

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 070052-EI

In the Matter of:

PETITION BY PROGRESS ENERGY
FLORIDA, INC. TO RECOVER COSTS
OF CRYSTAL RIVER UNIT 3 UPRATE
THROUGH FUEL CLAUSE.



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VOLUME 3

Pages 382 through 549

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LISA POLAK EDGAR
COMMISSIONER MATTHEW M. CARTER, II
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Wednesday, August 8, 2007

TIME: Recommended at 9:40 a.m.
Concluded at 1:15 p.m.

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

REPORTED BY: MARY ALLEN NEEL, RPR, FPR

APPEARANCES: (As heretofore noted.)

DOCUMENT NUMBER - DATE

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FLORIDA PUBLIC SERVICE COMMISSION

FPSC-COMMISSION CLERK

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P R O C E E D I N G S

(Transcript follows in sequence from
Volume 2.)

CHAIRMAN EDGAR: Good morning. Call this hearing to order. Welcome back, everybody. Any preliminary matters that we need to address?

MS. BENNETT: No, Madam Chair.

CHAIRMAN EDGAR: Okay. Seeing none, we can begin with the first witness.

MS. CHRISTENSEN: Good morning, Commissioners. Thereupon,

PATRICIA W. MERCHANT

was called as a witness on behalf of the Citizens of the State of Florida, and having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MS. CHRISTENSEN:

Q. Good morning. Can you please state your name and address for the record?

A. Patricia W. Merchant, 111 West Madison Street, Tallahassee, Florida, 32999.

Q. And did you cause to be filed on June 19, 2007, prefiled direct testimony consisting of 28 pages in this docket?

A. Yes, I did.

1 **Q.** And do you have any corrections to that
2 testimony?

3 **A.** Yes, I have one correction.

4 MS. CHRISTENSEN: I would request permission
5 to distribute a copy of that line correction for the
6 ease of the Commissioners and the court reporter --

7 CHAIRMAN EDGAR: Yes, ma'am.

8 MS. CHRISTENSEN: -- and the parties.

9 THE WITNESS: It's on page 4 of my testimony,
10 starting on line 5, the sentence that reads -- and I'll
11 read it as it should, the type-and-strike version.

12 "In its response to Javier Portuondo's
13 Late-filed Deposition Exhibit 3, PEF has revised the
14 total estimated costs to almost 450 million, an increase
15 of 68 million," and strike "in just one month," and then
16 add, "due to the recognition of allowance for funds used
17 during construction (AFUDC)." And that's my correction.
18 BY MS. CHRISTENSEN:

19 **Q.** And with that correction, if I were to ask you
20 the same questions today, would your answers be the
21 same?

22 **A.** Yes.

23 MS. CHRISTENSEN: I would ask that that
24 prefilled testimony with the corrections be read into the
25 record as though read, or as though testified to.

1 CHAIRMAN EDGAR: The prefilled direct testimony
2 with the amendment noted by the witness will be entered
3 into the record as though read.

4 BY MS. CHRISTENSEN:

5 **Q.** And, Ms. Merchant, did you cause to be filed
6 one exhibit labeled PWM-1 to be filed in this docket?

7 **A.** Yes, I did.

8 **Q.** And that was attached to your prefilled
9 testimony?

10 **A.** Yes.

11 **Q.** Do you have any corrections to that exhibit?

12 **A.** No, I do not.

13

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1 Water and Sewer as an analyst in the Bureau of Accounting. From May, 1989
2 to February, 2005 I was a regulatory supervisor in the Division of Water and
3 Wastewater which evolved into the Division of Economic Regulation.

4

5 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA**
6 **PUBLIC SERVICE COMMISSION?**

7 A. Yes, I have testified numerous times before the PSC. I have also testified
8 before the Division of Administrative Hearings as an expert witness.

9

10 **Q. ARE YOU SPONSORING AN EXHIBIT IN THIS CASE?**

11 A. Yes. I am sponsoring Exhibit PWM-1, a summary of my regulatory
12 experience and qualifications, which is attached to my testimony.

13

14 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

15 A. The purpose of my testimony is to discuss the proper regulatory treatment of
16 the Crystal River Unit 3 ("CR 3") nuclear Uprate costs that PEF seeks to
17 recover through the Fuel and Purchased Power Cost Recovery Clause ("fuel
18 clause").

19

20 **Q. HAVE YOU REVIEWED PEF'S PETITION FOR APPROVAL OF THE**
21 **COSTS ASSOCIATED WITH THE CR 3 UPRATE IN THIS DOCKET?**

22 A. Yes. PEF's original petition was filed on September 22, 2006, in Docket No.
23 060642-EI. In the original petition, PEF combined a request for determination
24 of need with a request to recover the costs of the Uprate project through the
25 fuel clause. Subsequently, the Commission separated the cost recovery

1 component from the need determination and opened Docket No. 070052-EI
2 for the purpose of considering the cost recovery request. On May 4, 2007,
3 PEF filed amended testimony describing 3 phases of the Uprate project. The
4 estimated cost of the project at the time the amended testimony was filed was
5 \$381 million. In its response to Javier Portuondo's Late-filed Deposition
6 Exhibit 3, PEF has revised the total estimated costs to almost \$450 million, an
7 increase of \$68 million ~~in just one month~~. Phase 1 relates to plant
8 *due to the recognition of allowance for funds used during construction (AFUDC)*
instrumentation and associated calculations to allow measurement uncertainty
9 recovery ("MUR") and is scheduled to be constructed in 2007. PEF
10 anticipates the MUR phase will add 12 thermal megawatts ("MWe") at a cost
11 of \$6.5 million. Phase 2 involves replacement of the turbine line components
12 to take advantage of greater steam efficiencies in the turbines and electrical
13 generator, and is projected to be placed in service with the CR3 refueling
14 outage in 2009. PEF projects this phase will add 28 MWe, with a preliminary
15 cost estimate of \$88 million. The 3rd Phase will increase the power or thermal
16 MWe produced in the reactor core by making plant modifications to allow for
17 use of more highly enriched uranium. Phase 3 is expected to add 140 MWe in
18 2011 at an estimated cost of \$199 million. Associated with this phase are
19 Point of Discharge ("POD") and transmission projects necessary to
20 accommodate the increased capacity of CR3, with preliminary cost estimates
21 of \$51 million and \$104 million, respectively.

22
23 **Q. HOW DOES YOUR TESTIMONY RELATE TO THAT OF MR.**
24 **LAWTON, WHO ALSO IS TESTIFYING FOR THE CITIZENS?**

25 A. Citizens' witness Dan Lawton addresses whether the costs are appropriate to

1 be recovered through the fuel clause. He and I both apply the results of his
2 analysis to the criteria for eligibility for recovery through the fuel clause. I
3 also testify on ratemaking theory and the principal tools available to the
4 Commission to ensure the design of fair and reasonable rates.

5

6 Ratemaking and Regulatory Theory

7 **Q. WHAT RATE RECOVERY MECHANISMS ARE AVAILABLE FOR**
8 **REGULATED ELECTRIC UTILITIES?**

9 A. The principal rate recovery mechanisms are base rates and special cost
10 recovery clauses. Each recovery method has its defined role, and they are
11 designed to work together to ensure that rates paid by customers are fair, just,
12 reasonable and not unduly discriminatory.

13

14 **Q. PLEASE DESCRIBE THE BASE RATE RECOVERY MECHANISM.**

15 A. Base rates are those that result from an examination of a utility's overall
16 revenue requirements in a setting that considers the entire operation. Base
17 rates are designed to allow the utility the opportunity to recover all of its
18 prudent operating costs, subject only to exceptions noted below, and a
19 reasonable rate of return on its investment in utility plant. In a base rate case,
20 a test year is used to examine the levels of plant investment and operating
21 costs that represent the levels that will be incurred when the rates go into
22 effect. Adjustments are made to remove any unreasonable amounts and to
23 normalize nonrecurring or extraordinary amounts in the test year. By
24 analyzing the data included in the utility's rate request, the Commission

1 determines the total amount of revenues the utility should be allowed to
2 collect and then designs rates that will generate that revenue figure.

3

4 **Q. HOW DOES THE COMMISSION ALLOW THE UTILITY THE**
5 **OPPORTUNITY TO RECOVER A REASONABLE RATE OF**
6 **RETURN ON ITS INVESTMENT?**

7 A. In setting rates, the Commission determines the overall rate of return on the
8 utility's investment in its utility plant. This overall cost of capital is based on
9 the weighted average cost of debt, equity and other sources of capital. The
10 cost of debt and other sources of capital are determined based on actual cost
11 rates. The cost of equity reflects the Commission's assessment of the fair
12 return on investment to which the investors are provided an opportunity to
13 earn. Mr. Lawton discusses the concept of return on equity further in his
14 testimony.

15

16 **Q. HOW DOES REGULATORY THEORY ADDRESS DESIGNING**
17 **RATES TO BE SUFFICIENT FOR FUTURE PERIODS?**

18 A. Ratemaking principles recognize that after rates are set, the future
19 relationships between costs and revenues will change from those levels used
20 in setting the rates. The level of a particular cost may increase, decrease, or
21 the cost may go away altogether. Costs that were non-existent during the test
22 period may arise after the rates take effect. Projected revenue levels will also
23 vary based on customer growth, changes in consumption, or a combination of
24 both. An increase in a particular expense level does not automatically cause a
25 utility to earn less than its fair rate of return on its investment or to not recover

1 the expense. In order to determine whether an increase in a single cost is
2 affecting a utility adversely, it is necessary to consider the overall relationship
3 of total revenues and total costs.

4

5 **Q. HOW DOES ONE GAUGE WHETHER THE RETURN ON**
6 **INVESTMENT IS REASONABLE AT A GIVEN POINT IN TIME?**

7 A. The Commission sets rates using the mid-point of the authorized rate of return
8 on equity (ROE) and then establishes a range for the ROE that it deems to be
9 reasonable. If the utility earns within the range, generally set at 100 basis
10 points on either side of the mid-point, then by definition the utility is
11 recovering its prudent operating costs and earning a fair return on its
12 investment. If the utility is earning above or below the approved range on its
13 ROE, then it is over- or under-earning, respectively.

14

15 **Q. WHAT ARE THE EXCEPTIONS TO THE ITEMS RECOVERED**
16 **THROUGH BASE RATES THAT YOU MENTIONED?**

17 A. The exceptions to base rate recovery are special cost recovery clauses. The
18 cost recovery clauses available to electric companies are the fuel clause, the
19 Environmental Cost Recovery Clause (“ECRC”), and the Energy
20 Conservation Cost Recovery Clause (“ECCR”). Base rates are designed to
21 generate revenues that reflect a variety of costs, and are intended to function
22 between revenue requirement cases without changing whereas cost recovery
23 clauses focus on specific costs and design a rate element or rate factor to track
24 changes in those costs outside the revenue requirements environment. In
25 Florida, the special cost recovery mechanisms feature a true-up mechanism.

1 Clauses provide dollar-for-dollar rate recovery of the specific eligible costs
2 identified for inclusion through the true-up process as long as those costs are
3 deemed to be prudently incurred. The cost recovery clauses are a departure
4 from the traditional base rate mechanism, under which the rates are designed
5 to provide the utility an opportunity, not a guarantee, to recover its prudent
6 costs and to earn a fair return. Base rate revenues and base rate earnings may
7 increase or decrease as relationships between costs and revenues change over
8 time. There is no true-up provision.

9

10 **Q WHAT RATIONALES SUPPORT THESE EXCEPTIONS TO THE**
11 **BASE RATE MECHANISM?**

12 A. The fuel clause provides recovery to the utility for the day to day fluctuations
13 in the cost of fuel that, because of volatility, cannot be treated adequately in
14 base rates. Without clause recovery of these volatile fuel costs, utilities could
15 be placed in the position of incurring and passing on the cost of expensive
16 base rate proceedings to its customers. In the case of environmental costs,
17 Section 366.8255, Florida Statutes, mandates the use of a cost recovery clause
18 for qualifying expenditures. Pursuant to Section 366.82, Florida Statutes, the
19 conservation clause allows utilities to recover costs to implement cost-
20 effective demand side conservation programs. Thus, each cost recovery
21 clause has a defined and legitimate function within the rate setting philosophy.
22 However, to meet the goal of overall fairness of rates, it is important to limit
23 the mechanisms to the costs that satisfy the eligibility criteria applicable to
24 each.

25

1 **Q. WHY IS IT IMPORTANT TO LIMIT THE COSTS THAT ARE**
2 **COLLECTED THROUGH A COST RECOVERY CLAUSE TO THOSE**
3 **THAT ARE ELIGIBLE?**

4 A. The reason is simple. If a cost does not legitimately meet the definition of
5 costs that qualify for a recovery clause, it should be borne through base rates.
6 To allow the cost to instead flow through the clause will result in an
7 unwarranted increase in overall charges borne by customers, resulting in a bill
8 for services that is unfair and unreasonable.

