BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Fuel and purchased power cost recovery clause and generating performance incentive factor.
_____/

Docket No. 140001-EI
Filed: November 6, 2014

MOTION TO EXCLUDE OR STRIKE INADMISSIBLE EXPERT TESTIMONY PERTAINING TO QUESTIONS OF LAW

1. The Florida Industrial Power Users Group (FIPUG), pursuant to Rule 28-106.204, Florida Administrative Code, moves to strike those portions of the rebuttal testimony of Florida Power and Light Company's witness Mr. Terry Deason that purport to set forth his interpretation of any law or policy applied, adopted by, or set forth in the Commission's rules or prior final orders.

2. It is a well-established principle of law that a witness may not testify to legal conclusions or express opinions upon questions of law. In re Estate of Williams, 771 So.2d 7, 8 (Fla. 2nd DCA 2000) (opinion testimony as to the legal interpretation of Florida law is not a proper subject of expert testimony); Edward J. Seibert, A.I.A., Architect & Planner,P.A. v. Bayport Beach and Tennis Club Ass'n, 573 So.2d 889, 891-92 (Fla. 2nd DCA 1990) (an expert should not be allowed to testify concerning questions of law); Devin v. City of Hollywood, 351 So.2d 1022, 1026 (Fla. 4th DCA 1976) ("[T]he trial court erred in relying upon expert testimony to determine the meaning of terms which were questions of law to be decided by the trial court.").[1]

[1] Narrow exceptions to this rule have been made in some cases involving a qualified lawyer testifying as an expert witnesses on a matter of complex and obscure legal questions that are "beyond the ordinary understanding" of the tribunal. See, In re Estate of Lenahan, 511 So.2d 365, 371 (Fla. 1st DCA 1987).

3. The instant section 120.57(1), Florida Statutes, administrative proceeding involves the application of law as set forth the Commission's regulations and prior final orders. The interpretation and meaning of the Commission's final orders and "regulatory principles" are questions of law strictly within the province of the Commission. "Expert opinion" purporting to interpret Commission rules or final orders, or concluding whether specific facts are or are not consistent with "regulatory principles" is inadmissible. Lee County v. Barnett Banks, Inc., 711 So.2d 34 (Fla. 2nd DCA 1997) ("Expert testimony is not admissible concerning a question of law. Statutory construction is a legal determination to be made by the trial judge, *with the assistance of counsels' legal arguments, not by way of 'expert opinion.* "") (emphasis added).

4. Mr. Deason candidly concedes that the primary purpose of his testimony is to offer his expert opinions as to "interpretations of regulatory principles" and to "discuss the regulatory policy basis by which the Commission should consider FPL's proposal." "Ex. A, J. Terry Deason Rebuttal Testimony, Page 3, Lines 6-7, 16-19." In those portions of testimony that are the subject of this motion, witness Deason does not testify about disputed facts, which could determine the applicability of Commission rules or policy as expressed in prior final orders, but instead opines as to "regulatory principles" and offers interpretations of the Commission's prior final orders. See, Gyongyosi v. Miller, 80 So. 3d 1070, 1075 (Fla. 4th DCA 2012), *reh'g denied* (Mar. 23, 2012), *review denied*, 109 So. 3d 780 (Fla. 2013). (The interpretation of a regulation is a question of law that cannot be the subject of expert testimony).

5. In addition to "interpreting regulatory principles," witness Deason also offers testimony as to the Commission's "intent" with respect to its prior final orders. This is impermissible. The best evidence of the "intent" of the Commission with respect to its final orders, regulatory principles, or policy is the plain language of the Commission's final orders,

rules, and regulations. Permitting an expert witness to testify after-the-fact as to the "intent" of a specific act of the Commission is reversible error. *See*, Ocean's Edge Dev. Corp. v. Town of Juno Beach, 430 So. 2d 472, 474-75 (Fla. 4th DCA 1983).

6. The rationale for prohibiting expert testimony as to the "intent" behind an action of a regulatory body was set forth by the District Court of Appeal in Ocean's Edge, citing the prior holding of the Florida Supreme Court:

> The error we perceive in the trial court's findings . . . lies in its deviation from the plain definitions within the plan and implementing zoning ordinance in favor of after-the-fact expert testimony as to legislative intent to fill in the cracks. Government cannot function in such after-the-fact fashion; property owners are entitled to rely upon the clear and unequivocal language of municipal ordinances. This principle is not innovative, nor does it originate with this court. In Rinker Materials Corp. v. City of North Miami, 286 So.2d 552, 554 (Fla. 1973), the supreme court said: "Where words used in an act, when considered in their ordinary and grammatical sense, clearly express the legislative intent, other rules of construction and interpretation are unnecessary and unwarranted. The intent of the North Miami City Commission in its enactment of the zoning ordinance in issue is to be determined primarily from the language of the ordinance itself and not from conjecture *alinude*. A statute or ordinance must be given its plain and obvious meaning." Also see Carroll v. City of Miami Beach, 198 So.2d 643, 645 (Fla. 3d DCA 1967), where the court said: It is our opinion that the City is bound by the express terms of its own ordinance in defining a "family" . . . *[i]f the City desires a different meaning for its ordinance in the future, it may amend, modify, or change the same by legislative process*. (Emphasis supplied.)

After-the-fact testimony as to the "intent" of the Commission with respect to its prior final orders is unnecessary, inappropriate, and should be excluded.

