amount of uncollectible expense and bad debt rate for the 2013 projected test year?

FPL's bad debt expense should be reduced by $1,760,000 to remove the accrual to increase the uncollectibles reserve. FPL's proposal is purely subjective and is not appropriate for ratemaking.

ARGUMENT:

No. The OPC challenges FPL's subjective accrual that is recorded as a forecasted bad debt or uncollectible expense component. OPC witness Schultz does not take issue with the $16.648 million of uncollectible expense that is based on historical net write-off. Instead, Mr. Schultz takes issue with the purely subjective accrual that FPL proposes as an estimated adjustment to the reserve for uncollectibles and he recommends that the amount included in expense for this component of the uncollectibles expense be reduced by $1.76 million. Also, he provides the corresponding calculation (EXH 266) and testifies that FPL's treatment of this expense is inconsistent with what he considers accepted practice. According to Mr. Schultz, the uncollectible expense in rates should be representative of the net write-offs expected, similar to the uncollectible factor used in the revenue expansion factor. (TR 2668)

OPC witness Schultz criticized the Company's approach based on its subjectivity and that, if allowed, is just based on company judgment and little else. He also noted that the Internal Revenue service does not allow that provision of the accrual to be deducted for current income taxes due to it being considered a contingency accrual. (EXH 117, p. 17) For these reasons, OPC recommends that the Commission reject FPL's efforts to subjectively increase ongoing expense by what could be a one-time and purely discretionary reserve adjustment.

<u>ISSUE 112</u>: Has FPL included the appropriate amount of expense associated with the AMI smart meters in the 2013 projected test year?

No. The Commission should utilize the net savings of $19,943,000 projected in the last rate case instead of the net expense of $3,735,000 ($3,744,000 system) FPL has included in the filing. See also OPC's position on Issue 113. Test year expenses should be reduced $3,735,000 ($3,744,000 system).

<u>ISSUE 113</u>: Has FPL included the appropriate amount of savings associated with the AMI smart meters in the 2013 projected test year?

No. FPL should be held to the net O&M savings projection for 2013 identified in Order No. PSC-10-0153-FOF-EI resulting in $19,893,000 ($19,943,000 system) of net savings. In approving inclusion of the AMI capital costs in rate base in the prior case, the Commission considered future savings to customers that would result. It would be inappropriate to now include the full capital costs in rates and include none of the annual cost savings that will result.

ARGUMENT:

With respect to setting rates based on the implementation of the Smart Meter/AMI program, OPC asks the Commission to require FPL to put its money where its mouth is. In the previous rate case, FPL sold the smart meter program and the associated $600 million-plus rate base item on the basis that it would provide benefits to customers amounting to $19.9 million by 2013, which is the test year in this case. When the current case was filed, FPL showed a total rate base of $554.6 million and a net expense of $3.7 million for the AMI program. On the eve of hearing, FPL corrected its plant in service schedule, which shifted dollars between plant categories. (TR 2753-2754) This was done to correct an error for the allocation of Department of Energy ("DOE") project funding to the appropriate plant accounts. This correction or shifting of dollars contained in plant-in-service in the filing increased the rate base component of the AMI project to $563 million; however, it did not have a lower O&M impact or greater savings projection. This represents a far cry from the scenario that FPL asked the Commission to accept when it gave its blessing to the investment.

OPC witness Ramas recommended that the Commission address this severe imbalance by holding FPL to the projected savings benefits that the Commission accepted in approving the investment and program in the last rate case. Despite the criticisms of the Company, the proposed adjustment is fair given the level of savings that the Company will receive in the years immediately after rates are set. Ms. Ramas correctly characterized the FPL approach, in which customers pay for all of the investment in rates, get no savings, and then FPL reaps the benefits immediately after rates are set, as "grossly unfair." (TR 2777-2778, 2804-2805) This unfairness can be ameliorated in part by the approach recommended by OPC.

OPC witness Ramas directed the Commission to view an estimate of the total financial impact of FPL's smart meter program on its customer rates. She presented a close approximation of the revenue requirements of the capital cost impact of the smart meter program in this case:

1	AMI Meter Plant in Service	$ 554,587,000
2	AMI Meter Accumulated Depreciation	$ (77,097,000)
3	Net Plant in Service	$ 477,490,000
4	Rate of Return, per FPL	7.0%
5	Required Return (3 x 4)	$ 33,424,300
6	Depreciation	$ 28,670,000
7	Income tax effect (6 x -.38575)	$ (11,059,453)
8	Interest Synch [(3) x 1.71% x (-.38575)]	$ (3,149,679)
9	Total NOI Requirements	$ 47,885,168
10	NOI Multiplier	1.6319
11	Revenue Requirement (9 x 10)	$ 78,143,806

(TR 2773-2774)

OPC witness Ramas pointed out that the impact does not include the $3.9 million of net O&M costs included in the filing for smart meters. Ms. Ramas also pointed out at the hearing that FPL's correction, which increases the net plant-in-service balance in the test year for the AMI project, increases the revenue requirement impact by an additional $1 million. (TR 2754)