9

10 **Q. CAN YOU GIVE AN EXAMPLE TO MAKE THIS POINT?**

11 A. Yes. Assume a utility has a rate base (a utility's net investment in utility plant)
12 of \$1 billion, a Commission-authorized fair rate of return with a range of 9%
13 to 11%, and net income of \$100 million. Assume that the Commission must
14 consider the following: a) allow the utility to collect an additional \$1 million
15 expense normally recovered in base rates through the fuel clause or b) require
16 the utility to absorb the expense in earnings achieved from base rates.
17 Assume the achieved rate of return before the additional expense will be 10%,
18 which is in the middle of the authorized range.

19

20 If the utility is allowed to collect the additional expense through the fuel
21 clause, base rates will not change; but the customers will pay additional fuel
22 revenues of \$1 million. However, if the Commission denies the request to
23 recover the expense through the clause, the utility will recover the expense
24 through revenues generated by base rates. In this later scenario, the
25 customers' overall bill will not go up — both fuel revenues and base rate

1 revenues will be unchanged. The income for the period becomes \$99 million
2 instead of \$100 million and the return falls from 10% to 9.9%. The return is
3 still well within the range of the return that the Commission established as fair
4 and reasonable.

5
6 Because cost recovery clause treatment enables the utility to avoid absorbing
7 the expense through base rate earnings, the utility has a powerful financial
8 incentive to steer as many increased costs as possible through recovery
9 clauses. Another side effect of allowing base rate incremental expenses or
10 capital costs in a clause is that offsetting decreases in expenses might not be
11 disclosed by the utility. So at the very time that a company is requesting
12 recovery of a new expense through the fuel clause, there can easily be
13 expenses that might be decreasing or going away which could substantially
14 offset or eliminate any need of the requested increase it in its entirety. This
15 illustrates the danger of reviewing a cost in isolation of the bigger picture.
16 Special cost recovery mechanisms have their places, but are not intended to
17 replace the base rate process, in which the Commission reviews the utility's
18 overall operation. For this reason, the Commission should be ever vigilant for
19 claims that new or unusual costs belong in a cost recovery clause as opposed
20 to being absorbed in base rates.

21

22 Commission Policy on Fuel Cost Recovery

23 **Q. PLEASE ADDRESS THE COMMISSION'S POLICY THAT**
24 **OUTLINES THE TYPES OF COSTS UTILITIES SHOULD BE**
25 **ALLOWED TO RECOVER THROUGH THE FUEL CLAUSE.**

1 A. While there are many orders that have been issued that address fuel recovery
2 issues, the primary order that outlines the basis for fuel cost recovery is Order
3 No. 14546. As part of the 1985 fuel clause docket, the Commission wanted to
4 delineate a policy by order to prescribe the proper means of recovery of fossil
5 fuel-related expenses – an instruction manual, if you will.

6
7 In the very first paragraph of the Order, the Commission expressed its goal for
8 the proceeding, which was to ascertain whether the utilities were passing
9 through the appropriate fixed and variable costs associated with fuel receipts
10 through each company's fuel factor. As a result of a stipulation, the parties to
11 the docket agreed on two essential points that reflect the Commission's
12 practical application of the fuel clause. First, the Commission should attempt
13 to treat cost recovery for fossil-fuel related expenses in a uniform manner,
14 recognizing that there may be times for dissimilar treatment. Second, and
15 most importantly, the parties agreed that prudently incurred fossil fuel-related
16 expenses which are subject to volatility should be recovered through the fuel
17 clause. The parties elaborated on the second point and agreed that:

18
19 The volatility of fossil fuel-related costs may be due to a
20 number of factors including, but not necessarily limited to:
21 price, quantity, number of deliveries, and distance. Except as
22 noted below, these volatile fossil fuel-related charges are
23 incurred by the utility for goods obtained or services provided
24 prior to the delivery of fuel to the electric utility's dedicated

1 storage facilities.... All other fossil fuel-related costs should be
2 recovered through base rates.

3

4 Thus, it is clear from the outset of this Order that the topic being discussed
5 was cost recovery for volatile fossil fuel-related expenses. The Order also
6 provided in detail a list of items that qualified and others that did not qualify
7 for fuel clause recovery. However, in item 10, the parties agreed, and the
8 Commission accepted, a provision for an exception to the normal fuel-type
9 cost as follows:

10

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

17

18 Order No. 14546 provided an example of what type of expense to which item
19 10 referred. The given example is a utility that leases an additional oil storage
20 tank for a short period to enable it to purchase a shipment of oil on favorable
21 terms: the rent paid to lease the oil tank makes possible the fuel savings, and
22 would qualify for inclusion in the fuel clause. In the illustration in the Order,
23 the expenditure is directly related to the delivered cost of fossil fuel to be
24 burned in the boilers to generate electricity.

25

1 While it is the Commission’s intent in this Order to establish
2 comprehensive guidelines for the treatment of fossil fuel-
3 related costs, it is recognized that certain unanticipated costs
4 may have been overlooked. If any utility incurs or will incur a
5 fossil fuel-related cost which is not addressed in this order and
6 the utility seeks to recover such costs through its fuel
7 adjustment clause, the utility should present testimony
8 justifying such recovery in an appropriate fuel adjustment
9 hearing. (at page 5) (Emphasis added)

10
11 It is clear that Item 10 was designed to address a situation in which a utility
12 that initiated a cost-saving measure would have no ability to have the costs of
13 the activity reflected in base rates timely.

14
15 **Q. WHAT DOES ORDER NO. 14546 SAY ABOUT THE TYPES OF**
16 **COSTS THAT ARE NOT APPROPRIATE TO BE RECOVERED**
17 **THROUGH THE FUEL CLAUSE?**

18 A. On page 3 of the Order, it states that operation and maintenance (“O&M”)
19 expenses at plants, storage facilities and terminals are relatively fixed and do
20 not tend to fluctuate significantly, are closely akin to other O&M expenses
21 and more properly recovered through base rates. On page 4 of the Order, the
22 Commission also addressed expenses that had previously been recovered
23 through the fuel clause that were inappropriate on a going-forward basis.
24 These related to non-fuel costs that were not volatile or costs that were
25 incurred after fuel was burned. These items demonstrate that the Commission

1 wanted to provide recovery through the fuel clause of volatile fuel costs and
2 delineate that non-volatile, non-fuel related costs belong in base rates.

3

4 Costs Not Anticipated or Included in the Company's Last Rate Case

5 **Q. WHAT ASPECT OF ORDER 14546 IS SIGNIFICANT TO PEF'S**
6 **REQUEST?**

7 A. PEF has the time and the ability to file a base rate request and have it decided
8 prior to the point in time at which the material costs of the Uprate project will
9 affect its financial situation. PEF's current settlement agreement expires at
10 the end of 2009. The Phase 2 and Phase 3 investments will not be placed into
11 service until the end of 2009 and 2011, respectively. PEF can submit a base
12 rate request in 2009, and rates reflecting its overall situation – including the
13 costs of the Uprate project – can be in place at the time it places the project
14 into service. Item 10 simply is not applicable to this situation, in which the
15 utility is not exposed to any lag in recovering the costs of a worthwhile
16 project.

17

18 **Q. YOU MENTIONED PHASES 2 AND 3. WHAT ABOUT THE MUR**
19 **PHASE, WHICH PEF HOPES TO PLACE INTO SERVICE IN 2008?**

20 A. This is where the concept of materiality must be given effect. The full cost of
21 the MUR is estimated to be \$6.5 million. If PEF places it in rate base in 2008,
22 the estimated annual costs of MUR (depreciation; taxes) will amount to \$1.05
23 million. This would have a de minimus impact on earnings. This is precisely
24 the type of fluctuation in investments, expenses, and revenues that base rates
25 are designed and intended to accommodate in-between base rate cases.

1 Q. GIVEN THE ABILITY OF PEF TO SUBMIT A BASE RATE
2 REQUEST PRIOR TO THE IN-SERVICE DATE OF THE
3 SIGNIFICANT CAPITAL IMPROVEMENTS, IS THERE A
4 PARTICULAR DANGER TO RATE PAYERS OF ALLOWING PEF
5 TO PASS THE COSTS THROUGH THE FUEL CLAUSE?

6 A. Yes. The danger, that I discuss generally above, is that customers will be
7 made to bear the costs of the Uprate project on an incremental basis as an
8 adder to the fuel factor, when a review of the utility's total circumstances may
9 demonstrate that base rate revenue growth may be adequate to absorb some
10 portion of the new costs without the necessity of a dollar-for-dollar increase.
11 Mr. Lawton describes in greater detail the consequences of allowing PEF to
12 avoid an examination of the Uprate costs in the full context of a revenue
13 requirements proceeding.

14
15 Q. PLEASE COMMENT ON MR. PORTUONDO'S STATEMENT THAT
16 THE COSTS OF THE CR3 UPRATE PROJECT WERE NOT
17 ANTICIPATED OR INCLUDED IN THE COMPANY'S LAST BASE
18 RATE TEST YEAR AND AS SUCH ARE NOT INCLUDED IN THE
19 COMPANY'S CURRENT BASE RATES.

20 A. Since the test year in the last base rate case was the projected year ended
21 December 31, 2006, the specific plant costs addressed in this petition were not
22 considered as a component in determining the rates that were ultimately
23 agreed to by the parties and approved by the Commission. However, I
24 disagree with the premise that only if a cost was reflected as a specific line
25 item in the last test year is it being recovered through base rates. As I testified

1 earlier, because base rates are designed and intended to recover all changing
2 base rate-related costs of whatever description, as long as the utility’s base
3 rate revenues exceed its expenses including debt, then it is recovering all of
4 those expenses. The earnings above that level all inure to the shareholders.

5

6 **Q. WHAT POINTS DO YOU HAVE REGARDING MFR PROJECTION**
7 **LEVELS?**

8 A. First, just because a cost is not specifically reflected in the minimum filing
9 requirements (MFRs) that does not per se show that a certain cost was not
10 anticipated or included as a projection in the details supporting the plant and
11 operational costs in the company’s last rate case. Second, basic ratemaking
12 theory recognizes that it is impossible to project exactly what levels will be
13 incurred after the rate case test year has concluded. This is precisely the basis
14 for allowing utility companies to earn within a range of reasonableness on its
15 rate of return on equity. Just because an item is not specifically spelled out in
16 the company’s last MFRs certainly does not mean that it cannot recover the
17 costs and earn a fair return on its investment through base rates. That is the
18 nature of the rate setting process and the company is adequately compensated
19 for this risk through the approved rate of return.

20

21

22 CR3 Net Savings

23 **Q. PLEASE ADDRESS MR. PORTUONDO’S ASSERTION THAT THE**
24 **CR3 ESTIMATED COSTS PRODUCE NET SAVINGS.**

1 A. As addressed by Mr. Lawton, PEF has proposed that the plant costs be
2 recovered over the amount of time in which the cost of the investment would
3 be offset by the projected fuel savings. By accounting for the recovery in the
4 manner as requested by PEF, the customers will not see any measurable
5 savings for any of the phases until 2016, which is 9 years after the cost of the
6 MUR has been fully recovered and 5 years after the completion of the last
7 three projects placed in service in 2011. Important to note is that PEF's case
8 represents the best case scenario in cost estimates. If the actual construction
9 project incurs material cost-overruns, which is what happened with PEF's
10 projected steam generator replacement costs projected in PEF's last rate case,
11 then the net cost savings presented here could decrease dramatically.

12

13 **Q. PLEASE EXPLAIN THE IMPACT OF THE COMPANY'S PROPOSED**
14 **COST SAVINGS ANALYSIS.**

15 A. What the Company has requested in this docket is that these costs should be
16 recovered through the fuel docket because there will be net savings by the
17 year 2036. But what PEF is proposing is that before you give the customers
18 those savings, let the Company recover the costs associated with the project
19 over the same period that the savings would have been generated. The
20 recovery period that the Company is requesting negates the rationale that
21 supports the need for the costs to be flowed through the fuel clause.

22

23 **Q. WHY SHOULD THE COMMISSION REFUSE TO ALLOW PEF TO**
24 **COLLECT THESE COSTS THROUGH THE FUEL CLAUSE?**

1 A. First, the costs associated with the CR3 Uprate are ineligible for the clause.
2 They are generation plant costs. They are not fossil-fuel related. They are not
3 volatile. When the plant is placed into service, the amounts will be constant
4 and will not vary from year to year except for any variation in the rate of
5 return allowed on the asset.