7. The specific portions of Mr. Deason's testimony that should be stricken as impermissible opinions as to questions of law, policy or "regulatory principles" are itemized below and highlighted in the attached Exhibit "A":

A. Page 3, Lines 4-10.

B. Page 3, Lines 14-21.

C. Page 4, Lines 19-21.

D. Page 5, Lines 7-9.

E. Page 5, Lines 12-13.

F. Page 5, Lines 15-23 and Page 6, Lines 1-9.

G. Page 6, Lines 12-23 and Page 7, Lines 1-12.

H. Page 7, Lines 14-16.

I. Page 7, Lines 20-23; Page 8, Lines 1-22; Page 9, Lines 1-2.

J. Page 9, Lines 5-22.

K. Page 10, Lines 16-21.

L. Page 12, Lines 5-10.

M. Page 15, Lines 9-23.

N. Page 16, Lines 7-10.

O. Page 16, Lines 16-23; Page 17, Lines 1-21.

P. Page 18, Lines 2-4, 6-15, 17-23; Page 19, Lines 1-7.

Q. Page 19, Lines 10-22.

R. Page 20, Lines 2-23; Page 21, Lines 1-2.

S. Page 21, Lines 13-23; Page 22, Lines 1-22.

T. Page 23, Lines 1-8, 12-16, 19-23; Page 24, Lines 1-3.

U. Page 25, Lines 4-11.

V. Page 25, Lines 16-23; Page 26, Lines 1-21.

W. Page 26, Line 23; Page 27, Lines 1-8.

X. Page 27, Lines 19-23; Page 28, Line 1.

Y. Page 28, Lines 13-14; Page 28, Lines 18-23, Page 29, Lines 1-3.

Z. Page 29, Lines 9-10, 12-16.

AA. Page 30, Lines 14-23; Page 31, Lines 1-4.

BB. Page 31, Lines 18-20, 22-23; Page 32, Lines 1-23; Page 33, Lines 1-4.

CC. Page 33, Lines 6-23.

DD. Page 34, Lines 8-11.

8. In each of the foregoing instances, witness Deason opines on matters of law, i.e., offering an interpretation of law, or the Commission's policy, or opining as to what the law or policy of the Commission should be, or stating whether a particular argument is "consistent" with

"regulatory principles" as described by the witness. Such testimony should be stricken for the reasons set forth above.

9. FPL opposes this motion. FIPUG was unable to ascertain the position of the other parties.

BASED ON THE ABOVE AND FOREGOING, the itemized portions of witness Terry Deason's rebuttal testimony described herein and highlighted in Exhibit "A" should be excluded or stricken from the record of this proceeding as impermissible expert testimony on questions of law.

DATED THIS 6th day of November 2014.

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I HEREBY CERTIFY that a true and correct copy of the foregoing motion was furnished to the following by Electronic Mail, on this 6th day of November, 2014:

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

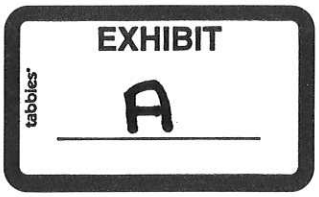
PETITION FOR PRUDENCE DETERMINATION

REGARDING ACQUISITION OF GAS RESERVES

REBUTTAL TESTIMONY OF J. TERRY DEASON

DOCKET NO. 140001-EI

OCTOBER 13, 2014



Q. Please state your name and business address.

A. My name is Terry Deason. My business address is 301 S. Bronough Street, Suite 200, Tallahassee, FL 32301.

Q. By whom are you employed and what position do you hold?

A. I am a Special Consultant for the Radey Law Firm, specializing in the fields of energy, telecommunications, water and wastewater, and public utilities generally.

Q. Have you previously submitted direct testimony in this proceeding?

A. No.

Q. Please describe your educational background and professional experience.

A. I have thirty-seven years of experience in the field of public utility regulation spanning a wide range of responsibilities and roles. I served as a consumer advocate in the Florida Office of Public Counsel ("OPC") on two separate occasions, for a total of seven years. In that role, I testified as an expert witness in numerous rate proceedings before the Florida Public Service Commission ("Commission" or "PSC"). My tenure of service at OPC was interrupted by six

years as Chief Advisor to Florida Public Service Commissioner Gerald L. Gunter. I left OPC as its Chief Regulatory Analyst when I was first appointed to the Commission in 1991. I served as Commissioner on the Commission for sixteen years, serving as its chairman on two separate occasions. Since retiring from the Commission at the end of 2006, I have been providing consulting services and expert testimony on behalf of various clients. These clients have included public service commission advocacy staff and regulated utility companies, before commissions in Arkansas, Florida, Montana, New York and North Dakota. My testimony has addressed various regulatory policy matters, including: regulated income tax policy; storm cost recovery procedures; austerity adjustments; depreciation policy; subsequent year rate adjustments; appropriate capital structure ratios; and prudence determinations for proposed new generating plants and associated transmission facilities. I have also testified before various legislative committees on regulatory policy matters. I hold a Bachelor of Science Degree in Accounting, summa cum laude, and a Master of Accounting, both from Florida State University.

Q. For whom are you appearing as a witness?

A. I am appearing as a witness for Florida Power & Light Company ("FPL" or the "Company").

Q. What is the purpose of your testimony?

A. The purpose of my rebuttal testimony is to respond to many of the positions and recommendations contained in the testimony of witnesses Donna Ramas and Daniel J. Lawton on behalf of OPC and witness Jeffrey Pollock on behalf of the Florida

Industrial Power Users Group ("FIPUG"). Collectively, I refer to these witnesses as "the intervenor witnesses."

Q. What do the intervenor witnesses recommend?

A. They all recommend that FPL's gas reserves project costs not be recovered through the Fuel Clause. In making their recommendation, they rely on misguided opinions on the risks of the project and incorrect interpretations of regulatory principles on how to manage risk for the benefit of customers. In some situations, they contort regulatory principles to fit their conclusion which, in the end, would be counterproductive to the Commission's goal and responsibility to regulate in the public interest.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibit JTD-1, which is my curriculum vitae.

Q. How is your rebuttal testimony organized?

A. I first discuss the appropriate use of the Fuel Clause mechanism to recover eligible costs, including costs associated with FPL's gas reserves project, and address the intervenor witnesses' overly restrictive and myopic view of previous Commission decisions. Second, I discuss the regulatory policy basis by which the Commission should consider FPL's proposal, and I identify incorrect interpretations of policy that are expressed by the intervenor witnesses. Lastly, I discuss how the Commission appropriately regulates in the public interest and the intervenor witnesses' ill-founded concerns over the Commission's ability to do so here.

I. Fuel Clause Mechanism

Q. What is the Commission's policy on the recovery of costs through the Fuel Clause?

A. The Commission has a long and consistent policy of allowing timely and complete recovery through the Fuel Clause of fossil fuel-related expenses which are subject to volatile changes. This policy has served the Commission, utilities and their customers well over the years, by allowing rates to reflect the current cost of fuel and thereby provide prompt and accurate price signals to customers, without the need for expensive and time-consuming rate cases.

