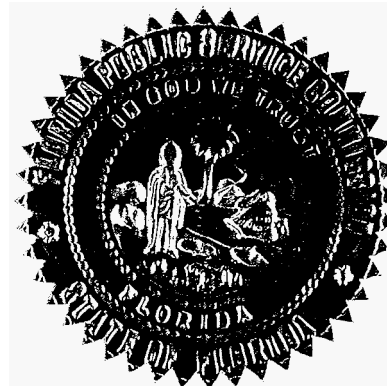


BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 041291-EI

In the Matter of

PETITION FOR AUTHORITY TO RECOVER
PRUDENTLY INCURRED STORM RESTORATION
COSTS RELATED TO 2004 STORM SEASON
THAT EXCEED STORM RESERVE BALANCE,
BY FLORIDA POWER & LIGHT COMPANY.



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VOLUME 1

Page 1 through 180

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN BRAULIO L. BAEZ
COMMISSIONER J. TERRY DEASON
COMMISSIONER RUDOLPH "RUDY" BRADLEY
COMMISSIONER CHARLES M. DAVIDSON
COMMISSIONER LISA P. EDGAR

DATE: Wednesday, April 20, 2005

TIME: Commenced at 9:30 a.m.

PLACE: Betty Easley Conference Center
Hearing Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: LINDA BOLES, RPR
Official FPSC Hearings Reporter
(850) 413-6734

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7 appearing on behalf of Florida Power & Light Company.

8 R. WADE LITCHFIELD, ESQUIRE, and NATALIE F. SMITH,
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10 Juno Beach, Florida 33408-0420, appearing on behalf of Florida
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15 HAROLD MCLEAN, ESQUIRE, JOSEPH McGLOTHLIN, ESQUIRE,
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20 JOHN McWHIRTER, ESQUIRE, and TIMOTHY PERRY, ESQUIRE,
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22 Florida 32301, appearing on behalf of Florida Industrial Power
23 Users Group.

1 APPEARANCES CONTINUED:

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3 Post Office Box 271, Tallahassee, Florida 32302, appearing on
4 behalf of the Florida Retail Federation.

5 MICHAEL B. TWOMEY, ESQUIRE, Post Office Box 5256,
6 Tallahassee, Florida 32314-5256, appearing on behalf of
7 Thomas P. and Genevieve E. Twomey and AARP.

8 COCHRAN KEATING, ESQUIRE, and KATHERINE FLEMING,
9 ESQUIRE, FPSC General Counsel's Office, 2540 Shumard Oak
10 Boulevard, Tallahassee, Florida 32399-0850, appearing on behalf
11 of the Florida Public Service Commission Staff.

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I N D E X

WITNESSES

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P R O C E E D I N G S

COMMISSIONER BAEZ: Good morning. We'll call the hearing to order. Let us have the pronouncement of the notice, please.

MS. FLEMING: Pursuant to notice issued by the Commission Clerk on March 23rd, 2005, this time and place has been set for a hearing in Docket Number 041291-EI.

COMMISSIONER BAEZ: Thank you. We'll take appearances starting stage left. Go ahead.

MR. HOFFMAN: Good morning, Mr. Chairman, Commissioners. My name is Kenneth A. Hoffman. I'm here this morning on behalf of Florida Power & Light Company.

MR. LITCHFIELD: Wade Litchfield, Natalie Smith and Stephen Huntoon for Florida Power & Light Company. And I would also enter an appearance for John Butler of Steel, Hector & Davis.

MS. CHRISTENSEN: Patty Christensen on behalf of the Office of Public Counsel.

MR. MCGLOTHLIN: Joe McGlothlin on behalf of the Office of Public Counsel. Let me enter an appearance also for Public Counsel Harold McLean.

MR. MCWHIRTER: John McWhirter assisting Tim Perry on behalf of the Florida Industrial Power Users Group.

MR. WRIGHT: Robert Scheffel Wright appearing on behalf of the Florida Retail Federation.

1 MR. TWOMEY: And Mike Twomey appearing on behalf of
2 LARP and Thomas and Genevieve Twomey.

3 MR. KEATING: Cochran Keating appearing on behalf of
4 the Commission.

5 MS. FLEMING: Katherine Fleming appearing on behalf
6 of the Commission.

7 COMMISSIONER BAEZ: Thank you all, and good morning
8 again.

9 Do we have any preliminary matters, Ms. Fleming or
10 Mr. Keating?

11 MS. FLEMING: Yes, Chairman. I'd just like to point
12 out that there are no pending motions in this docket. There is
13 one pending confidentiality request relating to the staff audit
14 work papers. No party has indicated an intent to use this
15 confidential information, and an order on this request is
16 pending.

17 COMMISSIONER BAEZ: Very well. And we've got some
18 composite exhibits to deal with this morning?

19 MS. FLEMING: Yes. That's correct. Staff has
20 prepared a comprehensive list of exhibits that identifies the
21 stipulated staff composite exhibits, the exhibits filed with
22 the parties' prefiled testimony, as well as a composite exhibit
23 consisting of the proof of publication of the newspaper notices
24 for the customer service hearings.

25 Also this morning FPL provided a composite exhibit,

1 as well as OPC provided a composite exhibit that has been
2 stipulated to by all the parties. We request that in an effort
3 to facilitate the entry of those exhibits that this
4 Comprehensive Exhibit List be marked as hearing Exhibit 1, and
5 that the rest of the exhibits be marked as numbered on the
6 sheet.

7 As for the FPL composite exhibit that we were just
8 handed this morning, that should be identified as hearing
9 Exhibit 33, and the OPC composite exhibit identified as
10 composite Exhibit 34.

11 COMMISSIONER BAEZ: Very well. If there's no
12 objections, we will show the Comprehensive Exhibit List marked
13 as Exhibit 1 and the subsequent exhibits listed therein marked
14 in sequence thereafter. And you said the FPL composite hearing
15 exhibit should be marked 33?

16 MS. FLEMING: That's correct.

17 COMMISSIONER BAEZ: And the OPC composite hearing
18 exhibit marked as 34.

19 MS. FLEMING: 34.

20 (Exhibits 1 through 34 marked for identification.)

21 MS. FLEMING: And at this time staff would ask to
22 move into the record Exhibit 1 and 2, which consists of the
23 actual list and staff's consolidated exhibit. And I believe as
24 well that Exhibits 32, 33 and 34 can be moved into the record
25 as well since they've been stipulated.

1 COMMISSIONER BAEZ: Are there any objections by the
2 parties at this -- all right then. Show Exhibits 1, 2, 32, 33,
3 and 34 moved into the record.

4 (Exhibits 1, 2, 32, 33 and 34 admitted into the
5 record.)

6 COMMISSIONER BAEZ: Ms. Fleming, what else do we
7 have?

8 MS. FLEMING: We'd just like to point out that the
9 prefiled testimony and exhibits of FPL Witness Whalin has been
10 stipulated by the parties for inclusion in the record.
11 Ms. Whalin has been excused and her prefiled testimony and
12 exhibits can be moved into the record, and her exhibits are
13 identified as 3, 4, 5 and 6.

14 COMMISSIONER BAEZ: Is there any objection with
15 moving 3, 4, 5 and 6 into the record and moving Ms. Whalin's.
16 Witness Whalin's testimony into the record at this time?

17 All right. Let the record show that the testimony of
18 Witness, FPL Witness Whalin is moved into the record as though
19 read, and the accompanying exhibits numbered 3, 4, 5 and 6 are
20 also accepted in the record.

21 (Exhibits 3, 4, 5 and 6 admitted into the record.)
22
23
24
25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

DIRECT TESTIMONY OF LINDA R. WHALIN

DOCKET NO. 041291-EI

I. INTRODUCTION AND CREDENTIALS

Q. Please state your name and business address.

A. My name is Linda R. Whalin. My business address is Florida Power & Light Company, 700 Universe Boulevard, Juno Beach, Florida 33408-0420.

Q. By whom are you employed and what is your position?

A. I am employed by Florida Power & Light Company ("FPL" or the "Company") as Director of Distribution Operations Support.

Q. Please describe your duties and responsibilities in that position.

A. My duties and responsibilities include developing and ensuring execution of reliability programs, restoration processes, administering external labor management contracts, construction standards and design processes, and communications with customers impacted by distribution processes. In addition, I am responsible for the development and deployment of the Distribution hurricane response plan. During hurricane restoration, I am the

1 Director of Restoration Operations Support. My primary charge is to direct
2 and manage the development of the overall restoration strategy including
3 resource acquisition and deployment plans, analysis of data for workload
4 forecasting, and operations status reports. In addition, I along with others,
5 provide direction and coordination for all distribution and transmission
6 support activities from FPL's General Office Command Center (GOCC).

7
8 **Q. Please describe your educational background and the business**
9 **experience.**

10 **A.** I have a BS in engineering sciences from Michigan State University. I have
11 held many positions at FPL in my 25 years of service, primarily in the
12 Distribution area. I began my career with FPL in the marketing department
13 where I worked until 1983. From 1983 to 1997, I filled many positions in
14 field operations, including field engineer, crew supervisor, dispatch
15 supervisor, lead supervisor, and ultimately Distribution Operations Area
16 Manager. My responsibilities grew from field and design, supervising
17 construction crews, supervising outage dispatchers, to eventually managing
18 multiple service centers in southern Miami-Dade County. In 1997, I joined
19 Distribution Staff in the role of Distribution Reliability Manager and for three
20 years, developed and administered FPL's reliability program. In 2000, I
21 became a Distribution Director leading a joint information technology
22 project to change out legacy systems in the Distribution business unit. Key
23 deployments were a new work management system, asset management

1 system, data warehouse, and mobile applications deployed to the field
2 workforce. In July 2003, I was promoted to the position of Director of
3 Distribution Operations Support.

4
5 **II. PURPOSE**

6
7 **Q. What is the purpose of your testimony in this proceeding?**

8 **A.** I will provide an overview of FPL's current emergency preparedness plans
9 and processes. I will discuss how these plans were initiated and executed
10 during the 2004 hurricane season. I will also describe the extent of these
11 hurricanes and the resulting impact and damage to FPL's distribution
12 facilities. Finally, I will discuss the factors contributing to FPL's overall
13 successful performance in safely restoring service to the greatest number of
14 customers in the least amount of time.

15 .
16 **Q. Are you sponsoring an exhibit in this case?**

17 **A.** Yes. I am sponsoring a Composite Exhibit consisting of 4 documents
18 attached to my direct testimony. Those 4 documents are:

19 Document LRW-1, Characterization of Hurricanes and Timeline

20 Document LRW-2, Peak External and FPL Personnel Resources

21 Document LRW-3, Percent of Customers Restored by Day

22 Document LRW-4, FPL vs. DVP, Percent of Customers Restored by Day

1 **III. OVERVIEW OF EMERGENCY PREPAREDNESS PLAN AND**
2 **RESTORATION PROCESS**

3
4 **Q. What is the objective of FPL's emergency preparedness plan and**
5 **restoration process?**

6 **A.**The primary objective of FPL's emergency preparedness plan and restoration
7 process is to safely restore the greatest number of customers in the least
8 amount of time. Meeting the customers' needs for quick restoration is the
9 most prudent response after a hurricane. Experience has shown that extensive
10 planning, training, process discipline, and execution that can be scaled quickly
11 to match the storm are critical to successfully achieving this objective. It must
12 be understood, of course, that the objective of safely restoring electric service
13 as quickly as possible does not mean that service will be restored at the overall
14 least cost. FPL responds to storm restoration based on the primary interest of
15 all concerned, e.g., customers, governmental policy makers and other
16 officials, as well as FPL, to have power restored quickly. Restoring service at
17 the lowest possible cost does not result in rapid restoration.

18
19 **Q. What are the key components of FPL's emergency preparedness plan?**

20 **A.**The key components include:

- 21 • Disaster response policies and procedures
- 22 • Adjustable internal organizational structures based on the required
- 23 response

- 1 • Timeline of activities to assure rapid notification and response
- 2 • Mutual assistance agreements and vendor contracts and commitments
- 3 • Plans for movement of resources, personnel, materials, and equipment
- 4 to areas requiring service restoration
- 5 • Communication and notification plans for employees, customers,
- 6 community leaders, emergency operating centers, and regulators
- 7 • An established centralized command center with an organization for
- 8 command and control of emergency response forces
- 9 • Checklists and conference call agendas to organize, plan, and report
- 10 situational status
- 11 • Damage assessment modeling and reporting procedures
- 12 • Field and aerial patrols to assess damage
- 13 • Comprehensive circuit patrols to gather vital information needed to
- 14 identify the resources required for effective restoration
- 15 • Systems necessary to support outage management procedures and
- 16 customer communications

17

18 **Q. How does FPL prepare and ensure readiness to effectively respond to**

19 **storm events?**

20 **A. Each year, prior to storm season, FPL reviews and updates its emergency**

21 **preparedness plan. The key focus areas of this plan are staffing the storm**

22 **organization, preparing logistics and support, and enhancing computer and**

23 **telecommunication systems all to ensure rapid restoration. As part of this**

24 **process, all business units in the company identify personnel for staffing the**

1 emergency response organization. In many cases, employees assume roles
2 different than their regular responsibilities. Training is conducted for many
3 storm personnel each year regardless of whether they are in a new role or a
4 role in which they have served many times. This includes training on
5 processes that range from analytical and clerical to reinforcing restoration
6 processes for managers and directors.

7
8 In the logistics support area, preparations include increasing material
9 inventory, establishing staging site plans, expanding and verifying lodging
10 arrangements, and securing agreements and contracts for catering, busing, and
11 office trailers. These activities are important to ensure availability and
12 delivery of these critical items on time and at a reasonable cost. If FPL is not
13 impacted by storms, this increase in material inventory is absorbed through
14 normal business by year end. All of these agreements and activities provide
15 the foundation to begin any restoration effort, while continuing to remain
16 flexible to scale up resources and commitments as necessary, and at the same
17 time recognizing the possibility of not having a storm that year.

18
19 **Q. How do you test your emergency preparedness plan?**

20 **A.** FPL's readiness is tested during a hurricane "dry run" exercise held annually
21 right before the start of hurricane season. This event simulates a storm
22 impacting FPL's territory. The purpose is to provide a realistic,
23 challenging scenario that causes the organization to practice functions not
24 generally performed during normal operations. It is a full scale drill which

1 takes place with active participation from employees represented from every
2 business unit in the company. After months of preparation, the formal drill
3 activities begin 72 hours from the mock hurricane's forecasted time and date
4 of impact. The GOCC is fully mobilized and staffed. Field patrollers are
5 required to complete simulated damage assessments which are then utilized by
6 office staff to practice updating storm systems, acquiring resources, and
7 developing estimated times of restoration. The exercise also includes
8 simulating customer and other external communications, updating our outage
9 management system, and other storm specific applications.

10

11 **Q. How do you activate your restoration process?**

12 **A. When a major storm threatens FPL's service territory, FPL responds by taking**
13 **well-tested actions at specified intervals prior to landfall. While these**
14 **hurricanes are developing in the Atlantic Ocean or Gulf of Mexico, our staff**
15 **meteorologists are monitoring conditions and various departments throughout**
16 **the company initiate preliminary preparations for addressing internal and**
17 **external resource requirements, logistics needs, and system operation**
18 **conditions. At 72 hours, the GOCC is activated, all storm personnel are**
19 **alerted, resource requirements are forecasted, initial restoration plans are**
20 **developed, contingency resources are activated, and commitments from**
21 **mutual assistance utilities are requested. In addition, all FPL sites begin to**
22 **prepare their facilities for the impact of the storm. At 48 hours, computer**
23 **models are run based on the projected intensity and path of the storm to**

1 forecast expected damage, restoration workload and potential customer
2 outages. Based on the modeled results, commitments are confirmed for
3 restoration personnel, materials, and logistics support. Staging site locations
4 are then identified and confirmed based on the storm's expected path. At 24
5 hours, the focus turns to positioning personnel and supplies to begin
6 restoration as soon as it is safe to do so. The Company also provides
7 information to the news media, customers and community leaders regarding
8 storm preparation, what to do in the event of an outage, as well as public
9 safety messages.

10

11 **Q. Has FPL had previous opportunities to execute its emergency**
12 **preparedness plan and restoration process?**

13 **A.** Yes, since Hurricane Andrew, FPL has experienced a number of events which
14 have provided opportunities to execute and refine our storm plans. More
15 recently, in 1999, Hurricane Irene and Hurricane Floyd impacted FPL's
16 service territory and required full scale implementation of our restoration
17 processes. These plans were also utilized during Tropical Storm Gabrielle in
18 2001. On a smaller scale, some components were executed during the 2003
19 tornados that impacted Miami-Dade and Palm Beach counties, and the
20 extraordinary mesoscale convective complex weather event that affected the
21 state in April 2004.

22

23

1 **Q. How does FPL ensure the emergency preparedness plan and restoration**
2 **process are consistently followed?**

3 **A.** Significant standardization in field operations has been institutionalized
4 including: work-site organization; work preparation and prioritization; and
5 damage assessment. Procedures to ensure rapid preparation and mobilization
6 of remote staging sites have been developed to allow us to locate them in the
7 most heavily damaged areas.

8
9 Storm plan requirements are documented in a variety of media including
10 manuals, on-line procedures, checklists, job aids, process maps, and detailed
11 instructions. System data is continuously monitored and analyzed throughout
12 the storm. Multiple daily conference calls utilizing structured agendas are
13 held with GOCC business leaders to discuss overall progress and issues.
14 Twice daily, very detailed conference calls are held with all field locations
15 providing a mechanism for ensuring critical activities are being performed and
16 communicated at all levels throughout the organization. Overall monitoring
17 and performance management of field operations is performed through the
18 GOCC. In addition, field visits by GOCC personnel are routinely conducted
19 to validate process application and progress at remote work sites, as well as
20 identify any adjustments that may be required.

21
22
23

1 **Q. Can you provide some examples of any recent innovations in technology**
2 **that have been incorporated in FPL's plan?**

3 **A. Yes, a few examples incorporated into our emergency plans include satellite**
4 **technology and other wireless alternatives that have been deployed to improve**
5 **the availability of data and communication transmissions. This provides fully**
6 **functional FPL network communications enabling full operational capabilities**
7 **at remote staging sites. Other critical technology innovations have included**
8 **enhancing our outage management system to accommodate large volumes of**
9 **customer calls and work-order management during major storms. In addition,**
10 **Geographic Information System (GIS) technology has been utilized to assist**
11 **in patrolling for damage and routing work orders as well as posting outage**
12 **maps on our internet website to enhance customer communications. As**
13 **previously mentioned, we've developed and continually refined predictive**
14 **models to estimate damage and resource needs.**

15

16 **IV. IMPACT AND SCOPE OF 2004 STORMS**

17

18 **Q. Please provide an overview of the 2004 hurricane season**

19 **A. In 2004, the state of Florida and FPL experienced a hurricane season where a**
20 **number of records were established. Only once in recorded history have four**
21 **hurricanes struck a single state in one year – and that was in Texas nearly 120**
22 **years ago. Also, never before have three hurricanes made landfall in FPL's**
23 **service territory in a single year. Additionally, to FPL's knowledge, the 2.8**
24 **million outages associated with Hurricane Frances were the most ever**

1 experienced by a single utility in U.S. history. The impact has been
2 staggering. FPL employees were actively engaged in either planning for or
3 responding to these storms from August 10 through October 4, 2004.
4 The storms impacted every part of the company's 27,000 square mile territory
5 and required FPL to restore service to nearly 5.4 million customer outages.
6 About 3.1 million, or about 75% of FPL's 4.2 million customers were affected
7 by at least one event. I have provided these and other statistics in the
8 Document labeled LRW-1. The immense service restoration effort was
9 unprecedented for FPL, and for any utility in the United States. Every part
10 of our electric infrastructure was impacted, including our transmission system
11 which had 44 line sections interrupted in Hurricane Charley and up to 108
12 interrupted in Hurricane Frances. Substations out of service ranged from 14 in
13 Hurricane Charley to 54 in Hurricane Frances. In all three storms, service was
14 swiftly restored to all of the substations within two days, permitting all
15 distribution circuits to be energized. This aided in restoring service to our
16 customers quickly.

17
18 In the aggregate, the efforts required hundreds of thousands of man hours of
19 labor and massive quantities of materials, including approximately 13,200
20 poles, 11,100 transformers, and 1,700 miles of conductor. The majority of
21 restoration personnel worked 16 hours per day, providing 24 hour coverage
22 throughout the storm without taking any days off.

23

1 Customer call volumes received by FPL were also unprecedented. Over 2.6
2 million calls were handled throughout all three hurricanes. This is double the
3 total call volume handled for all of 2003.

4
5 **Q. Can you describe for each event, the extent of damage to FPL's**
6 **distribution facilities, and the impact on customers?**

7 **A.** On August 13, 2004, Hurricane Charley made landfall at Port Charlotte on the
8 southwest Florida coast with sustained winds of up to 140 miles per hour
9 (mph) as a category four hurricane. It affected 22 of the 35 counties served by
10 FPL before exiting at Daytona Beach as a category one hurricane on the east
11 coast, resulting in a loss of power to 874,000 FPL customers. Hurricane force
12 winds were 60 miles wide and tropical storm force winds were 210 miles in
13 diameter. Hurricane Charley inflicted extensive damage throughout FPL's
14 service territory, completely destroying portions of the Company's electric
15 distribution system. Port Charlotte, Punta Gorda and Arcadia, all
16 communities just north of Fort Myers, experienced severe damage similar to
17 that incurred during Hurricane Andrew. Due to the massive destruction, FPL
18 had to completely rebuild most of its electrical facilities in these areas. During
19 the storm, 84% of our major feeder circuits in this area experienced an
20 interruption. Significant restoration efforts were also required in other areas
21 hard hit by Hurricane Charley, including counties on the east coast, ranging
22 from as far south as Brevard County to as far north as St. Johns County. In
23 total, more than 7,100 poles, 5,100 transformers, and 900 miles of conductor
24 were replaced to restore the electrical system.

1 On September 5, Hurricane Frances made landfall near Stuart on the east
2 coast of Florida with sustained winds of up to 105 mph, a strong category two
3 hurricane. As reported by the National Weather Service, the hurricane force
4 wind swath extended 145 miles across, and tropical storm force winds
5 extended 345 miles in diameter. The immense breadth of the storm, which
6 was the size of Texas, affected all 35 counties within FPL's service territory.
7 The slow-moving storm remained positioned over much of the state for more
8 than 60 hours, allowing winds to batter the electrical system over an extended
9 period of time, toppling thousands of poles and downing hundreds of miles of
10 power lines. Over 60% of all FPL feeder circuits state-wide experienced an
11 interruption during the storm. By the time the hurricane exited the state
12 near Tampa as a tropical storm, the damage it had inflicted was extensive.
13 Nearly 2.8 million, or 67%, of FPL's 4.2 million customers lost power during
14 the storm. In total, more than 3,800 poles, 3,000 transformers, and 550 miles
15 of conductor were replaced in restoring service to these customers.

16
17 On September 25, 2004, almost exactly three weeks after Hurricane Frances
18 struck, a third hurricane, Hurricane Jeanne, made landfall at nearly the same
19 location as Hurricane Frances. Though Hurricane Jeanne moved across FPL's
20 service area in 45 hours, more quickly than Hurricane Frances, it was a
21 stronger hurricane and almost as large. Jeanne affected customers in all 35
22 counties served by FPL before leaving the territory north of Lake City as a
23 tropical storm. The category three hurricane struck with sustained winds of

1 120 mph. In the Palm Beach and Treasure Coast areas, 81% of all feeder
2 circuits experienced an outage. Hurricane-force winds extended 125 miles
3 across, while tropical storm force winds were 315 miles in diameter. More
4 than 1.7 million, or 41%, of FPL's customers lost power during the storm.
5 The total effort required replacement of more than 2,300 poles, 3,000
6 transformers, and 250 miles of conductor.

7
8 **V. RESPONSE**

9
10 **Q. Can you summarize FPL's restoration response?**

11 **A.** As previously stated, FPL's principal objective in emergency situations is to
12 safely restore service to the most customers in the least amount of time. The
13 entire response process is geared toward meeting this objective which requires
14 expediting decision making in the field and removing operational barriers.
15 For all three storms we consistently followed our plans for pre-storm planning
16 and preparation activities, starting with conference calls 72 hours prior to the
17 projected landfall. Following landfall, we first assessed the overall system
18 and repaired damage to the FPL power plants and the transmission lines that
19 carry power from the plants to towns and communities while at the same
20 time deploying our field teams to conduct neighborhood-by-neighborhood
21 damage assessments. Next, we focused on restoring power to the customers
22 who provide essential services for community health, safety and public
23 welfare such as water, sanitary, police, fire and rescue, and major hospitals
24 while simultaneously making repairs to the main feeder circuits that will

1 return power to the largest number of people first. Once major repairs had
2 been made, we began working to restore smaller groups and individual
3 customers.

4
5 **Q. How did FPL coordinate with local and state emergency operating**
6 **centers?**

7 **A.** We recognized that both FPL and government, at all levels, had the same
8 objectives to return our customers and communities back to normality as
9 quickly as possible. State policy makers, including the Governor, legislators,
10 local government officials, and regulators continually reinforced the need to
11 restore power as quickly as possible. FPL representatives were positioned in
12 state and local EOCs throughout the impacted areas to communicate priorities
13 and progress being made during all of the events.

14
15 **Q. What were the resource requirements for each storm?**

16 **A.** Hurricane Charley restoration efforts involved a peak work force of more than
17 13,500 individuals in the field performing repairs and reconstruction or
18 directly supporting those tasks. This was comprised of 7,500 FPL employees
19 and local contractors, and 6,000 external personnel (see Document LRW-2).
20 Southeastern Electric Exchange assistance was not sufficient to fill our
21 resource needs and, therefore, we sought additional commitments from many
22 other utilities. The restoration effort required expediting the construction and
23 operation of 13 separate staging sites along with support from our existing
24 FPL Service Center locations. It also involved partitioning FPL's territory

1 into two major restoration areas, one on the west coast, and the other in the
2 Daytona Beach area. The west coast response was essentially a rebuild effort
3 due to the extensive damage from category four winds, whereas the northeast
4 coast response was a restoration effort due to lesser category one impacts. As
5 restoration was being completed in the northeast area and those staging sites
6 were being de-activated, the resources were then redirected to travel to the
7 west area and join up with our restoration efforts there. Several of the staging
8 sites in the Punta Gorda and Arcadia area doubled or tripled in size to
9 accommodate all of resources utilized to complete restoration in the west area.
10 FPL completed restoring service to customers interrupted by Hurricane
11 Charley in 13 days.