6
7 Secondly, Paragraph 10 in Order 14546 was meant to encourage utilities to
8 spend money that they might not spend to save fuel costs without the ability to
9 reflect those costs in rates. As I explained, that is not the case here. In
10 addition, PEF has included in its request \$89 million of transmission
11 upgrades, \$43 million of “POD” enhancements, and unspecified O&M costs
12 that would not qualify, for clause treatment even if the Commission
13 entertained PEF’s rationale – which it should not.

14
15 **Q. HAS THE COMMISSION ALLOWED UTILITIES TO PASS BASE**
16 **RATE-RELATED COSTS THROUGH THE CLAUSE IN THE PAST?**

17 A. Yes, the Commission has allowed some non-fuel related costs to be recovered
18 through the fuel clause on a case-by-base basis. One example that PEF
19 mentioned in this docket is that the Commission allowed Florida Power and
20 Light to recover the cost of a very limited nuclear Uprate to be flowed through
21 the fuel clause. In that case FPL incurred a cost of \$10 million for a 6.1 MWe
22 thermal Uprate and was allowed to expense the project over two years. In that
23 case, however, the savings generated from the Uprate began in year one and
24 by year three the savings were 3 times the cost of the plant. Also, in that case
25 ratepayers saw lower bills immediately – not eight years after the first phase.

1 It was easy to see in that case that the costs were de minimus in relation to the
2 almost immediate savings generated in fuel costs, as was the absence of
3 intergenerational inequities.

4

5 Encouragement of Innovative, Cost-saving Projects

6 **Q. IS FUEL CLAUSE RECOVERY THE PROPER VEHICLE TO**
7 **REWARD UTILITIES FOR INNOVATIVE PROJECTS AND**
8 **PROGRAMS THAT REDUCE TOTAL CUSTOMER COSTS?**

9 A. No it is not. While the Commission has allowed cost saving mechanisms to be
10 recovered through the fuel clause, many more have been recovered properly
11 through base rates. Any incentive mechanism can occur equally through base
12 rates or a clause and still provide the company recovery of and a return on the
13 costs that it has invested to generate customer savings. The base rate
14 regulatory mechanism has always provided the proper incentive for rate
15 recovery. However, the trend in recent years has been for companies that have
16 entered into base rate settlements or in years between rate cases, to continually
17 request clause recovery of normal base rate type costs in order to increase
18 earnings to its shareholders at the expense of higher than necessary rates to
19 customers. For the reasons I have given, it is incumbent on the Commission
20 to deny those requests that involve ineligible costs or otherwise do not qualify
21 for recovery.

22

23 **Q. DOES DENYING COST RECOVERY THROUGH THE FUEL**
24 **CLAUSE FOR NORMAL BASE RATE PROJECTS THAT RESULT IN**

1 **FUEL SAVINGS DISCOURAGE PRUDENT COST SAVING**
 2 **INVESTMENTS?**

3 A. No, it does not. First, this statement is so broad that if you follow this
 4 language through, any cost could be considered appropriate to consider in the
 5 fuel clause if it generates fuel savings. Next, the utility is obligated to provide
 6 cost-effective service to its customers and should not need additional
 7 incentives to do what it is already required to do. Third, as Mr. Lawton
 8 develops in more detail, utilities are compensated for the risk they incur by the
 9 opportunity to earn a fair rate of return. If the recovery of long-term
 10 investments in generating or other plant is shifted to the fuel clause, the risk
 11 incurred by the utility is correspondingly reduced, but the utility has not
 12 proposed to reflect the lower risk in the return it expects to earn – another
 13 reason why granting the request would result in overall rates that are unfairly
 14 and unreasonable high.

15

16 CR3 Revenue Requirements and Savings Analysis

17 **Q. PEF HAS PROJECTED THAT BECAUSE THE SAVINGS EXCEED**
 18 **THE COSTS ASSOCIATED WITH THESE PROJECTS, THE COSTS**
 19 **ARE APPROPRIATE TO BE RECOVERED THROUGH THE FUEL**
 20 **CLAUSE. HAS PEF INCLUDED IN ITS PETITION THE**
 21 **SUPPORTING CALCULATIONS TO SHOW THE ANNUAL**
 22 **SAVINGS AND COSTS?**

23 A. No, the petition and supporting testimony provide absolutely no showing of
 24 the revenue requirement components that PEF is proposing for recovery
 25 through the fuel clause or any of the assumptions used to calculate the

1 projected cost savings. Because of this, OPC requested and received through
2 discovery a breakdown of the revenue requirements and costs savings that
3 PEF projects will occur from 2007 out to 2036. I believe that it is important
4 for the Commission to consider several of the proposals that PEF used in
5 determining its revenue requirements that vary from the regulatory accounting
6 procedures that are normally employed for recovery of capital plant costs. I
7 also provide some comments about assumptions used to calculate PEF's
8 projected cost savings.

9

10 **Q. WHAT DEPRECIATION RATES DOES PEF PROPOSE FOR EACH**
11 **OF ITS PHASES?**

12 A. First, Mr. Portuondo stated in his deposition that PEF was proposing ten-year
13 depreciation recovery periods for all of the 5 phases of the Uprate. This life
14 was chosen "on the basis that over that period of time, there would be
15 sufficient savings to recover the costs." PEF estimated the recovery period for
16 the current projects to correspond with the time frame in which the savings
17 would be generated and would increase or decrease the amortization period
18 depending on the actual costs incurred. Essentially, PEF is requesting that the
19 recovery period be equal to the period of time that the fuel savings will exceed
20 the costs. Note that under this concept, customers will experience very
21 minimal, if any, savings until the utility has recovered 100% of the costs of
22 the project, including the return on its investment. The impact to customers
23 could even be greater if the actual construction costs materially exceed those
24 included in PEF's petition.

25

1 I also would note that in response to late-filed deposition exhibit 3, Mr.
2 Portuondo changed the recovery period of the \$6 million in plant costs
3 associated with the MUR Phase 1 project from 10 years to a full-year recovery
4 in year one. When asked in deposition, PEF witness Roderick stated that all
5 of the components that PEF will put into these 5 projects are designed to last
6 until 2036, or at least 25 years. Additionally, the tax depreciation lives that
7 PEF has used in its own analysis are 15 years for nuclear plant and 20 years
8 for the POD and transmission plant.

9
10 **Q. WHAT DOES THE UNIFORM SYSTEM OF ACCOUNTS (USOA)**
11 **STATE ABOUT RECOVERY OF DEPRECIATION EXPENSE?**

12 A. Rule 25-6.014 (1), Florida Administrative Code, requires that each investor-
13 owned electric utility shall maintain its accounts and records in conformity
14 with the Uniform System of Accounts (USOA) for Public Utilities and
15 Licensees as found in the Code of Federal Regulations, Title 18, Subchapter
16 C, Part 101, for Major Utilities as revised April 1, 2002, Uniform System of
17 Accounts Prescribed for Public Utilities and Licensees Subject to the
18 Provisions of the Federal Power Act. In Section 22A of the USOA for
19 electric utilities, the method of depreciation accounting is provided:

20
21 Utilities must use a method of depreciation that allocates in a
22 systematic and rational manner the service value of depreciable
23 property over the service life of the property.

24

1 **Q. DID PEF PROVIDE THE ACCOUNT TITLES TO WHICH IT WOULD**
2 **RECORD THE AMORTIZATION OF THE ASSETS RELATED TO**
3 **THE PHASES OF THIS PROJECT?**

4 A. Yes. In response to OPC's Interrogatory Nos. 4e, 8c and 11b, the utility has
5 indicated that once in service, the assets will be amortized, to the extent of
6 annual fuel savings achieved, to account 111, Accumulated Provision for
7 Amortization of Electric Utility Plant and account 404, Amortization of
8 Limited-term Electric Plant. In the USOA, the description of this account
9 states that it:

10

11 shall include amortization charges applicable to amounts
12 included in the electric plant accounts for limited-term
13 franchises, licenses, patent rights, limited-term interests in
14 land, and expenditures on leased property where the service life
15 of the improvements is terminable by action of the lease. The
16 charges to this account shall be such as to distribute the book
17 cost of each investment as evenly as may be over the period of
18 its benefit to the utility. (Emphasis added)

19

20 **Q. WHAT ISSUES DO YOU TAKE WITH THE PROPOSED**
21 **ACCOUNTING TREATMENT?**

22 A. First, the account title, *Amortization of Limited-term Electric Plant*, does not
23 even contemplate that long-term generation plant assets will be amortized by
24 this means. The instructions address specific types of limited-term assets, not
25 generation plant. Second, the amortization expense is to be evenly spread over

1 the period of time that the asset provides benefits to the utility, not the period
2 that fuel savings provide recovery of this cost. Both of these requirements are
3 clearly inconsistent with the Company's requested accounting and recovery
4 method. While the USOA requirements can be waived by the Commission,
5 PEF has not made any showing in this case why a deviation is proper or sound
6 regulatory policy.

7

8 **Q. WHAT CONCLUSION CAN YOU MAKE ABOUT THE**
9 **DEPRECIATION TREATMENT THAT PEF IS REQUESTING?**

10 A. Not only does PEF want the Commission to drastically cut the depreciation
11 period required by regulatory accounting conventions, it also wants to
12 depreciate it in a far shorter time than the accelerated depreciable life for tax
13 purposes. This dramatically short recovery time requires the current
14 generation of customers to recover the full cost of this long-term asset that
15 will provide benefits to customers out to the year 2036. This recovery scheme
16 is an extreme example of intergenerational inequity that the Commission
17 should deny outright.

18

19

20 **Q. HAS PEF TAKEN INTO CONSIDERATION IN THE ANALYSIS OF**
21 **SAVINGS THE COST OF USING THE MORE GREATLY ENRICHED**
22 **URANIUM FUEL THAT WILL BE USED IN PHASE 3 OF THE CR 3**
23 **UPRATE?**

24 A. No it has not. Below is PEF's response to OPC Interrogatory 17.

25

1 The effect of the Uprate is that more highly enriched uranium
2 fuel will be used, but there will also be more megawatts
3 produced. While this additional fuel will cost more, the net
4 effect is that the price of fuel per megawatt or megawatt hour
5 will remain the same. The fuel savings models were run
6 based on the price of fuel per megawatt hour.

7
8 In his deposition, Mr. Roderick also stated that the amount of the extra cost of
9 the more highly enriched uranium is offset because the cost per MWe will be
10 the same. I would point out that PEF has not provided any other support
11 which reflects that the cost per megawatt hour proportion will be the same
12 using more highly enriched uranium. If the cost of the more highly enriched
13 uranium proves to be more expensive in cents/kwh than the normal fuel now
14 being used, PEF's estimate of savings will have been fundamentally skewed
15 and overstated.

16

17 **Q. WHAT IS YOUR CONCLUSION ABOUT INCLUDING THE CR 3**
18 **PROJECT COSTS IN THE FUEL CLAUSE BECAUSE THE**
19 **CUSTOMERS WILL RECEIVE NET BENEFITS?**

20 Based on Mr. Lawton's analysis, customers will have to wait until 2015 to see
21 any measurable savings based on the Company's requested cost recovery
22 mechanism, which would only be farther away if the Company's very
23 preliminary cost estimates are understated. The end result of including these
24 base rate costs in the fuel clause is guaranteed recovery for the shareholders
25 with much greater reduced risk and no guaranteed cost savings for the

1 customers until at least 8 years out in the overall project. While the project
2 appears reasonable and prudent, the Commission should require the Company
3 to employ the proper regulatory mechanism for recovery as addressed in the
4 testimony of OPC's witnesses and require the costs to be recovered through
5 base rates over the estimated service life of the assets. Because available
6 time permits PEF to purpose a base rate request prior to the in-service dates of
7 the significant phases, there is no harm or prejudice to PEF in doing so.

8

9 **Q WOULD YOUR VIEW OF THE PROPER FUNCTIONS OF BASE**
10 **RATES AND COST RECOVERY CLAUSES CHANGE IF THE**
11 **UTILITY WAS EARNING LESS THAN A FAIR RATE OF RETURN**
12 **AT THE TIME IT INCURS THE COST FOR WHICH IT SEEKS**
13 **RECOVERY THROUGH A CLAUSE?**

14 A. No. If, hypothetically, the utility is earning less than the bottom of the range
15 of its authorized rate of return, then its appropriate recourse is -- not abuse a
16 clause -- but to avail itself of the opportunity afforded it by statute to seek an
17 adjustment in base rates. If it does so, then customers and the Commission
18 will have an opportunity to assess the company's condition on an overall
19 basis. Ultimately, the responsibility belongs solely with the utility's
20 management to consider the need to seek base rate relief.

21

22 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

23 A. Yes, it does.

1 BY MS. CHRISTENSEN:

2 Q. Okay. Can you please summarize your
3 testimony?

4 A. Yes. Good morning, Commissioners. My
5 testimony provides an overview of the process of setting
6 base rates and what exceptions are allowed for rate
7 recovery outside of base rates. Special cost recovery
8 mechanisms such as the fuel cause have their designed
9 function, but they're not intended to replace the base
10 rate process.