At the same time, however, the Commission recognized that allowing timely and complete recovery of fuel costs could reduce incentives for utilities to keep those costs low. The Commission has addressed that concern in two ways. First, when the Fuel Clause was initially amended to provide for recovery of projected costs and true-up to actual costs, the Commission included the Generation Performance Incentive Factor to provide an incentive to utilities to operate their generating units efficiently and at a high availability. Second, the Commission's policy was refined in an investigation docket in 1985 (Docket No. 850001-EI-B). At the conclusion of its investigation, the Commission, in its Order No. 14546, reiterated its desire to have utilities pursue opportunities to achieve fuel savings. The tenth item of a list of items eligible for recovery through the Fuel Clause reads:

Fossil fuel-related costs normally recovered through base rates but which were not recognized or anticipated in the cost levels used to determine current base rates and which, if expended, will result in fuel savings to customers. Recovery of such costs should be made on a case by cases basis after Commission approval.

Thus, Item 10 encouraged utilities to pursue innovative ways to lower fuel costs, by giving them an opportunity to seek prompt, Fuel Clause recovery of costs incurred to achieve fuel savings.

Q. Doesn't witness Ramas reference this same language from Order No. 14546 to support her conclusion?

A. Yes, but this is a prime example of how she is contorting Florida regulatory policy to support her misguided conclusion.

Q. Please explain.

A. Witness Ramas interprets two specific phrases from Item 10 in an incorrect and overly restrictive manner.

First, she concludes that the phrase "normally recovered through base rates" automatically excludes FPL's investment in the gas reserves project from consideration for recovery through the Fuel Clause, apparently because Florida electric utilities have not heretofore recovered that specific form of investment in base rates. That is the wrong standard and is not consistent with the intent of Item 10. The intent was and continues to be a policy statement to encourage prudent

investments which benefit customers by saving fuel costs, regardless of the nature of the investment. It was the intent of the Commission to emphasize that any prudent investment (regardless of whether or not it otherwise might have been a rate base type item) should be pursued to save customers money. In a sense, it was a declaration to utilities to "think outside the box" by looking for innovative ways to save fuel costs without being worried that an overly restrictive application of the "rate base versus clause" distinction would place recovery in jeopardy. Ironically, witness Ramas is urging exactly the sort of restrictive application of the Fuel Clause that Item 10 is intended to avoid.

Q. What is the second phrase from Item 10 that witness Ramas incorrectly interprets?

A. It is the phrase "will result in fuel savings to customers." She mistakenly interprets this phrase to require that fuel savings must somehow be guaranteed for recovery to be allowed. This interpretation should be rejected for at least two reasons.

First, it would amount to the use of hindsight in evaluating forward-looking utility decisions. That approach would be fundamentally inconsistent with the accepted and appropriate standard of prudence for either rate base inclusion of an investment or the recovery of costs through the Fuel Clause. A good example is the inclusion in rate base of a new generating plant that has gone through a need determination pursuant to the Power Plant Siting Act. In order to be built, the plant must be shown to be the most cost-effective alternative available. The standard is one of prudence, not that it must always show savings throughout its operating life in

comparison to other alternatives that were considered and rejected. Given that technologies will change and prices of inputs will also change, it would be inconsistent with both fundamental fairness and sound regulatory policy to require a utility to show consistent and always net positive savings over an investment's 40 or 50 year life.

Second, her interpretation again flies in the face of the purpose of Item 10, which is to encourage innovative ways to save fuel costs. In fact, following her interpretation would have just the opposite effect, i.e., it would be a tremendous disincentive for a utility to pursue innovative approaches to fuel savings. In effect, it would be a "heads I win, tails you lose" proposition that no rational investor would be willing to pursue.

Q. So Item 10 does not prevent the Commission from considering the recovery of FPL's gas reserves project through the Fuel Clause?

A. That is correct. Not only does it not prevent it, FPL's gas reserves project is exactly the type of innovative investment that Item 10 is designed to encourage.

Q. Is there a subsequent Commission decision that provides insight as to the proper interpretation of the language you and witness Ramas quote from Order No. 14546?

A. Yes. In Order No. PSC-11-0080-PAA-EI, the Commission explicitly addressed the proper interpretation of the language both I and witness Ramas quote from Order No. 14546. Four passages are of particular importance.

- First, immediately after quoting the passage from Order No. 14546, the

Commission made the following statement: "We find that the appropriate interpretation of this section of Order 14546 is that capital projects eligible for cost recovery through the Fuel Clause should produce fuel savings based on lowering the delivered price of fossil fuel, or otherwise result in burning lower price fuel at the plant." The Commission went on to note in that same paragraph that the fuel savings in that comparison would be "estimated."

- In the very next paragraph the Commission also noted, "As Order 14546 states, projects that request recovery of costs through the Fuel Clause should be 'fossil fuel related.'"
- In Attachment A to Order PSC-11-0080-PAA-EI, which the Commission characterized as "a complete review of the capital costs that have been recovered through the fuel clause pursuant to Order No. 14546," the Commission made the following summary statement regarding a number of the Commission orders allowing capital recovery pursuant to Order No. 14546: "Order 14546 allows a utility to recover fossil-fuel related costs which results in fuel savings when those costs were not previously addressed in determining base rates."
- Finally, the Commission summarized its going forward interpretation of this provision in Order No. 14546: "…we believe that the appropriate policy going forward is to restrict capital project cost recovery through the Fuel Clause to projects that are 'fossil fuel-related' and that lower the delivered price, or input price, of fossil fuel. At the same time, we reaffirm our

practice of reviewing the eligibility of projects for recovery on a case-by-case basis."