12
13 Hurricane Frances restoration efforts required substantially more resources
14 that were spread out at more locations throughout our entire service territory.
15 This included 8,700 FPL employees and local contractors, and 8,000
16 external personnel for a peak work force of 16,700. FPL utilized 12 separate
17 staging sites from Flagler to Miami-Dade counties, several accommodating
18 over 1,000 personnel. Most east coast FPL service centers also received
19 additional resources to supplement their normal workforce. The overall impact
20 from Frances to all 35 counties of FPL's service territory also required a
21 significant larger number of patrol personnel and support resources to
22 expedite our response, more of which had to be supplied from external
23 utilities and companies. In addition, FPL was unable to immediately begin its

1 response to Hurricane Frances due to the storm's extraordinary size, duration,
2 and impact to the I-95 corridor, which impeded travel. Despite the impact,
3 within three days of Hurricane Frances exiting FPL's service territory, FPL
4 had restored power to 75% of those who had lost power, or 2.1 million
5 customers. Within one week, FPL had restored power to 92%, or 2.6 of the
6 2.8 million customers who had lost power. FPL completed restoring service
7 to customers interrupted by Hurricane Frances in 12 days.

8
9 While Hurricane Jeanne required comparable resources to Frances, many line
10 workers from the SEE utilities, normally available, were already committed to
11 the restoration for Hurricane Ivan and working in the Florida panhandle,
12 Alabama, and Mississippi. We also contacted many of the alternative utility
13 and contractor sources that we had established during Charley and Frances for
14 line workers and support personnel but most had immediately relocated their
15 people following Frances to help assist in the Ivan restoration. FPL had been
16 able to retain approximately 1,000 contract workers immediately following
17 Frances to complete follow-up repairs and although these resources were able
18 to start the restoration effort resulting from Jeanne, they were not enough. It
19 was necessary to now appeal to governmental agencies, other utilities, and
20 organizations throughout the country, such as the Edison Electric Institute for
21 additional resources. Thankfully, the restoration following Ivan had
22 progressed to the point where line workers were now being released from
23 their respective utilities and contract companies and could now be redirected

1 to assist FPL. Additionally, the Florida west coast utilities began to
2 release resources to FPL mid-week which were all deployed in FPL's territory
3 to assist in our restoration efforts. Despite the resulting delay and unique
4 challenges in acquiring resources, more than 16,500 personnel eventually
5 worked to complete repairs to the electrical system. This included 8,600 FPL
6 employees and local contractors, and 7,900 external personnel. During this
7 event, 13 staging sites were opened, most of which had been utilized during
8 Hurricane Frances as well. Even with these challenges, FPL had restored
9 power to over 75% of the 1.7 million customers who had lost power by day
10 three. Within five days, FPL had restored power to 93% of those customers
11 who had lost power. FPL completed restoring service to customers interrupted
12 by Hurricane Jeanne in eight days.

13
14 **Q. How did FPL determine how many resources were needed for the**
15 **storms?**

16 **A.** There are a variety of factors which influenced this decision. In each storm,
17 we utilized FPL's state-of-the-art damage assessment model to predict, by
18 service area, the expected damage and hours of work to restore service. These
19 estimates are based on the location of FPL's facilities, the storm's projected
20 path, and the effects of varying wind strengths on different facilities. These
21 workload projections are matched with resource factors such as availability
22 and location, and FPL's capacity to efficiently and safely manage and support
23 available resources. After the storm passed, FPL assessed actual damage

1 through aerial and ground patrols and utilized results of customer outage
2 information contained in the outage management system. This enabled us to
3 validate the workload requirements, and to make on-going adjustments in our
4 plans for acquiring and allocating external resources.

5
6 **Q. What steps does FPL take to acquire additional resources?**

7 **A.** An important component of each of these restoration efforts was FPL's ability
8 to scale up its available resources to match the increased volume of workload.
9 FPL is a participating member of the Southeastern Electric Exchange Mutual
10 Assistance group. While this group is a non-binding entity, it provides FPL
11 and other members with guidelines on how to request, and/or respond to
12 requests, for assistance from a group of approximately 20 utilities primarily
13 located in the southern and eastern United States. The guidelines require
14 reimbursement for direct costs of payroll and other expenses, including travel
15 costs to and from, when providing mutual aid in times of emergency. In
16 addition, FPL participates with the Edison Electric Institute to gain access to
17 other utilities and has requested assistance from those companies based on
18 similar, mutual assistance agreements. Resource requests are for line crews,
19 tree trimming crews, patrol, material-handling personnel and in some cases,
20 logistics support. FPL has participated in many emergency events as both a
21 requester and a responder.

22

1 FPL also has a number of contractual agreements with line and vegetation
2 contractors throughout the U.S. Many of these agreements are with
3 contractors that we use during normal operations. These contracts are
4 competitively bid and as a result, FPL has among the lowest labor rates for
5 contractors in the industry. As a result of the restoration needs, a large
6 number of additional line and vegetation companies were contracted to
7 provide support, pending release from utilities for which they normally work.
8 With great urgency, FPL negotiated rates with these new contractors.

9
10 **Q. Describe FPL's plan for the deployment and management of these**
11 **incoming external resources.**

12 **A.** Deployment and movement of resources was controlled through the GOCC,
13 utilizing personnel tracking and outage management systems to monitor
14 execution of the plan. Daily management of the crews is performed by the
15 field operations organization, which is responsible for effectively
16 implementing FPL's restoration strategy. Decisions on opening of staging
17 sites to position the workforce in the most damaged areas were based on the
18 timing of the arrival of external resources. The resource acquisition team
19 coordinator maintained contact with incoming personnel to confirm the daily
20 resource deployment plan. Daily analysis of workload execution and
21 restoration progress permitted dynamic and effective resource management.
22 This enabled a high degree of flexibility and mobility in allocating and
23 deploying resources in response to changing conditions and requirements.

1 Another critical factor was FPL's ability to assemble trained and experienced
2 management teams to direct field activities. As part of the storm organization,
3 management teams included group leaders and crew supervisors to directly
4 oversee field work.
5

6 **Q. What logistics and support personnel and activities were required?**

7 **A.** To support the thousands of workers, various logistics functions were
8 required. These functions included, but were not limited to, acquisition,
9 preparation and coordination of: staging sites, lodging, laundry, buses,
10 caterers, ice and water, office trailers, light towers, generators, port-o-lets,
11 security guards, communications, and fuel delivery. On average, we served
12 38,000 meals and provided 20,000 gallons of water daily during each of the
13 three hurricanes. In most cases, agreements with primary vendors are in place
14 prior to the storm season as part of our storm planning process. Additional
15 logistic staffing needs are provided by FPL personnel from all parts of our
16 company. Most of these employees are pre-identified, trained and assigned to
17 provide site logistics management as well as to support other needs of the
18 restoration workforce. In some cases, additional manpower is provided by
19 contracting services.
20
21
22

1 **Q. Can you provide some examples of unique solutions to specific challenges**
2 **that FPL encountered?**

3 **A.** Each storm brought unique restoration challenges. With four hurricanes in six
4 weeks impacting much of the southeast U.S., preparing for and acquiring
5 needed assistance due to Hurricanes Charley, Frances and Jeanne involved
6 formidable tasks. Because of the size and potential path of Frances, other
7 utilities were unwilling to release resources in advance of Frances' landfall.
8 The presence of Hurricane Ivan made acquiring resources for Jeanne difficult
9 as well. With a clear commitment to restore customers as quickly as possible,
10 we brought crews to Florida from 39 different states and parts of Canada (see
11 Document LRW-2). Even though incurring these travel costs was not a
12 decision that would be made during normal times, we recognized it was
13 prudent to take these actions in order to ensure we could continue to meet our
14 prime objective to restore power quickly. Personnel, from as far away as
15 California, traveled to Florida by air, using rental and FPL vehicles to
16 participate in the restoration effort until their trucks arrived later via ground
17 transfer.

18
19 Damage, debris, vegetation and flooding created a lack of accessibility to
20 FPL's electric facilities but this was overcome by leveraging special
21 equipment such as large highly-mobile cranes, and a variety of swamp
22 vehicles. In some instances, helicopters were required to transfer poles. To
23 begin restoration on inaccessible island areas, FPL trucks and equipment were

1 transported on barges. Use of this equipment facilitated restoration to areas
2 that would have potentially experienced significantly longer outages.

3

4 Other examples included the use of specialized environmental vehicles to
5 vacuum mounds of sand from electric vaults located in coastal high-rise
6 buildings. Where storm surge and salt intrusion were prevalent, teams used
7 specialized equipment to wash and decontaminate underground equipment.
8 When one of our dispatch control centers lost both primary and contingency
9 communications, we were able to divert critical functions to another dispatch
10 control center due to our state-wide voice communications and control
11 systems capability.

12

13 The fuel shortage caused by overwhelming consumer demand for gasoline and
14 the closing of ports in Florida created many challenges for our fleet
15 department. To ensure that our vehicles and those of the assisting companies
16 were fueled, FPL contracted for additional tankers from Alabama, Georgia
17 and Texas. We also utilized 8,000-gallon compartmentalized transport
18 tankers that served as on-site mobile fueling stations at our staging sites for
19 both unleaded and diesel fuel. Additionally, we made use of skid tanks
20 ranging from 500 to 2,000 gallons in some of the smaller staging sites and
21 service centers. To maximize efficiency, the majority of our fueling, roughly
22 180,000 gallons per day, was done at night by mobile 4,400- gallon pumpers.

23

1 As additional crews were secured to join the restoration effort, the need for
2 additional staging sites grew. Consequently, senior managers were assigned to
3 all sites to coordinate logistical issues allowing restoration management teams
4 to focus on restoring service to customers. In addition, management teams
5 were kept together from one storm to the next, often at the same locations, in
6 order to capitalize on familiarity and other synergies to facilitate more
7 efficient mobilization.

8
9 To enhance back-up communications capabilities, FPL acquired outside
10 technicians to assist with radio functionality and repairs, and took steps to
11 establish network communication infrastructure to anticipated staging sites
12 prior to landfall. Satellite technology was utilized when normal
13 communications were unavailable.

14
15 Acquiring lodging for both FPL and external crews became extremely
16 difficult as many local residents had evacuated to area hotels. To further
17 compound the problem, many hotels suffered severe damage and were
18 uninhabitable. Alternative housing was utilized until lodging arrangements
19 could be made.

20
21 GIS mapping tools were deployed to field sites in order to create customized
22 maps which pinpointed damage locations to assist external workers unfamiliar
23 with local geography.

1 FPL's telecommunication organization assessed the quality of wireless and
2 cell phone service at each location. They then acquired and deployed the
3 appropriate equipment necessary to maximize quality and availability of
4 communications.

5
6 We established mini depots to locate materials right at specific job sites to
7 minimize travel time to keep crews productive. We also utilized roving
8 material trucks where crews were assigned to ensure material was readily
9 available.

10 11 **VI. OPERATIONAL PERFORMANCE**

12
13 **Q. How effective was FPL's plan during the events?**

14 **A.** As mentioned before, our primary goal is to safely restore the greatest number
15 of customers in the least amount of time to return the communities we serve to
16 normality. Many records were established in this unprecedented storm season.
17 More than 3.1 million customers across FPL's territory were affected at least
18 once by these storms. In each storm, over 75% of customers affected were
19 restored by the third day (see Document LRW-3). Document LRW-3 depicts
20 the percentage of customers restored each day in each hurricane. The high
21 percentages accomplished in the first few days in each storm result from
22 FPL's consistently applied restoration strategy - to restore devices that serve
23 the largest number of customers first. We were able to acquire an

1 extraordinary number of workers and managed more than twice as many
2 staging sites than ever before, while effectively managing field operations.
3 The different characteristics of each storm make true comparison metrics
4 difficult. In recent history, FPL had experienced a major category hurricane
5 only once before - Hurricane Andrew in 1992. In 2004 we experienced two
6 major hurricanes and one category two hurricane within six weeks. Still we
7 completed restoration in all of these storms in two weeks or less, as compared
8 to more than one month for Andrew.

9
10 **Q. Can you discuss what factors contributed to FPL's performance?**

11 **A.** There are numerous factors which contributed to FPL's overall performance.
12 We have solid plans and procedures, strong centralized command,
13 contingency plans for critical operations, and the tools and processes which
14 ensure effective communications and information flow. Focus on process
15 discipline and consistent execution of the plan resulted in consistent
16 performance as demonstrated in Exhibit No. LRW-3.

17
18 Our damage forecasting model, along with aerial patrols and ground
19 assessments allowed us to identify how many resources would be needed, and
20 where. Aggressively seeking resources prior to landfall, and continued
21 diligence when many of our traditional sources for personnel were
22 unavailable, resulted in successfully acquiring the necessary workforce, albeit
23 from greater distances. The centralized function of resource planning allowed

1 us to allocate personnel where needed, and redeploy as workload shifted.
2 Effective damage assessment through ground patrols confirmed the resource
3 allocation plan and allowed for adjustments.

4
5 Robust system design and functionality allowed us to continually gauge
6 progress and make adjustments as changing conditions and requirements
7 warranted.

8
9 As transmission and substation field workers completed their restoration
10 efforts, they were redirected to distribution work.

11
12 Strong alliances with our vendors assured ample supply of materials and
13 avoided delays.

14
15 Additionally, we have made considerable investments in our infrastructure
16 and various programs to improve the overall reliability of our distribution
17 system. From 1998 to 2003 alone, we have spent over \$900 million to
18 improve our service reliability. Because our service unavailability has been
19 reduced by 50% since 1997, we believe these initiatives have made a positive
20 impact to the service levels we provide to our customers. Had we not made
21 this investment in our infrastructure, we believe our performance would not
22 have been as good.

23

1 Finally, past experience, constant practice, and employee skill and
2 commitment gave us the ability to anticipate operational barriers and to
3 proactively develop alternative actions to overcome them.

4
5 **Q. Can you provide any external comparative information to help gauge**
6 **FPL's recent hurricane restoration efforts?**

7 A. Yes. Though it is not possible – for many widely recognized reasons (e.g.,
8 variations in topography, customer density, utility systems, structural damage,
9 etc.) – to draw precise conclusions when comparing different utilities’
10 responses to a given event, or the same utility’s response to different events,
11 some general observations can be made. For example, I have reviewed a
12 recent report prepared by the Virginia State Corporate Commission (VSCC)
13 Staff which examined the response to Hurricane Isabel. Preparation For and
14 Response to Hurricane Isabel by Virginia’s Electric Utilities, Special Report
15 of the Division of Energy Regulation, Commonwealth of Virginia State
16 Corporation Commission, September 20, 2004. Hurricane Isabel made
17 landfall near Cape Hatteras, North Carolina on September 18, 2003 as a
18 Category two storm with winds near 100 mph. This landfall was
19 approximately at the southern end of Dominion Virginia Power’s (DVP)
20 territory. About 1.7 million of DVP’s 2.1 million customers (or 81%) were
21 affected by the storm. As shown in Document LRW-4, the restoration rates
22 for FPL in all three events were basically the same or slightly faster than that
23 for DVP. The Staff concluded that “...restoration efforts following Hurricane

1 Isabel generally were reasonable and satisfactory by any standard measures of
2 performance. The time required for full restoration of service following
3 Hurricane Isabel was neither unexpected nor unreasonable...". Ibid, page iii. I
4 believe that FPL's response to each of the three hurricanes that struck its
5 service territory in 2004 compares favorably with DVP's response to
6 Hurricane Isabel that the VSCC Staff determined to be reasonable.

7
8 **VII. CONCLUSION**

9
10 **Q. Please summarize your testimony.**

11 **A.** FPL has highly effective emergency preparedness plans and processes.
12 Annual practice assures consistent and effective performance. We've
13 experienced natural weather events in the past, but 2004 was an
14 unprecedented year which tested our plans, expanded our capabilities, and
15 exceeded past performance. Critical to achieving these results was FPL's
16 processes and the management teams' experience. We know these were
17 catastrophic events not only for FPL, but for all of Floridians. Throughout
18 the events, FPL worked tirelessly to bring available internal and external
19 resources to bear. Once in position, all efforts were made to maximize the
20 productive hours such as feeding crews on site and nighttime fueling. We
21 took extraordinary actions in acquiring all necessary resources in order to
22 meet the prudent objective of restoring electric service as quickly and safely
23 as possible, to allow our customers and the communities we serve to return to

1 normality. Unique challenges required innovative solutions. We focused on
2 the objectives and strategies required to successfully execute our plans. We
3 took reasonable, necessary, and prudent actions in meeting our restoration
4 objective for each storm.

5

6 **Q. Does this conclude your direct testimony?**

7 **A. Yes.**

1 COMMISSIONER BAEZ: Anything else, Ms. Fleming?

2 MS. FLEMING: Not that I'm aware of, Chairman.

3 COMMISSIONER BAEZ: Parties, do we have any
4 preliminary matters that we need to address at this point? No?
5 Okay.

6 All right. We're going to start with opening
7 statements at this point. Pursuant to the prehearing order,
8 it's my understanding that each side has 25 minutes. The
9 intervenors, you all have agreed amongst yourselves as to how
10 you're going to apportion that.

11 MR. MCGLOTHLIN: Yes, sir.

12 COMMISSIONER BAEZ: Very well. And I guess we can
13 start with Mr. Litchfield.

14 MR. LITCHFIELD: Thank you. Good morning,
15 Mr. Chairman and Commissioners. We've been before you several
16 times already in this docket on various motions and, in
17 addition, you've presided over several service hearings in
18 locations throughout FPL's service territory relative to the
19 company's efforts to repair its system and to restore electric
20 service following each of the hurricanes that struck its
21 service territory in 2004. Therefore, you are generally
22 familiar with many of the facts and the positions of the
23 parties in this docket, and I do not expect to take the full 25
24 minutes allotted to the company this morning.

25 I do believe it's important, however, at the outset

1 to note that no party to date has disputed that under very
2 extreme circumstances never before faced by an electric utility
3 in Florida and even the nation FPL did a fantastic job in
4 restoring power to millions of customers in a very short span
5 of time. In fact, you have heard from various parties at this
6 table over the last six or seven months that they do not
7 dispute the performance of the company, using the term
8 "Herculean" and other superlatives to characterize FPL's
9 efforts in this regard. You have heard some say that they
10 fully expect that some huge portion of the costs, indeed, were
11 reasonable and prudently incurred. Others have simply said
12 that they are not challenging the reasonableness and prudence
13 of the costs. Yet today you likely will hear from some of the
14 parties that the company's performance is a nonissue in this
15 proceeding.

16 As an aside, I think it's safe to say that had the
17 company's performance been poor, that might well be the only
18 issue we were discussing today, to determine what portion of
19 the costs might be disallowed based on the application of a
20 reasonableness and prudence standard.

21 But under the circumstances there really is no
22 advantage to those who oppose the surcharge to discuss FPL's
23 performance or the prudence of the costs incurred, and so they
24 would ask that you ignore FPL's performance. In fact, as their
25 position has recently evolved, you might even be asked to

1 reserve any such question for another day to somehow keep the
2 ball up in the air. We urge you to resist that request.

3 This has been the time to discuss the reasonableness
4 and prudence of the costs incurred. Although the initial
5 request for recovery filed in November of 2004 by the company
6 necessarily was based on estimated costs at the time, the
7 description of activities and the nature and the categories of
8 the costs were fully documented, audited and fully addressed
9 through discovery conducted by intervenors over the months of
10 this proceeding.

11 More importantly, over time as more invoices were
12 received it became possible to provide a firmer estimate. As
13 you know, that number net of insurance proceeds is
14 \$890 million, over 90 percent of which already has been paid by
15 FPL or invoiced to FPL. The jurisdictional amount net of the
16 \$354 million in the Storm Damage Reserve as of December 31,
17 2004, is \$533 million. That is the amount for which FPL seeks
18 recovery. That also is the amount that FPL has agreed would
19 operate as a cap relative to the recovery of the current Storm
20 Damage Reserve deficit.

21 Parties to this docket have been provided or have had
22 access to every piece of paper in the company's possession that
23 underlies the request. While there will be a true-up of the
24 surcharge at the end of the recovery period to ensure only that
25 no more than the authorized amount of storm damage costs in

1 fact are collected, that should be limited to a simple
2 mathematical computation and not an excuse to reopen and
3 relitigate issues that were properly before you in this
4 proceeding. Now is the time to conclude that the costs charged
5 to the Storm Damage Reserve relative to the 2004 storm season
6 are reasonable and prudently incurred, unless found to the
7 contrary in this proceeding. And that issue is squarely before
8 you as Issue 17 in the prehearing order.

9 Indeed, in knowing how to plan and how to prepare for
10 the 2005 and future storm seasons, we respectfully submit that
11 the company has a legitimate need and right to know the extent,
12 if any, to which the costs or categories of costs that it
13 incurred in responding to the 2004 storm season might be
14 considered unreasonable or imprudent.

15 But instead of addressing prudence and reasonableness
16 of costs incurred and the company's performance in repairing
17 its system and restoring electric service, the intervenors in
18 this case have taken two alternate approaches. First, they've
19 chosen to target the manner in which the company accounts for
20 storm damage costs. And, second, they argue that the company's
21 shareholders should bear a portion of the costs associated with
22 restoring electric service to customers. We submit that both
23 of these contentions should be rejected.

24 With respect to the first, in deciding in 1993 at the
25 time whether or not to adopt an automatic adjustment clause to

1 handle future storm damages in the circumstances that existed
2 immediately following Hurricane Andrew, this Commission
3 concluded in that docket that questions had been raised and not
4 adequately addressed regarding the types of charges and the
5 manner of costs that would be properly charged to the Storm
6 Damage Reserve. Specifically, the Commission noted, and I
7 quote from Order Number 93-0918-FOF-EI, "From the record in
8 this docket it is unclear what storm-related expenses FPL
9 intends to draw from the reserve fund. For example, it is
10 unclear whether normal salaries would be charged to the fund if
11 employees worked on storm-related tasks. In addition,
12 employees repairing storm damage would be required to spend
13 time away from their everyday work tasks, which would result in
14 catch-up expense."

15 The Commission continues, "In addition, it is unclear
16 whether the cost of damage assets would be accounted for at
17 replacement cost or net book value. For example, if there were
18 \$100 million of net book value of assets that were destroyed
19 and it took \$200 million to replace those, what accounting
20 entries would be made?"

21 The Commission continued, "FPL shall address these
22 questions in the company's study discussed above. The company
23 shall also provide information concerning the treatment of all
24 Hurricane Andrew related transmission and distribution damages
25 under its existing policy. The company study shall include a

1 listing of the type of storm-related expenses FPL intends to
2 draw from the reserve fund and what type of accounting entries
3 would be made for each item." Docket 930405-EI --I'm sorry.
4 End of quote.

5 Docket 930405 was held open to receive FPL's storm
6 study filing. OPC and FIPUG, among others, were parties to
7 that docket, and FPL submitted its study in October of '93.
8 And you'll hear it referred to throughout this hearing as the
9 '93 study or the storm study.

10 In February of 1995 the Commission entered an order
11 approving the '93 study based on its staff's recommendation.
12 That order number is 95-0264-FOF-EI. And it is styled, "Order
13 Approving Storm Damage Study and Adjustments to Self-Insurance
14 Mechanism." You'll hear it sometimes referred to in this
15 proceeding as the '95 order.

16 There was no protest or appeal filed by parties in
17 that docket, including OPC and FIPUG. In fact, there's no
18 evidence in that docket of any contrary positions or concerns
19 relative to staff's recommendation and the Commission's
20 approval of that study, that is until now, ten years later.

21 But rather than suggest that this Commission should
22 revisit the '93 storm study and the accounting principles in
23 that, in that study, Public Counsel and others have taken the
24 position that the '95 order didn't approve the accounting
25 guidelines in the '93 storm study at all. And based on their

1 position that the Commission never approved those guidelines,
2 the intervenors feel unrestrained, therefore, to assert that
3 those guidelines used by FPL are improper, saying that they
4 result in double recovery and implying that this Commission
5 would be addressing these issues for the very first time.

6 I'll mention just two of these issues as
7 illustrative. One is the way in which capital costs are
8 handled. Pursuant to the methodology in the '93 study, the
9 manner in which FPL charges capital costs results in no net
10 increase to plant as a result of storms; thus, it is rate base
11 neutral. The intervenor's approach, as sponsored by Public
12 Counsel's witness, on the other hand would add to the company's
13 net plant in service, increasing rate base and, thus,
14 increasing base rates. Contrary to the intervenor's
15 implication, this issue was fully considered by the staff and
16 the Commission in 1995, and it is even summarized in the
17 '95 order.

18 FPL has followed this approach for each storm over
19 the last ten years. As a result, rate base is lower today than
20 it would have been.

21 Is this the only approach to handling capital costs?
22 Of course not. But it is one that was thoughtfully addressed
23 and approved by the Commission in 1995, not challenged by the
24 parties, has been in place ever since and has been repeatedly
25 applied by FPL in connection with storm restoration charges

1 over the last decade. If a new approach were desired by the
2 Commission, we submit that it should be applied only
3 prospectively.

4 Another item; payroll costs are another hot button
5 for the intervenors. They assert that those costs are
6 reflected in the base rates of a utility and that to charge
7 them to the storm reserve would result in double recovery. Now
8 on the surface that has a nice ring to it, but the issue really
9 is not nearly that straightforward.

10 Utilities, as you know, do not staff to meet peak
11 storm requirements. When a major storm hits, they draw upon a
12 mix of internal and external resources. External resources
13 clearly result in incremental costs. But using internal
14 resources also results in incremental costs that are not
15 charged to the storm reserve. When employees are removed from
16 their normal assignments to fulfill storm restoration duties,
17 the work does not go away. Others, including contractors, may
18 be used to backfill the work left undone by employees assigned
19 to storm duty. Similarly, there are incremental costs that FPL
20 witnesses will refer to as catch-up work, work that must be
21 caught up following the storm performed by incremental
22 contractors or other personnel for whom overtime compensation
23 is paid. Under the existing guidelines, all of these indirect
24 and incremental charges are booked to normal operating
25 expenses, not to the Storm Damage Reserve.

1 So allowing payroll charges to be booked to the
2 reserve makes sense from the standpoint of allowing the company
3 to assign individuals to the storm effort without reservation
4 or concern regarding the incremental costs that will hit normal
5 operating expenses.

6 Further, the intervenors' suggestion that charging
7 direct payroll to the reserve results in double recovery
8 ignores the other half of the ratemaking equation; namely,
9 revenues. Base rates are set, as you know, not only on the
10 basis of projected expenses, but on the expectation of
11 realizing certain revenues. The intervenors' position would
12 ask the company to assume that it has recovered payroll costs
13 through revenues that were not received while the power was
14 out.

15 Again, all of these factors were considered by the
16 staff and the Commission in the '93 docket and approved by the
17 Commission in the '95 order. Is it the only approach? Of
18 course not. But, again, any changes in the approach, we
19 believe, would need to be considered in full context and only
20 applied prospectively, not retroactively. And in spite of the
21 intervenors' contentions, we really do see that a reasonable
22 result was obtained in this instance through the application of
23 the principles applied by the company pursuant to the '95 order
24 if we simply compare the O&M costs Public Counsel claims are
25 double recovered to the amount of lost revenues and other

1 indirect costs not reflected in or charged to the Storm Damage
2 Reserve. That total is approximately \$40 million compared to
3 \$38 million in lost revenues and at least another \$9 million in
4 other indirect costs such as backfill and catch-up work, and
5 that's not even counting additional amounts that simply weren't
6 tracked by the company in that manner because FPL was
7 appropriately relying upon the accounting principles approved
8 in the '95 order.