11 In a base rate case, the Commission reviews
12 the utility's overall operation at a given point in time
13 as a proxy of what levels of investment and expenses
14 will be incurred in the future. The base rate process
15 contemplates that all components are fluid and that
16 investments, revenues, and expenses will continually
17 change, and the earnings will fluctuate accordingly.

18 If investment levels fall, revenues increase,
19 and expenses decrease, or even go away, as we heard
20 yesterday, base rate earnings could easily exceed those
21 provided for in the last rate case. But if the opposite
22 is true, the earnings could likewise decrease below
23 those approved in the last test year. Each of these
24 scenarios illustrate how the overall process is designed
25 to allow base rates to continue into effect without

1 change as long as the earned rate of return falls within
2 a reasonable range.

3 If the utility's base rate earnings are within
4 the allowed range and the utility is allowed to pass
5 through base rate related costs through the clause, the
6 earnings to shareholders are increased as customers'
7 bills go up. In such a case, the base rate cost that
8 the utility wants to flow through the clause would
9 require customers to pay more in total than would be
10 necessary. This is a form of double recovery, and we
11 believe that it results in that unwarranted, back-door
12 rate increase. Therefore, I believe it's important to
13 limit the exceptions to the fuel clause recovery of
14 otherwise ordinary base rate type costs, and the
15 recovery of generation plant assets certainly does not
16 qualify as an exception.

17 Order No. 14546 details the Commission's
18 fundamental policy on fuel cost recovery. Particularly,
19 that policy states that prudently incurred fossil
20 fuel-related expenses which are subject to volatility
21 should be recovered through the fuel clause, and that
22 non-volatile, non-fuel costs belong in base rates.
23 While Item 10 in that order creates an exception for
24 allowing fossil fuel-related base rate costs in the fuel
25 clause, the Commission has retained its discretion on

1 fuel recovery to those costs on a case-by-case basis.

2 Meeting the criteria that the costs were not
3 anticipated in the last rate case and that those costs
4 generate fuel savings is just the initial starting
5 point. Those are not the sole criteria, and fuel
6 recovery is certainly not automatic if those two points
7 are met. Consideration on a case-by-case basis provides
8 that the Commission can take any information that it
9 deems necessary and take -- in determining whether any
10 requested exception should be allowed through the fuel
11 clause.

12 Additionally, if you accept PEF's request in
13 this case, one might believe that any new base load
14 generation plant could qualify for inclusion in the fuel
15 clause if it offsets higher costs, less efficient
16 generation plant, and it was constructed after the last
17 test year. This is clearly contrary the policy outlined
18 by the Commission in Order No. 14546.

19 An Item 10 exception to the fuel clause is
20 unnecessary in this case, as the \$1 million annual
21 revenue requirement of Phase 1, the MUR, can easily be
22 absorbed into PEF's base rate earnings. The de minimis
23 impact on earnings is precisely the type of fluctuation
24 in investments, expenses, and revenues that the base
25 rate concept was designed to accommodate in between rate

1 cases.

2 Additionally, the vast majority of PEF's
3 requested cases -- excuse me, requested costs for Phases
4 2 and 3 won't be incurred until after 2009. PEF has
5 ample opportunity to include these costs in a base rate
6 case if it needs to, which will give the Commission the
7 opportunity to look at the company's total operations
8 and review their earnings at that point in time.

9 I also disagree with the company's requested
10 accelerated recovery period for each phase. The proper
11 recovery period for long-term plant assets is the useful
12 life of the plant. The fact that they've requested
13 shorter lives negates PEF's fuel savings argument. A
14 ten-year recovery period asks today's generation of
15 customers to pay for recovery of costs that will provide
16 service to customers for at least 25 years out into the
17 future, which is an extreme case of intergenerational
18 inequity.

19 In conclusion, my testimony is simple. Fuel
20 costs should belong in the fuel clause and base rate
21 costs in the base rate calculation, and Item 10
22 exceptions should be carefully scrutinized and limited.
23 And finally, nuclear generation plant that is non-fuel
24 related represents the typical and historical type of
25 cost that's included in base rates, and that should

1 remain in base rate recovery. And that concludes my
2 testimony, my summary.

3 MS. CHRISTENSEN: We tender the witness for
4 cross. Thank you.

5 CHAIRMAN EDGAR: Mr. McWhirter, any questions?

6 MR. McWHIRTER: No questions.

7 CHAIRMAN EDGAR: No questions. Mr. Brew.

8 MR. BREW: No, thank you.

9 CHAIRMAN EDGAR: Okay. Mr. Twomey.

10 MR. TWOMEY: No, thank you.

11 CHAIRMAN EDGAR: And Mr. Wright.

12 MR. WRIGHT: No questions.

13 CHAIRMAN EDGAR: No questions. All right.

14 Thank you very much. Ms. Triplett.

15 MS. TRIPLETT: Thank you.

16 CROSS-EXAMINATION

17 BY MS. TRIPLETT:

18 Q. Good morning, Ms. Merchant.

19 A. Good morning, Ms. Triplett.

20 Q. The company's request for fuel clause recovery
21 in this proceeding is under Order 14546, so do you have
22 that order with you?

23 A. Yes, I do.

24 Q. And at page 3 of my version, under the heading
25 "Commission's Findings," right before the list of ten

1 items, there's a phrase that starts, "As a result of."
2 Do you see where I'm at?

3 **A.** Yes.

4 **Q.** And that phrase says, "As a result of our
5 determinations in this proceeding, prospectively, the
6 following charges are properly considered in the
7 computation of the average inventory price of fuel used
8 in the development of fuel expense in the utilities'
9 fuel cost recovery clauses." Did I read that
10 accurately?

11 **A.** Yes.

12 **Q.** And then there's a list of ten items that are
13 proper charges?

14 **A.** Yes.

15 **Q.** And I believe in your deposition you said that
16 Items 1 through 9 were the generally applicable items;
17 is that correct?

18 **A.** That's correct.

19 **Q.** And by generally applicable, you mean the
20 utility can include those costs in Items 1 through 9 in
21 the fuel clause without prior Commission approval; is
22 that right?

23 **A.** I believe those are the general items that are
24 commonly requested in the fuel clause.

25 **Q.** And so parties can include those without

1 getting prior Commission approval?

2 **A.** To the extent that they're prudent.

3 **Q.** Now, looking at the proper charges under Item
4 10 of Order 14546, you've said that you have to look at
5 each cost item that the company wants to include and
6 then determine why the cost is generating fuel savings,
7 and if the cost is historically a base rate type item,
8 you don't believe it should be recovered under Item 10;
9 is that correct?

10 **A.** No, I think what I said is that you have to
11 look at the requests as they come in. I think if they
12 generate fuel savings and they weren't considered or
13 included in base rates in the last rate case, then
14 that's the starting point. You have to look at all the
15 facts and circumstances beyond that to see whether or
16 not it even meets the qualifications. And certainly
17 recovery on a case-by-case basis means that you can look
18 at any circumstances. The Commission has the discretion
19 to look at anything they deem to appropriate to consider
20 whether something should be considered under Item 10.

21 **Q.** Okay. Just so we're clear, do you have a copy
22 of your deposition transcript?

23 **A.** I do.

24 **Q.** And if you could turn to page 10.

25 **A.** Okay.

1 **Q.** Okay. And I'm going to start with line 5.
2 This was -- it starts, "Well, let me ask you this." And
3 the question was -- are you there?

4 **A.** Yes.

5 **Q.** The question was, "Well, let me ask you this.
6 Is it your position that no matter what the project is
7 and how much the net fuel savings above costs are that
8 are generated by the project, that the costs should not
9 be recovered under Item 10?"

10 And your answer, "I think this order gives a
11 good example of what type of item would be considered
12 under Item 10, and that was a short-term lease that the
13 company was able to take advantage of in order to
14 generate fuel savings. But I think you have to look at
15 each cost item that the company wants to have included
16 under Item 10, or the Commission needs to, and determine
17 what is that cost, why is it generating fuel savings, is
18 it historically a base rate -- typically a historic base
19 rate type item, like generation plant, like it is in
20 this case. Just because it says it generates fuel
21 savings doesn't necessarily mean that's an appropriate
22 item to include under Item 10 in Order 14546." Did I
23 read that correctly?

24 **A.** Correct.

25 **Q.** So it's your position that if a cost is

1 historically a base rate type item like a generation
2 plant, then you do not believe it should be recovered
3 under Item 10; is that correct?

4 **A.** No, it's not. I don't think that a generation
5 plant qualifies, but I think that the example that the
6 order gave, which was a short-term lease of a terminal
7 that they could use in between -- they needed that
8 terminal to take advantage of that fuel savings. It
9 happened to be in between base rate cases. It might not
10 be an expense that they would incur in a test year
11 after -- you know, at the time that they filed for base
12 rates.

13 So I think that that's a perfect type of an
14 example that Item 10 was talking about. So, no, it's
15 not a -- any base rate cost doesn't go into fuel. Item
16 10 gives you that exception.

17 **Q.** If an uprate generates fuel savings, would
18 that qualify under Item 10?

19 **A.** I think you would have to look at the facts
20 and circumstances under each case. And I know that the
21 Commission has allowed St. Lucie for FPL, but the facts
22 and circumstances are different in that case too. I
23 still think the Commission has the discretion to
24 consider all the components that go into that decision
25 whether they meet the requirements of the exception

1 under Number 10.

2 Q. Well, let's talk about the factors under Item
3 10. You would agree with me that Item 10 of Order 14546
4 lists two specific factors to consider in determining
5 whether to approve a utility's request; is that right?

6 A. That's correct. And I believe that those are
7 the first two that you have to meet to get in the door.

8 Q. Because it's your position that the Commission
9 can consider whatever it wishes to consider under Item
10 10; is that right?

11 A. On a case-by-case basis. And I think there's
12 another part of the order that's before Item 10 that I
13 would like to point out that the parties stipulated --
14 and it's on page 2 of my order, and our page numbers are
15 not the same, but let me see if I can tell you what
16 section it's under. It's under the background, and it's
17 Item Number 1, and it reads, "When similar circumstances
18 exist, the Commission should attempt to treat, for cost
19 recovery purposes, specific types of fossil fuel-related
20 expenses in a uniform manner among the various electric
21 utilities. At times, however, it may be appropriate to
22 treat similar types of expenses in dissimilar ways."
23 And that also goes along with the on a case-by-case
24 basis analysis that's specifically included in Item
25 Number 10.

1 **Q.** Is it true that none of the things that you
2 recommend that the Commission consider are actually
3 expressly written in Item 10 of Order 14546?

4 **A.** No. The items that I've talked about are not
5 specifically written in there, but I think the
6 Commission has the ability to look at whatever they
7 believe is necessary. So if they need to look at an
8 earnings test, if they need to look at materiality, if
9 they need to look at the calculation how the savings
10 were done, it's a very broad statement. You know,
11 wasn't considered in the last rate case or contemplated,
12 you know, what does contemplated mean? So I think
13 there's a lot of discretion there that the Commission
14 needs to consider before they allow something in Item
15 Number 10.

16 **Q.** Okay. And just to be clear, when you
17 distinguished the Commission's approval of the FPL
18 uprate, you said that FPL's uprate costs were de minimis
19 compared to this project; is that right?

20 **A.** I think that they were de minimis compared to
21 FPL's fuel costs. I think FPL's fuel costs are over
22 \$7 billion right now, so \$10 million to \$7 billion is
23 quite de minimis to me.

24 **Q.** But Item 10 of Order 14546 has no reference to
25 a project cost being de minimis or not; is that right?

1 **A.** It doesn't say that specifically, but what it
2 does allow is the Commission to take whatever
3 circumstances it needs to consider in reviewing that
4 request. So it's not limited to that. It doesn't state
5 it, but it's not limited to. There's no limits in
6 there.

7 **Q.** Okay. I think you've also said that
8 materiality might be a factor that the Commission can
9 consider, but again, that's not something that's
10 expressly written in Item 10 of Order 14546; is that
11 right?

12 **A.** Right. But what we just talked about is
13 that's something the Commission can consider on a
14 case-by-case basis.

15 **Q.** And the same thing for this earnings test?
16 That's not expressly written in the order; is that
17 right?

18 **A.** No, but it's a case-by-case basis. And I
19 think if you take that a step further, if the company
20 wants to take a normal base rate type item out of base
21 rates and put it into fuel, the company is using that as
22 an earnings test. By doing that, if they could absorb
23 that cost in base rates and they shift that cost into
24 fuel, they raise the rate of return to the shareholders,
25 and that, in effect, is an earnings test. The company

1 is increasing their earnings by shifting it into the
2 fuel clause. So I think the company has flipped it into
3 an earnings test itself.