Q. So this order shows that witness Ramas' interpretation of the Commission's policy is incorrect?

A. Yes. Order No. PSC-11-0080-PAA-EI gives further clarification of Order No. 14546 and clearly shows that both of witness Ramas' interpretations of Order No. 14546 are erroneous. First, her interpretation of the "normally recovered through base rates" language in Order No. 14546 as requiring gas production costs to have previously been in rate base completely misses the point – which is whether the costs of a Fuel Clause capital project are already reflected in base rates. This is seen best in Order PSC-11-0080-PAA-EI where the Commission repeatedly states in Attachment A of the Order: "Order 14546 allows a utility to recover fossil-fuel related costs which results in fuel savings *when those costs were not previously addressed in determining base rates*." (Emphasis added) This clearly does not mean that a project must have previously been in base rates at some point in time before it is eligible for recovery through the Fuel Clause. Second, witness Ramas' interpretation of the following language from Order No. 14546, "will result in fuel savings to customers" as requiring certainty of fuel savings is entirely at odds with the Commission's explicit acknowledgement that the savings to customers were "estimated." There is nothing certain about an estimate or projection, yet the Commission acknowledged in Order No. PSC-11-0080-PAA-EI that it relies upon fuel savings estimates in determining eligibility for Item 10 recovery.

Q. In two decisions since Order No. PSC-11-0080-PAA-EI, Fuel Clause recovery under Item 10 has been limited in each year to the actual fuel savings resulting from the projects in question, with any portion of that year's revenue requirement that is not recovered being deferred for recovery in future years when the level of fuel savings permit. Would that approach be appropriate for FPL's gas reserves project?

A. No. The orders in question approved Fuel Clause recovery for fuel conversion projects at two Tampa Electric Company ("TECO") power plants (Polk Unit 1 -- Order No. PSC-12-0498-PAA-EI and Big Bend Units 1-4 – Order No. PSC-14-0309-PAA-EI). The approach taken in those orders would not be appropriate here for several reasons:

- In its petitions for both of the fuel conversion projects, TECO proposed to limit its annual recovery of project costs to that year's fuel savings, and the orders accepted the proposed limitation. Thus, it would not be accurate to characterize that limitation as arising out of an interpretation of Order No. 14546; rather, it appears that the Commission merely approved TECO's proposal to impose the condition. Two of the Commissioners commented on this feature of TECO's petition at the agenda conference where the Big Bend fuel conversion project was approved, characterizing it as specific to the unique factors of TECO's particular project, without an expectation that other utilities would follow suit.
- The relationship over time between fuel savings and costs to be recovered for the TECO fuel conversion projects appears to be quite different from

what one expects with gas reserves projects. TECO is depreciating the investment in its fuel conversion projects over a short, fixed period of five years. TECO expects that the generating units at which the projects have been implemented will remain in service -- and the projects will continue to generate fuel savings -- for many years thereafter. Thus, deferral of cost recovery as a result of the fuel-savings cap would impose little risk of ultimate non-recovery. In contrast, recovery of the gas reserves project investment occurs via depletion that is proportional to the volume of produced gas each year as a fraction of the total expected production volume. At the point when only a small portion of the gas reserves investment remains to be recovered, the volume of gas remaining to be produced will be small as well. Thus, if the market price of fuel were to be lower than forecasted for the first several years of the project, when most of the gas is produced, there never would be a period when FPL could reasonably expect to recoup deferred costs out of "surplus" fuel savings. This would impose an asymmetric risk of recovery. I discuss this point elsewhere in connection with witness Ramas' testimony.

- Imposing a fuel-savings cap would also be logically inconsistent with one of the important benefits of a gas reserves project: providing a form of long-term hedging against volatility in natural gas market prices. When a hedge is used to mitigate market volatility, it is expected that the hedge price will remain relatively constant while market prices go up *and* down. This means that the hedge price can reasonably be expected to exceed market price at

times, just as it is expected to fall below market price at other times. Because of this reasonable expectation that prices under a well-designed hedge will occasionally exceed volatile market prices, a fuel-savings cap on recovery for hedging costs could result in an under-recovery. This would be an illogical and punitive outcome. It also would be inconsistent with the Commission's established practice concerning the recovery of hedging costs through the Fuel Clause, whereby costs incurred consistent with a utility's approved hedging plan are recoverable without regard to whether they lead to savings or costs in a particular period. I discuss the Commission's policy on hedging later in my testimony.

Q. Does witness Ramas misuse another Commission order in arguing against FPL's gas reserves petition?

A. Yes, she refers to Order No. 20604 and argues that gas reserves project costs should not be recovered through the Fuel Clause because those costs would not reflect market prices for natural gas. In doing so, she completely misses the point of FPL's proposal and the benefits it offers customers.

Witness Ramas is correct that in 1989 the Commission decided to change to a market-based pricing for coal that was purchased from an affiliated company. The first ordering paragraph of Order No. 20604 reads: "ORDERED by the Florida Public Service Commission that as a matter of general policy, market-based pricing for affiliate fuel and fuel transportation services shall be used for the purposes of fuel cost recovery where a market for the product or service is reasonably

available." In reaching its decision, the Commission concluded that the then-current system had been "generally successful in allowing only reasonable and prudent costs to be passed through" but cited concerns over administrative costs and lingering suspicion over contract negotiations. However, witness Ramas' interpretation of that order with relation to FPL's gas reserves project is misguided and myopic.

Q. Please explain.

A. Ms. Ramas' reference to Order No. 20604 suggests that the situations there and here are analogous. They are not, for several reasons:

- First, FPL is not proposing to buy any gas from an unregulated affiliate. FPL is proposing to make an investment through a wholly-owned subsidiary, which merely preserves certain accounting benefits for customers that FPL witness Ousdahl has explained. For purposes of ratemaking and cost-recovery policy, however, it is a distinction without meaning. Nor will FPL be negotiating the terms of the gas reserves investment with an affiliate. Instead, FPL affiliate USG Properties Woodford I, LLC ("USG") will be making an upfront investment in a gas reserves, which will entitle USG to a stated percentage of the natural gas output from that reserve, regardless of what the market price of natural gas may be at any given time. USG will then transfer its investment and concomitant gas entitlement to FPL's wholly-owned subsidiary at USG's cost, upon Commission approval of FPL's proposal to recover its investment through the Fuel Clause. Review of USG's investment (and

FPL's assumption of it) is more akin to an upfront prudence determination, much like a need determination for new generating plants subject to the Power Plant Siting Act. Furthermore, the gas output will be for the purpose of lowering the cost of generating electricity for FPL customers and will not be sold as a profit making enterprise as was the case for much of the coal output from the affiliated coal companies addressed in Order No. 20604.