In the 2009-2010 rate case, FPL projected $30.4 million in savings and $10.4 million in expenses for smart meters, resulting in net savings of $20 million for 2013. (TR 2774)

In discovery in this case, FPL was asked to provide an updated version of the table appearing on page 95 of Commission Order PSC-10-0153-FOF-EI (OPC's 9th Set of Interrogatories, No. 173, EXH 75). (TR 2775) This interrogatory requested that FPL include the amounts incorporated in the Company's filing in this case on the updated table. Predictably, the projected net savings of $19.9 million for 2013 had vanished and the impact is now projected to be a net cost of $3,744,000, or a $23.7 million swing to the detriment of customers. This is on top of the revenue requirement impact of over $79 million associated with the AMI rate base.

Not surprisingly, FPL shows significant net savings in the years immediately <u>after</u> the test year – savings that shareholders would be able to pocket immediately. In her testimony, OPC witness Ramas shows that FPL projects *<u>net O&M cost savings of $12.9 million in 2014 and $27.6 million in 2015.</u>* The response shows that the projected O&M costs will decline from the $20.4 million incorporated in the filing for 2013 to $13.6 million by 2015. The annual O&M

savings are projected to increase from the $16.5 million of savings incorporated in the filing for 2013 to $41.2 million by 2015. Thus, while FPL has projected a net O&M cost of $3.9 million in the test year, it is projecting annual net O&M savings of $27.6 million by 2015. (TR 2777)

FPL hopes to score a trifecta between the two rate cases. Not only does the Company's proposal allow FPL to recover nearly all of its capital costs, but the projected cost savings are also kept out of the test year so that shareholders can reap the windfall in the out-years. This will result unless the Commission adopts the common-sense adjustment proposed by OPC witness Ramas.

Thus, the OPC recommends that the Commission adopt the specific proposal advanced by OPC witness Ramas. For purposes of setting base rates, FPL should be held to the net O&M savings projection for 2013 identified in Commission Order No. PSC-10-0153-FOF-EI (at pp. 95-96). This would result in net O&M savings of $19,943,000, which is still less than the full annual net cost savings that FPL projects will ultimately result from the smart meter implementation.

<u>ISSUE 114</u>: Is FPL's requested level of O&M Expense of $1,542,322,000 ($1,568,633,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of O&M Expense should be $1,398,494,000 on a jurisdictional basis. This reflects a decrease of $143,828,000.

<u>ISSUE 116</u>: Is FPL's requested amortization of $191,000,000 the appropriate amount of the theoretical depreciation reserve surplus to be amortized for the 2013 projected test year?

No. Amortization of the theoretical depreciation reserve surplus in the test year should be increased by a net amount of $40,550,000 (jurisdictional) as shown on Exhibit HWS-10, to account for appropriate adjustments to 2012 projected revenue requirements. Adjustments to the employee complement (with corresponding benefits and payroll taxes adjustments), tree trimming, pole inspections and uncollectibles reduce the needed amortization of the surplus in 2012 with a corresponding increase to the remaining amount available for 2013.

ARGUMENT:

FPL has proposed to record an estimated amount of depreciation surplus amortization in the test year in fulfillment of its obligation under the prior rate case and stipulation orders (Order No. PSC-11-0089-S-EI; Order No. PSC-10-0153-FOF-EI). While this is all well and good, FPL has proposed to record $191 million in the test year assuming that approximately $526 million of amortization is used in 2012. FPL takes the position that this is the amount they forecast and that their forecast is so good that the Commission and intervenors should not question whether they will be able to use $526 million in 2012 and that there should be no question as to the correctness of the $191 million estimate for 2013. (TR 3596)

There are at least two problems with this approach as pointed out in the testimony of OPC witness Schultz. First, the amount included for amortization in 2013 is an estimate based on the projected cost of service for 2012. FPL estimated that $525.529 million of the ordered $894 million reserve surplus amortization (credit) would be utilized in 2012. OPC witness Schultz observed that the amount for 2012 is not known and measurable, and is subject to change based on changes in facts and/or assumptions that were employed in the forecasting of rate base, revenues, and expenses for 2012. His prediction was vindicated when FPL witness Barrett conceded that the forecast now shows that the amount of surplus that would be used in 2012 is approximately $506 million instead of the original $526 million amount. (TR 1212-1213; EXH 109, pp. 16-22) Accordingly, an additional $20 million of surplus should be used to reduce revenue requirements in 2013.

Mr. Schultz also testified that the Company's proposed amortization of the surplus in 2012 is overstated because FPL has overstated expenses due to the same factors that led to the need to make adjustments in 2013. The overestimated areas are payroll, tree trimming, pole inspections, uncollectible expense, employee benefits, and payroll taxes. In addition, Mr. Schultz described the basis for the 2012 payroll adjustment, which reduced 2012 payroll expense by $27.517 million on a jurisdictional basis. He testified that he calculated the adjustment in the same way he did for the 2013 projected test year, except that he used the 2012 Company estimated costs and employee counts. Additionally, since he did not adjust the employee incentive compensation for 2012, he left those incentive costs from the payroll dollars in the amount to reduce expense when he calculated the average cost per employee.

