BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

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DOCKET NO. 140001-EI

FUEL AND PURCHASED POWER COST RECOVERY CLAUSE WITH GENERATING PERFORMANCE INCENTIVE FACTOR.
________________________________/

VOLUME 6

Pages 663 through 871

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN ART GRAHAM
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER RONALD A. BRISÉ
COMMISSIONER EDUARDO E. BALBIS
COMMISSIONER JULIE I. BROWN

DATE: Tuesday, December 2, 2014

TIME: Commenced at 9:30 a.m.
Concluded at 11:55 a.m.

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

REPORTED BY: TERRY WILHELMI, CCR
Notary Public in and for
the State of Florida
at Large

APPEARANCES: (As heretofore noted.)

WITNESSES

EXHIBITS

NUMBER:	ADMITTED
Exhibits 35, 36, 37, 38 39	799
Exhibit 20	841
Exhibits 31 and 32	870

P R O C E E D I N G S

(Transcript follows in sequence from Volume 5.)

CHAIRMAN GRAHAM: Well, the Art Graham clock says 9:30 and I have a quorum. So, OPC, I believe you have a witness.

MR. SAYLER: Yes, sir. Good morning, Mr. Chairman, how are you doing this morning?

CHAIRMAN GRAHAM: Just fine.

MR. SAYLER: All right. The Office of Public Counsel would like to call Daniel J. Lawton, Esquire to the stand.

Whereupon,

DANIEL J. LAWTON, ESQUIRE

was called as a witness on behalf of Office of Public Counsel, and testified as follows:

DIRECT EXAMINATION

BY MR. SAYLER:

Q Would you please state your name and business record -- excuse me, your name and business address for the record?

A Sure. My name is Daniel Lawton and my business address is 12600 Hill Country Boulevard, Austin, Texas.

Q And by whom are you employed?

A I am self-employed. I have a law firm and a consulting practice.

Q All right. And on whose behalf are you appearing today?

A Office of Public Counsel.

Q And did you prepare and submit prefiled testimony in this proceeding on September 22, 2014?

A I did.

Q All right. And do you have that testimony with you?

A I do.

Q And do you have any corrections or revisions to make to your prefiled direct testimony?

A Not that I'm aware of at this time, no.

Q Okay. And do you adopt your prefiled testimony as your testimony today?

A I do.

Q All right. And you are also sponsoring five exhibits to your testimony, those are Exhibits DJL-1 through 5, is that correct?

A Yes, it is.

Q Okay.

MR. SAYLER: Commissioners, for the record, those are identified in Staff's comprehensive exhibit list as Exhibits 36 through 39.

CHAIRMAN GRAHAM: Duly noted.

BY MR. SAYLER:

Q All right. Mr. Lawton, do you have any changes to your exhibits?

A Not that I am aware of at this time.

MR. SAYLER: All right. Mr. Chairman, Office of Public Counsel would ask that the testimony of this witness be inserted into the record as though read.

CHAIRMAN GRAHAM: We will insert Mr. Lawton's prefiled direct testimony into the record as though read.

MR. SAYLER: All right, thank you.

(Whereupon, prefiled testimony was inserted.)

DIRECT TESTIMONY

OF

Daniel J. Lawton

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 140001-EI

I. INTRODUCTION/BACKGROUND/SUMMARY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Daniel J. Lawton. My business address is 12600 Hill Country Blvd, Suite R-275, Austin, Texas 78738.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I have been working in the utility consulting business as an economist since 1983. Consulting engagements have included electric utility load and revenue forecasting, cost of capital analyses, financial analyses, revenue requirements and cost of service reviews, and rate design analyses in litigated rate proceedings before federal, state and local regulatory authorities, and in court proceedings. I have worked with numerous municipal utilities developing electric rate cost of service studies for reviewing and setting rates, including fuel clause rates and reconciliations. In addition, I have a law practice based in Austin, Texas. My main areas of legal practice include administrative law representing municipalities in electric and gas rate proceedings and other litigation and contract matters. I have included a brief description of my relevant educational background and professional work experience in my Exhibit ___ (Schedule DJL-1).

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN UTILITY RATE PROCEEDINGS?

A. Yes. I have previously filed testimony in Florida and a number of jurisdictions across the country. A list of cases where I have previously filed testimony is included in my Exhibit ___ (Schedule DJL-1).

Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS PROCEEDING?

A. I have been retained to review the Florida Power & Light Company ("FPL" or "Company") Petition regarding FPL's proposed gas exploration and production joint venture with PetroQuest Energy, Inc. ("the Woodford Project") and its proposed guidelines for additional such ventures ("Petition"), on behalf of the Office of Public Counsel, State of Florida ("OPC").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony in this proceeding is to address some of the economic and regulatory policy issues surrounding the Company's Petition and its potential impacts on consumers if approved by the Florida Public Service Commission ("Commission"). Another OPC witness, Donna Ramas, will address other aspects of FPL's Petition.

Q. WHAT MATERIALS DID YOU REVIEW AND RELY ON FOR THIS TESTIMONY?

A. I have reviewed prior rate orders of the Commission, the Company's Petition and Direct Testimony of FPL witnesses Sam Forrest, Kim Ousdahl, and Dr. Tim Taylor, Company responses to interrogatories, financial reports of the Company and proposed Woodford Project partner, PetroQuest Energy, Inc. ("PetroQuest"), along with other information available in the public domain. When relying on various sources, I have referenced such sources in my testimony and/or attached Exhibits.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE REASONABLENESS OF FPL'S PROPOSED WOODFORD PROJECT AND ITS PROPOSED GUIDELINES FOR FUTURE SUCH JOINT VENTURES.

A. My analysis of the Company's Petition is that it should not be approved by the Commission for the following reasons:

1. The capital investments and profits on those investments that FPL proposes to flow through the fuel cost recovery clause on

a preapproved basis would be made in the natural gas exploration, drilling, and production industry—a highly competitive market that is not regulated by the Commission. Such investments would not be part of FPL's regulated monopoly utility operations and so would not be recovered through base rates that customers pay. Under the Commission's fuel clause exception criteria, the investments should be ineligible for recovery through the fuel cost recovery clause. The fundamental role of the Commission is to protect customers from monopolistic excesses by serving as a substitute for competition. If the Commission were to grant FPL's petition, the Commission would be instead requiring customers to protect FPL from competition (in a different, nonutility industry). Granting the petition would shift the risks of its gas exploration ventures onto its customers and require them to backstop FPL's desire to diversify into a risky, competitive business.

2. FPL's claim that the Woodford Project venture with PetroQuest will generate savings for customers necessarily stems from the assumption that the price that FPL pays its subsidiary for the Woodford gas will be less than the market price of gas. In discovery, FPL provided recent historical data regarding the relationship between the cost of production in the

Woodford area and the market price of gas that belies this critical assumption. For the past four years (2010–2013), the cost of Woodford gas has exceeded the market price of gas—and the difference has been material.[1] Not surprisingly, given this relationship, the major players (including drillers who control far more acreage than PetroQuest) have virtually ceased new drilling activity in the Woodford area.[2] Thus, FPL's claim that the market price of gas will be higher than its subsidiary's costs of production plus FPL's return on investment bears no relationship to recent past experience or current reality as evidenced by the actions of competitive oil and gas exploration and drilling firms.

3. FPL's gas industry partner/ project operator, PetroQuest, says it does not know what will happen to the market price of gas over time.[3] Yet, in support of its Petition FPL purports to project the market price of gas over a 50-year period. In the face of historical data of an unfavorable relationship between the cost of Woodford gas and the market price of gas, in its projections FPL predicts that the project will generate savings for customers over the entire 50-year time horizon of the Woodford Project. Critical to the Company's conclusion is FPL's assumption that the market price of gas will increase

[1] See FPL's Response to Staff's Second Set of Interrogatories No. 75.
[2] "NGI'S North American Shale & Resource Plays Factbook" (2014), at pages 30-31. Also See Natural Gas Intelligence, www.natgasintel.com/shaledaily
[3] PetroQuest Energy, Inc. 2013 Annual Report, 10K at 20.

markedly in the near term—including an increase in the first five years of 50% and a year-over-year increase of over 22% in the 2017 to 2018 period alone.[4] Through such assumed increases in early years, in its 50-year exercise FPL builds substantial early year savings and a long-term trajectory of market prices higher than Woodford gas. These projected increases in the market price of gas naturally favor the economics of the Woodford project; however, they are inconsistent with recent history, current drilling activity, and much of what we know about the current supply and demand situation. In my view, FPL's assumptions of early increases in the market price of gas relative to Woodford gas are unreasonable, bias the analysis in favor of the Woodford project, and render FPL's conclusions unreliable.

4. FPL's conclusions of benefits to customers also remain highly vulnerable to sensitivity analyses. Under reasonable and even conservative changes in assumptions of Woodford production and the rate of change of market prices, customers could realize a loss of the majority of FPL's estimated savings, or even negative project savings (in the form of higher fuel cost recovery charges) relative to the market price of gas, or net benefits that would not be realized for decades.

[4] See Direct Testimony of FPL witness Sam Forrest at Exhibit SF-8, Column H, the natural gas market price for 2017 is $4.70 which increases to $5.74 in 2018 this is a 22.13% increase. Also see Table 2.

5. While the conclusion of net savings is built on speculative and unsupported assumptions regarding the market price of gas, under its Petition FPL would be assured recovery of all of its costs, plus a handsome profit. FPL would bear zero risk; all risks of FPL's participation in the gas exploration and production business would be shifted to its customers. FPL's customers would effectively be required to become investors in a risky, unregulated industry.

6. If approved, FPL would earn approximately [redacted] of nominal after tax profits on the Woodford project while bearing zero risk.[5] However, the severely skewed nature of the risk/reward aspects of the Petition come into focus only when FPL's proposed guidelines are taken into account. FPL proposes to spend as much as $750 million annually on similar ventures in future years.[6] Importantly, this is an annual spending limit, not a total cap: each year, under its proposed guidelines FPL could layer another $750 million of capital investments in the gas industry on top of previous years.[7] Each such annual outlay of $750 million would yield approximately $47 million of after-tax profits annually.[8] In as little as ten

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[5] See FPL's Response to OPC's 4th Request for POD's No. 12, Attachment 1.
[6] Direct Testimony of FPL witness Forrest at Exhibit SF-9, Guideline I:D.
[7] *Id.*
[8] Calculated employing 10.5% equity return, 59.6% equity ratio or (10.5% * 59.6%)=6.258% weighted cost of equity times $750 million annual investment cap per Guidelines.

years, FPL could earn hundreds of millions of dollars in profits from its gas exploration joint ventures while requiring its customers to shoulder 100% of the risk of those ventures—and FPL's excursions into the gas exploration industry would be preapproved.

For all the above reasons I recommend that FPL's Petition be denied.

II: <u>SUMMARY OF ISSUES ADDRESSED</u>

Q. WHAT ISSUES DO YOU ADDRESS WITH REGARD TO THE COMPANY'S PROPOSAL TO INVEST IN GAS EXPLORATION AND PRODUCTION JOINT VENTURES AND TO PASS THE INVESTMENT, EXPENSES, AND RETURN THROUGH THE FUEL CLAUSE?

A. I address first, whether FPL's proposed transactions are inconsistent with the ratemaking paradigm in Florida and second (assuming the proposal survives this threshold determination) whether the proposal is reasonable in light of the customer/shareholder equities.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. In Section III of my testimony I provide an overview or summary of FPL's proposed Woodford Project.

Section IV addresses the regulatory and policy impacts and implications of the proposed Woodford Project. I discuss that the Petition is inconsistent with the Commission's mandate to permit the collection of only reasonable costs and that the transactions contemplated by the Petition are inconsistent with the fuel cost recovery clause under the Commission's criteria. These are very important considerations that extend well beyond this docket: as I discuss below, it is not unrealistic to expect that an approval of the Woodford Project and FPL's proposed guidelines may lead most or every utility in Florida regulated by this Commission to seek similar riskless fuel investments with a guaranteed equity return.

In Section V, I specifically address FPL's economic valuation quantification. In this part of the testimony I demonstrate that FPL's forecast of long-term market natural gas prices, which is key to any economic evaluation of the proposed project, is skewed in favor of the project and its claim of over $100 million of net benefits to customers is speculative and suspect.

In Section VI, I address specific company risk and risk-shifting issues surrounding the Woodford Project partner PetroQuest. I discuss and show how PetroQuest would be able to benefit under the terms of the agreements under the Woodford Project by shifting risks to FPL and how FPL in turn wishes to shift those same risks to its customers. Also, I address how PetroQuest's inability to forecast future natural gas prices, something PetroQuest candidly acknowledges, is a key risk factor facing any drilling and exploration participant.

In Section VII of the testimony, I compare and contrast examples of past diversification efforts by electric utilities outside the core electric generation, transmission, and distribution services. I discuss how these efforts have been failures in many instances and in some cases caused financial harm to consumers. This is important because the proposed Woodford Project is an FPL diversification effort outside its core monopoly service business.

Section VIII addresses issues associated with FPL's proposed guidelines for future projects similar to the Woodford Project. Obviously, if the Commission denies the FPL proposal these guidelines become moot. However, if the Commission approves the proposed Woodford Project, then there are a number of issues that need to be addressed in FPL's guideline proposals.

Lastly, in Section IX I outline my conclusions and recommendations regarding FPL's Petition for approval of the Woodford Project. Each of the conclusions and or recommendations comes from the various testimony Sections outlined in the paragraphs above.

These issues and topics are addressed in the following testimony to arrive at a recommendation in this case.

III: <u>FPL WOODFORD PROJECT PROPOSAL OVERVIEW</u>

Q. PLEASE DESCRIBE AND SUMMARIZE FPL'S PETITION.

A. The Company's primary request in this proceeding is a determination by the Commission that FPL's investment in a joint development agreement or venture with PetroQuest to develop gas reserves in Oklahoma would be a prudent investment venture for acquiring a portion of FPL's future natural gas supplies. Specifically, the Company requests the Commission to assure it that all venture-related costs, including the investment to develop these Oklahoma properties, plus a profit or shareholder return on this investment, and all ongoing operating expenses associated with developing and recovering these gas reserves may be recovered through the Company's Fuel Cost Recovery Clause ("Fuel Clause").[9]

Another element of FPL's Petition is a request that the Commission approve a set of guidelines for investing in additional gas reserve projects in the future, such that FPL would be presumptively eligible to recover the investment and associated revenue requirements through the Fuel Clause, so long as the future projects meet the guidelines.[10]

As administered by this Commission, the Fuel Clause is a rate mechanism that authorizes periodic adjustments to a factor designed to collect costs of purchasing fuel. The fuel mechanism or factor is subject to periodic

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[9] Direct Testimony of FPL witness Forrest at 5:10-15.
[10] *Id.* at 5:22-23 through 6:1-4.

reconciliation of prior estimates through refunds or surcharges. Utilities do not make a profit on fuel costs passed through the clause. Only base rate-related capital expenditures are eligible for the fuel clause mechanism, and only upon meeting this Commission's established recovery criteria relating to fossil fuel savings projects.[11]

In this proceeding, through its Petition, the Company requests the Commission to expand the traditional Fuel Clause so that FPL can import investments in the gas exploration industry and require customers to bear not only the risk of market price volatility, but also all the investment risk associated with gas exploration and production. Under FPL's proposal, the Company would remain shielded from market related fuel price and fuel exploration risk; the traditional fuel clause mechanism could become an additional vehicle for all Florida utility companies to safely expand opportunities for future shareholder earnings. This is not the purpose of the fuel clause recovery mechanism in Florida.

Q. PLEASE PROVIDE AN OVERVIEW OF THE PROPOSED FPL WOODFORD PROJECT.

A. The proposed Woodford Project transaction entails the following:

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[11] See generally Docket No. 100404-EI, Order No. PSC-11-0080-PAA-EI (January 31, 2011), pages 6-10 and Attachment A.

i. PetroQuest is a publicly traded independent oil and gas company engaged in the acquisition, exploration, development, and operation of oil and gas properties in Oklahoma, Texas, and offshore Gulf Coast Basin.[12] FPL's affiliate, USG Properties Woodford I, LLC, ("USG"), entered into a joint venture with PetroQuest (the June 18, 2014 PetroQuest Agreement). FPL proposes to acquire USG's interest and to recover all the purchase investment, other capital expenditures, and operating costs through the Fuel Clause.[13] FPL's initial buy in cost is estimated at $68.4 million[14];

ii. Under FPL's proposal, FPL would be a working interest partner with PetroQuest. Thus, under the Woodford Project FPL would pay a share of the cost for developing, drilling, and operating natural gas wells in the Oklahoma Woodford Shale Gas region. In return, FPL would receive a portion of the PetroQuest interest in the gas produced by the wells[15];

iii. FPL's obligations under the PetroQuest Agreement would be to pay PetroQuest a carry or premium for its working interest. Per the Agreement, FPL would be obligated to pay [redacted] and PetroQuest would pay the remaining [redacted] of the capital

[12] Yahoo Finance at www finance.yahoo.com
[13] *Id*. at 5.
[14] See FPL's Response To Staff's Second Set of Interrogatories No. 14.
[15] Petition at 5.

expenditures for development and drilling costs for each well.[16] FPL would be entitled to [redacted] of the PetroQuest output entitlement and PetroQuest would be entitled to [redacted] of the well output[17];

iv. FPL would be obligated to participate in a minimum of 15 wells by the end of 2015 and up to 38 wells under the Agreement[18];

v. FPL estimates its initial capital cost for USG's current interest at net book value would be $68.4 million, assuming Commission approval and transfer of interest from USG to FPL on January 1, 2015[19];

vi. The total project capital expenditures for FPL under the Project Agreements are estimated to be approximately $191 million[20];

vii. FPL would have to provide PetroQuest notice of consent or non-consent for each proposed well[21];

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[16] Direct Testimony S. Forrest at Exhibit SF-6, page 3, Confidential.
[17] Direct Testimony S. Forrest at Exhibit SF-6, page 3, Confidential.
[18] FPL's Response to Staff Request 2-79.
[19] See FPL Petition at 17.
[20] *Id.*
[21] FPL's Response to Staff Request 2-79.

viii. FPL would have to pay both its working interest share of capital expenditures plus the agreed upon carry amount of capital expenditures for each well in which FPL participates[22];

ix. FPL would have to pay its working interest share of the PetroQuest operating expenses for each well in which FPL participates[23]; and

x. FPL would have to pay PetroQuest for FPL's portion of royalty payments.[24]

In support of its Petition, FPL claims that the project holds "potential" benefits for customers of $106.9 million over the assumed 50-year project life.[25]

Q. IN PLEADINGS IN THIS CASE, FPL DISPUTES THAT IT WOULD BE EARNING A PROFIT ON THE PROJECTS UNDER ITS PROPOSAL. PLEASE COMMENT.

A. FPL asserts it "… is seeking to recover only its actual costs for the projects (including its Commission-authorized rate of return on investment), no different than any other project or investment made in

[22] *Id.*
[23] *Id.*
[24] *Id.*
[25] Direct testimony Sam Forrest Exhibit SF-8, Page 1 of 1.

furtherance of providing electric service."[26] FPL, like other corporations, is in the business of making money for its shareholders. The "cost" of acquiring equity capital means simply that investors expect a certain level of profitability to inure to them when they buy shares of a corporation; the "rate of return on investment" is a metric that measures profitability by relating the earnings (profit) to the amount of capital invested. However, the Commission prohibits utilities from making a profit on fuel costs that flow through the Fuel Clause.[27]

Q. IN ITS PETITION AND PROPOSED GUIDELINES, FPL CLAIMS THAT THE WOODFORD PROJECT PROPOSAL IS A FORM OF A LONG-TERM PHYSICAL HEDGING FOR NATURAL GAS. PLEASE COMMENT.

A. I disagree with FPL's characterization. It would be more correct to conclude that the Woodford Project puts the typical FPL customer in the risk position of an oil and gas exploration and drilling speculator. Hedging, like FPL's financial hedging program, involves locking in a future price to avoid the adverse effects of price fluctuations. Hedging does not lower costs or create savings but rather stabilizes prices over time. FPL's portrayal of the Petition as a hedging mechanism is at odds with its representation that customers will likely see a lower cost of gas if its Petition is granted.

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[26] See FPL's Response In Opposition To Office Of Public Counsel's Motion To Dismiss FPL's June 25, 2014 Petition For Lack Of Subject Matter Jurisdiction (Filed August 29, 2014) at 10.
[27] Order No. PSC-11-0579-FOF-EI, issued in Docket No. 110001-EI on December 16, 2011, at page 6.

A physical hedge would be a bilateral contract for gas at a fixed price. The Woodford investment has been presented not as a hedging vehicle, but rather as an investment in potential gas reserves that may result in savings if numerous assumptions turn out correct over the next 50 years. Under the proposed Woodford venture, FPL consumers are getting no protection against future market swings that one would find in a hedging instrument. Instead, consumers will bear whatever costs and risks that the market and circumstances bring to the Woodford venture. For these reasons I do not agree with FPL's physical hedge characterization for the Woodford project.

IV: <u>REGULATORY POLICY IMPLICATIONS OF THE PROPOSED WOODFORD PROJECT</u>

Q. PLEASE DESCRIBE THE FUEL CLAUSE MECHANISM.

A. The Commission in Order No. PSC-11-0080-PAA-EI outlines the history of the Fuel Clause and current fuel mechanism. As in most regulatory jurisdictions around the country, the purpose of the fuel clause mechanism in Florida is:

> **…** a regulatory tool designed to pass to utility customers the costs associated with fuel purchases. The purpose is to prevent regulatory lag, … [r]egulatory lag has historically been a problem for utilities because of the volatility of fuel costs. It is not as much of a problem, however, when expenses, such as capital improvements, and operations and management

> costs, can be planned for and included in base rate calculations.[28]

Over the years, the fuel clause has been adjusted a number of times addressing both frequency of fuel filings, use of historical or projected data, and identification of costs and exceptions that are allowable under the fuel clause.[29] Fuel filings are now annual and based on projected data that is ultimately reconciled to actual costs.[30]

In terms of the types of costs that are exceptions or would normally be recovered through base rates the Commission's fuel mechanism policy is flexible enough to recognize:

> … recovery through the fuel adjustment clauses of expenses normally recovered through base rates when utilities are in a position to take advantage of a cost-effective transaction, the costs of which were not recognized or anticipated in the level of costs used to establish the utility's base rates.[31]

Thus, there is a threshold requirement that costs must first be eligible for base rates in order to be considered for the fuel cost recovery clause. The proposed capital investments described by FPL would be made in conjunction with FPL's decision to diversify into a separate, unregulated industry. The proposed investments are not related to FPL's regulated

[28] In re: Petition by Florida Power & Light Company to recover Scherer Unit 4 Turbine Upgrade costs through environmental cost recovery clause or fuel cost recovery clause, Docket No. 100404-EI, Order No. 11-0080-PAA-EI (January 31, 2011) at 6.
[29] *Id.*
[30] *Id.*
[31] *Id.* at 7. Citing the Stipulation of the Parties adopted by the Commission in Order No. 14546.

monopoly utility business that is supported by customers through the base rates that they pay; therefore, these proposed investments do not appear to qualify for base rates.

Q. DO PAST REGULATORY DECISIONS BY THE COMMISSION—FOR EXAMPLE, ALLOWING FPL TO PURCHASE RAIL CARS AND FLOW THEM THROUGH THE FUEL COST RECOVERY CLAUSE—SUPPORT FPL'S REQUEST IN THIS CASE?

A. No. The purchase of rail cars for coal transportation was evaluated as a lower cost alternative to leasing the same equipment. Thus, like many corporate decisions made by FPL, the lower cost alternative between owning and leasing, ultimately the lowest cost or most beneficial route was selected and ultimately approved by this Commission.[32] But, this own or lease alternative of rail cars is a very different choice compared to choosing between leasing rail cars or *manufacturing* rail cars. Theoretically, if given certain regulatory guarantees, FPL may in fact be able to manufacture rail cars at a lower cost than leasing or purchasing in the open market. Nevertheless, allowing FPL to manufacture rail cars and guaranteeing FPL a return on investment for a rail car manufacturing facility would go well beyond the essential electric utility functions of generation, transmission, and distribution of electricity. Moreover, an unregulated and competitive market for the manufacturing of rail cars exists, but if the Commission were to authorize FPL a regulatory return

[32] See Docket No. 100404-EI, Order No. PSC-11-0080-PAA-EI, (January 31, 2011) at 9, citing Order No. PSC-95-1089-FOF-EI (September 5, 1995).

and cost recovery, FPL's customers would be guaranteeing FPL's profits and insulating it from the necessity of competing in that market.

FPL's Woodford Project proposal in this case is analogous to the rail car *manufacturing* example above. In other words, regulatory authority would be employed outside the core area of the natural monopoly and the result would be to insulate FPL from the risks of competing with non-regulated firms in non-regulated competitive markets, through the use of the powers of the Commission and the wallets of FPL's customers.

