BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company	)	Docket No. 120015-EI
	)	Filed: November 2, 2012

DIRECT TESTIMONY

OF

JACOB POUS

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

IN RESPONSE TO PUBLIC SERVICE COMMISSION

ORDER NO. PSC-12-0529-PCO-EI

J. R. Kelly
Public Counsel

Joseph A. McGlothlin
Associate Public Counsel
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400
(850) 488-9330

Attorneys for the Citizens
of the State of Florida

DIRECT TESTIMONY

OF

Jacob Pous

On Behalf of the Office of Public Counsel

In Response To

Order No. PSC-12-0529-PCO-EI

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. WHAT IS YOUR OCCUPATION?

A. I am a principal in the firm of Diversified Utility Consultants, Inc. ("DUCI"). A copy of my qualifications appears as Appendix A to my direct testimony filed on July 2, 2012 as part of this proceeding.

Q. PLEASE DESCRIBE DIVERSIFIED UTILITY CONSULTANTS, INC.

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

support to clients in electric, gas, telephone, water, sewer, and cable utility matters.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN PUBLIC UTILITY PROCEEDINGS?

A. Yes. The aforementioned Appendix A also includes a list of proceedings in which I have previously presented testimony. In addition, I have been involved in numerous utility rate proceedings that resulted in settlements before testimony was filed. In total, I have participated in well over 400 utility rate proceedings in the United States and Canada. I have also testified on behalf of the staff of 5 different state regulatory commissions and one Canadian regulator.

Q. WHAT IS YOUR PROFESSIONAL BACKGROUND?

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

Q. DID YOU TESTIFY ON BEHALF OF THE OFFICE OF PUBLIC COUNSEL (OPC) DURING THE HEARING ON FLORIDA POWER & LIGHT'S (FPL)'S MARCH 19, 2012 PETITION?

A. Yes. In my earlier testimony in this docket, I responded to criticisms and mischaracterizations of the Commission's decision in Docket No. 080677-EI (FPL's last base rate case) to require FPL to amortize $894 million of depreciation reserve surplus over 4 years. I also expressed my view that the Commission should order FPL to cease recording amortization of depreciation

reserve surplus after FPL complies with the requirement to complete the amortization of that amount of depreciation reserve surplus by the end of 2013, unless and until the Commission directs it to amortize any other surplus reserve in the context of a future base rate proceeding.

Q. WHAT IS THE PURPOSE OF YOUR ADDITIONAL TESTIMONY?

A. On August 15, 2012, FPL, SFHHA, FIPUG, and FEA submitted a document captioned "Stipulation and Settlement," referred to herein as the "August 15 document," and a joint motion asking the Commission to approve their August 15 document as the disposition of FPL's pending base rate request. I have been informed by OPC counsel that OPC disputes the legal validity of the August 15 document, and that, among other things, OPC has challenged that document on legal grounds before the Florida Supreme Court. In Order No. PSC-12-0529-PCO-EI, the Commission Chairman identified several components of the August 15 document that were not within the scope of FPL's March 19, 2012 petition as the subjects of an evidentiary hearing scheduled for November 19 through 21, 2012. Two of the issues that the Chairman identified are the proposal to authorize FPL to amortize some $209 million of fossil dismantlement reserve over the four-year term of the August 15 document to allow FPL to manage its earned return, and the postponement of depreciation and dismantlement studies now due in March 2013 until after the end of the four-year term of the August 15 document. Inasmuch as OPC's legal challenges to the validity of the purported settlement are

still pending, I have been asked by OPC to address those issues, and the related testimony of FPL witness Barrett and others.

Q. WHAT STANDARD SHOULD THE COMMISSION RELY UPON WHEN DETERMINING WHETHER TO ACCEPT THE PSA AS IT RELATES TO THE ISSUES YOU WILL ADDRESS?

