

**Eric Fryson**

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**Subject:** e-filing (Dkt. No. 120015-EI)

**Attachments:** 120015 OPC prehearing statement FINAL.sversion.docx  
Electronic Filing

a. Person responsible for this electronic filing:

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b. Docket No. 120015-EI

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

c. Documents being filed on behalf of the Office of Public Counsel

d. There are a total of 10 pages.

e. The document attached for electronic filing is: 120015 OPC prehearing statement FINAL.DOCX.

Thank you for your attention and cooperation to this request.

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DOCUMENT NUMBER-DATE

07572 NOV-8 09

11/8/2012

FPSC-COMMISSION CLERK

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

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

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Docket No: 120015-EI

Filed: November 8, 2012

**PREHEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL**

The Citizens of the State of Florida ("Citizens"), through the Office of Public Counsel ("OPC"), pursuant to the Third Order Establishing Procedure in this docket, Order No. PSC-12-0529-PCO-EI, issued October 3, 2012, hereby submit this Prehearing Statement.

**APPEARANCES:**

Joseph A. McGlothlin  
Associate Public Counsel

Charles J. Rehwinkel  
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Patricia A. Christensen  
Associate Public Counsel

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On behalf of the Citizens of the State of Florida

**1. WITNESSES:**

The Citizens intend to call the following witnesses, who will address the issues indicated:

<u>NAME</u>	<u>ISSUES</u>
James W. Daniel	4, 5
Kevin W. O'Donnell	5
Jacob Pous	2, 3, 5
Donna Ramas	1, 5

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FPSC-COMMISSION CLERK

**2. EXHIBITS:**

Through James W. Daniel, Kevin W. O'Donnell, Jacob Pous, and Donna Ramas, the Citizens intend to introduce the following exhibits, which can be identified on a composite basis for each witness:

<u>Witness</u>	<u>Exhibits</u>	<u>Title</u>
James W. Daniel	JWD-1	List of Regulatory Proceedings
James W. Daniel	JWD-2	Incentive Mechanism Comparison
Kevin W. O'Donnell	KWO-11	Dow Jones Utility Index
Kevin W. O'Donnell	KWO-12	Federal Reserve Article
Kevin W. O'Donnell	KWO-13	ROE Comparison
Kevin W. O'Donnell	KWO-14	Equity Ratio Comparison
Kevin W. O'Donnell	KWO-15	30-Year US Treasury Yields
Donna Ramas	DR-7	Per FPL Original Revenue Requirement, Modified for Revised ROR
Donna Ramas	DR-8	Per FPL Post-Hrg Revenue Requirement, Modified for Revised ROR

**3. STATEMENT OF BASIC POSITION**

OPC renews its objection to what Order No. PSC-12-0529-PCO-EI labels "Settlement Issues" on the grounds that the purported settlement contained in the signatories' August 15, 2012 document ("August 15 document") is legally invalid. OPC is participating in the proceedings announced in Order No. PSC-12-0529-PCO-EI, including the evidentiary hearing scheduled for November 19-21, 2012, under protest, and subject to its legal objections.

Anticipating that the Commission will reject the purported settlement (whether in recognition of the legal invalidity of the August 15 document or of its avaricious one-sidedness), OPC also registers a continuing objection to the use of any evidence to be adduced during the November 19-21 hearing for any purpose related to the decision on FPL's March 2012 petition. Necessarily, in the course of demonstrating the deficiencies and conspicuous excesses of the August 15 document, OPC's witnesses will allude to the record of the August 2012 hearing during the November 19-21 hearing. However, the evidence received as part of the (legally impermissible) consideration of the August 15 document cannot be used to "supplement" either the issues identified in Prehearing Order No. PSC-12-0428-PHO-EI, dated August 17, 2012, or the evidence received during the August 2012 hearing on those issues.