Q. EARLIER, YOU SAID THAT APPROVING FPL'S PETITION WOULD HAVE IMPLICATIONS FOR THE FUTURE OPERATION OF THE FUEL CLAUSE IN FLORIDA. PLEASE EXPLAIN WHAT YOU MEAN.

A. If the Commission shields an electric utility from risks in the competitive oil and gas exploration and drilling business by transferring the risks to the utility's customers through the operation of the Fuel Clause, the decision could create incentives that would negatively impact customers' costs. Other participants in the competitive market must factor market conditions into a decision to produce or not to produce. However, a utility that has received "preapproval" of its project and assured recovery of its investment and operating costs would have an incentive to disregard those market signals. Such incentives could turn the Fuel Clause from a mechanism designed to filter out unreasonable costs to one that encourages a utility to disregard cost levels. I illustrate this point further, using the Woodford Project as an example, later in this testimony.

V: <u>FPL'S WOODFORD PROJECT COST/BENEFIT ANALYSIS</u>

Q. A SECOND REQUIREMENT UNDER THE ORDER NO. 14546 FUEL EXCEPTION IS A REQUIREMENT THAT THE INVESTMENT, (IN THIS CASE THE WOODFORD PROJECT) "IF EXPENDED WILL RESULT IN FUEL SAVINGS TO CUSTOMERS." ON WHAT ECONOMIC BASIS DOES FPL SEEK TO JUSTIFY ITS REQUEST FOR AUTHORITY TO COLLECT WOODFORD PROJECT COSTS THROUGH THE FUEL CLAUSE?

A. In support of its Petition FPL relies principally on a "base case" analysis in which it claims that the project holds "potential" benefits for customers of $106.9 million over the assumed 50-year project life.[33]

Q. WHAT IS THE BREAKDOWN OF THE OPERATING COSTS RETURN ON CAPITAL AND PROFIT THAT FPL ESTIMATES FOR THIS PROJECT?

A. The Company's specific economic analysis can be found in Confidential Exhibit SF-8 of Mr. Forrest's direct testimony. Some of Exhibit SF-8 is not designated Confidential and I discuss these non-confidential items below. This 50-year economic analysis or project life-cycle analysis

[33] Direct testimony Sam Forrest Exhibit SF-8, Page 1 of 1.

(covering the period 2015 through 2065) develops the expected annual gas production output (Exhibit SF-8 at Column "B"), and the expected annual revenue requirement (including all operating costs and requested shareholder profits in Column "F"), and computes an annual unit cost of gas from the participation in the Woodford Project in Column ("G").[34] These forecasts of gas costs from participation in the Woodford Project are compared to FPL's forecast of market prices of gas for the next 50 years shown in Column ("H").[35] FPL then compares the annual projections of the Woodford Project gas acquisition costs and requested return on investment with the Company's forecast of the annual market price of the natural gas alternative. The difference between the Woodford Project annual unit cost and the annual forecasted market unit cost of gas is the claimed annual nominal savings to customers. These annual nominal cost differences are then multiplied by the expected annual Woodford Project gas output to arrive at a total annual forecasted cost difference between the Woodford Project and market purchases. These estimated annual cost differences are shown in Mr. Forrest's testimony at Confidential Exhibit SF-8, Column ("I"). The nominal annual cost differences of the Woodford Project are then discounted to a net present value using a 7.5% discount rate to arrive at the claimed $106.9 million of projected Project savings for customers. This net present value estimate is shown in Mr. Forrest's testimony at Confidential Exhibit 8, Column

[34] The forecasted annual cost of gas over the 50-year time horizon measure in ($/MMBtu) is shown in the Direct Testimony of Sam Forrest Confidential Exhibit SF-8, at Column G. These annual amounts are estimated by dividing annual estimated revenue requirements (Column F) by annual estimated gas production (Column B).

[35] Direct testimony Sam Forrest Exhibit SF-8, Page 1 of 1

("K").

To illustrate how the analysis is constructed, I have summarized the non-confidential project totals in the Table 1 below.

TABLE 1

FPL'S ESTIMATED WOODFORD PROJECT LIFE CYCLE SAVINGS

YEARS	WOODFORD PROJECT OUTPUT (BCF)	WOODFORD PROJECT REVENUE REQUIREMENT	WOODFORD AVERAGE UNIT COST	FPL MARKET PRICE FORECAST	FPL CLAIMED NOMINAL SAVINGS	NPV SAVING
2015-2065	137.8	$709.4 ($MM)	$5.148 ($/MMBTU)	$8.01 ($/MMBTU)	$394.7 ($MM)	$106.9 ($MM)

As shown in Table 1, FPL estimates that this project will produce 137.8 Bcf of gas over the 50-year projected project life. FPL estimates that the 50-year Project life operating expenses will be $323.2 million, depreciation expense will be $190.8 million, and the investment return requirements consisting of debt cost, shareholder profit, and associated income taxes will total $195.5 million for a total forecasted Woodford Project revenue requirement cost of $709.4 million.[36] The average unit cost of gas from the Woodford Project is the result of the ratio of projected Woodford Project revenue requirement of $709.4 million to projected Woodford Project output of 137.8 Bcf of gas, resulting in an average price

[36] *Id*. The operating expenses, depreciation expenses, and return on investment are combined to the $709.4 mm in Column 3 of Table 1 Revenue Requirement.

of $5.148 per MMBtu over the expected project life. FPL's analysis compares these annual Woodford Project forecasts of gas costs resulting from the Woodford Project revenue requirements to the Company's forecast of annual future natural gas market prices to estimate annual Woodford Project net savings. I have provided in Table 1 the average natural gas market price and resulting nominal savings FPL claims will result if these 50-year forecasts and all Woodford Project assumptions hold true over the 50-year time horizon of the forecast. Under FPL's estimates and assumptions the Woodford Project will result in $394.7 million of forecasted gas cost savings versus the 50-year gas market price forecast. This $394.7 million of nominal project savings implies an FPL average forecast natural gas price of $8.01 (($394.7 nominal savings + $709.4 Revenue Requirement)/137.8 Bcf output). Lastly, these $394.7 million of projected nominal savings is discounted to a net present value of $106.9 million employing the 7.5% discount rate.

Q. DOES FPL GUARANTEE FUEL SAVINGS FROM THE WOODFORD PROJECT?

A. No, it does not. The $106.9 million of Woodford Project net present value savings are a projection by FPL, not a guarantee.[37] If natural gas market prices or Woodford Project projections are different and more negative than the levels projected by FPL, customers will have lower than the

[37] See FPL's Response to Staff's 2nd Set of Interrogatories No. 93.

estimated savings and potentially negative savings.[38] The only guarantee under FPL's Woodford Project proposal is that no matter how the cost projections or forecasts of natural gas prices turn out, FPL will collect its investment, operating costs, and profits. In the current Woodford Project proposal FPL will earn approximately [redacted][39] in additional nominal profits whether this project produces a dime of consumer savings, over the 50-year life of the project.

FPL obviously has an economic incentive to get this proposed project approved, up, and running. Further, FPL stands to gain additional annual earnings or profits of approximately $47 million per year if the maximum investment level for each year is met under the proposed Guidelines for future projects.[40] The $47 million is not a total, cumulative figure; each year, through additional joint ventures with gas production companies, this level of profits could be added to prior profit levels. Because of the "true up" feature of the fuel cost recovery clause, these project investment amounts would be guaranteed recovery for FPL. The potential over the next number of years for future guaranteed profits in the many hundreds of millions of dollars is additional incentive for FPL to support this proposal.

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[38] *Id*.
[39] See FPL Confidential Response to OPC 3rd Request, No. 37(c). Also, see Confidential Response to OPC 4th Request for POD's, Request No. 12, Attachment 1.
[40] Calculated as weighted equity return of (10.5% ROE * 59.6% Equity level) * $750,000,000 Guideline maximum annual investment level.

Q. WILL THERE BE A NEGATIVE IMPACT ON AVAILABILITY OR PRICE OF GAS TO FPL CUSTOMERS THROUGH THE FUEL CLAUSE IF THE WOODFORD PROJECT IS REJECTED?

A. No. The Woodford Project has no impact on natural gas supplies available to FPL for generation of electricity. The proposed Woodford Project has nothing to do with risks to supply. Instead, FPL claims ownership of gas reserves can benefit customers by lowering gas prices. But customers would bear all the risks of FPL ownership initiative. Thus, FPL's proposal would require Florida electric customers to become speculators in the risky natural gas reserve, exploration, and drilling industry. If the investment guess is correct FPL will profit and customer savings will occur; if not, FPL will profit to the same extent, but customers may pay more than the market cost of gas.

The true beneficiaries under FPL's Petition are FPL's shareholders. The Company would be able to expand capital expenditures and earnings growth through the fuel clause mechanism and be guaranteed a profit at no risk. Under its proposed criteria over time FPL's shareholders would have the potential to gain many hundreds of millions of dollars in additional earnings at zero risk.

Q. IN YOUR OPINION, WHAT ARE THE KEY COMPONENTS OF

THE FPL PROPOSED PROJECT LIFE CYCLE ANALYSIS YOU DESCRIBED ABOVE?

A. First, it must be remembered that this is a 50-year estimate. Obviously, actual results will be different from these forecasts. The key drivers in the economic evaluation of the Woodford project proposal are the reasonableness of the projections of gas output from the Woodford project, the reasonableness of costs and revenue requirement estimates for FPL's proportionate share of ownership in the Woodford project, and the reasonableness of the forecasts of the market price alternative for natural gas. With respect to the project's output of gas over time, FPL employs a ten percent sensitivity factor, asserting that a ten percent up or down factor of estimated output is a value commonly employed in the industry. I have no reason to doubt FPL's claim regarding what the industry uses to modify estimates of the ability to extract identified resources in gas reserves. I would note, however, that this ten percent factor does not take into account structural changes that may occur over the 50-year project life regarding such contingencies as new legislation and regulatory changes. In any event, a review of the underlying sensitivity analyses discussed at page 38 of Mr. Forrest's testimony indicates that the output sensitivity factor has a smaller impact than market price forecast on the economics of the Woodford project.

The second economic driver is the costs of producing the Woodford Project gas. FPL's proposed subsidiary will simply provide capital to

PetroQuest; PetroQuest will operate the venture and incur the production costs. Just as legislative, regulatory, or other structural changes can affect the output of the Woodford Project during its expected 50 years of operation, they can affect PetroQuest's production costs. Unlike the assumptions as to output, FPL has not accounted for the risk of greater-than-projected production costs in any sensitivity analysis. Moreover, as OPC witness Donna Ramas observes in her testimony, the Commission has no authority to audit PetroQuest's production costs for reasonableness.

The third and probably key economic variable—the future prices of natural gas—is a wild card. FPL and PetroQuest cannot predict future market prices for natural gas—a fact that PetroQuest readily acknowledges.[41] The unknowable nature of future prices of natural gas and oil is one of the reasons natural gas and oil exploration and drilling is a risky business. For this proceeding, FPL forecasts annual future natural gas prices over a 50-year period. FPL concludes that its estimates of annual future gas prices are higher than the Company's estimates of the annual gas costs from the Woodford Project; thus FPL concludes customers benefit under the Woodford Project.

Q. HAVE YOU REVIEWED THE FPL FORECAST OF FUTURE MARKET PRICES?

A. I have reviewed the FPL market price forecasts of natural gas presented in

[41] PetroQuest Energy, Inc., Annual Report at 20, (2013)

Mr. Forrest's Exhibit SF-8 and evaluated the annual increases embodied in these estimates. The following table shows FPL's proposed annual Woodford Project output gas production, Woodford estimated cost per unit of gas in \$/MMBtu, FPL's market price forecasts, along with the annual percentage changes in these FPL estimates. I have also included the compound annual growth rate ("CAGR") for FPL's Woodford Project cost estimate and the Company's forecast of natural gas market prices.

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TABLE 2

FPL FORECAST ESTIMATES OF WOODFORD PROJECT OUTPUT, UNIT COSTS, AND FUTURE NATURAL GAS MARKET PRICES 2015 THROUGH 2024

YEAR	WOODFORD OUTPUT (Bcf)[42]	CUMULATIVE PERCENT OUTPUT	FORECAST WOODFORD COST PER $/MMBtu[43]	ANNUAL PERCENT CHANGE	FPL FORECAST MARKET PRICE[44]	ANNUAL PERCENT CHANGE
2015	15.6	11.32%	$3.48	____	$4.02	_____
2016	16.8	23.51%	$3.56	2.30%	$4.30	6.97%
2017	11.3	31.71%	$4.00	12.36%	$4.70	9.30%
2018	8.7	38.03%	$4.40	10.00%	$5.74	22.12%
2019	7.1	43.18%	$4.96	12.73%	$6.03	5.05%
2020	6.1	47.61%	$4.79	-3.43%	$6.13	1.66%
2021	5.3	51.45%	$4.94	3.13%	$6.33	3.26%
2022	4.7	54.86%	$5.08	2.83%	$6.63	4.74%
2023	4.3	57.98%	$5.21	2.56%	$6.73	1.51%
2024	3.9	60.81%	$5.34	2.50%	$7.03	4.46%
TOTAL AT 2064-65	137.8	100%	$12.81[45]	2.70% CAGR	$31.51[46]	4.29% CAGR

[42] Direct Testimony Sam Forrest at Exhibit SF-8, Column B.
[43] *Id.* at Column G
[44] *Id.* at Column H
[45] OPC's 4th Request for POD's, Request No. 12, Attachment 1.
[46] *Id.*

The Woodford Project output is substantial in the early years. For example, by 2018, during which FPL projects the market price will increase by about 22% over the prior year, over a third of total output has been recovered. When asked in discovery to support the 22% projected increase for the period 2017 to 2018, other than the statement that the Company transitioned to a different market price forecasting method during this period, FPL failed to provide a credible economic basis or explanation for the substantial market forecast increase.[47] I do not regard that answer as credible support for such an assumption.

By 2024, the tenth year of the 50-year project, over 60% of the projected output is recovered. Thus, early year forecasts will have a larger impact on project economics. Early year higher output levels also lowers the Woodford Project per unit cost as well. In year 2015 the projected Woodford Project per unit cost of gas is \$3.48. Between 2016 and 2017 when annual output declines from 16.8 Bcf to 11.3 Bcf or (about a 33% decline) Woodford unit cost goes from \$3.56 in 2016 to \$4.00 in 2017 which is a 12.4% increase in Woodford cost. I have included the Woodford per unit cost and percentage changes in Table 2. I also estimated FPL's claimed Woodford Project cost CAGR to be 2.70%.

FPL's forecast of alternative market natural gas prices starts out at \$4.02 for 2015 and increases substantially through 2020. Significantly, during

[47] OPC's 4th Set of Interrogatories Question No. 61.

the early stages of the Woodford Project (2015 through 2020), a period in which *FPL projects substantial market price increases* (about 52.5% increase in the price of natural gas in this period \$4.02 to \$6.13) almost half of the expected total gas recovery from the Woodford Project is accomplished. The remaining 50% of gas expected from the Woodford Project will be recovered over the remaining life of the project. I am aware of no reason or factor impacting gas markets that supports such substantial price changes during the 2015 to 2020 period.

The bottom line is that FPL starts out with a low cost for the Woodford Project compared to FPL's forecast of alternative market prices for natural gas. FPL then estimates that future natural gas market prices will increase at a much faster rate than Woodford Project costs. Under FPL's assumptions the end result of FPL's exercise is a mathematical certainty, Woodford will always cost less in FPL's model. The question that needs to be addressed is whether FPL's assumptions are reasonable and reliable.

Q. HOW SENSITIVE TO CHANGES IN THE PROJECTED MARKET PRICES IS FPL'S CLAIM OF NET BENEFITS TO CUSTOMERS?

A. The amount of benefits is very sensitive to changes in market price assumptions. FPL includes low and high sensitivity analyses for its natural gas market price forecast.[48] When the FPL low natural gas price

[48] Direct Testimony S. Forrest at 37- 38.

sensitivity analysis is combined with a 10% reduction in projected Woodford output, the economics of the entire Woodford Project become negative for consumers during all years of the project.[49] Alternatively, when only future gas prices are lowered and all other FPL assumptions remain the same as FPL has presented, customer net present value savings amount to only $10.3 million over the 50-year life of the project.[50] This low price sensitivity case represents a 90.4% reduction to FPL's base case estimate of $106.9 million of savings. Under this scenario of lower market prices and all other FPL assumptions being correct, customers do not receive cumulative positive net present value benefits from the project until 2037.[51] In other words, all benefits come from the back end of the 50-year project. I have included in Confidential Schedule (DJL-2) a summary of the annual benefits showing that the first year of cumulative customer benefits occur in 2037. This amount of forecast benefit is not worth all the risks being imposed on customers over the 50-year life of the Woodford Project.

Q. WOULD FPL LOSE MONEY IF THE FORECAST OF NATURAL GAS RECOVERY, REVENUE REQUIREMENTS, OR FORECASTS OF FUTURE MARKET NATURAL GAS PRICES IS DIFFERENT FROM THOSE PROJECTED?

A. No. FPL would recover all its operating costs, investment, taxes, and earn

[49] *Id*. at 38.
[50] *Id*.
[51] See Confidential Schedule (DJL-2)

a guaranteed profit no matter how these estimates turn out. As I discuss above, in the scenario where one assumes all of FPL's assumptions are correct except the low natural gas market price forecast assumption is employed, customers would receive a net present value benefit of $10.3 million. FPL will receive added nominal profits of about [redacted] over the project 50-year life. No matter what happens regarding FPL's assumptions, FPL would earn the guaranteed profit through the fuel mechanism.

Q. HAVE YOU REVIEWED OTHER FPL SENSITIVITY CASES?

A. Yes, I have. Another example is the sensitivity case where FPL employs its low market price forecast and its high estimate of Woodford natural gas output. All other FPL assumptions remain as assumed in the Company's projections. FPL concluded that customer net present value benefits from the 50-year project would be $34.1 million.[52] This sensitivity case demonstrates that the projected net benefits for customers would be about 68% lower than FPL's $106.9 million base case projection under these assumptions. What FPL and Mr. Forrest do not say is that consumers must wait until 2020 before net benefits turn positive for customers. I have included Schedule (DJL-3) showing these calculations. Under this sensitivity scenario FPL will earn its guaranteed [redacted] equity return.

[52] Direct Testimony S. Forrest at 38:8-12.

Of course, all of FPL's projections and scenarios depend on the validity of its initial, underlying assumption regarding a favorable relationship between Woodford Project production costs and the market price**.** That assumption is itself not supported by available data.

Q. WHAT DOES HISTORICAL EVIDENCE SHOW REGARDING THE RELATIONSHIP BETWEEN THE WOODFORD SHALE NATURAL GAS PRODUCTION COST AND ACTUAL MARKET PRICES FOR NATURAL GAS?

A. In response to Staff's 2nd Set of Interrogatories, No. 75, FPL provided historical information showing historical cost of production from the Woodford Shale area of Oklahoma versus the historical natural gas market price as measured by the NYMEX Henry Hub. I have included in Table 3 below the historical Woodford costs and actual market gas prices.

TABLE 3[53]

ACTUAL PRODUCTION COST VERSUS ACTUAL MARKET PRICE

	2010	**2011 1H**	**2011 2H**	**2012 1H**	**2012 2H**	**2013 1H**	**2013 2H**
Production Cost	$4.75	$4.96	$4.40	$4.11	$3.87	$4.04	$3.89
NYMEX Henry Hub	$4.39	$4.21	$3.87	$2.48	$3.10	$3.71	$3.59

[53] See Response To Staff 2nd Set of Interrogatories, No. 75.

Table 3 above shows what actually happened in the Woodford Arkoma natural gas region of Oklahoma (the area of interest for FPL's Woodford Project). Based on the above information customers would have paid higher than market costs in 2010 through 2013 if FPL's Woodford Project proposals had been in place during this period. Yet, in the face of this recent negative data FPL projects that its Woodford Project will generate a substantial portion of the benefits to customers from the outset, and asks the Commission to accept its projections as a reason to authorize FPL to recover all its operating costs, investment, taxes, and guaranteed profit no matter how these estimates turn out. Only customers are at risk under the Woodford Project proposal.

Q. HAVE YOU COMPARED FPL'S PROJECTIONS OF SIGNIFICANT NEAR TERM INCREASES IN THE MARKET PRICE OF GAS WITH ANOTHER ESTIMATE OF MARKET SUPPLY AND MARKET PRICES?

A. Yes, I have. The federal Energy Information Agency (EIA) is an objective source of such information. It projects no such significant increases in the market price of gas during 2015-2018. Instead, it forecasts a continuation of the current trajectory of gas supply and no abrupt year over year increases in natural gas prices in the natural gas markets. Based on the EIA's Annual Energy Outlook 2014 ("AEO2014") there is an expected

56% increase in total natural gas production between 2012 and 2040.[54] The largest contributor of this growth in natural gas production comes through increased production of shale gas, which, increases by more than 10 Trillion cubic feet between 2012 and 2040.[55] Natural gas demand by the U.S. electric power industry is expected to grow at about 0.7% annually from 2012-2040.[56]

In terms of forecasts of prices for natural gas, current EIA forecasts indicate a reference case forecast of 3.7% annual price increase through 2040, bounded by a low and high estimate of 3.5% to 4.0%.[57] There are no EIA forecasts supporting the assumption of year-over-year increases as high as 22% by 2018.

Q. IF THE CURRENT EIA REFERENCE CASE NATURAL GAS PRICE FORECAST OF 3.7% ANNUAL INCREASE IS EMPLOYED IN FPL'S WOODFORD PROJECT ECONOMIC EVALUATION, WHAT ARE THE RESULTS?

A. Employing a natural gas price increase rate of 3.7% and applying that price growth rate to FPL's $4.02/ Mcf 2015 estimate starting point, indicates proposed consumer benefits decrease from FPL's claimed $106.9 million (net present value) to about $43.8 million. (See Confidential Schedule DJL-4) Thus, employing the EAI's most current

[54] EIA's Annual Energy Outlook 2014 ("AEO2014") at MT-23
[55] *Id*. Where Tcf equals trillion cubic feet.
[56] *Id.* Reference Case Forecast MT-26
[57] *Id.* At MT-22

reference case analysis for future gas prices, results in reducing FPL's Woodford Project projected economic benefits by approximately 59%, before consideration of any alternative risks and also assuming all of FPL's remaining assumptions and projections regarding the initial relationship of Woodford production costs to market price and projected output are valid.

Q. WHAT IS YOUR CONCLUSION AFTER CONSIDERATION OF EIA'S MOST CURRENT ESTIMATES FOR NATURAL GAS PRODUCTION AND NATURAL GAS PRICE FORECASTS?

A. There appears to be ample evidence of an abundant supply of natural gas in the U.S. projected to supply domestic energy needs well beyond EIA's current forecast horizon of 2040. Moreover, in contrast to FPL's projections of significant increases in market price in the near term, price forecasts of domestic natural gas are below 4% annually in most scenarios. Application of EIA's reference case price forecast of 3.7% annual price increases to FPL's base case proposal results in minimal annual benefits over the expected 50-year project life. Moreover, moreover neither the EIA forecast nor FPL's base case incorporates contingencies to reflect risks and unknowns over the 50-year time horizon.

Q. PLEASE ELABORATE ON WHAT YOU MEAN BY CONTINGENCIES AND THEIR IMPACT ON PROJECT RISK.

A. With any investment comes risk, including known risk and unknown or unforeseeable risk. Certainly, things can happen that we do not expect or predict. That is why contingencies are often built into forecasts and economic projections of the future in order to carefully evaluate certain investments. In this case I have found no contingencies built into FPL's estimates in the current case to reflect possible structural or external changes. Instead, we find the two basic sensitivity analyses regarding gas volume output and market forecast prices discussed earlier. Moreover, no contingency considerations are built into the proposed guidelines that will guide future gas reserve investments. To ignore alternative contingency scenarios would be shortsighted.

Examples of contingencies can be found in basic budgeting and planning for projects where there are a great many unknowns. We often see contingencies included in construction and demolition budgets. For example, nuclear decommissioning expense estimates is a classic example of where regulatory authorities employ contingencies in the estimates for estimating costs and setting rates.

The bottom line is that a reasonable contingency factor can help evaluate whether the base project economics produce sufficient benefits to even consider moving forward, considering the remaining risks and unknowns.

Q. GIVEN THAT THERE IS A GREAT DEAL OF DATA CONCERNING NATURAL GAS RESERVES DRILLING AND EXPLORATION COSTS, IS IT NECESSARY TO EMPLOY CONTINGENCY CONSIDERATIONS?

A. Yes. While it is true that there is substantial historical experience regarding costs associated with gas reserves drilling and exploration, that does not mean a contingency for this long-term 50-year projection should not be employed.

An example of a reason to employ a contingency is the consideration of technology change impacts on future electric demand not only at FPL, but also around the country. This would have an impact on both the utilities' demand and need for natural gas and the future price of natural gas. Innovations and efficiencies built into electric and gas consuming devices have certainly impacted consumer demand over the years. In the natural gas utility distribution business, local gas distribution companies have seen small consumer use per customer decline for a number of years, due in part to improved and more efficient appliances and recognition of conservation efforts.