A. In my opinion, the standard is clear. Chapter 366, Florida Statutes, dictates that rates for public utilities shall be fair, just, and reasonable (Sections 366.03, 366.041, 366.05, 366.06, and 366.07, F.S.). My testimony will demonstrate that permitting FPL to amortize $209 million of fossil dismantlement reserves and the postponement of the scheduled depreciation and dismantlement studies for several years will not result in fair, just, and reasonable rates.

Q. PLEASE SUMMARIZE YOUR TESTIMONY REGARDING THE PROPOSAL TO AUTHORIZE FPL TO AMORTIZE $209 MILLION OF FOSSIL DISMANTLEMENT RESERVE.

A. The purpose and mechanics of the accounting for fossil dismantlement expense are identical to the purpose and mechanics of the accounting for depreciation expense. Unlike the Commission's treatment of depreciation reserve surplus in FPL's last rate case, FPL's current proposal to amortize $209 million of dismantlement reserve for the purpose of managing its earnings, in the absence of a study and outside of the evaluation of test year expenses in a base rate case, would turn the fundamental purpose of capital recovery accounting on its head.

The proposal is deftly designed to avoid having to include the "newly discovered" surplus reserve accruals and resulting amortization credits in the measurement of test year revenues on which rates are based. Accordingly, if adopted, the proposal outlined in the August 15 document would enrich FPL at the expense of treating customers unfairly. Any rates that would be designed and implemented as a consequence of adopting this aspect of the August 15 document would by definition be unjust, unfair, and unreasonable.

Q. HOW ARE THE PURPOSES OF ACCOUNTING FOR FOSSIL DISMANTLEMENT EXPENSE SIMILAR TO THE PURPOSES OF DEPRECIATION EXPENSE?

A. Each is related to the manner in which the utility recovers its capital investment in plant. The goal of depreciation accounting is to have each generation of customers pay its fair share of the investment — also known as "the matching principle." Because the task of retiring and possibly dismantling a fossil fuel-fired generator and restoring its site differs from the tasks relating to the end of service lives of other classes of physical assets, it is accounted for separately. However, the purpose of dismantlement accounting is identical to that of depreciation accounting. It is to ensure that each generation of customers pays its fair share of the cost of the asset that serves it, and by doing so avoids intergenerational inequity.

Q. HOW ARE THE MECHANICS OF DISMANTLEMENT ACCOUNTING SIMILAR TO THE MECHANICS OF DEPRECIATION ACCOUNTING?

A. In my earlier testimony addressing FPL's March 19, 2012 petition, I described how a utility recovers its capital investment through depreciation expense over the life of the asset. In terms of mechanics, the original investment or gross plant on the books remains unchanged over time, but is offset by a growing reserve (or by the accumulated provision for depreciation) as the utility applies depreciation rates, accrues depreciation expense over time, and recognizes actual retirements, cost of removal, and salvage. As required by the Commission, the utility performs periodic studies to determine whether it is collecting the appropriate amount of depreciation expense. Typically, if there is an imbalance (difference between the amount collected and the amount that should have been collected by the time of the study), the difference (whether positive or negative) becomes part of the unrecovered investment and that total is recovered over the remaining lives of the assets. If a surplus imbalance is so severe as to create an unfair level of intergenerational inequity, as was the case in FPL's last rate case with respect to the depreciation reserve, the Commission can require the utility to return the surplus to customers over a shorter period through amortizing the surplus over a prescribed number of years. The amortization is a credit to expense, which means that it effectively lowers the utility's overall depreciation expense. When the amortization of depreciation reserve surplus is prescribed at the same time rates are being set, the amount of amortization applicable to the test year serves to lower the utility's overall revenue requirements and, therefore, the rates that

customers pay. In this manner, the amortization enables customers to actually receive the benefit of the amortization through lower rates, rather than simply permitting the utility to clean up its books.

