BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of : **DOCKET NO. 981390-EI**

Investigation into the equity ratio and return on equity of Florida Power & Light Company.

PROCEEDINGS: **AGENDA CONFERENCE**
ITEM NO. 10

BEFORE: CHAIRMAN JULIA L. JOHNSON
COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER JOE GARCIA
COMMISSIONER E. LEON JACOBS, JR.

DATE: **Tuesday, November 3, 1998**

TIME: Commenced at 9:30 a.m.

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

REPORTED BY: JOY KELLY, CSR, RPR
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TIM DEVLIN, BETH SALAK, PETE LESTER, ANDREW MAUREY, DAVID DRAPER and **JOHN SLEMKEWICZ**, Division of Auditing & Financial Analysis.

MATTHEW CHILDS, Steel, Hector & Davis, representing Florida Power & Light

VICKI GORDON KAUFMAN, Decker, Kaufman, Arnold & Steen, representing Florida Industrial Power Users Group

RICHARD J. SALEM, Salem, Saxon & Nielsen, representing Harris Corporation.

P R O C E E D I N G S

MR. LESTER: Commissioners, Item 10 is an investigation into the equity ratio and return on equity for Florida Power and Light Company. For 1998, according to the Forecasted Surveillance Report, FP&L's equity ratio was 65.7%, and that's very high compared with other electric utility companies. It remains high after allowing for the effect of purchased power agreements. Also FP&L's equity ratio has increased steadily over the past four years. Common equity is the highest cost source of capital so the higher percentage of common equity in capital structure, the higher the overall cost of capital.

Regarding the return on equity, long-term interest rates have declined and are currently quite low. And other states have set ROEs that are lower than FPL's currently authorized ROE of 12%.

For these reasons Staff believes there's potential overearnings and we're recommending a hearing at this time.

Staff has passed out an exhibit that condenses these issues. This shows the revenue effect of return on equity and equity ratio at various levels.

CHAIRMAN JOHNSON: Who wants to go -- I'm not sure who you represent, I'm sorry. If you could state your name and who you represent.

MR. SALEM: Madam Chairman, members of the Commission, Staff, I'm Richard Salem with Salem, Saxon on behalf of Harris Corporation, together with Robert Sands, vice president of Harris Corporation.

As you're aware, Harris Corporation is headquartered in Melbourne, Florida, with 28,000 employees worldwide. 8500 of them reside in the Florida Power and Light service area.

This item is of vital importance to Harris Corporation. It consumes a great deal of electric power, and it is concerned, as we all are, on increasing costs and expense in doing business.

To the extent that the Staff has recommended that the return on equity, the earnings ratio and earnings be reviewed on an analytical basis, and to the extent that those considerations can be taken into account in reviewing the embedded rates and leasing and electric rates themselves, Harris Corporation commends the Staff, and recommends and requests that the Commission consider carefully this item in proceeding with the investigation as recommended.

Mr. Sands is here to answer any inquiries you might have. And we appreciate your consideration.

CHAIRMAN JOHNSON: Thank you. Ms. Kaufman.

MS. KAUFMAN: I'm Vicki Gordon Kaufman of the McWhirter Reeves law firm. I'm here on behalf of the Florida Industrial Power Users Group.

And we support the Staff's recommendation to hold hearings on the appropriate ROE and equity structure for Florida Power and Light.

MR. CHILDS: Commissioners, my name is Matthew Childs. I'm here on behalf of Florida Power and Light Company. The Staff recommendation is rather lengthy and technical, and I have some comments that will take some time, but bear with me.

We ask that this Commission take the longer view towards addressing the best interests of the customers and not look to, what I think is in the recommendation, more of a short-term perspective.

I remind the Commission that its longer view was addressed as recently as January of this year when the Commission extended the amortization authorized for Florida Power and Light Company for two years through 1999.

The plan under the Commission's policy was to authorize FP&L to record additional expense in those years equal to 100% of the revenue between the low band, and most likely revenue band forecast from 1996, and at least 50% of the amount of revenue actually -- this is base rate revenue -- actually realized above that most likely band.

That amount, the amortization, was to be applied under the Commission's approved method to various categories. Appendix B of your Order in January sets those out.

For instance, it says that they are to go to the correction of any depreciation reserve deficiency resulting from an approved depreciation study, writing off the unamortized loss on reacquired debt, correction of the reserve deficiency, if any, exisiting in FPL's fossil dismantlement reserves, and correction of the reserve deficiency, if any, existing in FP&L's nuclear decommissioning reserves.

In prior years, 1995 through '97, the amount that FP&L -- this is under an earlier version of the amortization plan -- FP&L amortized and charged to expense about \$60 million for its depreciation reserve deficiency, \$109 million for the loss on reacquired debt, and nearly \$175 million relating to the nuclear production depreciation reserve deficiency. In addition, \$30 million was charged per year for nuclear production plant amortization.

Outside of the plan, the amortization plan in 1995 and '97, FP&L wrote off on the balance sheet approximately $87 million in litigation costs that had been deferred by prior action of this Commission, and $21 million for nuclear maintenance reserves.

These write-offs and actions to improve FP&L's balance sheet and to effect the basis for a long-term cost reduction were the result of FP&L's aggressive control of costs.