4 Q. Ms. Merchant, if none of these additional
5 factors that you say the Commission can consider are
6 actually included in Item 10, a utility following the
7 policy doesn't know what these other factors are, does
8 it?

9 A. No, but I think that they can -- you know,
10 base rate generation type plant, as the request is in
11 this case, is your most common type of item included in
12 base rates. So I think that, number one, you've got the
13 biggest item that's included in base rates that the
14 company has asked for recovery through the fuel clause.

15 If there were some other type expense that
16 they couldn't -- they would not recover the cost in
17 between rate cases and it was short-term type cost, I
18 think the company would recognize that that was the type
19 of item that they wanted to request recovery of, but not
20 the base rate, base load generating plant. That's just
21 clearly over the top.

22 Q. In your testimony, you also argue that the CR3
23 uprate costs are not fossil fuel-related; is that right?

24 A. That's correct.

25 Q. But you acknowledge that FPL's uprate to its

1 nuclear plant was approved for fuel clause recovery
2 under Item 10 of Order 14546?

3 **A.** Right. But I think what's really important
4 there, I don't know that the word "fossil" is as
5 important, but I think "fuel related" is really where
6 the emphasis should be made, because it's really not
7 fuel related. The order talks a lot about fossil fuel
8 costs all throughout, but nuclear was not contemplated,
9 but certainly nuclear expenses are included in the fuel
10 clause. So the word "fossil" doesn't give me as much of
11 a problem, but the word "fuel-related costs," that's
12 where I think base load generating plant is not
13 fuel-related plant. It's base rate type plant. It's
14 not fuel-related.

15 **Q.** But FPL's uprate was an uprate to a base load
16 nuclear plant; right?

17 **A.** That's correct, it was.

18 **Q.** And do you have Order 96-1172? If you don't
19 have it handy, I can hand you a copy.

20 **A.** I've got it. What was the order number again?

21 **Q.** 96 -- PSC-96-1172.

22 **A.** Yes, I do have that.

23 **Q.** Okay. And in case our pages are different,
24 I'm looking under the company-specific fuel adjustment
25 issues. It's on page 9 of my order.

1 **A.** That's what I have.

2 **Q.** Okay. And under the heading Florida Power &
3 Light Company, if we could just go to the second
4 paragraph, the third sentence. And that reads, "The
5 savings are due to the difference between low cost
6 nuclear fuel replacing higher cost fossil fuel. Order
7 No. 14546 issued July 8, 1985, allows a utility to
8 recover fossil fuel-related costs which result in fuel
9 savings when those costs were not previously addressed
10 in determining base rates." Did I read that correctly?

11 **A.** That's what the order says.

12 **Q.** Okay. Ms. Merchant, do you agree that Item 10
13 in Order 14546 was meant to encourage utilities to spend
14 money that they might not otherwise choose to spend to
15 save fuel costs?

16 **A.** Yes, but I think it was designed to
17 incorporate short-term projects in between rate cases,
18 items that they weren't required to spend to take
19 advantage of fuel savings. The terminal in the order,
20 the example in the order was a perfect example, I
21 believe, of a type of cost that would be reasonably
22 recovered under Item 10.

23 Now, on base load generating plant, the
24 company has an obligation to provide efficient,
25 sufficient service to its customers, and I think that

1 it's their obligation to go ahead and build this plant
2 if it's efficient. And the order on the need
3 determination said it was efficient, so I think if the
4 company chose not to build this plant that was already
5 considered to be efficient, that would not be a good
6 management decision. So I think in this case, it's not
7 something they would not choose to do. So base load
8 generating plant that's efficient is not a valid reason
9 to come in and ask for fuel cost recovery under Item 10.

10 **Q.** Okay. I'm a little confused. Let's just go
11 to your deposition transcript. And I'm on page 33. And
12 actually, let's start on page 32 of that. At the bottom
13 is where we're starting, on line 21.

14 **A.** And that reads, "Okay"?

15 **Q.** Yes. And then I was asking you if you had
16 your direct testimony that you filed in the modular
17 cooling tower docket.

18 **A.** That's correct.

19 **Q.** Okay. And then if we go to the next page,
20 where I asked you -- I read part of your modular cooling
21 tower testimony, and in that testimony you stated -- and
22 I'm on line 9 of page 33. "'Secondly, Paragraph 10 in
23 the order was meant to encourage utilities to spend
24 money that they might not otherwise choose to spend to
25 save fuel costs.'" Did I read that correctly?" And you

1 answered, "That's correct"; right?

2 **A.** Correct. But I think that statement right
3 there is -- you've got to consider the total context of
4 it, and I think that it's not something -- it's not like
5 the base load generating plant that they need to incur
6 to keep rates low for their customers. I think it's
7 really going back to those types of costs that they can
8 take advantage of the fuel savings that are short-term
9 in nature that will tie them over until the next rate
10 case, that they won't have an opportunity to earn a rate
11 of return in between rate cases. And I really believe
12 that that's what I was talking about at that point in
13 time.

14 MS. TRIPLETT: Okay. Thank you. No further
15 questions.

16 CHAIRMAN EDGAR: Commissioners, any --
17 Commissioner Skop.

18 COMMISSIONER SKOP: Thank you, Madam Chair.
19 Just a real quick question for the witness.

20 With respect to Order 14546, on page 3, where
21 it speaks to the example that's provided in terms of a
22 lease, I notice that that paragraph speaks to a
23 cost-effective transaction, singular rather than plural.
24 Would it be, based upon your testimony and your
25 understanding, that the example illustrated in that

1 paragraph is representative of the intent of this order?

2 THE WITNESS: Yes, I agree. I think there's
3 quite a lot of difference between a transaction and a
4 major project building base load generation plant, so I
5 think that was also an important distinction on
6 approving Item Number 10 as an exception to the fuel
7 clause recovery.

8 COMMISSIONER SKOP: Okay. And as a follow-up
9 to that, assuming that Order 14546 opens the door via
10 Item 10, and also the first paragraph on page 5, where
11 it speaks to a utility having the ability to seek
12 permission for an innovative project, but that this
13 order may have been subsequently interpreted outside of
14 its intended context, and then going back to what you
15 said about Item 1 on page 2 speaking to fairness in
16 terms of consistent treatment between utilities, how did
17 you overcome the precedent of the stretch rate uprate
18 approved by this Commission in PSC Order 96-1172-FOF-EI?
19 How do you overcome that precedent?

20 THE WITNESS: Well, I think the Commission at
21 that point in time, they looked at those circumstances
22 in that case. And, you know, a \$5 million fuel expense
23 compared to a \$7 billion fuel expense is not a very
24 material number. It probably wouldn't even impact the
25 fuel charge.

1 So I think -- how much do you fight that item?
2 I certainly wasn't involved in that case, so I don't
3 know what went into it, what types of discovery was done
4 at that point in time, and I'm not sure exactly what the
5 Commission considered. But all I can say is that it was
6 very immaterial. It was a very small uprate. And those
7 are the items that distinguish it from this case.

8 COMMISSIONER SKOP: And as a follow-up to
9 that, other than the costs and the technical risks
10 associated with what's being proposed now versus what
11 was done, how do you distinguish an extended power
12 uprate from a stretch uprate? I mean, to the extent
13 that -- you know, it's essentially an uprate. It's just
14 one -- I think the testimony that Mr. -- and I don't
15 know if you're familiar with that, but the testimony
16 that Mr. Pollock gave within one of his exhibits, JP-2,
17 on page 2 of that, it speaks to the classification of
18 uprates, and basically itemizes a MUR uprate, a stretch
19 power uprate, and an extended power uprate, and kind of
20 speaks to that.

21 But just generally on the high level view, how
22 do you distinguish one uprate from the other not really
23 looking at cost? Still, this Commission has previously
24 approved an uprate that had a benefit to consumers, it's
25 just now that the cost magnitude is substantially

1 different. So how would you reconcile that if you
2 were --

3 THE WITNESS: Well, I'm not a nuclear
4 engineer, and I really don't know the difference between
5 a stretch uprate and an MUR uprate. I really am not
6 qualified to address that. I'm a CPA, so I look at
7 cost, and I look at materiality, so that's the angle
8 that I'm coming from. So as far as his exhibit and his
9 testimony, I probably couldn't give you any advice on
10 that.

11 COMMISSIONER SKOP: Okay. And just one final
12 question just to be clear. Based upon your testimony,
13 you're suggesting that this Commission should recede
14 from its prior precedent or just maintain the order of
15 magnitude of previously approved requests, that it
16 should not extend that further; is that correct?

17 THE WITNESS: Right. What I think is the
18 Commission has the discretion, the case-by-case basis,
19 and they will treat -- they might treat different
20 utilities differently given the circumstances. So I
21 think that even though they did approve that in the
22 St. Lucie case for FPL, the Commission is not bound to
23 that decision, because each case is looked upon for the
24 facts and circumstances that exist in that case when it
25 comes in. But this is a big order of difference between

1 the stretch uprate, as you called it, in the FPL case
2 and the uprate that's in this case.

3 COMMISSIONER SKOP: But finally, you would
4 agree that both are uprates, though?

5 THE WITNESS: Yes. According to the orders
6 that I read, they both stated that they were megawatt
7 uprates.

8 COMMISSIONER SKOP: Thank you.

9 CHAIRMAN EDGAR: Commissioner McMurrin.

10 COMMISSIONER McMURRIAN: Thank you, Chairman.
11 Hi, Ms. Merchant.

12 THE WITNESS: Good morning.

13 COMMISSIONER McMURRIAN: Yesterday in
14 Mr. Walls' opening arguments, he said something about --
15 and I definitely don't have the quote in front of me,
16 but he was talking about if the Commission were to
17 change policy, and I think he was saying if we were to
18 depart from what we did in Order 14546, that it should
19 be done prospectively in more of a generic fashion and
20 involve everyone who might be affected.

21 And that reminded me of an earlier discussion
22 we had had, and frankly, I couldn't remember exactly
23 which docket it was, but it happened to be in this one
24 in an earlier agenda conference. And I remember that --
25 in fact, maybe it wasn't a discussion. I think it was

1 in the staff recommendation, but there was some
2 discussion about a filing that might be made by OPC to
3 sort of bring these issues up on a generic basis as far
4 as what would be appropriate in fuel recovery. And I
5 just wondered if you could tell me what was the status
6 of that. I honestly do not know if anything has been
7 filed or not or if there still are plans to. Can you
8 help me with that?

9 THE WITNESS: I have a new boss now, so I'm
10 not sure exactly what the status is of that. Nothing
11 has been filed that I know of yet.

12 But I think the -- we're not asking that the
13 Commission change its policy. I think that 14546 allows
14 the Commission to determine what level of consistency it
15 needs based on the facts and circumstances. So I really
16 don't think -- certainly we're not adding the words in,
17 on a case-by-case basis. That is something that's
18 clearly in Item 10, as well as in that first paragraph
19 that I addressed where they might treat different
20 utilities differently based on the facts and
21 circumstances.

22 CHAIRMAN EDGAR: Commissioner Argenziano.

23 COMMISSIONER ARGENZIANO: I think -- I don't
24 know if Ms. Merchant can answer this. Maybe staff can.
25 Because when we discuss precedent, what comes to mind

1 also -- I mean, I'm looking at the order, and the words
2 in the order, case-by-case, do make a difference. And
3 I'm not sure. If we're discussing precedent that has
4 been set before by the Commission, have there ever been
5 cases that were denied on a case-by-case? And if you're
6 discussing precedent, you have to take that into
7 consideration also.

8 THE WITNESS: That's correct. There was a
9 case for the 2005 fuel docket for FPL. They requested
10 nuclear sleeving costs to be recovered through the fuel
11 clause because it generated fuel savings, and it wasn't
12 included in the company's last rate case.

13 And certainly that was a request under Item
14 10, but what the Commission said in its order was that
15 that was a maintenance item, it wasn't a, quote, fuel
16 item. The avoidance of expense was not a savings, and
17 that's what we argued in that case too. But the
18 Commission said and their finding was that it wasn't --
19 this expense was known at the time that they entered
20 into negotiations for the settlement, and that they
21 could have contemplated that in their last rate case,
22 and that's what the Commission denied it on.

23 So certainly it was a denial of an Item Number
24 10 request, but the basis for denying it was slightly
25 different. They were saying they could have

1 contemplated it, but it certainly wasn't included in the
2 last rate case. It wasn't projected. So I still think
3 it was a denial under Item Number 10.