9 Again, whether you as a Commission choose to revisit
10 these guidelines for FPL or for investor-owned utilities as a
11 whole, that is certainly within your discretion. But we would
12 submit that the guidelines as approved in the past and applied
13 by the company and relied upon by the investment community for
14 years without any issue or question, including their use in the
15 application in connection with the tremendous accomplishments
16 of FPL in restoring power over the course of the 2004 storm
17 season, that they should be upheld by the Commission for
18 purposes of FPL's cost recovery request in this proceeding.

19 Let me address the concept of sharing. Intervenors
20 in this docket contend that shareholders should bear a portion
21 of the costs incurred; in fact, as large a portion of the costs
22 as is necessary to lower FPL's earned return for 2004 to
23 10 percent return on equity. Now we acknowledge that there are
24 two other IOUs who have reached settlements that purport to
25 share some burden of the restoration costs with shareholders,

1 but it's important to note that those settlements addressed
2 much more than storm costs incurred in the 2004 season. They
3 settled at the same time base rate situations of companies who
4 do not have a pending request before this Commission for base
5 rate relief and who, unlike FPL, have not made significant
6 reductions in their base rates in recent years. Unfortunately,
7 that is not the situation that FPL faces. And it is
8 inappropriate to infer anything from those settlements relative
9 to FPL's ability or obligation to absorb the costs to restore
10 electric service. FPL, of course, since 1988 -- since 1998 has
11 reduced its base rates by a total of \$600 million annually and
12 provided substantial refunds resulting in almost \$4 billion in
13 total savings to customers over that time period.

14 Now Public Counsel and others will ground their
15 sharing position on a few paragraphs of the 1993 decision in
16 which the Commission declined to approve an automatic
17 adjustment clause proposed by FPL to cover future storm costs,
18 but we believe that that order and those paragraphs are not
19 dispositive of this case.

20 The Commission in that case explicitly declined to
21 adopt any type of earnings test. That was a position that had
22 been advocated by Public Counsel, it was an express issue in
23 the docket and there was a split staff recommendation on the
24 issue. And the Commission did not vote on the issue,
25 determining that it was moot because of their decision not to

1 adopt the proposed clause mechanism at that time.

2 Much has changed since then. Facts and circumstances
3 are different today. At the time some commercial insurance was
4 still thought to be available. The company was directed to
5 make such a determination. It was later acknowledged in
6 subsequent decisions that commercial insurance had become
7 practicably unavailable. As a result, the regulatory framework
8 implemented by the Commission to address storm costs
9 increasingly relied on a combination of the accrual, the growth
10 in the storm fund reserve, taking into account concerns about
11 unbounded growth in the fund and the impact on customer rates,
12 but balanced by the likelihood of having to implement a special
13 assessment to recover any deficit in the event one should
14 occur. And, indeed, the Commission has recognized that such a,
15 such a situation could well occur.

16 Consistent with that post-Andrew framework, the
17 Commission as recently as 1998 in Order Number 98-0953 states,
18 'In the event FPL experiences catastrophic losses, it is not
19 unreasonable or unanticipated that the reserve could reach a
20 negative balance. The December 1997 balance of \$251.3 million
21 is, we believe, sufficient to protect against most emergencies.
22 In cases of catastrophic loss, FPL continues to be able to
23 petition the Commission for emergency relief as reflected in
24 Order Number PSC-95-1588-FOF."

25 The Commission also in that decision affirmed that,

1 'The costs of storm damage incurred over and above the balance
2 in the reserve and the costs of the use of the lines of credit
3 would still have to be recovered from ratepayers."

4 Commissioners, these are precepts that to date have
5 governed the actions of FPL both in planning for and carrying
6 out storm restoration activities, and they have consequently
7 shaped the perceptions of its investors.

8 Now after many years in which we have been very
9 fortunate to have avoided large hits the reserve has had a
10 chance to grow somewhat. Nevertheless, the resulting deficit
11 that has occurred was not unreasonable or anticipated and it is
12 indeed a large deficit. And we are facing yet another
13 potentially very active hurricane season.

14 Intervenors also will tell you that the settlement
15 agreement reached in the last base rate proceeding for Florida
16 Power & Light Company would preclude the company from earning
17 anything above 10 percent in 2004 and that storm costs ought to
18 be first charged to earnings before they are passed on to
19 customers. We believe that's an incorrect interpretation of
20 that agreement.

21 In negotiating the agreement, FPL conceded to an
22 immediate \$215 million base rate reduction, we conceded to
23 share revenues above certain thresholds, and the current
24 agreement will provide customers with total savings of
25 approximately \$1 billion through 2005. So already,

Commissioners, there has been a lot of sharing, if you will.

Now the intervenors want to have the agreement read in a way that deprives the company of key protections that were part of the overall negotiated solution and to take away from the company the very benefits that, in fact, permitted a settlement. FPL conceded to the large base rate reduction and to the revenue sharing, but only on condition that OPC and others agree that FPL would have the right to, quote, petition the FPSC for recovery of prudently incurred costs not recovered from the Storm Damage Reserve and insurance coverage. And that the fact that insufficient funds had been accumulated in the Storm Damage Reserve to cover costs associated with a storm event or events shall not be the basis of a disallowance, and that the revenue mechanism herein described, not excess storm restoration costs, but the revenue mechanism will be the appropriate and exclusive mechanism to address earnings levels. But if the intervenors' position and interpretation of that agreement is accepted, FPL would, A, have no right to rate relief without reference to a 10 percent earnings level; B, be faced with an effective significant disallowance, the result of not having had sufficient funds accumulated in the Storm Damage Reserve; and, C, have its earnings levels lowered for 2004 by reference to something other than the settlement agreement's revenue mechanism. Intervenors would have this Commission ignore those key conditions. The Commission should reject

1 those contentions. The Commission should uphold the provisions
2 of the settlement agreement, not only because it's the correct
3 application, but because it will preserve the integrity of the
4 settlement process itself.

5 OPC's interpretation of the agreement and, indeed,
6 its position that would reduce the company's earnings to
7 10 percent is inconsistent with sound public policy. Under
8 that approach, the better the company has managed its
9 operations during the term of the agreement, the more storm
10 restoration costs are absorbed by shareholders. Thus, the
11 intervenors' approach operates in effect as a shareholder
12 penalty on productivity improvements and operational
13 inefficiencies.

14 Commissioners, we believe that this body has
15 established a framework that has worked very well for the state
16 of Florida and for customers, aligning all interests with one
17 common objective of restoring power quickly and safely. The
18 proof of the merits of that system is found in the performance
19 of FPL and other utilities in restoring service following the
20 most devastating season on record. The intervenors here today
21 would ask that you ignore that record of performance and the
22 principles upon which it was based, ignore orders that
23 established that framework, ignore key provisions of a
24 settlement agreement pursuant to which customers will realize
25 over a \$1 billion in savings and, in effect, penalize

1 shareholders for superior efforts of the company in restoring
2 electric service this past season. We ask respectfully,
3 Commissioners, that you reject those contentions; that you
4 confirm the company's performance and the accounting principles
5 upon which it was based; uphold the proper interpretation of
6 the settlement agreement and send an appropriate message to the
7 investment community that shareholders of investor-owned
8 utilities in Florida are not expected to assume the risks of an
9 insufficient Storm Damage Reserve, particularly when the
10 company has no ability to shield them from that risk through
11 the purchase of commercial insurance.

12 I thank you, Commissioners, and that concludes my
13 opening remarks.

14 COMMISSIONER BAEZ: Thank you, Mr. Litchfield.
15 Mr. McGlothlin.

16 MR. MCGLOTHLIN: Good morning, Commissioners.
17 Joe McGlothlin of the Office of Public Counsel. Based on our
18 huddle at this end of the table, I'll use about ten minutes of
19 the 25 that's been allocated to the intervenors.

20 I would use my portion of the time to emphasize the
21 need for perspective as you review the testimony in this case.
22 FPL's theme in this case to date has been one of entitlement.
23 FPL contends that the extreme and unreasonable views of OPC and
24 of the intervenors whose positions are similar to OPC's are
25 interfering with FPL's ability to collect from customers

1 \$533 million representing the negative balance in the Storm
2 Damage Reserve, something that it regards as a matter of right.

3 Viewed from the proper perspective though, based upon
4 the background of this case and the evidence that you will
5 hear, you will see that it is FPL who is taking extreme
6 positions in this case, not OPC and not the other intervenors.
7 Now that proper perspective is gained at the outset from a
8 realization that when FPL arrived at the PSC with its petition
9 in hand, FPL was already the beneficiary of a significant
10 regulatory intervention. Unregulated companies who experience
11 severe storm costs or storm damages were required by accounting
12 principles to recognize those costs in the same period in which
13 they were incurred.

14 As a utility regulated by this Commission, FPL could
15 have availed itself of the Commission rule which allowed FPL to
16 defer all of those storm-related costs. And it's because of
17 that ability to defer that FPL showed for the calendar year
18 2004 a return on equity in the neighborhood of 12.8 percent,
19 even with the experience of the devastating storms in that same
20 time.

21 Obviously, the Commission rule that allowed FPL to
22 defer those costs was designed to have that as a temporary
23 situation pending the ability of the Commission to assess and
24 dispose of the issue of what should happen to these deferred
25 costs.

1 And consider for a moment the range of possibilities
2 before the Commission as it addressed that situation. At one
3 end of the spectrum it's possible that the Commission could
4 determine that the Commission should expense the entire
5 \$533 million. At the other end of the spectrum it's possible
6 that the Commission could allow FPL to collect the \$533 million
7 through a surcharge.

8 But there are other alternatives within the range of
possibilities. The Commission rule and the Commission's order
address the possibility of instructing a utility in such a
situation to amortize the deferred costs over several years, in
which case there's no surcharge but, by the same token, the
13 utility is able to cushion the effect on any one year by
14 spreading those costs over several years. And the Commission
15 recognized as early as 1993 another possibility would be to
16 respond to a petition such as this one while allowing the
17 company to collect a portion of the costs through a surcharge
18 to customers but absorb the balance of the costs through
19 earnings. Thus, the range of possibilities.

20 When FPL came to the Commission in 1993 with its
21 request for approval of a self-insurance program, it included a
22 request for the ability to establish a cost recovery mechanism
23 that would ensure its ability to collect from customers through
24 a surcharge 100 percent of any deficiency amortized over five
25 years. So from the word go FPL was aiming at this extreme end

1 of this spectrum, the one that says we want to collect
2 everything through a surcharge to the customers.

3 In the 1993 order that approved the self-insurance
4 program the Commission addressed that aspect of the request,
5 and it denied the request for a cost recovery mechanism. And
6 in doing so, the Commission said FPL failed to take earnings
7 into account. FPL inappropriately attempted to place all risk,
8 storm-related risk on customers. FPL inappropriately attempted
9 to require customers to indemnify FPL on a dollar-for-dollar
10 basis, something we don't think should be done. These costs,
11 said the Commission, we don't view as a candidate for a cost
12 recovery clause because they're sporadic in nature. And more
13 importantly, the Commission said in that 1993 order, the bottom
14 line is storm costs should not require a utility to earn less
15 than a reasonable return. And to that end, the Commission said
16 it would respond to a petition in the future by reviewing all
17 of the circumstances and fashioning a remedy that was
18 reasonable under those circumstances.

19 In 1993, the Commission took a balanced approach and
20 equitable approach, one that balanced the interests of the
21 company and customers, and recognized that any disposition of a
22 future petition would be fact-specific.

23 Now it's interesting that following the entry of that
24 1993 order FPL has been on a determined campaign to alter that
25 result, and it began in the 1993 study that counsel for FPL

1 mentioned. Within that study, which is offered as an exhibit
2 to one of the witness's testimony in this case, FPL arrived at
3 a construct, a regime that consisted of two components and two
4 components only: An annual accrual and special assessments,
5 their word for a surcharge to customers. And under that view
6 of the world, if there was any deficiency, all storm costs
7 would be collected 100 percent through a combination of either
8 a low accrual and high assessments or a high accrual and low
9 assessments. But it was like a closed loop. It did not even
10 admit the possibility that the company's earnings in a given
11 situation would ever come into play. And that's one attempt to
12 alter the result that it received in 1993.

13 More recently after the 19 -- after the 2004 storms
14 FPL filed a petition asking the Commission to establish the
15 storm-related costs as a regulatory asset, which your
16 accountants will tell you is another attempt to ensure that it
17 would recover on a -- and be indemnified by customers on a
18 dollar-for-dollar basis through a surcharge.

19 And, finally, we have the instant petition. And,
20 again, in this petition FPL has approached the situation from
21 the far end of the spectrum, wanting to collect 100 percent of
22 the costs through a surcharge.

23 Our approach has been consistent with the disposition
24 of the request in 1993. We could have taken the position that
25 FPL should be told to bear all the costs; we did not. We

1 should -- we could have asked the Commission to tell FPL to
2 bear the costs but amortize them over the years; we didn't do
3 that either. We have taken the middle-of-the-road approach,
4 which is the same balanced approach the Commission took in
5 1993, and that is look at the facts of the situation, look at
6 the earnings for 2004 and assess what portion FPL can absorb
7 and still realize a fair and reasonable return on equity for
8 the period. We think that's a reasonable and balanced approach
9 and is consistent with your earlier decision.

10 In order to implement that concept, our position is
11 that the Commission should use a 10 percent return on equity to
12 quantify the portion of the costs that FPL should be required
13 to absorb through earnings, and we arrive at the 10 percent
14 return on equity through two different sources.

15 First of all, the 10 percent return on equity was the
16 threshold in the 2002 stipulation that ended the 2002 base rate
17 proceeding. And in terms of our interpretation of that, of
18 that stipulation, it's very simple. The wording of the
19 10 percent ROE threshold is unqualified. It doesn't say
20 "except for storm costs." And our position very simply is that
21 if the intent was to carve out storm costs so that the
22 10 percent ROE threshold did not apply to it, the English
23 language is perfectly capable of getting that done. But,
24 again, the ROE threshold is unqualified, and that tells us that
25 it's necessary to give effect to both provisions.

1 But even if the Commission ultimately disagrees with
2 that interpretation, we continue to assert that the 10 percent
3 ROE is the appropriate mechanism with which to quantify the
4 portion of storm costs that FPL should be told to absorb
5 through earnings. Because the expert testimony in this case
6 through our witness James Rothschild will establish in this
7 record the same fact that the Commission realized in 1993,
8 which is that investors are paid to accept risks, and it would
9 be inequitable and unfair in the extreme to on the one hand
10 require customers to compensate investors for their risks and
11 at the same time insulate those investors through a surcharge
12 that shifts that risk to the customers. For that reason, we
13 believe the 10 percent ROE is applicable even if the
14 testimony -- even if the stipulation is deemed not to be
15 applicable here.

16 Let me speak a moment about the capital cost
17 component of the storm-related costs, because that's another
18 example in which there are, there is a spectrum of
19 possibilities. Because of the storms the replacement plant was
20 installed at a high premium above what normally would have been
21 the case. And, again, there's a range of possibilities in
22 terms of how one accounts for that. At one extreme one could
23 tell the company to capitalize in all those costs, and because
24 of the premium that would have the effect of inflating rate
25 base significantly.

1 At the other end of the, other end of the spectrum it
2 is possible to tell the company to charge all those capital
3 costs to the storm reserve, in which case you have, as the
4 company intends, a rate base that's unchanged, even though you
5 have a very different system after the restoration activities
6 than you had before the storm.

7 And there's a middle-of-the-road position, and that
8 is capitalize the amount that normally would have incurred and
9 treat the extraordinary increment as O&M that should be charged
10 to the storm reserve. Again, that's the approach that we have
11 taken and, again, we think it is one that has the balancing
12 effect that is needed in a situation such as this case, such as
13 the one this case presents.

14 And by the way, FPL's witness testifies that FPL has
15 the ability to calculate those, those normal costs, and so that
16 is not a hardship on FP&L.

17 As you learned very recently, we also have
18 supplemental testimony asking the Commission to take into
19 account the availability of a depreciation reserve excess in
20 its consideration of the petition. And in response FPL has
21 cited several orders and has argued that the proposal would be
22 somehow a violation of accounting principles or other agencies'
23 standards.

24 We will demonstrate that the Commission does have
25 that ability, notwithstanding the matters cited by FPL, and we

1 will ask the Commission to keep its options open so that it can
2 utilize the opportunity to take the depreciation reserve excess
3 into account in a manner that best serves the interest of
4 ratepayers. Thank you.

5 COMMISSIONER BAEZ: Mr. McWhirter.

6 MR. McWHIRTER: May it please the Commission, my name
7 is John McWhirter with the Florida Industrial Power Users
8 group. This case amounts to a lot of money. As Mr. Litchfield
9 told you, they're seeking a one-time short-term recovery of
10 \$533 million. In addition to that amount, in a pending rate
11 case they're asking for another \$384 million. \$100 million of
12 that is attributable to rebuilding the storm reserve.

13 If you divide the amount that'll be collected in 2006
14 just by its customer base, the cost per customer would amount
15 to something like between \$160 and \$200 per customer. But, of
16 course, it isn't counted in that way.

17 Mr. Litchfield did, I think, an excellent job of
18 putting this case into perspective, and I hope you listened to
19 what he said very carefully. Probably the most important thing
20 he said is that you should take the case in the context of all
21 that has gone before, and that means go back to 1993, as he
22 did, in the original order in which Florida Power & Light
23 sought to convert their insurance coverage program into a
24 self-insurance program.

25 And the two issues he said that are important in this

1 case, he's narrowed down the 30 issues in the prehearing order
2 to two, and the two he identified is the accounting method
3 used, that's the method by which the utility keeps its normal
4 operating expenses attributable to linemen and other people
5 that are involved in storm damage, and collects, seeks to
6 collect for those expenses again through a storm damage
7 surcharge. The effect of doing that is to increase earnings.

8 And he said the other thing you should look at is the
9 impact on shareholders of this case and whether this
10 stipulation should be used to injure shareholders. Well, I
11 would suggest to you that nobody has on our side, and I'm sure
12 Florida Power & Light, has for a minute suggested that
13 shareholder dividends be restricted. What we're talking about
14 is how the excess cash from excess earnings due to the new
15 accounting methodology will be utilized and what that amount of
16 money should be.

17 Now Mr. Litchfield said put the case in context, and
18 the context is that in all previous cases that have dealt with
19 storm damage, they've dealt with it in the, in the window of
20 base rates in base rate proceedings. The major thing that's
21 changed in this case is they're seeking a cost recovery clause
22 which guarantees a full recovery of storm costs. And that's a
23 dramatic difference, that's a dramatic difference, as
24 Mr. McGlothlin has told you, that is brought out by FP&L in
25 this case. And the reason is that when you give guaranteed

1 most recovery without considering the impact on base rates, you
2 remove earnings from the, from the study. And we don't -- they
3 haven't told you what the earnings are for 2004, the year of
4 the storm, when they were able to reduce expenses dramatically
5 by deferring a lot of labor costs to a future year. And they
6 say that doesn't count because when we entered into a rate
7 settlement in 2002, return on equity was taken off the table.
8 So they don't want to count it, the stipulation on the -- they
9 do want to consider the stipulation on the top side where it
10 lets them earn whatever they want to on earnings, but it
11 doesn't want to apply the stipulation on the bottom side where
12 it says the earnings in the event of untoward, unforeseen
13 circumstances, you'll still be entitled for your company to get
14 a 10 percent return on your investment, which is in this era a
15 good return.

16 So we suggest to you that when you consider this
17 case, as you said yesterday, you consider the whole context.
18 You consider what's gone before, what's always been done in
19 base rates before, you consider that we have a major balance
20 sheet adjustment in the depreciation reserve that is now before
21 the Commission, and you have a rate proceeding before the
22 Commission, and put all these things together and try to come
23 up with a fair solution. And I would never for one moment
24 suggest that Florida Power & Light didn't do a fine job on
25 storm restoration. All we suggest is that they get enough

1 money to have a fair return on their investments and that they
2 cover all of their storm costs, but that they share that with
3 the customers who are going to have to bear the burden. It
4 isn't self-insurance as proposed by Florida Power & Light. It
5 is a full customer cost plus additional profit. And that
6 element that gives them the additional profit is the one that
7 sticks in the craw of people who understand what's going on.
8 Thank you.

9 COMMISSIONER BAEZ: Mr. Wright.

10 MR. WRIGHT: Thank you, Mr. Chairman, Commissioners.
11 What is at issue in this proceeding involves some accounting
12 issues: Whether some expenses are properly claimed as expenses
13 chargeable to the storm reserve, whether appropriate offsets
14 based on normal expense levels have been accounted for, and
15 perhaps most significantly whether any of the risks associated
16 with costs incurred due to the hurricanes are to be borne by
17 FPL and its shareholders.

18 On this last point this case is really very simple.
19 Our theory, and by "our" I mean the customers of FPL who are
20 represented by everybody at this end of the table, our theory
21 of the case is that FPL's shareholders have been and are,
22 continue to be compensated handsomely and generously by their
23 customers, our clients, who pay through their rates money
24 sufficient to generate returns for FPL's shareholders that are
25 far greater than risk-free returns available in the capital

1 markets.

2 Accordingly, our theory of the case is that FPL's
3 shareholders have been compensated for taking risk, and that
4 now, accordingly, they should share in some of the risk, not
5 all of the risk, of the costs incurred due to the 2004
6 hurricanes.

7 The evidence will show that FPL's shareholders have
8 received millions of dollars in contributions from their
9 customers as a risk premium, payments above a true risk-free
10 cost of equity capital. Our theory is that the Commission, in
11 doing your job to ensure that the totality of FPL's rates are
12 fair, just and reasonable, must require FPL's shareholders to
13 share some of that money in restoring FPL's storm reserve fund.
14 We believe that the appropriate amount is that which would
15 still leave FPL's shareholders receiving a 10 percent ROE,
16 which will still provide FPL's shareholders with millions of
17 dollars in compensation for taking a risk above a risk-free
18 rate of return after accounting for and recovering storm costs,
19 and which is consistent with the provisions of the 2002
20 stipulation and settlement, and which is generous, very
21 generous relative to today's capital market conditions.

22 FPL's theory, on the other hand, is that they get to
23 keep all the money and that FPL's customers have to bear all
24 the risk and all the costs of the hurricanes. This is unfair,
25 inequitable, unjust and unreasonable, and the Commission must

1 deny FPL's request and instead require FPL's shareholders to
2 share in the risks.

3 Frankly, we believe that you could, in deciding this
4 case, require FPL to replenish the storm reserve with earnings
5 from 2004 and 2005 to the point at which FPL earns a 10 percent
6 rate of return on equity. This is not a penalty. It is
7 prospective ratemaking only. FPL has no entitlement to a
8 surcharge per se. They do, of course, have a statutory right
9 to have you, the Commission, determine rates that are
10 considered in their totality fair, just, reasonable and not
11 unduly discriminatory. FPL's customers, whom we have the
12 privilege to represent, have the same right, and that's all
13 we're asking you to do. Thank you.

14 COMMISSIONER BAEZ: Mr. Twomey.

15 MR. TWOMEY: Thank you, Mr. Chairman, Commissioners.
16 I want to speak momentarily about the Commission's
17 responsibility in this case. We view that you have a duty to
18 balance the interest of the company that's before you as well
19 as its customers. Providing the company with the relief it's
20 requesting here today, that is 100 percent protection for the
21 stockholders, does not meet that balancing test in our view.

22 The -- I was struck in Mr. Litchfield's comments how
23 frequently he told you or referred to shareholder expectations
24 or Wall Street expectations or shareholder interests. It
25 struck me, again, how often he said that as if it was some kind

1 if a code word that was supposed to communicate an interest
2 hat they had, Wall Street had superior interest to the
3 customers. Of course, that's not the case.

4 And, again, giving the company what it asks would
5 protect the shareholders of this company 100 percent. It would
6 provide them with no exposure, no financial cost to the
7 consequences of repairing their company as a result of the
8 damage suffered during the three hurricanes. You shouldn't --
9 obviously, you should not lean in that direction.

10 You heard Mr. McGlothlin's discussion of this
11 Commission's precedents leading up to this case in terms of
12 dealing with storms and hurricane damage. The precedents in no
13 way support surcharges at all. I don't recall seeing a case in
14 which you've granted a company surcharges. Instead, as you're
15 aware or should be aware, you have allowed the company to
16 increase its accrual often through use of additional or excess
17 profits, and then you've required the companies to charge storm
18 damage expenses against the reserve without surcharges. So
19 having a surcharge is contrary to your precedent. Having a
20 surcharge that allows a company to avoid 100 percent the
21 repairs for its company, its systems is way outside of your
22 precedents. It's not only not supported by precedent, it is
23 fundamentally unfair not to have a sharing.

24 The -- I want to say briefly, I was a signatory on
25 behalf of a party to the settlement agreement, and I don't view

1 that settlement agreement as precluding the relief, the sharing
2 concept sought by the customers in this case.

3 The second issue you have to address -- and I want to
4 go back and say the, the, the sharing concept, Commissioners,
5 although it's, in our view, contrary to your prior precedents,
6 it's not really, it's a factual issue, it is in large part
7 legal, I think, but it is a policy decision that y'all have to
8 make. You have to decide whether you're going to go with the
9 shareholders 100 percent as the company asks, whether you're
10 going go 100 percent with the customers, which is not even
11 being requested, as has been pointed out by each of the
12 previous speakers for the customers. We think at least
13 theoretically under your precedents you could have no
14 surcharge, and no customer group is taking that position here.
15 They're saying engage in a sharing that still allows
16 Florida Power & Light's shareholders to earn a very respectable
17 10 percent, and concedes that the customers should pay well in
18 excess of \$100 million for these costs. That is, again,
19 customers, many of whom, as you know, suffered financial
20 consequences that were not reimbursed with this loss of food,
21 shelter, business and so forth.

22 The second thing that is largely a policy issue that
23 you have to confront in this case as opposed to factual, I
24 would submit, is the concept of double-dipping. The customers'
25 representatives uniformly oppose the notion of paying workers

1 for their eight-hour day and not just the overtime. AARP, my
2 other clients support the Public Counsel in saying that what
3 the company should have considered, even before you address the
4 sharing concept, is only the expenses they have that are
5 incremental to whatever their expenses would have been on a
6 day-to-day, month-to-month operational expense that is included
7 in the base rates the customers have already paid.

8 So I would close by saying I would urge you, keep in
9 the forefront of your minds the notion that there should be a
10 sharing. It's the only fair outcome. And look with some
11 dubious eyes the notion that this double-dipping should be
12 going forward. Thank you.

13 COMMISSIONER BAEZ: Thank you, Mr. Twomey.

14 I thought I heard something. We're ready to move on
15 to witnesses now, unless, Commissioners, would you like to take
16 a five-minute break before we move onto the witnesses?