To refresh our recollection a little bit on the prior efforts of Florida Power and Light I have some statistics. Between 1991 and 1997 FP&L's capital expenditures were $5.9 billion. It added 2,794 megawatts of capacity. However, its O&M costs in that same period declined -- that's O&M cost per customer -- declined by 24%; from $380 to $290. Rates for a thousand kilowatt hours declined a little over $3 in that same period for residential service, thousand kilowatts, $80.43 to $77.30.

During this period where these declining costs were recognized, and despite the substantial increase in the investment by Florida Power and Light, the annual decommissioning costs increased by $47 million a year and the dismantlement costs increased by $7 million a year. Even before the PSC had authorized amortization, FP&L incurred substantial cost reductions and charged approximately $228 million to achieve those cost reductions in manpower in the '91 and '93 period. Between '91 and 1997 FP&L retired $4.7 million in debt.

During those years FP&L did not limit its write-off amount or the expenses, that is expenses charged, so as only to produce an earned return equal to the maximum authorized. In fact, it consistently was below the maximum authorized, and for two years was below the minimum of the zone.

Those are a lot of facts and figures. And I ask you to take them, and they are being presented because I think they have a lot to do with what is before you today.

We believe that these efforts have already produced substantial benefits for FP&L's customers and have the opportunity to continue to produce substantial benefits but of a more long-term nature. I think that it's more important that we focus on that goal now. There are several positions, however with the recommendation that's before you today that trouble us. And although we think the long-term goal is the proper focus, I believe it's appropriate to comment on several matters that are in that recommendation.

First, on Page 2 of the recommendation the

Staff says that FP&L's Forecasted Earnings Surveillance Report projects an equity ratio of 65.7%. It says this is high, and it uses this as a point of departure to attempt to compare Florida Power and Light Company to other utilities to make the point that the equity ratio is not appropriate. And it does that in Attachment 3.

First of all, I'd like to comment that FP&L's report, its Surveillance Report, its forecast for 1998 operations, nowhere states an equity ratio of 65.7%. Instead, this number is a number that was constructed for purposes of the recommendation to make a point. In the recommendation, significant or repetitive references are made to S&P --

COMMISSIONER DEASON: Mr. Childs, do you disagree with the number?

MR. CHILDS: I disagree with the significance of the number, and that's what I'm trying to get to, Commissioner. That the comparison that the Staff uses -- if you look at Attachment 3, which is the basis for Attachment 6 that Staff just handed out -- is a comparison of equity ratios between FP&L and various other utilities that have AA ratings. Now, this is a selected group where Staff eliminated some of the utilities that have AA ratings, and did its comparison. The significance of Standard & Poor, however, is this is Standard & Poor's rating of AA, and, therefore, the number that the Staff has used, I think, of 57% is important.

Standard & Poor does not calculate this equity ratio. When they determine how to rank the riskiness of utilities, they don't compute the equity ratio that Staff did. Instead, they recognize a debt ratio. And in calculating the debt ratio, they include off-balance sheet obligations, or a portion of off-balance sheet obligations, to determine what the real debt is when those off-balance sheet obligations are included. In fact, they treat it as debt, a certain portion of those obligations, because the utility, in their view, has to pay them, and it affects cash flow.

Now, if one were to look to the ratings, it's based upon adjusted debt/equity as one of the components -- excuse me, debt ratio as one of the components, not adjusted equity. However, Staff's calculation has another omission, I think, and that is that it does not reflect the differences in the companies for their preferred. So their number does not produce 100% of capitalization, and if you looked at -- and the numbers are available -- if you looked at the preferred stock for the various companies and included the preferred stock as equity instead of just common equity, you would see a different result. Three or four of the companies have ratios that are higher than Florida Power and Light has.

My point, Commissioner Deason, as to whether I disagree with the number is that I believe the Staff's view is backwards. It looks at a constructed equity number instead of an adjusted debt ratio. And I believe the backwardness of that is illustrated on Page 7 of the recommendation where it -- the comment is made that the debt cost for Florida Power and Light Company in a recent issuance -- the issuance was only for ten years -- normally they are 30. But, nevertheless, the Staff used this as a basis to conclude that when comparing the cost for the debt for FP&L to the cost of debt for Con-Ed and said there isn't very much difference. But it pointed out that the equity ratio for Florida Power and Light was 64.1%, and that's for a different period, Commissioner. That's for the period ending March 31st, 1998. So it was 64.1% for Florida Power and Light Company, and 54.9% for Con-Ed; nearly 9%, or a little more than a 9% difference. Now, the Staff does as a parenthetical note on that Page 7, the adjusted -- so-called adjusted equity ratios. But the point is, is that looking at Attachment 3 you see that the S&P rating for these AA -- you see these companies are rated AA that the Staff has selected. That rating is based upon the debt ratio. And when you look at the debt ratio of Con-Ed from the same data source that Staff had you see it's 45.8% and Florida Power and Light Company's is 42.5%. The reason simply is Florida Power and Light, as a percentage of capital, has a significantly greater amount of off-balance sheet obligations than Con-Ed does.

COMMISSIONER DEASON: Could you repeat those percentages again?

MR. CHILDS: 45.8% for Con-Ed and 42.5% for FP&L. That's the adjusted debt ratio recognizing the off-balance sheet. The riskiness of the bonds is based on that ratio, not an equity ratio.

Now, my point about the preferred stock is simply that the reciprocal of the debt ratio is one minus the debt ratio. And when you do that calculation you get a number. It's not apparent or evident in the calculation that the Staff has done, and they make no comparison for the differences between the companies when you look at preferred.