4 CHAIRMAN EDGAR: Commissioner Carter.

5 COMMISSIONER CARTER: Thank you, Madam
6 Chairman. Good morning, Ms. Merchant.

7 THE WITNESS: Good morning.

8 COMMISSIONER CARTER: Good to see you again.
9 I want to kind of go -- kind of step back for a moment.
10 In its pleading here, Progress Energy is asking for the
11 CR3 uprate, and they said that it would provide
12 substantial fuel savings to the customers, right, to the
13 tune of 2.6 billion, with an expected net present value
14 of savings close to 320 million to retail customers;
15 right?

16 THE WITNESS: That's what they've proposed,
17 yes.

18 COMMISSIONER CARTER: Do you have any reason
19 to dispute these numbers or anything? I'm going
20 somewhere with this, if you don't mind.

21 THE WITNESS: I don't have any reason to
22 dispute their estimates, but they are just estimates.
23 They're projections. They're estimates. And certainly
24 the last two projects, the POD and the transmission are
25 very rough estimates. And we also disagree that there

1 have been some expenses that they haven't included in
2 their cost estimates. I'm not disputing the methodology
3 that they used for calculating the revenue savings, but
4 they are just estimates.

5 COMMISSIONER CARTER: I'm glad -- I wanted to
6 talk to you, because I wanted to talk to the numbers
7 person. You're a CPA, so I'm sure you checked those
8 out. So what would you think would be the actual amount
9 of savings based upon your evaluation of the information
10 presented in this case so far? I know you had an
11 opportunity to look over the docket information as well
12 as the testimonies of witnesses, et cetera.

13 THE WITNESS: Well, one of the things I'll
14 have to tell you is I'm not a rate person, so I didn't
15 actually go into the calculation of the nuclear fuel
16 savings. That was the first component. The second
17 component was the costs. So they compared the savings
18 minus the costs, and that was the net savings. So I
19 focused mainly on the cost component.

20 But several of the things that I looked at on
21 the fuel savings were that they didn't put in the cost
22 of the highly enriched uranium. That was in my
23 testimony. They amortized the plant over one year for
24 the MUR, and they amortized the other phases over ten
25 years, which is substantially shorter than what regular

1 base rate depreciation rates would be, which would be
2 the life of the asset. So those were several of the
3 things that we looked at that we disagreed with.

4 Also, in their analysis of cost savings, they
5 included O&M expenses. I know Mr. Portuondo says that
6 they weren't going to ask for recovery of O&M expenses
7 or deferred taxes in their fuel case, but those numbers
8 were included in their cost analysis. So I wouldn't
9 agree that the O&M expenses would be included in the
10 fuel clause at all.

11 COMMISSIONER CARTER: I'm trying to get to a
12 bottom line, though, in the context of their number, and
13 I know you had a chance to look at that. Were you able
14 to have at least some kind of estimate as to whether or
15 not the ratepayers would receive a savings on this?

16 THE WITNESS: I think that anytime you add in
17 nuclear generation to the fuel mix and you offset any
18 other higher cost base load generation, I think you will
19 generate fuel savings, and I think -- I'm not going to
20 dispute their costs, because I didn't go into great
21 detail. I don't have the expertise or all the documents
22 necessary to analyze all those costs.

23 But I think there's no doubt about it that
24 this plant will generate fuel savings, and I think it's
25 their basic responsibility as a regulated utility to

1 pursue items that will lower rates to the customers,
2 lower fuel costs and be the most cost-effective plant
3 that they can put in. So I think -- I'm not disputing
4 the fuel savings or the recovery of this plant. What
5 we're disputing is that it just should go through base
6 rates, not just the fuel. So there isn't any
7 disallowance that we're recommending.

8 COMMISSIONER CARTER: And this is collaterally
9 related. As I read Number 10 on this case we've been
10 beating a dead horse to sleep on, on Order No. 14546,
11 that first portion there says, "will result in fuel
12 savings to customers"; right?

13 THE WITNESS: That's correct. It says --

14 COMMISSIONER CARTER: I'm just taking the last
15 portion of the first sentence, "will result in fuel
16 savings to customers"; right?

17 THE WITNESS: That's correct.

18 COMMISSIONER CARTER: So I guess what you're
19 saying is not so much what they're asking for -- I hope
20 I'm not putting words in your mouth. You'll be able to
21 respond. It's not so much what they're asking for.
22 You're saying it's how they're asking for it.

23 THE WITNESS: That's correct. That's the
24 whole point that we're trying to make here, is that we
25 think this is a prudent decision for them to go ahead

1 and build this plant, but the recovery of this base load
2 generation plant is in base rates, not in fuel. I think
3 the very top part of Item 10 says fuel-related. It says
4 fossil fuel, but it says fuel-related costs. And to me,
5 a generating plant is not a fuel-related cost. It's
6 just quite separated from it.

7 When you're building a plant, you're looking
8 at two different things. You're going to look at the
9 fuel savings it generates, and you're going to look at
10 the cost of construction. Those are two separate
11 things.

12 So I think what we're looking at here is the
13 cost of construction. This will generate fuel savings,
14 but so will any new generation plant that they put on
15 that's going to be more efficient. Hopefully any new
16 generation plant will be more efficient than some of the
17 older plants that they have out there because of
18 technology. They wouldn't build it if it was
19 inefficient.

20 So any new generating plant would qualify
21 under that to generate fuel savings, and what we're
22 saying is that base rates provides that proper
23 incentive. They get a fair rate of return. They get
24 recovery of their costs. That's just the proper
25 mechanism, not through fuel. And we're certainly not

1 recommending disallowance of those costs.

2 COMMISSIONER CARTER: Thank you, Madam Chair.

3 CHAIRMAN EDGAR: Commissioner Skop.

4 COMMISSIONER SKOP: Thank you, Madam Chair. I
5 just wanted to go back to two points that you raised.
6 With respect to -- I think you mentioned a 2005 case
7 that involved sleeving? Was that correct?

8 THE WITNESS: That's correct.

9 COMMISSIONER SKOP: Was that brought to this
10 Commission under 14546?

11 THE WITNESS: Yes, it was. It was inside
12 their testimony, their projected testimony for 2006
13 recovery.

14 COMMISSIONER SKOP: And that was denied by
15 this Commission?

16 THE WITNESS: Yes, it was.

17 COMMISSIONER SKOP: A question to counsel.
18 Why was that adverse precedent not disclosed to this
19 Commission?

20 MR. WALLS: Well, we believe it was in the
21 background material, in the orders, but we didn't
22 believe it was applicable to this case because it was
23 denied because it didn't meet the first part of the
24 test. What the Commission found was that that sleeving
25 was anticipated in FPL's base rate case, so that was

1 distinguishable from our case. It wasn't on point.

2 COMMISSIONER SKOP: And you didn't feel the
3 need to footnote that or anything or bring it to light?
4 I know that you may be able to distinguish it, but
5 certainly putting it in text and distinguishing it in
6 print prevents something being raised that caught me by
7 surprise.

8 MR. WALLS: We can certainly address that in
9 our briefs. We haven't filed briefs yet in this case.
10 You know, the practice is that we file briefs after the
11 testimony. You know, our testimony was presenting the
12 affirmative case, those cases that we believed supported
13 it, and we read that case and saw it as different from
14 our case.

15 COMMISSIONER SKOP: Okay. I'll skip the legal
16 argument on disclosing adverse precedent.

17 But going back to Ms. Merchant, with respect
18 to recovery periods that mentioned, you mentioned that
19 you're not recommending any disallowance. But with
20 respect to Phase 3, which is putting the rotors in the
21 turbine, you mentioned that those typically have a
22 longer life than the recovery period being sought. So
23 would you still not recommend any disallowance, or would
24 you recommend that those recovery periods, although
25 atypical, are still consistent with implementing the

1 project based upon the requests being made?

2 THE WITNESS: My testimony is not a
3 disallowance at all. It's basically taking those
4 costs -- normally they would take the costs of the
5 generation base load plant and spread it over the life
6 of the plant. They testified in this case that the life
7 of the plant will be extended out to 2036, so -- that is
8 common Commission practice.

9 So spreading it over ten years is a much
10 shorter period, but spreading the costs out to 2036 is
11 not a disallowance. It's just making it less every
12 year. And they get to earn a rate of return on the
13 undepreciated balance, so they're not losing recovery of
14 any cost by depreciating it over the useful life. It's
15 just that they don't get to recover it as fast as they
16 wanted to.

17 COMMISSIONER SKOP: Okay. And then finally,
18 you would agree, though, that bringing on additional
19 nuclear generation would displace other more expensive
20 methods of fossil fuel generation resulting in savings;
21 correct?

22 THE WITNESS: Certainly.

23 COMMISSIONER SKOP: Thank you.

24 CHAIRMAN EDGAR: Commissioners, anything
25 further at this point? No. Questions from staff.

1 MR. YOUNG: Three, Madam Chairman.

2 CROSS-EXAMINATION

3 BY MR. YOUNG:

4 Q. Good morning, Ms. Merchant.

5 A. Good morning.

6 Q. Order 14546 was a stipulation of all the
7 parties in the fuel clause in Docket No. 850001-EI;
8 correct?

9 A. Correct, and it was accepted by the
10 Commission.

11 Q. And the same order established policy on --
12 Commission's policy on fuel cost recovery; correct?

13 A. That's correct.

14 Q. And wouldn't it be fair to say that all
15 stakeholders of the utilities were on board with the
16 Commission's policy set forth in Order 14546?

17 A. I believe they were. I'm not sure if that's
18 spelled out, but I would assume it would have been all
19 of the utilities here today. I mean not here this this
20 hearing, but that come before the Commission today,
21 regulated electric utilities.

22 MR. YOUNG: All right. Thank you, Madam
23 Chairman.

24 CHAIRMAN EDGAR: Commissioner Carter.

25 COMMISSIONER CARTER: I was looking forward to

1 you whipping out your calculator doing all --

2 THE WITNESS: I don't have it with me. I was
3 going to have to borrow one.

4 COMMISSIONER CARTER: Okay. Thank you.

5 CHAIRMAN EDGAR: Mr. Twomey has one if we need
6 to get there. Okay. Questions on redirect?

7 MS. CHRISTENSEN: No redirect, Madam Chairman.

8 CHAIRMAN EDGAR: No redirect. Okay. Thank
9 you.

10 THE WITNESS: Thank you.

11 MS. CHRISTENSEN: At this time --

12 CHAIRMAN EDGAR: Your witness.

13 MS. CHRISTENSEN: All right. At this time,
14 before this witness leaves the stand, I would ask that
15 her prefiled exhibits be entered into the record.

16 CHAIRMAN EDGAR: Exhibit 10 will be entered
17 into the record.

18 (Exhibit 10 was admitted into the record.)

19 MS. CHRISTENSEN: Thank you.

20 CHAIRMAN EDGAR: Thank you.

21 MR. MCGLOTHLIN: OPC calls Dan Lawton.

22 Thereupon,

23 DANIEL LAWTON

24 was called as a witness on behalf of the Citizens of the
25 State of Florida, and having been first duly sworn, was

1 examined and testified as follows:

2 DIRECT EXAMINATION

3 BY MR. McGLOTHLIN:

4 Q. As soon as you're settled, sir, would you
5 identify yourself for the record?

6 A. Yes. My name is Daniel Lawton.

7 Q. And what is your business address, Mr. Lawton?

8 A. My business address is 12113 Roxie Drive,
9 Austin, Texas.

10 Q. Mr. Lawton, did you prepare and submit on
11 behalf of the Citizens of the State of Florida prefiled
12 testimony in this docket?

13 A. Yes, I did.

14 Q. Do you have any changes or corrections to make
15 at this point?

16 A. None that I'm aware of.

17 Q. Do you adopt the prefiled testimony, including
18 all questions and answers, as your testimony here today?

19 A. Yes, I do.

20 MR. McGLOTHLIN: I request that the prefiled
21 testimony be inserted into record at this point.

22 CHAIRMAN EDGAR: The direct prefiled testimony
23 will be entered into the record as though read.

24 BY MR. McGLOTHLIN:

25 Q. And did you also prepare exhibits to your

1 testimony, Mr. Lawton?

2 **A.** Yes, I did, sir.

3 BY MR. MCGLOTHLIN:

4 **Q.** I believe those have been identified as 10
5 through 15 in the comprehensive list. Do you have any
6 changes or corrections to those exhibits?

7 **A.** None that I'm aware of.