17 We'll break for five minutes.

18 (Recess taken.)

19 COMMISSIONER BAEZ: Go back on the record. At this
20 point will any -- well, let me, let me take 30 seconds just to
21 make sure any of the witnesses that are supposed to be in the
22 room today are, are in.

23 MR. BUTLER: We have Mr. Davis here, who is our first
24 witness. We may have a couple of others. I don't think we --
25 we certainly don't have all of our witnesses who will testify

1 --
2 COMMISSIONER BAEZ: No. I know you don't have -- I
3 know they're not all in town or, you know, physically. But,
4 out those that are, I'd like to cut down on the swearing. I'm
5 sorry. I mean the swearing in. That's what I meant.

6 (Laughter.)

7 Well, I guess not. Everyone -- any witnesses that
8 are in the room, would you please stand up and raise your right
9 hand.

10 (Witnesses collectively sworn.)

11 COMMISSIONER BAEZ: Thank you, gentlemen.

12 Mr. Butler, go ahead and call your witness.

13 MR. BUTLER: Mr. Chairman, we would call
14 K. Michael Davis as FPL's first witness.

15 K. MICHAEL DAVIS
16 was called as a witness on behalf of Florida Power & Light
17 Company and, having been duly sworn, testified as follows:

18 DIRECT EXAMINATION

19 BY MR. BUTLER:

20 Q Would you please state your name and address for the
21 record, Mr. Davis.

22 A K. Michael Davis, 9250 West Flagler Street, Miami,
23 Florida 33174.

24 Q What position do you hold with FPL?

25 A I'm a Vice President, Controller and Chief Accounting

Officer of Florida Power & Light Company.

Q Okay. Do you have before you the following prefiled testimonies: Testimony of K. Michael Davis consisting of 13 pages and an attached exhibit designated KMD-1; supplemental direct testimony of K. Michael Davis consisting of four pages and attached exhibits designated revised KMD-1 and KMD-2; rebuttal testimony of K. Michael Davis consisting of 32 pages and attached exhibits designated KMD-3, KMD-4 and KMD-5; and finally supplemental rebuttal testimony of K. Michael Davis consisting of 17 pages and an attached exhibit designated KMD-6?

A Yes, I do.

Q Were the testimony and exhibits prepared under your direction, supervision or control?

A Yes, they were.

Q Okay. And, Mr. Chairman, we distributed during the break a brief errata sheet for Mr. Davis. And I'd just ask Mr. Davis, do you concur with the changes that are reflected on this errata sheet?

A Yes, I do.

Q With those corrections, if I were to ask you the questions contained in your prefiled testimony today, would your answers be the same?

A Yes, they would.

MR. BUTLER: Okay. And, Mr. Chairman, I note that

1 Exhibit Numbers, let's see, 7, 8, 24, 25, 26 and 31 have been
2 preassigned to Mr. Davis's exhibits revised KMD-1 through
3 KMD-6 respectively, so I don't think there's any need for
4 further marking of them.

5 COMMISSIONER BAEZ: No. Let the record show them,
6 all the -- KMD-1 through KMD-6 already marked as Exhibits 7, 8,
7 24, 25, 26 and 31 respectively.

8 MR. BUTLER: Thank you. I'd ask that Mr. Davis's
9 prefiled testimony be inserted into the record as though read.

10 COMMISSIONER BAEZ: Without objection, show Michael
11 Davis's prefiled direct, rebuttal and supplemental rebuttal
12 entered into the record as though read.

13 MR. BUTLER: And his supplemental direct testimony.

14 COMMISSIONER BAEZ: I'm sorry. And his supplemental
15 direct as well. I apologize.

16 MR. BUTLER: Thank you.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

TESTIMONY OF K. MICHAEL DAVIS

DOCKET NO. 041291-EI

I. INTRODUCTION AND CREDENTIALS

Q. Please state your name and business address.

A. My name is K. Michael Davis, my business address is 9250 West Flagler Street, Miami, Florida 33174.

Q. By whom are you employed and what is your position?

A. I am employed by Florida Power & Light Company ("FPL" or the "Company") as Vice President, Controller and Chief Accounting Officer.

Q. Please outline your educational qualifications and experience.

A. I graduated from the University of Florida in 1968 with a Bachelor of Science degree in Business Administration, with a major in Accounting. In that same year I was employed by Deloitte Haskins & Sells (DH&S), Independent Public Accountants (presently Deloitte & Touche). I was promoted to manager in 1976 and was elected a Partner in 1981. During my tenure with DH&S, I participated in engagements involving services to a number of diverse industry

1 groups including the utility industry. In addition, I was responsible for handling
2 accounting questions concerning the utility industry during a three-year
3 assignment in the DH&S executive office in New York. In December 1988, I
4 was employed by FPL as comptroller. On July 1, 1991, I accepted my current
5 position as Vice President, Controller and Chief Accounting Officer. I am a
6 Certified Public Accountant in the State of Florida, and a member of the
7 American Institute of Certified Public Accountants and the Florida Institute of
8 Certified Public Accountants. I am a member and past chairman of the
9 Accounting Executive Advisory Committee of the Edison Electric Institute
10 (EEI). **That group** is composed of Chief Accounting Officers from utilities that
11 **are members of** EEI and oversees the activities of the various accounting
12 **committees of** EEI and advises senior EEI committees on accounting issues.
13 **That committee** meets annually with the Financial Accounting Standards Board
14 **to discuss accounting** issues of interest to the membership and approves all
15 **comment letters** issued by EEI on accounting matters.

16
17 **Q. What are your duties as Vice President, Controller and Chief Accounting**
18 **Officer of FPL?**

19 **A. As Vice President, Controller and Chief Accounting Officer, I am responsible for**
20 **the development, interpretation and implementation of FPL's accounting**
21 **policies, procedures and related internal accounting controls, and for maintaining**
22 **the accounting records in compliance with financial and regulatory accounting**

1 requirements. Also, I am responsible for ensuring the adequacy of the systems
2 necessary to support the accounting process.

3
4 **Q. Are you sponsoring an exhibit?**

5 A. Yes. I am sponsoring Exhibit KMD – 1 which shows estimated storm damage
6 costs by hurricane and cost category, net of expected insurance reimbursement.

7
8 **II. PURPOSE**

9
10 **Q. What is the purpose of your testimony in this proceeding?**

11 A. The purpose of my testimony is to discuss FPL's accounting treatment for the
12 storm damages in the Storm Damage Reserve. I will discuss the amount charged
13 to the storm damage reserve and what FPL expects the reserve deficiency to be at
14 December 31, 2004. I will discuss how FPL's treatment is consistent with
15 Commission rules, Order No. PSC-95-0264-FOF-EI, issued February 27, 1995 in
16 Docket No. 930405-EI and the terms and conditions of the settlement agreement
17 approved in Order No. PSC-02-0501-AS-EI, issued April 11, 2002 in Docket
18 No. 001148-EI. In addition, I will discuss the appropriate mechanism and the
19 appropriate time frame for recovery of these costs.

III. HURRICANE COSTS AND ACCOUNTING TREATMENT

Q. What is the current amount of the storm damage from the hurricanes?

A. The total damages to date are approximately \$818 million. The company expects to receive an insurance reimbursement of \$108 million for non-transmission and distribution property. The \$108 million has been recorded as a receivable from the insurance company. Consequently, the total amount charged to the reserve to date is \$710 million on a total system basis.

Q. Please provide a breakdown of the \$710 million charged to the Storm Damage Reserve for hurricane damages by storm.

A. The following is a breakdown by storm of the \$710 million:

(in millions)

<u>Charley</u>	<u>Frances</u>	<u>Jeanne</u>	<u>TOTAL</u>
\$209	\$267	\$234	\$710

The \$710 million is an estimate of the total uninsured hurricane damages. It is subject to adjustment as the actual invoices are received and paid.

Q. Please provide a breakdown of the \$710 million by category.

A. Exhibit KMD – 1 shows the breakdown of the \$710 million by category and by storm, net of the expected \$108 million of insurance reimbursement.

1 **Q. How was the \$710 million (system) of storm damages recorded?**

2 A. In accordance with Commission rule 25-6.0143 Florida Administrative Code
3 (FAC) all costs incurred related to the hurricane were debited to the Storm
4 Damage Reserve.

5

6 **Q. What effect did the \$710 million (system) have on the Storm Damage**
7 **Reserve?**

8 A. **The \$710 million (system) charged to the Storm Damage Reserve created**
9 **a deficiency in the reserve which will be discussed in more detail later**
10 **in my testimony.**

11

12 **Q. Is the deficiency in the Storm Damage Reserve recovered by any other**
13 **recovery mechanism?**

14 A. No. The annual accrual of \$20.3 million will continue to be recorded by FPL.
15 Because FPL proposes that the recovery of the deficit will be based on the
16 reserve balance as of December 31, 2004, the continuation of the \$20.3 million
17 annual accrual, beginning January 1, 2005 would be used to begin rebuilding the
18 reserve for future storm losses.

19

20 **Q. Are the current accrual and the recovery of the deficit authorized**
21 **by Commission orders?**

22 A. Yes. The current accrual amount of \$20.3 million was approved in Order No.
23 PSC-95-1588-FOF-EI issued December 27, 1995, in Docket No. 951167-EI and

1 reaffirmed by the Commission in Order No. PSC-98-0953-FOF-EI, issued July
2 14, 1998, in Docket No. 971237-EI. In this order the Commission stated that,
3 "In cases of catastrophic loss, FPL continues to be able to petition the
4 Commission for emergency relief." In addition, the settlement agreement
5 approved by the Commission in Order No. PSC-02-0501-AS-EI, issued April 11,
6 2002 in Docket No. 001148-EI states, "In the event that there are insufficient
7 funds in the Storm Damage Reserve and through insurance, FPL may petition the
8 FPSC for recovery of prudently incurred costs not recovered from ~~these~~ ^{those}
9 sources."

10

11 **Q. What is FPL proposing to recover at this time?**

12 A. FPL is only requesting recovery of the deficiency.

13

14 **Q. What is the history of FPL's Storm Damage Reserve?**

15 A. FPL's Storm Damage Reserve started in 1946, and became a funded reserve in
16 1958. FPL has increased the reserve by the amounts authorized by the
17 Commission. In addition, the reserve has been increased by the earnings from
18 investments held in the related fund. The reserve has been reduced by amounts
19 needed to repair damage caused by hurricanes and other named storms. As such,
20 FPL's customers have benefited from the existence of the reserve. It is the
21 catastrophic nature of the three hurricanes experienced in 2004 that has wiped
22 out the entire reserve and created the deficit FPL is now seeking to address.

23

1 **Q. Please describe the accounting entries to record the \$20.3 million annual**
2 **accrual.**

3 **A.** Monthly accruals are recorded as a debit to Account 924 – Property insurance
4 expense - and a credit to Account 228.1 – Accumulated provision for property
5 insurance – Storm and Property Damage Reserve. Monthly accruals are equal to
6 one-twelfth of the annual amount authorized. This accounting is consistent with
7 Rule 25-6.0143 of the Florida Administrative Code and the Uniform System of
8 Accounts prescribed by this Commission.

9
10 Since the monthly accrual to Account 924 is not deductible for income tax
11 purposes, a credit to above-the-line deferred tax expense and a debit to a deferred
12 tax asset Account 190 – Accumulated deferred income tax - is recorded to
13 recognize the future tax deductibility at the time actual storm losses are incurred.

14 In addition, because FPL's reserve is a funded reserve, entries are required to
15 recognize the investment of the after-tax accruals in a special fund. Monthly
16 contributions are made to the fund on an after tax basis equal to the gross accrual
17 less current federal and state income tax payable. The amount contributed to the
18 fund is recorded as a debit to Account 128.3 – Other special funds – storm and
19 property damage fund. The use of the fund is restricted to un-insured losses that
20 are covered by the storm and property damage reserve. To date, actual
21 withdrawals from the fund have been limited to losses resulting from storm
22 damages.

23

1 **Q. How does FPL account for the earnings from investments held in the Fund?**

2 A. In accordance with prior Commission orders, earnings from investments held in
3 the fund, less any applicable income taxes, are reinvested in the fund resulting in
4 an increase in the fund balance and a corresponding increase (credit) to the
5 reserve. Fund earnings and applicable income taxes are recorded to below-the-
6 line non-operating income accounts. FPL also accrues a below the line expense
7 equal to the pre-tax value of reinvested earnings and records a credit to the
8 reserve for a like amount. Since the expense representing the reinvestment of the
9 fund earnings is not deductible for income tax purposes, a credit to deferred tax
10 expense, Account 411 and a debit to deferred tax asset, Account 190 is also
11 recorded. Fund income, current tax expense, accrual for earnings charged to the
12 reserve, and deferred tax expense are all recorded to below-the-line accounts and
13 net to zero on a monthly basis. Therefore, there is not an impact on FPL's net
14 income resulting from reinvestment of fund earnings. The benefit accrues to the
15 customers as an increase in the available reserve balance to offset storm
16 damages.

17

18 **Q. What is the effect of hurricane damages on the expected balance in the**
19 **Storm Damage Reserve at December 31, 2004?**

20 A. The balance in the Storm Damage Reserve excluding the \$710 million (system)
21 of charges would have been a credit (positive) balance of approximately \$354
22 million (system). The storm reserve is expected to have a debit (deficit) balance
23 of approximately \$356 million (system) at December 31, 2004. This deficit

1 balance is the direct result of charging the reserve, as directed by the
2 Commission, with \$710 million (system) of storm related costs. FPL has
3 continued to increase the reserve on a monthly basis with one-twelfth of the
4 annual accrual. In addition, earnings from investments held in the storm fund
5 have continued to have a positive effect on the reserve balance. In order to
6 minimize any negative effect on investment earnings from the liquidation and
7 withdrawal of funds, the funds are being withdrawn over the October through
8 December period. Any earnings realized from investments held in the fund
9 during this period have been and will continue to be credited to the reserve until
10 all funds have been withdrawn and the balance in the fund is reduced to zero.
11 The continuation of monthly accruals and recognition of fund earnings through
12 the end of the year have been applied to reduce the deficit resulting from the
13 \$710 million (system) of storm damage costs charged to the reserve.

14
15 **Q. Is FPL's methodology for accounting for the storm fund consistent with**
16 **Commission Rules and Orders?**

17 **A.** Yes. FPL's methodology for accounting for the storm fund is consistent with
18 Commission Rule 25-6.0143 Florida Administrative Code for establishing and
19 maintaining a reserve. All costs incurred in connection with the three named
20 hurricanes which hit FPL's service territory in 2004, both capital and O&M,
21 have been charged to the storm reserve. The accounting treatment used was
22 approved by the Commission in Order No. PSC-95-0264-FOF-EI, issued
23 February 27, 1995 in Docket No. 930405-EI.

1 **Q. How does FPL capture costs related to Storm Restoration?**

2 A. When a storm threatens FPL's service territory 72 hours prior to landfall the
3 General Office Command Center (GOCC) is activated and FPL establishes a
4 work order unique to that storm. All costs related to the storm are charged to this
5 work order, including preparation and restoration costs. FPL's main purpose for
6 utilizing a unique work order is to simplify the accounting as the main focus of
7 the Company's effort is on storm restoration. The use of work orders captures
8 all costs by source, e.g., payroll, vehicle, cash voucher, etc., and allows the
9 Company to maintain the appropriate audit trail.

10

11 **Q. How does FPL propose to collect the Storm Reserve deficiency?**

12 A. Upon Commission approval, FPL proposes to initiate recovery of the
13 jurisdictional portion of the estimated Storm Reserve deficiency of \$356 million
14 (system), or \$354 million (jurisdictional), through a monthly surcharge "Storm
15 Restoration Surcharge" to apply to customer bills based on a twenty-four month
16 period or until the \$354 million (jurisdictional) amount is collected commencing
17 January 1, 2005, or as early as practicable. The recovery of the \$354 million
18 (jurisdictional) will only allow FPL to recover the deficiency.

19

20 **Q. Why is a 24 month recovery period appropriate?**

21 A. In an effort to limit the impact to FPL's customers while still recovering the
22 Storm Reserve deficiency in a timely manner, FPL proposes to recover the
23 deficiency over a 24 month period or less. FPL has already incurred an

1 extraordinary cost of \$818 million (\$710 million after expected insurance
2 recovery of \$108 million) to restore electrical power to its customers.
3 Immediate recovery of these costs through FPL's storm reserve fund, insurance
4 proceeds and customers would restore FPL's financial position to what it was
5 before the hurricanes. In addition, it would provide the best match between the
6 timing of the incurrence of the extraordinary costs with the timing of their
7 recovery. Because of financing costs, the longer the recovery period, the more
8 costly it is for FPL's customers.
9

10 **Q. How will the \$356 million (system) or \$354 million (jurisdictional) be**
11 **amortized over the proposed recovery period?**

12 **A.** FPL will amortize the \$356 million (system) or \$354 million (jurisdictional) as a
13 regulatory expense over the 24 month period or less. The amount amortized will
14 be equal to the amount recovered from customers each month. The remaining
15 unamortized balance will accrue interest at the 30 day commercial paper rate.
16

17 **Q. What is the revenue requirement amount used to determine the Storm**
18 **Restoration Surcharge?**

19 **A.** The estimated 2005 annual revenue requirement amount is \$183,179,800.
20

21 **Q. Please describe how you calculated the estimated annual revenue**
22 **requirement amount of \$183,179,800.**

23 **A.** The estimated 2005 annual revenue requirement amount of \$183,179,800 was

1 calculated by making the assumption that the deficit amount of \$356 million
2 (system) would be recovered ratably over a 24 month period of time. In
3 addition, FPL accrued interest on the declining balance at the assumed 30 day
4 commercial paper rate. The calculation does not take into consideration the
5 monthly variation in sales. Any variances in any of the components will be
6 included in the calculation of the final true-up amount.

7
8 **Q. Will the recovery of the jurisdictional portion of the estimated Storm**
9 **Reserve deficiency be subject to a true-up?**

10 **A. Yes. Within 60 days following expiration of the recovery period, FPL will file**
11 the final actual hurricane costs underlying the Storm Reserve deficiency. Any
12 actual over-recovery of the Storm Reserve deficiency based upon such filing
13 would be refunded on customer bills as soon as practicable following a final
14 Commission order accepting the proposed true-up, such refund to be allocated in
15 the same manner as the surcharge was applied. For any under-recovered portion
16 of the Storm Reserve deficiency, FPL would propose the means by which it
17 would be recovered at that time. In addition to identifying the actual, final Storm
18 Reserve deficiency in its filing, and any under or over-recovered amounts, FPL
19 would supply the revised Storm Recovery Factor corresponding to the refund or
20 recovery, as appropriate, in connection with the true-up. As an alternative, the
21 Commission may choose to apply any over-recovered amounts to the storm
22 reserve. This would benefit our customers by increasing the funds available for
23 future storm damage.

1 **IV. CONCLUSION**

2

3 **Q. Can you please summarize your testimony?**

4 A. Yes. As previously discussed, FPL maintains a funded reserve. Absent the
5 hurricanes this funded reserve would be expected to reach \$354 million at
6 December 31, 2004. Due to unprecedented storm damage from Hurricanes
7 Charley, Frances and Jeanne, FPL sustained \$818 million (\$710 million after
8 expected insurance recovery of \$108 million) in damages. FPL's expected
9 insurance reimbursement is \$108 million and as a result the Storm Damage
10 Reserve was charged with \$710 million on a total system basis. After application
11 of the expected \$354 million in the funded reserve, FPL expects to have a deficit
12 of \$356 million (total system) for which it is seeking recovery of \$354 million
13 (jurisdictional) over 24 months. FPL's treatment is consistent with Commission
14 rules and orders and is consistent with a settlement agreement reached by various
15 parties and approved by the Commission.

16

17 **Q. Does this conclude your direct testimony?**

18 A. Yes it does.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

REBUTTAL TESTIMONY OF K. MICHAEL DAVIS

DOCKET NO. 041291-EI

I. INTRODUCTION AND SUMMARY

Q. Please state your name and business address.

A. My name is K. Michael Davis, my business address is 9250 West Flagler Street, Miami, Florida 33174.

Q. Did you previously submit direct and supplemental direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. I will respond to portions of the testimony submitted on behalf of the Florida Office of Public Counsel (OPC) by Michael J. Majoros, Jr., which address the proper treatment and accounting for costs charged to the Storm Damage Reserve.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Exhibit KMD-3, the study filed on October 1, 1993 in Docket No. 930405-EI (the 93 Study), which included accounting standards for storm restoration costs that FPL was required to file pursuant to Commission Order No. PSC-93-0918-FOF-EI, issued June 17, 1993 in Docket No. 930405-EI (the 93 Order). The Commission approved the 93 Study in 1995 in Commission Order No. PSC-95-

0264-FOF-EI, issued February 27, 1995 (the 95 Order), attached to my rebuttal testimony as Exhibit KMD-4. I am also sponsoring Exhibit KMD-5 which describes the Company's computation of lost revenues.

Q. Please briefly describe the purpose of your rebuttal testimony.

A. As described in my direct and supplemental direct testimony, the Company has incurred estimated total storm restoration costs of \$999 million. Storm restoration costs have been accounted for in compliance with the 93 Study approved in the 95 Order. Estimated insurance reimbursements cover \$109 million of those damages, leaving an amount charged to the reserve of \$890 million (system). The \$890 million (system) storm restoration cost, net of the Storm Damage Reserve positive balance of \$354 million at December 31, 2004, results in a deficiency of \$536 million on a total system basis. Using the factor proposed by FPL in this proceeding, the jurisdictional portion of the deficiency of \$533 million would be collected over approximately three years.

Mr. Majoros has proposed that the Company not recover \$309 million. This disallowance is based on the Company's initial estimated storm restoration costs of \$818 million. As I indicated in my supplemental direct testimony, the estimated restoration costs charged to the Storm Damage Reserve increased by approximately \$180 million (original estimate \$710 million, current estimate \$890 million), although no new categories of costs have been identified.

1 The Commission should not adopt Mr. Majoros' recommended disallowance or the
2 reasons for his proposed disallowance. Mr. Majoros either ignores or does not
3 accurately characterize relevant Commission Orders. Ten years after the Commission
4 approved the 93 Study in a docket in which OPC participated, Mr. Majoros would
5 change the standards after the fact and impose a staggering financial burden on the
6 Company. In addition, Mr. Majoros' implication that FPL may be "double billing" or
7 making money on storm events is simply not true. He is in error regarding the
8 characterization of removal costs and certain storm restoration activities. Aside from
9 proposing that the Commission ignore practices it previously approved, Mr. Majoros
10 has provided no reason to deny the Company recovery of storm restoration costs.

11
12 **II. COMMISSION STANDARDS FOR THE STORM DAMAGE RESERVE**

13
14 **Q. Do standards exist for determining what costs are chargeable to the Storm**
15 **Damage Reserve?**

16 **A. As I stated in my direct testimony, the Commission authorized the creation of the**
17 **Storm Damage Reserve and, in 1995, approved standards for charging costs to the**
18 **Storm Damage Reserve. The Company has accounted for storm restoration costs in**
19 **compliance with these standards since they were approved in 1995.**

1 Q. On Page 15 of his direct testimony, Mr. Majoros asserts that the Commission
2 never adopted accounting standards for the Storm Damage Reserve and,
3 therefore, OPC is free to propose new standards that would be applied
4 retroactively to determine the accounting for storm restoration costs. Do you
5 agree?

6 A. No. The Commission did approve standards for the Storm Damage Reserve in
7 Docket No. 930405-EI. Mr. Majoros has omitted mention of the 93 Order, which is
8 important in understanding the purpose and context of the study submitted by the
9 Company. That Order stated (page 4):

10 "From the record in this docket it is unclear what storm related
11 expenses FPL intends [to] draw from the reserve fund. For example it
12 is unclear whether normal salaries would be charged to the fund if
13 employees worked on storm related tasks. In addition, employees
14 repairing storm damage would be required to spend time away from
15 their everyday work tasks which would result in "catch up" expense.
16 It is unclear from the record whether FPL intends to draw "catch up"
17 expense from the reserve fund. The record reflects that such "catch
18 up" expense is not recoverable under FPL's current insurance policy.
19 In addition it is unclear whether the cost of damaged assets would be
20 accounted for at replacement cost or net book value. For example, if
21 there were \$100 million of net book value of assets that were
22 destroyed and it took \$200 million to replace those, what accounting
23 entries would be made?

24
25
26 FPL shall address these questions in the company study discussed
27 above."
28

29 In compliance with the 93 Order, the Company submitted the required study on
30 October 1, 1993. The 93 Study is attached as Exhibit KMD-3.

31
32 The Commission addressed the accounting standards of the 93 Study in the 95 Order
33 at pages 4-5 as follows:

1 “...the study addressed the issues raised in the [June 17, 1993] order
2 concerning the types of expenses that would be charged to the reserve.
3 However, we have the authority to review any expenses charged to the
4 reserve for reasonableness and prudence. FPL stated that it would use
5 the actual restoration cost approach for determining the appropriate
6 amounts to be charged to the reserve. This methodology is consistent
7 with the manner in which replacement cost insurance works.
8

9 In accounting for the restoration and replacement costs to plant, the
10 gross original cost of the replaced plant should be retired by a credit to
11 the plant accounts and a debit to the depreciation reserve. Then, a
12 credit would be made to the plant accounts so that the replacement
13 gross plant would be reduced by the available balance of the storm
14 reserve until it is equal to the value of the plant it replaced. In
15 addition, the depreciation reserve would be credited with an amount
16 equal to the gross cost of the replaced plant. This would restore the
17 plant accounts and depreciation reserve to their original values prior to
18 the damage caused by the storm.”
19

20 In the ordering paragraphs at the conclusion of the 95 Order (page 6), the
21 Commission expressly stated: “ORDERED that the storm damage study submitted
22 by Florida Power & Light Company is hereby found to be adequate.” The 95 Order
23 is attached as Exhibit KMD-4.
24

25 Understanding the purpose and context of the 93 Study and recognizing the
26 Commission’s substantive review of the study, it is clear that the 95 Order reflected
27 the Commission’s approval of the study and the standards that the Company has been
28 using over the last decade. Putting aside OPC’s participation in Docket No. 930405-
29 EI, its position in this proceeding ignores the fact that these issues were fully aired
30 and considered by the Commission Staff in making their recommendation to the
31 Commission and ultimately, by the Commission in issuing the 95 Order.
32
33

1 Q. Did other parties participate in Docket No. 930405-EI?

2 A. Yes. In the approximate two years between the time the Docket was opened and
3 issuance of the 95 Order, all parties had an opportunity to be heard. In addition to
4 FPL, Florida Industrial Power Users Group (FIPUG), OPC, and four other
5 intervenors, participated in the proceeding. OPC now seeks to suggest that these
6 issues somehow are new. Yet, clearly the Commission was provided with the diverse
7 opinions of not only its own staff but also of FPL and two of the major parties to the
8 current proceeding. After a thorough review, the Commission issued the 95 Order
9 approving the standards and methodology in the 93 Study. FPL has relied upon this
10 decision since that date.