Staff's method, in short, is based upon, I think, a questionable selection process of the companies that are in its comparable group. It's based upon a flawed methodology, with the stated goal of reducing FP&L's equity ratio, quote, "to the average." And it proposes to do so --

COMMISSIONER CLARK: Mr. Childs, just so I'm clear, they've sort of laid out their analysis to date, and they provide that analysis as the basis for suggesting we look at it through a hearing process.

MR. CHILDS: Right.

COMMISSIONER CLARK: And you're suggesting that analysis is so flawed that we shouldn't even look at it through a hearing process?

MR. CHILDS: My suggestion, Commissioner, is that, first, to remind the Commission that we're in the midst of a two-year amortization program just approved this year, running through 1999. And my position, as I urged the Commission, is to take the longer view and to stay with that program and not take this side trip that is suggested to you. And in addressing that, what I was attempting to point out is that I believe there are sufficient difficulties with the analysis that's presented to you, particularly when you look at what the longer term view could achieve, that it's not necessary or appropriate to follow through with the recommendation that is being made to you.

Their recommendation, to repeat, is to move the equity ratio of Florida Power and Light Company to the average, and to do so regardless of consideration of the preferred equity ratios and regardless, apparently, of how the equity ratio came about.

What they just distributed is their basis for this. If you look at the number 57.13 that they have there. That is shown on their Attachment 6 where they show, supposedly, an adjusted -- excuse me, an equity ratio of Florida Power and Light of 57.13. And if they adjust that equity ratio of Florida Power and Light to the average that they compute for their selected group, then they would produce a revenue effect. We think that's flawed. They bring us to --

COMMISSIONER DEASON: Mr. Childs, it's flawed because you disagree with 57.13% as being the average, or you disagree because it's inappropriate to base it upon an average?

MR. CHILDS: Well, I disagree -- I disagree, first of all, because I think it's flawed as a matter of technique. I think it's flawed as a matter of technique simply because Standard & Poor, which is the rating agency that Staff has used for its selection of comparables, looks at adjusted debt ratio; it does not look at adjusted equity ratio.

COMMISSIONER DEASON: But you indicated that the adjusted debt ratio is -- I forget my mathematical terminology -- but it's one minus the debt ratio would equal the equity ratio.

MR. CHILDS: That's correct. And what I'm saying is, is that the numbers that are shown here on the Staff's Attachment No. 3, under adjusted equity ratios, are not the result of one minus the adjusted debt ratio. In fact, all they present is the common equity ratio. They ignore preferred. So you don't know that if one company has more preferred than another -- which is the case -- you don't know how they fit. You don't know what the relationship is. And that's the other part of what I think is a technical flaw, and I think it's a significant one in the calculation.

The third area of flaw in that methodology --

COMMISSIONER DEASON: I'm sorry. What was the second flaw?

MS. CHILDS: The second is that it does not include the preferred component and then make a comparison that way.

Now, the selection process itself that the Staff has used is to exclude any AA companies that did not have off-balance sheet obligations. I think you can see that if you compute an adjusted equity ratio, if you don't have any off-balance sheet obligations, your equity ratio is what it was before. It's not adjusted. They didn't include any of those so you don't get that view either.

I think another flaw in the approach is this: It doesn't look to how the equity ratio that Florida Power and Light has came about. Just as, for instance, it doesn't look to how the adjusted equity ratio that they've computed for other companies may have come about. For instance, that Florida Power and Light has spent substantial money -- and I gave the figure earlier, $4.7 billion of debt that had been redeemed, and that's going to have an impact on your capital structure. I don't think -- and this is another area of the difficulties that I have with this suggestion -- I don't think that it's appropriate to look sort of in mid-stream when we're in the process of attempting to take and implement a long-term view to cost reduction and say, "Well, let's stop here."

COMMISSIONER CLARK: Well --

MR. CHILDS: Let me finish that thought.

For instance, and I think it's only to give the flip side a little bit, but for instance, in rate cases this Commission, when companies have gone through heavy construction programs where they've issued a lot of debt and their equity ratios are low and they have a lot of debt outstanding because of the heavy commitment for construction programs -- this is something that happened with a lot of utilities in the '70s. When those companies came in for rate increases, they had low equity ratios. The Commission didn't say, "Well, it ought to be higher." In fact, what it said is -- and it said this to Florida Power and Light in the '80s, "It may make sense to improve your equity ratio, but outside of a rate case." I'm not saying that that justifies a particular ratio, but I think it justifies taking a longer term view as opposed to a shorter term view.

Now, I think that the result, when you see, for instance, the Attachment 6 that's in color now, that based upon the Staff's computation that was in the recommendation, or someone's recommendation, that the way that he would achieve this result of producing the 57.13% equity ratio to the average for the AA companies selected would be issue approximately $610 million of debt and dividend it all upstream to the parent. That would fix the equity ratio. And I don't think that's appropriate financial behavior.

COMMISSIONER CLARK: I'm sorry, Mr. Childs. Would you repeat that?

MR. CHILDS: That if the Florida Power and Light Company were to implement the recommendation, that is to reduce the equity ratio that's on this sheet that was just passed out to you at the start, reduce that adjusted -- or that equity ratio from 57.13% to the 48.93% that is computed for the other AA companies that are the comparables, that would require a transfer of funds to change the equity ratio of the company. Which would mean, you'd have to dividend out approximately $600 million to the parent. The only way you're going to get that money is to either stop your amortization substantially and issue debt, or issue all debt and dividend it out. I think that's -- I bring that to you because I think it supports what our view is, is that you're being asked to look to a short-term view.