A forecasted change in the electric utility industry is the cost competitiveness of solar and battery storage distributed generation that would cut into grid consumption and overall utility demand and generation needs. A recent article in Barron's magazine reports that Barclay's Bank announced a downgrade for all electric utility bonds due to viable solar alternatives gaining a cost competitive advantage.[58] Barclays downgraded the entire U.S. utility bond market based on the increasing opportunities to cut "… grid electricity consumption with solar and battery storage."[59] Barclays further recommended that investors move out of utility bonds "… whenever solar-plus-storage is becoming cost competitive, including in Hawaii now, California by 2017, New York and Arizona by 2018, and many other states soon after."[60]

While such technology advances, changes, and large scale severing of ties from the local electric company may be difficult to imagine today, all one need consider is that it wasn't that long ago when most customers were hard wired into the facilities of the rate regulated local telephone provider. But the telephone service has changed dramatically in the past 25 years. One must keep in mind that 25 years is only half the life of the proposed Woodford Project.

Q. IN THE ABSENCE OF SCENARIOS INCORPORATING SUCH EXPLICIT CONTINGENCIES, WHICH ECONOMIC ANALYSIS DO YOU BELIEVE COMES CLOSEST TO MIRRORING THAT PRACTICE?

[58] "Barclays Downgrades Electric Utility Bonds, Sees Viable Solar Competition", Barron's (May 23, 2014)
[59] *Id.*
[60] *Id.*

A. The sensitivity in which FPL combined its low range forecast of annual natural gas market price growth with FPL's lower Woodford Project output assumption would be the best proxy for an analysis that adequately incorporates a provision for decreases in demand from electric providers and the resulting demand decreases in natural gas demand contingencies. Employing FPL's low range market price growth rate in the economic evaluation model with its low output case results in negative net present value savings of ($14.4) million for the Woodford Project. Said differently, this analysis indicates that customers would pay more, not less, than market price for gas obtained from the Woodford Project under these assumptions.

Q. WHAT DO YOU CONCLUDE REGARDING FPL'S ECONOMIC EVALUATION OF THE PROPOSED WOODFORD PROJECT?

A. First, all forecasts will be wrong. The question is whether the forecasts are reliable and reasonable estimates with which to bet customers' future rates, as FPL has proposed. This is because no matter how the forecasts turn out, under the proposal FPL recovers all costs, investments, and profits. Only customers are at risk.

Thus, while actual future values will be different, so long as the relative relationships of these variables remain as estimated the overall conclusions should also hold. But, if one variable — whether costs, output, or market price estimates — should change from the projected relationship assumption then all the conclusions could collapse. The one variable that this Commission should be most concerned about is FPL's or any entity's claim of being able to reasonably forecast a long run estimate of future market natural gas prices. In 1979, the U.S. government proclaimed a natural gas shortage and banned construction of new natural gas generating facilities. Now, in the 2014 forecast the U.S. government estimates an abundant supply of natural gas at historically low prices that is expected to be a primary fuel source for many industries, including the electric generation sector. As I have described, FPL predicts that the market price of gas will increase significantly during the early years of the Woodford Project, including a 22% increase projection for 2018 alone. Given the historical relationship between Woodford production costs and the market price, the economics of the project would look very different without such assumed increases. It is easy for FPL to make such predictions and to ignore contingencies when the Company has zero risk if the predictions fail. FPL actually gains a mechanism to earn a guaranteed profit, no matter how these projections turn out. But the customers have a great deal to lose, with very little upside given the current state of natural gas markets. The bottom line is that FPL's underlying economic analysis of the proposed Woodford Project is unreasonably biased in favor of its proposal. As I have demonstrated, FPL's claim of net benefits dissipates with adjustments to moderate the unrealistic market price increases it projects for the early years of the Woodford Project and to incorporate some recognition of contingencies.

Q. IS THERE A RECENT PRECEDENT THAT YOU REGARD AS A PARALLEL TO THE COMMISSION'S APPRAISAL OF FPL'S SUPPORT FOR THE WOODFORD PROJECT?

A. Yes. FPL's Woodford Project proposal is in many ways analogous to FPL's EnergySecure Pipeline request that the Commission denied in Docket No. 090172-EI.[61] In FPL's EnergySecure transaction proposal, the Company requested Commission approval of need for a 280-mile natural gas transmission pipeline that would be owned and operated by FPL and included in FPL's electric plant rate base, with the costs collected through base rates.[62] In that proceeding, FPL alleged present value savings of $115 million to $400 million which savings, FPL claimed, were "confirmed" by a third party expert.[63]

The Commission ultimately rejected the FPL pipeline proposal. In its Order, the Commission noted that the evidence demonstrated the sensitivity of the analyses when certain assumptions are replaced with reasonable alternatives.[64] It also observed that the risk of overstated demand would be borne, not by FPL, but by its customers.[65] The economic evaluation presented in the present case suffers many of the same infirmities outlined by the Commission in FPL's pipeline case.

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[61] In re: Petition to determine need for Florida EnergySecure Pipeline by Florida Power & Light Company, Docket No. 090172-EI, Order No. PSC-09-0715-FOF-EI (October 28, 2009).
[62] Id. at 2
[63] Id. at 3.
[64] *Id*. at 4-5.
[65] *Id.* at 4.

VI: <u>OVERVIEW OF FPL'S PARTNER IN THE WOODFORD PROJECT PETROQUEST ENERGY, INC.</u>

Q. WHAT ISSUE DO YOU ADDRESS IN THIS SECTION OF YOUR TESTIMONY?

A. In this section I address the business operations and risks of PetroQuest the proposed FPL partner in the Woodford Project. I discuss the PetroQuest natural gas and oil exploration and drilling business and risks, and also show how PetroQuest operations are very different from the utility business. As will be discussed below the PetroQuest exploration and drilling operation is riskier than any FPL electric utility function. Further, PetroQuest's smaller size and scale make PetroQuest riskier than its gas and oil exploration and drilling industry peers. Another important part of this Section is that much of the PetroQuest risk is associated with the unknown of future commodity prices for natural gas and oil. PetroQuest readily acknowledges to its investors its own inability to forecast future market prices and the attendant risk associated with depressed future prices. Thus, unlike FPL, PetroQuest acknowledges that it is not able to forecast future gas prices.

Another important point addressed in this Section is that PetroQuest reduces its risk in a couple of ways by having FPL as a partner in the Woodford Project. PetroQuest shifts a portion of its Project risk to FPL (which FPL proposes to put squarely and entirely on the backs of FPL customers) and PetroQuest receives through the transaction with FPL capital to expand operations and develop reserves. I discuss each of these issues in the following pages.

Q. DESCRIBE THE BUSINESS OPERATIONS AND FINANCIAL RISKS OF FPL'S PROPOSED PROJECT PARTNER PETROQUEST.

A. PetroQuest is not a regulated monopoly, but rather operates in the competitive and more risky oil and gas exploration industry. The business and financial risks faced by PetroQuest are the competitive market risks one finds in the gas and oil exploration, development, and production business.

The corporate profile of PetroQuest is best summarized as an;

> " … independent Energy Company engaged in the exploration, development, acquisition and production of oil and natural gas reserves in Texas, the Arkoma Basin, South Louisiana and the shallow waters of the Gulf of Mexico."[66]

Thus, the PetroQuest business is dependent on the success of gas and oil exploration and production, and the successful sale of gas, gas liquids, and/or oil into the markets at sufficient price and quantity levels to cover its costs and generate a profit.

[66] PetroQuest Energy, Inc., Annual Report at 2, (2013)

In terms of market risks, PetroQuest explicitly recognizes that oil and gas markets are beyond the control of PetroQuest and that it has no ability to assure investors or business partners (such as FPL in this proposed transaction) that PetroQuest will be able to market all of the oil and/or natural gas production, or that favorable market prices can be obtained for the oil and/or natural gas produced.[67]

Q. GIVEN THAT PETROQUEST'S RISKS ARE DETERMINED IN LARGE PART BY FUTURE MARKET PRICES, DOES PETROQUEST PREDICT FUTURE MARKET PRICES?

A. No, it does not. To the contrary PetroQuest cautions investors of its inability to make such estimates and states:

> In view of the many uncertainties affecting the supply and demand for oil, natural gas and refined petroleum products, ***we are unable to predict future oil and natural gas prices*** and demand or the overall effect such prices and demand will have on [PetroQuest][68] (emphasis added)

As discussed earlier, the economic viability of FPL's proposed Woodford Project depends largely that FPL's forecasted 50-year market price will be substantially higher than the expected cost of producing the natural gas from the Woodford Project. FPL's partner, PetroQuest, experienced in the industry and dependent on the natural gas and oil markets, is unable to make such forecasts of the natural gas market. Instead, PetroQuest is willing to say the following about the future of natural gas markets:

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67 *Id.* Attached 10K at 9.
68 *Id* at 9.

> Natural gas continues to supply a significant portion of North America's energy needs and we believe the importance of natural gas in meeting this energy need will continue. The impact of the ongoing economic downturn on natural gas supply and demand fundamentals has resulted in extremely volatile natural gas prices, which is expected to continue.[69]

Thus, PetroQuest, despite its expertise in the exploration, production, and sale of natural gas, is unable to estimate the price levels or even the future direction of such prices.

Q. DOES PETROQUEST IDENTIFY THE RISKS RELATED TO THE GAS AND OIL EXPLORATION AND PRODUCTION BUSINESS AND INDUSTRY?

A. Yes. Again PetroQuest points out that the success or failures of investments in natural gas and oil exploration such as the Woodford Project in this case are dependent "primarily on the prices we receive for our oil and natural gas production."[70] Risk factors identified by PetroQuest include:

(i) Minor changes in the supply or demand for oil and natural gas;

(ii) Condition of the United States and worldwide economies;

(iii) Market uncertainty;

(iv) Level of consumer product demand;

[69] *Id.* at 13.
[70] *Id*. at 19.

(v) Weather conditions in the United States;

(vi) Domestic governmental regulations and taxes; and

(vii) Price and availability of alternate fuels. [71]

The bottom line according to PetroQuest is "[**w]e cannot predict future oil and natural gas prices and such prices may decline**."[72](emphasis added)

Q. HOW DOES PETROQUEST REDUCE ITS RISK?

A. One approach is to enter joint development agreements ("JDA's") by selling off an interest in various projects- such as the Woodford Project FPL has presented to the Commission in this case. On this strategy PetroQuest states the following:

> As a result of the impact of low natural gas prices on our revenues and cash flow, we have focused on growing our reserves and production through a balanced drilling budget *with an increased emphasis on growing our oil and natural gas liquids production*. In May 2010, we entered into the Woodford joint development Agreement **("JDA")[73] which provided us with $85 million in cash during 2010 and 2011, along with a drilling carry that we have utilized since May 2010 to enhance economic returns by reducing our share of capital expenditures in the Woodford Shale--- During February 2012 we amended the JDA---** Under the amended JDA, the Phase 2 drilling

[71] *Id*.
[72] *Id.* at 20.
[73] The JDA mentioned in this quotation is between PetroQuest and another NextEra affiliate. It is not the contract between USG and PetroQuest which is confidential and which I identify as "DDA" in later paragraphs.

> carry was expanded to provide **for development in both the** Mississippian Lime and **Woodford Shale plays** whereby **we will pay 25% of the cost to drill and complete wells and receive a 50% ownership** interest.[74] (emphasis added)

Thus, risk shifting agreements such as the JDA for the Woodford Shale reduce PetroQuest's risk, reduces PetroQuest's investments, and provide it with liquidity and capital by limiting its capital outlays relative to overall cost, while still providing PetroQuest significant output entitlements.

In terms of the impact of the JDA's on its operations, PetroQuest states:

> As a result of the Woodford JDA and the success of our drilling programs, we have grown our estimated proved reserves by 18% and production by 10% since 2010, while maintaining our long-term debt 28% below 2008 levels.[75]

The bottom-line impact for PetroQuest resulting from entering into JDA's with Next Era Energy Resources, LLC subsidiaries such as WSGP Gas Producing LLC ("WSGP") is increased liquidity, lower risks, and lower exposure to market price declines.

It is important to note that the Drilling and Development Agreement ("DDA") that is the subject of FPL's proposal in this proceeding requires that PetroQuest pay [redacted] of drilling cost in return for [redacted] of the output entitlements.[76] This limits the PetroQuest investment risks to [redacted] and fits perfectly with the PetroQuest claimed strategy of pursuing with increased emphasis *oil and natural gas liquids production* while

[74] PetroQuest Energy, Inc., Annual Report, (2013) Attached 10K at 5.
[75] PetroQuest Energy, Inc., Annual Report 2012, 10K Attachment at 4.
[76] Direct Testimony S. Forrest at Exhibit SF-6, page 3.

growing reserves.[77] As discussed below the Woodford Project area of interest contains relatively low quantities of oil or natural gas liquids; therefore, because low natural gas prices are expected to continue, most gas and oil exploration firms – including PetroQuest – are pursuing more profitable alternative ventures containing higher ratios of oil and natural gas liquids.

Q. IS THERE MARKET EVIDENCE THAT GAS AND OIL EXPLORATION AND DRILLING FIRMS ARE REDUCING ACTIVITIES IN THE WOODFORD SHALE DUE TO LOW NATURAL GAS PRICES AND PURSUING MORE PROFITABLE EXPLORATION AND DRILLING OPPORTUNITIES?

A. Yes. To my knowledge other large and small gas and oil firms engaged in exploration and drilling activities in the area do not have a group of utility customers to whom they have shifted the drilling and exploration risk, and so must bear the market risk. The current natural gas market drilling evaluation of the Arkoma-Woodford area is as follows:

> At one point in 2008, there were more than 50 drilling rigs working the Arkoma-Woodford, but low prices, especially relative to crude oil and NGL prices, have all but choked off investment in the region. Most publicly traded companies barely even mention the play in their investor relation presentations anymore, and rig activity in the Arkoma-Woodford has slowed to a near standstill.[78]

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[77] PetroQuest Energy, Inc., Annual Report 2013, Attached 10K at 5.
[78] North American Shale and Resource Plays Fact Book, Natural Gas Intelligence 2014 .

I have included in my Exhibit (Schedule DJL-5) a summary from the North American Shale 2014 Fact Book that addresses the Woodford Project area.

The other firms involved in the drilling and gas exploration business that likely do not have the regulatory guarantees like FPL, or regulatory related risk shifting contracts like the FPL/PetroQuest Agreement, view the Arkoma-Woodford natural gas drilling opportunities as less profitable than other drilling ventures. Continued low natural gas prices could well explain why other competitive market firms in the Arkoma-Woodford area are at a basic drilling *standstill* at the present time.

Thus, the market information suggests that drilling should be delayed, as more profitable opportunities can be found elsewhere. But, FPL's proposed Woodford Project with all its regulatory guarantees, ignores the competitive market price signals and FPL never explains why customers should bear the risk that competitive firms are avoiding.

Q. ARE THE OTHER FIRMS IN THE ARKOMA-WOODFORD REGION POTENTIALLY LARGE PLAYERS IN TERMS OF DRILLING ACREAGE?

A. Yes. The following table summarizes net acreage holdings for the Arkoma-Woodford shale area.

TABLE 4[79]

Arkoma-Woodford Shale

ExxonMobile	**385,000**
BP	**160,000**
Newfield Exploration	**90,000**
Vanguard Natural Resources	**66,000**
PetroQuest	**60,000**
Cinco Resources	**40,000**
Continental Resources	**33,000**
Panhandle Oil & Gas	**26,291**

As can be seen in the above table there are a number of large participants in the Arkoma-Woodford region that are not as optimistic as FPL given current market conditions.

Q. DOES PETROQUEST RECOGNIZE THE RISK INHERENT IN THE DRILLING OPERATIONS ASSOCIATED WITH THE IMPACT OF FUTURE MARKET PRICES FOR NATURAL GAS?

A. Yes. PetroQuest identifies market prices for natural gas and oil as a determinant of profitability and risk that impacts PetroQuest as an investment.[80] In terms of oil and natural gas market price risk on the PetroQuest operations, the 2013 PetroQuest Annual Report states the following:

> **Oil and natural gas prices are volatile, and an extended decline in the prices of oil and natural gas would likely have a material adverse effect on our**

[79] Natural Gas Intelligence, NGI's North American Shale & Resources Plays Factbook at 31 (2014)

[80] PetroQuest Energy, Inc. 2013 Annual Report, Attached 10K at 9.

> **financial condition, liquidity, ability to meet our financial obligations and results of operations.**[81] (Emphasis in original.)

PetroQuest goes on to state more specific risk impacts:

> Our future financial condition, revenues, results of operations, profitability and future growth, and the carrying value of our oil and natural gas properties depend primarily on the prices we receive for our oil and natural gas production. Our ability to maintain or increase our borrowing capacity and to obtain additional capital on attractive terms also substantially depends upon oil and natural gas prices. … **The prices we will receive for our production, and the levels of our production, will depend on numerous factors beyond our control**.[82](emphasis added)

Some of the factors influencing oil and natural gas market prices enumerated by PetroQuest include the following:

> … relatively minor changes in the supply of or the demand for oil and natural gas; the condition of the United States and worldwide economies; and market uncertainty.[83]

The bottom line is that market price of oil and natural gas is the key driver in terms of success for oil and natural gas exploration and production companies like PetroQuest. Market forces and influences whose predictability is commonly wrought with error determine these market prices.

PetroQuest recognizes the inability to predict future market natural gas and/or oil prices when it states:

> **We cannot predict future oil and natural gas prices and such prices may decline.** An extended decline in

[81] *Id*. at 19.
[82] *Id.*
[83] *Id*.

> oil and natural gas prices may adversely affect our financial condition, liquidity, ability to meet our financial obligations and results of operations. Lower prices have reduced and may further reduce the amount of oil and natural gas that we can produce economically and has required and may require additional ceiling test write-downs and may cause our estimated proved reserves at December 31, 2014 to decline compared to our estimated proved reserves at December 31, 2013.[84](emphasis added)

PetroQuest makes clear to its investors that PetroQuest is not able to predict future market prices. This inability to predict future market prices is a significant risk factor in the oil and natural gas and exploration industry.

Q. HOW DOES THE JOINT VENTURE WITH FPL AFFECT PETROQUEST'S RISK PROFILE?

A. The deal that PetroQuest struck with FPL would allow PetroQuest to make [redacted] of the investment, but retain [redacted] of the gas output.[85] PetroQuest has made clear to its investors that 50% of the entire CAPEX budget will be allocated to the Woodford Shale targeting liquids rich gas.[86] Further, PetroQuest tells its investors it has managed risk exposure in the following manner:

> We plan to continue several strategies designed to mitigate our operating risks. We have adjusted the working interest we are willing to hold based on the risk level and cost exposure of each project. For example, *we typically reduce our working interests in higher risk exploration projects* while retaining greater working interests in lower risk development projects. **Our partners often agree to pay a disproportionate**

[84] *Id*. at 20.
[85] Direct Testimony Sam Forrest at Confidential Exhibit SF-6.
[86] PetroQuest Energy, Inc. 2013 Annual Report, Attached 10K at 8.

> **share of drilling costs relative to their interests, allowing us to allocate our capital spending to maximize our return and reduce the inherent risk in exploration and development activities**.[87] (emphasis added)

PetroQuest benefits by shifting the investment risk relative to its entitlements and freeing up capital for other investments, which provides an opportunity to maximize its return while reducing the inherent risk in exploration and development activities. The risk PetroQuest avoids is shifted through FPL down to FPL customers.

Q. PLEASE SUMMARIZE YOUR APPRAISAL OF PETROQUEST AND THE RISKS OF THE PROPOSED WOODFORD PROJECT.

A. PetroQuest is a small firm involved in the risky and competitive natural gas and oil exploration and drilling business. PetroQuest's bond rating is below investment grade at single B relative to FPL's current investment grade bond rating of single A.[88] PetroQuest's most recent borrowing cost was at 10%, while FPL's current debt interest cost would be less than half of the recent PetroQuest cost.[89]

PetroQuest's current strategy and business plan for the Woodford shale area is to shift the risk of drilling to FPL (and ultimately FPL customers) through the DDA which require PetroQuest to pay [redacted] of drilling expenditures but retain the right to [redacted] of output entitlements.

[87] *Id*. at 6.
[88] See AUS Utility Reports (August 2014) also see FPL Response to Staff 2nd Request for POD's, No. 4.
[89] PetroQuest Energy, Inc. 2013 Annual Report, Attached 10K at 6.

PetroQuest claims it will focus one half of its capital budget to the strategy of seeking liquid rich natural gas. PetroQuest's short-run strategy is to capitalize on this risk shifting to FPL. While PetroQuest readily acknowledges it cannot predict future market prices, the cost and risk shifting through the JDA's and in this case the DDA provides PetroQuest the necessary protections and incentives to allocate 50% of its capital budget to areas of liquid rich natural gas.

Q. UNDER THE WOODFORD PROPOSAL IN THIS CASE, WILL FPL BEAR THE MARKET RISK, PRICE RISK, ENVIRONMENTAL RISK, OR ANY OTHER RISK ASSOCIATED WITH AN OWNERSHIP INTEREST IN THE WOODFORD SHALE GAS PROJECT?

A. No, it will not. Under FPL's Woodford Project proposal all costs and risks associated the Woodford Project are shifted to FPL customers. FPL customers are expected to incur the following risks:

- Future market prices are less than projected by FPL;
- Future natural gas demand changes;
- Future environmental costs not factored into the Woodford Project costs;
- Future operating and maintenance costs are different than estimated by FPL;

- Future output and reserve levels are different than forecasted by FPL;
- Future capital cost requirements are different than projected by FPL; and
- Future federal and state regulatory requirements and obligations are different that forecasted by FPL.

All of these risk factors can significantly alter the economics of the proposed project are risks that the customers not FPL will bear under the Company's Proposal.

The end result of this proposal would that the risk of natural gas exploration, drilling, and recovery that is typically incurred by market participants such as PetroQuest, is now being shifted by PetroQuest through FPL and/or its affiliate, directly to FPL's customers. All capital cost for drilling or exploration at or over budget is shifted to customers. All operating costs risks at or above budget are shifted to customers. All risk associated with maximizing gas recovery is shifted to customer. Free markets will no longer dictate customer obligation through the fuel clause. Instead, the customer-borne costs would be a function of the specific risks faced by PetroQuest at each well and drilling site included in the project.

Q. EARLIER, YOU INDICATED FPL'S PETITION COULD HAVE NEGATIVE POLICY IMPLICATIONS THAT WOULD PROVIDE INCENTIVES TO FPL TO DISREGARD THE DISCIPLINE OF THE COMPETITIVE MARKET IN A WAY THAT COULD NEGATIVELY AFFECT CUSTOMERS. DOES YOUR DISCUSSION OF THE RISKS FACED BY FPL, PETROQUEST, AND OTHER DRILLERS IN THE WOODFORD AREA ILLUSTRATE YOUR POINT?

A. Yes. FPL in its Petition asks the Commission to guarantee full cost recovery and fully guarantee profits no matter the market price for which the natural gas products can be sold in the market place, or the amount of gas ultimately produced. By having the Florida Commission authorize FPL to direct all Woodford Project entitlements to its Florida generation and requiring FPL customers to pay all Woodford Project operating cost, investment cost, and profits on investment no matter the amount of gas or the alternative market price, FPL would have a risk free investment opportunity. For example, under FPL's Woodford Project proposal and assumptions (if correct) the Company is guaranteed about [redacted] of additional profit for shareholders.[90] Other investors in the competitive gas exploration business that do not have a regulatory guarantee or risk free opportunity to extract natural gas and oil products from the Woodford Shale area would have to factor market data into a decision to produce or not to produce.

[90] See FPL Confidential Response to OPC 3rd Question 37(c). Also see Confidential Response to OPC 4th Request for POD's, Request No. 12, Attachment 1.

Reports discussed earlier indicate that natural gas drilling in the Arkoma-Woodford area is at a standstill. The other firms involved in the drilling and gas exploration business have responded to low market natural gas prices relative to oil or natural gas liquids alternatives by slowing or ceasing drilling in the Arkoma-Woodford natural gas area. PetroQuest reports that it will target natural gas rich in liquids. The market information suggests that drilling should be delayed as more profitable opportunities can be found elsewhere. However, when FPL looks at the risks of gas drilling in the Arkoma-Woodford region it sees no corporate risk, as it would be guaranteed full cost recovery and a 10.5% return on investment. FPL says that if its Petition is granted drilling should commence immediately in January 2015. The sooner drilling starts and investment is made by FPL, the sooner the Company can begin earning a no risk, guaranteed 10.5% equity return on investment. I believe this is evidence of how the ability to shift risk to customers through the granting of FPL's Petition and the operation of the Fuel Clause could affect FPL's (or any utility's) approach to entering the risky gas production business and ultimately increase the costs borne by customers.