Putting aside the legal infirmities of the purported settlement for the purpose of addressing the contents of the August 15 document, OPC submits that determining the appropriate disposition of the "deal" struck by and among FPL, FIPUG, FEA, and SFHHA is an easy call. The August 15 document is overwhelmingly skewed toward the interests of FPL, to the detriment of customers (except those who would benefit from the shifting of revenue requirements among customer classes that FPL employed to induce them to sign the document). Rates that would result from the implementation of the August 15 document would be unfair,

unjust, and unreasonable, and therefore not in the public interest. Consider:

***Excessive return on equity*** — The 10.7% return on equity (ROE) specified in the August 15 document is far higher than current economic conditions and capital costs warrant. This ROE is higher than any other for a regulated utility established anywhere in the United States during 2012 of which OPC is aware. (Prehearing Order No. PSC-12-0428-PHO-EI reflects that the positions of OPC, FRF, SFHHA, FEA, and FIPUG on the appropriate ROE for FPL range from 8.5% to 9.25%. Without adjusting the equity ratio, and assuming that a change of 100 basis points in ROE translates to \$160 million of revenues for FPL, reducing the ROE from 10.7% to even FPL's currently authorized midpoint of 10% would reduce FPL's revenue requirement by another \$112 million annually.) The 10.7% ROE is rendered even more excessive by the extravagant 59.62% equity ratio that the August 15 document retains. Like the 10.7% ROE, to the best of OPC's knowledge, the 59.62% equity ratio is richer than any other that has been approved in 2012. Further, the appropriate ROE for FPL is a function of its investment risk. The provisions of the August 15 document that would authorize FPL to (a) increase base rates in 2014 and 2016 by the full amount of the revenue requirements of its Riviera Beach and Port Everglades generation modernization projects, and (b) manage its earnings by amortizing \$400 million of depreciation and dismantlement reserve over four years, would lower FPL's risk profile below that which was considered during the August 2012 hearing. In other words, the August 15 document rewards FPL with a premium ROE for developing a four-year plan that exposes it to less risk. This is not in the public interest and would not result in fair, just, and reasonable rates.

***Unreasonable and unrealistic \$378 million increase in revenues*** — In addition to the impact of the excessive 10.7% ROE, the \$378 million increase associated with the August 15 proposal implicitly assumes that, of the tens of millions of dollars of adjustments to rate base and expenses that OPC and other parties (including FIPUG, SFHHA, and FEA) have identified and supported in evidence and argument, the adjustments ultimately adopted by the Commission would total *zero*. The assumption is unreasonable and untenable on its face.

***Unreasonable and prejudicial (to customers) piecemeal ratemaking, in the form of base rate increases in 2014 and 2016 of \$243,043,000 and \$217,862,000, respectively*** — The “generation base rate adjustments” that are proposed for 2014 and 2016 (increases that would occur beyond the projected test year and that were not requested in FPL's March 2012 petition) would ensure that FPL would receive more revenues during 2013-2016 under the “compromise” of the August 15 document than it would be authorized to receive under FPL's March 2012 petition during the same period — even if the Commission were to agree to FPL's originally requested 11.5% ROE *and* adopt FPL's positions on all other disputed issues! The “generation base rate adjustments” are a form of “piecemeal ratemaking.” This means that FPL seeks authority to tack the entire revenue requirements associated with a future asset onto base rates when it enters service, without any consideration at that time of whether the utility's earnings may be sufficient to absorb the asset into rate base with either no increase or a smaller rate increase. The proposal would turn a fundamental precept of ratemaking on its head: while a rate case is designed to produce *fixed* rates that will produce an *overall* rate of return which will vary within a prescribed *range*, FPL would vary (increase) *base rates* in order to receive a guaranteed, *point-specific* return on a *single* asset — whether or not FPL's overall return would remain in the prescribed range without the increase. The “benefits” claimed for the “generation base rate adjustments” include the claim that these rate increases would obviate the costs of protracted

base rate proceedings. Even those purported benefits would inure to FPL, and not the vast majority of its customers, because the Commission, Staff, and parties would have fewer opportunities to scrutinize its operations. Besides, in view of the predictable propensity of FPL and other regulated utilities to overstate their needs, a one-time rate case expenditure that frequently results in downward adjustments (relative to the utility's request) of tens of millions of dollars or more in *annual* revenue requirements is money very well spent.