The next point on the recommendation --

CHAIRMAN JOHNSON: Could you go back to that point? You said you'd have to dividend out about 600 million to the parent. You said the only way you could do that is what mechanism?

MR. CHILDS: My point is -- I'm sorry, the only way to do that is what?

CHAIRMAN JOHNSON: The two mechanisms.

MR. CHILDS: Well, assuming that a plan continues at all, if you follow this recommendation, if the plan continues at all for a continued amortization expense, then in theory cash produced by the amortization expense could be dividended upstream to the parent. But you wouldn't have enough, so you'd have to issue debt to make up the $600 million. And I think that's one of the points that I'm trying to make, Commissioner Johnson, when you bring it up. As you go through time, when cash is produced, one of the things a company could do is to say, well, cash is produced through some of these expenses that we're recognizing. Well, what do we do with it? One of the things that was done was to redeem some long-term debt. Of course, you could dividend it out.

And I think that in terms of looking at it -- and I hope to get to some better comparisons -- that when you see the impact of some of these actions and what I think is an inappropriate view of those actions, that you might see the difference.

On Attachment 4 of the recommendation, this is presented to support the assertion on Page 5 that

FP&L's actual and adjusted equity ratio increase significantly from '93 to March 31, 1998. And then Page 5 the recommendation states, "Whereas, the averages for the peer group do not show a corresponding increase." Well, if we turn to Attachment 4 and look at the entries under "Adjusted Equity Ratio" you'll see that what is said is true. What is said is true. Except it doesn't point out to you that FP&L's adjusted equity ratio number for 1994 is 11% lower than the average for those companies for the prior year. So as someone might say, you started with your foot in the bucket and then you measure your rate of change. I don't think that's a fair comparison.

Another interesting factor, however, is look up the page to Florida Power Corporation. And this is an issue of why are these numbers what they are? And look at the entry for the year '96 and the year '97. And you see that Florida Power Corporation's equity ratio declined from 51.9% to 42.3%. No mention at all as to why. Well, you know, I don't know why, but I doubt that it was something that wasn't dramatic. It seemed that was about the time there were some write-offs by them of some costs. But when you're computing averages and saying the goal is to reduce you to the average, I think some these factors are important. We don't think that they were taken into account.

The Staff refers to other recent ROEs that have been allowed, and they refer to that on Pages 10 and 11 of the Recommendation. There's several difficulties that we have with this.

First of all, in earlier documentations that were given to us by the Staff in some of our discussions it showed that AA companies, which are now being used as the comparable for Florida Power and Light, had allowed returns of under one list 12.3%, that's the midpoint, and under another 12.5%. So those were the comparables and those were the allowed returns.

The other thing is that -- or another point, as I look at the companies, and we have, quite frankly, had some difficulty running some of these down to find out what happened. And I don't have a complete explanation. I know that I got one, I think just this morning, while I was sitting here, and it's Empire. The best I can figure out is that Empire was a distribution-only company, very small, less than 5,000 customers in Arkansas. And it was a settled case. And I don't think that indicates a whole lot.

Pacific Corp was a distribution-only case. It had, incidentally, in addition to the 10% return for ROE, it had a program where the range was, the cap was 2.5 points higher. So it earned a 12.5 under that. And the bottom was 2.5 in the other direction. One of the other ones, I think it's Concord, was a distribution-only case. Some of these distribution-only cases are cases where they are setting returns for distribution in connection with various reorganizations. I think it was also Concord -- pardon me if I'm wrong -- but one of them I looked at in trying to read the order -- they are not published and they are not easy to find -- but it said yes, it acknowledged that its 10% return had been challenged because there was no evidence to support it. But they noted that it was a return that any of the companies could adjust when they came in with their rate filings. So I don't take that as indicating much of anything.

I would note that the only other recent allowance that I'm aware of is one for Wisconsin Electric. It's a AA rated company. It's not on this list. It was allowed in April of '98, 12.2 as an equity return.

Finally, what I want --

COMMISSIONER CLARK: Let me ask a question. What is Con-Ed rate?

MR. CHILDS: A+. It was AA through, I believe, 1995.

COMMISSIONER CLARK: A+ is less than AA-right?

MS. CHILDS: It's the next bracket down.

Finally, what I want to comment on is Attachment 5 to the Recommendation. And the Recommendation's conclusion is set forth on Page 7. And at this time I'd like to ask you to turn to Attachment 5 and there you see these lines. It's not real clear on the copy that I have what the numbers are exactly. But you can get pretty close. And I think you can take the clue that Florida Power and Light's the top one on each graph. And it shows that what the Staff has done is fixed, as they state, the cost, the return rate on equity at 12%. And then they computed the cost of capital using the other components of capital other than -- and they've excluded deferred taxes, customer deposits, tax and credits.

Now, Page 7 of the Recommendation talks about that a little bit, and this is in the middle paragraph. It says "However," middle paragraph, I think it's about third sentence down, "However, in FP&L's situation equity maintained at the utility level has increased significantly without commensurate decrease in the cost of debt." And the final sentence in that paragraph says "This shows that over the past five years" and it names the companies, one company's cost of capital has increased slightly, and FPC and Gulf's costs have declined in contrast to FP&L's overall cost of capital has steadily increased.