VII: UTILITY DIVERSIFICATION STRATEGIES AND FAILURES

Q. WHAT ISSUES WILL YOU ADDRESS IN THIS SECTION OF YOUR TESTIMONY?

A. In this Section of my testimony I discuss electric utility diversification strategies and failures. Given that FPL's proposed Woodford Project is a business diversification outside the monopoly core business of electric generation, transmission and distribution, it is important to visit some historical lessons learned regarding electric utility diversification and potential impacts on customers.

Q. PLEASE GENERALLY DESCRIBE PAST DIVERSIFICATION EFFORTS BY UTILITIES.

A. There is a long history of utility diversification efforts in the utility industry. A number of these ventures outside the core utility generation and delivery business led to disastrous financial results, a number of which negatively impacted customers.

One period in which utility diversification efforts accelerated was the early and mid-1980's following large construction programs and the inclusion of expensive nuclear facilities in rates. Utilities had new and higher cash flows through higher rates, but lower capital expansion needs. Some utilities saw opportunities to enter alternative utility and non-core utility business ventures as a means of increasing shareholder earnings. These diversification ventures ranged from purchasing foreign utility operations, to domestic real estate, banking, and insurance operations. Many of these ventures did not end well for the utility or its customers.

One example of a failed diversification strategy is El Paso Electric Company ("El Paso"). In the mid-1980's, El Paso employed a portion of the proceeds from the sale and leaseback of its ownership share of Palo Verde Nuclear Units 2 and 3 to invest in a range of non-utility businesses. The initiative failed miserably. The Value Line Investment Survey assessment of El Paso's tragic diversification effort stated:

> El Paso Electric has completed the sale of its non-utility holdings. The company's diversified ventures included the purchase of a hotel and two office buildings in downtown El Paso as well as investments in specialty steel products manufacturing unit and in a savings and loan association. None of these enterprises ever contributed to corporate net. In fact, losses from these pursuits drained much needed capital from the utility operations. With the sale and the writeoffs of these investments behind the company, management can now focus its attention on shoring up its core electric business.[91]

El Paso Electric ultimately ended up filing for bankruptcy protection in January 1992. While the diversification investments (real estate and banking) seemed reasonably safe at the time they were made all investments entail risk and sometimes that risk impacts customers.

A similar example of diversification gone badly is FPL's purchase of Colonial Penn Life Insurance Company in 1985. In "Billion Dollar Lessons," a book about what you can learn from the most inexcusable business failures, the authors describe how in 1985 FPL paid $565 million for Colonial Penn Life Insurance Company, which price represented a

[91] Value Line Investment Survey of April 20, 1990.

50% premium over Colonial Penn's book value.[92] While Wall Street initially applauded the diversification, FPL ended up selling Colonial Penn in "1991 for $128 million" taking "a $629 million write-off."[93] The authors quote then FPL chairman James L. Broadhead as stating; "[n]ow it's time to focus efforts on the utility."[94]

Q. HOW DOES FPL'S PETITION DIFFER FROM THE PAST EXAMPLES OF DIVERSIFICATION EFFORTS THAT YOU HAVE MENTIONED?

A. In the above examples, the utilities simply used the cash flow of the utility operation to springboard their way into nonutility ventures. If these nonutility ventures failed, the losses were reflected on their financial statements and absorbed by their shareholders. In this case, FPL's diversification strategy is an opportunity for the Company to guarantee recovery of all the diversification investment, operating costs, and return. FPL's diversification strategy also creates new capital investment opportunities for the future with guaranteed profit levels. On the other hand, all the diversification risks bearing on the success or failure of these gas exploration and drilling investments are placed solely on customers. Thus, if the Woodford Project is approved as proposed all the risk associated with diversification failure falls on consumers. FPL's

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[92] Carroll, Paul & Mui, Chunka, "*Billion Dollar Lessons*" (2008) at 136-137.
[93] Id at 137.
[94] Id.

shareholders would have zero diversification risk under the Woodford Project proposal.

It would appear historical lessons regarding the risk of diversification to its shareholders have been learned by FPL, as the Woodford Project proposal guarantees cost recovery, investment recovery, and profits. FPL cannot lose under this diversification effort. Only FPL customers can lose under FPL's risk shifting proposal.

The key lesson that should have been learned from the history of diversification is that when utilities venture outside their core business areas bad results can happen that should not be allowed to affect customers. This is true in areas presumed to be of conservative or low risk such as real estate, banking, and even life insurance whose primary market was the elderly. It certainly should be true of diversification into risky oil and gas exploration, which has the potential to have very negative results.

Q. FPL'S WOODFORD PROJECT PROPOSAL DIVERSIFIES ACTIVITIES TO THE NATURAL GAS FUEL AREA. GIVEN THAT NATURAL GAS IS ESSENTIAL TO FPL'S PRODUCTION OF ELECTRICITY, DOES THIS LEAD TO A LESS RISKY DIVERSIFICATION?

A. No. While it is true gas and oil reserve ownership, exploration, and drilling operations are quite different from investments in real estate, banking, or insurance, FPL is not in the gas exploration, drilling, and production business and risks – some of them currently unknown – could impact these operations. FPL acknowledges that even the accounting requirements in this new business are so specialized and different from utility accounting that the Company must retain a third party that specializes in this accounting area to keep the books.[95] Thus, the fact that natural gas fuel is used in the utility business and purchased in large quantities by FPL does not mean the Company is prepared or qualified to be in the natural gas exploration and drilling business. I am sure FPL, like many corporations, purchased property insurance and life insurance for many years prior to the purchase of Colonial Penn Life Insurance, but those past insurance purchases didn't help mitigate FPL's problems of owning Colonial Penn. The end result is that being a purchaser of services, even a large purchaser, does not mitigate the risks associated with owning the business, or mean it is prudent to take on the risks of a new business.

Q. WHAT ARE THE POTENTIAL FINANCIAL IMPACTS AND CONSEQUENCES OF THE WOODFORD PROJECT DIVERSIFICATION ON FPL'S BASE RATES?

A. FPL's diversification into gas reserve ownership requires that the Company finance these purchases. Thus, FPL will be required to employ debt and equity capital to make these investments. Such investments in

[95] Direct Testimony Kim Ousdahl at 6:7-13.

gas reserve projects require that debt and equity capital beyond FPL's typical levels and amounts of capital expenditures be employed; increasing annual debt and equity return requirements. If the Commission were to approve the guaranteed recovery through the fuel clause mechanism such debt and equity obligations, if recovered immediately, should not result in harm or a strain to FPL's financial metrics, but might strain FPL's customers' budgets. Also, capital available to FPL is not infinite. Capital that goes to fund oil and gas ventures would not be available to fund FPL's utility business generation, transmission, and distribution requirements.

VIII: <u>FPL'S PROPOSED WOODFORD PROJECT GUIDELINES</u>

Q. WHAT ISSUE(S) ARE YOU ADDRESSING IN THIS SECTION OF YOUR TESTIMONY?

A. In this section I address FPL's proposed Woodford Project Guidelines for future natural gas and/or oil exploration and drilling. The Company has presented a set of Guidelines, which if approved, would form the basis, and circumstances for future Woodford Project-like transactions. FPL claims a need for such guidelines because such future transaction opportunities must be acted upon quickly without time for a rate filing Commission consideration and decision. FPL further asserts that such Guidelines are necessary because it is "… essential that a process be established so that FPL will be able to make decisions on the projects with confidence regarding their recoverability."[96]

Through its proposed Guidelines FPL seeks assurance that future gas exploration joint ventures will be deemed eligible for recovery through the Fuel Clause.[97]

Q. PLEASE COMMENT ON FPL'S PROPOSED GUIDELINES FOR FUTURE GAS RESERVE TRANSACTIONS.

A. Guideline I. entitled "Scope of Gas Reserve Project Participation." addresses the maximum portion of FPL's average daily natural gas burn that can come from gas reserve projects. This Guideline generally serves as a limit on gas investment in Woodford type projects in an effort to maintain diversity between gas market purchases from third parties and gas reserve investments. The problem is that it does not serve as much of a limitation. For example, applying this "limitation" guideline the 2017 gas reserve projects limit of a maximum 25%[98] of FPL's average daily burn is a huge number – about seven times the Woodford Project level. These are significant investments whose economic viability relies entirely on the relative accuracy of the forecast of the future market price alternative. One only needs to look at Guideline 1.D and find that FPL's proposed gas

[96] FPL Application at 8.
[97] Id at 25, paragraph 55.
[98] Direct Testimony S. Forrest Exhibit-SF-9.

reserve project investment limit is an astounding $750 million per year.[99] After a few years of active participation in the exploration and drilling business FPL could easily find an added $2 billion investment and earn an additional $125 million per year of profit.[100] Given that FPL has no risks, the Company has every incentive to maximize investment and guaranteed profits. Investing the maximum of $750 million per year results in an additional $47 million per year of guaranteed profit for FPL.[101] The only consumer protection this guideline provides is to limit how much in guaranteed profits FPL can earn in a given year, consumers` bear all project risks and all market risks.

Q. DESCRIBE FPL'S SECOND PROPOSED GUIDELINE "CUSTOMER SAVINGS".

A. FPL's second guideline limits project prudence challenges on future investments to whether a project showed net present value savings "… relying solely on information … available to FPL at the time the transaction was entered, including the use of an independent third party reserve engineering report and FPL's standard fuel price forecasting methodology."[102] Based on this guideline, so long as FPL files testimony consistent with the approaches and general findings in this case, so long as there is just one dollar of consumer net present value savings (no matter

[99] Direct Testimony S. Forrest Exhibit-SF-9.
[100] $2 billion times equity return of (59.6% * 10.5%)
[101] [$750] million times equity return of (59.6% * 10.5%)
[102] Direct Testimony S. Forrest Exhibit-SF-9.

when such savings occur in the project) the Commission must find the investment prudent.

There is no balancing of the equities in these gas reserve investment proposals. FPL's no risk investments can produce hundreds of millions of dollars of added shareholder profits, but so long as FPL projects that consumers receive a single dollar of projected net present value savings the project would be deemed prudent and pass the guideline test. Such an approach or guideline is not fair, or equitable, or a consumer protection.

Q. DESCRIBE GUIDELINE IV "CHARACTERISTICS OF GAS RESERVES".

A. This guideline addresses projects where there are opportunities for oil and natural gas liquids ("NGL's") extraction. FPL proposes to sell off at market NGL's and oil produced and credit project revenue requirements with these revenues. The economic value of these NGL's and oil products will be taken into consideration when evaluating the economic viability of the project. Under this guideline customers must take on the additional risk that oil markets and NGL markets perform as projected by FPL. While FPL again has no risk in the added oil and NGL market and FPL will be guaranteed cost recovery and profit, a project's net present value savings may come down to future market performance of oil or NGL's. This Guideline adds more, not less, risk to customers by expanding the risk free investments FPL may make. This again is not a consumer protection. It actually adds risks to consumers.

Q. PLEASE SUMMARIZE YOUR TESTIMONY ON FPL'S PROPOSED GUIDELINES.

A. If the Commission declines to accept FPL's proposal then the Guideline issue is moot. With respect to FPL's proposed Guidelines, as I discuss above they essentially add more risk to consumers and guarantee profit opportunities to FPL. The Guideline proposals are one-sided, favoring FPL at every opportunity with no real equity for customers. FPL can only promise not guarantee savings based on projections that may or may not materialize. However, approval of FPL's Guidelines would assure full cost recovery and locked-in shareholder profits.

Q. DO YOU BELIEVE GUIDELINES ARE NECESSARY?

A. No, I do not. To the contrary, the Commission has stated that proposals to pass capital investments through the fuel clause must be brought on a case-by-case basis.[103] If the Commission were to decide to accept the Woodford Project, I recommend that all future gas reserve opportunities be addressed on a case-by-case basis.

FPL claims Guidelines are necessary because counterparties in the gas reserve market are unwilling to wait for standard regulatory approvals to

[103] Docket No. 100404-EI, Order No. PSC-11-0080-PAA-EI, at 7-8 (January 2011).

execute an agreement. FPL further claims counterparties are looking for definitive start dates to begin or continue drilling "… and cannot wait more than a month or two as market prices fluctuate."[104] This Commission should take caution from FPL's claim. If gas reserve market participants must act within a month or two month window **as market prices fluctuate,** why would this Commission or any regulator consider the Woodford Project or any future gas reserve investment where the economic viability rests primarily on a 50-year forecast of market prices, and more than a two-month delay may change the economics of the deal?

For all the above reasons, I recommend rejection of FPL's proposed Guidelines.

IX: <u>CONCLUSIONS AND RECOMMENDATIONS</u>

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS REGARDING FPL'S REQUESTED APPLICATION FOR COST RECOVERY OF THE WOODFORD PROJECT GAS RESERVES OWNERSHIP PROPOSAL.

A. I recommend that the Commission deny FPL's requested Woodford Project proposal for the reasons outlined below.

1. FPL's proposed gas exploration, drilling, production joint ventures are not regulated utility services. Rather, they constitute

[104] FPL Petition at 24, paragraph 53.

an effort to participate in an unregulated, nonutility industry that is characterized by a high degree of competition and the risks that accompany that competition. The Commission has no oversight authority to regulate the currently proposed Woodford Project gas exploration venture in Oklahoma or the potential numerous future unknown ventures subject to the FPL proposed Guidelines. The FPL Woodford Project proposal is merely a corporate diversification proposal in which all the risks of entering a competitive business are transferred to FPL's customers and FPL's shareholders are guaranteed rewards with no risk.

2. The FPL Woodford Project joint venture proposal does not satisfy the basic criteria established in past Commission fuel clause decisions and precedents that govern the limited circumstances in which a utility may flow base rate costs and capital investment through the Fuel Clause.

3. The assumptions and projections underlying FPL's prediction of net benefits to customers are unreasonable and/or unrealistic. When risks are identified and accounted for, it is clear that imposing those risks on customers for the purpose of assuring FPL's profitable venture into the unregulated gas exploration business would be grossly inequitable to customers.

4. FPL’s proposed guidelines for future ventures are designed to provide profits, not protect customers. They are not consistent with sound ratemaking or Commission precedent.

5. If the Commission were to grant FPL’s Petition, the Commission would be guaranteeing FPL’s shareholders risk-free profits on the Woodford Project for the next 50 years, as well as risk free profits on other gas exploration, drilling, and possibly including fracking projects under FPL’s proposed guidelines. At the same time, as a result of such a decision FPL’s customers would be required to become involuntary investors in risky gas exploration, drilling, and fracking projects.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BY MR. SAYLER:

Q Mr. Lawton, would you please summarize your testimony for the commissioners?

A Sure. Thank you and good morning, Mr. Chairman and Commissioners. My name is Daniel Lawton, I'm here on behalf of the Office of Public Counsel, and I thank you to start with for giving me the opportunity to speak on this issue this morning on behalf of my client.

My testimony in this case addresses three primary issues. First I talk about regulatory policy issues involved in the Woodford Project. Second I talk about risk issues among the players in the risk or stakeholders in the Woodford Project, the risk to PetroQuest, to FPL, and ultimately to customers. And in addition to that, I talk about the economic evaluation of the Woodford Project and where some problems may possibly be found in that economic evaluation.

In terms of the regulatory issues, I primarily focus on the Fuel Clause that this Commission has implemented over the years, including the exceptions to the Fuel Clause that were talked about by a number of witnesses, and what I point out is particularly at page 18 of my testimony, that it appears that the Woodford Project does not comport with the Fuel Clause in the exceptions in terms of the precedent that's laid out by this Commission in numerous cases under the Order 14456.

In addition, I also talk about that the Woodford Project, in terms of a Fuel Clause exception, appears to be quite different in terms of scope and size than other kinds of Fuel Clause exceptions, and I talk about that in my testimony when I discuss the Scherer rail car kind of exception.

Now, this Commission as guardian of all costs that consumers pay is the guardian of the Fuel Clause and I point out that if the Commission adopts the Woodford proposal and changes the approach to the Fuel Clause, I point out in my testimony that the first thing that's going to happen is every utility in Florida is going to knock on your door and say we want this as well.

And the reason is because my analysis indicates what we're setting up here through the Fuel Clause and the Woodford Project is more of a new earnings platform for utilities and shareholders.

Now, the second part of my testimony, I address the risk to the stakeholders, and who are the stakeholders. Well, every transaction many times has winners and losers and we can look through the evidence in this case -- and I have done it in my testimony -- find out who are the winners, who are the losers.

The first party or stakeholder is PetroQuest. They own and operate gas exploration business. They are the Woodford Shale original investors. And what they have done is they have passed 100 percent of the risk on to FPL. They told their shareholders -- they being PetroQuest -- we have risky projects, what we do is we pass those risks on to other counter-parties through joint development agreements, and in this case it's FPL, and then they pursue -- they being PetroQuest -- other ventures.

FPL takes 100 percent of the risk and passes it on to customers. They now have an opportunity to earn a profit on their fuel costs, so they are winners.

Customers will bear the risk, they get all the risk, and the bottom line is they have to rely upon FPL's bet that they can beat the market. They being we forecast that the market price will always for the next 50 years be higher than the cost of production at Woodford.

Many people have tried to beat the market over the years and they have failed. You just don't beat the market in the long run. You can do it in the short run, but in the long run, it just doesn't seem to work out.

Lastly I talk about economic analysis. I think the company's forecast is flawed. I point that out in my testimony. The historical data from Woodford provided by the company in discovery in this case shows Woodford is more expensive than the market.

And it looks like my time is -- oh, 30 seconds, I'll wrap it up.

And the forecasted materials presented by FPL also appear to be flawed and they are not consistent with other good market forecasts and if you use reasonable estimates, you'll find that the savings either go away or become negative for a number of years.

For all those reasons, I ask that the Commission deny FPL's proposals. And my light's out.

MR. SAYLER: Mr. Chairman, the Office of Public Counsel tenders Mr. Lawton for cross.

CHAIRMAN GRAHAM: Okay. Retail Federation and FIPUG, any non-friendly cross?

MR. MOYLE: FIPUG doesn't have any questions.

CHAIRMAN GRAHAM: Okay, Florida Power &

Light.

MR. GUYTON: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. GUYTON:

Q Mr. Lawton, my name is Charlie Guyton, I do have a few questions for you this morning.

Good morning.

A Good morning, Mr. Guyton. I think I remember you from last time I was here.

Q I seem to recall that as well. Welcome back to Tallahassee.

Mr. Lawton, let's -- before we start butting heads, let's see if we can agree on a few things.

A Sure.

Q Can we agree that FPL relies heavily on natural gas to fuel its electric generation?

A Yes.

Q And can we agree that FPL projects that it will generate approximately 65 percent of its electricity from natural gas in the future?

A I haven't done the analysis, but I have seen FPL's presentation and I have no reason to dispute that number so, yes, I could agree with that.

Q And can we agree that in 2013, FPL used 550 billion cubic feet of natural gas to generate

electricity, substantially more than any other investor owned utility in the country?

A More in absolute volume or as a percentage of fuels? I'm not -- your question is somewhat vague and I want to be clear.

Q A greater volume.

A In terms of volumes, that may be and probably is so. As a matter of fact, I think the volumes are going to go up to 600 billion cubic feet.

Q And can we agree that in 2015, FPL projects it will use 567 billion cubic feet of natural gas to generate electricity?

A I believe I saw that number. I asked for, in a discovery request, I think I asked for a few years going forward and it sounds about right.

Q Can we agree that that 567 billion cubic feet of natural gas that's projected to be used in 2015 would cost just over $2.9 billion, all of which would be passed on to FPL's customers?

A Well, I don't know what the costs will be. You have estimated $2.9 billion. If you give me a moment.

The cost seems a little bit high. I'm estimating roughly $5.11 in MCF, based on the numbers you have just gave me, and that certainly seems a little high.

Q Would you accept, subject to check, that the Commission approved a stipulation that not only FPL, but OPC entered into, that 567 billion cubic feet of natural gas in 2015 would cost just over $2.9 million?

A 2.9 billion.

Q Billion, thank you.

A Yes, sir. The Commission -- you know, the stipulation certainly speaks for itself. I mean, if the Commission accepts it, I can accept that.

Q Okay. Can we also agree that the price volatility of natural gas is a significant risk to FPL's customers?

A Today?

Q Yes.

A Is there a time frame? Today I would say no relative to past.

Q And can we agree that the price volatility of natural gas is a significant risk to FPL's customers in the future?

A Based on the latest forecasts and production estimates, the answer to that would also be no relative to the past. The volatility is less of a problem. That's why many utility commissions around the country are eliminating financial hedging from utilities, because the volatility is not as much of a problem.

Q Well, let's look at it in this perspective. Let's look at the $2.9 billion that's forecasted to be spent by FPL in 2015.

A Okay.

Q If the price of natural gas were to increase by 10 percent, that would be a cost increase to FPL's customers of $290 million, would it not?

A Yes, a 10 percent increase. And a 10 percent decrease would be a $290 million decrease to consumers.

Q Would you agree that that's a significant risk to FPL's customers, $290 million?

A 290 million is a risk to anybody.

Q Can we agree that long term fixed price physical supply contracts for natural gas are not readily available to FPL?

A They are not readily available to FPL or anybody else in terms of long term fixed prices. That kind of process ended in the seventies and early eighties.

Q And can we also agree that a gas supplier that attempted to sell gas at a fixed price over a long term would have significant credit exposure?

A I would think so. I would agree with that.

Q Can we agree that the price of natural gas is a large part of FPL's customer's bills for electricity?

A Yes.

Q And can we agree that FPL buys most of its gas at market prices?

A Yes, like most utilities, they buy it at market.

Q And can we agree that given that most of FPL's gas is bought at market prices, its customers are exposed to market price volatility?

A Its customers are exposed to market price volatility, market price risks, just as these customers have been exposed to those risks for the past 80 years or so that we've had the gas generators and gas purchases. Nothing has changed.

Q And will be in the future as well?

A Excuse me?

Q And will be exposed to the same types of market price volatility into the future?

A They will be exposed to the same market risks in the future, yes, as all customers are, no different.

Q Now, are we in agreement that the Woodford

Project is a fossil fuel related project?

A We are. Natural gas is fossil fuel.

Q Now, I noticed in your testimony that you're an attorney. Are you a practicing attorney or are you a recovering attorney?

A Well, I don't know what recovering attorney means, I'm still too young for that, but I do have an active practice. I represent cities throughout Texas where I practice, in utility rate proceedings like this.

Q In your testimony, you mentioned several prior Commission decisions, correct?

A Excuse me?

Q In your testimony, you mentioned several prior Commission decisions, correct?

A Commission decisions referring to the FPL Commission, yes.

Q Yes.

A I mean, Florida Commission, excuse me.

Q I would like to ask you to focus on one in particular, that being order number 11-0080, that you quote at the bottom of page 17 and the top of page 18.

A Do you have a copy of that order or --

Q I do. I'm going to give -- in fact, let me just go ahead and pass it out now for ease of

reference.

A Thank you.

MR. GUYTON: Mr. Chairman, I'm not going to ask that this be marked. I'm simply passing it out for ease of the Commission's and the witness's reference.

A I have the order, sir.

BY MR. GUYTON:

Q All right. And you quote from that order at the bottom of page 17 and the top of page 18 of your testimony, do you not?

A Yes. And the footnote reference indicates it's from page 6 of that order that you just handed me.

Q Okay. Let's look at the paragraph that you quoted at least in part at the bottom of page 17 and page 18. That's not the entire quote of that paragraph at page 6 of the order, is it?

A Well, yes, that's obvious it's not a quote of the entire paragraph. It starts with the ellipse.

Q Well, let's look at the ellipse and what you left out of the quote.

A Okay.

Q Would you read for the Commission the entire sentence that you only quoted the first part of, "The

purpose is to prevent regulatory lag?"

A And I'm at the top of page 6, starting at the second sentence. Is that where you want me to read from, sir?

Q Yes, sir, if you would just read that entire sentence.

A Sure. This is the second sentence at the top of page 6. "The purpose is to prevent regulatory lag, which occurs when a utility incurs expenses but is not allowed to collect offsetting revenues until the regulatory body approves cost recovery."

Q So in your quote, you left out the explanation of what regulatory lag is, correct?

A No. I think in the next ellipse, the regulatory lag has historically been a problem. In terms of the first sentence, yes.

Q Now, in this case, FPL is seeking recovery of revenues to offset costs for gas reserves that are not being currently recovered in FPL's base rates, correct?

A Right, fuel costs generally are not recovered in base rates. The Commission has a Fuel Clause where the company projects fuel costs and they are periodically updated and reconciled so that you fully recover your costs. That's the basic fuel mechanism in Florida and around the country.

Q If FPL made its investment in the Woodford Project, it wouldn't be covered in FPL's current base rates, would it?

A Well, I don't know what all is included in the current base rates. In listening to the -- I participated in the last case, it's my understanding it was a settlement and typically in settlements, parties don't agree on issues, so it's a black box settlement. In other words, we don't specify what's in there, here's the total dollar amount and here's why it's reasonable. So I can't sit here today and tell you what is or is not in those rates. Certainly this project was being considered during that time frame.

Q If FPL made its investment in the Woodford Project and it was not allowed to recover it through the Fuel Clause, would FPL be experiencing costs that were not allowed for recovery?