***Amortization of dismantlement reserve for the express purpose of enhancing FPL's earnings*** — The objective of capital recovery accounting is to collect the costs of plant in a way that, based on the analysis of available information, will allow the recovery of capital costs over the life of the capital asset and is fair to both the company and each generation of customers. The amortization of a reserve imbalance is intended to eliminate significant levels of intergenerational inequity, and any impact of such an adjustment on earnings is a by-product of the pursuit of that objective. The purpose of the provision in the August 15 document that would enable FPL to amortize \$209 million of dismantlement reserve is to enhance FPL's earnings. The impact on customers would be a by-product of the earnings enhancement mechanism, and the document would *require* (through the postponement of studies mandated by Commission rule) that supporting information be *unavailable*. Thus, the August 15 document would stand the purpose of capital recovery accounting on its head. Further: if a utility is authorized to amortize a reserve surplus to enhance its earnings, customers should receive a corresponding benefit in the form of a commensurate reduction in base rates. Tellingly, FPL has timed the introduction of this proposal in a way that is designed to avoid having to reflect an annual amortization in the calculation of revenue requirements in the test year of a base rate proceeding. If the August 15 document is adopted, FPL will have increased future rate base by \$209 million while customers will have received nothing in return. This is not in the public interest and would not result in fair, just, and reasonable rates.

***The "asset optimization" provision would expand the existing, narrowly defined wholesale incentive program into inappropriate areas with inadequate safeguards for customers*** — Regulated utilities have an obligation to provide reliable and economical service. One of the primary tools that a utility employs to adhere to this standard is to meet the demand on its system by calling on its resources in ascending order of their costs. This concept is called "economic dispatch." Purchasing power when it is available at a price lower than the utility's cost of generating it is part of the economic dispatch rationale. By proposing to include savings from power *purchases* in an expanded incentive program, FPL is audaciously seeking "bonuses" for carrying out the most fundamental aspect of its obligation to serve. The Commission should also be mindful of the potential for unintended consequences. The "asset optimization" categories, which include high dollar transactions, would produce an incentive for FPL to employ its low-cost resources for off-system transactions (and incentive dollars) instead of retail service in a way that would be difficult for the Commission to monitor or police.

***The purported "settlement" of the August 15 document bears no resemblance to the public interest*** — The concept of a settlement involves a compromise that provides benefits to all of the interests represented in the case. The bottom line of any settlement presented to the Commission must be fair and reasonable terms that translate into fair, just, and reasonable rates. Among other things, the August 15 document provides for: (1) an ROE that is excessive in view of the conditions of capital markets and FPL's risk profile; (2) an unvetted increase in revenues that would give FPL a "pass" on the myriad of adjustments to rate base and expenses that OPC

and other parties advocated during the case; (3) future base rate increases that would occur far beyond the projected test year, and would not be mitigated by strong earnings, no matter how high; (4) amortization of dismantlement reserve that will increase FPL's earnings, but not reduce customers' rates; and (5) an expansion of the existing wholesale sales incentive mechanism that would "reward" FPL for adhering to the most fundamental of economic obligations, and perversely incentivize FPL to seek off-system opportunities at the expense of retail customers. These egregious terms, individually and collectively, would produce rates that would be unfair, unreasonable, and unjust, and would not be offset by any countervailing benefits to customers. The Commission should see the Joint Motion For Approval for what it is — a "joint" Christmas wish list.

#### 4. ISSUES

**Issue 1:** Are the generation base rate adjustments for the Canaveral Modernization Project, Riviera Beach Modernization Project, and Port Everglades Modernization Project, contained in paragraph 8 of the Stipulation and Settlement, in the public interest?

OPC: No. FPL's generation base rate adjustment proposal should be rejected for the reasons stated in the testimony of Donna Ramas and in Order No. PSC-10-0153-FOF-EI (the Commission's final order in FPL's last rate case, Docket No. 080677-EI, in which the Commission cited the testimony of SFHHA witness Lane Kollen when rejecting FPL's proposed generation base rate adjustment mechanism). The in-service dates of the Riviera Beach and Port Everglades generation modernization projects are well beyond the projected test year on which the Commission has based its consideration of FPL's March 2012 filing. On that basis alone, the Commission should refuse to entertain the proposal, just as it refused FPL's proposal for a "subsequent step increase" in the year beyond its projected test year in Docket No. 080677-EI. (In that instance, FPL had provided information regarding its future overall operations that the Commission deemed to be unreliable. In the instant case, FPL proposes to eliminate "overall information" completely.) More importantly, FPL seeks to add the full revenue requirements of each generation project to base rates incrementally, without any obligation to demonstrate that its earnings in the future could not absorb all or part of the additional costs without an increase in rates. (In the past, FPL has added several power plants to rate base without increasing customers' rates.) This proposal would allow FPL to increase base rates even if FPL is earning above its range during the period in which the projects are placed into service. The proposal is tantamount to a "power plant cost recovery clause" within base rates. FPL's argument that a generation base rate adjustment could not cause it to overearn is an exercise in misdirection. Base rates are designed to produce a return that will vary within a reasonable range while rates remain constant. FPL hopes to "flip" that concept and increase rates so that its earnings will remain whole. This "piecemeal," "incremental" approach to ratemaking would inappropriately shift the burden of demonstrating the need for a change in rates from the utility to the Commission and the utility's customers.