Applying these adjustments on the same basis for 2012 for the 2012 account balances decreases the amount of depreciation amortization in 2012 by $53.808 million. (TR 2670; EXH 267) As a result, the depreciation reserve surplus applied as a reduction to cost of service in 2013 should be increased by $40.55 million from $190.918 million, thus resulting in a reduction of $231.468 million. Id. The net amortization adjustment to 2013 is reduced by $13 million due to the 2011 amortization actual being $13 million greater than originally estimated at the time the filing was prepared. As noted above, the total adjustment to the 2013 amortization credit would be $60.55 million ($40.55 per Mr. Schultz' adjustments plus the additional amount available due to the Company's reduced need for surplus depreciation reserve amortization in 2012).

This adjustment to reduce 2012 expense also reduces rate base by $20.275 million, or one-half of the additional credit not required in 2012 due to OPC witness Schultz' proposed adjustments. Consistent with his methodology for determining the rate base effect of the corresponding expense adjustment, the additional $20 million in reduced amortization need for 2012 yields a reduction in rate base of $10 million. The total reduction to test year rate base for this issue is $30.275 million.

Predictably, FPL takes issue with the adjustments to be made in 2013 and those same or corresponding proposed adjustments in 2012; however, FPL recognizes that these adjustments follow the Commission's determination of their test year impact. (EXH 109, pp. 26-27) OPC recommends that the expense and rate base adjustments proposed by Mr. Schultz for 2012 be made in accordance with the Commission's treatment of the same items in 2013.

<u>ISSUE 117</u>: Given that in Order No. PSC-11-0089-S-EI the Commission directed FPL to complete the amortization of $894 million of depreciation surplus during the period 2010-2013, and in light of the Commission's decision regarding the amount of remaining reserve surplus to be amortized in the 2013 test year in conjunction with the resolution of Issue 116, should the Commission direct FPL to discontinue recording amortization of reserve surplus on its books after 2013 unless authorized or directed by subsequent Commission order?

Yes. The Commission prescribed this amortization to correct a severe intergenerational inequity. Resulting rate base is no higher than if FPL had collected plant costs on the appropriate schedule all along. Customers should benefit through lower rates whenever a surplus is reversed. Going forward, the situation should revert to the normal interplay (rate base, return, expenses) unless and until the Commission orders FPL to return reserve surplus to customers in a future base rate proceeding.

ARGUMENT:

FPL criticized the Commission's decision in the 2010 rate case to require FPL to amortize $894 million of depreciation reserve surplus as a temporary means of reducing rates, and pointed to the related increase in rate base as a "driver" of the pending rate case. (TR 1159) Through a series of such long-distance (from the last rate case) "potshots," FPL mischaracterized the Commission's action. The goal of depreciation accounting is to collect the cost of plant, through annual depreciation expense, over the lives of the related assets, so that each generation of customers pays equitably for the plant that serves it. This is called the "matching principle." (TR 2512) As a result of, among other things, FPL's aggressively *accelerated* depreciation practices in the 1990s, FPL overcollected depreciation expense to the extent that the imbalance between its actual book depreciation reserve and the much smaller reserve it should have accumulated created a severe intergenerational inequity. Even provisions in two settlements that required FPL to return $1 billion of depreciation reserve surplus to customers ($125 million per year over the terms of the settlement agreements) (TR 2513) were inadequate to reduce FPL's huge reserve imbalance materially. The Commission concluded in FPL's last consolidated depreciation/rate case that FPL had a depreciation reserve surplus of $1.2 billion. To achieve intergenerational fairness, in its 2010 order the Commission required FPL to return $894 million of depreciation reserve surplus over four years instead of the 18-year remaining lives of the related assets. The quicker return was needed to ensure that many of the customers who overpaid in prior years also received the benefit of the reversal. FPL points to the fact that the effect of reversing past entries to the depreciation reserve is to increase rate base. However, FPL fails to mention that the rate base resulting from the four-year amortization will be no higher than it would have been had FPL been applying depreciation rates that would have collected the appropriate amount of depreciation expense along the way. (TR 2515)

Nor does the increased rate base attributable to the corrective action constitute a "driver" of FPL's base rate request. FPL's revenue requirements are a function of many variables, of which the amortization of reserve surplus is one. As OPC witness Ramas demonstrates, when all factors – including the impact of the amortization on rate base – are considered, FPL has too many revenues for the test year rather than too few.

FPL's allusions to the non-cash nature of earnings stemming from amortization of reserve surplus do not support its claim of prejudice. In its April 2012 report (EXH 636), Moody's commented not only on the adequacy of FPL's current 10% authorized ROE, but also on the fact that FPL's cash flow metrics are well above the level needed to maintain its "A" rating.