- Second, contrary to intimations from witness Ramas, the Commission did not find that the cost-plus standard previously used for coal (even as an affiliate purchase of fuel) resulted in any unreasonable or imprudent costs. Rather, the Commission cited concerns over administrative costs and lingering suspicions arising from the nature of affiliated contract negotiations. Addressing these affiliate-contract negotiations, the Commission stated:

> In contrast to this, the typical affiliate contract is let without the benefit of competitive bidding. Instead, confident that the contract will be given to the affiliate, representatives of the two companies negotiate the rate at which the product or service will be purchased. They must do so recognizing that a favorable contract concession to the utility (and its ratepayers) comes at the expense of the affiliate and, ultimately, the parent holding company. Conversely, terms favorable to the affiliate come at the expense of the utility and, because of the pass-through nature of the fuel adjustment clauses, its customers.

As I stated earlier, FPL will be making an upfront investment and there will be no negotiations with an unregulated affiliate over the prices to be paid for the fuel that could pit the interest of the utility against the interest of its affiliate. So a major reason for relying on market prices for coal in 1989 does not apply to FPL's gas reserves project.

- Finally, it is undisputed that natural gas has now become the dominant source of fuel for utilities in Florida. The market for natural gas is inherently volatile and fundamentally different than the market that existed for coal in 1989. In fact, in 2002 as part of its investigation into risk management for fuel procurement (Docket No. 011605-EI), the Commission approved a framework for fuel hedging initiatives that in great part was precipitated by the increasing reliance on natural gas as a fuel source to generate electricity and the high level of volatility in those prices. In accepting a proposed resolution of the issues, the Commission acknowledged the importance of managing fuel risk when the reliance on one type of fuel grows. Order No. PSC-02-1484-FOF-EI states: "...the greater the proportion of a particular fuel or purchased power it relies upon to provide electric service to its customers, the greater the importance of managing price volatility associated with that energy source." FPL is proposing a project that is a long-term physical hedge fully consistent with the Commission's policy on hedging; and the fact that it is made through a subsidiary is entirely understandable and, in my view, appropriate to the circumstances.

Witness Ramas' heavy reliance upon Order No. 20604 shows that she has a blind faith in the natural gas market and the prices that it charges. But the FPL gas reserves project challenges that blind faith with a fundamental and important question: "Is there a better way to protect customers than simply assuming that 100% reliance on natural gas market prices is best?" As shown in the direct and rebuttal testimony of FPL's witnesses, the answer is a clear "yes." Neither Order No. 14546 nor Order No. 20604 should be interpreted in a way that interferes with the Commission's and FPL's ability to use this better way for the benefit of customers.

II. Regulatory Policy Considerations

Q. What are the regulatory policy considerations relevant to the Commission's consideration of FPL's gas reserves project?

A. Unsurprisingly, they are the same considerations as those that are applied to any investment made by a regulated utility to provide service to its customers. Among these are:

- A regulated utility has the obligation to provide reliable and cost-effective service to its customers and to deploy capital to meet this obligation. Inherent in this obligation is a responsibility to manage costs and mitigate risks where reasonably possible.
- All investments are subject to a determination of prudence, based on the

reasonably anticipated costs, risks, and benefits of said investment that are known or reasonably known at the time that the investment is made. Concomitant with this principle is that future changed circumstances that can be known and applied only in hindsight are not a valid basis to reverse a previous determination of prudence.

- All prudently incurred investments that are used and useful in providing service are to be afforded rate recovery treatment, both in the form of a reasonable return on the investment and a reasonable return of the investment, generally over the useful life of said investment.
- The reasonable rate of return is a necessary cost to provide service and should be set at a level to adequately compensate investors for the risk of their investment and to be fair to customers on whose behalf the capital is deployed. Inherent in this principle is the expectation that customer and investor interests are balanced in a fair and symmetrical manner.
- While the reasonable return on investment is not guaranteed, there is an expectation that rates will be set to afford a utility a reasonable opportunity to actually earn its authorized rate of return. Without that reasonable opportunity, the allowed return would have to be substantially higher, and over time this would result in higher electric rates for customers.
- The reasonable rate of return is set and monitored to fall within an established band, so that the return is neither excessive nor deficient.

Q. Do the intervenor witnesses adhere to these principles?

A. No, not consistently. There are at least three significant instances in which the intervenor witnesses stray from these principles or at least do not appreciate the need to evaluate FPL's gas reserves project consistent with them.

Q. What is the first such instance?

A. The first instance concerns the concept of risk mitigation and witness Ramas' apparent misunderstanding of the purpose of the gas reserves project. This is aptly illustrated by the following quote from page 27 of her testimony: "Under FPL's approach, 100% of the risk associated with FPL entering into gas exploration, drilling and production projects – whether from unconventional or conventional sources – would be pushed onto ratepayers." Obviously, witness Ramas does not understand or simply chooses to ignore the fact that one of the central purposes of the gas reserves project is to mitigate risks through hedging for the benefit of customers. There is no risk shifting from investors to customers, merely a proposal to better manage and mitigate a risk that is currently being borne by customers.

Q. Please explain what risk the customers are currently bearing.

A. Customers are already bearing the price risk associated with the high volatility of the natural gas market. This volatility is felt directly by customers through the functioning of the Fuel Clause, in which fuel costs are passed directly through to customers. The drillers and producers of natural gas are not concerned about the prices paid by customers. In fact, it is in their best economic interest to have prices as high as possible. It is only natural and expected that drillers and producers will seek to maximize their returns when they are not constrained by regulation. In

contrast, FPL is proposing to make an investment to mitigate this risk by making the output of the gas reserves available exclusively to benefit its customers and to have its return on investment limited to a reasonable level (its authorized level) consistent with its role as a regulated utility. In short, FPL's gas reserves project mitigates and manages risks that customers already bear. The project represents a natural extension of FPL's obligation as a regulated utility to provide service reliably and cost-effectively and to mitigate risks where reasonably possible.