Now, when you look at this sheet, Attachment 5, you see this is their point; the cost rate is steadily increasing. And I want to distribute at this point a sheet also for you to look at.

What we've done, while that's being distributed -- what we've done is -- and we didn't do it for all, we just didn't have the time to include the Gulf number, but we went to the reports, Surveillance Reports for the other utilities, and we computed the total capital and the sources of capital and the weighted cost rate from those surveillance reports. And you'll see, for instance, that for the entry at the top, under the column headed 12/31/98, that the cost for Florida Power and Light is shown as 10.57%, and that corresponds to what is shown in the attachment that I was just referring to that's attached to the recommendation.

This is what I want to point out. If we look at the cost rate, we can see that the cost rate, that is on the rate of cost for capital for Florida Power and Light, did increase in those years from 10.02 to 10.57. The next company down increased under the weighted average cost, the capital cost rate, a little bit; not as much as FP&L. And the final company listed is about the same in '98 as it was in '94. This is the point I want to make.

Look at the weighted cost, the capital. That's the comparable to rate base. The capital. Florida Power and Light's capital, even though it has made over $5 billion in additions, and I don't think -- that's not over the same periods, so the amount is not that big -- but as a matter of change, FP&L's capital has declined absolutely by over $500 million. It's declined. Now, we see that the next company down, it's much, much smaller than Florida Power and Light, its capital increased or rate base increased by $350 million. So we have a $850 million difference between those two companies. Florida Power and Light and the next one down.

COMMISSIONER CLARK: Mr. Childs, is some of that decline in rate base as a result of us allowing the amortization plan?

MR. CHILDS: It's the result -- it is the result of the amortization plan in our view principally. In our view it's the amortization plan that we want you to continue that we think has had this kind of an effect.

Now, if you go to the last company it shows that the capital in that period increased by 18% or nearly $500 million. If you look at the rate of the cost of capital you will see that FP&L's rate is a little higher. If you look at the base to which that rate is applied you'll see that FP&L has a substantial decrease, $500 million. We think that -- and the next point is that even in the annual cost, FP&L's annual cost has actually declined while the other companies have increased substantially. And stated differently, if FP&L's rate base had grown at the 18% level that one of these companies actually experienced, and the cost rate for FP&L's capital were reduced to the 9.54% that that company shows, then FP&L's cost of capital in 1998 would have been $860 million, or $100 million higher than it is.

So I guess my point on that is that we look at this effect and say that's good, that offers long-term benefits. The Recommendation looks at it and says that's bad. And we think that you ought to stay with what you're doing and that you should continue to recognize that there's this opportunity to go forward.

One final comment to make, and that is a suggestion that in the Recommendation that perhaps we could change the equity ratio for Florida Power and Light Company and there wouldn't be any impact on Florida Power and Light Company's credit rating because -- and there's a discussion of other factors -- because. I would point out that the Standard & Poor report for Florida Power and Light Company covers situations I guess somewhat analogous to that and it points out -- and it's analogous in the sense that it says FP&L's rating is stable. It doesn't say it's tenuous or that it would -- you know, right at the top or right at the bottom; it says it's stable. Therefore, I don't think that a suggestion that you should make this dramatic change is appropriate, and we urge you to continue with the program that you have. Thank you very much.

COMMISSIONER CLARK: I didn't understand that last point. Would you repeat it?

MR. CHILDS: Yes. Standard & Poor, which again is a credit rating agency that rates all of these companies that was used by Staff to select the comparables that it shows in various of its documents, it issues a report on the credit rating for the company, any comments on it. It's a narrative. Talks about the financial posture of the companies and the business posture of the companies.

In the Recommendation, however, where there's a discussion about the need to change the equity ratio for Florida Power and Light Company, it is suggested that FP&L is healthy in other areas. And, therefore, suggested that you can change FP&L's equity ratio and it wouldn't affect the credit rating.

What I'm saying to you, first of all, that's little bit like reading tea leaves. But on the other hand, there is some evidence. And the evidence is what the rating agency itself says It says the rating is stable. It doesn't say that you can draw that conclusion, that changing the equity ratio would have no affect on credit rating.

COMMISSIONER CLARK: I don't get that.

MR. CHILDS: Okay.

COMMISSIONER CLARK: It seems to me if they say it's stable, it indicates to me that you have a stable credit rating and if you do make some fluctuations, it won't affect it being stable, whereas, if it were at the top or at the bottom a change is more likely to affect that rating.

MR. CHILDS: I don't think so I think the stable means, and as they discuss, they are reading it and looking at all of these factors, and it's in an equilibrium. For instance, when you saw that Con-Edison --

COMMISSIONER CLARK: So the factors making up the rating are stable, not that the rating is stable.

MR. CHILDS: I think they both go together. The factors are stable. That's why you have a stable rating. Because the business profile and the financial profile is stable. For instance, they state in there that in 1997 FP&L dividended up most of its earnings and they expected it to continue in the future. That's one of the factors that they look to when they say it's stable.

COMMISSIONER JACOBS: Your argument is that the debt ratio is going to be a more accurate reflection of the demands on cash flow?

MS. CHILDS: It's a more accurate reflection of the relationship of credit worthiness of one company versus another because it measures the cash flow relationship of the two companies.

COMMISSIONER CLARK: Mr. Childs, what is the difference between your cost of capital as a result of maintaining -- are you AA- or are you AA?

MR. CHILDS: AA-.

COMMISSIONER CLARK: AA- as opposed to A+.

MS. CHILDS: What is the result of cost of capital?