After the Commission establishes the amount of depreciation reserve surplus that FPL should amortize in 2013, it should direct FPL to record no further amortization in 2014, and subsequent years, unless and until such amortization is ordered in a future rate case. As the 2010 settlement agreement will have terminated, FPL should revert to the normal interaction of expenses, return, and revenues. A specific instruction to this effect by the Commission will avoid any ambiguity that could fuel differing interpretations in the future. (TR 2523-2526)

<u>ISSUE 118</u>: Is FPL's requested level of Depreciation and Amortization Expense of $802,761,000 ($819,794,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of Depreciation and Amortization Expense is $762,211,000 (jurisdictional), which reflects a decrease of $40,550,000 in Surplus Depreciation Reserve Amortization addressed in Issue 116.

<u>ISSUE 119</u>: Is FPL's requested level of Taxes Other Than Income of $371,710,000 ($378,853,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of Taxes Other Than Income should be $370,133,000 on a jurisdictional basis. To correspond with OPC witness Schultz' adjustment to payroll in Issue 102, Payroll Tax Expense should be reduced by $1,577,000 ($1,601,000 system).

<u>ISSUE 120</u>: Should the Commission adjust FPL's test year current state income taxes or rate base to recognize benefits, if any, that FPL has provided, or will provide, to any affiliates in furtherance of the affiliate's ability to elect to apportion adjusted Federal income tax under s.220.153, Florida Statutes (single sales factor)?

Yes. To the extent that FPL or its affiliates have utilized any items projected for inclusion in the rate base in order to qualify affiliate profits for a reduction in state income taxes, the Commission should reduce rate base accordingly or impose an appropriate adjustment (reduction) to FPL's income tax expense.

ARGUMENT:

The crux of this issue is that FPL's parent, NEE, theoretically has the ability to lower its state income taxes based on meeting a minimum investment and employment presence in Florida that entitles it to be taxed based solely on its sales inside the state. (Sections 220.153(2) and 220.15(5), Florida Statutes (2012)). The benefit under this statute inures to a company with a substantial investment and employment presence in Florida, but with little or no sales inside the state.

OPC raised this issue well in advance of rebuttal testimony. FPL provided no testimony on the issue and essentially refused to respond to questions on this subject – including during the hearing — as shown in the Company's position in the Prehearing Order (at p. 134). One would have thought that if there was not an improper future transfer of customer funded benefits or the foundation for non-regulated tax benefits, FPL would have gladly provided all the information needed to dispel any concern.

Even so, the apparent lack of transparency in this affiliated arena can still be addressed in ratemaking if in the future it is revealed that Florida ratepayers funded benefits to the non-regulated operations of FPL's affiliates. OPC believes that the only way NEE can achieve the tax benefit will be by taking credit for the threshold amount of a $250 million in investment in the state of Florida over a two-year period (required for eligibility to utilize the single-sales factor for determining taxable income). FPL would utilize its rate base, or at least the assets that are required to provide service to customers regardless of whether or not these assets are allocated based on a separations factor. (See generally, Section 220.153, Florida Statutes.)

FPL witness Ousdahl – the Company's Controller and Chief Accounting Officer – testified that FPL does not participate in a consolidated income tax return (TR 1079-1080) with NEE and that FPL is <u>the</u> taxpayer. The actual testimony was that FPL files a separate return. (TR 1079) There was further testimony that FPL "prepare[s] our cost of service, including our tax obligation, on a stand alone basis as though FPL were operating alone." (TR 1080) This could suggest that perhaps the tax obligation (statutory tax rate) for ratemaking is determined on a standalone basis while FPL participates in a consolidated tax return with NEE. This possible inconsistency can be addressed in a future proceeding when the actual investment and taxes are recognized on a return filed with the state. FPL witness Ousdahl was perhaps a bit glib when she said that she could not testify that NEE does not utilize FPL's regulated rate base in order to receive any tax benefits under the provision of Section 220.153, Florida Statutes. In her role as the designated FPL witness on this issue, she claimed that it [what NEE used for tax benefits] was irrelevant to this proceeding. (TR 1080)

OPC recommends that FPL be held accountable for the representations made at hearing and that if the future reveals that Florida ratepayers are paying a return on investments that are or that will be used by NEE or any other affiliate of FPL to pay lower Florida state income taxes on sales made outside Florida, then the Commission should reserve its ability to make appropriate adjustments, whether as an adjustment in the affiliated transaction area or as a reduction (apportionment) in rate base used for the affiliated benefit.

<u>ISSUE 121</u>: Is FPL's requested level of Income Taxes of $513,276,000 ($528,838,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

No. Income tax expense should be $567,106,000 on a jurisdictional basis.

<u>ISSUE 123</u>: Is FPL's requested level of Total Operating Expenses of $3,250,894,000 ($3,317,404,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of Total Operating Expenses should be $3,118,769,000 (jurisdictional).