In Docket No. 080677-EI, FPL included its proposed generation base rate adjustment mechanism in its petition. The Commission rejected it emphatically. In the instant case, FPL waited until five days before the beginning of the August 2012 hearing before injecting a similar generation base rate adjustment proposal into this proceeding. One must assume that FPL believes that its chances for success (following the rejection in its last case) may be better if it is presented as part of a “settlement” package. However, the purported settlement is not properly before the Commission, and the terms of the August 15 document provide no offsetting or countervailing benefits to customers that would justify the self-serving generation base rate adjustment proposal.

**Issue 2:** Is the provision contained in paragraph 10(b) of the Stipulation and Settlement, which allows the amortization of a portion of FPL’s Fossil Dismantlement Reserve during the Term, in the public interest?

OPC: No. The provision is intended – not to accomplish intergenerational fairness – but to enhance FPL’s earnings. It is structured – not to aid in establishing fair and reasonable rates – but to avoid providing customers with a commensurate reduction in base rates. Moreover, the provision is dependent – not on a supporting study of the status of the current expectation and related collection of dismantlement costs – but on the proposed postponement of such a study. The provision, in short, is severely skewed to only benefit FPL, as the amortization that produces increased earnings will also increase future rate base, without customers having received any corresponding monetary benefit. Rates based on the provision would not be fair, just, and reasonable. Accordingly, the provision is not in the public interest, either individually or as part of the August 15 document.

**Issue 3:** Is the provision contained in paragraph 11 of the Stipulation and Settlement, which relieves FPL of the requirement to file any depreciation or dismantlement study during the Term, in the public interest?

OPC: No. The purpose of the depreciation and dismantlement studies that the Commission requires FPL and other regulated utilities to file periodically is to enable the Commission to gauge whether a utility is “on course” with respect to collecting the appropriate amount of capital costs from customers over time (the “matching principle”), and to take remedial action to achieve fairness between generations of customers if an imbalance is identified. As demonstrated in FPL’s last rate case, establishing the degree to which FPL is “on course” or “off course” at a given point in time can involve a variance of more than a billion dollars, depending on the reasonableness of the assumptions contained in a study. Variances of such magnitudes demand timely studies to support any necessary reactions to correct intergenerational inequities. By contrast, the transparent

objective of this provision of the August 15 document is to ensure that the amortization of fossil dismantlement reserve sought by FPL, the stated purpose of which is to enhance and stabilize FPL's earnings, is not contradicted or undermined by a study that would show whether (and the extent to which) amortization is or is not warranted by adherence to the matching principle. The proposed amortization will have the effect of increasing future rate base, which is appropriate if future customers otherwise will have paid too little of their fair share for the use of the assets; however, a study is needed to establish whether (and to what degree) that is the case. Acting to authorize amortization of a reserve without first performing a study that would establish whether or not an amortization is warranted would be inimical to the establishment of fair, just, and reasonable rates, and therefore would not be in the public interest. In addition, FPL proposes that such studies occur after the end of the four-year period prescribed in the August 15 document. If one assumes that FPL will file a base rate request during the fourth year and base it on a projected test year, the proposed timing of the next studies would enable FPL to avoid reflecting the amortization in its revenue requirements and in its customers' rates, both in this docket and in the next base rate proceeding. Rates that do not reflect the reduction in revenue requirements occasioned by an amortization of reserve, the purpose of which is to increase earnings, would not be fair, just, or reasonable. Accordingly, for this reason, too, the provision is not in the public interest.