COMMISSIONER CLARK: What's the difference in the cost of capital? Because it would seem to me one thing you would want to look at is, is it appropriate for you to maintain that ratio.

MR. CHILDS: Sure. And I think that's implicit in the Recommendation.

COMMISSIONER CLARK: You think Staff is saying implicitly that you should maintain that rating.

MS. CHILDS: I think they may be saying that. I think they probably are saying that. However, I think that that's my point, Commissioner, about the difference between the long view and the short view, is that the company's situation as to its equity ratio is in large part due to the efforts that it is now undergoing, and has undergone, to which we think have produced very significant effects with our rates being lower than they were before.

You need to -- I think we're urging you to keep that in mind when you look at and say, "Well, is your equity ratio two points higher or two points lower than somebody else?" Secondly, as I said on the flaw, on the equity ratio when you look at preferred, we're not -- do not have the same difference that is shown in the Recommendation. But finally, Commissioner, as to the cost, I mean it's like the exercise in a rate case. Exercise in a rate case -- and you've looked at it, you've looked at it once and said, "Well, do we have increase earnings in order to permit a company to improve its credit rating?" And the Commission has concluded that no, it didn't want to that. But it didn't want to do that in the context of a rate case. That's my point is that in a rate case where you had to grant additional revenue for that purpose, said, no, we shouldn't do that. However, outside of a rate case it makes sense to do it.

I think that over the long term, for instance, we can look at the spreads and issuance costs for Con-Ed and Florida Power and Light in the recent past and say, well, what does that prove? I don't know, when you look at the capital markets in the short term, what that proves. But I think we need to take the longer term. Because once you change these ratios -- Florida Power and Light Company had a lower ratio for years, and it took years of -- after the changes, construction schedule and construction budget, to get out from under some of those earlier ratings. So my point is that precipitous actions are not necessarily the right ones.

COMMISSIONER CLARK: I'm not sure we're suggesting a precipitous action. I think all the Staff has said is here are some factors that argue a closer look.

MR. CHILDS: Well --

COMMISSIONER CLARK: And let me just ask the second question. If we don't take action now and do as you suggest, that we wait until after the amortization has run out, which is 1999 if I understand what you've said, we've lost any opportunity to recover for the ratepayers any money that we might subsequently believe was excessive because of the ratio equity or the return on equity allowed.

MR. CHILDS: Well, I guess what I'm urging the Commission to do -- I don't think that -- I mean we know that the program continues through '99, and we acknowledge the Commission can look at that program.

We understand that. I'm suggesting to you that I think the longer term view is to not say today -- not say as a Recommendation, that the information presented to you suggests that there's an imbalance as to equity ratio, and the information presented today suggests there's an imbalance on equity returns and that you ought to do something. Once you start taking that action it has an effect on it. And that's one reason I made the point, Commissioner, that in the past, when it was company management choice about what it was writing off, it didn't write down to the maximum of the authorized rate of return. And in two years even though it was engaged in write-offs it didn't even earn the minimum.

And I sort of feel that we're in a situation now where there's a bump up against a level that the authors of the Recommendation think is appropriate and we've got to stop right now. I'm urging please take the longer view because you can't turn it around real fast.

COMMISSIONER CLARK: With respect to looking at the concern expressed about higher debt to equity ratio and the point that the Commission did not feel it was appropriate to do that in the rate case, that it would be appropriate to take place outside of the rate case, I assume what that meant was we weren't going to allow increased revenues that would reflect a higher equity ratio than actually existed, but that as it was improved, that that higher equity ratio, for surveillance purposes, would be reported and would earn the higher ratio -- it would earn the equity rate, not that it would be kept at the prior ratios of equity to debt that were found in the rate case.

And I would point out, at least, I think, in a United Telephone case we found that they had too much equity. We imposed a hypothetical equity ratio and allowed returns based on that. And the Court said that that was appropriate to do.

MS. CHILDS: I think if that's being considered, that it ought to be considered very seriously, Commissioner, and I would ask to go back and look through the sheet I passed out. That's my distinction between cost rate and cost. Is that if you think that the -- now, what is being measured here is the effect of the ratio. That's the change that's being measured. Because they've kept -- you see from the prior attachment they've kept the return on equity constant. So the increase is only the result of the change in the equity ratio. And what I'm attempting to say is when you look at that -- and it's criticized in the recommendation -- when you look at that and you see Florida Power and Light Company has had an absolute reduction, even though it's added billions of dollars in plants, had an absolute reduction in its plant in service or its rate base.

Yes, if you do the calculation so that you measure the impact of the equity ratio change on cost of capital, FP&L's cost of capital overall has gone up a little bit here compared to these other companies but its costs have gone down substantially. And once again, it's the costs all along in terms of FP&L's programs in the past. It's the ability to contain costs, the effort and incentive to contain costs that the company had which made it able to do that. And those costs then were fed back into the process.

So if you -- I don't know how it can be said that, well, we don't want to change the equity ratio but we won't allow you to have it, because if you don't allow the company to have an equity ratio, then -- I mean it's different to say we're going to look at it, we're going to monitor it, that's fine. But if you're going to change it and the recommendation is to change rates on that basis then we would urge you no.

COMMISSIONER CLARK: As I understand the recommendation it's to, in effect, investigate through a hearing process.

MR. CHILDS: Well --

COMMISSIONER CLARK: Is there another way you'd like us to investigate it?