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **DOCKET NO. 070052-EI**

3 **DIRECT TESTIMONY OF DANIEL J. LAWTON**

4 **ON BEHALF OF CITIZENS OF THE STATE OF FLORIDA**

5

6 **SECTION 1: QUALIFICATIONS, BACKGROUND AND INTRODUCTION**

7

8 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

9 A. My name is Daniel J. Lawton and my business address is 12113 Roxie Drive,
10 Suite 110 Austin, Texas 78728.

11

12 **Q. BY WHOM ARE YOU EMPLOYED?**

13 A. I am a principal in the firm of Diversified Utility Consultants, Inc. (“DUCI”).

14

15 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
16 **WORK EXPERIENCE.**

17 A. I have been working in the utility business as an economist for the last 25 years.
18 Consulting engagements have included electric utility load and revenue
19 forecasting, cost of capital and financial analyses, revenue requirement/cost of
20 service issues, prudence inquiries, and rate design/cost allocation studies in
21 litigated rate proceedings as well as developing rate studies for municipally
22 owned utilities. In addition to my duties at DUCI, I also have a law practice
23 based in Austin, Texas. My main areas of practice include Administrative Law

1 representing municipalities in utility rate matters before regulatory agencies and
2 contract matters and litigation. I have included a brief description of my relevant
3 educational background and professional experience in my Exhibit __ (DJI-1).

4
5 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN RATE**
6 **PROCEEDINGS?**

7 A. Yes. A list of cases where I have previously filed testimony is included in my
8 Exhibit __ (DJI-1).

9
10 **Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. DUCI has been retained by the Office of Public Counsel (“OPC”) to review and
13 respond to the Progress Energy Florida (“PEF” or “Company”) Petition to
14 Recover Costs of Crystal River Unit 3 (“CR3”) Uprate through the Fuel Clause
15 (“Uprate Petition”).

16
17 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
18 **PROCEEDING?**

19 A. As noted above, the purpose of my testimony is to address the issues raised in the
20 Company’s proposal to collect base rate costs through the fuel clause. My
21 testimony is organized in the following fashion with regard to the issues I
22 specifically address:

23 Section 2: Company Uprate Proposal;

1 Section 3: Evaluation Standards and Ratemaking Alternatives;

2 Section 4: The General Rate Setting Process;

3 Section 5: Inappropriate Rate Components of PEF's Uprate Request

4 A. Depreciation

5 B. Accumulated Deferred Income Taxes

6 C. Cost of Capital

7 D. Timing Consideration

8 Section 6: Transmission and POD Proposals

9 My analysis of these issues is based on my background in utility regulation as a
10 consultant, economist and as an advisor to regulatory authorities. OPC witness
11 Merchant addresses some of these same issues from the perspective of an
12 accountant.

13

14 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR FINDINGS AND**
15 **CONCLUSIONS.**

16 A. The facts and circumstances of this case do not support fuel clause treatment of
17 the Company's Uprate request. The size of this major nuclear addition is an issue
18 that is typically analyzed in the context of a major rate proceeding where all costs
19 (increases and decreases) are examined to determine the appropriate customer
20 rates. Fuel cost recovery is unwarranted, in that these amounts can and should be
21 considered timely in the context of a base rate filing. The Company is not in any
22 danger of under earning its cost of capital or revenue erosion, because it has the
23 ability and opportunity to recover this nuclear investment following a normal base

1 rate proceeding. This fact distinguishes this case from the situation envisioned in
 2 the Commission order on which PEF chiefly relies. The Company's proposal
 3 would result in lopsidedly enormous benefits to shareholders at the expense of
 4 customers. PEF proposes accelerated recovery, guaranteed returns and
 5 enhancement of shareholder values by shifting risks of recovery to customers.
 6 Under PEF's proposal PEF would recover its costs from current customers on an
 7 accelerated basis, but the projected fuel savings would be delayed in reaching
 8 customers, creating intergenerational inequities among customers. Moreover, the
 9 costs and benefits of this project are most difficult to analyze, given the very
 10 preliminary nature of the cost estimates. Any material failure to adequately
 11 project the costs could result in further delays in customer benefits under the
 12 Company's plan.

13 Given the above, I recommend that this Commission deny the Company's
 14 request to treat the proposed \$448 million of nuclear investment as a cost eligible
 15 for fuel clause treatment.

16 **SECTION 2: COMPANY UPRATE PROPOSAL**

17
 18 **Q. PLEASE DESCRIBE THE COMPANY'S CR3 POWER UPRATE**
 19 **PROJECTS.**

20 A. The Company proposes to "uprate", (increase the power output of) CR3 by
 21 approximately 180 MWe. (See Direct Testimony of Javier Portuondo at 4:20-23).
 22 The uprate, if successfully completed, will increase the capability of CR3 from

1 900 MWe to 1,080 MWe. The increase of 180 MWe's of low cost CR3 nuclear
2 generation will provide customers with increased low fuel cost output resulting in
3 fuel savings, by displacing other more costly generation and/or purchased power.
4 The Company asserts that there will be \$2.6 billion (nominal) of fuel net savings
5 (net present value fuel savings ("NPV") of \$640 million) by the end of 2036,
6 based on the numbers included in its amended filing. (Id at 7:1-3).

7 The expected investment including AFUDC to complete this uprate
8 project is a total expected outlay of about \$448 million. (PEF's response to OPC
9 Interrogatory 12 Attachment 1). This cost estimate is based on the following
10 three components; (i) a \$293 million investment required for the power uprate; (ii)
11 modifications required for transmission system reliability of \$103.9 million; and
12 (iii) point of discharge ("POD") investment to address water cooling issues from
13 the power uprate of \$51.1 million. These are not firm final cost proposals, but
14 rather Company estimates subject to refinement. (See Direct Testimony of Javier
15 Portuondo at 6:1-2). In fact, with the exception of the MUR phase scheduled for
16 installation in 2007, it is clear that PEF's estimates are preliminary
17 "placeholders," and that the studies necessary to estimate the costs have not been
18 completed. Under the Company's uprate proposal in this case, the Company
19 asserts customers are expected to enjoy lower fuel costs of about \$706 million
20 (NPV) resulting in a total \$353 million benefit (NPV) to customers. (PEF's
21 response to OPC Interrogatory No. 12 Attachment 1)

22

1 **Q. HOW DOES THE COMPANY PROPOSE TO RECOVER THE COSTS**
2 **ASSOCIATED WITH THIS PROJECT FROM CUSTOMERS?**

3 A. The Company proposes to recover the entire non-fuel base rate costs associated
4 with this nuclear investment project, approximately \$448 million of costs, (CR3
5 nuclear power plant investment, transmission investment, Point of Discharge
6 investment, O&M and auxiliary power costs) through the fuel clause. In other
7 words, the Uprate capital costs which normally are recovered through base rates
8 would instead be recovered as part of the fuel factor. The costs proposed by the
9 Company to be recovered through the fuel clause include; (i) the recovery of all
10 capital costs incurred for the CR3 power Uprate; (ii) all costs associated with
11 transmission system changes; and (iii) all costs incurred to offset the POD impact
12 for the project. (Id at 8:20 – 25). These costs include a return on average
13 investment and taxes, depreciation, deferred tax impacts and O&M, with the
14 recovery of the investment shortened from the service life (2036) to 1-year or 10-
15 year periods.

16 The Company proposes to begin recovery through the fuel clause as each
17 of the three phases of the project is completed. Phase 1 resulting in a 12 MWe
18 power uprate associated with the measurement uncertainty recovery (“MUR”)
19 project is to be completely recovered in 2008. Phase 2 and Phase 3 of this project
20 are expected to result in the start of cost recovery in of 2009 and 2011,
21 respectively.

22

1 **SECTION 3: EVALUATION STANDARDS AND RATEMAKING**
2 ALTERNATIVES

3

4 **Q. HAS THE COMMISSION PREVIOUSLY ESTABLISHED STANDARDS**
5 **THAT ARE APPLICABLE TO ITEMS THAT ARE NORMALLY BASE**
6 **RATE ITEMS BUT MAY BE ALLOWED FOR RECOVERY THROUGH**
7 **FUEL ADJUSTMENT CLAUSES?**

8 A. Yes, the Commission has previously addressed this issue in Order 14546, which
9 states at item 10:

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

16
17 The Commission further stated in Order No. 14546 the types of costs more
18 appropriately considered in the computation of base rates. Those items are as
19 follows.

- 20 1. Operations and maintenance expense at generating plants or
21 system storage facilities. This includes unloading and fuel
22 handling cost at the generating plant or storage facility.
23 2. Transportation charges between dedicated storage facilities and
24 generating plants.
25 3. Fuel procurement administrative functions.
26 4. Fuel additives neither blended with fuel prior to burning nor
27 injected into the boiler fire chamber along with the fuel.
28

29 **Q. DID THE COMMISSION PROVIDE GUIDANCE AS TO WHY IT HAS**
30 **ALLOWED WHAT MIGHT NORMALLY BE CONSIDERED NON-FUEL**
31 **ITEMS TO BE RECOVERED THROUGH BASE RATES?**

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A. Yes. The Commission said it wanted to provide the utility an incentive and opportunity to take advantage of certain projects which will result in the savings of fossil fuel-related costs to customers when such costs savings arise after rates have been established and before they could be recognized in future base rates.

Q. IN YOUR OPINION, DOES THE COMPANY'S REQUEST IN THIS PROCEEDING MEET THE STANDARDS OR GUIDELINES PREVIOUSLY ESTABLISHED BY THE COMMISSION?

A. No. In short, the Company's argument is that these uprate costs are not in current base rates and if the costs are expended the result will be fuel savings for customers. (Direct Testimony Mr. Portuondo at 4:9-12). The Company's approach is rather simplistic and fails to establish a reasonable basis for including these costs in the fuel clause – especially given the substantial detrimental impacts on customers.

In my opinion, the Company's proposal should be denied for the following reasons;

- First, the vast majority of such costs can and should be recognized in the Company's future rate proceedings that could occur in 2009. At that time, such costs can be better estimated along with all other base rate costs to determine the appropriate level of earnings, and will not deprive the Company of a reasonable and necessary level of return on such investment.

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- Second, the costs associated with the Uprate of CR3 are not volatile in nature. This is one of the key criteria underlying the establishment of the fuel cost recovery clause in the first place. The projected investments associated with the CR3 Uprate and POD investment are one-time expenditures that have an identifiable, useful life equal to the expected life of the CR3 generating facility. Once placed into service, such expenditures are known and measurable and are not volatile over the period they will be used and useful in the providing service to customers.

- Third, the Company's request, as it pertains to the transmission related expenditures, are not associated with fuel savings. Rather, the expenditures for transmission are tied to reliability concerns necessary to meet the outage of the largest single unit on the system.

- Fourth, while the expenditures associated with the MUR investment project are anticipated to be in service prior to the next rate proceeding, these costs are not only relatively small in nature, but further have not been distinguished from other capital expenditures normally made by the Company in between rate proceedings for which it has not sought similar rate treatment.

1 • Fifth, the Company’s cost recovery request incorporates a useful life
2 that is a form of accelerated depreciation that conflicts with principles
3 of normal ratemaking as well as the Federal Energy Regulatory
4 Commission’s (“FERC”) Uniform System of Accounts (“USOA”).
5 Allowance of such artificially short depreciation periods would
6 significantly reduce NPV savings to customers during the early years
7 of the project.

8
9 • Sixth, the Company’s requested overall cost of capital of 13.19%
10 (including income taxes) is excessive given that in the event the
11 Commission were to allow clause treatment, there is no risk of non-
12 recovery under the Company’s proposal. The application of debt costs
13 would be the appropriate proxy for return in this situation. PEF’s
14 approach therefore overstates the costs that should be borne by the
15 customers under PEF’s proposal.

16
17 The Commission’s Order No. 14546 clearly states that requests such as the
18 Company’s will be reviewed on a case by case basis.

19 Thus, as to guidance for the consideration of the Company’s proposal the
20 Commission should consider the following:

- 21 1) The Company’s proposal guarantees 100% recovery of costs
22 and returns and enhances shareholder values while minimizing
23 shareholder risks;

- 1 2) Customers must wait behind shareholders for years before
2 enjoying any savings;
- 3 3) Cost estimates have not been refined, which would place
4 estimates of fuel savings to customers at more risk;
- 5 4) Most of the fuel savings are in outer years where forecast
6 estimates are most likely to be incorrect; and
- 7 5) The Company does not face any substantial risks if these costs
8 are included in base rates.

9 The bottom line is that this Uprate project can be included in base
10 rates and customer savings can be improved without jeopardizing the
11 Company's financial integrity. There is no compelling reason or necessity
12 for including the Uprate costs in the fuel clause. On the other hand, to
13 grant PEF's request would be detrimental to customers.