The mechanics of accounting for fossil dismantlement expense are similar. The utility accrues annual dismantlement expense and accumulates past costs in a fossil dismantlement reserve — precisely as it is done with the accumulated provision for depreciation. Factors (including the methodology for dismantling plants) that affect the appropriate amount of dismantlement expense can, and do, vary over time. Accordingly, the Commission requires the utility to conduct periodic studies — again, just as it is done with depreciation accounting. If, after appropriate review, the Commission identifies a reserve imbalance, it can take corrective action. Where the corrective action is a requirement that the utility amortize a surplus and the annual amortization amount falls within a test year, the rates that customers pay will be lower as a result of the amortization. Inasmuch as the purpose of the corrective action is to return the over collection of past expense to customers, incorporating the credits into the calculation of base rates is an important step in the fair and just implementation of that action.

Q. DOES THE COMMISSION'S DECISION IN THE LAST CASE PROVIDE GUIDANCE TO ITS CONSIDERATION OF FPL'S PROPOSAL TO AMORTIZE $209 MILLION OF FOSSIL DISMANTLEMENT RESERVE?

A. Yes. Three important principles embedded in the manner in which the Commission determined and treated the depreciation reserve surplus in FPL's last rate case are not only conspicuous, but also provide guidance in its consideration of FPL's August 15 document: (1) the Commission's purpose and motivation in Docket No. 080677-EI was to adhere to the matching principle, and the effect on FPL's earnings was a by-product of that objective; (2) the amortization was ordered after a detailed study and, where the study was challenged, a proceeding that included competing evidence and argument occurred (i.e., the Commission determined factually, based on a detailed evidentiary record, the existence and magnitude of the surplus imbalance); and (3) the amortization ordered by the Commission occurred simultaneously with the construction of test year revenue requirements and the setting of rates, so that customers who overpaid in the past benefited directly through cost of service and rate reductions.

Q. WHY ARE THESE PRINCIPLES IMPORTANT?

A. The matching principle must be paramount in the decision to modify a reserve through an ordered amortization; otherwise, the accounting for capital recovery will become distorted to the prejudice of either past or future customers. If the amortization is not directly adjusted in the test year revenue requirements of a rate case, FPL will modify its rate base; however, the intergenerational inequity will not be corrected most effectively, because customers will not receive the money that they overpaid.

It is important to have a study and, where the study is challenged, a determination by the Commission. This is because a surplus correction will have the effect of increasing future rate base, thereby affecting the rates that future customers will pay. Before a step is taken that will require a future generation to pay higher rates, the Commission should investigate whether it is on solid evidentiary footing. Indeed, in the last base rate case the Commission adjusted many of FPL's depreciation proposals after its study was challenged. It is also important to address the imbalance at the same time that base rates are set. This is because it would be patently unfair and unreasonable to effectively lower FPL's expenses materially — *for the stated purpose of boosting its earnings and achieved rate of return* — and not reflect those lower expenses in the rates that customers pay.

Q. HOW DOES FPL'S CURRENT PROPOSAL TO AMORTIZE DISMANTLEMENT RESERVE COMPARE TO THE COMMISSION'S APPROACH TO DEPRECIATION RESERVE SURPLUS IN FPL'S LAST RATE CASE?

A. FPL's current proposal, which is outlined in the August 15 document, is dissimilar to the Commission's treatment in ways that render the proposal unfair, unjust, and unreasonable to customers. The Commission's actions in the last rate case are a good example of how to treat depreciation accounting in a way that will accomplish the capital recovery objective fairly and effectively. By contrast, the provisions of the August 15 document that address the fossil dismantlement

reserve and depreciation reserve illustrate how the Commission should *not* treat these items.

Q. PLEASE EXPLAIN.

A. First, FPL's objective within the August 15 document is *not* to implement the matching principle. Instead, FPL's stated goal is to provide a source of financial wherewithal that it can draw down to enhance its earnings during the four-year term of the August 15 document. Any customer impact on current and future generations is a by-product of FPL's desire for earnings flexibility and stability. This concept turns the purpose of capital recovery accounting on its head. Secondly, FPL has not submitted a study that supports its request — indeed, a key part of FPL's proposal is the postponement of the next study until after the end of the four-year term of the August 15 document. In other words, FPL wants to avoid the very measure that is needed to support its request for earnings flexibility. Thirdly, by addressing its $209 million fossil dismantlement reserve amortization request in the August 15 document instead of its original March 19, 2012 petition, FPL has timed and structured the proposed amortization in a way that avoids having to reduce the revenue requirement borne by customers' rates by the amount of annual amortization credits associated with the August 15 document. As a matter of fact, if one assumes that FPL would file and that the Commission would process a base rate request during the last year of the four-year term of the August 15 document; the base rate case would be based on a projected test year that is beyond the four-year term of the amortization period of