MR. CHILDS: I know it asked to investigate, but one of the, I guess, points of concern is, is that first of all, you know, repetitively, we think we're correct. But independent of that, when a docket is opened to say investigate, it suggests a lot of things. And I have -- I mean it suggests that -- I mean we have this docket, for instance, that suggests an investigation, but it suggests you have a hearing and you have it right away. And I think once you start rolling downhill that way, it sometimes becomes difficult to say, well, let's remind ourselves this was just an investigation.

CHAIRMAN JOHNSON: Any questions?

COMMISSIONER DEASON: Commissioners, is it Staff's intent to try to go through a line-by-line rebuttal of what Mr. Childs has said?

MR. DEVLIN: No, Commissioner I wanted to make a couple of comments and then pass out a sheet of paper.

COMMISSIONER DEASON: I don't want to preclude you from doing that but let me at least say a little something and we may not need to go there. Obviously the other Commissioners want to see it. But let me just say I think we need to stop for just a moment and look and see where we are.

I think the discussion that we have had here has been official but it is not an evidentiary hearing. We're just trying to determine if we want to go forward with one.

I believe that Staff, in the Recommendation, has pointed out some areas of concern. I think Mr. Childs, on behalf of the company, has indicated some areas of concern within Staff's analysis. And we're not here today to decide who is right or who is wrong but I think we're here today to assess where we are and where we want to go.

As a matter of history, if you'll indulge me for a moment, I think that it is good that the Commission has these type problems to deal with. I remember the days when we had companies with low equity ratios, low interest coverage ratios, inadequate cash flows to meet construction budgets; having to go to debt market when interest rates were at all time highs; the threat of eminent and serious rate increases at times of high inflation on customers. Those would not happy times.

This company has engaged in a series of cost reductions and those were quite painful; engaged in and made a very difficult decision to reduce the dividend payout ratios, which if that dividend payout ratio had been maintained, perhaps, we wouldn't have the equity ratio problem we have now. I don't know what that impact would be. Mr. Childs indicated that a quick fix would be to declare dividends and pay out excess cash flows to the parent company. But I don't think we want to encourage that either. But from a historical perspective, it's good we have these type problems as opposed to the other side of the coin as those problems.

We have been through the company's cost reductions and through negotiated settlements which have encouraged the reduction of what I refer to as balance sheet costs, capital cost and the regulatory assets, reserve deficiencies, things of that nature. This company has positioned itself quite well, and I think that's illustrated by the handout that was presented by Mr. Childs, indicating while there may have been an increase in the cost of capital, the fact that it is applied to a much smaller base actually shows a net reduction in total capital costs. That I believe is significant. I cannot accept this on its face and say that cures all the problems and addresses all the problems which Staff has raised. It does not.

I guess the bottom line that I'm trying to get to is that this Commission has encouraged the companies to become more efficient. I think the companies have responded to that encouragement from the Commission, as well as from the reality that perhaps there's going to be a day of reckoning, i.e., competition. That perhaps has had more impact than even this Commission.

I think this company has taken those -- reacted accordingly, and this Commission over the years has implemented a number of plans to take advantage of a window of opportunity to reduce costs in the long term. And I think the Commission and company has taken the long term perspective. But I think we cannot ignore what Staff is bringing to us.

But before we actually go to a proceeding, declare a hearing and look at these matters, I think we owe it to the parties, including everyone that has appeared here today, and our Staff, to give the negotiated process one more opportunity to see if a negotiated settlement cannot be reached. I know we have a plan in effect already, but I think that the concern Staff raises are legitimate, and that if there is not a negotiated settlement, I'm fully prepared to go forward with an evidentiary hearing and we'll sort through all of the things Mr. Childs has been saying and more, and perhaps things that our Staff would be saying in some of the rebuttal they probably have prepared here today. But I would want to give that opportunity one more chance. And I would advise our Staff, the company and the parties that it is time to make a decision.

COMMISSIONER CLARK: I would agree.

COMMISSIONER DEASON: Because we do -- if we're going to go forward, we do need to put -- make a decision. And if the decision in what Staff recommended is such that we need to put money subject to refund, that needs to be done in a timely manner. But I'm not prepared to do that today.

I think that to some extent some of the cards have been placed on the table, and I think that's beneficial and it's certainly educational for the Commissioners.

But I guess I would recommend, and if a motion is in order, I would move that we keep this docket open, that we allow the parties one more opportunity to sit down and negotiate, and negotiate -- lay out all the cards on the table and agree what you can agree with. And if you cannot agree, come back to the Commission say "We can't agree and we're prepared to go to hearing." Because that's what's going to be the result. If there's not an agreement, we're going to go to hearing, at least that's what I would vote to do, to go to hearing. But I want that process to have one last opportunity. And I would suggest that we do it in very short order. I think there's an agenda for the 1st of December, and come back on the 1st of December either with this same recommendation or a recommendation of a settlement, one or the other, and then go forward from there.

COMMISSIONER CLARK: I would support that if you add to it that when the recommendation comes back to us, if there is no agreement, that there be a response to -- that the recommendation include a response to the points made in opposition to what the Staff has suggested so we have the opportunity to read that ahead of time.

COMMISSIONER DEASON: I don't have a problem with doing that. The only thing I'm saying today is I don't want to get involved in a line-by-line rebuttal --

COMMISSIONER CLARK: Not today, no.

COMMISSIONER DEASON: -- or what they had to say today. If they want to include that in the next -- if there's no settlement and they want to provide that in the recommendation, that's fine.