<u>ISSUE 124</u>: Is FPL's projected Net Operating Income of $1,156,359,000 ($1,187,603,000 system) for the 2013 projected test year appropriate? (Fallout Issue)

The appropriate amount of Net Operating Income should be $1,288,484,000 (jurisdictional).

<u>REVENUE REQUIREMENTS</u>

<u>ISSUE 125</u>: What are the appropriate revenue expansion factor and the appropriate net operating income multiplier, including the appropriate elements and rates for FPL?

The appropriate NOI multiplier should be 1.63188.

<u>ISSUE 126</u>: Is FPL's requested annual operating revenue increase of $516,521,000 for the 2013 projected test year appropriate? (Fallout Issue)

*No. Based on OPC's primary recommendation, annual operating revenues should be *decreased* by $253,446,000. Based on OPC's alternative recommendation, annual operating revenues should be *decreased* by $184,396,000. If all of OPC's adjustments and positions — including the revenue decrease – are adopted, and even if FPL's changes to OPC's cash flow metric calculations are made, FPL will continue to exhibit strong, "A" rating-worthy cash flow metrics and financial integrity.*

ARGUMENT:

OPC witness Ramas incorporated all of OPC's adjustments to cost of capital and operating expenses into her calculation of FPL's net "deficiency" (additional revenue need) or "sufficiency" (excessive revenues at current rates). Her schedules demonstrate that, if the Commission accepts all of OPC's adjustments, it should reduce FPL's current rates by either $253.4 million annually (if it adopts a 50% equity ratio and a 9% ROE midpoint) or, alternatively, by $184.4 million annually (if it maintains FPL's 59.62% equity ratio for ratemaking purposes and sets the ROE at 8.5%). (EXH 270, 272) With these adjustments, FPL will continue to exhibit cash flow metrics and a debt to capitalization value that will qualify for its current "A" rating by Moody's and S&P.

Cash flow metrics – When gauging a utility's creditworthiness, Moody's and S&P measure the utility's cash flow relative to its total debt.[18] OPC witness Dan Lawton applied the cash flow criteria that Moody's and S&P employ when rating a utility's financial status to the results shown on OPC witness Ramas' schedules. In both of OPC's recommended scenarios, OPC witness Lawton concluded that, after applying all of OPC's adjustments, FPL would continue to exhibit cash flow metrics that fall within the rating agencies' established criteria, expressed as a range of values, for an "A" rated utility. (EXH 277) For Moody's, this means the criteria and ranges contained in its "Ratings Methodology" document, identified as Exhibit 638, which the Commission explicitly applied in Order No. PSC-10-0153-FOF-EI, at p. 86. After modifying OPC witness Lawton's original schedule to account for a minor calculation error that FPL identified in rebuttal testimony to add short-term debt to the inputs to the calculation, and even to give effect to the S&P "imputed debt" adjustment for power purchase contracts, the financial profile and cash flow metrics resulting from OPC's primary recommendation *continue to satisfy* the "A" rated cash flow criteria established by Moody's and S&P for the utility industry. (EXH 452) (OPC disputes the S&P "imputed debt" adjustment for reasons stated elsewhere in this Brief. However, it is noteworthy that after making the adjustment, the resulting ratios still satisfy S&P's "A" ranges. The adjustment is not applicable to Moody's appraisal in any event.)

It is important to bear in mind the nature of the scenarios to which Mr. Lawton applied the criteria. OPC's primary recommendation is to *reduce FPL's current annual revenues* by $275.9 million. The alternative recommendation *would reduce FPL's current annual revenues* by $205.7 million. At these reduced revenue levels, and after incorporating FPL's minor adjustments to OPC witness Lawton's "primary recommendation" scenario, FPL would continue to satisfy the cash flow requirements of an "A" rating. Without abandoning its position that the

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[18] For an "A" rating, S&P measures whether the relationship of "funds from operations to debt" falls within a range of 20-45% and whether "debt divided by earnings before interest, taxes, depreciation and amortization" falls within a range of 2.0X to 4.0X, while Moody's employs "cash flow from operations divided by debt" in a range of 22%-30% and "cash flow from operations divided by interest" in a arrange of 4.5X to 6.0X. FPL witness Dewhurst's EXH 452 reflects that, after his correction and other modifications to OPC witness Lawton's corresponding EXH 277, FPL's resulting cash flow metrics still fall within these ranges.

Commission should reduce FPL's rates, OPC observes that injecting either $275 million or $205 million of annual revenues into Mr. Lawton's calculations of cash flow wherewithal – hefty infusions of cash that correspond merely to increasing assumed revenues *back to the level of FPL's existing rates* – would significantly strengthen the already adequate cash flow metrics.