A It would depend on how the Commission handled that sort of transaction. For example, if FPL were to time the transaction with a base rate proceeding, it could easily include the Woodford costs in its base rates and not avoid non-recovery of costs.

We found similar transactions like that when nuclear power plants came on line before the rate case was completed. There's concepts called deferred accounting. There's all types of regulatory mechanisms that have been employed over the years to address these types of regulatory lag problems.

Q So absent a new base rate case that you just postulated that would allow cost recovery, if FPL made its investment in the Woodford Project and was not allowed Fuel Clause recovery, FPL would be experiencing regulatory lag, the very thing that order 11-0080 says the purpose of the Fuel Clause is to prevent?

A It would experience regulatory lag, just like FPL experiences regulatory lag when it goes out tomorrow and replaces transmission facilities or anything else on the system that breaks, until it can get those items in rates. That does not mean we put light poles in the Fuel Clause.

Q Let's go to the -- back to your quote at the bottom of page 17 and the top of page 18?

A I'm there, sir.

Q Let's look at the rest of the order, that paragraph on page 6 that you quote, would you read for the Commission the last two sentences in that quote that you didn't put in your testimony?

A I don't understand your question. Read what, sir?

Q Yes, sir. You see the reference on page 6 where we have -- of order 11-0080 that you pulled this quote out of?

A Yes, sir.

Q All right. And you didn't, in quoting it, you didn't quote the last two sentences of that paragraph in your testimony, did you?

A Correct.

Q Would you read those last two sentences to the Commission?

A Yes. Reading from page 6, the last two sentences of the first paragraph. "Different states have addressed volatile fuel costs and the problem of regulatory lag in differing ways. Several jurisdictions, like Florida, have allowed recovery of fuel costs in a Fuel Adjustment Clause, and in Florida, the implementation of the Fuel Clause has changed and developed over the years."

Q And you agree that the Fuel Clause implementation in Florida has changed over the years?

A Yes. And I think the next full paragraph discussions the changes from, for example, I think 1925 to 51 monthly filings and then the Commission started and they had different requirements and now it's based on a projected estimate that's reconciled.

Q And one of the changes that's referred to in this order is the adoption of Order Number 14546, correct?

A Yes.

Q And, indeed, a good part of the remainder of this order discusses the Commission's Order 14546 and its implementation, does it not?

A It does.

Q Okay. And Order 14546 is the same order that FPL is relying upon in this case, correct?

A I think FPL witnesses have said they are relying upon it, yes, other than it's their proposal is inconsistent with the order.

Q Now, if you turn to page 9 of the order 11-0080?

A I am there, sir.

Q And there the Commission quotes from Order Number 14546, does it not?

A At the top of the page, sir.

Q And then immediately after that quotation, in the first sentence of the following paragraph, the Commission interprets that provision, does it not?

A Yes, it says, "We find the appropriate interpretation of this section."

Q Go ahead and finish that sentence, would you?

A You want me to read it into the record, sir?

Q Yes, sir.

A Okay. "We find that the appropriate interpretation of this section of Order 14546 is that capital projects eligible for recovery" -- "eligible for cost recovery through the Fuel Clause should produce fuel savings based on lowering the delivered price of fossil fuel or otherwise result in burning lower price fuel at the plant."

Q Now, you didn't share that interpretation of Order 14546 in your testimony with the Commission, did you?

A No. I shared with them their prior order, the statement of what 14456 is -- or 546, excuse me, I'm suffering from reversing the letters or numbers.

Q I understand, I transpose them sometimes myself.

Would you go down to the topic sentence, the next paragraph.

A Do you want me to read "As Order Number?"

Q Yes, sir, if you would just read that sentence.

A "As Order Number 14546 states, projects that request recovery of costs through the Fuel Clause should be fossil fuel related." And fossil fuel related is in quotes.

Q And that's another provision of 14546 that you didn't share with the Commission, correct?

A No, I shared their order. I didn't share the whole order. It's the Commission's order, they know what their order is.

Q Okay. If you would look at the next paragraph and if you would just read the topic sentence to the next paragraph in Attachment A?

A Yes, sir. You want me to read it into the record again?

Q Yes, please.

A All right. "In Attachment A to this order, we have included a complete review of the capital costs that have been recovered through the Fuel Clause pursuant to Order 14546."

Q So you knew from reading this order that Attachment A was a complete review of Commission decisions implementing this provision of 14546 as of the date of this order?

A As of the date of this order, I did. And, for example, I discussed the Scherer plant rail car issue, which is one of the items on this list, in the testimony, and I thought I discussed one other issue.

Q Let's turn to Attachment A.

A I'm there.

Q Okay. If you would look at the reasons for approval for Docket Number 95001, FPL's recovery of rail cars?

A I'm there.

Q Okay. Now, the Commission acknowledged in its summary of that order that there were unanticipated fuel related costs not included in the computation of base rates, correct?

A That's what the order states, yes, sir.

Q And we also know from the Commission's summary of that order that the savings were "projected," correct?

A Yes.

Q Let's look at the next entry, FPC's conversion of the Intercession City. Would you read the first full sentence in the reasons for approval box?

A "Order Number 14546 allows a utility to recover fossil fuel related costs that result in fuel savings, even if those savings were not previously addressed in the determination of base rates."

Q Now, you don't take issue with the

Commission's characterization of Order 14546 here that you just read, do you?

A No.

Q Okay. Now, if you would you look, I'm not going to take you through each one, but I do want to give you a minute to take a look at it.

A Sure.

Q The sentence that you just read, "Order 14546 allows the utility to recover fossil fuel related costs that result in fuel savings even if those costs were not previously addressed in base rates," would you agree with me that the Commission repeated that summary when it summarized in Appendix A or Attachment A, Order PSC 960353, PSC Order 971045 and PSC 970359?

A If you could point me to those other PFD's, I'm missing something here.

Q Sure. The first one that I gave you, 0353, was the FPC conversion of Intercession City P-8 and P-10?

A I'm there.

Q That sentence appears in that summary of that order as well, doesn't it?

A Right.

Q And if you look down to the next item in that table, PSC 971045, FPC's conversion of the Debary Unit

9, that sentence appears in that summary as well, does it not?

A It does.

Q And then if you would turn over -- or if you would turn to -- I'm sorry, don't turn over, go to the next --

A It's the last one on the page.

Q Yes, sir, thank you.

A Okay.

Q It appears there as well?

A Yes.

Q Now if would you turn over?

A Okay.

Q And if you would look at Order 981715, FPC's conversion of Debary 8 to burn natural gas?

A I'm there.

Q And that sentence appears in that summary of that order as well?

A It does.

Q And you don't take issue with that characterization of the Commission's holding in any of those orders, do you?

A No, I mean, the order speaks for itself, that's exactly what it says.

Q When you were looking at Order 11080, did you

find any statement of a going forward policy by the Commission?

A I guess I'm vague on your question. What do you mean?

Q In your review of Order 11-0080, did the Commission make a statement as to what is appropriate policy as regards Order 14546 should be on a going forward basis?

A I don't recall.

Q Would you turn to page 10, please?

A Okay. I'm there.

Q Would you read for the Commission the second full sentence in the paragraph at the top of page 10?

A Sure. "While it is true that we granted recovery of non-fossil fuel related costs through the Fuel Clause, in those two discreet instances, we believe that the appropriate policy going forward is to restrict capital project costs recovery through the Fuel Clause to projects that are fossil fuel related and that lower the delivered price or input price of fossil fuel."

Q And we have already agreed that the Woodford Project is fossil fuel related, correct?

A We have.

Q Okay. In addition to being an attorney, you

are also an economist?

A I am.

Q Now, economists don't have rules of conduct like lawyers do, do they?

A We're good people.

Q I'm sorry, were you speaking as an economist or as an attorney?

A I am a combination attorney/economist and we're good people.

Q Now there are principles that economists follow, are there not?

A Sometimes.

Q Fair enough. Would one of those generally accepted practices or principles be that it would be inappropriate to compare nominal costs or savings with net present value costs or savings?

A Well, I don't know if that's an economic principle, but that's something that mathematically you generally would not do and I have not done here.

Q And such a comparison wouldn't be appropriate because one would be comparing a nominal or an undiscounted value with a net present value or discounted value?

A Yeah, the classic example is you're comparing an apple to an orange.

Q Or as a friend of mine says, apples to tuna fish?

A To what?

Q I'll skip that. I'll withdraw that.

And you wouldn't want to do that, because it would be potentially misleading to whoever is reading the comparison?

A Well, I -- you do not compare nominal values to present values directly.

Q Would you turn to page 34 of your testimony, please?

A I'm there, I think. Hold on. I'm there.

Q Would you look at lines 11 through 15? Now, on line 15, you report a net present value of benefits for customers shown in one of FPL's sensitivity analyses, correct?

A Yes, the 34.1 million.

Q And then at line 22 -- or 20 through 22, you presented a nominal equity return from the same sensitivity analysis, instead of using a net present value quantification, correct? And I want to caution you about not revealing the number.

A Oh, yeah, okay, thanks for the hand wave on that one.

Yes, and I won't reveal the number. But I don't compare it directly to the 34.1. I was careful throughout this entire testimony to note, when I note that number that you see down there, that secret number, that it is a nominal value.

Q I'm sorry, where did you indicate that it was nominal?

A I thought throughout the testimony that I said 99 million was nominal and it appears to be missing there.

Q So, in this paragraph, you did contrast a net present value number with a nominal value?

A I did not. All I said was that the number on line 21 is what the return will be and I think you will find throughout the testimony I was careful to say that that was always a nominal value.

Q But you certainly didn't indicate it here at line 20 through 22?

A Right, and if the reader was misled, I apologize for that, but the word was left out and you saw it and everybody I think saw it in every other location.

Q If you would turn to page 27 of your testimony, please?

A I'm there.

Q At lines 4 through 10, you talk about three

key drivers in the Woodford Project economic evaluation, the reasonableness of the projected gas production, the reasonableness of costs and revenue requirements, and the forecasted market price of gas, correct?

A Yes.

Q I want to take a look at each of those drivers briefly. Let's look at what you call the first key driver in FPL's economic analysis, the projected natural gas production. Now, FPL's projected natural gas production from the Woodford Project was performed by Dr. Taylor, correct?

A It was.

Excuse me, sir, what page are you reading from again?

Q I was at page 27, lines 4 through 10.

A Okay, I lost my spot, thank you.

But, yes, it was performed by Dr. Taylor and I think I said in my testimony I don't dispute the output projections of Dr. Taylor, nor do I dispute the 10 or 20 percent variation in output that can occur.

Q And Dr. Taylor is a petroleum engineer, correct?

A I was here yesterday, I think he is, yes.

Q And you are not a petroleum engineer are you?

A I am not a petroleum engineer. I'm a lawyer/ economist.

Q And Dr. Taylor has not only a B.S., but also a master's and Ph.D. in petroleum engineering, correct?

A Yes.

Q And, in contrast, you have no degree in petroleum engineering?

A That is correct.

Q And Dr. Taylor has taught oil and gas reserve determination at the University of Texas, correct?

A I believe he taught at some university, I don't recall if it was Texas or another location. It may be.

Q You have not taught oil and gas reserve determination anywhere, have you?

A No. I taught economics and statistics and econometrics.

Q And you wouldn't -- well -- and you have never performed an estimate of future volume of natural gas at any site, including the Woodford Project, have you?

A That is correct, nor do I dispute it in this case.

Q And you have never performed a natural gas

reserve assessment, have you?

A That is correct.

Q Now, neither you nor any other intervenor witness have performed a natural gas reserve assessment for the Woodford Project, correct?

A Correct.

Q So the only natural gas estimate, reserve estimate, before the Commission in this case is Dr. Taylor's reserve estimate and the reserve estimate that is a part of Dr. Taylor's testimony of Forrest Garb & Associates?

A We have Dr. Taylor's estimate, which I believe he gave the data to Forrest Garb and they checked his arithmetic is what I recall.

Q And -- I'm sorry.

A Hold on, I'm not done.

All I know is I'm not challenging the estimate. All I know is that an estimate for the next 50 years is wrong, it's not going to be exactly that number, it's going to vary, and I think Dr. Taylor admitted that yesterday on the witness stand.

Q And those are the only two estimates of natural gas reserves in this proceeding, correct?

A I believe so.

Q Okay. Let's look at the second driver of the

economic analysis, what you considered to be the projected level of costs and revenue requirements. We have already established you're not a petroleum engineer. Typically the estimation of production costs associated with natural gas production is performed by a qualified petroleum engineer, is it not?

A Well, they may be estimating the production costs, but it's typically based on costs that have occurred at similar type wells over the years, some history in that area.

Q And typically is performed by a petroleum engineer, correct?

A I can't say that. I don't know that it would typically be performed by a petroleum engineer. I would think an accountant or anybody versed in the types of costs with the historical data in a similar field could estimate it as well.

Q However, you have never performed an estimate of future gas production costs for any natural gas reserve, have you?

A No.

Q And neither you nor your firm have been retained to analyze shale gas production in the Woodford Shale Project?

A That is correct, we don't do --

Q Or anywhere else?

A That is correct.

Q And you have never filed testimony before an agency addressing natural gas production costs in the Woodford Shale area or anywhere else?

A I was -- I recently filed testimony in Alaska regarding the municipality of Anchorage and they are involved in -- its not a shale facility, but it's a gas reserve, and they are involved with other parties and I did file testimony on that issue in Alaska.

Q And did that testimony address the natural gas production costs and the estimates for that?

A At that addressed natural gas production costs, because the issue was in Anchorage, Alaska, the municipality, it's a municipal electric utility, they own an ownership share of a gas reserve in Beluga Bay outside of Anchorage, and I recommended that the third party sales, the profits, be used as an offset to a rate increase proposal. So it involved both the expenses and the revenues associated with those gas reserves.

Q And was that testimony filed subsequent to your answering interrogatory 57 that FPL sent to the Office of Public Counsel?

A No, I think I filed that in April.

Q Okay.

A I filed that testimony prior to issues in this case.

Q Okay. I'm going to --

MR. GUYTON: May I approach the witness?

A I have it, sir.

BY MR. GUYTON:

Q All right. Mr. Lawton, would you read for the Commission -- first off, are you familiar with the document that I've handed you?

A Yes. It's the interrogatories that were sent to me by your client, FPL, regarding my testimony.

Q And would you read for the Commission interrogatory 57 and your answer to 57?

A Sure. "Has witness Lawton ever testified regarding natural gas production costs associated with shale gas in the Woodford Shale region or elsewhere?"

Answer, "No. Mr. Lawton would generally address actual or expected natural gas market costs and not the production of costs of a specific designated location."

And part B is answered, "With regard to elsewhere, see A above."

And that's perfectly consistent, because the

Beluga gas that I spoke to you about earlier is not a shell formation. It is a different type of reserve.

Q Okay. Am I correct that the only forecast of future production costs at the Woodford Shale Project before the Commission is the forecast provided by Dr. Taylor and Forrest Garb?

A I don't know the answer to that. You may have other production estimates, but the ones before this Commission would be the ones that are in the record. Who came up with them, I don't recall.

Q You're not aware of any other than those two?

A That's all I know of.

Q Okay.

A Those are the numbers I've been using and I've pointed out that I don't challenge the production costs either.

Q So we talked about the first two key drivers in the economic analysis, let's look at the third one that you characterized as the forecasted market price of gas?

A Yes.

Q You have an alternative natural gas price forecast in your testimony, correct?

A Yes, I think in schedule DJL-4, which is attached to my testimony, I used an alternative estimate.

Q And would you turn to that, please?

A I'm there.

Q Once again, it's a confidential exhibit, I'm going to give you one value off of it which is cumulative and doesn't show -- I'm going to give you one value off of it, it is cumulative, it doesn't show the calculations.

A Gotcha.

Q Okay. If you would look at that exhibit, using your alternative market price forecast --

A Yes.

Q -- FPL's customers would achieve a net present value savings of $43.8 million for the Woodford Project, correct?

A Yes, if only a more reasonable forecast were used before you considered other sensitivity analyses, the savings under the project would be $43.76 million.

MR. GUYTON: If I may have a minute just to summarize.

(Record paused briefly.)

MR. GUYTON: That's all I have. Thank you, Mr. Lawton.

THE WITNESS: Thank you, sir, I appreciate it.

CHAIRMAN GRAHAM: Staff?

MS. BARRERA: Good morning, Mr. Lawton.

THE WITNESS: I'm great. I'm just going to ask you to speak up, because I'm not only optically challenged, I have got some audio challenges as well.

MS. BARRERA: Okay, can you hear me now?

THE WITNESS: I do.

MS. BARRERA: Good morning.

THE WITNESS: Good morning.

CROSS EXAMINATION

BY MS. BARRERA:

Q If FPL and its customers were to share 50/50 the Woodford Project gains and losses between the production costs and the market price of gas, and share 50/50 the cost of the return on the investment above the line, in your opinion, would that provide FPL with an incentive to minimize costs to be shared with customers?

A Any time you employ a sharing mechanism, you incent immediately one of the parties, the party in control, in this case FPL, to minimize costs, because they are only going to get half the amount, and the way to maximize the amount of recovery you're going to get under your hypothetical is to truly minimize costs to get that margin up higher and higher, because half of 50 is better than half of 25.

Q If FPL and its customers were to share 50/50 the Woodford Project gains and losses between the production costs and the market price of gas, and share 50/50 the cost of the return on the investment above the line, in your opinion, would that retain for FPL and its customers access to producing wells and the benefits of more stable gas prices?

A It could in the following way. If you look at the Woodford Project as presented by FPL, they have built in a cost of capital of 10.5 percent for equity. This entire project could easily be financed with all debt, for example, and as a result, customer costs would be way down if you reran these numbers, because not only would you remove more expensive equity, which is twice as high as debt, but you remove the entirety of federal income taxes. That would reduce the cost to consumers.

And I think in your example, you would be talking about the sharing of the equity costs. My example goes a step further, it would eliminate the equity costs because there is no need for it.

I gave an example to Mr. Guyton earlier of a case in Alaska, it's a municipality, they financed the entirety of the gas reserve with debt. They don't have equity in municipalities.

Q   And would that provide appropriate incentives for FPL to minimize costs and maximum gains?

A   Absolutely, because FPL has said throughout this entire proceeding that its goal is to present lower fuel costs for consumers. If your goal is to present the lowest fuel costs for consumers, either splitting on the savings or eliminating the equity costs will minimize the costs of consumers, which is FPL's stated goal.

Q   Do you think it's a feasible and workable alternative to FPL's proposal, which places all the risk and benefits on its customers, to have FPL and its customers share 50/50 the Woodford Project gains and losses and share 50/50 the cost of the return on the investment above the line?

A   Yes, because what it does, and there's an old economics and lawyer saying, FPL would have skin in the game. In other words, right now all the risks are on consumers and FPL is saying don't worry, we have made a forecast and every year for the next 50 years, the market prices are going to be higher. But if FPL has skin in the game, in other words, the consequences of these decisions will come back to affect them, then

I think you might see very different forecasts and results and proposals. So I think by having a sharing or a true cost minimization, FPL is incentivized to come up with the right approach.

MS. BARRERA: Thank you. Staff has no more questions.

CHAIRMAN GRAHAM: Commissioners? Commission Balbis.

COMMISSIONER BALBIS: Thank you and thank you for your testimony.

THE WITNESS: Good morning, sir.

COMMISSIONER BALBIS: Good morning. I have a few questions, and since you're from Texas, I guess I should ask, are you familiar with Florida Fuels Generation Mix?

THE WITNESS: Florida Fuels Generation Mix, it's primarily gas in FPL service area in terms of the fuel purchases, but in terms of the actual -- I would suspect it's -- I've looked at it, I don't remember the numbers at the time. I know there's nuclear, there used to be a lot more oil in days back, and now it's more efficient gas.

COMMISSIONER BALBIS: Okay. And are you aware that this Commission, that we have to consider fuel diversity?

THE WITNESS: Sure.

COMMISSIONER BALBIS: Okay.

THE WITNESS: Most commissions do.

COMMISSIONER BALBIS: Aren't some of the benefits of having a diverse fuel portfolio is that it mitigates against price fluctuations of any one of the individual fuels for each generation source?

THE WITNESS: Absolutely.

COMMISSIONER BALBIS: One of the things that I struggle with is what other options we have from a diversity standpoint, so are you aware of any other legitimate options for diversifying our fuel portfolio?

THE WITNESS: Well, right now we have had the fuel portfolio problem and fuel diversity problem for as long as electric utilities have been around. And over the years, the commissions, the way they have handled it is different, depending upon which was the key fuel.

If it's coal, for example, commissions are struggling with that because of EPA, and so they are trying to push utilities over to, in some senses renewables and gas, because -- or purchase power, because it's many times a cheaper alternative.

So I understand every commission faces this issue and you're facing it now, but I don't think the alternative is to put 100 percent of the risks under this proposal on consumers. I don't think that's --

COMMISSIONER BALBIS: And that wasn't my question. I'll get to that point.

THE WITNESS: Okay.

COMMISSIONER BALBIS: The first thing is, the issue is fuel diversity and mitigating price fluctuations.

THE WITNESS: Yes, sir.

COMMISSIONER BALBIS: And wouldn't it be prudent for this Commission to encourage protection from those price fluctuation, especially it if results in a savings?

THE WITNESS: It is always prudent to mitigate volatility, but it's also prudent to consider, for example, you're faced, this Commission, with a gas diversity issue. Right now, the gas market over the past number of years has more gas and low, low prices. The diversity or the problem with fluctuations is not as pronounced as it has been in the past and the future looks bright in terms of those availability of gas supplies.

COMMISSIONER BALBIS: Okay. And let's talk a little bit about the future, because obviously we're -- these are long terms projections, long term investments.

THE WITNESS: Sure.

COMMISSIONER BALBIS: EPA's proposed 111(d) specifically for Florida, but I'm sure all the states in one of their building blocks recommended going to a 70 percent utilization rate or additional usage of gas, and would you agree that nationwide states are going to start using more gas as a result of EPA's regulations?

THE WITNESS: I think nationwide you're going to see use of more gas and/or a buildup of, we're seeing in other places, some renewables and a combination.

COMMISSIONER BALBIS: Okay. So as an economist, wouldn't you expect if there is more demand, that the price is going to go up?

THE WITNESS: Ordinarily, but you would see right now we have an enormous supply and availability of natural gas. What we have had over the past few years is more and more discoveries or expansion in the shale deposits and the gas availability and all you have to do is read the same report that FPL presented in this case. Energy Information Administration's most recent forecast of availability of gas, there is nothing out there pushing that price up like that.

COMMISSIONER BALBIS: Okay. And then from a producer's standpoint --

THE WITNESS: Yes, sir.

COMMISSIONER BALBIS: -- when they are out in the market trying to attract capital, those capital markets are looking for the highest return --

THE WITNESS: Yes.

COMMISSIONER BALBIS: -- in most cases. And so the producer can either drill oil wells or liquids or go for gas and historically which has produced the highest returns?

THE WITNESS: It depends on the timing. For example, in 1986, oil was driven down to $10 a barrel by OPEC flooding the market with supply, so oil didn't produce much. And natural gas, when it was up at $12 or $15, provided great, great returns. Right now, natural gas in the Woodford is a very risky venture, because its production costs relative to what you can get, according to PetroQuest is too risky. They are going to go for natural gas liquids and that's what we're seeing right now.

COMMISSIONER BALBIS: Okay. And so you have testified that you expect natural gas prices to remain low?

THE WITNESS: Yes, sir.

COMMISSIONER BALBIS: Okay. So now the competition for investment either in the liquids drilling, oil drilling, versus gas, there is going to be the disparity where investors are going to focus on the oil side because the returns on the gas may not be as high, or risky, as you say?

THE WITNESS: Right.

COMMISSIONER BALBIS: So, in this case, with the Woodford agreement or any future agreements, it's insuring that additional investment is being made in the production of gas, regardless of the returns, because the utilities need gas to operate their plants. So wouldn't this insure that additional investment and production is occurring?

THE WITNESS: No, I don't think this is increasing the output of gas. As gas prices and demands --

COMMISSIONER BALBIS: And that wasn't my statement. I said --

THE WITNESS: Okay, I'm trying to --

COMMISSIONER BALBIS: Yeah, doesn't that insure that the investment in gas production is occurring, regardless of the competition with oil, because the utilities do not need oil, they need gas, so this is one mechanism to make sure that the drilling operations will continue and move forward and produce gas?

THE WITNESS: It will in this case, only because this Commission will be giving a regulatory subsidy to the utility to drill. The market has said we don't want to drill in this section of the Woodford.

PetroQuest, in my testimony, I quote them, they are telling the Securities and Exchange Commission, the Woodford is risky for us, what we do is we pass those risks to FPL and they are willing to take it and pay a disproportionate amount while we, PetroQuest, go drill for oil. And the only way FPL will do this is if this Commission guarantees the return. It's not the market doing it, it would be the commission.

COMMISSIONER BALBIS: Okay. So let's focus on the guidelines. You testified that the guidelines of 25 percent maximum percentage is a "huge number?"