COMMISSIONER CLARK: That would be --

COMMISSIONER DEASON: But I'm convinced even without that rebuttal of what Mr. Childs said that I think Staff's original recommendation raises enough concern if there's not a negotiated settlement, I'd vote to go to hearing and just lay that out on the table. Because while I agree Mr. Childs raises a lot of concerns that perhaps are legitimate and would be -- would come out in a evidentiary hearing, to me they don't solve all of the problems Staff has indicated. But, anyway, that would be my motion.

COMMISSIONER CLARK: I second.

CHAIRMAN JOHNSON: There's a second.

COMMISSIONER GARCIA: Did you modify it because I certainly would like to have Staff address some of issues that Mr. Childs --

COMMISSIONER CLARK: In a subsequent recommendation, if it is necessary.

COMMISSIONER GARCIA: Right.

COMMISSIONER DEASON: That's fine. That would be -- that's perfectly permissible.

COMMISSIONER GARCIA: What you mean by subsequent recommendation is when they come back to us.

COMMISSIONER CLARK: December 2nd or whatever it is.

CHAIRMAN JOHNSON: Motion and second. Is there any further discussion?

MR. SALEM: Commissioners, may we mention any other concerns, Chairman?

CHAIRMAN JOHNSON: I'm sorry. You said can you mention other concerns.

MR. SALEM: Yes. Is there an opportunity for us to -- for Harris Corporation to advance any further thought on this before you vote?

CHAIRMAN JOHNSON: In the negotiation process with Staff, interested parties can participate. To the extent there are other issues that need to be addressed, they can be raised in that forum.

MR. SALEM: We understand that negotiations have been ongoing for quite some time, and the issues that Mr. Childs raised, in all deference to it, they are of an elloquent, cogent nature, are compelling inasmuch as they do address needs that need to be aired in a hearing. And our interest is to put all of the issues on the table for you, as the protectors of our well being and our rates in the future, to consider them in an open forum, in the Sunshine State, as opposed to negotiations behind closed doors. So --

COMMISSIONER DEASON: I don't think there's been any negotiations behind closed doors. And I think that is an inappropriate statement to make and I take offense by it. When has there been a closed door that you have confronted and you've not been allowed to enter?

MR. SALEM: We were unaware, Commissioner --

COMMISSIONER DEASON: Unawareness is not a closed door, sir.

MR. SALEM: Well, I apologize, Commissioner. I didn't mean it in the sense they were locked doors but --

COMMISSIONER JACOBS: Can I ask one -- are there issues that you would intend to raise consistent with the ROE issues that have been raised by Staff or are they outside of those?

MR. SALEM: The issues that we are -- intend to raise are those that are consistent with the factual data that the Staff has developed. Now, how those factor into the equation, Commissioner, we're not certain at this point. But in preparation for hearing, the issues would be framed and the information developed sufficient to present to you for consideration.

COMMISSIONER JACOBS: Sounds like it would be appropriate then, at least for the short term, for you to be a part of -- Staff has -- what I'm hearing you saying, Staff has framed your issues properly. You would be involved in whatever negotiation takes place from this point until we come back, if we are to come forward again, and you'll be able to deal with that in the context of those negotiations?

MR. SALEM: We believe that the data that the Staff has raised is adequate to frame issues, and in deference to Mr. Childs' arguments, some of the methodology and techniques do deserve scrutiny for the fairness of all parties, including customers. So in that context we do want to ferret out how best to look at the information so that the customers, such as Harris Corporation and our employees, do get the benefit of the effort in your final decision making.

COMMISSIONER CLARK: Madam Chairman, I don't think deferring this to provide for settlement will change the hearing dates. The hearing dates are the 9th and 10th. I don't think allowing a little more time for negotiation is going to adversely affect that date. Even if we decide in December to go to hearing, I think they would still be good. So, you know, we're just --

MR. ELIAS: That's our belief.

COMMISSIONER CLARK: We're just saying let's see if a negotiated process will bear fruit.

CHAIRMAN JOHNSON: There's a motion and second. Any further discussion?

COMMISSIONER JACOBS: No comments.

CHAIRMAN JOHNSON: Seeing none, all those in favor signify by saying "aye." Aye.

COMMISSIONER DEASON: Aye.

COMMISSIONER CLARK: Aye.

COMMISSIONER JACOBS: Aye.

COMMISSIONER GARCIA: Aye.

CHAIRMAN JOHNSON: Opposed? Show it approved unanimously.

MR. ELIAS: So we're clear procedurely, there will be no order issued as a result of this discussion. The motion was to defer action on the recommendation, continue to negotiate, and if those negotiations are unsuccessful, come back with a recommendation that addresses the issues that were raised by the parties.

COMMISSIONER JOHNSON: That's right.

STATE OF FLORIDA)
:
COUNTY OF LEON)

CERTIFICATE OF REPORTER

I, JOY KELLY, CSR, RPR, Chief, Bureau of Reporting, Official Commission Reporter,

DO HEREBY CERTIFY that the Agenda, Item 10 in Docket No. 981390-EI was heard by the Florida Public Service Commission at the time and place herein stated; it is further

CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript, consisting of 47 pages, constitutes a true transcription of my notes of said proceedings.

DATED this 4th day of November, 1998.

Joy Kelly

JOY KELLY, CSR, RPR
Florida Public Service Commission
Chief, Bureau of Reporting

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