In his rebuttal testimony, FPL witness Dewhurst contended that the cash flow values resulting from OPC's primary recommendation would not satisfy a new set of "FPL-specific" limitations on FPL's ability to maintain its "A" rating that Moody's described in a report dated April 10, 2012. In that report (in which Moody's also described the 10% authorized return on equity as "still adequate"), Moody's said that a downgrade "would be considered" for FPL if the cash flow to debt ratio were to fall below 25% and cash flow from operations to interest would decline to below 5.0X. Moody's did not explain why it would assign new, limiting values for FPL that terminate in the *midrange* of the established criteria applicable to utilities generally. Further, in its April 2012 report, Moody's described FPL's performance as well above the level needed to maintain its current rating: "FPL continues to exhibit some of the stronger financial performance measures and cash flow coverage ratios in the industry, with ratios that are generally well above the parameters required for its rating under our Regulated Electric and Gas Utilities rating methodology. These include CFO pre-working capital interest coverage in the 6.0x to 8.0x range and CFO pre-working capital to debt in the 30% to 35% range in recent years." (EXH 636, at p. 2) Most tellingly of all, in June 2012 Moody's published a report on NEE in which it devoted a section to FPL. In the portion that described FPL, Moody's referred again to the general utility criteria of Moody's Rating Methodology — without mentioning any intervening, conflicting, more limiting, FPL-specific standards: "FPL continues to exhibit some of the stronger financial performance measures and cash flow coverage ratios in the industry, with ratios that are generally well above the parameters required for its rating under our Regulated Electric and Gas Utilities rating methodology." (EXH 637, at p. 4) In the last rate case, the Commission correctly applied the standards of Moody's "Ratings Methodology" to FPL. (See Order No. PSC-10-0153-FOF-EI at page 86) The Commission should ignore a transient, internally inconsistent reference to the inexplicably more confining views in the April 2012 Moody's document. Finally, as OPC demonstrated during the cross-examination of FPL witness Dewhurst, the financial metrics that result from OPC's alternative recommendation of an 8.5% ROE with a 59.62% equity ratio, and $184 million of reduced revenues satisfy even the curiously truncated ranges of the suspect "A" criteria of Moody's April 2012 document![19] (TR 4864; EXH 277)

Debt to capitalization metrics – In addition to the above measurements of the adequacy of cash flow to service debt obligations, Moody's and S&P employ a metric called "debt to capitalization." At first blush, it would appear that OPC's recommended equity ratio of 50% (implying a "flip" ratio of debt at 50%) would violate Moody's debt to capitalization target range of 35% to 45%. However, a closer examination demonstrates that the debt to capitalization metric is not the "flip" of the equity ratio terminology that OPC and other parties have employed liberally in this proceeding. For instance, a Moody's document recites that FPL's current debt to capitalization ratio is 33.8%. (EXH 637) We know that the "flip" of FPL's current 59.62% equity ratio is 40.38% debt – which clearly does not correspond to the "debt to capitalization" figure of 33.8%.

Obviously, the "debt to capitalization" metric employed by Moody's does not line up with equity ratio values. The definition of "debt to capitalization" in Moody's Ratings Methodology document dispels the seeming discrepancy. It establishes that Moody's makes numerous technical adjustments to a utility's accounting and financial data when deriving its debt to capitalization value:

> The denominator of the debt/capitalization ratio includes Moody's standard adjustments, the most important of which for some utilities is the inclusion of deferred taxes in capitalization, which tempers the impact of our debt adjustment.

(EXH 638, at p. 12)

> Debt/Capitalization: (Total debt + operating lease adjustment + under-funded pension liabilities + basket-adjusted hybrids + securitizations + guarantees + other debt-like items)/ (Shareholders' equity + minority interest + deferred taxes + goodwill write-off reserve + Total debt + operating lease adjustment + under=funded pension liabilities + basket=adjusted hybrids + securitizations + guarantees + other debt-like items) or RAV

[19] The changes that Mr. Dewhurst made to Mr. Lawton's exhibit displaying OPC's primary position of 50% equity ratio and 9% ROE — with one of which (the S&P adjustment to power purchase obligations) OPC philosophically disagrees — did not alter the result that OPC-related metrics satisfy "A" rating criteria. While Mr. Dewhurst affected to be unconcerned by Mr. Lawton's exhibits, these are two of the most pivotal documents that the Commission received in evidence. Each demonstrates that FPL could reduce its existing rates and continue to qualify for an "A" rating.

(EXH 638, Appendix D, at p. 25)

To translate Moody's debt to capitalization ratio to the rate case's "equity ratio" frame of reference, a simple calculation based on ratios, using data that are in the record of this docket, is in order. Using the relationship between FPL's current (33.8%) and Moody's maximum (45%) debt to capitalization values to which Moody's refers as a reference, one can approximate the upper bounds (for "A" rating purposes) of the "flip" level of debt associated with the equity ratio that corresponds to the limits of Moody's "A" rating debt-to-capitalization ratio (33.8% current debt/capitalization is to 45% maximum debt/capitalization as 40.38% debt implicit in the current equity ratio is to X). The answer places the value in the low fifties – which would accommodate either OPC's primary equity ratio position (50%) or its alternative position (FPL's current capital structure) within the "A" range.