THE WITNESS: It is.

COMMISSIONER BALBIS: Is there a number that wouldn't be huge?

THE WITNESS: Well, this case --

COMMISSIONER BALBIS: That would provide diversification protections from price fluctuations?

THE WITNESS: This case is roughly 2.7 percent. It is not huge relative to the 25 percent guideline. But what you would do, if you went to 25 percent, the reason I called it huge is that it's like I think 11 times or 10 times the value in this case, that's a huge investment and we're going to count on the next 50 years to be right, and that's a big risk for customers.

COMMISSIONER BALBIS: Okay. So you indicated that the 2.7 or 2.9 percent isn't huge. Would 5 percent be huge, would 10, would 15?

THE WITNESS: I haven't evaluated all the ranges, but if you take, for example, 5 percent of your gas supply, that's not a huge amount.

COMMISSIONER BALBIS: Okay, that's all I have.

CHAIRMAN GRAHAM: Any redirect?

MR. SAYLER: Give me a moment, I have a lot of notes here.

CHAIRMAN GRAHAM: Sure. I didn't mean to wake you.

MR. SAYLER: Sir?

CHAIRMAN GRAHAM: Kidding.

REDIRECT EXAMINATION

BY MR. SAYLER:

Q Mr. Lawton, do you remember being asked by Mr. Guyton about the Commission approving $2.9 billion in natural gas fuel costs for recovery in 2015 through the Fuel Clause mechanism; do you recall questions about that?

A Oh, 2.9 billion is what --

Q Yeah, 2.9 billion, sorry.

A Yeah, I do.

Q And do you recall him stating that OPC stipulated to that?

A I do recall that it was subject to a stipulation. I don't recall if he said OPC was on the stipulation or not.

Q Okay. If OPC took no position or a type 2 or

3 stipulation, do you know if that would be reflected in the order?

A I would think that all the parties to the stipulation would be reflected on the order. They usually are.

Q Okay. Now, do you recall being asked about FPL not being allowed to recover the Woodford costs in the Fuel Clause and whether they would be allowed to recover those costs in base rates; do you recall that?

A Yes, because of the regulatory lag issue, yes.

Q Right. Now, if FPL cannot recover Woodford Project costs and base rates because they agreed to a base rate freeze, would that be a management decision by FPL?

A I didn't hear your question.

Q If FPL can't recover the Woodford Project through the Fuel Clause and they cannot recover it in base rates because of a settlement, would that -- agreeing to that settlement have been a management decision?

A Yes, I mean, if management agreed to a settlement earlier and they couldn't agree to or couldn't collect based on their agreement, I mean, that's -- management has to live with what they do.

Q Okay. Do you have a copy of the order that Mr. Guyton passed out?

A I do.

Q All right. Would you turn to page 6 of that order?

A Page 6?

Q Yes, sir.

A I'm there.

Q Do you see where it shows a history of the Fuel Clause going from monthly adjustments in the second paragraph to adjustments every six months and then finally to annual adjustments?

A I do.

Q Now, in your opinion, does going from monthly adjustments to annual adjustments mitigate or insulate customers from fuel price volatility?

A It does. I mean, historically, one of the reasons for Fuel Clauses getting longer is that people complained month to month their utility bill was jumping up and down, especially in times when we had the oil crisis in I guess the early seventies. Nowadays, it's an annual type of thing so it smooths out the price impact to consumers, volatility is down.

Q Okay. Do you recall some questions about financial hedging?

A I do.

Q All right. I believe you testified that some Public Service Commissions around the country are eliminating fuel hedging, is that correct?

A That is correct.

Q Which commissions are eliminating or considering to eliminate?

A I'm trying to recall if it was Kentucky or Tennessee was looking at a concern or have eliminated because it's the cost of the hedge. It's basically an insurance policy and you're insuring against price changes and utilities don't make money on hedging or lower costs. What they do is try to remove price volatility and there is a cost to it and the commissions are concerned about is this cost worthwhile.

I know in Texas hedging is -- they just don't do it in terms of the electric side. On the gas side, they do, but that's being mitigated as well.

Q All right. Do you recall being asked about a 10 percent swing in the cost of natural gas, that $2.9 billion we were discussing earlier?

A Yes, I do. It was a $290 million impact.

Q Right. Currently in the market, do utilities face a risk of that -- excuse me, let me rephrase.

Are utilities currently facing a 10 percent risk of that swing currently?

A You don't see that currently, no.

Q What's the percentage amount currently?

A It varies in terms of the time period you look at, but we're seeing gas prices, natural gas prices sitting and expected to be in the high 3's and low 4's, dollars per MMBtu.

Q Okay. In the same order that Mr. Guyton used, PSC 11-0080, you were asked a number of questions about another commission order, 14546. You're familiar with that order, correct?

A Yes.

Q Both orders. In Attachment A to that order, you see it lists a number of projects?

A I do.

Q Are you aware of the relative size of those projects as compared to what FPL is proposing through its guidelines?

A You can see it in the order, you know, for example, the Scherer project was $24 million, as I recall, in costs. There was $24 million in savings, which Mr. Guyton said were projected, but as I recall, looking at that case, the only projection was the number of rail car deliveries. The price of ownership was known and leasing was known. It's not a real projection in the context of Woodford. Also, you'll see most of the cases are smaller dollars than what we see in Woodford.

Q Okay.

A That's what I talked about in my opening on size and scope of these types of projects.

Q Okay. So all of these projects are significantly smaller than the Woodford proposal, correct?

A As I recall looking through them, yes.

Q And significantly smaller than 750 million?

A Yes.

Q Are aware if most of these projects eventually went into rate base?

A I know one of them, I think it was the Martin project, there was a lateral pipeline that FPL built that was going to create some cost savings, it was put in the Fuel Clause and I think it was conditioned it had to go into the next base rate case.

Q Okay.

A Whether that happened, I have not followed that up.

Q All right. Do you remember a number of questions about various FPC, Florida Power Corp,

conversions of plants to burn natural gas?

A I saw those, yes.

Q And I believe you were asked to agree that it said that order number 14546 allowed a utility to recover fossil fuel related costs that results in fuel savings?

A Yes.

Q All right. Now, in a number of those orders, it used the word resulted, past tense, do you see that?

A Yes.

Q All right. So those were not projected savings, but actual savings, is that correct?

A Well, by the language of the order, it looks like it resulted in savings and so it was allowed to put in rates.

Q All right. Now, is FPL, through its Woodford Project, projecting a resulted savings or estimated savings?

A All are estimates, there's no results. Fifty years of estimates.

Q Earlier you were asked about if the Woodford Project were not approved to go through the Fuel Cost Recovery Clause, do you recall that?

A Yes.

Q Are you familiar with what would happen if the Commission denied FPL's request to recover the Woodford Project in the Fuel Clause?

A Nothing would happen on fuel. FPL has already acknowledged the fuel supply they can get in the market. There is no change. All the consumer prices will be based on market, not on these 50 year projections.

Q And would FPL continue with the Woodford Project or would they leave it with USG?

A The Woodford project, as I recall, would be owned by USG. FPL, if they don't get what they are asking for, their affiliate owns it.

Q Okay. Going back to the same order, PSC 11-008, would you turn to page 9?

A I'm there.

Q All right. You see where it has a full quote from Order 14546, correct and then that first paragraph after that, Mr. Guyton asked you to read into the record a sentence or two?

A Yes, regarding the interpretation.

Q Right. And in the interpretation, I believe you read into the record projects eligible for cost recovery through the Fuel Clause that should produce fuel savings based on lowering the delivered price of

fuel. Do you see that?

A Yes.

Q Now, as an attorney or an economist, is there a qualitative difference between should and could or should and may?

A There can be a difference, certainly. If it should produce savings, I mean, I think that's more of a result oriented approach.

If it could produce savings, that's, you know, anything could happen.

Q But you would agree that this order doesn't use could or may or possibly or projected, it says should, correct?

A Yes.

Q You were asked a few questions about FPL's projected savings, is that correct?

A Yes.

Q Do you have a copy of FPL SF-8 as well as their revision to it that was provided to OPC in discovery?

A I thought I did. I do.

Q Okay.

MR. SAYLER: Commissioners, just for an easy comparison, Exhibit 64 that Mr. Truitt passed out yesterday contained a redacted version of the

revised SF-8, just if you want to do a comparison.
BY MR. SAYLER:
Q If you look at column H in the original fuel forecast -- or the original forecast provided with testimony and the one that was revised, if you look at column H, what has changed?
MR. GUYTON: Objection. This goes well beyond the cross, it is not redirect. It is about an exhibit that was sponsored by another witness. This is an attempt at supplemental direct. The only question that I asked him was about his fuel forecast and the projected savings, not FPL's or Mr. Forrest.
MR. SAYLER: Okay.
CHAIRMAN GRAHAM: Mr. Sayler?
MR. SAYLER: I will limit my questions to your questions, Mr. Guyton. Give me a moment.
BY MR. SAYLER:
Q All right. Do you recall being asked by Mr. Guyton about projected reserves -- or, excuse me, projected production amounts or values?
A Yes.
Q Okay. And using SF-8 as an illustrative example, you would agree that annual production amounts that Dr. Taylor forecasted are shown on these

exhibits, is that correct?

A It is, yes.

Q All right. And with regard to these projected production amounts, are you aware that Dr. Taylor testified that those could vary by plus or minus 20 percent?

MR. GUYTON: Objection. We're beyond the scope of cross examination. We're recounting now what other people have testified. It's just inappropriate redirect.

CHAIRMAN GRAHAM: Mr. Sayler?

MR. SAYLER: All right. Mr. Chairman, Mr. Guyton said that -- he was questioning our witness about his familiarity with production and things of that nature as far as some of the key assumptions that go into FPL's savings and what I'm trying to do is to allow him to testify or to explain how those assumptions affect the projected savings, but if you would prefer me to move on, I will.

CHAIRMAN GRAHAM: I would prefer you to move on.

MR. SAYLER: All right.

BY MR. SAYLER:

Q Do you recall a question about -- being asked

about the net present value versus nominal?

A I do.

Q All right. Would you please turn to page 34 of your testimony?

A I'm there.

Q All right.

MR. GUYTON: Excuse me, Erik, I just want to make sure we don't have an inadvertent blurting of the confidential information here, just a reminder.

MR. SAYLER: No, I appreciate it, no blurting.

BY MR. SAYLER:

Q Now, starting at page 33, you have a Q and A that continues on through page 34, is that correct?

A I do.

Q All right. At the top of page 34, line 5, there's a confidential number there, but prior to that confidential number, you use the term nominal, is that correct?

A Yes, I refer to nominal profits and then the number.

Q And then later on, you continue on and you cite another, the same confidential number, I believe,

is that right?

A Yes.

Q All right. And my last question, do you recall being asked questions by commission staff about a 50/50 sharing?

A Yes.

Q All right. In the testimony that you prepared for OPC, is that your recommendation, a sharing or a denial of the project?

A My recommendation would be denial as presented. It's risky the way FPL proposes, but if staff were to propose a sharing or some composite of adjustment, it would be a different project to examine and to consider.

I'm not clear exactly what is being proposed, but I think what's being proposed is FPL would have, as I used the phrase, skin in the game, and they would certainly be incentivized to make sure that the costs were the lowest possible costs for consumers for purposes of price volatility and fuel diversity as the Commission is concerned about.

MR. SAYLER: All right, thank you, Mr. Lawton.

THE WITNESS: Thank you.

MR. SAYLER: No further redirect.

CHAIRMAN GRAHAM: Exhibits?

MR. SAYLER: I do have several exhibits to move into the record. Those are Exhibits 36 through 39.

CHAIRMAN GRAHAM: 36, 37, 38 and 39.

MR. SAYLER: Including 35, sorry. 35, 36, 37, 38 and 39, I misspoke.

CHAIRMAN GRAHAM: Any objections to those?

MR. GUYTON: No.

MR. SAYLER: 35 through 39, I apologize.

MR. GUYTON: FPL has none.

CHAIRMAN GRAHAM: All right. We will move 35 through 39 into the record.

MR. SAYLER: And may this witness be excused?

CHAIRMAN GRAHAM: Yes, sir.

MR. SAYLER: All right. Thank you very much.

CHAIRMAN GRAHAM: Thank you for your time.

Florida Power & Light, your first rebuttal witness.

MR. BUTLER: Thank you, Mr. Chairman. We would call Mr. Ousdahl to the stand.

Whereupon,

H. KIM OUSDAHL

was called as a witness on behalf of Florida Power & Light, and testified as follows:

DIRECT EXAMINATION

BY MR. BUTLER:

Q Good morning, Ms. Ousdahl, would you please just state your name for the record?

A Kim Ousdahl.

Q And you testified yesterday on direct, correct?

A I did.

Q Okay. Have you prepared and caused to be filed 15 pages of rebuttal testimony on October 13, 2014 in this proceeding?

A I did.

Q Do you have any changes or revisions to your prefiled rebuttal testimony?

A I do not.

Q Okay. If I asked you the same questions contained in your rebuttal testimony today, would your answers be the same?

A They would.

MR. BUTLER: Okay. Mr. Chairman, I would asked that Ms. Ousdahl's prefiled rebuttal testimony be inserted into the record as though read.

CHAIRMAN GRAHAM: We will insert this witness's prefiled rebuttal testimony into the record as though read.

MR. BUTLER: Thank you.

(Whereupon, prefiled testimony was inserted.)

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Kim Ousdahl and my business address is Florida Power & Light Company ("FPL" or the "Company"), 700 Universe Boulevard, Juno Beach, Florida 33408.

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

A. Yes. My direct testimony was submitted on June 25, 2014.

Q. Have your position, duties, or responsibilities changed since you last filed testimony in this docket?

A. No.

Q. Are you sponsoring any exhibits to your rebuttal testimony?

A. Yes. I am sponsoring Exhibit KO-8 – Environmental Clause Sample Form 42-4P.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address accounting and auditing issues, errors and misstatements presented by Office of Public Counsel ("OPC") witness Donna Ramas. Specifically I will:

1. Clarify the use of the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA") for the accounting and ratemaking associated with investment in the Woodford Project and

potential future gas reserves projects, including the related depletion accounting;

2. Demonstrate the adequacy of the FPL internal controls and audit capabilities relied on for FPL's current joint venture activities and the reliance the Florida Public Service Commission ("Commission" or "FPSC") has placed on those controls and audits along with the applicability of that approach to gas reserves projects; and
3. Clarify the purpose and benefits of outsourcing the transactional accounting for the gas reserves activity.

Q. Please summarize your rebuttal testimony.

A. The Company's proposed investment in gas reserves for the benefit of customers can be readily and appropriately accounted for consistent with the USOA, and the proper accounting for those investments is the responsibility of FPL management. FPL's books and records form the basis for proper ratemaking, and I will explain how the Company's internal controls and active annual audits are relied on by this Commission for ratemaking as it relates to FPL's current joint venture activities. The Company's decision to outsource the accounting for these activities was premised upon considerations of both efficiency and effectiveness. The design and operating effectiveness of the outsourcer's internal controls, coupled with the complementary controls provided by FPL, will provide assurance such that the financial information provided by the outsourcer can be relied on for ratemaking.

II. APPLICATION OF THE UNIFORM SYSTEM OF ACCOUNTS

Q. OPC witness Ramas asserts that "capital investments in gas exploration, drilling, and production joint ventures are so foreign to an electric utility's regulated monopoly business that such items are incompatible with the system of accounts that the Commission prescribes for electric utilities." Do you agree with her assertion?

A. No. As explained in my direct testimony on page 27, lines 9 through 12, and illustrated in Exhibit KO-7, FPL is proposing to use the FERC USOA natural gas chart of accounts in FPL's consolidated financial statements as shown in the aforementioned exhibit. Witness Ramas is evidently unfamiliar with the use of account mapping. The transactional information that we will receive electronically from the gas reserves project's operator will be coded using the standard financial accounting classifications for this industry in the subsidiary ledger which will be maintained using the industry standard chart of accounts. For FPL consolidation and financial reporting and ratemaking, the activity will be mapped to the USOA natural gas chart of accounts. In this fashion, we can lever the robust industry-standard controls at the transactional level in the subsidiary ledger, while remaining compliant with the FERC natural gas chart of accounts.

Q. OPC witness Ramas' testimony on Page 9, Lines 18-20 states in part, that "FPL and its subsidiary *are not* proposing to record the investments in gas exploration, drilling and development ventures in Plant in Service accounts that fall under the FERC USOA." Is she correct?

A. No. Exhibits KO-5 and KO-6 were prepared to illustrate the financial results for the first year of the FPL's subsidiary operations and a sample schedule which will be provided to the Commission as part of the Fuel Clause filing, respectively. Exhibit KO-7 bridges the gap between the industry standard accounts and the FERC natural gas chart of accounts.

Witness Ramas concludes on lines 1 through 4 of page 10 that because Exhibit KO-6 identifies the projects as "investments" instead of "plant in service," they do not qualify as utility rate base. This underscores her complete misunderstanding of FPL's proposed accounting and of this Commission's established practice for presentation of clause-recoverable capital projects. Exhibit KO-6 is patterned after Form 42-4P that is used to present the calculation of revenue requirements for capital environmental projects through the Environmental Clause. The format of Form 42-4P is specified by the Commission Staff. I have attached as Exhibit KO-8 a copy of the Form 42-4P for FPL's Commission-approved Clean Air Interstate Rule ("CAIR") Compliance Project that was filed in Docket No. 140007-EI on August 22, 2014. That project relates to emission-control equipment that is installed on power plants that FPL owns or co-owns. As you can see, Form 42-4P refers to the cost of those emission-control assets as “Investments” in exactly the same way that Exhibit KO-6 refers to the gas reserves project assets as “Investments.” There obviously would be no merit in the assertion that the emission-control equipment is not Plant in Service simply because Form 42-4P uses the term “Investments,” yet that is exactly what witness Ramas is asserting with respect to the gas reserves assets that appear on Exhibit KO-6. Please note that Exhibit KO-7 reflects Account 101 Gas Plant in Service, which is where the “Investments” on Exhibit KO-6 will be recorded in FPL’s books.

Q. Do you agree with OPC witness Ramas’ assertion on Pages 17 and 18 that the USOA and Generally Accepted Accounting Principles (“GAAP”) accounting are mutually exclusive?

A. No. GAAP contemplates the effects of regulation, as codified in Accounting Standards Codification (“ASC”) 980 Regulated Operations. As explained previously, FPL will utilize the USOA to reflect the costs incurred in gas reserves development and production while concurrently reporting its results in accordance with GAAP and the Securities and Exchange Commission (“SEC”) requirements. The successful efforts method of accounting preferred by the SEC will not change the economic or ratemaking results of the transaction in any material way. Regulatory ratemaking is strengthened where GAAP and FERC are consistent. This is evident as the few changes to the

USOA that FERC has made over the years are generally in recognition and adoption of changes in GAAP such as accounting for leases, derivatives, and asset retirement obligations.

Q. Is the use of depletion accounting as contemplated by FPL appropriate and consistent with FERC and FPSC rules?

A. Yes. Subchapter F of the USOA Natural Gas, Part 201, 12A reads:

> "12. A. *Depletion,* as applied to natural gas producing land and land rights, means the loss in service value incurred in connection with the exhaustion of the natural resource in the course of service."

FERC account 404.1 - Amortization and Depletion of Producing Natural Gas Land and Land Rights, reads in part:

> "A. This account shall include charges for amortization and depletion of producing natural gas land and land rights. (See account 111, Accumulated Provision for Amortization and Depletion of Gas Utility Plant).
>
> B. The charges to this account shall be made in such manner as to distribute the cost of producing natural gas land and land rights over the period of their benefit to the utility, based upon the exhaustion of the natural gas deposits recoverable from such land and land rights."

Witness Ramas evidently does not recognize that depletion accounting, which by definition results in application of a new rate in each reporting period, is integrally woven into the FERC USOA.

III. ACCOUNTING CONTROLS AND AUDITING JOINT VENTURE ARRANGEMENTS

Q. Please describe the purpose of the Commission audits of financial results in the context of ratemaking.

A. The objective of the FPSC clause audits is to ensure that the costs included in rates are reasonable. This is done by examining the books and records of the utility to validate that the costs which make up the revenue requirement are properly recorded in compliance with the USOA such that the resulting revenue requirement is reasonable. This examination ensures that the costs reflected in the clause are recoverable from customers under the applicable orders, rules and statutes.

Q. In the conduct of audits of FPL by the Commission, what records are sampled for the purpose of confirming the reasonableness of the financial results provided by the Company?

A. Generally in audits of clause financial records, the auditors will agree amounts reflected in the clause schedules to the general ledger thereby ensuring that the customer bill reflects the actual costs incurred by the Company in providing that service. In addition, other procedures are performed including sampling of invoices and agreeing those invoices to the general ledger. Likewise, they will review contracts and purchase orders as evidence of the reasonableness of the costs invoiced and recorded to the general ledger.

Q. Are there any costs in an adjustment clause today that are incurred through a joint venture agreement between FPL and a third-party owner/operator?

A. Yes. FPL contracted in 1982 with JEA for a 20% ownership interest in its St. Johns River Power Park ("SJRPP") and for a 37½% interest in JEA's 80% remaining interest through a purchased power agreement ("PPA"). Additionally, in 1991 FPL purchased a 76.4% interest in the Georgia Power Company's Plant Scherer Unit 4. JEA remains the owner/operator of SJRPP and the same is the case for Georgia Power Company with Scherer Unit 4. FPL recovers the fuel costs for both plants through the Fuel Clause, the capacity charges under the SJRPP PPA through the Capacity Clause, and FPL's share of environmental costs for both plants through the Environmental Clause.

Q. Does the Commission staff utilize a different procedure for the audit of FPL's current joint venture activities?

A. Not to my knowledge. The audit procedures utilized by Staff that we are able to observe in its report are no different for those costs than for any other invoiced costs.

Q. Does FPL have any additional controls related to its participation in joint venture agreements?

A. Yes. FPL's joint venture agreements all provide FPL access to the owner/operator's books and records for periodic on site audit of its billings to FPL to ensure all charges are appropriately incurred by FPL's customers. In addition, all of these entities are subject to external audits which provide assurance that the financial statements are free of material misstatement and that the entity is maintaining effective internal controls. These are the same rights that FPL will have under the Drilling and Development Agreement ("DDA") for the Woodford Project.

Q. Does the Commission Staff audit the books and records of any of FPL's vendors or joint venture partners?

A. Not to my knowledge. Rule 25-6.0151 F.A.C., Audit Access to Records requires access to books and records of FPL (including its subsidiaries) in order to perform a staff audit and does not contemplate the audit of transactions of its vendors or partners or the access to records thereof.

Q. How does FPL's external audit address costs that FPL incurs with its vendors or joint venture partners in order to express an opinion on FPL's financial statements?

A. FPL's external audit would include sampling and agreeing invoices from vendors and joint venture partners to amounts recorded on FPL's general ledger and to the contractual agreements themselves. FPL would expect its external auditors to take the same approach to the extent the Woodford Project and any future gas reserves projects are subject to their audit procedures.

Q. Do you agree with OPC witness Ramas' conclusion on Page 20, lines 12 through 15 of her testimony that because the Commission would have no ability to audit PetroQuest, it does not have jurisdiction over the FPL gas reserves activities?

A. No. As explained above, an audit of FPL's books and records involves testing *FPL's* books and records, not those of its vendors or partners. FPL's rates are derived from its financial statements and the Commission can be confident of the reasonableness of those financial results based on the Company's external audit, the Company's documented internal controls and the audit of those controls in compliance with Sarbanes Oxley ("SOX") Section 404 and the Commission's audit of the financial statements as performed today.

Q. Does FPL intend to design and implement new controls and revisions to its existing controls in order to provide appropriate assurance of the reliability of financial reporting for its investment in gas reserves projects?

A. Yes. Upon approval of the Woodford Project by the Commission, FPL will develop and implement SOX processes designed to ensure gas reserves transactions are in compliance with GAAP and any unique regulatory requirements, if any. These processes will likely include controls around:

* Review and approval of Authorizations for Expenditure ("AFE")

* Verification of ownership interests
* Estimating and recording accruals
* Calculating depletion including reserve validation

It is also important to note that the controls of any service provider that FPL ultimately chooses for performing the gas reserves accounting will be examined by an independent auditor in compliance with the American Institute of Certified Public Accountants' Statement on Standards for Attestation Engagements 16. This provides further assurance of the adequacy of the design and operation of their internal controls around the transactional accounting for this activity.

IV. PURPOSE AND BENEFITS OF OUTSOURCING THE GAS RESERVES SUBSIDIARY LEVEL ACCOUNTING

Q. Why has FPL decided to contract with a third-party provider to perform the accounting, recordkeeping and reporting for the gas reserves transaction accounting?