the August 15 document. Further, the scheduled depreciation and dismantlement studies would be postponed until after the next base rate case has been completed, and FPL would have completely dodged any requirement to reflect the annual amortization impact of $209 million of fossil dismantlement reserve in the calculation of base rates.

Q. ARE YOU SURPRISED BY THE EXTENT TO WHICH THE AUGUST 15 DOCUMENT DEPARTS FROM THE PRINCIPLES THAT YOU IDENTIFIED AT THE OUTSET OF YOUR TESTIMONY?

A. No. The contrast between FPL's resistance to the amortization of depreciation reserve surplus that the Commission ordered in the last rate case and its enthusiastic support for the proposed amortization of fossil dismantlement reserve in this case is revealing, but not surprising.

Q. PLEASE ELABORATE.

A. In the last base rate case, FPL proposed three-year capital recovery programs for assets that were retired and for which the corresponding reserve was inadequate. The three- year capital recovery program would have increased test year expenses and increased rates that customers pay. FPL proposed this capital recovery program-related increase in depreciation expense in spite of the fact that its own studies indicated a substantial depreciation reserve surplus. In other words, rather than use the overall surplus to offset and absorb the shortfall associated with specific capital recovery program items being retired, FPL's preference was to

keep the surplus on its books and increase customers' rates. And, for that much larger surplus reserve, the Company requested that the surplus be returned to customers over the approximately 20-year remaining lives of the investments. Stated otherwise, FPL wanted significant and immediate rate treatment for its under-recovery, but was not willing to offset the under-recovery with admitted over-recoveries for which it sought corrective measures over a 20-year period. Further, when OPC recommended that an amortization of reserve be accompanied by a corresponding lowering of test year expenses, cost of service, and base rates, FPL opposed the measure and complained about it afterwards. FPL's consistently one-sided approach to such situations demonstrates the need for the Commission to properly investigate reserve amortization positions to establish fair, just, and reasonable rates. After a full evidentiary hearing in Docket No. 080677-EI, FPL's proposal in that case was found by the Commission to be anything but fair, just, and reasonable. In the instant case, neither FPL nor the Commission has identified or quantified a surplus in the dismantlement reserve that is the subject of FPL's $209 million proposal in the August 15 document. In fact, in its last case, FPL requested a 41% *increase* (from $15.2 million to $21.5 million) in annual dismantlement accruals! In this case, FPL has not proposed to reduce the size of the annual fossil dismantlement accrual, even though it now proposes a $209 million dismantlement reserve excess amortization.

Rather, in the absence of a current study — much less a determination by the Commission that an amortization is warranted in any amount — FPL proposes to

raid the fossil dismantlement reserve "piggy bank" for the purpose of stabilizing its future earnings, and in a manner that avoids giving customers the corresponding and commensurate benefit of a rate reduction. FPL made no mention of its fossil dismantlement reserve in its March 19, 2012 petition. Only when FPL filed its August 15 document did it assert that its fossil dismantlement reserve is available to be amortized for the purpose of providing "earnings" flexibility.

Virtually by definition, and especially in light of the fact that the Commission is nearing the end of a rate setting docket, rates that deliberately do not take into account the impact of a proposed $209 million reduction in expense levels over the period outlined in the August 15 document would not be fair, just, or reasonable.