Q. What is the second instance in which the intervenor witnesses stray from regulatory principles?

A. Witness Ramas appears to suggest that it would be inappropriate for FPL to be allowed a return on its prudently incurred investment. This is illustrated by the following passage from pages 27 and 28 of her testimony:

> If the Commission approves FPL's request without modification, the result would be that FPL's investors, who are ultimately the shareholders of NextEra Energy, Inc., would earn additional returns through the operation of FPL's fuel cost recovery clause and such returns would be guaranteed. This would result as FPL would be applying a rate of return to the associated capital costs in the fuel clause calculations. That return includes a return on equity component at the Commission's authorized rate of return on equity for FPL, which is essentially the earnings or profit that is applied on behalf of investors.

Q. What is incorrect in her statement?

A. First and foremost is her inference that it would be inappropriate for FPL to earn a return on an investment, even though it is being made as a regulated utility exclusively for the benefit of its customers. Consistent with the regulatory principles I previously identified, all such investments that have been determined to be prudent and incurred to produce benefits for customers are an appropriate cost and should be allowed for recovery, including a reasonable return. Second is her misleading characterization that FPL would "earn additional returns" on future gas reserves projects. It is true that, if additional investments are made, those investments should be allowed to earn a rate of return. However, this would be the same allowed return that is earned on all other regulated investments and simply illustrates the unremarkable mathematical outcome that if the level of investment goes up then the dollars (but not the rate) of return will increase proportionately.

While witness Ramas' apparent concern is that customers would be paying for an additional return in their rates, the more meaningful question is how much customers are already paying in their rates to provide unregulated returns to the drillers and producers of natural gas. While this would be an interesting exercise to try and ascertain, it is really not germane to the issue at hand. The real issue is whether the gas reserves project is prudent and produces benefits for customers. The regulated return earned by FPL is but one cost component in making that overall determination. Contrary to witness Ramas' apparent concern, there is nothing inappropriate or untoward for a regulated utility to earn a reasonable return

on additional investments prudently made to serve customers. In fact, it is essential and is a healthy thing, both for customers and investors.

Q. Does OPC witness Lawton address the return component of FPL's gas reserves project?

A. Yes. He refers to a 2011 Commission order that, in turn, refers back to Order No. 6357 that was issued in a 1974 investigation docket (Docket No. 74680-CI). In Order No. 6357 the Commission stated that "a utility does not make a profit on its fuel costs." Mr. Lawton opines that the return component of FPL's gas reserves project would result in FPL earning a profit in excess of the cost of fuel and that doing so would be inconsistent with the order. However, witness Lawton is completely wrong in his assertion.

Q. Please explain.

A. Witness Lawton apparently does not understand or simply fails to appreciate the fact that the Commission's policy and practice is to allow the recovery of all prudent fuel costs incurred by a utility in generating electricity for its customers. And this recovery is generally restricted to the actual cost, except perhaps for rewards or penalties pursuant to the Commission's Generation Performance Incentive Factor. The phrase cited by witness Lawton simply means that no recovery is allowed beyond those prudent costs, like a mark-up on the commodity price of fuel purchased. The Commission's policy appropriately recognizes that the determination of "fuel cost" properly includes a cost of capital component for any investments prudently incurred to obtain fuel reliably and cost-effectively. Order No. 6357 recognizes this: "The charge reflected on a customer's bill each month is

designed only to provide for a recovery of fuel costs experienced by the utility in generating the customer's power…." Order No. 6357 also states: "Certainly, all reasonable costs incurred up to the time the fuel is burned represent a part of a utility's fossil fuel expense" and in addressing the trade-off between capital and fuel, the Order states: "In our judgment, the proper design criterion is to minimize both capital and fuel costs combined."

It should also be emphasized that since 1974, the Commission has supplemented its policy by encouraging utilities to look for innovative ways to reduce fuel costs and to engage in hedging activities to mitigate the impacts on customers of fuel price volatility. As previously noted, one of those changes in policy was made in 1984 in Order No. 14546, Item 10. Order PSC-11-0080-PAA-EI explains this change in policy in great detail and explicitly notes that the new policy is an extension of the policy established in Order No. 6357.

> In Order No. 14546 we approved the stipulation of the parties and adopted them as our own. We found that the stipulated provisions (including the fuel clause exception to base rate recovery) [Item 10], were an appropriate extension of the policy established by Order No. 6357.

Order PSC-11-0080-PAA-EI goes on to give an extensive discussion of "capital projects eligible for cost recovery through the Fuel Clause." Such recovery necessarily includes a return on the capital investment in the project.

Contrary to witness Lawton's assertion, there is nothing in Order 6357 that would suggest that the return component of FPL's investment in gas reserves would result in a recovery that exceeds the amount of fuel costs "experienced by the utility in generating the customer's power." Moreover, subsequent Commission decisions extending Order No. 6357 make it explicitly clear that certain capital projects can be recovered through the Fuel Clause, and that a necessary cost for such projects is a return on investment. See, Order No. 14546, Order No. PSC-11-0080-PAA-EI and the orders cited in Attachment A to Order No. PSC-11-0080-PAA-EI.

Q. Has the Commission addressed how the return on investment is to be calculated for capital investments eligible for recovery through the Fuel Clause?

A. Yes. The practice of allowing utilities to earn a return on investments through the Fuel Clause and other clauses has become so well established that the Commission approved in 2012 a stipulation setting out the details of how the weighted average cost of capital for such investments is to be calculated. Order No. PSC-12-0425-PAA-EI. OPC and FIPUG were parties to that stipulation.

Q. What is the third instance in which the intervenor witnesses stray from regulatory principles?

A. The third instance can be succinctly stated as witness Ramas' "heads I win, tails you lose" philosophy. She recommends that the Commission tell FPL that if it goes forward with its gas reserves project then the benefits must be guaranteed or there will be no cost recovery. In essence, she wants FPL to take all the risks of the project and recover costs only to the extent that actual benefits result – and to do so

for only a reasonable regulatory rate of return. She takes the foundational concepts of fairness and symmetry embedded in the regulatory principles I earlier identified and turns them on their heads.