A. We have carefully evaluated the path forward for gas reserves accounting and business management to ensure that it is prudently operated and accurately reported so that customers' rates based on those costs are reasonable. In making the evaluation as to how to manage this effort, we began by gathering information that would help us to assess the risks and benefits of managing all the processes including the transactional accounting and reporting. That due diligence is nearly concluded and we have learned that not only can an experienced third-party service provider ramp up faster due to its existing systems and processes, but it can provide an immediate robust internal control environment which helps ensure the accuracy all parties desire. Additionally, as we finalize our negotations with a short list of firms, it is clear that the cost, at least at the outset, will be lower with the use of a third-party than what FPL would incur initially; thereby saving customers money.

FPL's management is responsible to ensure that it maintains adequate internal control over financial reporting and that its books and records fairly present its financial results in accordance with GAAP, FERC and FPSC requirements. In addition as Chief Accounting Officer, I am committed to ensuring that FPL's regulators continue to feel confident in our ability to provide accurate information derived from those financial statements for ratemaking. In this instance, I have concluded that FPL's and my responsibilities will be most efficiently and effectively met by engaging a third-party to perform the accounting, recordkeeping and reporting for the gas reserves transaction accounting, at least initially.

Q. Could FPL perform this accounting without the use of the third-party service provider?

A. Yes. Contrary to Witness Ramas' assertion on page 22, lines 5 through 7, FPL could have managed this effort internally; however, doing so initially would not have been efficient given the alternative available. The third-party firms are experienced and efficient, and have working knowledge of the operators, accounting and industry regulatory requirements. In addition, they are able to ramp up so quickly that contracting for this support in advance of the Commission approval was preferred due to the lead times that would have been required for us to develop and put into place the systems, process and people necessary to handle the accounting by the end of the year. FPL will continue to evaluate the relative merits of performing those functions in-house versus outsourcing them as our experience and portfolio of gas reserves projects evolve.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BY MR. BUTLER:

Q Ms. Ousdahl, you have one attached exhibit, KO-8, is that correct, to your rebuttal testimony?

A Correct.

Q And do you have any changes or corrections to that exhibit?

A No, I do not.

Q Okay. Is it true and correct to the best of your knowledge and belief?

A Yes, it is.

MR. BUTLER: Mr. Chairman, I would note that her Exhibit KO-8 is identified as Exhibit 20 on the staff comprehensive exhibit list.

CHAIRMAN GRAHAM: Duly noted.

BY MR. BUTLER:

Q Ms. Ousdahl, would you please provide a summary of your rebuttal testimony?

A Yes, thank you.

Commissioners, Chairman, good morning. My rebuttal testimony will address the errors and misstatements of the Office of Public Counsel Ramas concerning accounting and auditing. I will discuss how the FERC Uniform System of Accounts is properly used for gas reserve projects.

I'll demonstrate the adequacy of the internal controls and audit activities for FPL's current joint venture activities and the reliance the Commission has placed on those controls and audits and I'll demonstrate the applicability of the current approach to the gas reserves projects.

Lastly, I clarify the purpose and benefits of outsourcing the transactional accounting for gas reserves.

Witness Ramas concludes that FPL should not be allowed to recover its investment in gas reserves through the Fuel Clause, because the FERC electric chart of accounts would be incompatible with this activity. This is simply not a valid concern. FPL has demonstrated that a simple mapping from the industry standard chart of accounts to the FERC natural gas chart of accounts will satisfy the compliance reporting and regulatory ratemaking objectives.

Witness Ramas further asserts that gas reserve investments are not utility rate based, simply due to the title that is used on my Exhibit KO-6. Contrary to her argument, the forms used by the Commission today to recover utility plant investment through environmental clause use the exhibit titling found on Exhibit KO-6. Regardless of the label, the investment is used and useful to customers and must be incurred in order to generate the savings we propose to pass through to those same customers.

Witness Ramas also argues that depletion cannot be recorded in electric accounts as it is inconsistent with the Commission's depreciation rule for recording depreciation on electric plant. She is correct that a unit of production method would be inconsistent with the Commission's depreciation rule for electric plant, but of course that should not and would not be a reason not to properly record depletion on gas plant just as the FERC USOA prescribes.

Next Ms. Ramas argues that because this Commission will not have jurisdiction over PetroQuest and cannot audit its books, therefore "the transactions fall outside the limit's of the Commission's regulatory domain." This exact arrangement exists today in the form of joint venture undivided interests that FPL holds in two coal facilities, Scherer and JEA. The cost of those facilities are recovered by FPL through the clauses. There's never been a suggestion by the Commission audit's staff that they are dissatisfied with their oversight of those arrangements, which relies in part on our audit of the books and records of the operating partner, just as would be the case with PetroQuest.

Finally, Witness Ramas expresses concern about FPL's collective lack of knowledge of the specialized accounting. This concern is not well founded. One reason there are so many third party accounting service providers is that there are scores of companies investing in exploration production that are conducting these activities as non-operators, just as we intend to do. We have considered very carefully how to conduct those activities successfully and concluded that we should take advantage of the cost savings and expertise that can be afforded to us through an outside services arrangement. Not only can an experienced third party service provider ramp up faster due to its existing systems and processes, but it can provide an immediate robust internal control environment which helps insure the accuracy that all parties desire.

In conclusion, OPC raises no valid concerns about the efficiency and appropriateness of accounting for gas reserves projects. It's difficult to believe that the Office of Public Counsel recommends this Commission forgo substantial benefits for customers from those projects, simply because of some accounting concerns that she has raised. The Commission may rest assured that I am and FPL is fully committed to insuring that this Commission continues to feel confident in our ability to maintain and provide accurate regulatory accounting information about the gas reserves projects.

That concludes my summary.

Q Thank you, Ms. Ousdahl.

MR. BUTLER: I tender the witness for cross.

CHAIRMAN GRAHAM: Mr. Rehwinkel.

MR. REHWINKEL: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. REHWINKEL:

Q Good morning, Ms. Ousdahl.

A Good morning.

Q Page 10, if you would, please, of your rebuttal testimony, and if I could direct you to the first two lines. Is it your testimony that the Commission staff would, in their initial audit of the PetroQuest/FPL joint venture, do sampling?

A My discussion here in the Q and A that precedes that page 10 talks about generally in audits of clause financial records, these are the sorts of activities that the staff would perform. They design an audit plan using agreed procedures for each and every audit that they do and they could vary but, yes, these would be, as I understand it, the typical types of activities, including sampling.

Q Okay. Now, you would agree with me that the Florida Public Service Commission staff auditors, as good as they are, have never audited a joint venture transaction like the one you're proposing?

A I don't know, but I would agree with you that it is probably not likely.

Q Okay. Now, would you also agree with me that in the very first year, if your drilling plan goes as portrayed, that there would be as many as 38 wells drilled?

A That's correct.

Q And you would also agree with me that 38 wells over the 12 to 14 months would generate transactions numbering into the thousands, on the JIB or Joint Interest Billing, into the thousands?

A Yes, I think --

Q Per JIB?

A At least hundreds per JIB, yes.

Q Okay. This would monthly, how often would the JIBs come?

A Monthly. It's an invoice.

Q And you characterize this as a massive amount of transactions?

A It is.

Q They are quite voluminous, right?

A They are.

Q Okay. Do you know whether the JEA, the Jacksonville Electric Authority, I think, is that what JEA stands for?

A Yes, it is.

Q That's part of the City of Jacksonville?

A It's a municipal authority.

Q Okay. They are subject to auditing by the standards that the City requires, is that right?

A That's what I understand. They certainly do have an audit performed.

Q Is FPL the only joint venture entity with the St. John's River Power Park?

A That FPL has?

Q Yes.

A Yes.

Q Okay. So it's just JEA and FPL?

A Oh, are we the only two partners?

Q Yes.

A Yes, I believe that's correct.

Q On page 5 of your rebuttal, please, this is where you discuss using the FERC USOA natural gas chart of accounts and mapping from the industry

standard accounts, or this is where you start talking about that, I guess, between pages 5 and 6?

A Yes, I'm with you.

Q Okay. You would agree with me, would you not, that the USOA natural gas utility chart of accounts that you would use, you would not fully comply with the detailed accounting instructions that go with those USOA natural gas chart of accounts, right?

A Yes. What I have testified to, certainly in the deposition and what we have responded to in discovery, is to explain that we can be consistent with the hierarchy and the design of the gas chart of accounts, which did contemplate investments in gas reserves.

There are certain detailed instructions that just simply do not apply and I have been through a few of those in the record through the deposition. That does not, in my estimation, at all mean that we can't be consistent with the way in which the FERC USOA was designed to report results.

Q So the FERC natural gas condensed chart of accounts, that's what you describe it as, right?

A That's correct.

Q Okay. That's not something that the FERC has

designated that utilities use, is it?

A Yes, the condensed hierarchy would directly come from the FERC USOA.

Q Okay. But they don't allow any of the gas utilities to use it only at the condensed level, right?

A No, they're -- to the extent they are still regulating any LDCs, they would use the full chart of accounts.

Q Okay. The condensed chart of accounts is something that FPL came up with to try to make this transaction fit into what the Commission here has historically and traditionally used for the regulated provision of utility service, right?

A What we tried to do was serve multiple purposes with financial accounting and reporting, which we do each and every day. It's not something that's obvious to most of you, but we report our results once transactionally in an SAP natural chart of accounts, which has nothing to do with FERC, and then our systems translate those transactions into multiple other reporting views. One being FERC. One being FPSC, which has a few differences from FERC. We have a tax basis also. So this is what the accountants do, they enter transactions in one form and then they use their systems and tools to report in others.

We found it quite logical to be able to provide a view in each of those formats that hopefully our audit staff and the Commission will also feel comfortable relying on.

Q So the answer to my question was yes?

A Yes.

Q Okay. The Florida Public Service Commission has never approved the use of the FERC natural gas condensed chart of accounts for any utility that it regulates, right?

A Not to my knowledge.

Q Okay.

MR. REHWINKEL: Thank you, those are all the questions I have. Thank you.

THE WITNESS: Okay.

CHAIRMAN GRAHAM: Retail Federation?

MR. LAVIA: No questions.

CHAIRMAN GRAHAM: FIPUG?

MR. MOYLE: Thank you.

CROSS EXAMINATION

BY MR. MOYLE:

Q Good morning, Ms. Ousdahl.

A Good morning.

Q You described the JIB as having thousands and thousands of pages, is that right?

A Well, hundreds of pages, I would estimate, potentially thousands of transactions.

Q And what does JIB stand for?

A Joint Interest Billing.

Q Okay. Is there a document in the record somewhere that shows what that is going to look like that consists of hundreds and hundreds of pages?

A No. I provided an example in my direct testimony at the summary level and that's kind of the way the JIB looks. It's -- these transactions are all summarized through the systems and electronic data interchange, so it's not as though we all have to deal with the thousands of transactions. They are posted automatically and then they are summarized. So in my direct testimony I showed the summary. Behind that, in a real JIB, would be each and every transactions.

Q Okay. And I had assumed that for the purposes of the Commission getting a good feel as to what the paper flow would look like, there would be something that would show here's what it's like as compared to a summary, but that hasn't been provided, just to be clear?

A That's because you don't typically touch each of those pieces of paper. One of the reasons we like to use --

Q I wouldn't, but go ahead.

A None of us would. The reason we rely on the electronic data interchange is that the transactions are very voluminous. So the system served that purpose, I didn't feel it necessary to provide volumes of information. However, it's certainly available if folks are interested.

Q You would agree that the ability of this Commission to look at PetroQuest is limited, I mean, they can't look at PetroQuest and their books and records, they have to do it through FPL or FPL's subsidiary, correct?

A They don't need to look at PetroQuest. They need to look at the transactions FPL incurs through its joint venture with PetroQuest --

Q Okay. Hypothetically --

A -- and that's fully available to the Commission.

Q -- if there was something that came up where there was a charge for a lawyer, a couple million dollars for a lawyer, it flowed through and they said, hey, this doesn't look right, you know, well, it came from PetroQuest and they wanted to get to the detail

that PetroQuest has, the lawyer's time records, this Commission could not do that, correct?

A This Commission could do that through FPL's inquiry.

Q But they couldn't go direct to PetroQuest and ask PetroQuest, correct?

A They cannot do that today with our arrangements with JEA. It's exactly the same.

Q With respect to FPL and its ability to get records from PetroQuest, you would agree that that's governed by the contractual relationship, all those thick voluminous documents that are attached to Mr. Forrest's testimony, is that right?

A I would. If I could clarify, this is not new territory that anybody is forging here. The business has been around forever and parties are very familiar with the process of reviewing the transactions and seeking and making inquiries about those transactions for which they may have questions.

Q No, I appreciate that, but this new -- this is new business for all of us, correct, you don't have experience in oil and gas accounting, right?

A No, I do not.

Q Right. And nobody on -- none of these parties, the Commission, and we're kind of forging new

ground here, correct?

A Right, I was referring to the contractual arrangements. They have been in place for quite some time and parties understand how that works and it's workable.

Q The contractual arrangements in this case you're testifying to?

A That you just referred to --

Q Okay.

A -- that contain the support for the arrangement by which we will receive information from our operator.

Q My understanding is that those agreements, some of them were just recently signed, you were here yesterday when they talked about the operating agreement that I think the testimony was it was just recently signed, correct?

A I think it's been -- yes, I think it's been made clear hopefully on the record that the way this industry approaches the model form operating agreements is they have standard agreements that are in place that everybody party expects to ultimately execute, so it's not a free form, we're going to create a new agreement. They use a standard form and then they just change certain provisions to meet the contractual arrangements that exist in that commercial transaction, so --

Q And how do you know that?

A I know that from --

Q Talking to somebody?

A From consulting with U.S. Gas, yes. I have talked to their controller a lot and I have talked to our commercial attorneys about that.

Q But you don't have any firsthand information about what you testified to, correct?

A Obviously not.

Q I want to see if I can have you agree to amend your testimony, your rebuttal testimony for me. Would you be willing to consider trying to do that?

A Consider amending my rebuttal?

Q Yes, ma'am.

A No. I mean, I'm obviously going to sit and listen to you, but I don't think I'll ultimately be amending my rebuttal.

Q But you would be open to a conversation to talk about it, wouldn't you?

A Certainly.

Q You're not close-minded on that?

A Oh, not at all.

Q Good. Let me refer you to page 4.

A I'm there.

Q Line 10, you're asked to please summarize your testimony, and then just read into the record your first sentence response?

A "The company's proposed investment in gas reserves for the benefit of customers can be readily and appropriately accounted for consistent with the USOA and the proper accounting for those investments is the responsibility of FPL management."

Q And my proposed amendment to your testimony was after the word customers, to insert "and FPL shareholders," and would ask you would you agree to amend your testimony as I suggest?

A No, I will not amend my testimony to insert those words.

Q And is that just because as a matter of principle you don't want to amend your testimony or you think that's not true?

A It's because that's not why we're here. I mean, it's certainly a win-win, nobody is going to argue that there is not a return of our cost of capital under this arrangement, but we're here to lower the cost for customers, that's been the premise of the strategy. That's all I'm referring to here.

Q So you would agree that this proposal has

benefit for FPL shareholders, correct?

A It returns our cost of capital if properly executed, yes.

Q With a return on that cost of capital?

A Yes, return of and on.

Q Okay. And that's a benefit to the shareholders?

A It's a required return by shareholders.

Q Okay. But you are not comfortable to suggest or even recognize that possibly this proposal is also for the benefit of shareholders --

CHAIRMAN GRAHAM: Mr. Moore, that's been asked and answered.

MR. BUTLER: Yeah.

BY MR. MOYLE:

Q Well, let me ask you this, so why would you do this for the benefit of the shareholders?

A Pardon me?

Q I mean, I'm sorry, the customers. The customers are saying no, thank you, we don't really want this and, you know, we kind of feel like you're jamming it down our throats. If you're doing it for customers and customers are saying we don't want this, why continue to push so hard?

MR. BUTLER: I'm going to object. I think this is well beyond the scope of Ms. Ousdahl's testimony. She's clearly here to present how FPL will account for the transaction and Mr. Moyle is trying to leverage off a comment about benefit of customers to go into an entirely unrelated theme of the sort of policy considerations for our proposal.

MR. MOYLE: She brought it up in her rebuttal testimony and we just had the discussion about whose benefit, you know, this is for. I think it's fair game to explore that.

CHAIRMAN GRAHAM: I'll allow the question, but let's move on.

THE WITNESS: You'll have to repeat it.

MR. MOYLE: Could you read the question back?

(Court reporter complies.)

MR. MOYLE: I may have asked her about force feeding, but that may have been --

THE WITNESS: I'm uncertain of the question, if you could just repeat it.

MR. MOYLE: Okay, let me come at it this way.

BY MR. MOYLE:

Q You have testified that this is for the benefit of the customers. The customers have said no,

thank you, we're opposed to this. My question is why, I think I use the term force feed, but why continue to push so hard on imposing this on customers when they have clearly said they don't want it?

A I think we're sitting here over these last two days trying to get the evidence in the record so that the Commission can determine what they feel is in the best interests of customers. That's why we're still talking about this and presenting evidence.

Q On line 21, you have used the phrase that the controls will -- and I'm going to pick up -- "will provide assurance that the financial information provided by the outsourcer can be relied upon for ratemaking."

You want to give this Commission comfort that the documentation and information provided to them for ratemaking purposes is accurate and reliable, correct?

A Absolutely.

Q The way that you have the proposal now, with FPL not having "skin in the game," the financial incentive really is not to control costs, correct?

A This is no different than anything else we do in the business of providing electric service to our customers.

Q Could you --

A I disagree. The answer to your question is no. This is no different, we have skin in the game everyday in executing well for our customers, insuring that their costs are low, which is beneficial for our investors, no question. I mean, we have talked about the virtuous cycle at this Commission in many rate cases, so if we execute well, it's a win-win.

Q Okay. Let me just pose this hypothetical. If there is one set of invoices in from PetroQuest for a day and it's $10,000 and then something changes and they say, oh, you know, we forgot something here, here's another set that is for 20,000, so you have a 10,000 set and a 20,000 set, the way I understand this works is if you put the 20,000 set in -- and I'm not suggesting you would do anything improper, but the 20,000 set, you would earn more money on those invoices for 20,000 as compare to 10, right --

A Well, I guess --

Q -- through the Fuel Clause, all other things being equal?

A If the $20,000 is capital, not expense, if it's expense, we don't earn a return --

Q Assume it's capital.

A -- there's no investment.

If it's capital, then we should be recovering our interest costs and our required return on equity.

Q So from just the standpoint of return to FPL shareholders, the 20 is better than the 10, correct?

A If the --

Q Assuming it's all capital.

A If the 20 is our cost, then the return on the 20 is appropriate.

Q I understand, I'm just asking you if you can answer yes or no from a pure economic standpoint --

A No, I don't think it is better and, you know, you're talking to the controller of the company. My job is to insure that we don't record a cost that is not incurred, that the costs on the books and records are the appropriate costs. My job is not to try to say to myself, oh, well, if there is a mistake here and it's higher, that's going to be better for our investors. So I completely disagree with the premise of your question.

Q Okay. And I'm not trying to impugn your credibility or integrity. I know you --

A No, it's a fact.

Q -- have that.

A It's a fact.

Q I'm just trying to isolate the financial incentives here, and as OPC's witness just testified,

you know, basically if it's a straight pass-through, there's not an incentive that would be there if there was a shared 50/50, we would say wait a minute, you know, these costs may not be right, because you would earn the return on whatever is passed through, correct?

A I disagree with the premise. I don't think it's beneficial for our company to take advantage of rate payers by allowing rates to be higher than they would.

Q And you have duties to rate payers not to do that, right?

A The company and myself, certainly.

Q Right. And you have a special unique relationship with rate payers, given the regulatory structure and monopoly relationship?

A It's a reg -- we are -- yes, I'm employed by a regulated utility, yes.

Q And that follows along with the relationship question I just asked, it's a special relationship with customers?

A I'm not sure what you mean by special relationship. Yes, I do believe we must advocate and work to insure that our customers are provided reliable electric service at the lowest possible cost, yes.

Q We talked about fiduciary duty in your deposition, which is now in the record, but if you can just answer a question yes, no. Do you believe in your opinion that you owe a fiduciary duty to the rate payers?

A Yes, I answered the question in the context of my role as the controller and I think whether it's a really a regulated utility or any other enterprise, that my responsibility is to insure that assets are protected, that controls are in place, and that we are maximizing the value of those assets and insuring that there are, you know, no material misstatements and that folks can rely on investors, in this case regulators can rely on the books and records of the company. So, yes, I do believe I have a special role as a controller.

Q Okay. And included in that yes is you believe you have a fiduciary relationship with your customers?

A As I explained, I think that's true in the regulated utility, you know, environment or space and also would be true in any other public enterprise.

Q Okay, well, thank you for that answer.

MR. MOYLE: I have no further questions.

CHAIRMAN GRAHAM: Staff?

MS. BARRERA: Staff has no questions.

CHAIRMAN GRAHAM: Commissioners? Redirect?

MR. BUTLER: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. BUTLER:

Q Ms. Ousdahl, briefly, you were asked by Mr. Moyle, I'm sure, and I think also by Mr. Rehwinkel about the level of control over joint ventures and you had discussion of the joint venture for the Scherer Power Plant in Georgia, the JEA joint venture for the SJRPP project. Would you please address or compare the degree of access that you would anticipate this Commission and its auditors would have over the joint venture with PetroQuest compared to the access that they have with respect to the Scherer and SJRPP joint ventures?

A Yes, my expectation is that our interaction, our access to information, that available to the staff auditors, would work exactly as it does with our other joint venture relationships. I realize it's a different activity and we are all at this point unfamiliar, though, there will be a learning curve, but in terms of the way in which we will approach our duties as far as auditing and insuring that we are properly reporting those costs, getting access to the parties and the parties' information, it will work as it does today.

I think the audit staff, as I have said in my direct, has been comfortable with our oversight. We actively audit on site at Scherer and JEA, we would be doing the same with the operator. Obviously I'm going to rely early on in the process on experts to conduct those audits and to teach us along the way, but we are able to go and audit those activities and those costs, so I feel like the controls will work exactly as we are all used to employing them.

MR. BUTLER: Thank you, Ms. Ousdahl, that's the only redirect that I have.

CHAIRMAN GRAHAM: I actually have a question.

MR. BUTLER: Okay.

CHAIRMAN GRAHAM: JEA is a municipality --

THE WITNESS: They are.

CHAIRMAN GRAHAM: -- so you're going to have full access to everything, because it's all public record. How is that going to be the same as PetroChem -- Petro --

THE WITNESS: Quest.

MR. BUTLER: Quest.

THE WITNESS: Yeah, well, actually the audit rights give us access to information that would be in more detail than you would have just through public records so, you know, if you just wanted to access JEA information through public records, you couldn't get to the detailed transactional level, but we're able to do that through our audit rights.

CHAIRMAN GRAHAM: You can actually get to every level --

THE WITNESS: Absolutely.

CHAIRMAN GRAHAM: -- because it's a municipality of JEA.

THE WITNESS: Publicly, without any proprietary relationship, oh, I did not realize. Well, we -- then I would explain that it would be the same. I mean, to the extent we have transactions coming from PetroQuest, just as we do JEA and Scherer, we will be able to audit what the support is for those transactions.

CHAIRMAN GRAHAM: I'm sorry. Mr. Butler?

MR. BUTLER: That's all that I have.

CHAIRMAN GRAHAM: Exhibits?

MR. BUTLER: I would move into the record Exhibit 20.

CHAIRMAN GRAHAM: I see no objections to

entering Number 20.

MR. BUTLER: And may Ms. Ousdahl be excused?

CHAIRMAN GRAHAM: Yes.

MR. BUTLER: For good this time.

CHAIRMAN GRAHAM: Thank you very much.

MR. BUTLER: Thank you.

CHAIRMAN GRAHAM: It looks like a good time to take a break. I have about 11:22 back there, let's come back at 11:30, about seven or eight minutes.

(Brief recess taken.)

MR. BUTLER: All right. FPL calls as its next witness Dr. Taylor.

Whereupon,

DR. TIMOTHY TAYLOR

was called as a witness on behalf of Florida Power & Light, and testified as follows:

DIRECT EXAMINATION

BY MR. BUTLER:

Q Dr. Taylor, would you just please state your name for the record?

A Timothy Dale Taylor.

Q Thank you. And you're the same Dr. Taylor who testified on direct yesterday, is that correct?

A Yes.

Q Okay. Have you prepared and caused to be filed 10 pages of prefiled rebuttal testimony on October 13, 2014 in this proceeding?

A Yes.

Q Do you have any changes or revisions to your prefiled testimony?

A No.

Q If I ask you the same questions contained in your direct -- I'm sorry, in your rebuttal testimony, would your answers be the same?

A Yes.

Q And you have Exhibits TT, is it 10 through 12 that is attached -- I'm sorry, 11 and 12 that are attached to your rebuttal testimony?

A Yes.

Q Do you have any changes or corrections to those?

A No.

Q Are they accurate and correct to the best of your knowledge and ability?

A That's correct.

Q Okay.

MR. BUTLER: I'm sorry, Mr. Chairman, I neglected to ask that Dr. Taylor's rebuttal testimony be inserted into the testimony as though read.