Q. IN SUPPORT OF ITS PROPOSAL TO POSTPONE THE DEPRECIATION STUDY THAT IS DUE IN MARCH 2013, FPL WITNESS BARRETT STATES AT PAGE 21 OF HIS DIRECT TESTIMONY THAT THE FACTORS THAT LED TO THE 2010 FINDING OF A SURPLUS DEPRECIATION RESERVE ARE UNLIKELY TO RECUR, AND REFERS TO AN "ANTICIPATED DEFICIT TREND." HOW DO YOU RESPOND TO HIS REASONING?

A. As with the other portions of FPL's August 15 document associated with depreciation or dismantlement, there is no demonstration of fact. Indeed, I

believe that, when based on a proper evaluation, a significant surplus depreciation reserve will be determined in the next proceeding after review of a full study. I base this conclusion on the fact that: (1) the Company's significant investment in combined cycle generating facilities reflects an artificially short life span; (2) the analysis that I performed in the last case, which demonstrated that the surplus reserve was in fact more than a billion dollars greater than identified by FPL in its study: and (3) not only may FPL not fully retire a generating facility, but it may also repower such facilities for extended use many decades longer than what was previously indicated. All of these factors strongly indicate that a sizeable excess reserve for depreciation would be determined after a study and evidentiary hearing. I believe that similar factors indicate that a surplus in the fossil dismantlement reserve may be determined at the same time. However, that argues for completing the study, not postponing it, so that the Commission can consider the manner in which to address the matching principle on an informed and timely basis — as well as in a manner that treats customers fairly.

Q. FPL WITNESS BARRETT ALSO ALLUDES TO FPL'S GENERATION MODERNIZATION PROJECTS TO SUPPORT THE VIEW THAT NEITHER THE $209 MILLION AMORTIZATION OF FOSSIL DISMANTLEMENT RESERVE NOR THE POSTPONEMENT OF A DISMANTLEMENT STUDY WOULD HARM CUSTOMERS. HOW DO YOU RESPOND?

A. Those factors and others — including changes in dismantlement methodology — argue for the completion of the study and for the correction of the factor in the context of a base rate proceeding. For example, if other production facilities at repowered generating stations are anticipated to have service lives of potentially 40 years or longer, yet the initial dismantlement studies anticipated full green fielding of the sites rather than repowering, then the fossil dismantlement reserve will undoubtedly be materially over accrued. Moreover, the Company's very sizeable investment in combined cycle generating facilities will already have been over accrued due to FPL's initial short life span estimates. These are precisely the types of factors that must be fully investigated in order to determine the most appropriate value to be utilized for ratemaking purposes. It is unreasonable to simply assume some level of reserve position for the purpose of providing earnings flexibility to the utility when there have been major changes to system operations at present and into the future.

Q. IN YOUR VIEW, DOES THE PROPOSED AMORTIZATION OF $209 MILLION OF FOSSIL DISMANTLEMENT RESERVE TREAT FPL AND CUSTOMERS' INTERESTS IN A FAIR AND BALANCED MANNER?

A. No. The proposal in the August 15 document is severely skewed toward serving FPL's interests at customers' expense.

Q. PLEASE EXPLAIN.

A. As previously discussed, intergenerational inequity is created when the matching principle has not been properly followed. The correction of intergenerational inequity through amortization of excess reserves can most effectively occur when the correction is tied to the test year revenue requirements establishing base rate charges for customers, or if the terms of an overall settlement provide sufficient value to customers to offset the absence of a reduction in revenue requirements and rates (OPC witnesses Donna Ramas, Kevin O'Donnell and James Daniel demonstrate that the other terms of the August 15 document are skewed one-sidedly to FPL's advantage). Otherwise, the correction becomes simply an accounting mechanism on FPL's books and results in a benefit to FPL only. Especially where the initiative is to increase the utility's earnings, the two components must be tied together in order to effectively and equitably correct for prior over collections.