BASE RATE STEP ADJUSTMENT

ISSUE 128: Should the Commission approve a base rate step adjustment for the Canaveral Modernization Project?

FPL has the burden of demonstrating that the Canaveral Modernization Project should result in a rate increase. In any event, any such rate increase should be no greater than $120,588,000 based on the OPC primary recommendation using a 50% equity capital structure and 8.5% ROE and other adjustments shown in the testimony of OPC witness Ramas and EXH 269, Schedule DR-3.

ARGUMENT:

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 on 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 step increase, just as a new revenue source or increased savings from smart meter installation 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 step increase would instead increase rates by 100% of the new unit's revenue requirements. This means, necessarily, that at any time when base rates could absorb a portion of the costs, the step increase will result in total bills higher than necessary to yield a fair return on FPL's investment. FPL has not met the burden in this case to show that its current earnings will be insufficient to absorb the cost (or a portion thereof) of the Canaveral project.

If the Commission does approve the step increase, the rate increase should be no greater than $121,486,000 based on the OPC primary recommendation using a 50% equity capital structure, an 8.5% ROE, and other adjustments shown in the testimony of OPC witness Ramas and on EXH 271, Schedule DR-3. (See Issues 129-134; EXH 271, 273)

<u>ISSUE 129</u>: Should deferred taxes be included in the capital structure rather than as a reduction to rate base for the Canaveral Modernization Project base rate step adjustment?

In order to reflect the full impact on revenue requirements associated with the deferred income taxes that will result from the Canaveral Modernization Project, the Canaveral Modernization Project deferred income taxes should be reflected as a reduction to rate base for the step adjustment. This is consistent with the approach taken by both FPL and OPC in their Canaveral Step Increase calculations.

ARGUMENT:

OPC witness Ramas used the same methodology used by FPL to reduce rate base by the amount of the deferred income taxes associated with the Canaveral project. (EXH 271, 273) This approach will reflect the full impact of the tax benefits in the post-test year step increase revenue requirement when using the 13-month average cost of capital for the 2013 test year.

<u>ISSUE 130</u>: Is FPL's requested rate base of $821,325,000 ($837,297,000 system) for the Canaveral Modernization Project appropriate?

No. Canaveral Modernization Project rate base should be $811,822,000 ($827,515,000 system). Rate base should be reduced by $9,606,000 ($9,782,000 system) to reflect updated projections filed by FPL.

ARGUMENT:

OPC witness Ramas recommended that the projected amount of rate base associated with the project be updated based on more recent forecasts. FPL updated its projected construction costs related to Other Production, which was $10,360,000 lower than the amount in the original filing. This update also impacted the accumulated depreciation, depreciation expense, and accumulated deferred income taxes. Additionally, FPL changed its jurisdictional factors in the Canaveral step increase calculations from those used in its 2013 test year rate base. With no further explanation from FPL, Ms. Ramas used the factors from the 2013 test year amounts. Ms. Ramas' adjustments reflect a reduction to rate base of $9,606,000 jurisdictional ($9,782,000 system) as shown in Exhibit DR-3, Schedules B-1 and B-2. (TR 2794-2795, EXH 271)

FPL witness Ousdahl also has reflected reductions to rate base in similar but not identical amounts in her Late-filed Exhibit 1, which is attached to her deposition. (EXH 110, Late-filed EXH 1) Ms. Ousdahl did not rebut Ms. Ramas' position on this issue, other than a description in Item No. 18 of Exhibit KO-16, which reflected a $1.8 million revenue decrease for a change in plant and deferred income taxes related to the Canaveral step increase. (EXH 399) While Ms. Ousdahl updated the components that made up the $1.8 million decrease in the revenue requirement, she did not rebut or explain why the jurisdictional factors were changed. Based on this information, OPC believes that Ms. Ramas' adjustments should be made, and Ms. Ousdahl's should not.

ISSUE 131: What is the appropriate weighted average cost of capital, including the proper components, amounts and cost rates associated with the capital structure, to calculate the base rate step adjustment for the Canaveral Modernization Project?

The Commission should use the same overall weighted average cost of capital to set base rates as reflected in Issue 61 of 5.45% using OPC's primary recommendation or 5.52% under OPC's alternative capital structure. If the Commission determines in Issue 129 that deferred taxes associated with the project should be included in the capital structure, then the capital structure should be revised to add the deferred taxes associated with the Canaveral Modernization Project.