11 Q. Is the 95 Order unclear to you in its approval of the study?

12 A. No. Mr. Majoros' claim that the Commission did not "bless" the study (page 15)
13 cannot be squared with the portions of the orders quoted above, or with the title of the
14 95 Order which is (emphasis added):

15

16 **NOTICE OF PROPOSED AGENCY ACTION**
17 **ORDER APPROVING STORM DAMAGE STUDY AND**
18 **ADJUSTMENTS TO SELF INSURANCE MECHANISM**
19

20 The title of the order removes any doubt that the order approved the study. For FPL to
21 have concluded otherwise, and to have used an accounting approach other than as
22 described in the 93 Study without further Commission action would have been
23 completely untenable. The discussion in the 95 Order clearly demonstrates that the
24 Commission understood that FPL would apply the standards recommended in the 93
25 Study in its accounting for storm costs and that it found FPL's recommended

1 accounting appropriate for regulatory purposes. Certainly I, as Chief Accounting
2 Officer of the Company, would have no reason to conclude anything to the contrary.

3 **Q. What is the significance of the 95 Order's mention of a possible future**
4 **rulemaking on uniform guidelines?**

5 A. None. It appears the Commission may have been considering whether to open a
6 rulemaking to establish uniform guidelines for all Florida utilities. But, in the ten
7 years since the 95 Order was issued the Commission has not initiated such a
8 rulemaking, a clear indication that the Commission found no reason to do so.
9 Therefore, the standards set forth in the 93 Study, as approved by the Commission in
10 1995, have remained applicable to FPL. As a result, FPL has no alternative but to
11 follow the accounting standards set forth in the 93 Study.

12 **Q. Has the Commission issued any orders since the 95 Order that changed the**
13 **standards approved for FPL in that Order?**

14 A. No. There have been several orders dealing with the Storm Damage Reserve;
15 however, none of them changed the standards approved in the 95 Order. In fact,
16 Order No. PSC-95-1588-FOF-EI, issued December 27, 1995 in Docket No. 951167-
17 EI and Order No. PSC-98-0953-FOF-EI, issued July 14, 1998, in Docket No. 971237-
18 EI, both referenced the 95 Order.

19
20 More recently, in Order No. PSC-04-1150-PCO-EI, Docket No. 041291-EI, issued
21 November 18, 2004, in Docket No. 041291-EI the Commission stated:

22 "On September 9, 2004, Florida Power & Light Company (FPL) filed
23 a petition for approval to establish as a regulatory asset for storm
24 damage costs that exceed the \$345 million balance of the Storm
25 Reserve. FPL also sought authorization for the future recovery of

1 reasonable and prudently incurred storm damage costs in excess of its
 2 Storm Reserve fund. By Order No. PSC-04-0976-PAA-EI, issued
 3 October 8, 2004, in Docket No. 041057-EI (and consummated by
 4 Order No. PSC-04-1114-CO-EI, issued November 9, 2004), this
 5 Commission found it was unnecessary to create a separate regulatory
 6 asset to do this because allowing a negative balance to be recorded in
 7 the Storm Reserve served the same purpose and was contemplated by
 8 Rule 25-6.0143, *Florida Administrative Code*. This Commission
 9 made its decision with the understanding that FPL will continue
 10 booking amounts consistent with its current accounting practice. The
 11 amounts are subject to our review and approval, in the event that a
 12 subsequent petition for recovery of storm-related damages is filed.”
 13 [emphasis added]
 14

15 **Q. Has FPL adhered to the approved standards?**

16 A. Yes. As I stated earlier, after the approval of the 93 Study, the Company has
 17 consistently followed the methodology recommended in that Study. Between 1993
 18 and 2003 the Company has experienced 8 storms totaling \$152.0 million in aggregate
 19 restoration costs, all of which have been charged against the Storm Damage Reserve.
 20 The Company has followed the standards set forth in the 93 Study in its accounting
 21 for storm restoration costs for all these storms. In that timeframe, I am not aware of
 22 any audit by the FPSC Staff that has disclosed any errors on the part of the Company
 23 or any inconsistency with the 93 Study approved by the Commission in the 95 Order.
 24 It does not appear that Mr. Majoros is making any allegation to the contrary, except
 25 perhaps with regard to the costs of a salt spray and a vegetation study. I address these
 26 two items later in my rebuttal testimony.

27 **Q. Has the Commission conducted audits of storm damage costs using these**
 28 **standards?**

29 A. Yes. On February 7, 2005 the Audit Staff of the Florida Public Service Commission
 30 issued a report on the costs that the Company charged to the storm reserve (the

1 Audit). Ileana Piedra, the Audit Manager, attached the Audit to her direct testimony
2 as Exhibit IHP-1. At page 4 of 12, Exhibit IHP-1 notes that the Audit Staff read the
3 “approved study...and [the 95 Order]” in connection with the Audit. The Audit had
4 no findings that FPL improperly charged any costs to the storm reserve or that the
5 Company did not follow the standards of the 93 Study approved by the Commission.

6
7 In fact, in her direct testimony at page 7, Ms. Piedra states: “FPL has recorded the
8 above costs as proposed in its 1993 study and discussed in the 1995 order, using the
9 actual costs.” It is apparent that the PSC Staff after conducting its own independent
10 review concluded that FPL has charged costs to the Storm Damage Reserve
11 consistent with the methodology set forth in the 93 Study. Commission orders and
12 the Staff’s Audit all point to a consistent application of the approach that the
13 Company recommended and the Commission approved.

14 **Q. Do you agree with Mr. Majoros’ statement that “...FPL wants the customers to**
15 **bear 100% of the risk of storm damage...” (Page 12, Line 17)?**

16 **A.** No. Mr. Majoros inappropriately equates recovery of the deficit in the Storm
17 Damage Reserve with the risk of storm damage. In doing so, he ignores the fact that
18 as a result of the hurricanes the Company lost revenues due to customer outages and
19 incurred other costs that were not charged to the Storm Damage Reserve. Further, he
20 ignores the fact that none of the increases in the annual accruals for storm damages
21 during the 1990s were accompanied by an increase in the rates charged to customers,
22 and instances where the Company made voluntary contributions to the Storm Damage
23 Reserve. Finally, he fails to recognize that restoration costs are, as discussed by FPL

witness Moray P. Dewhurst in his rebuttal testimony, a foreseeable cost that for good reasons has not been fully provided for in the normal cost of service used in setting base rates. Consequently, it is entirely appropriate under cost-based rate regulation for the Company to seek recovery of the resulting deficit.

Q. Has the Commission previously recognized that restoration costs may exceed the balance in the Storm Damage Reserve resulting in a need for recovery from customers?

A. Yes. The Commission recognized exactly this type of situation in Order No. PSC-98-0953-FOF-EI, issued July 14, 1998, stating:

“FPL’s financial resources from the lines of credit and the fund appear to be sufficient to cover most storm emergencies. However, the costs of storm damage incurred over and above the balance in the reserve and the costs of the use of the lines of credit would still have to be recovered from the ratepayers.”

In the event FPL experiences catastrophic losses, it is not unreasonable or unanticipated that the reserve could reach a negative balance. Rule 25-6.0143 (4)(b), Florida Administrative Code, recognizes that charges to a reserve may exceed the reserve balance resulting in a negative balance, as was the case of Gulf Power Company in Order No. PSC-96-0023-FOF-EI, issued January 8, 1996, in Docket No. 951533-EI.” (emphasis added)

In addition, the Commission ordered FPL to file a study on the reasonableness of the level of the reserve and accrual by no later than December 31, 2002.

Q. Did FPL file the study requested by the Commission?

A. Yes, FPL filed the study on September 28, 2001. That study was the basis for the petition filed by FPL on the same date which requested permission to increase the accrual from \$20.3 million to \$50.3 million.

1 **Q. What was the outcome of FPL's request?**

2 A. The Company agreed to withdraw its request as part of the negotiated settlement
3 reached with OPC and other parties that produced a \$250 million reduction in base
4 rates. But, as discussed by Mr. Dewhurst in his rebuttal testimony, the settlement
5 agreement included a key provision that addressed storm deficits. Paragraph 13 of
6 the 2002 Stipulation and Settlement states:

7 "In the event there are insufficient funds in the Storm Damage Reserve
8 and through insurance, FPL may petition the FPSC for recovery of
9 prudently incurred costs not recovered from those sources. The fact
10 that insufficient funds have been accumulated in the Storm Damage
11 Reserve to cover costs associated with a storm event or events shall
12 not be evidence of imprudence or the basis of a disallowance..."

13

14 **Q. What do you conclude from this?**

15 A. The customers have benefited from the settlement agreement which reduced base
16 rates by \$250 million. Also, the Company relied on existing assurances that a deficit
17 would be recoverable. This rate reduction and the settlement agreement are further
18 discussed in the rebuttal testimony of Mr. Dewhurst.

19 **Q. Do you have any comments on the "OPC Storm Damage Guidelines"?**

20 A. Mr. Majoros states that he endorses what he describes as "OPC Storm Damage
21 Guidelines" (pages 5-6). If OPC thought their guidelines were superior to those
22 recommended by FPL and approved by the Commission, they should have raised
23 them in Docket No. 930405-EI or at least well in advance of a major event resulting
24 in a Storm Damage Reserve deficit so that expectations of relevant constituents could
25 have been properly adjusted in the event of any changes. The record in Docket No.
26 930405-EI indicates that OPC did raise the incremental cost approach which was
27 apparently rejected by the Commission in approving the 95 Order. It is not

1 appropriate for OPC to ignore the standards approved by the Commission in the 95
2 Order, to subsequently let 10 years and other storms pass (all accounted for in
3 accordance with the 95 Order) and, only after a storm fund deficit has been created,
4 propose a different set of standards for retroactive application. This is not the
5 appropriate forum to discuss changing those standards.

6
7 But OPC's guidelines, in any event, are flawed. For example, OPC's proposal to
8 adjust storm damages for instances where the Company expense is less than the
9 amount planned in a particular category of expense is an inappropriate benchmark.
10 There are innumerable reasons why the Company might spend more or less than the
11 budgeted amount in any given year or business cycle, especially on a category by
12 category basis. The budget is a plan built on management expectations of the
13 business circumstances during the period the expenses will be incurred. As
14 expectations change or actual circumstances become known, management must revise
15 its plan to reflect the changes. Thus, a Company's plan for tree trimming may change
16 by a significant percentage solely due to changing circumstances. Such a change
17 would not ordinarily be reflected in the budget. Likewise, actual expenditures and,
18 therefore, budget variances also will show movement solely due to changes in
19 circumstances whether or not there are hurricanes. OPC's proposed guidelines in this
20 respect are inherently flawed. FPL's methodology is straightforward, follows the 93
21 Study approved by the Commission and avoids endless debate regarding why a
22 particular budget variance existed.

1 **Q. What observations can you make regarding the effect of OPC's proposed**
2 **guidelines in this particular instance?**

3 **A. Even if OPC's guidelines were accepted, there are several examples of how applying**
4 **Mr. Majoros' and OPC's inappropriate benchmarking would not result in any change**
5 **to the amount of the requested recovery. Call Center costs charged to the Storm**
6 **Damage Reserve consisted of incremental costs of staffing this function and training**
7 **employees, including a significant number of non-care center employees assigned to**
8 **the care centers during the storm, on process changes and information relative to**
9 **responding to customer inquiries in each of the specific restoration situations**
10 **following the hurricanes. The Company spent nearly all of its tree trimming budget**
11 **(\$47.0 million vs. \$46.0 million). Significantly more was spent on storm restoration**
12 **and was properly charged to the Storm Damage Reserve. The Materials and Supplies**
13 **budget for Power Systems was almost spent in its entirety (\$26.9 million vs. \$25.4**
14 **million), yet incrementally more was spent on storm restoration.**

15 **Q. How would changing the standards retroactively prejudice FPL?**

16 **A. FPL has followed the existing standards in accounting for storm damage costs and**
17 **has relied on these standards in a number of ways. FPL has charged actual storm**
18 **restoration costs to the Storm Damage Reserve as required by Commission Orders.**
19 **As a result, a deficit in the reserve was created and left on the balance sheet at**
20 **December 31, 2004, as required by Commission Orders. Also, FPL has structured its**
21 **response to storms under the belief that the accounting standards approved in the 95**
22 **Order were still applicable. As I discuss below, changing the rules after the Company**
23 **has restored power and created a Storm Damage Reserve deficit of \$536 million is**

1 unfair and would raise serious questions regarding the ability of the Company and of
2 investors to rely on Commission Orders as governing and controlling precedents.

3 **Q. Please explain the importance of maintaining the existing standards as they**
4 **relate to the way in which FPL has booked the costs and reported them in its**
5 **balance sheet at December 31, 2004 and how this avoids prejudicing FPL?**

6 A. FPL has relied on the existing standards in reporting its financial condition to the
7 Securities and Exchange Commission and shareholders. Those costs were booked in
8 accordance with those standards and were included in the Storm Damage Reserve
9 deficit that was reported as an asset in the Company's 2004 financial statements.
10 Changing the standards retroactively would undermine the basis for financial
11 reporting with potentially serious consequences for the capital market's perception of
12 regulatory risk. The nature and significance of this risk is discussed by Mr.
13 Dewhurst.

14
15 FPL charged its actual restoration costs to the Storm Damage Reserve in 2004, even
16 though a deficit was created. The appropriateness of this action was reaffirmed in
17 Order No. PSC-04-0976-PAA-EI, issued October 8, 2004 in Docket No. 041057-EI.
18 FPL relied on that Order along with the 95 Order and multiple Orders issued between
19 1995 and 2004 to maintain the storm deficit on its balance sheet as an asset rather
20 than charging the deficit to expense in 2004.

21
22 Statement of Financial Accounting Standards No. 71, Accounting For the Effects of
23 Rate Regulation (SFAS No. 71), requires that the effects of rate regulation be

1 recognized by companies like FPL. Implicit in this requirement is that the ratemaking
2 authority, in the case of a cost deferral like the Storm Damage Reserve deficit, will
3 allow recovery of those costs in the future. Absent that intent by the ratemaking
4 authority, the costs should have been expensed as they would have been for a non-
5 rate regulated entity.

6
7 In the 95 Order and other Orders, the Commission authorized defined charges to the
8 Storm Damage Reserve, subject to review for “reasonableness and prudence.” The
9 Commission emphasized that in the event of catastrophic loss causing the Storm
10 Damage Reserve to become deficient, the Company could petition for emergency
11 relief. Further, the Commission provided assurance that in such circumstances it
12 would “act quickly to protect the company and its customers” (the 93 Order, page 3).

13
14 The Company has relied on the ability to effect timely recovery of reasonable and
15 prudently incurred costs to support creation and maintenance of the deficit in the
16 Storm Damage Reserve as an asset. Any inability to recover reasonable and
17 prudently incurred storm damage costs would impair the ability of FPL to rely on
18 SFAS 71 as a basis for recognizing the effects of rate regulation in its financial
19 statements. This, in turn, could adversely affect the amounts reported on the income
20 statement and balance sheet of the Company, frustrating regulatory objectives and
21 increasing the regulatory risk perceived by those who rely on the Company’s
22 financial statements. Such a consequence should not be taken lightly. Losing an
23 ability to rely upon established rules and precedents could have devastating effects on

1 the Company's ability to attract and retain necessary capital. To put this in context,
2 expensing the storm deficit instead of reporting it as an asset would have reduced
3 FPL's 2004 Net Income by 44%. This reduction is material and would have a
4 significant effect on investors' perception of FPL.

5 **Q. Why would changing the rules after the fact prejudice FPL regarding its**
6 **response to the storm?**

7 A. In response to significant hurricane damage the Company mobilizes all available
8 employees with one common objective - restore power to customers as safely and as
9 quickly as possible. This effort requires the involvement of linemen and other field
10 personnel to actually restore power and staff personnel to enable and support the
11 restoration effort through damage surveys, organizing and running restoration sites,
12 and other support activities. These support activities run the gamut from distributing
13 food to crews in the field to patrolling feeders and laterals. All of the restoration
14 activities are performed pursuant to detailed restoration plans that are updated at least
15 annually and practiced several times before hurricane season begins. As a result of
16 our planning and practicing, the Company is prepared to begin its restoration
17 activities as soon as it is safe to do so. All of the costs associated with annual
18 planning activities and practicing for storm restoration are charged to normal
19 operating expenses, not the Storm Damage Reserve.

20
21 The duties normally performed by staff personnel generally do not go away; they are
22 merely deferred or performed by others during storm restoration. Both the backfill
23 and catch up work necessary to ensure that these duties are caught up generally

1 involve overtime or the use of contractors or temporary labor that is charged to
2 normal operating expense, not the Storm Damage Reserve. The Company
3 incrementally spent \$7.0 million on contractors and outside professional services and
4 \$9.0 million of overtime was charged to normal operating expenses during the last
5 two months of 2004. If, for example, the Company were denied recovery of the
6 regular payroll associated with personnel working on storm restoration, it might make
7 financial sense to utilize contractors to perform the restoration work rather than
8 incurring the additional overtime and other costs for backfill and catch up work.
9 Ultimately that decision would depend on an assessment of the effect of using those
10 contractors on the restoration effort versus the avoidance of an additional cost burden
11 on the Company and its shareholders. That is not an acceptable position in which to
12 place the Company and its management. The Company wishes only to have one
13 interest and purpose during the restoration activities – to restore power as quickly and
14 safely as possible. In any case, changing the rules after the fact precludes the
15 Company from making this assessment. Also, the ability to make that specific
16 assessment is further limited because the Company, relying on the approved
17 standards, had no reason to specifically track this overtime or outside services.

1 **III. THE DOUBLE COUNTING AND COST SAVING ALLEGATIONS**

2
3 **Q. Is Mr. Majoros correct that the existing standards result in customers paying**
4 **twice for the same costs?**

5 **A.** No. Mr. Majoros claims (pages 11-14 and 17-19) that the existing standards require
6 customers to “pay twice” for base salaries (regular payroll) and FPL vehicle expense
7 – once in base rates and a second time in the Storm Restoration Surcharge. He is not
8 correct.

9
10 Before addressing the “pay twice” claim it is important to emphasize that charging
11 these costs to the Storm Damage Reserve was clearly set forth in the 93 Study and
12 approved by the Commission in the 95 Order. Actual restoration costs were defined
13 to include “FPL payroll costs, costs associated with the use of vehicles and
14 equipment...” and again set forth in the more detailed description of actual restoration
15 costs: “FPL employee payroll – regular, overtime, and temporary relieving pay” and
16 “Charges for FPL owned or leased vehicles and equipment which are considered part
17 of the Company’s normal operating fleet” (Exhibit KMD-3, page 8 and Attachment 1,
18 page 2). These are specific provisions responsive to the Commission’s own questions
19 posed in the 93 Order, such as “...whether normal salaries would be charged to the
20 fund if employees worked on storm related tasks.” (Order, page 4).

21
22 As stated above, FPL relied on these existing standards. Even if Mr. Majoros were
23 correct in his criticism of this standard, the effect of any change should be prospective

1 only. But, Mr. Majoros is not correct in his criticism. FPL's base rates are designed
2 under the assumption of normal costs and normal revenues. Normal costs include
3 regular payroll and vehicle charges. The revenue requirement is divided by a normal
4 level of sales to set the base rates. During the hurricanes there were very significant
5 outages during which sales and corresponding revenues were lost. Thus, while
6 hurricanes result in reductions of some base rate costs because those costs are charged
7 to the Storm Damage Reserve, there also are reductions of base rate revenues. Even
8 if there were merit to Mr. Majoros' concern, to determine whether there was any
9 "double dipping" one would have to ask whether total avoided base rate costs are
10 greater than lost base rate revenues. In the case of the 2004 hurricanes, the Company
11 estimates lost base rate revenues of \$38.2 million, the calculation of which is attached
12 as Exhibit KMD-5, while only \$32.0 million in estimated regular payroll was charged
13 to the Storm Damage Reserve. Even if FPL vehicle expense of \$5.3 million were
14 added to regular payroll as proposed by Mr. Majoros, the total would remain less than
15 lost base rate revenues. Moreover, as I described previously there are other
16 incremental, base rate expenses such as for catch up and backfill work that also would
17 have to be taken into account under his approach. In addition, the \$32 million of
18 regular payroll cited by Mr. Majoros would not have been charged entirely to the
19 operating expense categories normally associated with base rates. On an annual
20 basis, approximately 6% of regular payroll is charged to cost recovery clauses and
21 other and approximately 22% is charged to capital. If these percentages are applied
22 to the regular payroll amount cited in Mr. Majoros' testimony, they would yield
23 approximately \$1.9 million for cost recovery clauses and other and \$7 million for

1 capital. Also, the adjustment proposed by Mr. Majoros to capitalize property
2 additions and cost of removal is estimated to include approximately \$22.9 million of
3 payroll. These amounts are not additive, they merely serve to illustrate the fallacy of
4 the simplistic approach taken by Mr. Majoros.

5
6 In addition, I would note that there is an inconsistency between Mr. Majoros'
7 proposed adjustment for regular salaries and OPC's guidelines which propose
8 adjusting only bargaining unit payroll. Bargaining unit regular payroll charged to the
9 Storm Damage Reserve aggregated only \$9.5 million. As should be obvious from the
10 foregoing discussion, even if it were appropriate to revisit the storm accounting
11 standards in this proceeding, there are numerous issues that would have to be factored
12 into any decision to move to the approach advocated by Mr. Majoros. Of course,
13 these are the same types of issues that were addressed in connection with the 93
14 Study that was approved in 1995.

15 **Q. Does Mr. Majoros ignore other incremental costs not charged to the Storm**
16 **Damage Reserve?**

17 **A.** Yes. This is an important element in the overall impact of the hurricanes that is
18 ignored by Mr. Majoros in his allegations of "double dipping" and cost savings by
19 FPL.

20
21 As I indicated above FPL suffered lost base rate revenues of \$38.2 million. I also
22 described earlier the backfill and catch up overtime costs that are not charged to the
23 Storm Damage Reserve even though directly caused by the hurricanes. Further, the

1 Company estimates that uncollectible accounts receivable increased nearly \$6 million
2 as collection efforts were suspended because field collectors were mobilized for
3 storm duty.

4
5 Mr. Majoros has not taken the lost revenues or the incremental costs into account.
6 His implication that FPL may be making money from the storm events (Majoros
7 Testimony, page 6) is simply not true.

8
9 **IV. SPECIFIC CRITICISMS OF STORM COST ACCOUNTING**

10
11 **Q. Mr. Majoros testifies on Pages 16-17 of his direct testimony that the cost of two**
12 **studies should not be charged to the Storm Damage Reserve. Please comment.**

13 A. The Company has contracted for two studies, one involving an evaluation of salt
14 spray, sand and salt water intrusion problems in coastal communities, and the other
15 involving post-storm vegetative conditions. The nature of and necessity for these
16 studies are discussed in the testimony of FPL witness Geisha Williams.

17 **Q. Mr. Majoros also claims on Page 17 that projects incomplete as of December 31,**
18 **2004 are not necessarily related to storm damage. Please comment.**

19 A. The Storm Damage Reserve includes incomplete projects totaling \$43.4 million as of
20 December 31, 2004. The need for these projects is discussed in Geisha Williams'
21 testimony. The necessity for performing follow up work directly related to storm
22 damage is not unique to Hurricanes Charley, Francis and Jeanne. For example, one

1 type of follow up work was described in detail in a Commission Order issued
2 December 27, 1995, in Docket No. 951167-EI (page 4):

3 "FPL suffered extensive salt water damage to underground facilities as
4 a result of Hurricane Andrew and the March 1993 Storm. It is the
5 Company's intent to repair these facilities as they fail, or during any
6 normal upgrading of the facilities. Certain of these facilities are
7 expected to fail in the near future. Based on engineering estimates of
8 anticipated future repair costs, an insurance settlement of \$6.7 million
9 was reached. This is a final settlement; if the repairs exceed this
10 amount the Company will not be able to file for additional insurance
11 reimbursement.

12
13 It appears from FPL's petition that the Company wishes to establish a
14 separate liability for the \$6.7 million, rather than placing it in the
15 reserve. The \$6.7 million received by the Company represents a
16 settlement of claims for which neither the actual total amount nor the
17 timing of the replacement can be accurately determined. This is
18 exactly the situation a storm reserve is designed to cover. Therefore,
19 we find that this amount shall be added to the reserve and the after tax
20 amount added to the fund. By doing so, the amount can be invested
21 and accrue interest. This will help to mitigate any costs for repairs
22 should they exceed the Company's original estimates. As the repairs
23 are actually completed, the reserve shall be charged for the cost of the
24 repairs." (emphasis added)

25
26 The appropriate criteria for determining whether the follow up work should be
27 charged to the Storm Damage Reserve is the root cause of needed repair and
28 restoration of the system to pre-hurricane status, not the timing of the work.

29 **Q. Please address Mr. Majoros' specific criticisms of the Company's accounting for**
30 **base salaries.**

31 **A.** As discussed earlier in my testimony, Mr. Majoros has chosen to ignore the existence
32 of incremental costs incurred by the Company in backfill and catch up work. Also,
33 he ignores the fact that not all of the regular salaries charged to the Storm Damage
34 Reserve would have been charged to expense categories normally associated with
35 base rates. Should a decision be made to remove any or all of regular payroll,

1 provision should be made for all of these items. Also, the adjustment proposed by
2 Mr. Majoros to capitalize a portion of the restoration costs includes approximately
3 \$22.9 million of payroll.

4 **Q. Please address Mr. Majoros' testimony regarding FPL vehicle expense.**

5 A. On Page 18 of Mr. Majoros' direct testimony, he proposes to make an adjustment of
6 \$5,261,887 as "these vehicles have already been included in the annual budget". The
7 Company did charge its vehicle expenses to the Storm Damage Reserve, just as it had
8 proposed to do so in the 93 Study that was approved in the 95 Order. In proposing
9 this adjustment, Mr. Majoros ignores the fact that some of these vehicle costs would
10 not have been charged to expense categories normally associated with base rates. On
11 an annual basis, approximately 47% of the annual vehicle costs are charged to capital
12 projects. Assuming the same split is applied to the vehicle costs charged to the Storm
13 Damage Reserve, would yield approximately \$2.4 million. Also, as discussed above
14 for payroll, the adjustment proposed by Mr. Majoros to capitalize property additions
15 and cost of removal includes approximately \$4.3 million of vehicle charges. These
16 amounts are not additive, they merely serve to illustrate the fallacy of the simplistic
17 approach taken by Mr. Majoros.