CHAIRMAN GRAHAM: We will insert Dr. Taylor's prefiled rebuttal testimony into the record as though read.

MR. BUTLER: Thank you.

(Whereupon, prefiled testimony was inserted.)

Q. Please state your name and business address.

A. My name is Dr. Tim Taylor. My business address is 601 Travis, Suite 1900, Houston, Texas, 77002.

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

A. Yes. My direct testimony was submitted on June 25, 2014.

Q. Have your position, duties, or responsibilities changed since you last filed testimony in this docket?

A. No.

Q. Are you sponsoring any rebuttal exhibits?

A. Yes. I am sponsoring Exhibits TT-11 and TT-12, which are Type Curve 1 (Western): 5.3 Bcf Estimated Ultimate Recovery ("EUR") and Type Curve 2 (Eastern): 7.4 Bcf EUR, respectively.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address claims made in the direct testimony of the Office of Public Counsel witness Lawton and the Florida Industrial Power Users Group witness Pollock. Specifically, my rebuttal testimony addresses and refutes witness Pollock's and witness Lawton's erroneous assertions regarding production risks of the Woodford Project. I will discuss the production risk for the Woodford Project's Area of Mutual Interest ("AMI"), which I conclude is very low. I also explain why it is possible to forecast production and operation expenses for the Woodford Project with a high degree of accuracy. Finally, I review investment in gas reserves throughout the Arkoma-Woodford region generally, and refute assertions about the quality of PetroQuest.

I. WOODFORD PROJECT PRODUCTION RISKS ARE LOW

Q. Mr. Lawton asserts that FPL's customers will be incurring risks of future output and reserve levels being different than forecasted by FPL. How would you characterize the level of that risk?

A. While it is certainly possible that the output and reserve levels will vary to some degree from the forecasted levels, I do not expect any such variances to be significant. In order to assist us in forecasting production for the wells in the Woodford Project, we analyzed the production performance of the 19 existing wells in the AMI and built type curves that represent the average performance of wells to be drilled in close proximity to the existing wells. These type curves, based on the 19 wells drilled in the AMI by PetroQuest, are shown in Exhibits TT-11 and TT-12. The red line on each graph is the type curve. It represents the average performance of all the wells in the western (Exhibit TT-11) and eastern (Exhibit TT-12) portions of the AMI. The grey lines represent the individual existing PetroQuest wells in the AMI that were averaged in order to create the type curves. The grey lines include all actual data to date together with updated forecasts of future production based on the actual data. As explained in my direct testimony, two type curves were necessary because of the difference in well performance in the eastern and western areas of the AMI. Since the actual start date of production for the wells in the AMI varies by well, I normalized the curves by showing all wells as starting at Year 0. There is little deviation in the pattern of production among individual wells and the type curves (the red lines) closely follow the pattern for the individual wells

The production risk of the Woodford Project with PetroQuest is very low. Exhibits TT-11 and TT-12 show that production from all 19 wells in the AMI has been robust and consistent, as well as highly predictable. There is little deviation in the pattern of production among individual wells, and the average for the wells (the red line) closely follows the pattern for the individual wells. This provides a high degree of confidence that the type curves we have used to forecast production from the Woodford Project accurately model the performance of wells in the AMI and provide a realistic and reasonable prediction of actual production from the Woodford Project wells.

The use of type curves is an industry standard method of forecasting production with a proven high level of confidence. In my career, I have built a large number of type curves in this manner. After new wells were drilled, their actual production performance was routinely compared to the forecasted production from the type curves. In my experience, when sufficient, consistent data was available to build type curves, as is the case in the Woodford Project, this method has proved to be very accurate. Furthermore, my production estimates were confirmed by an independent third party consulting firm, Forrest A. Garb & Associates, Inc., a trusted engineering firm with experience in the Woodford Shale.

This is not an exploration project where FPL will be "wildcatting" (i.e. drilling exploration wells). It is a development project in an area that has been thoroughly defined by the existing wells. Thus, it has been "de-risked" to a substantial degree by the time the Woodford Project begins.

Q. Mr. Pollock states that the benefits to customers are uncertain in part because of uncertainty about the operating costs incurred to produce the gas. Do you agree with this assertion?

A. No. Mr. Pollock's assertions evidence his lack of experience and expertise in the area of natural gas production. Natural gas production is a well understood technology, and the operating costs associated with gas production are highly predictable. Furthermore, PetroQuest has a long history of production in the Arkoma-Woodford region, and it is very familiar with operations in the region. That is one of the great benefits of selecting PetroQuest as a partner in this Joint Venture.

Q. Mr. Pollock expresses concern that FPL assumed no escalation of production costs in calculating projected total costs, arguing that it is not reasonable to assume that production costs will not change during the projected life of the Woodford Project. Similarly, Mr. Lawton asserts that FPL customers will be incurring risks of future operating and

maintenance costs being different than estimated by FPL. Do you agree with these assertions?

A. No. As discussed above, natural gas production costs are well understood. For the Woodford Project we examined the actual operating cost for each of 12 prior months from PetroQuest's records. We used the average of that operating cost in our PHDWin database to represent the future operating cost for all Proved Developed Producing (PDP), Proved Undeveloped (PUD) and Probable (PRB) wells. We did not escalate this operating cost because the continuing evolution of the production technologies is likely to cause those costs to decline, not increase, over time.

As discussed in the rebuttal testimony of FPL witness Forrest, the effective costs for production in the Woodford Shale region have been declining over the past few years as a result of technological advances. The following are just a few examples of such advances since 2008:

- Efficiencies in horizontal drilling from pads has made it possible to better operate multiple wells from a common surface location meaning several wells can share production equipment, which lowers the per-well operating costs.
- Operating multiple wells from a common surface location has also allowed those wells to share the same water disposal facilities and thus decrease salt water disposal costs.

- Additional experience in the dry gas portion of the Arkoma Woodford has allowed operators to refine the types of surface equipment, well treatments and choke sizes that regulate the surface pressure of the wells, all of which reduce down-time and the amount of man-time necessary for operating the wells.

These and future technological advances will impact the productions costs for the Woodford Project. For example, though not forecast in FPL's models, drilling in well-established areas such as the AMI is entering into a "manufacturing" mode where multiple wells can be drilled from one surface location. In view of this well-established and continuing pattern of technological progress, FPL's assumption that the production costs will remain the same over the life of the Woodford Project is, if anything, conservative.

II. ARKOMA-WOODFORD AREA MEETS FPL'S NEEDS

Q. Do you agree with Mr. Lawton's assertion that the market suggests that drilling in the Arkoma-Woodford area is decreasing to a "basic drilling standstill" at this time?

A. No. His assertion is simply not true. While it is true that drilling activity is less than it was four years ago, that activity is far from coming to a "basic drilling standstill" and, in fact, is increasing between 2013 and 2014. In 2013, there were 25 drilling rigs active in the Woodford in the Arkoma Basin. In

2014 that number grew to 37 rigs. Further, in 2013 there were 66 Woodford drilling permits issued by the State of Oklahoma. So far in 2014, 97 such drilling permits have been issued.

Moreover, Mr. Lawton's inaccurate assertion is not relevant to determining the value of the investment for FPL in the region. Rather, the specific economics of the project for FPL are what dictate whether the project is a good investment. As I indicated in my direct testimony, the Woodford Project is an economically viable and commercially attractive natural gas recovery project, operated by an industry leader in this region.

Q. Mr. Lawton suggests that FPL is ignoring competitive market price signals by investing in the Arkoma-Woodford region. Do you agree with his suggestion?

A. No. First of all, as I discuss above, it is simply not the case that drilling activity has dried up in the Arkoma-Woodford region. Second of all, to the extent that other investors are currently putting more emphasis on drilling in areas with substantial NGLs and oil rather than dry gas, then this creates an excellent opportunity for FPL to obtain dry gas on favorable terms from the Arkoma-Woodford and similar regions. Now is an excellent time for FPL to invest in dry-gas regions, while the competition for dry gas is lower than it will be in periods of higher gas prices. So there is no reason for FPL to delay its investment in the Arkoma-Woodford region; delay could end up costing

FPL's customers a substantial premium when general market interest returns to dry-gas drilling.

III. PETROQUEST IS AN APPROPRIATE PARTNER FOR FPL

Q. What is your opinion of Mr. Lawton's suggestion that PetroQuest's relatively small size and scale make it riskier than its peers in the gas and oil exploration and drilling industry?

A. Mr. Lawton does not understand the oil and gas industry. PetroQuest's size has nothing to do with its ability to drill and produce wells in an efficient and profitable manner. There are many more small independent companies in this industry than there are major companies. Because the smaller companies have fewer employees does not mean they are lacking in technical expertise. Rather, smaller companies are often substantially better at managing expenses such as overhead, and can focus their expertise. Because PetroQuest concentrates in only a few areas, it has become expert in drilling, completing and operating wells in those areas. PetroQuest has a long history of very successful operations in the oil and gas industry generally and the Arkoma-Woodford region in particular, which has made it highly respected within the industry.

Q. Does this conclude your rebuttal testimony?

A. Yes.

BY MR. BUTLER:
Q Dr. Taylor, do you have an oral summary of your rebuttal testimony?
A I do.
Q Would you please give that at this time?
A Yes.
Q Yes. Good morning, Mr. Chairman, Commissioners. My rebuttal testimony addresses assertions made by intervenor witnesses Pollock and Lawton as to risks associated with the Woodford Project.
The first assertion is that there would be a risk of reserve levels and output from the Woodford Project being significantly different than those forecasted by FPL. I disagree. I performed a rigorous analysis of the performance of the existing wells in the AMI using all the data available to me. From this analysis I generated two type curves that in my opinion represent the forecasted performance of the 38 wells to be drilled. While it is certainly possible that the output and reserve levels can vary to some degree from the forecasted levels, I do not expect any such variances to be significant in the aggregate. This is evidenced by my rebuttal exhibits.
Further, my analysis was confirmed by a

respected third party independent oil and gas engineering firm, Forrest A. Garb & Associates. In my opinion, the production volume risks are low.

In this regard, my rebuttal testimony also points out that the Woodford Project is not an exploration project where FPL will be drilling exploration wells, often referred to as wildcatting, rather it is a development project in an area that has been thoroughly defined by the existing wells. Thus, it has been de-risked to a substantial degree by the time the Woodford Project begins.

Mr. Pollock and Mr. Lawton also assert there's a substantial uncertainty around the operating costs used in our analyses. Again, I disagree. Natural gas production is a well understood technology and the operating costs associated with gas production are highly predictable.

Furthermore, PetroQuest has a long history of production in the Arkoma Woodford region. That is one of the great benefits of selecting PetroQuest as a partner in this joint venture.

For the Woodford Project, I examined the actual operating costs of each of the 12 prior months from PetroQuest's records. We used that average of that operating cost in our PHDWin economic database program to represent the future operating costs for all wells. We did not escalate this operating cost, because in my experience, the manufacturing mode in which these wells will be drilled, along with continuing evolution of production technology, it is likely to cause those costs to decline, not increase over time.

Mr. Lawton asserts the drilling in the Arkoma Woodford area is basically at a standstill. This is simply not true. In reality, drilling activity in that area is higher in 2014 than it was in 2013. In any event, Mr. Lawton's assertion is not relevant to determining the value of the investment for FPL in the region. Rather, the specific economics of the project for FPL are what dictate whether the project is a good investment.

The Woodford Project is an economically viable natural gas recovery project operated by an experienced operator in this region.

Mr. Lawton goes on to argue that FPL is ignoring competitive market pricing by investing in the Arkoma Woodford Project, but in my opinion the opposite is true. To the extent that other investors are currently putting more emphasis on drilling in areas with substantial NGLs and oil rather than dry

gas, this creates an excellent opportunity for FPL to obtain dry gas reserves on favorable terms from the Arkoma Woodford and similar regions, so there is no reason for FPL to delay its investment in the Arkoma region.

Finally, Mr. Lawton asserts that PetroQuest, because of its small size, is riskier than its peers. Again, in my opinion, Mr. Lawton misses the mark. PetroQuest's size has nothing to do with its ability to drill and produce wells in an efficient and profitable manner. There are many more small companies and independent companies in this country than there are major companies. Because the smaller companies have fewer employees does not mean they are lacking in technical expertise. Rather, smaller companies are often substantially better at managing expense, such as overhead, and can focus their expertise.

Because PetroQuest concentrates in only a few areas, it has become an expert in those areas. PetroQuest has a long history of very successful operations in the Arkoma Woodford Basin.

And this concludes my summary, thank you.

MR. BUTLER: Thank you, Dr. Taylor.

I would just note for the record that

Exhibits TT-11 and 12 are Hearing Exhibits 31 and 32 respectively. And with that I tender the witness for cross examination.

CHAIRMAN GRAHAM: OPC?

MR. TRUITT: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. TRUITT:

Q Good morning, Dr. Taylor.

A Good morning.

Q Again, I'm going to try and keep this brief. Now, you had mentioned significant in your opening, and that's what I'm looking at on page 4 of your rebuttal, where you said, "I do not expect any such variances to be significant."

Now, isn't it true that your definition of significant in this context is a variance of 10 to 20 percent per well?

A Ten to 20 percent in the aggregate.

Q Okay. Now, I'm also wanting to look at your TT-11 and 12, if we could just generally speaking. You would agree with me that the earliest well in your type curve analysis -- and I'm combining the two in this question -- was drilled in 2010, correct?

A Yes.

Q Okay. And you would also agree with me that

some of the actual production data in this is based on a well drilled as recently as 2013, correct?

A I think the latest one is in 2012.

Q 2012, okay.

A I think so, yes.

Q So it would be accurate for me to say that on your exhibits you have the lines Labeled Production of Individual Existing PetroQuest Wells in the AMI, it would be accurate to say that the qualifier to that is you have at least 21 years or 22 years of extrapolation up to -- I'm sorry, 21 years of extrapolation up to 23 years of extrapolation, that would be correct?

A That would be correct, yes.

Q Okay. I noted also in your rebuttal you mentioned the increase in permits. Are you aware of any requirement that if you get a permit, you have to drill the well?

A Absolutely.

Q If you get a permit, you have to drill a well, so every --

A No, no, I'm sorry, you do not have to drill the well.

Q Okay.

A If you get the permit, that is the intent to drill the well.

Q Okay. Now, you testified that you based your estimates of drilling costs on the 12 month history, correct?

A Yes, the operating costs, not the drilling costs.

Q I'm sorry, the operating costs.

Now, when you analyze these companies in looking at this, looking at the history of the company, you look at the history of the company as it operated in that area, is that correct, when you're doing this type of review?

A Yes, I wouldn't want to use that same data from another area to forecast the production costs in this area.

Q Right. And you also look at the ability to maintain capital costs within a reasonable range of expectation, isn't that correct?

A That's correct.

Q Now, we discussed this in the deposition, isn't it true that for you, operating costs at 20 to 30 percent range is after that range, that's when your level of comfort is exceeded?

A I thought that question pertained to production levels and not operating costs.

Q Do you have a copy of your --
A I do.
Q -- deposition in front of you?
Okay. If we could turn to page 36, which I know this has already been admitted into the record as exhibit --
A Of my rebuttal testimony?
Q No, no, no, I'm talking about your deposition, sir.
Yeah, it was admitted in as 57. Do you have a copy of your deposition, sir?
A Oh, the deposition?
Q Yes.
A Yes.
Q Will you look at page 36, you would agree with me the question I asked here, starting on line 2, I asked, "In terms of variance in production costs, what percentage of variance, from what you're anticipating, do you consider to be okay, now we're outside the range of what I'm comfortable with?"
And you would agree with me that your answer, "If I saw operating costs 20 to 30 percent higher than I anticipated, I would consider that to be outside my range of comfort."
A Yes, I stand corrected, that is what I said.

Q Okay, I just wanted to make sure we were clear on the record.

Now, again, on the topic of drilling, you testified in your rebuttal that PetroQuest was an industry leader in the region, correct, I think that was the word you used?

A In my opinion, yes.

Q Okay. Now, isn't it true that you did not do an analysis to see what other companies' performance have been in the Arkoma Woodford?

A That's correct, I did not.

Q Okay.

MR. TRUITT: No further questions.

CHAIRMAN GRAHAM: Retail Federation?

MR. LAVIA: No questions, Mr. Chairman.

CHAIRMAN GRAHAM: FIPUG?

MR. MOYLE: Thank you, Mr. Chairman.

CROSS EXAMINATION

BY MR. MOYLE:

Q I have a few questions of you, Dr. Taylor. Good morning.

A Good morning.

Q If this Commission does not approve this deal and it stays with USG, you're okay with that, right, as a company?

A It meets our investment requirements, so if the Commission does not approve this project, USG will continue with the joint venture.

Q Okay. On page 6, line 7, you use the phrase de-risked?

A Of which document?

Q I'm sorry, this is on your rebuttal testimony. It's toward the -- it's the end of an answer, but you say, "Thus, it has been de-risked to a substantial degree by the time the Woodford Project begins," and I just want to be clear that when you use the term de- risked, what you're referencing there is the risk of whether there is going to be natural gas in the area, correct?

A I'm actually referring to the risks associated with the volumes of production that I have forecasted and that can be pointed out very easily on the map over here, because if you look at all these dark lines in here, those are existing wells, seven to 19 wells have been drilled in 19 sections. So it would be highly unlikely that the performance of a well drilled in between two of these wells could have a different outcome from what I have forecasted.

Q Okay. Well, I'm still learning the nomenclature on this, so I may not have asked the

right question. But the de-risked phrase doesn't -- you know, is not referencing the risks that we talked about last night when I provided you that PetroQuest annual report, that excerpt that had all those risks, correct?

A No, and I stated that that document had no bearing on my analysis. When I refer to de-risk here, I'm talking about the risk of reserves.

Q I just want to make sure that the record was clear and we were communicating clearly on the de-risked phrase.

You take issue with FIPUG's witness Pollock on page 6 and page 7. Mr. Pollock, I think, criticizes you for assuming no escalation of production costs in calculating your projected total costs, is that right?

A Yes.

Q And how long did you have a projection for, how many years, how many years out did you project with no escalation?

A Until the economic limit was reached, and in some cases, I think that went out as far as 50 years.

Q Okay. And do you have familiarity with the Consumer Price Index?

A Vaguely, but I don't use it.

Q Do you know what it is?

A I do.

Q What is it?

A It's a consumer price index escalation factor.

Q And in commercial transactions, a lot of times people, to cover possible escalation in price, they use CPI, Consumer Price Index, correct?

A They certainly could, yes.

Q And your belief is is that even over 50 years, that the production costs of extracting natural gas is going to essentially remain the same?

A Yes, and there are reasons for that. So, one, you know, as I described earlier in my opening statement, this is not an exploration project, it's a development project. And the fact that we are going to start developing these undrilled locations in a manufacturing mode, meaning that we're going to drill multiple wells from a common surface location, and when that happens, your operating costs are going to go down because you have got less personnel -- fewer personnel dealing with a larger number of wells. When you get service work done on the wells as far as treatments or whatever, it's cheaper, because you have got a concentrated surface area.

Q And I asked you, I think it was yesterday, you didn't have familiarity with the guidelines, so to the extent that the guidelines are approved, you don't know whether they would contemplate exploration as well, correct?

A I do not, because as I said, I'm not familiar with the guidelines, I didn't use those in my analysis. They had no bearing on my analysis.

Q Okay.

A This certainly is not an exploration project, it's a development project.

Q I understand. But you, in your answer to my previous question, you kind of were careful to say this is not an exploration project. To the extent that future projects involved exploration, would your opinion change with respect to the production costs?

A There would certainly be less -- you would have less assurance, because you wouldn't have a history of production costs in an exploration project.

Q Likewise, that chart I tried to show you last night that had production costs for the region, you didn't have familiarity with that chart and the production costs for the region?

A I have the same answer as I did last night. I have no familiarity with that document.

Q Okay. All right. Well, I will ask Mr. Forrest questions about that. Thank you and safe travels.

A Thank you.

CHAIRMAN GRAHAM: Staff?

MS. BARRERA: Staff has no questions for this witness.

CHAIRMAN GRAHAM: Commissioners? Commissioner Edgar.

COMMISSION EDGAR: Thank you, Mr. Chairman.

Very briefly, welcome back. You had a discussion with Mr. Moyle briefly about some of the difference with nomenclature between an exploration site and also a production site. With that in mind, are the terms production and development synonymous, or for the nomenclature for this type of activity, do those different terms denote some different level of activity?

THE WITNESS: I think it depends on the project you're looking at. So production generally refers to the volumes of oil that are -- or gas that are being produced from a well and how they are handled once they get to the surface.

Operating costs are the costs of getting those to the market.

COMMISSION EDGAR: So for the site that we are discussing for this proposed project, do you believe that it is an exploration site?

THE WITNESS: I believe it is not an exploration site, it's definitely not, because this 19 sections have 19 wells, all of which are currently producing and all of which have been producing for some period of time. In fact, a long enough time for me to project what their future performance will be.

And, in fact, if you look at the graph and you did the math on those two exhibits, you would see that over 40 percent of the reserves in these wells are recovered in the first four years of production.

COMMISSION EDGAR: And how long has this site been in production?

THE WITNESS: The earliest well in the AMI was drilled in 2010.

COMMISSION EDGAR: Okay, thank you.

CHAIRMAN GRAHAM: Commissioner Balbis.

COMMISSIONER BALBIS: Thank you, just a quick question. You had some discussion with Mr. Truitt about permits or approvals and I assume from the Oklahoma Corporation Commission?

THE WITNESS: Yes.

COMMISSIONER BALBIS: When a company receives authorization to drill, is there a timeframe where that approval or permit expires, and if so, how long it that?

THE WITNESS: Yes. In Oklahoma that permit is good for six months. So, in other words, if you get a permit to drill a well, from the date the permit is issued, if you do not start the drilling operations or some operation related to drilling within six months, the permit will expire.

COMMISSIONER BALBIS: Okay. And would that be one of the reasons why FPL's petition has not been replicated, in that the regulatory lag normally is longer than six months?

THE WITNESS: I'm sorry, I'm not sure I see the connection.

COMMISSIONER BALBIS: Well, here this petition was filed I think in June and we're in December and we're still deliberating over this and if the permits are only good for six months, wouldn't it be important to have a quick process for companies to engage in this activity?

THE WITNESS: Yeah, so the way it works with us in PetroQuest, and we are currently partners with PetroQuest in this area, is that we get involved in the planning of the wells to be drilled and PetroQuest does the actual permitting in enough lead time that we have the rigs available at the time those wells need to be drilled.

COMMISSIONER BALBIS: Okay, thank you.

CHAIRMAN GRAHAM: Redirect?

MR. BUTLER: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. BUTLER:

Q Dr. Taylor, would you turn to your Exhibits TT-11 and TT-12, the curve showing the expected recovery?

A Yes.

Q I just want to confirm something that you had discussed with Mr. Truitt. Basically the first four years from the left are the periods in which there is actual data, is that right?

A That's correct. And after that they are forecasts.

Q Would you -- well, how would you characterize the fit of the red line, the type curve, within the actual data for the four years where we have actual

data?

A I would say it's extremely good. You don't see large variations in the performance of the wells relative to the type curve.

Q Okay. Mr. Truitt asked you a question out of your deposition or confirmed something out of your deposition where you had said that it wouldn't be surprising, I think, or it wouldn't be significant for operating costs to be higher by a range of 20 to 30 percent. Do you remember that?

A Yes.

Q Okay. Do you expect that sort of upward variation in the operating costs for the Woodford Project?

A I do not expect that operating cost to go up within that range. In fact, I looked back at the historical operating costs very recently and for the last two years it's been flat.

Q Okay.

A And I expect that to go down when we enter the manufacturing mode that I mentioned earlier.

Q Okay. And from the experience you have seen so far in the Woodford region, the area of mutual interest where the Woodford Project would be conducted, what is your expectation as to the

variability percentage terms on aggregate for the project on the volume of production?

A I think I stated in my testimony that plus or minus 10 percent, although if you look at the type curves that I have developed here and the actual performance relative to those type curves, we're currently within 1 percent of that forecast.

MR. BUTLER: Thank you. That's all the redirect that I have.

I would move Exhibits 31 and 32, if I have the numbers right.

CHAIRMAN GRAHAM: Any objections? We will enter 31 and 32 into the record.

MR. BUTLER: And may Dr. Taylor be excused?

CHAIRMAN GRAHAM: Yes, he can.

THE WITNESS: Thank you.

CHAIRMAN GRAHAM: Sir, travel safe.

MR. BUTLER: Our next witness is Mr. Deason.

(Transcript continues in sequence with Volume 7.)

* * * * *

CERTIFICATE OF REPORTER

STATE OF FLORIDA:

COUNTY OF LEON:

I, TERRY WILHELMI, Certified Court Reporter do hereby certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter translated under my supervision; and the foregoing pages numbered 663 through 870 are a true and correct record of the aforesaid proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor relative or employee of such attorney or counsel, or financially interested in the foregoing action.

DATED THIS 3rd day of December, 2014.

Terry Wilhelmi
TERRY WILHELMI, CCR
Certified Court Reporter