Q. Please explain.

A. Witness Ramas' unfair and asymmetrical position is stated on page 30 of her testimony: "the recovery of the cost of natural gas obtained by FPL from such joint ventures will be limited to the market price of gas." She continues by directing the Commission to: "ensure that any recoveries by FPL of its proposed investments each year are limited to the actual resulting fuel savings." What she does not address in a symmetrical fashion is the situation where market gas prices exceed the cost of the gas produced from the reserve project (which is the expected outcome from most of the scenarios analyzed). In that situation, she wants to deviate from her basic position that the market price of gas is the best and most fair price for customers to pay, such that customers would continue to pay FPL only the actual cost of production for the gas. In essence, she wants to have her cake and eat it too.

Q. Is there a way to make her position symmetrical?

A. Yes, but doing so would strip FPL's gas reserves project of all benefits for customers.

Q. Please explain.

A. For witness Ramas' proposal to be fair and symmetrical, FPL would have to be compensated for gas from the gas reserves project at the market price of natural gas regardless of whether the market price were above or below the cost of production. Should the market price of natural gas fall below the cost of gas from the reserves

project, the market price would be used in the Fuel Clause and FPL would incur a loss. Should the market price of natural gas exceed the cost of gas from the reserves project, the market price would still be used in the Fuel Clause and FPL would achieve a gain. While this would be symmetrical, it would not be consistent with other basic tenets of regulation and would not produce any customer benefits compared to the current status quo of buying all gas on the open market.

In contrast, FPL's proposal is entirely consistent with the concept of a regulatory rate of return and other fundamental tenets of rate regulation. FPL's proposal is designed to provide significant benefits for customers within the established principles of rate regulation that I earlier identified.

Q. Are these benefits limited to the potential for cost savings?

A. No. While the potential for significant cost savings are an integral part of FPL's proposal, there are also hedging benefits that must be considered.

Q. What is the Commission's policy on fuel hedging?

A. In Docket No. 011605-EI, opened to address public utility risk management policies and procedures, the Commission approved a settlement among the parties, which included OPC and FIPUG. The settlement endorsed the use of hedging, both financial and physical hedges, as a risk management tool to mitigate price volatility for the benefit of customers. In Order No. PSC-02-1484-FOF-EI, the Commission stated:

> We find that the Proposed Resolution of Issues, modified as set forth above, provides a reasonable resolution of all issues in the

docket. The Proposed Resolution of Issues establishes a framework and direction for the Commission and the parties to follow with respect to risk management for fuel procurement. It provides for the filing of information in the form of risk management plans and as part of each IOU's final true-up filing in the fuel and purchased power cost recovery docket, which will allow the Commission and the parties to monitor each IOU's practices and transactions in this area. In addition, it maintains flexibility for each IOU to create the type of risk management program for fuel procurement that it finds most appropriate while allowing the Commission to retain the discretion to evaluate, and the parties the opportunity to address, the prudence of such programs at the appropriate time. Further, the Proposed Resolution of Issues appears to remove disincentives that may currently exist for IOUs to engage in hedging transactions that may create customer benefits by providing a cost recovery mechanism for prudently incurred hedging transaction costs, gains and losses, and incremental operating and maintenance expenses associated with new and expanded hedging programs. For these reasons, we approve the attached Proposed Resolution of Issues, as modified above.

Q. Is FPL's proposed gas reserves project consistent with this policy?

A. Yes, it is. In particular, the policy recognizes that the Fuel Clause is an appropriate

mechanism to effectuate cost recovery for hedging initiatives, that there should be flexibility in structuring hedging proposals, that there should be a determination of prudence, that customer benefits should be the emphasis of a hedging initiative, that potential disincentives to hedging should be removed that otherwise could prevent achieving customer benefits, and that both gains and losses can result from prudent hedging initiatives. Consistent with this policy, FPL is seeking a determination of prudence for its gas reserves project that is anticipated to provide costs benefits along with its hedging benefits.

Q. Would the approach recommended by the intervenor witnesses be a disincentive to achieving the benefits of a gas reserves project as a prudent hedging initiative?

A. Yes. I cannot imagine any utility being willing to pursue a gas reserves project under the conditions that they recommend.

III. Public Interest Regulation

Q. Where does the Commission derive its authority and obligation to regulate utilities in the public interest?

A. The Commission's authority and obligation to regulate in the public interest is derived from Section 366.01, Florida Statutes, which says: "The regulation of public utilities as defined herein is declared to be in the public interest and this chapter shall be deemed to be an exercise of the police power of the state for the protection of the public welfare *and all the provisions hereof shall be liberally*

construed for the accomplishment of that purpose." (Emphasis added)

Q. How is this relevant to FPL's gas reserves project?

A. FPL's gas reserves project is a new innovative approach that provides benefits to customers by investing in gas reserves. Such an initiative has not been attempted before by an investor-owned utility in Florida. It has been attacked by the intervenor witnesses because it is new and different from traditional approaches. Witness Ramas even declares that the costs of the reserve project are ineligible for recovery because "capital investments in gas exploration, drilling, and production are so foreign to an electric utility's regulated monopoly business that such items are incompatible with the system of accounts that the Commission prescribes for electric utilities." She continues: "As such, these costs do not qualify for recovery through the fuel cost recovery clause under the order upon which FPL relies." Witness Ramas' positions are shortsighted and inconsistent with Chapter 366, Florida Statutes.

Q. Please explain.

A. Witness Ramas attempts to limit the Commission's discretion to determine what activities and investments are eligible for cost recovery to those that have traditionally been undertaken by "regulated monopolies." However, her standard is not the correct one. Section 366.01, Florida Statutes, makes it clear that the public interest is the ultimate test and not whether an investment incurred to provide electric service to customers at a lower and more stable fuel cost has been traditionally done or whether it fits neatly in a Uniform System of Accounts designation. If a project can be shown to be in the public interest, it should be

considered on the same basis that other investments are considered. The Commission certainly has the discretion to do so, and perhaps the obligation to do so as well.

Q. What does the statute say about the recovery of utility investments?

A. Section 366.06 requires the Commission to "investigate and determine the actual legitimate costs of the property of each utility company, actually used and useful in the public service" and that the net investment "shall be used for ratemaking purposes and shall be the money honestly and prudently invested by the public utility company in such property...." So, succinctly stated, the standard is one of prudently incurred costs in property which serves the public.