18 **Q. Please address Mr. Majoros' direct testimony on Page 19 regarding tree**
19 **trimming expense.**

20 A. FPL's practice with respect to tree trimming during storm restoration is to trim only
21 what is necessary to allow the Company to safely restore service to its customers.
22 Mr. Majoros states "Tree trimming expense should be limited to the amounts which
23 exceed FPL's normal expenses." As discussed earlier in my testimony, the

1 benchmark analysis proposed by Mr. Majoros is inappropriate. Nevertheless, because
2 FPL spent and charged to normal expenses all but approximately \$1 million of the
3 amount it had budgeted for tree trimming in 2004, it would appear that even under
4 Mr. Majoros' logic the \$89.4 million incurred and charged to the Storm Damage
5 Reserve for tree trimming should be recoverable.

6 **Q. Please address Mr. Majoros' direct testimony on Page 19 regarding call center**
7 **expense.**

8 A. I have previously discussed the inappropriateness of this benchmark adjustment.
9 However, even under Mr. Majoros' view, these costs should be recoverable since
10 only incremental costs were charged to the Storm Damage Reserve. The Company
11 did not charge normal costs of operation for the Call Center to the Storm Damage
12 Reserve.

13 **Q. Do you have any comments regarding OPC's guidelines on Materials and**
14 **Supplies charged to O&M?**

15 A. Yes. Again this is an inappropriate benchmark adjustment as discussed earlier.
16 Nevertheless, even under Mr. Majoros' reasoning any adjustment would be
17 insignificant because virtually the entire 2004 budget was spent without consideration
18 of amounts charged to the Storm Damage Reserve.

19 **Q. Is Mr. Majoros correct that FPL is following an inappropriate accounting**
20 **methodology for the replacement of plant in service destroyed by the**
21 **hurricanes?**

22 A. No. In determining the amounts to be charged to the Storm Damage Reserve, FPL is
23 following the accounting standards approved in the 95 Order. As with the various

1 cost categories already discussed, the time to establish standards is before not after
2 the event occurs.

3
4 The existing standards are designed to maintain the plant in service and depreciation
5 accounts at the same levels after the hurricanes as existed before the hurricanes. This
6 recognizes that the reason for replacing the assets was not to improve the system, but
7 to restore it to the condition that existed before the hurricanes.

8
9 If the Commission adopts Mr. Majoros' recommendations, plant in service would
10 increase, accumulated depreciation would decrease and annual depreciation expense
11 would immediately increase due solely to the impact of hurricanes. This would place
12 upward pressure for a long-term increase in electric rates because of an increase in
13 return requirements as well as an increase in cost of service.

14 **Q. Why would plant in service increase under the OPC approach endorsed by Mr.**
15 **Majoros?**

16 **A.** Plant in service would increase because the poles, wires and other equipment and
17 related installation costs are generally higher even at normal costs than the costs
18 associated with the property destroyed by the hurricanes and retired. This increase is
19 due to inflation and other factors occurring between the time the destroyed assets
20 were installed and when they were replaced.

21
22 In addition, as described in the 93 Study, the normal costs of the replacement assets
23 would have to be estimated because the assets are being replaced under extraordinary

1 conditions. It is impossible to track the normal cost associated with the replacement
2 assets under the conditions that exist when the Company is restoring service after a
3 hurricane.

4 **Q. Why would accumulated depreciation decrease under the OPC approach**
5 **endorsed by Mr. Majoros?**

6 A. Accumulated depreciation would decrease for the following reasons:

- 7 ■ The assets being replaced have not reached the end of their normal lives;
8 therefore they have not been fully depreciated.
- 9 ■ Likewise, because the cost of removal associated with the destroyed assets is
10 calculated in the same manner as depreciation, the full normal cost of
11 removing the destroyed assets has not been accumulated.

12 The combined effect of these circumstances is to leave a deficit or shortfall in
13 accumulated depreciation for the destroyed assets. This shortfall increases rate base
14 resulting in an immediate increase in revenue requirements. Also, the shortfall will
15 have to be factored into future depreciation rates resulting in higher costs to
16 customers in the future. This is in addition to the fact that those customers face their
17 own risk of future catastrophic hurricane events.

18 **Q. Why would depreciation expense immediately increase under the OPC approach**
19 **endorsed by Mr. Majoros?**

20 A. Depreciation expense would immediately increase because of the higher plant in
21 service balances. Annual depreciation expense is determined by applying an
22 approved depreciation rate to plant in service balances. As plant in service increases,

1 so does depreciation expense, without any change in rates. The change in rates
2 discussed in my previous answer could compound the effects of this increase.

3 **Q. Wouldn't the fact that the equipment is newer offset these increases in**
4 **depreciation expense?**

5 A. The fact that the equipment is newer would certainly mitigate the effects because of
6 the longer remaining life. Whether it would offset the full effect would depend on the
7 amount of the cost differential for the assets, the remaining lives of those assets, and
8 the extent to which the original cost and removal cost of the destroyed asset had been
9 accumulated.

10 **Q. Does the Company consider the effects of hurricanes in determining**
11 **depreciation rates?**

12 A. No. Because hurricanes occur at irregular intervals and the physical effects vary from
13 storm to storm, the Company excludes the effects of hurricanes from the depreciation
14 studies used to obtain Commission approval for depreciation rates. Inclusion of the
15 hurricane related effects would potentially understate the life characteristics of plant
16 and overstate the cost of removal, thereby overstating the depreciation expense
17 associated with normal operations.

18 **Q. Is Mr. Majoros correct in his assertion on Page 23 of his direct testimony that**
19 **the existing standards inappropriately treat the removal reserve?**

20 A. No. As I previously discussed, only a portion of the normal removal cost related to
21 the destroyed assets would have been accrued since those assets generally would have
22 remaining life left. The removal cost component included in the depreciation rate
23 takes into account a future cost to remove an asset assuming normal retirements. This

1 removal cost component is determined based on the historical relationship of removal
2 cost to the plant investment and excludes extraordinary retirements such as those
3 caused by hurricanes. As such, the removal costs embedded in accumulated
4 depreciation are designed to cover normal end of service life retirements, not
5 catastrophic events like hurricanes.

6 **Q. Is Mr. Majoros correct in his assumptions on removal cost related to the assets**
7 **retired resulting from the hurricane?**

8 A. No. Mr. Majoros would lead you to believe that the removal cost collected is related
9 solely to the assets that would be retired for extraordinary events. The \$1.1 billion
10 that Mr. Majoros referenced relates to the estimated removal cost associated with all
11 of the Transmission and Distribution system assets. In order to identify the removal
12 cost associated with the assets retired due to the hurricanes, the specific assets to be
13 retired must be identified along with the vintage year. Then, the component of
14 removal cost included in depreciation expense would need to be multiplied times the
15 cost of the asset retired to determine the annual amount for each year that the
16 depreciation rate was used and changed to reflect any represcription of depreciation
17 rates. The total of all these annual amounts would be accumulated to determine the
18 amount of removal cost included in the accumulated depreciation reserve related to
19 the retirements associated with the hurricane.

1 **Q. Has FPL estimated the capital additions, removal costs, and retirements that it**
2 **expects to record as a result of storm restoration under the recommended**
3 **approach, “Actual Restoration Cost” approved in the 93 Study?**

4 **A. Yes.** FPL estimates that approximately \$58 million of capital additions, \$12.2 million
5 in removal costs, \$36.4 million in retirements, \$21.7 million in Contributions in Aid
6 of Construction, and \$48.5 million in other recoveries will be recorded in March
7 2005. The effect of recording these amounts is to restore the plant and reserve
8 accounts to their pre-storm balance. This approach is consistent with the 93 Study
9 and 95 Order.

10
11 These estimates do not include the effects of approximately \$18 million of the
12 approximately \$43.4 million of incomplete projects identified in Exhibit KMD-2 as
13 “Remaining Work.”

14
15 **V. CONCLUSION**
16

17 **Q. Would you please summarize your testimony?**

18 **A. Yes.** My rebuttal testimony refutes all the major points in Mr. Majoros’ testimony.
19

20 He erroneously asserts that the Commission never adopted accounting standards for
21 the Storm Damage Reserve and, therefore, OPC is free to propose new standards that
22 would be applied retroactively to determine the accounting for storm damage costs. I
23 disagree. In the 95 Order the Commission approved standards for charging

1 restoration costs to the Storm Damage Reserve. In the 10 years since that Order was
2 issued, nothing has occurred that would change the applicability of those standards.
3 The standards accepted by the Commission in that Order were appropriate then, and
4 remain appropriate for purposes of addressing FPL's request in this proceeding. Any
5 changes to the established standards should be done on a prospective basis.
6

7 FPL has followed the existing standards in charging storm damage costs, and has
8 maintained its financial books and records and prepared its 2004 financial statements,
9 in accordance with those standards. A decision to deny recovery of reasonable and
10 prudently incurred storm damage costs could impair the ability of FPL to rely on
11 SFAS 71 for creation and maintenance of regulatory assets. This, in turn, could
12 adversely affect the income statement and balance sheet of the Company and
13 negatively affect the Company's ability to attract and retain capital. The
14 Commission's Audit Staff after conducting an independent review agrees that FPL
15 has recorded storm costs as proposed in the 93 Study using actual costs. In stark
16 contrast, Mr. Majoros believes it would be appropriate to change the rules at any
17 point and apply new standards retrospectively. If OPC wishes to change the existing
18 standards for charges to the Storm Damage Reserve it should petition the
19 Commission with that request and provide the level of detail and explanation that was
20 provided in the 93 Study. I would note that OPC participated in the docket in which
21 the 93 Study was reviewed and approved. OPC has had 10 years to raise any
22 concerns or objections regarding the standards set forth in the 93 Study. But the fact
23 remains that the issues raised by OPC in this proceeding were essentially the same

1 issues fully considered in Docket 930405-EI, culminating in the issuance of the 95
2 Order.

3
4 Mr. Majoros erroneously claims that the existing standards require customers to “pay
5 twice” for base salaries (regular payroll) and FPL vehicle expense – once in base rates
6 and a second time in the Storm Restoration Surcharge. I disagree. FPL’s base rates
7 are designed under the assumption of normal costs and normal revenues. During the
8 hurricanes there were very significant outages during which sales and corresponding
9 revenues were lost, and incremental expenses incurred that were not charged to the
10 Storm Damage Reserve. Thus, while hurricanes result in reductions of some base
11 rate costs (through charges to the Storm Damage Reserve); they were more than
12 offset by greater reductions of base rate revenues and increases in other costs charged
13 to normal operations. Mr. Majoros ignores the fact that not all of base salaries and
14 vehicle expense is charged to expense categories normally associated with base rates.
15 He also ignores the fact that the costs he proposes to capitalize include both regular
16 payroll and vehicle costs.

17
18 Mr. Majoros erroneously makes several specific criticisms of storm cost accounting
19 which I have addressed in this testimony. The Company has charged the costs of two
20 studies and \$43.4 million for future work in its determination of the Storm Damage
21 Reserve deficit, all of which are a direct result of storm damage and therefore should
22 be recoverable. His position on tree trimming expense, call center costs and materials

1 and supplies, even if accepted, would permit recovery of the amounts charged to the
2 Storm Damage Reserve.

3
4 With respect to capital issues, the existing standards are designed to make the
5 customer neutral with regard to rate base. In fact, if FPL records the removal costs as
6 Mr. Majoros is suggesting it would shift this responsibility to future customers.

7 **Q. Does this conclude your rebuttal testimony?**

8 **A.** Yes, it does.

9
10
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12
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14

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FLORIDA POWER & LIGHT COMPANY

SUPPLEMENTAL DIRECT

TESTIMONY OF K. MICHAEL DAVIS

DOCKET NO. 041291-EI

Q. Please state your name and business address.

A. My name is K. Michael Davis. My business address is 9250 West Flagler Street,
Miami, Florida 33174.

Q. Did you previously submit direct testimony in this proceeding?

A. Yes.

Q. What is the purpose of this supplemental direct testimony?

A. I am updating the estimate of storm damage costs that was provided in my direct
testimony.

Q. Are you sponsoring any exhibits?

A. Yes. I am sponsoring Revised Exhibit KMD-1 which shows updated estimated storm
damage costs by hurricane and cost category, net of expected insurance
reimbursement. This revised exhibit was provided to Staff and the parties at my
deposition on January 28, 2005. I also am sponsoring Exhibit KMD-2 which shows

1 the portion of each storm cost category that is based on actual invoices and the
2 amount that still represents an estimate.

3
4 **Q. Please describe the updated estimate of storm damages and describe what has**
5 **changed.**

6 A. My direct testimony provided an estimate of storm damages of approximately \$818
7 million. The Company estimated insurance reimbursement of \$108 million for non-
8 transmission and distribution property. Consequently, the total amount charged to the
9 reserve was \$710 million on a total system basis.

10
11 The estimate for total storm damages has increased by \$180 million. The Company
12 estimates total storm damages at \$998 million. The insurance reimbursement
13 estimate is unchanged at \$108 million. The total amount charged to the reserve is
14 now \$890 million. Revised Exhibit KMD-1 shows the breakdown of the \$890
15 million by category and by storm.

16
17 Further detail regarding the \$890 million storm damage cost is provided in Exhibit
18 KMD-2. This exhibit shows the portion of each storm cost category that is based on
19 actual invoices and the amount that still represents an estimate. As shown in KMD-2,
20 approximately 93% of the total estimated cost of \$890 million is based on actual
21 payments, invoices or direct contact with the applicable vendor.

1 The \$890 million storm damage cost, net of the storm reserve positive balance of
2 \$354 million at December 31, 2004, results in a deficiency of \$536 million on a total
3 system basis (an increase of \$180 million from the estimated system deficiency of
4 \$356 million in my direct testimony). The jurisdictional portion of the deficiency is
5 approximately \$533 million (an increase of \$179 million from the estimated
6 jurisdictional deficiency of \$354 million in my direct testimony).

7
8 **Q. What has caused the change in estimated storm damages?**

9 A. The severity of the hurricanes required the Company to request assistance from
10 foreign utilities located well beyond the usual geographic area for which the
11 Company had past cost data. Invoices received have exceeded the projections for
12 foreign utility expense underlying the October 31, 2004 estimate. In addition,
13 contractor expenses exceeded original estimates because the follow-up work was
14 greater than originally estimated. The combined effect of these two categories is the
15 primary reason for the increase in total estimated storm damages.

16
17 **Q. Is FPL proposing a change in the level of the surcharge?**

18 A. No. As described in FPL's original petition, FPL proposed that the Commission enter
19 an order allowing FPL to recover over a two-year period, subject to true-up, an
20 amount equal to the difference between the amount in the Storm Reserve as of August
21 31, 2004, adjusted for the monthly storm fund accruals and the storm fund earnings
22 through the period September 1, 2004 to December 31, 2004, and the actual amount
23 of prudently incurred storm restoration costs associated with storms occurring during

1 the calendar year 2004, net of insurance proceeds, (the “Storm Reserve Deficit” or
2 “Deficit”). With the updated estimate provided in this testimony, FPL anticipates the
3 deficiency at the end of the two years will approximate the annual amount recovered
4 by the Storm Restoration Surcharge. For this reason, FPL is proposing the
5 continuation of the Storm Restoration Surcharge, at the current level, for an additional
6 year or such shorter period as is necessary to recover the Storm Reserve Deficit.

7
8 **Q. Does this conclude your supplemental direct testimony?**

9 **A. Yes, it does.**

10

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
2 **FLORIDA POWER & LIGHT COMPANY**
3 **SUPPLEMENTAL REBUTTAL TESTIMONY OF K. MICHAEL DAVIS**
4 **DOCKET NO. 041291-EI**
5 **APRIL 5, 2005**
6

7 **Q. Please state your name and business address.**

8 A. My name is K. Michael Davis, my business address is 9250 West Flagler Street,
9 Miami, Florida 33174.

10 **Q. Did you previously submit direct, rebuttal and supplemental direct testimony**
11 **in this proceeding?**

12 A. Yes.

13 **Q. Are you sponsoring an exhibit as part of your supplemental rebuttal**
14 **testimony?**

15 A. Yes. It is Exhibit KMD-6, Comparison of Revenue Requirements.

16 **Q. What is the purpose of your supplemental rebuttal testimony?**

17 A. The purpose of my testimony is to rebut Mr. Majoros' proposal to use the
18 identification of a theoretical depreciation reserve surplus in FPL's recently filed
19 depreciation study as a basis for offsetting the deficit balance in the Storm
20 Damage Reserve that is approved for recovery by the Commission and his
21 conclusion that this is proper regulatory accounting. In fact, Mr. Majoros'
22 proposal violates FPSC policy and orders as well as Generally Accepted
23 Accounting Principles (GAAP), Securities and Exchange Commission (SEC)

1 guidance, and Federal Energy Regulatory Commission (FERC) policy and orders.
2 In addition, my testimony will show that Mr. Majoros' proposal is economically
3 disadvantageous to FPL's customers because it will require them to continue
4 paying for the costs of 2004 storms for more than 20 years, increasing the revenue
5 requirements on a net present value basis by \$144 million.

6 **Q. What has FPL done to address the theoretical depreciation reserve surplus?**

7 A. The depreciation study that FPL recently filed has properly included the effects of
8 the theoretical depreciation reserve surplus in the development of prospective
9 depreciation rates. As a result, those rates are lower than they would have been
10 without the surplus. This will have the dual effect of reducing the depreciation
11 expense that customers will pay through base rates and of eliminating the
12 theoretical depreciation reserve surplus over the remaining life of the affected
13 assets.

14 **Q. Is FPL's treatment of the theoretical depreciation reserve surplus consistent**
15 **with Commission policy, orders and GAAP?**

16 A. Yes. As I explain later in my testimony, flowing through the effects of the surplus
17 in this manner over the remaining useful lives of the assets to which the surplus
18 relates is appropriate ratemaking and consistent with Commission policy, orders
19 and GAAP.

20 **Q. Does Mr. Majoros agree with FPL's treatment of the theoretical depreciation**
21 **reserve surplus?**

22 A. No.

23

1 **Q. What does Mr. Majoros propose instead?**

2 A. Mr. Majoros' proposal is to utilize the theoretically determined \$1.24 billion book
3 depreciation reserve excess identified in FPL's depreciation filing on March 17,
4 2005, to offset any Storm Damage Reserve deficit that is approved for recovery
5 by the Commission. He defines this depreciation reserve excess to be the amount
6 of money that FPL has charged to and collected from its customers in excess of
7 current requirements. He then asserts that regulatory accounting principles permit
8 such an offset.

9 **Q. What is the practical effect of Mr. Majoros' proposal?**

10 A. The practical effect of Mr. Majoros' proposal has two dimensions. The first is to
11 take costs previously included in cost of service primarily as a component of
12 nuclear production costs and, in a single period, recast them as storm damage
13 costs. This is comparable to the transfer of a depreciation reserve accumulated in
14 one FERC function to another FERC function. The second practical effect of his
15 proposal is to defer and amortize the Storm Damage Reserve deficit over a period
16 in excess of 20 years. Both of these effects have adverse consequences to FPL's
17 customers that I will address later in my testimony.

18 **Q. Do you agree with Mr. Majoros?**

19 A. No. There are three reasons that I disagree with Mr. Majoros. First, Mr. Majoros
20 is attempting to use a theoretical depreciation reserve surplus calculated at one
21 point in time to offset entirely unrelated storm costs. Second, it is neither proper
22 nor appropriate from a regulatory accounting perspective to make a lump sum
23 adjustment to a depreciation reserve designed for long-lived assets that remain in

1 service on FPL's system. Mr. Majoros' proposal goes beyond this and suggests
2 using a reserve accumulated primarily for nuclear production assets to reduce or
3 absorb a deficit balance in another reserve account, in this case the Storm Damage
4 Reserve. Doing so would violate FPSC policies and orders, GAAP, SEC
5 guidance and FERC policies and orders. Third, Mr. Majoros' proposal is not
6 sound economically because it will cost FPL's customers more on a net present
7 value basis compared to the surcharge FPL is requesting. Using an 8% discount
8 rate, on a net present value basis, Mr. Majoros' proposal would cost customers
9 \$144 million more than FPL's proposed storm surcharge. In fact, the discount rate
10 required for customers to break even is approximately 15%. That is to say that
11 customers would have to be able to earn at least 15% per year on their
12 investments over the 22 year recovery period in order to break even. As can be
13 seen by the magnitude of the discount rate required for FPL's customers to break
14 even, Mr. Majoros' proposal is simply not economically sound.

15

16 **Theoretical Depreciation Reserves**

17 **Q. What is a theoretical depreciation reserve?**

18 A. A theoretical depreciation reserve is a calculated rather than an actual reserve
19 which is used as a guide in analyzing the actual reserve condition. It is not an
20 exact measurement for determining the condition of the actual reserve. It is
21 calculated at a point in time based on current or proposed depreciation
22 parameters. Mr. Majoros is taking this "snapshot" theoretical reserve concept and
23 somehow concluding that there is an actual cash "excess" in the accumulated

1 provision for depreciation that can be used to offset the negative balance in the
2 accumulated provision for storm damage reserve. This is analogous to his
3 viewing one frame from a motion picture and concluding he has seen the entire
4 film including the ending.

5 **Q. Can you explain the difference between the accumulated provision for**
6 **depreciation and the accumulated provision for storm damage reserve?**

7 A. Yes. The accumulated provision for depreciation is the cumulative effect of the
8 recovery over time, through depreciation charges, of plant in service. This reserve
9 account reduces plant in service included in rate base and, as a consequence, the
10 return requirements associated with base rates. The accumulation in this account
11 is the result of a systematic and rational recovery of plant in service over its
12 estimated useful life through the depreciation process. The systematic recognition
13 of this cost is reflected in the income statement as depreciation expense in
14 Account 403.

15
16 The accumulated provision for storm damage reserve is a funded reserve under
17 FPSC Rule No. 25-6.0143, Use of Accumulated Provision Accounts 228.1, 228.2
18 and 228.4. Under Account 228.1 Accumulated Provision for Property Insurance
19 this rule states: "This account may be established to provide for losses through
20 accident, fire, flood, storms, nuclear accidents and similar type hazards to the
21 utility's own property or property leased from others, which is not covered by
22 insurance." This account has nothing to do with the accumulation of depreciation,
23 and it is not included in FPL's rate base since it is a funded reserve and earns its

1 own return. It is an operating reserve established to recover current and future
2 costs not covered by insurance. The accruals related to this account are reflected
3 as a component of operations and maintenance expense in account 924, property
4 insurance. As a result of an extraordinary storm season, in late 2004 the balance
5 in the Storm Damage Reserve changed from a positively funded reserve to protect
6 the Company and its customers from potential storm losses, to an unfunded deficit
7 balance that the Company has temporarily financed through short term borrowing
8 pending the outcome of this proceeding.

9 **Q. Mr. Majoros refers in his testimony to a \$1.24 billion book depreciation**
10 **reserve excess which he defines as “the amount of money that FPL has**
11 **charged to and collected from its ratepayers in excess of current**
12 **requirements.” Do you agree with his definition?**

13 **A.** No. The \$1.24 billion amount to which Mr. Majoros refers is actually the result of
14 comparing a theoretical depreciation reserve balance generated as a result of
15 current assumptions used in the depreciation study as if those assumptions had
16 always been used in determining the annual depreciation expense, with the actual
17 depreciation expense accumulated on the basis of studies previously filed with
18 and approved by the Commission in prior years. The excess is primarily the
19 result of newly approved NRC license extensions for the nuclear generating
20 facilities which result in a change in the estimate of the useful lives of these units.
21 As I explain later in my testimony, changes in the estimated useful lives of
22 depreciable assets should be reflected in the current and future periods as a
23 prospective change to depreciation rates and not by adjusting the accumulated

1 provision for depreciation in a single period. Since the theoretical reserve is
2 based on the proposed assumptions used in the depreciation filing, it ignores
3 changes that may—and based on past experience, are likely to—occur in the
4 future. For example, if circumstances change and the nuclear units are not
5 operated through the end of the license extension period, this surplus will be
6 reduced or eliminated. In addition, the theoretical reserve calculation ignores the
7 fact that FPL will be incurring substantial capital costs in the near future in the
8 nuclear function in order to operate these units into their extended lives. The
9 impact of these additional capital costs will reduce the theoretical depreciation
10 reserve surplus. Although such future events are not reflected in the computation
11 of the theoretical reserve, they are appropriately a factor to be considered in
12 evaluating the excess. For these reasons and in spite of the systematic and
13 rational approach used in depreciation studies, FPL's theoretical reserve balances
14 can fluctuate significantly over time generating theoretical deficiencies and
15 surpluses due to changes in circumstances and assumptions.

16 **Q. Has FPL's theoretical depreciation reserve surplus/deficiency fluctuated over**
17 **time?**

18 A. Yes. As an example, prior to the NRC license extensions, FPL calculated the
19 depreciation expense for its nuclear plants over their original license periods.
20 This approach yielded a deficiency in the reserve for the nuclear function that was
21 reflected in FPL's 1997 depreciation study. In 1998, FPL proposed and the FPSC
22 approved a consolidation of the Property Retirement Unit Catalog. In FPL's 2001
23 depreciation study, the prior deficiency became a surplus. Additionally, the

1 license extensions approved by the NRC for the Turkey Point and St. Lucie
2 nuclear units have the effect of increasing the estimated useful lives of the units
3 and adding to the theoretical depreciation reserve surplus. The extent to which
4 that surplus survives or becomes a deficit depends on future events and
5 circumstances including the impact of the substantial capital costs expected in the
6 nuclear function. These are just a few examples of how theoretical reserves can
7 fluctuate over time due to changes in assumptions, estimates and actual events.
8 That is why I made the analogy to viewing one frame from a motion picture film
9 and assuming that you not only have seen the whole picture but know how it ends.
10 These fluctuations are precisely why the Commission requires depreciation rates
11 to be reviewed at least every four years and why the effects of a change in useful
12 life is recognized over the life of the remaining useful life of the asset.

14 Accounting and Regulatory Principles

15 **Q. You stated that Mr. Majoros' proposal violates FPSC policy and orders as**
16 **well as GAAP, SEC guidance, and FERC policy and orders. Would you**
17 **please explain why?**

18 **A.** Yes. I will discuss each item below.

19 **Q. Can you please explain how Mr. Majoros' proposal is contrary to FPSC**
20 **policy?**

21 **A.** Yes. The FPSC has rules covering the depreciation process which specify in
22 detail the methods to be used and the information required for filing studies with
23 the FPSC. These rules are very specific about keeping plant and reserve balances

1 separated by FERC function and do not allow utilities to transfer reserves between
2 account or subaccount without their prior approval. The FPSC policy as
3 established in its orders goes even further by stating in Order No. PSC-98-0027-
4 FOF-EI in Docket No. 970410-EI, issued on January 5, 1998:

5 “In conclusion, we will not consider reserve transfers between
6 functions because they may result in pricing issues. Further, we
7 will continue to consider reserve transfers between plant
8 accounts within the same production unit and between units
9 within the same production site.”

10 In reaching this conclusion, the FPSC referred to Order No. PSC-94-1199-FOF-
11 EI, issued September 30, 1994 in Docket No. 931231-EI and stated that:

12 “This Order clearly shows that our approach to reserve transfers
13 is to make them between accounts within the same function and
14 not between accounts across functions.”