By analogy, assume that an individual obtains a mortgage from a bank for a property. Further, assume that over time the individual pays off the mortgage, but then makes 5 additional payments (overpayment) without realizing that the mortgage has been previously fully paid off. When the bank realizes that it has received 5 additional monthly payments than it was entitled to, rather than refunding the overpayments to the individual, it simply amortizes equal credits on its books over the next 5 months so that at the end of the period the balance on the mortgage is zero (0). Under this arrangement, the bank shows that it has

recovered the right amount of money (from its accounting perspective without actually refunding any overpayments), yet the individual who made the extra mortgage payments did not receive an actual refund for the 5 months of overpayments that were made (the individual is still out the 5 extra payments). Indeed, the bank actually recovered more than it was entitled to, but its books now reflect the accounting correction to its satisfaction. It is preposterous to consider that a bank would entertain such a scenario, but that is analogous to what FPL is proposing in this case. Therefore, such a situation should be unacceptable.

Q. CAN THE AMORTIZATION OF THE FOSSIL DISMANTLEMENT RESERVE, EVEN IF REFLECTED IN BASE RATE REVENUE REQUIREMENTS, STILL HARM CURRENT CUSTOMERS?

A. Yes. While I do not dispute that an excess imbalance may exist in the fossil dismantlement reserve, I believe that it is necessary to test the level of excess reserve in order to establish fair, just, and reasonable rates. I also believe that this would be especially important in this case, where the utility's stated objective is to create a means of managing its earnings levels. For example, if the excess imbalance in the fossil dismantlement reserve was in fact $300 million rather than the $209 million from the August 15 document, then FPL would only recognize a limited level of intergenerational inequity that requires correcting and postpone the greater corrective amount for many years. That is precisely why scheduled dismantlement and depreciation studies are critically important to the establishment of fair, just, and reasonable rates.

Q. DOES FPL ACTUALLY RECOGNIZE THE PROPER PROCEDURE FOR ESTABLISHING RESERVE POSITIONS AND HOW TO CORRECT MAJOR IMBALANCES?

A. Yes. At page 17 of Mr. Barrett's direct testimony, he notes that FPL can provide for future dismantlement costs "by authorized amounts approved by the Commission after reviewing dismantlement studies filed periodically by the Company." (emphasis added). In other words, FPL recognizes that the proper process is to perform studies to quantify the best estimate of the position that exists for a particular reserve. This is logical and makes perfect sense. However, because Mr. Barrett's and FPL's purpose is to support an earnings management program advantageous to FPL rather than to serve the principle of equity between generations of customers, this process is completely opposite to the approach of the August 15 document.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and foregoing Direct Testimony of Jacob Pous has been furnished by electronic mail on this 2nd day of November, 2012, to the following:

Caroline Klancke
Keino Young
Florida Public Service Commission
Office of the General Counsel
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Vickie Gordon Kaufman
Jon C. Moyle
c/o Moyle Law Firm
118 North Gadsden Street
Tallahassee, FL 32301

Karen White
Federal Executive Agencies
c/o AFLOA/JACL-ULFSC
139 Barnes Drive, Suite 1
Tyndall Air Force Base, FL 32403

John W. Hendricks
367 S. Shore Drive
Sarasota, FL 34234

Linda S. Quick
South Florida Hospital and
Healthcare Association
6030 Hollywood Blvd., Suite 140
Hollywood, FL 33024

William C. Garner
Brian P. Armstrong
Nabors, Goblin & Nickerson, P.A.
1500 Mahan Drive, Suite 200
Tallahassee, FL 32308

John T. Butler
R. Wade Litchfield
Florida Power & Light Company
700 Universe Boulevard
Juno Beach, FL 33408-0420

Kenneth L. Wiseman
Mark F. Sunback
J. Peter Ripley
Andrews Kurth LLP
1350 I Street, NW, Suite 1100
Washington, DC 20005

Robert Scheffel Wright
John T. LaVia
Gardner Law Firm
1300 Thomaswood Drive
Tallahassee, FL 32308

Thomas Saporito
6701 Mallards Cove Rd., Apt. 28H
Jupiter, FL 33458

Ken Hoffman
Florida Power & Light Company
215 S. Monroe St., Suite 810
Tallahassee, FL 32301-1859

Joseph A. McGlothlin
Associate Public Counsel