Q. Does FPL's proposed gas reserves project fall within this statutory provision?

A. Yes. FPL is seeking the Commission's determination that its investment in the gas reserves project is prudent and is used and useful in serving the public, such that it is in the public interest and eligible for cost recovery. What is being sought is squarely within the statutory framework and is eligible for cost recovery through the Fuel Clause.

Q. Does witness Ramas present other arguments in support of her position that FPL's gas reserves project should be ineligible for cost recovery?

A. Yes, she presents a variant of her primary argument that the gas reserves project is new and different. She opines that the Commission would be unable to audit the project and that the Commission is ill equipped to regulate the project stating: "While the Commission has some very qualified and experienced auditors and analysts on its staff, I suspect that the PSC audit and technical staff also lack the

specialized expertise in the unique and 'very specialized' accounting requirements associated with the competitive gas exploration, drilling and production industry."

Q. Are witness Ramas' concerns well-founded?

A. No. She is correct that the Commission does indeed have very qualified and experienced auditors and analysts. I can personally vouch for that based on my first-hand knowledge and experience with the Commission as a consumer advocate, PSC staffer, commissioner, and expert witness over the past 37 years. However, in those 37 years, this is the first time that I recall a witness concluding that a public interest determination be constrained by what they believe to be deficiencies in the ability of PSC staff to understand and effectively oversee a new proposal. Witness Ramas' concern is ill-founded and, frankly, fails to appreciate the talents of the PSC staff.

Q. Please explain.

A. The Commission's role is to regulate in the public interest and in so doing should not be constrained by witness Ramas' "business as usual" considerations. Stated differently, the scope of regulation should be determined by what is needed to serve the public interest and not have the determination of what is in the public interest constrained by the existing scope of regulation. This would be the proverbial "tail wagging the dog" situation. If a new proposal can be shown to be in the public interest, it is the responsibility of the regulator to adapt to the requirements to effectively regulate it in the public interest. This is something that I have seen the Commission do very well as technology, governmental policies, risk factors, and economic considerations have changed over the years. By necessity, regulating in

the public interest is a dynamic undertaking. It is my opinion that the Commission and its staff have the ability to effectively regulate FPL's gas reserves project. Even if this means that existing staff expertise needs to be refined and expanded, I have every confidence that staff will be able to do so.

Q. Is witness Ramas correct in her assessment that the Commission would be unable to audit the gas reserves project?

A. No. The Commission staff would be able to audit the gas reserves project in the same manner and to the same extent that it audits the whole range of utility transactions with third parties. FPL's investment in the project would be auditable. In addition, FPL would be able to audit transactions with its joint venture partner and the Commission auditors would have access to the results of those audits.

Witness Ramas asserts that this conventional approach to auditing utility transactions would be insufficient here and declares that this asserted deficiency is "germane to OPC's position that the transactions fall outside the limits of the Commission's regulatory domain." She apparently believes that the Commission must have the ability to directly audit the third party operators and suppliers as a prerequisite for the gas reserves project to be eligible for cost recovery. However, hers is the wrong standard and could result in unnecessary and ill-advised rejections of third party arrangements that would be beneficial for customers.

Q. Please explain.

A. The Commission has full audit capability over Florida regulated utilities and their affiliates which do business with the regulated utility. This enables the

Commission to ascertain the correctness and the reasonableness of costs which are sought for recovery through rates. The Commission does not have the authority to audit third party operators or suppliers. However, the Commission still retains its authority and ability to judge the reasonableness of costs incurred from third parties.

A good example is a regulated utility's purchase of power from a third party cogenerator. The Commission does not have the authority to directly audit the third party cogenerator, but still determines the reasonableness of the costs incurred by the regulated utility to obtain the power. The Commission can and does rely on the regulated utility's audits and other verifications that the power is being delivered consistent with the contracts that have been approved by the Commission. This is analogous to what is being proposed for the gas reserves project.

Witness Ramas' incorrect standard would call into question a whole array of third party arrangements that have produced benefits for customers, such as cogenerated power and joint venture arrangements like FPL's co-ownership of Plant Scherer in Georgia. Obviously, the Commission does not have the ability to audit Georgia Power Company ("Georgia Power"). However, the Commission did thoroughly review and ultimately approved FPL's co-ownership arrangement with Georgia Power and routinely relies on FPL audits and transactional verifications in judging contract compliance and the reasonableness of costs flowing from those transactions with Georgia Power. This too is analogous to what is being proposed

by FPL for the gas reserves project. Another analogous third party arrangement that has produced benefits for customers is FPL's ownership interest in JEA's St. Johns River Power Park, as discussed in the rebuttal testimony of FPL witness Ousdahl.

Q. Please summarize your testimony.

A. FPL's gas reserves project is an innovative approach to provide fuel savings and hedging benefits for customers. Like any other capital expenditure made by a regulated utility for the benefit of its customers, eligibility for cost recovery should be governed by a prudence determination that is based on an informed assessment of its costs, benefits, and risks. Cost recovery should also be treated consistent with the sound principles of ratemaking that I identified and not by the inconsistent and asymmetrical application of those principles as suggested by the intervenor witnesses.

FPL's gas reserves project is an innovative approach to reducing fuel costs of the type that is contemplated and encouraged by the Commission's policy on Fuel Clause eligibility as contained in Order No. 14546. Such a project is especially needed in today's environment of increasing reliance on natural gas to generate electricity and the volatile nature of the market price for natural gas. Indeed, the project is also consistent with the Commission's hedging policies.

The intervenor witnesses contort previous decisions of the Commission to support their incorrect conclusion that the gas reserves project should be ineligible for cost

recovery. They do not understand or simply choose to ignore the benefit of the project in mitigating risks that are currently borne by customers. Consistent with the Commission's responsibility to regulate in the public interest, the Commission should ask this question: "Does the gas reserves project offer a better way to protect customers from the vagaries of the natural gas market than simply continuing with a 100% reliance on natural gas market prices?" If the Commission answers this question in the affirmative, then the costs for the project should be recoverable through the Fuel Clause. Not only would this be the appropriate treatment for the project, but also it would reconfirm the Commission's commitment to encourage the development of innovative ways to reduce fuel costs and mitigate fuel risks for the benefit of customers.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

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