15 Mr. Majoros’ proposed use of theoretical depreciation reserve surpluses primarily
16 to the nuclear function as an offset to storm damage costs primarily incurred in
17 non-nuclear functions is contrary to the FPSC’s policy that transfers of
18 depreciation reserves should be within the same function. In fact, it is even
19 farther afield of this FPSC policy because it would use a theoretical *depreciation*
20 *reserve* excess to offset costs in a totally unrelated *non-depreciation* reserve.
21
22

1 **Q. Mr. Davis, have you considered the effect Mr. Majoros' proposal would have**
2 **on the jurisdictionalization of the storm damage deficit recovery?**

3 A. Yes. Because Mr. Majoros' proposal would recover storm damage costs via an
4 increase in plant in service and this recovery primarily affects the nuclear
5 function, the recovery of these costs will be based on the jurisdictional factor
6 applied to nuclear. The retail jurisdictional factor for nuclear is greater than that
7 used for FPL's proposed storm surcharge. Therefore, if the Commission adopted
8 Mr. Majoros' proposal, it would result in a shift of cost responsibility from
9 wholesale to retail customers.

10 **Q. Mr. Davis, are there any other aspects of the FPSC's policy on depreciation**
11 **that Mr. Majoros' proposal violates?**

12 A. Yes. The FPSC's policy has been to preserve the long term nature of the
13 depreciation recovery process by requiring that both theoretical reserve surpluses
14 and deficiencies be used to adjust depreciation rates on a prospective basis, rather
15 than running the differences through the current income statement. The FPSC
16 also recognizes the fallacy of a "snapshot" view of the status of depreciation
17 reserves and requires that a study be filed for each category of depreciable
18 property at least once every four years (i.e., continuing the viewing of the "motion
19 picture").

20 **Q. Can you please explain why Mr. Majoros' proposal is contrary to GAAP?**

21 A. Yes. As described in Accounting Research Bulletin (ARB) No. 43, Chapter 9 C,
22 paragraph 5:

1 “The cost of a productive facility is one of the costs of the
2 services it renders during its useful economic life. Generally
3 accepted accounting principles require that this cost be spread
4 over the expected useful life of the facility in such a way as to
5 allocate it as equitably as possible to the periods during which
6 services are obtained from the use of the facility. This procedure
7 is known as depreciation accounting, a system of accounting
8 which aims to distribute the cost or other basic value of tangible
9 capital assets, less salvage (if any), over the estimated useful life
10 of the unit (which may be a group of assets) in a systematic and
11 rational manner. It is a process of allocation, not ^{of} ~~a~~ valuation.”

12 This is the process used by FPL to calculate depreciation expense for its
13 depreciable assets. Mr. Majoros proposes to contaminate this depreciation
14 process by introducing an unrelated cost into the accumulated reserve for
15 depreciation and requiring that the unrelated cost be spread over the useful life of
16 the asset. Furthermore, the accounting treatment of a change in the estimated
17 useful life of a depreciable asset is addressed in Accounting Principles Board
18 Opinion No. 20, Accounting Changes (APB 20). APB 20 specifically addresses
19 changes in accounting estimates and states in paragraphs 10 and 31:

20 “Changes in estimates used in accounting are necessary
21 consequences of periodic presentations of financial statements.
22 Preparing financial statements requires estimating the effects of
23 future events. Examples of items for which estimates are

1 necessary are uncollectible receivables, inventory obsolescence,
2 service lives and salvage values of depreciable assets.....The
3 Board concludes that the effect of a change in accounting
4 estimate should be accounted for in (a) the period of change if
5 the change affects that period only or (b) the period of change
6 and future periods if the change affects both.”

7 Mr. Majoros’ proposal is in direct contradiction to APB 20. He would use a
8 theoretical depreciation reserve surplus that relates to life extensions affecting
9 FPL’s system for many years into the future to offset a storm reserve deficit that
10 relates only to the past.

11 **Q. Can you please explain why Mr. Majoros’ proposal is contrary to SEC**
12 **guidance?**

13 A. Yes. In reviewing the financial statements of Microsoft Corporation, the SEC
14 determined in Accounting and Auditing Enforcement Release No. 1563, dated
15 June 3, 2002, that Microsoft acted without regard to the GAAP requirement that
16 changes in depreciable lives of assets be accounted for prospectively rather than
17 retrospectively when it charged the cumulative effect of a change in the life of
18 personal computers (from 3 years to 1 year) and buildings (from 30 years to 15
19 years) directly to depreciation expense as accelerated depreciation in one year.
20 The SEC determined that the accelerated depreciation account was not in
21 compliance with GAAP. Mr. Majoros’ proposed use of accumulated depreciation
22 as an offset of storm costs would effectively recognize the benefit of the change in

the estimated useful lives of nuclear production assets in one period, which is precisely what the SEC objected to in the enforcement action against Microsoft.

Q. Can you please explain why Mr. Majoros' proposal is contrary to FERC policy?

A. Yes. ~~The FERC Code of Federal Regulations, System of Accounts, under General Instruction 22(a) (Depreciation Accounting, method) Definitions, for Depreciation Accounting, under the heading "Method", states~~ that:

“Utilities must use a method of depreciation that allocates in a systematic and rational manner the service value of depreciable property over the service life of the property.”

Additionally, in a letter to Florida Power Corporation, FERC described the general policy guidance regarding depreciation. FERC stated that:

“Under [FERC’s] Uniform System of Accounts, depreciation is viewed as an allocation process. It allocates the costs of depreciable property in a systematic and rational manner over the property’s estimated service life. There are several acceptable methods that can be used to allocate the cost of an asset over the period expected to benefit from its use, but the method most widely used by utilities and the one most readily accepted by the Commission is the straight-line remaining life method. Under this method, over and under accruals of depreciation recorded in past accounting periods are corrected

1 over the remaining life of the related property by adjusting the
2 book depreciation rates prospectively.”

3 Not only is Mr. Majoros not using an acceptable depreciation method but, as I
4 previously noted, he is attempting to contaminate the depreciation process with a
5 totally unrelated cost.

6
7 Consistent with its policy on depreciation, FERC issued an order in Docket Nos.
8 ER96-2637-000 and FA96-49-000 addressing a South Carolina Public Service
9 Commission decision which allowed the transfer of a surplus reserve from the
10 transmission and distribution functions to the nuclear function. Specifically, the
11 Order concluded that the company’s transfer of depreciation reserves from
12 transmission and distribution plant was improper under GAAP and the FERC
13 Uniform System of Accounts and required correcting journal entries. Mr.
14 Majoros is proposing that an accumulated provision for depreciation primarily in
15 the nuclear function be used to offset a deficit in the Storm Damage Reserve,
16 which is a result of costs primarily incurred in non-nuclear functions. Not only is
17 this clearly contrary to what FERC has already decided is improper as described
18 above but he is recommending offsetting a funded reserve (storm damage) with an
19 unrelated and unfunded reserve (depreciation).

Economic Consequences of Mr. Majoros' Proposal

Q. You indicated earlier in your supplemental rebuttal testimony that one practical effect of Mr. Majoros' proposal is to defer and amortize the Storm Damage Reserve deficit over a period exceeding 20 years. Please explain.

A. The theoretical depreciation reserve excess (assuming no further changes in circumstances, which I have already shown to be unrealistic) will reduce depreciation expense over the remaining useful lives of the related assets. If the amount of that theoretical excess is reduced by the approved Storm Damage Reserve deficit, the accumulated provision for depreciation would decrease (and the annual depreciation expense would increase over the remaining asset lives). Consequently, it has the same effect as deferring and amortizing the approved Storm Damage Reserve deficit, and earning FPL's allowed rate of return on the unamortized balance over the remaining useful life of the nuclear assets in question.

Q. What are the consequences of such a deferral?

A. Such a deferral will result in an increase in rate base and in the annual return requirements associated with rate base. Also, the resulting amortization of the deferral will increase future cost of service, effectively assigning the costs of the 2004 storms to future customers even though they face the same risks of subsequent catastrophic storm losses that our current customers experienced in 2004. Under Mr. Majoros' proposal customers twenty years from now would still be paying for the costs of the 2004 hurricane restoration efforts.

1 **Q. Have you calculated the net present value of the difference in revenue**
2 **requirements that FPL's customers would have to support under Mr.**
3 **Majoros' proposal and under FPL's proposed surcharge?**

4 **A.** Yes. As shown in my Exhibit No. KMD-6, the net present value of the revenue
5 requirements for Mr. Majoros' proposal, at an 8% discount rate, will be \$144
6 million higher than for FPL's proposed surcharge. Exhibit KMD-6 also shows
7 that unless customers can earn an unrealistic 15% each and every year on their
8 investment for the next 22 years, they would be harmed by Mr. Majoros' proposal.
9 This is due to the impact of an increase in rate base of \$533 million on a
10 jurisdictional basis as filed in this docket due to the transfer of nuclear book
11 depreciation reserves to offset the storm damage reserve deficiency. The recovery
12 of this additional rate base over the 22 year composite remaining life of the plant
13 in the nuclear production function in FPL's recently filed depreciation study
14 results in \$1.2 billion in cumulative revenue requirements. In contrast, FPL's 3
15 year storm surcharge for the recovery of the \$533 million in storm damage
16 deficiency costs results in \$552 million in cumulative revenue requirements. The
17 substantial difference between these revenue requirements is a result of pushing
18 current period costs that should be financed with short term capital out into the
19 future (i.e., the 22 year composite remaining life of the plant in the nuclear
20 function) and leaving them outstanding for an extended period, thereby requiring
21 long term financing of the costs at FPL's overall cost of capital.

1 **Q. Please summarize your supplemental rebuttal testimony.**

2 A. Mr. Majoros' proposal to offset the approved Storm Damage Reserve deficit
3 should not be adopted because it is economically disadvantageous to FPL's
4 customers. Further, it violates GAAP and regulatory accounting principles as well
5 as Commission policy. Additionally, it would shift cost responsibility from
6 wholesale to retail customers. FPL has properly addressed the theoretical
7 depreciation reserve surplus by using remaining life depreciation rates over the
8 lives of the assets to which the surplus relates resulting in reduced depreciation
9 rates which are included in base rates.

10 **Q. Does this conclude your testimony?**

11 A. Yes.

1 BY MR. BUTLER

2 Q Mr. Davis, would you please summarize your testimony.

3 A Yes, thank you.

4 Mr. Chairman, Commissioners, the cost of repairing
5 FPL's electrical system and facilities due to damage caused by
6 Hurricanes Charley, Frances and Jeanne is approximately
7 \$890 million. Over 90 percent of those costs have been paid by
8 or invoiced to FPL. These costs were charged to the Storm
9 Damage Reserve as required by Commission Rule 25-6.0143. As a
10 result, the existing Storm Damage Reserve balance of
11 approximately \$354 million was completely utilized in a deficit
12 balance of \$536 million or \$533 million on a jurisdictional
13 basis was created.

14 FPL accounted for the costs incurred in restoring
15 service to its customers utilizing standards set forth in a
16 Storm Damage Study filed with this Commission in 1993. That
17 study was prepared by FPL and filed at the direction of this
18 Commission to answer specific questions regarding the costs FPL
19 would charge to the Storm Damage Reserve and the accounting for
20 capital assets replaced during the storm restoration process.
21 The study was approved by this Commission in 1995.

22 FPL utilized those standards consistently for the
23 eight storms and \$152 million in restoration costs that were
24 charged to the Storm Damage Reserve from 1995 through 2003. It
25 would be unreasonable and inappropriate to now decide after the

1 2004 restoration costs have already been incurred to ignore
2 those standards and ten years of precedent and retroactively
3 apply different standards. Changes in standards should only be
4 made on a prospective basis. Changing standards retroactively
5 denies FPL the opportunity to conform its past practices or
6 activities to new standards and can have significant financial
7 consequences.

8 In particular, retroactive application of new
9 standards could significantly undermine the basis for FPL's
10 financial reporting and the financial community's confidence in
11 FPL's accounting for the effects of regulatory actions in its
12 financial statements.

13 As directed by the Commission at December 31, 2004,
14 FPL did not expense the deficit balance in the Storm Damage
15 Reserve as would have been required under generally accepted
16 accounting principles. Reporting the deficit on the balance
17 sheet instead of as an expense on the income statement was
18 predicated on an expectation of recovery that was created by
19 the Commission's orders on this subject over the last ten
20 years.

21 The Office of Public Counsel, through Mr. Majoros,
22 has proposed guidelines that would be applied retroactively to
23 the 2004 storm costs. Public Counsel's guidelines are
24 inherently flawed because they treat annual budgets as
25 absolutes rather than as a plan subject to revision based on

1 circumstances. Also they focus only on budgeted costs and fail
2 to consider other components such as lost revenues and indirect
3 costs that were not charged by FPL to the Storm Damage Reserve
4 and for which FPL is not seeking recovery.

5 Application of Public Counsel's guidelines without
6 consideration of the other components would result in FPL
7 having to expense storm restoration costs that should properly
8 be charged to the Storm Damage Reserve in addition to suffering
9 a loss of revenues and absorbing indirect costs like
10 uncollectible accounts expense and backfill and catch-up work.

11 Mr. Majoros has also suggested offsetting any
12 approved deficit amount against theoretical excesses in FPL's
13 depreciation accounts. Such an offset is not appropriate under
14 generally accepted accounting principles or from a regulatory
15 accounting perspective and, in fact, would violate the stated
16 policy of this Commission and the FERC regarding reserve
17 transfers.

18 The practical effect of such an offset would be to
19 defer and amortize the 2004 storm restoration costs over the
20 remaining lives of the nuclear plants as they account for a
21 substantial portion of the theoretical excess. Such a deferral
22 would be economically disadvantageous to our customers, costing
23 them an additional \$144 million on a net present value basis.
24 It also would result in customers paying 2004 storm restoration
25 costs for the next 22 years, while still being subjected to the

1 risk of future hurricane losses throughout the 22-year period.

2 This concludes my summary.

3 MR. BUTLER: I would tender Mr. Davis for
4 cross-examination.

5 COMMISSIONER BAEZ: Mr. McGlothlin.

6 CROSS EXAMINATION

7 BY MR. MCGLOTHLIN:

8 Q Good morning, sir.

9 A Good morning.

10 Q Let me first refer you to Page 29 of your rebuttal
11 testimony.

12 A Okay.

13 Q IN response to the first question on that page you
14 say that FPL estimates that approximately \$58 million of
15 capital additions, \$12.2 million of removal costs,
16 \$36.4 million in retirements and \$21.7 million in contributions
17 in aid of construction would be recorded in March 2005.

18 At the time you prepared this rebuttal testimony you
19 were anticipating an accounting transaction to be done in
20 March. Can you tell me whether the, the actual March entries
21 differed materially from these estimates?

22 A The entries as recorded in March are consistent with
23 these amounts. They've been recorded in our general ledger.
24 They have not been recorded down in the subledger for property
25 at this point. That will, that will take some additional time.

1 Q But for our purposes, these values that were
2 stimulates at the time remain accurate?

3 A Yes.

4 Q Okay. There's one item that I want to make sure
5 we've covered adequately, adequately well for the record, and
6 I'll just ask you the question to see if you know the answer
7 without looking at the discovery response.

8 But in response to OPC's sixth set of
9 interrogatories, Interrogatory Number 46, we asked the company
10 to provide some information regarding payroll charged to storm
11 reserve. And with respect to the category of regular payroll,
12 the total was \$27,786,667. Do you recognize that as the
13 response to the company?

14 A That is the total direct payroll for all
15 classifications of employees that was charged to the, to the
16 Storm Damage Reserve. So, yes, I guess I should have answered
17 yes to begin with.

18 Q Well, as shown on the exhibit, it is shown as the
19 regular payroll expense. Is that what you intended with your
20 response?

21 A Yes. It is the regular payroll expense that was
22 charged to the Storm Damage Reserve.

23 Q (By Mr. Butler)

24 MR. McGLOTHLIN: For the next item I think I do need
25 to distribute an exhibit. And this has not been marked at this

1 point, Chairman Baez.

2 COMMISSIONER BAEZ: I'm sorry, Mr. McGlothlin. I
3 didn't hear that last part.

4 MR. MCGLOTHLIN: I'm distributing an exhibit that has
5 not been marked at this point.

6 COMMISSIONER BAEZ: I'm showing OPC's sixth set of
7 interrogatories, 49D?

8 MR. MCGLOTHLIN: Correct.

9 COMMISSIONER BAEZ: Show that marked as Exhibit 35.

10 (Exhibit 35 marked for identification.)

11 BY MR. MCGLOTHLIN:

12 Q Mr. Davis, do you have what's been marked as Exhibit
13 35, which is the response to OPC's Interrogatory 49D?

14 A Yes, I do.

15 Q And do you recognize this as something that was
16 prepared by you or under your direction?

17 A It was prepared by the company and I believe provided
18 as, in response to an interrogatory from Office of Public
19 Counsel. Off the top of my head, I don't know exactly who
20 prepared it.

21 Q Now this displays a comparison of the budgeted amount
22 of tree trimming for the Year 2004 with the, with the actual
23 values, does it not?

24 A It reflects the budget roll-up at the top, the top
25 two lines are the budget roll-up for transmission and

1 distribution. The bottom two are the actuals. I would note
2 that the schedule as it was provided to you also has January
3 05 on there, which would make it a 13-month year, I guess. So
4 it would have to be adjusted to remove that from the totals.

5 Q But as, as displayed on, on this exhibit, do I
6 understand correctly that the budget amount was \$50.9 million
7 and the actual was somewhat lower, \$48.9 million?

8 MR. BUTLER: I'm going to object to the question if
9 he's characterizing that as the 2004 budget amount because of
10 the comment just made about the fact that it includes January
11 05.

12 COMMISSIONER BAEZ: Mr. McGlothlin?

13 MR. MCGLOTHLIN: I'll accept the clarification that
14 this is 13-month figure and not, not limited to the 2004
15 calendar year.

16 THE WITNESS: By -- okay. You haven't asked a
17 question. I'll wait.

18 COMMISSIONER BAEZ: Go ahead. Ask your question,
19 Mr. McGlothlin.

20 BY MR. MCGLOTHLIN;

21 Q Does this document reflect that for the 13-month
22 period shown the budgeted amount of tree trimming expense was
23 \$50.9 million and the actual for the same period was
24 \$48.9 million?

25 A That is correct. But I will offer up the, the

1 correction to remove January '05, the budgeted amount was
2 \$47 million, and I think that's what I have in my testimony.
3 And the actual amount is \$46 million, leaving \$1 million
4 difference

5 MR. McGLOTHLIN: All right. I need to distribute
6 another document. Chairman Baez, could we have a number
7 assigned?

8 COMMISSIONER BAEZ: Well, let's give it a title.
9 What would you like to use, Mr. McGlothlin, because this seems
10 to be the same exhibit?

11 MR. McGLOTHLIN: It is the same exhibit. For
12 purposes of the question we intend to focus on a subset of the
13 values shown.

14 COMMISSIONER BAEZ: All right. Show it, show it as
15 OPC 6th Interrogatory 49D Highlighted. I don't know. Does
16 that work?

17 MR. McGLOTHLIN: I missed the last thing you said.

18 COMMISSIONER BAEZ: Highlighted.

19 MR. McGLOTHLIN: Highlighted. That's fine.

20 COMMISSIONER BAEZ: And show that marked as 36.

21 (Exhibit 36 marked for identification.)

22 BY MR. McGLOTHLIN:

23 Q Mr. Davis, on Exhibit 36 we have highlighted the
24 period August through, August 2004 through January '05. And
25 take a moment, if you need to, but would you accept, subject to

1 any checking you want to do, that when one focuses on that
2 period, the budgeted total is \$24.3 million and the actual is
3 \$20.1 million?

4 A For the six-month period that includes January '05, I
5 would accept that.

6 Q All right. I have several questions for you that
7 relate to the 1993 study to which you alluded in your summary.
8 Would you turn to that exhibit, please?

9 COMMISSIONER BAEZ: Mr. McGlothlin, which exhibit are
10 you referring to?

11 MR. MCGLOTHLIN: It's KMD-3.

12 COMMISSIONER BAEZ: Thank you.

13 BY MR. MCGLOTHLIN:

14 Q Are you there, sir?

15 A I am.

16 Q Now this study contains the rationale that the
17 company submitted to the Commission in support of the total
18 restoration cost approach it has employed for accounting
19 purposes in this case; is that correct?

20 A I would not agree with that characterization. The
21 study was submitted to the Commission to answer specific
22 questions that the Commission asked earlier in the 1993 docket.
23 They ordered that we prepare this study and file it within a
24 set number of months after the issuance of the particular
25 order, but it was to answer all the questions regarding two

1 principles issues. One is the costs that would be charged to
2 the Storm Damage Reserve and, number two, the treatment of
3 capital costs. And it also addressed the provided alternatives
4 relative to the level of accrual that would be included in base
5 rates.

6 Q In response to the Commission's direction did the,
7 did the company conclude and represent that its view is that
8 the actual restoration cost approach should be used?

9 A Yes. The company provided three alternative
10 approaches and recommended that the actual restoration cost
11 approach be used because it was consistent with how replacement
12 cost insurance worked. We were talking at the time about a
13 self-insurance reserve, and there were a number of other issues
14 that were identified in the study relative to the other, to the
15 other approaches.

16 Q So the study does contain the support on which the
17 company relied at the time and relies now for its use of the
18 total restoration approach; correct?

19 A I would say what I rely -- as the Chief Accounting
20 Officer of Florida Power & Light what I rely on as the basis
21 for using the actual restoration cost approach is the direction
22 of this Commission. Presumably they read this and considered
23 this, certainly the staff did, in reaching the conclusion that
24 they did in the 1995 order. So I would not say that the
25 company's recommendation in this is the basis upon which I am

1 Following the actual restoration costs. I believe I'm
2 following the direction given by this Commission.

3 Q Was the company's recommendation based upon the
4 contents of this study?

5 A Yes, it was.

6 Q And to the extent it's your position that the
7 Commission accepted the study, do you think it was based upon
8 the content of the study, the rationale expressed within it?

9 A Yes. I would, I would assume -- again, I go back --
10 all I can say is what I said earlier, and that is that
11 presumably the Commission and its staff considered the
12 alternatives in the study, considered other alternatives that
13 they may have had in their own minds, and made an informed
14 judgment as to what approach we should be using.

15 Q Okay. Please turn to Page 9 of 51 as, as identified
16 in the header at the top of the page.

17 A Page 9 of 51. I'm there.

18 Q Yes. And for purposes of my next question, would you
19 read into the record the paragraph that begins with the word
20 "depending" at the bottom of the page?

21 A The entire paragraph?

22 Q Yes, sir.

23 A Okay. "Depending on the future level of replacement
24 cost insurance varying levels of reliance on the reserve can be
25 anticipated. It is probable that future storm losses will be

1 covered by some combination of insurance proceeds and charges
2 to the reserve. Use of the actual restoration cost approach is
3 consistent with the replacement cost insurance, and avoids the
4 cumbersome and potentially arbitrary accounting for storm
5 restoration utilizing two different methodologies. The cost of
6 the actual restoration cost approach also avoids the need to
7 determine what portion of insurance proceeds apply to
8 capitalized costs, normal costs or to nonincremental costs
9 which would be required if either the net book value or
10 incremental cost approach is used for determining the costs to
11 be charged to the reserve."

12 Q Now within that statement there's a reference to the
13 cumbersome accounting utilizing two different methodologies.

14 Do I understand it correctly that the need for two
15 different methodologies would be to have one for dealing with
16 the insurance carrier and another dealing with regulatory
17 purposes?

18 A No, that is not correct.

19 Q And what is the, what is the context then for the
20 reference to the requirement of two different methodologies?

21 A May I have you turn to another page and I think it
22 will become clear?

23 Q If that answers the question.

24 A Page 15 of 51.

25 The point -- I'll wait until you get there. It's a

1 comparison of the three methods.

2 Q Okay.

3 A We presented three methods in the study as, as a way
4 of providing a basis for comparison versus just a single point
5 of assessment.

6 The actual restoration cost approach, which was based
7 upon how we accounted for Hurricane Andrew. With a couple of
8 exceptions in Andrew, the insurance policies provided for
9 certain predefined levels of overheads and so forth. So this
10 just reflects the costs, the actual out-of-pocket costs in the
11 first column, 270.

12 And what that paragraph is trying to highlight there
13 is that under the actual restoration cost, you focus on the
14 event. Your accounting is driven by the event. You had a
15 storm. You incurred certain costs associated with that storm.
16 All of those costs that are reflected in that column were
17 directly related to the restoration from the damage caused by
18 the event.

19 When you get to the second column, you have actual
20 restoration costs, which again starts with the same number,
21 with a net book value adjustment. And all you're doing in that
22 column is simply reducing it for the level of capital, the
23 accounting for capital costs, if you will. In other words, the
24 \$51 million would be the capital additions at normal cost,
25 meaning not the higher emergency-related restoration costs but

1 rather the normal costs, which would be an estimate from our
2 work management systems. We can go in and we can estimate what
3 it would cost, for example, to put in a pole, you know, a
4 fully, fully dressed pole. We can also go into those same work
5 management systems and estimate the net book value of the
6 retired assets. It has net book value of the retired assets.

7 Okay. The net book value of the retired assets, that
8 also, that's a bit more complicated because you have to go in
9 and determine the vintage years of, of the individual poles
10 that were retired. You have to do that on a county-by-county
11 basis, and then you go in and try to estimate what the
12 accumulated depreciation was on the poles. So there's a number
13 of steps, all of which involve amounts of estimation. That's
14 the point that is being made, one of the points that is being
15 made in the, in that paragraph regarding arbitrary adjustments.
16 You have to make certain assumptions.

17 The last column, which is entitled the "Incremental
18 Cost Approach," and which, in fact, was talked about in the, in
19 the '93 docket, in the hearings that were held early on in that
20 docket, starts with the same number but then it makes a number
21 of adjustments. And the first such adjustment would be to
22 remove the straight time payroll, which is the equivalent of
23 what you were talking about and asking me about a few minutes
24 earlier. You looked at it both on an annual basis and carving
25 out the four months starting with August when the storms hit

1 through the end of the year. Actually it also had January on
2 there. But it would take that out.

3 But then it would turn around and say, well, part of
4 those costs would not on a normal basis be charged to O&M and,
5 therefore, base rates in the year in which they're incurred.
6 They would have been capitalized. Because if you look at our
7 payroll costs, you will see that on a recurring basis a portion
8 of our payroll cost is charged to capital. So that's the
9 11 adjustment that's on that page.

10 The next one would be loading on nonincremental
11 payroll. That would be removing pension, welfare and taxes
12 that's associated with the 25 of regular payroll.

13 And then vehicle charge is a nonincremental, which I
14 think is one of the adjustments that you're suggesting in your
15 position ought to be removed.