**Issue 4:** Is the provision contained in paragraph 12 of the Stipulation and Settlement, which creates the "Incentive Mechanism" including the gain sharing thresholds established between customers and FPL, in the public interest?

OPC: No. The "incentive mechanism" set forth in paragraph 12 of the August 15 document is neither fair nor reasonable, and does not provide benefits to FPL's ratepayers. On the contrary, the expanded incentive mechanism produces significant additional margin-sharing opportunities for FPL's shareholders, to the detriment of ratepayers.

Under the current wholesale incentive mechanism, approved by Order No. PSC-00-1744-PAA-EI, issued on September 26, 2000, the ratepayers are credited with 100% of the gains associated with short-term power sales below a three-year rolling average and 80% of the gains associated with gains above that threshold. Under the paragraph 12 expansion of the wholesale mechanism, additional types of wholesale power sales would be included and the "savings" from short-term power *purchases* would be used in calculating the eligible gains. Had FPL's expanded incentive mechanism been in effect during the period from 2001 to the present, the fuel costs for ratepayers would have been \$47.65 million more than the amount FPL actually incurred, because the \$47.65 million would have been paid to FPL for actions it would have undertaken anyway.

The inclusion of power purchases in the proposed incentive program is inappropriate, because buying power when it is available at prices lower than

FPL's cost of generating it is part of FPL's fundamental obligation to provide service at the lowest reasonable cost.

Further, the higher incentives in the proposed expansion could encourage FPL to pursue such margins at the expense of undermining electric service for its native load customers. Moreover, due to the complexity of the transactions, it would be difficult to reconstruct the transactions and ascertain whether or not the lowest cost generation was used for the benefit of the native load customers.

In addition, it is likely that other utilities will seek to adopt a similar expanded incentive mechanism. Thus, if the proposed modifications to the current wholesale incentive mechanism are to be considered at all, it would be better to consider any modification in a generic rulemaking proceeding rather than in an expedited proceeding on a company-specific proposal.

**Issue 5:** Is the Settlement Agreement in the public interest?

OPC: No. Adopting the August 15 document would not be in the public interest, because the provisions, individually and collectively, would not result in rates that meet the fair, just, and reasonable criteria of Chapter 366, Florida Statutes. Further, implementing the August 15 document would require departures from sound regulatory policy. The August 15 document does not reflect a fair and reasonable compromise of the interests of all parties. Instead, the August 15 document is asymmetric in the extreme. It is designed and structured to lavish inordinate and expensive benefits and advantages on FPL, to the detriment of the vast majority of FPL's customers. The exorbitant ROE and the foregone opportunity to resolve numerous rate base and O&M expense issues associated with the August 15 document would produce unreasonably high rates. The proposal to amortize fossil dismantlement reserve while postponing related depreciation and dismantlement studies would distort the objective of accounting for capital costs, and deny customers any monetary benefits that would be commensurate with the earnings enhancement that FPL would derive. The proposed generation base rate increases and the proposed expansion of the current wholesale incentive program would involve potentially costly sacrifices of future regulatory oversight and scrutiny. Overall, the August 15 document would present an enormous gift to FPL; it would be an atrocious deal for the vast majority of FPL's customers.

**5. STIPULATED ISSUES:**

None at this time.

6. **PENDING MOTIONS:**

None.

7. **STATEMENT OF PARTY'S PENDING REQUESTS OR CLAIMS FOR CONFIDENTIALITY:**

None.

8. **OBJECTIONS TO QUALIFICATION OF WITNESSES AS AN EXPERT:**

None at this time.

9. **STATEMENT OF COMPLIANCE WITH ORDER ESTABLISHING PROCEDURE:**

There are no requirements of Order No. PSC-12-0529-PCO-EI with which the Office of Public Counsel cannot comply.

Dated this 8<sup>th</sup> day of November, 2012

J.R. Kelly  
Public Counsel

s/ Joseph A. McGlothlin  
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**CERTIFICATE OF SERVICE**

**I HEREBY CERTIFY** that a true and foregoing **PREHEARING STATEMENT OF THE OFFICE OF PUBLIC COUNSEL** has been furnished by electronic mail and/or U.S. mail on this 8<sup>th</sup> day of November, 2012, to the following:

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