ARGUMENT:

OPC witness Ramas testified that the rate of return the Commission should apply to the Canaveral project rate base should be based on OPC's overall recommended rate of return. FPL's requested 9.06% incremental cost of capital used a hypothetical capital structure which included only long-term debt and equity, with an even higher equity ratio than FPL requested in the 2013 test year. Further, FPL's requested higher equity ratio increases the amount of income tax expense that ratepayers would have to pay for this project above what would be charged if the overall cost of capital were used by the Commission. The Commission has based prior approved step increases for major capital projects on the authorized overall rate of return found to be appropriate for determining the change to base rates in a rate case proceeding.[20] (TR 2792-2794, 2797)

FPL witness Ousdahl also admitted in her deposition that the Commission's practice has always been to use a 13-month average embedded cost basis for calculating revenue requirements. (EXH 110, pp. 19-20) Further, her lengthy attempt to explain the inconsistency between her testimony that the capital structure should be reconciled to rate base because funds cannot be traced, with her testimony that it is appropriate in this certain instance to use an incremental capital structure is insufficient and unreasonable. (EXH 110, pp. 25-28) Just because Ms. Ousdahl stated that FPL's adjustments to remove the incremental costs from the rate base calculation were consistent with how the adjustments were included in the step increase, it does not demonstrate that this treatment is consistent with prior Commission practice and reasonable to calculate the step increase. (TR 3788) FPL's incremental cost of capital clearly results in an overstatement of the revenue requirement calculation, is inconsistent with Commission practice, and should be rejected. OPC recommends that, if approved, the overall cost of capital for the step increase should be 5.45% using OPC's primary recommendation. If the Commission approves OPC's alternative capital structure, a 5.52% rate of return is appropriate. Additionally, if the Commission determines that deferred taxes associated with the project should not be reflected as a reduction to rate base, the capital structure should be revised to include those deferred taxes.

<u>ISSUE 132</u>: Is FPL's requested net operating loss of $32,092,000 ($32,712,000 system) for the Canaveral Modernization Project appropriate?

No. The appropriate net operating loss should be $29,649,000.

ARGUMENT:

OPC witness Ramas recommended that adjustments should be made to depreciation and amortization expense, property taxes, and income taxes associated with the updated Canaveral projected plant costs addressed in Issue 130. On a system basis, FPL's depreciation and amortization expense should be reduced by $335,000 ($341,000 system) and property taxes

[20] See Order No. PSC-12-0179-FOF-EI, issued April 3, 2012, in Docket No. 110138-EI, In re: Petition for increase in rates by Gulf Power Company; and Order No. PSC-09-0283-FOF-EI, issued April 30, 2009, in Docket No.080317-EI, In re: Petition for rate increase by Tampa Electric Company.

reduced by $211,000 ($215,000 system) from the amounts originally filed as reflected on OPC witness Ramas' Exhibit DR-3, Schedule C-2. (TR 2794-2795, EXH 271) Ms. Ramas also testified that start-up costs of $816,000 ($831,000 system) are one-time, non-recurring charges and should be removed from base rates. (TR 2796-2797, EXH 271 [DR-3, Schedule C-1], EXH 44 [Staff Interrogatory 290], EXH 76 [OPC Interrogatory 206]) OPC witness Ramas also made an adjustment in her exhibits to reflect the fall-out impact of income tax expense, but her adjustment should be updated to reflect the Commission-approved capital structure and cost of debt. OPC's recommended adjustment to income tax expense should be a decrease of $1,081,000 ($1,347,000 system). The above adjustments reflect Ms. Ramas' use of FPL's jurisdictional separation factors for its 2013 test year revenue requirement instead of those revised factors that FPL used in its Canaveral calculations. (TR 2795-2796)

FPL witness Ousdahl did not rebut Ms. Ramas' adjustment to remove the non-recurring start up costs or explain why FPL changed the jurisdictional factors. Ms. Ousdahl did provide a $1.8 million revenue decrease adjustment for the updated Canaveral project plant as described in Item No. 18 of Exhibit KO-16 (EXH 399) While Ms. Ousdahl updated the components that made up the $1.8 million decrease in the revenue requirement as a late-filed exhibit to her deposition, she did not reflect which jurisdictional factors were used, nor did she make an adjustment to remove the non-recurring start up costs. (EXH 110, LFE 1) Based on this information, OPC believes that the record supports that Ms. Ramas' adjustments should be made.

<u>ISSUE 133</u>: Is FPL's requested Net Operating Income Multiplier of 1.63188 for the Canaveral Modernization Project appropriate?

Yes.

<u>ISSUE 134</u>: Is FPL's requested base rate step increase of $173,851,000 for the Canaveral Modernization Project appropriate?

No. FPL has the burden of demonstrating that any revenue requirement associated with the Canaveral Modernization Project should result in increased rates. If the Commission determines that FPL has nevertheless met this burden, any such rate increase should be no greater than $121,486,000 based on the OPC primary recommendation using a 50% equity capital structure and 9% ROE and other adjustments shown in the testimony of OPC witness Ramas and Exhibit 271.

ISSUE 193: Should this docket be closed?
* No.*

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 $253.4 million annually, effective January 1, 2013. Any step increase associated with the commercial in-service date of the Canaveral Project should not exceed $121.4 million.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and foregoing **CITIZENS' POST-HEARING STATEMENT OF POSITIONS AND POST-HEARING BRIEF** has been furnished by U.S. Mail and/or electronic mail on this 21st day of September, 2012, to the following:

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