16 Then it comes down and says, well, what else is
17 incremental? What has -- what else has happened to the company
18 as a result of the hurricanes? Well, we've lost revenue.
19 That's where there's a problem. We're not seeking recovery of
20 lost revenues. That is, in fact, a normal function, a normal
21 risk that a, any commercial company takes unless they have
22 business interruption insurance.

23 The next would be catch-up and backfill. In this
24 particular case, ironically it faces the same problem that I
25 have today and I alluded to it in my rebuttal testimony.

1 Backfill and catch-up has two characteristics. One is that
2 you're doing a normal job, but you're doing it generally on
3 overtime because you had to take those people -- I mean, half
4 my department was out on storm, so they had to catch up. I
5 didn't -- we didn't track it during Andrew, nor did I track it
6 during Frances, Charley and Jeanne. So we would have to
7 estimate it. That's, again, one of the -- I'll call it an
8 arbitrary adjustment. That's a rather long-winded answer, but
9 that's what that particular paragraph is alluding to.

10 Q Well, I appreciate the explanation of the comparison
11 there and we're going to get to that. But I don't think it's
12 responsive to my specific question, which has to do with the
13 reference to utilizing two different methodologies.

14 Now looking at the same page to which you referred
15 us, do I understand correctly that the actual restoration cost
16 is a methodology?

17 A It is the methodology that we recommended in the
18 study. So, yes, it is a methodology.

19 Q And the actual restoration costs with the net book
20 adjustment and the incremental costs are the second and third
21 methodologies that are described and assessed within the study;
22 correct?

23 A That is correct.

24 Q Okay. Now back on Page 9 of 51, this discussion is
25 within the page captioned "Actual Restoration Cost Approach,"

1 and those are, I assume, is intended to describe the operation
2 of the actual restoration cost approach. And if one advantage
3 is that it is consistent with replacement cost insurance and
4 avoids the need to utilize two different methodologies, doesn't
5 that mean that it is unnecessary to use a different accounting
6 standard for some purpose other than replacement cost
7 insurance?

8 A I believe it could be. I believe it could be read
9 that way. I did not read it that way initially. I read it as
10 a comparison of the, of the other approaches, but.

11 Q So having reread it, would you agree with me that at
12 the time this was prepared the advantage seen in the use of the
13 actual restoration cost approach is that the company could more
14 or less satisfy two needs with a single approach, and that is
15 an approach that is consistent with the insurance carrier's
16 requirements and at the same time satisfies other accounting
17 needs, therefore, avoiding the need to have more or less two
18 sets of books?

19 A I don't think I would -- I would not disagree with
20 that.

21 Q Well --

22 A I will agree with that.

23 Q Thank you.

24 A I don't mean to be argumentative.

25 Q All right. Now having established that, is it also

1 true that at the time this was prepared the expectation was
2 that the company would have in place at least some portion of
3 replacement cost insurance on, on this transmission and
4 distribution network?

5 A I believe expectation may be too strong a word, but
6 there was certainly a hope at that point in time that the
7 insurance market would soften a bit, which they, which, of
8 course, they did not.

9 Q Okay. Well, let's look again at the same paragraph.
10 Does this not say as follows: "It is probable that future
11 storm losses will be covered by some combination of insurance
12 proceeds and charges to the reserve"?

13 A Yes, it does.

14 Q And is it true, sir, that currently the company has
15 no casualty insurance on its transmission and distribution
16 network?

17 A That is correct.

18 Q Now let's go back to Page 15 of 51 --

19 A Okay.

20 Q -- which shows the comparison of the three
21 methodologies. And the comparison purports to demonstrate that
22 the amount charged to reserve is, would be higher using the
23 incremental costs than with the actual restoration costs;
24 correct?

25 A Yes, that is what it shows.

1 Q But that depends upon the acceptance of the
2 assumption in this methodology that lost revenues would be
3 categorized as an incremental cost; is that correct?

4 A That is correct.

5 Q In fact, if you take the value of \$46 million shown
6 for lost revenue, subtract that from 299, do you get the result
7 of \$253 million?

8 A Correct.

9 Q Is that less than the corresponding value shown for
10 the actual restoration cost?

11 A Correct.

12 Q A moment ago you alluded to business interruption
13 insurance. The petition of the company is part and parcel of
14 the existing program of self-insurance, is it not?

15 A Yes. I believe that is the case. You say part and
16 parcel. I mean, it's developed under that because the Storm
17 Damage Reserve, which was intended as a self-insurance reserve,
18 has been exhausted.

19 Q And it's in place because of the unavailability of
20 insurance, commercial insurance at an affordable rate.

21 A I believe that the Commission's intent was that it
22 would be replacing -- that it's a self-insurance program.

23 Q When the company had commercial insurance in place,
24 did that insurance policy include coverage of lost revenues?

25 A No, it did not. And, in fact, it put the company in

1 exactly the same position that we find ourselves in today. It
2 covered certain -- it covered the actual restoration cost,
3 which is all the company is seeking in this proceeding.

4 Q Let's return to Page 29 of your rebuttal testimony.

5 A I'm sorry. Page 29?

6 Q Page 29. Yes.

7 A Of the testimony?

8 Q Rebuttal testimony, yes.

9 A Okay. I have it.

10 Q You identify there \$12.2 million in removal costs and
11 \$36.4 million in retirements. Do you see that?

12 A Yes, I do.

13 Q And do I understand correctly that the removal costs
14 are associated with the cost of removing from service the plant
15 items that were retired because of storm damage?

16 A That is, yes, the \$12.2 million. Yes.

17 Q Now the ratio of the removal costs to the value of
18 retirements, 12.2 to 36.4, is roughly one-third or 33 percent;
19 is that correct?

20 A Approximately.

21 MR. MCGLOTHLIN: I want to distribute another
22 document at this point. And could I have a number, Chairman
23 Baez?

24 COMMISSIONER BAEZ: I'm holding FP&L Depreciation
25 Study Status Reports '98 through 2003. Show that marked as

1 Exhibit 37.

2 (Exhibit 37 marked for identification.)

3 BY MR. MCGLOTHLIN:

4 Q Mr. Davis, you've been provided a copy of what has
5 been marked as Exhibit 37, which is an excerpt from the
6 depreciation study that the company filed in March of this
7 year. And specifically this excerpt consists of supporting
8 materials, and you'll see the caption "Status Reports for the
9 years 1998 through 2003." I assume that you were involved in
10 the preparation or the supervision of the preparation of the
11 depreciation study that was filed and are familiar with its
12 contents?

13 A The depreciation study was prepared by people that
14 report to me. I did not review it in detail, so -- I mean, I
15 don't recognize this, this particular page, but.

16 Q Well, I'll represent to you that this is an excerpt
17 from the pending study. And for purposes of our question
18 please focus on the columns captioned "Retirements and Cost of
19 Removal" that are in approximately the middle portion of the
20 page. And I want to focus on the account for poles and
21 fixtures, 355, and overhead conductors and devices, 356. Those
22 are typical of the type of plant you would find in a
23 transmission system, would you not, and that would be
24 susceptible to storm damage?

25 A I'm not sure I understand. I mean, it is the large

1 items that were replaced during the storm: Poles, conductor,
2 what have you. Yes.

3 Q Okay. And the corresponding accounts for
4 distribution plant 364 and 365, again encompassing poles,
5 towers and overhead conductors and devices.

6 A Yes.

7 Q Okay. Looking at the transmission plant first, does
8 this reflect that based upon the supporting material from the
9 depreciation study, for poles and fixtures during the period of
10 time that this represents, the retirements amounted to
11 \$6,702,000 and the cost of removing those retirements was
12 \$5.9 million?

13 A Correct.

14 Q And the corresponding values for the overhead
15 conductors and devices, the retirements were \$4,549,000 and the
16 cost of removal was \$4,068,000.

17 A Correct.

18 Q And very quickly looking at the corresponding values
19 under the distribution plant, the retirements for poles, towers
20 and fixtures was \$3.974 million and the cost of removing was
21 over \$6 million.

22 A That is what the schedule shows.

23 Q And the last value for the overhead conductors and
24 devices, the retirements were \$8.8 million and the cost of
25 removal was \$9.1 million.

1 A That is correct.

2 Q The \$12.2 million value that you show on Page 29 is,
3 represents about one-third of the cost of the associated
4 retirements there. But does this suggest to you that perhaps
5 the ratio and the calculation of your cost removal related to
6 retirements should be closer to a one-to-one value?

7 A It does not.

8 Q Why not, sir?

9 A Because I, I do not draw that conclusion from this.
10 I would have far more faith in the estimation, the work
11 management system that would tell me exactly how many person
12 hours or manhours, however you care to characterize it,
13 vehicles and so forth are required to retire a pole. For
14 example, a new 35-foot wood pole today, the install cost of
15 that is about \$704. That same work management system would say
16 that the cost of removing that pole is about \$240. That number
17 is going to change over time. Just sitting here now looking at
18 this, and I can't explain why those numbers are as high as they
19 are, but to use the illustration that I was just using,
20 that \$704 for a wood pole, if the retirements that are being
21 depicted here were particularly old poles, let's say they were
22 35 years old, then the, the, you're paying in current dollars
23 for the cost of removal. But the original cost of the pole,
24 once we go through the, the Iowa curves and determine what
25 vintage years we should retire, you may get a very strange

1 relationship. So I think that the only thing you can do is
2 look at the current cost and draw your inference from the
3 current cost of the poles, because the value of retirements
4 goes, will be higher or lower depending on the vintage years.
5 And that depends on how new the area was, in other words, how
6 recently were those poles installed, versus how old the poles
7 were. If they were very old, you would see a very low
8 retirement cost, but it wouldn't affect the salvage, I mean,
9 the cost of removal. But if it was a very new area, you would
10 have a much higher retirement cost, something approximating the
11 relationship I described with the 704 and the 240. So I don't,
12 I don't draw any inference whatsoever from the schedule
13 attached to the depreciation schedule other than that is what,
14 that is the numbers that were recorded in the books and records
15 of the company over the particular period.

16 Q Well, the schedule at the top of page is captioned
17 'Accumulated Provision for Depreciation Amortization as of
18 12/31/03.'" Now have the cost relationships changed that
19 materially from, from the data, actual data from '03 to what is
20 now current.

21 A No. Obviously I did not explain it very well.

22 The column "Retirement," when you retire something
23 from the fixed assets, and particularly in the categories you
24 are describing, let's look at distribution poles, if I may,
25 it's considered to be mass property. So I don't have -- if you

1 say it's Pole 154, I can't tell -- I don't keep the accounting
2 records for Pole 154. In fact, I don't even know 154 is out
3 there.

4 What I do know is that in 1970 I installed, say,
5 5,000 poles and today there are 800 of those remaining. And
6 I'm making those numbers up, so don't, don't draw any inference
7 to the relationship. The point is that I would, using Iowa
8 curves, I would have X number of poles that were being retired
9 in a particular county at a particular point in time. I would
10 take that curve and apply it to the surviving property balances
11 and I would retire the original install cost of those. So if
12 you, you're only looking at one part of the depreciation study.
13 I don't believe you have here the plant-in-service side of it,
14 and that's what the retirement represents. When you retire a
15 piece of property in group life depreciation, you reduce the
16 plant-in-service number and you record it as a reduction, if
17 you will, of depreciation expense. So if the, if the pole was
18 fully depreciated, you have no change in net plant. If the
19 pole was retired prematurely, you create a deficit that has to
20 be made up in subsequent depreciation studies. And that's a
21 function of the remaining life methodology. If the pole lasted
22 longer than the anticipated life, then you would leave a
23 surplus in the net -- in accumulated depreciation.

24 So I think you're mixing -- you can't get to where
25 you want to go from, from this, at least where I'm thinking. I

1 just don't think you can draw any inference from this schedule
2 other than that the retirements during the period covered by
3 this schedule, and it is not clear what that period is, for
4 Account 364 totalled \$3.974 million. That's, that's the only
5 thing I would be willing to infer from this.

6 Q You would also conclude, would you not, that
7 associated with those retirements was the cost of removal of
8 \$6 million?

9 A That is correct.

10 Q And would this not reflect -- and would this reflect
11 a mix of, a mix of geographical areas that would be encompassed
12 within this report?

13 A Yes. It would reflect retirements and salvage for
14 that period, which I don't know exactly which period it is
15 that's covered by this.

16 Q With respect to the \$12.2 million value in removal
17 costs, does that represent the actual costs incurred or was
18 that a normalized cost?

19 A That is -- it's neither. It is an estimated cost
20 that came out of the work management system. It is akin to the
21 \$240 I described to you with respect to a 35-foot wood pole.
22 In other words, the work management system, based upon tracking
23 of labor over long periods of time, and they periodically
24 update it based upon recent trends and practices, they know how
25 many hours of labor is required to, to do particular tasks. In

1 the case I'm talking about, it's how many hours of labor would
2 be required to retire a pole. And along with that comes the
3 vehicle cost, and along with that would come payroll adders.

4 Q I think you answered my question. But what I'm
5 getting at is this: Does -- has the \$12.2 million been
6 calculated in a way that reflects any of the extraordinary
7 costs or exigencies such with removing plant during the storm,
8 higher labor, more difficult to access, that type of thing, or
9 is it based upon some sort of historical norm that was used in
10 lieu of that?

11 A It would not reflect -- it would be a normal cost,
12 what I think we've all talked about as a normal cost.

13 Q Okay. I have before me now your additional
14 supplemental testimony responding to Mr. Majoros's comments on
15 the depreciation reserve excess.

16 COMMISSIONER DEASON: Mr. McGlothlin, you're leaving
17 the depreciation exhibit?

18 MR. MCGLOTHLIN: Yes.

19 COMMISSIONER DEASON: I hate to interrupt. I have a
20 question about that before we leave that.

21 Sir, the column entitled "Retirements" -- I'm back on
22 the exhibit which is entitled "Depreciation Study 1998 through
23 2003." Do you have that?

24 THE WITNESS: Yes, Commissioner.

25 COMMISSIONER DEASON: Okay. I'm just -- so I can get

1 it straight in my mind, the column, Column C entitled
2 "Retirements," the amount that, the amounts that are shown
3 under that column, is that the original cost of the asset less
4 the accumulated depreciation such that that is a net number or
5 is it some other number? Can you, can you explain what that
6 number represents?

7 THE WITNESS: It should represent the original cost
8 of the item retired. It should not, it should not be net.

9 COMMISSIONER DEASON: Okay. So that is --

10 THE WITNESS: It's a gross original cost.

11 COMMISSIONER DEASON: Just the gross original cost?

12 THE WITNESS: Yes, sir.

13 COMMISSIONER DEASON: All right. Thank you.

14 BY MR. McGLOTHLIN:

15 Q At Page 7, Mr. Davis, beginning at Line 6, you state,
16 "The theoretical reserve calculation ignores the fact that FPL
17 will be incurring substantial capital costs in the near future
18 in the nuclear function in order to operate these units into
19 their extended lives." Are you there?

20 A Yes.

21 Q If the company incurs additional capital costs, will
22 not the associated plant have its own depreciation life and its
23 own depreciation rates established?

24 A Yes, it will.

25 Q At the bottom of that page you say that the PSC

1 approved consolidation of the Property Retirement Unit Catalog.
2 Would you explain what you mean there?

3 A Right. On Page 7, Line 21, I talk about the
4 consolidation of the Property Retirement Unit Catalog. What
5 that is is a listing of retirement units.

6 So, for example, you would have a nuclear facility, a
7 nuclear plant, and that would consist of thousands of so-called
8 retirement units. And the distinction there is that if I add a
9 retirement unit, I record it as new capital. If I retire a
10 retirement unit, I would retire that, charge it to accumulated
11 depreciation under the group life system.

12 The consolidation of that was an attempt to look at
13 the and align the property retirement units with how they might
14 manage those particular assets. So we consolidated those. We
15 took some smaller units which have shorter lives and
16 consolidated them, say, into a system or a larger unit that
17 would in most cases have a longer life. So you can obviously
18 see that that would have the effect of appearing to extend the
19 life of the property units because I've removed some of the
20 lower cost, I'm sorry, some of the shorter-lived assets. So, I
21 mean, that's basically all it is. It's how we account for it.

22 Now the practical affect of that would be that if I
23 have something as a retirement unit, if I replace it, it's
24 capital. If it's less than a retirement unit, I would expense
25 it.

1 Now I will go ahead and add that one of the things
2 now we're looking -- we have been looking at the results of
3 having made those consolidations, and I'm currently, I guess a
4 simple way of saying it, getting pushed back from the nuclear
5 people who are saying that you've gone beyond our operating
6 practices.

7 So we're -- you're having me account for something
8 that I treat as a capital asset from an operational perspective
9 as if it were expense so that they are pushing me to break down
10 some of these, not go back as far as we were, but to break some
11 of these down, which will have exactly the opposite effect.

12 Q In terms of the relative impacts, what impact did the
13 consolidation have relative to the extension of the licenses
14 for the nuclear units?

15 A It had nothing -- it had no change on the overall
16 life of the unit. But in particular asset categories, it would
17 have made the expected life longer.

18 Perhaps a way of putting it in perspective would be
19 to say that, that the consolidation of those units added about
20 \$300 million to the theoretical reserve surplus. And I would
21 expect that the, breaking these units back out a bit will have
22 an effect, I don't know that it will be that large, I have no
23 idea how much of an effect it would be. My main objective is,
24 in breaking these units back down is to, is to finally find the
25 point at which my accounting is consistent with their

1 operational practices.

2 Q At Page, Pages 8 and 9, beginning at Line 21, you
3 discuss the PSC's rules governing depreciation, and you say,
4 "These rules are very specific about keeping plant and reserve
5 balances separated by FERC function and do not allow utilities
6 to transfer reserves between account or subaccount without
7 their prior approval."

8 You're referring there to the Florida Commission, are
9 you not, without the Florida Commission's prior approval?

10 A That is correct.

11 Q And you don't dispute that the Commission in a given
12 situation could approve such a transfer, if it's, if it, if it
13 concluded that the transfer was warranted?

14 A I would not. The Commission has the power to do what
15 they, I guess, choose to do.

16 Q So these rules are not absolute and the Commission
17 can decide to depart from the rules in a given situation.

18 A Yes. I would, I would agree with that.

19 But I would also ask you to turn the page and look at
20 the next page because I think the Commission's view on it has
21 been articulated quite well in the quotes on Page 9 of my
22 testimony.

23 Q Well, you've anticipated my next question. And the
24 quoted material says, "We will not consider reserve transfers
25 between functions because they may result in pricing issues.

1 further, we will continue to consider reserve transfers between
2 plant accounts within the same production unit and between
3 units within the same production site."

4 The pricing issues to which this quotation refers
5 relates to what happens when a reserve excess in one account
6 s, is used to offset a reserve deficiency in another; is that
7 correct?

8 A The reserve transfers, yes. But the translation of
9 hat into a rate consequence, meaning what is charged to the
10 customer, has to do with how you allocate different cost
11 categories for rate purposes, rate setting purposes. When
12 you -- you know, what you're going to charge to the customer.

13 Q Yes. But in the specific context of this quotation
14 the Commission was addressing the potential for interclass rate
15 impacts that would occur if across (phonetic) functions one
16 were to use a reserve excess to offset a reserve deficiency
17 elsewhere; is that correct?

18 A I'm not sure I know how to answer your question. I'm
19 sorry. The, the, the reserve transfers obviously would be
20 within functions, not within accounts. Say, it would not be
21 within, say, distribution accounts. They would allow reserve
22 transfers within the distribution function, but would not allow
23 transfers between distribution and production. And the reason
24 for that, where they allude to pricing, I believe, is the fact
25 that generation would be allocated to the retail segment of the

1 business differently than would be distribution and so forth.

2 Hopefully I've answered your question.

3 Q Well, I think so, but I want to pursue that for just
4 another moment. Because I, I think that in context it was
5 clear that in this order the Commission was addressing the type
6 of interclass allocation problems that would occur if a, if
7 between functions a reserve increase was used to offset a
8 reserve deficiency in another function. Are we together?

9 A I believe so, yes.

10 Q Okay. Now with respect to the company's existing
11 situation, do I understand correctly that virtually across the
12 board the company has deficiency reserve excesses in all
13 functions?

14 A By and large.

15 COMMISSIONER DEASON: Mr. McGlothlin, what do you
16 mean by "deficiency reserve excesses"? Did you say "deficiency
17 reserve excesses"?

18 MR. MCGLOTHLIN: I misspoke. Depreciation reserve
19 excesses.

20 COMMISSIONER DEASON: Okay. I'm sorry. I may have
21 misheard you. I'm sorry.

22 MR. MCGLOTHLIN: I think I probably misspoke.

23 THE WITNESS: I would agree that the theoretical
24 reserve surpluses exist in, in most of the categories. I won't
25 say all of them. But I think in most of the categories they

1 vary widely, however, in terms of the order of magnitude.

2 BY MR. McGLOTHLIN:

3 Q All right. But granted that they vary in terms of
4 order of magnitude, but across the board the depreciation
5 reserve show excesses in all functions.

6 A I would not agree with that.

7 Q All right. What is your disagreement?

8 A I told you earlier that I would not agree that it's
9 in every function. I believe it is in most of the functions.
10 If we can work with that; otherwise, I need to, to refer to
11 something else because I didn't think there was a reserve
12 excess in the general plant function.

13 Q All right. Let's focus then on those functions that
14 show depreciation reserve excesses.

15 A Okay.

16 Q And you will acknowledge, will you not, that where a
17 depreciation reserve excess is identified, some remedial action
18 is warranted to, to address the excess?

19 A I would not agree that remedial action is necessary.
20 I think the normal action of the remaining life methodology
21 that has been approved by this Commission works out the excess
22 over a particular period of time, that period of time being the
23 remaining life of the plant. It's a normal consequence of
24 applying that because you have a finite amount of dollars that
25 you are seeking to depreciate. When you get to the end, you,

1 you do not result in depreciating more or less than the amount
2 you set up to, you know, set up to depreciate. So if you have
3 a \$100 asset to be depreciated over ten years on the straight
4 line method, you would, you would normally assign \$10 per year
5 to that. And if for whatever reason, whether there were
6 retirements in there or whatever, you at a point in time on a
7 theoretical basis were either ahead or behind. Let's say in
8 year six, you would have four years left to then correct that
9 excess, theoretical excess or surplus, and that would affect
10 the amount of depreciation expense that would be charged in the
11 next four years. It's not like you can take that money and go
12 somewhere else with it.

13 Q If I understand your answer correctly, you were
14 saying that where an excess is identified, one way to deal with
15 it would be to modify the depreciation rate going forward over
16 the remaining life; is that correct?

17 A Correct.

18 Q Isn't that one form of a remedial action?

19 A I think we're arguing words. You may consider it
20 remedial action. I would consider it the, the normal
21 consequence of depreciation accounting where you're trying to
22 assign the cost of a long-lived asset over -- and, in fact, in
23 our case thousands and thousands of long-lived assets, in fact,
24 millions of long-lived assets over, you know, 20-, 30-, 40-year
25 periods.

1 Q In any event, an adjustment would be made to address
2 the depreciation reserve excess; correct?

3 A It's going to seem like I'm arguing with you, but I
4 would say, no, an adjustment is not made. The -- you have a --
5 as a consequence you have a lower net book value under the
6 remaining life methodology, and that lower net book value is
7 depreciated over the remaining life. So inherently that
8 theoretical reserve excess means you have less to depreciate
9 over the remaining period and, therefore, your depreciation
10 expense is lower than it otherwise would be. However, you do
11 not make a separate adjustment to create an amortization
12 schedule or something like that for that so-called theoretical
13 excess. That's the distinction I'm trying to draw. The
14 remaining life methodology is self-correcting is my point.

15 Q Self-correcting? Doesn't it involve the preparation
16 and submission and approval of revised depreciation rates?

17 A Absolutely. And that's -- it is the revision of
18 those depreciation rates to reflect the net book value that has
19 to be amortized that causes the correction. I'm really
20 distinguishing do you, do you stay with what you were doing on
21 the one hand and have a correction on the other, and that is
22 not the case. The Commission has in place a depreciation
23 methodology that works quite well.

24 Q What's -- for the purpose of my next question let's
25 focus on those functions that show depreciation reserve

1 excesses.

2 If the Commission were to adopt an alternative means
3 of addressing the excesses such that the excesses were reduced,
4 perhaps more in some than in others, in that instance one would
5 not see the type of interclass pricing issue that would be
6 associated with using an excess in one function to address a
7 deficiency in another; is that correct?

8 A I, I don't understand. If I'm looking at
9 transmission and distribution property, which is the primary
10 property we're talking about, maybe I'm anticipating something
11 here in the case of, say, the storm damage, and I were to use
12 that to reduce the theoretical reserve excess in transmission
13 and distribution, then you're correct that in terms of a
14 pricing issue you would not have that crossing over problem
15 with pricing. However, as I've indicated in my rebuttal, no,
16 supplemental rebuttal testimony, it is more costly because
17 you're going to spread that cost over the remaining life of
18 the, of the property. So instead of recouping this as an event
19 driven item in the two- or three-year period that we're talking
20 about here, I would be spreading it over, say, the remaining
21 30-year life of the distribution plant while those folks have
22 the same risk of, same risk of hurricane damage in those future
23 years. So --

24 Q Yes. But the premise of that last statement is that
25 this methodology would somehow roll uncollected storm costs

1 into the depreciation regime. Is that what you're saying?

2 A If you use the theoretical reserve excess as an
3 alternative to recovery of storm costs, yes, that is precisely
4 what I'm saying.

5 Q Well, I understand that the application of the excess
6 to reduce or eliminate the indicated deficiency in Storm Damage
7 Reserve would have the effect of removing that deficiency and
8 restoring it to zero at the time the transfer is made. Is that
9 what the accounting would accomplish?

10 A I'm trying to sort out the pieces there.

11 Yes. If you, if you make a, an adjustment
12 for \$100 to remove a theoretical excess, then the net book
13 value of your plant is going to be 100 higher, meaning that the
14 return requirements associated with that plant are going to be
15 higher because the net book value is higher, the rate base is
16 higher. Depreciation expense going out into each of the future
17 years is going to be higher because the net book value is
18 higher.

19 (Transcript continues in sequence with Volume 2.)

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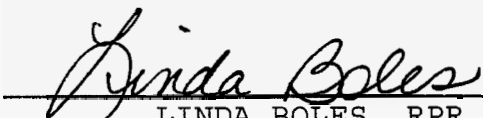
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4 I, LINDA BOLES, RPR, Official Commission
5 eporter, do hereby certify that the foregoing proceeding was
6 eard at the time and place herein stated.

6 IT IS FURTHER CERTIFIED that I stenographically
7 eported the said proceedings; that the same has been
8 ranscribed under my direct supervision; and that this
9 ranscript constitutes a true transcription of my notes of said
10 roceedings.

9 I FURTHER CERTIFY that I am not a relative, employee,
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11 or employee of any of the parties' attorneys or counsel
12 onnected with the action, nor am I financially interested in
13 he action.

12 DATED THIS 21st DAY OF APRIL, 2005.

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