14

15 **Q. IF THE COMMISSION DENIES PEF'S PETITION, WILL THE**
16 **COMPANY BE ABLE TO RECOVER THE FULL REVENUE**
17 **REQUIREMENT OF THE MUR UPRATE PROJECT THAT IS**
18 **SCHEDULED FOR COMPLETION BY THE END OF 2007?**

19

20 A. Yes. Under any scenario, the Company's financial integrity will not be harmed
21 by requiring PEF to place the MUR-related capital costs in rate base. OPC
22 witness Merchant has calculated that, if the Company places the MUR in rate base
23 and depreciates the plant over the useful life of the asset, the full 2008 revenue

1 requirement associated with MUR will be about \$1.05 million. Absorbing this
2 amount in base rate revenues would reduce the Company's equity return from
3 10.90% to about 10.86%. Even under the Company's inappropriate cost recovery
4 request (where \$6.45 million of MUR investment is recovered in the single year
5 2008), the 2008 and 2009 total MUR-related revenue requirement would be \$8.67
6 million. If the Company is required to recover these costs in base rates, I estimate
7 that the Company's equity return would drop from about 10.90% to about 10.50%
8 based on PEF's recent return report.

9
10 **SECTION 4: BASIC RATEMAKING**

11
12 **Q. WHAT IS THE PRINCIPAL UNDERLYING BASIS ASSOCIATED WITH**
13 **THE RATE SETTING PROCESS FOR ELECTRIC UTILITIES?**

14 A. OPC witness Patricia Merchant will address this topic in some detail. I provide
15 the following brief summary of the differences between fuel cost recovery and
16 base rate recovery for regulated electric monopolies, from my perspective as an
17 economist. My purpose is to explain more fully why requiring PEF to place the
18 Uprate investment in rate base in the normal fashion is the appropriate regulatory
19 outcome in this case. The basic economic proposition underlying utility
20 regulation is that a utility incurs costs in order to provide electricity and customers
21 reimburse the utility for all reasonable and necessary costs. A utility recovers its
22 costs by billing its customers based on their usage.

23

1 **Q. WHAT ARE THE COMPONENTS OF THE BILL THAT CUSTOMERS**
2 **NORMALLY RECEIVE?**

3 A. A customer's bill typically has a base rate component and separate rate elements
4 that apply to special cost recovery mechanisms. I am informed that in Florida
5 there are several such special mechanisms. As PEF's proposal involves a decision
6 between base rates and the fuel clause, I will confine this discussion to those
7 components.

8

9 **Q. WHY DOES A CUSTOMER'S BILL SHOW FUEL COSTS SEPARATELY**
10 **FROM BASE RATES?**

11 A. Many decades ago, there was no fuel adjustment clause. Fuel costs were
12 generally stable enough and could be reasonably predicted and included along
13 with all other costs such as salaries, material costs, etc. in establishing the rates
14 charged to customers. As the cost of fuel became volatile and unpredictable,
15 utilities sought relief outside the confines of traditional rate cases. While the
16 timing of the initial implementation of a fuel clause varied between utilities, many
17 began employing fuel clauses after the 1973 Oil Embargo. Regulators allowed
18 the creation and implementation of fuel adjustment clauses that were intended to
19 recover the actual fuel costs incurred to provide electric service to customers,
20 given that fuel costs were normally outside the control of a utility. In fact,
21 regulators normally created fuel adjustment clauses with a true-up provision so
22 that a utility would not over or under recover its fuel costs and would not be
23 subject to the corresponding financial risk.

1

2 **Q. TRADITIONALLY, IS THERE A STRICT SEPARATION BETWEEN**
 3 **BASE RATE COST AND FUEL COST?**

4 A. Yes. Given the underlying basis for the fuel adjustment clause and its associated
 5 reduced level of risk due to the true-up mechanism, the traditional process has
 6 been to limit costs to be recovered through the fuel clause to be those associated
 7 with the actual cost of fuel. Base rate costs continue to be reviewed in a base rate
 8 proceeding, so as to permit the establishment of a normalized level of annual costs
 9 along with a reasonable rate of return on net investment.

10

11 **Q. WHAT TYPE OF COSTS ARE INCLUDED IN THE BASE RATE**
 12 **PORTION OF A BILL?**

13 A. The short answer is that the base rate component includes all costs excluding fuel
 14 or other clause recovered costs. This component normally includes salaries, other
 15 operating and maintenance expenses, administrative costs, depreciation of capital
 16 investment, taxes and a return on the capital investment of the utility.

17

18 **Q. DO BASE RATES CHANGE ON A FREQUENT BASIS?**

19 A. No. If annual costs and sale levels are reasonably estimated when rates are
 20 established, then as a utility continues to operate and incur different levels of costs
 21 over time, it is also anticipated that it will experience corresponding changes in
 22 the level of sales. As part of the rate setting process, per unit customer, energy,
 23 and demand charges are established so as to recover the utility's revenue

1 requirements from individual customers through their monthly bills. While
2 not normally in lock step, costs and revenues tend to move in the same direction.
3 Normally, residential and small commercial customers have a customer charge
4 and a per unit energy charge. Larger commercial and industrial customers
5 normally have a customer charge, an energy charge, and a demand charge. Each
6 of these charges is established on a per-unit basis. In other words, a customer
7 charge applies to each customer delivery point. An energy charge applies to each
8 Kilowatt hour sold, and a demand charge applies to each Kw of metered capacity.
9 Thus, as a customer uses more energy or demand, that customer also pays the unit
10 charge for each unit of use. As long as the relationship between costs and
11 revenues does not vary significantly on a per unit basis over time then the base
12 rate can continue to be used without change.

13
14 **Q. IF A UTILITY EXPERIENCES GROWTH IN SALES, DOES IT ALSO**
15 **EXPERIENCES A GROWTH IN REVENUES.**

16 A. Yes. The more units of electricity sold, the more revenues charged and collected
17 by the utility. However, just like any other business, as sales increase, so do
18 expenses. While the interrelationship between revenues and expenses is a
19 dynamic process, it normally stays within a reasonable level of equilibrium for a
20 period of time. Only when expenses change in a disproportionate manner to sales
21 is it necessary to reestablish an equilibrium through a new base rate proceeding.

22

1 **Q. DOES A UTILITY NORMALLY EARN A LEVEL OF RETURN**
2 **DIFFERENT THAN WHAT WAS ALLOWED IN ITS LAST RATE CASE?**

3 A. Yes. The allowed rate of return set in a rate proceeding is a point estimate
4 established to be representative of a reasonable range of earnings. Since, for
5 example, weather may be colder or warmer than normal, the actual level of sales
6 may be greater or less than anticipated during the rate setting process resulting in
7 a variation from the allowed rate of return. As long as the return level stays
8 within a reasonable range of the point estimate, it is assumed that base rates are
9 functioning properly.

10

11 **Q. IF A UTILITY CONTINUES TO ADD INVESTMENT TO MEET THE**
12 **NEEDS OF EXISTING AND NEW CUSTOMERS AFTER A RATE CASE,**
13 **WILL THE ADDITIONAL INVESTMENT RESULT IN A NEED FOR A**
14 **NEW BASE RATE PROCEEDING?**

15 A. No, not necessarily. For example, if sales and expenses increase by one percent
16 and the net investment level increases by one percent, then the net return remains
17 relatively constant. In other words, it is fully anticipated that a utility will make
18 expenditures for capital requirements, incur different levels of expenses, as well
19 as different types of expenses over time yet can properly function on a consistent
20 financial basis without the need for a base rate adjustment. However, if sales
21 decline or stay flat, but expenses and net investment rise appreciably then a rate
22 adjustment most likely would be required.

23

1 **Q. WHAT TYPES OF COSTS ARE INCLUDED IN THE FUEL PORTION OF**
2 **A BILL?**

3 A. Normally the fuel adjustment clause recovers only the costs of various types of
4 fuel necessary to generate electricity (i.e. natural gas, coal, oil and nuclear) paid
5 by the utility to fuel suppliers.

6
7 **Q. HOW DOES THE COMPANY'S CASE IN THIS PROCEEDING**
8 **CONFLICT WITH THE TRADITIONAL RATE SETTING PROCESS?**

9 A. The Company seeks to recover base rate costs through the fuel cost recovery
10 clause. This request is inconsistent with the traditional rate setting process.

11

12 **Q. PLEASE EXPLAIN HOW THE COMPANY'S REQUEST IS**
13 **INCONSISTENT WITH RATEMAKING STANDARDS.**

14 A. All the costs in the proposed Uprate are non fuel costs. In other words, all the
15 Uprate costs are properly included as part of non fuel base rates. As is explained
16 elsewhere in this testimony, the timing of the completion of the project is such
17 that the Company is not harmed by including these Uprate base rate costs in
18 future base rate cases. However, if the Company's requested fuel treatment of
19 those non-fuel Uprate costs is approved, customers will be harmed while
20 shareholders enjoy a substantial windfall.

21

1 **Q. IN YOUR OPINION, WOULD A UTILITY PREFER TO COLLECT ITS**
 2 **ENTIRE REVENUE REQUIREMENT THROUGH A FUEL**
 3 **ADJUSTMENT CLAUSE?**

4 A. Yes. Under a fuel adjustment mechanism, with true-up and reconciliation, a
 5 utility is guaranteed 100% cost recovery. Thus, a utility would recover all costs
 6 and a guarantee of its authorized return. On the other hand, when base rate
 7 recovery is authorized, a utility is allowed to charge a rate that recovers costs plus
 8 an opportunity to earn its cost of capital. Given the two alternative models a
 9 rational company will vote for the guaranteed return – especially if that return is
 10 not adjusted to reflect the much lower risk associated with a true-up mechanism..
 11 In this case, the Company’s proposal would in fact be a guaranteed return to
 12 equity shareholders of 11.75% after tax.

13 This argument is supported by the Company’s own analysis contained in
 14 the MUR Project Plan where the following is stated:

15 Progress Energy plans to increase the electrical power output of
 16 Crystal River 3 in order to minimize cost to our customers and
 17 enhance shareholder value. (Project Plan at Bates PEF – CR3-
 18 0482).

19
 20 The Company goes on to state:

21 The business case for a series of power up-rates was developed to
 22 seek funding from either corporate sources or through the Fuel
 23 Adjustment Clause... The Florida Public Service Commission is
 24 currently reviewing a request for approval to utilize the Fuel
 25 Adjustment Clause as a source of funding for this project. The
 26 strategy to minimize risk and cost exposure is to increase power
 27 level in three distinct phases... (Id. at Bates PEF – CR3-0486).
 28

1 The Company obviously evaluated seeking internal funding (a base rate case
2 alternative) and the Fuel Adjustment Clause approach and selected the Fuel
3 Adjustment Clause. The inclusion of the costs in fuel minimizes risk and cost
4 exposure to the Company and enhances shareholder value – both goals of the
5 Company are satisfied.

6
7 **Q. IS THE COMPANY PROPOSING TO MAKE THE UPRATE**
8 **EXPENDITURES IN ORDER TO SAVE CUSTOMERS FUEL COSTS?**

9 A. Yes.

10
11 **Q. ISN'T IT FAIR TO ALLOW THE RECOVERY OF SUCH COSTS**
12 **THROUGH THE FUEL RECOVERY CLAUSE IF IT SAVES**
13 **CUSTOMERS FUEL EXPENSE?**

14 A. No, it would be unfair to customers. Many base rate expenditures can, and do,
15 save customers fuel expense, yet they are not included in the fuel cost recovery
16 process. However, without analyzing all of the new expenditures in total along
17 with existing costs, no one can tell if a utility is over or under earning its allowed
18 return. Thus, allowing a base rate cost to be recovered through the fuel cost
19 recovery clause may result in excess earnings; once through the fuel costs and a
20 second time through the existing base rate charges. In other words, without
21 testing the entire regulatory base rate level of normalized costs in comparison to
22 normalized revenues, it is impossible to precisely determine if a utility's earnings
23 are falling outside the allowed reasonable range of earnings due to any particular

1 transaction. There may very well be costs that are decreasing that more than
2 offset costs that are increasing.

3

4 **Q. ISN'T IT A RATHER STRAIGHTFORWARD PROCESS TO**
5 **DETERMINE WHETHER THE EQUILIBRIUM LEVEL OF BASE**
6 **RATES FALLS OUTSIDE OF A REASONABLE RANGE?**

7 A. No, and that is why base rate cases are complex and time consuming. Many items
8 of cost must be properly analyzed in order to determine if they represent a
9 normalized or average expected level of cost for ratemaking purposes. For
10 example, in this proceeding the Company proposes to assign a 1-year
11 amortization "life" for the CR3 MUR uprate investment. That 1-year life assumes
12 that 100% of the investment will be recovered in the first year of service. As
13 noted elsewhere in this testimony, this is an inappropriate assumption, given the
14 life expectancy for the investment is 29 years. It is precisely for this reason that
15 expenses and other costs must be properly analyzed so that what is simply
16 reported on the Company's books or proposed by the Company is not assumed
17 and accepted as an appropriate or accurate presentation for ratemaking purposes.

18

19 **Q. IN YOUR OPINION, WHAT IS THE DANGER OF ALLOWING PEF TO**
20 **PASS BASE RATE-RELATED COSTS THROUGH THE FUEL COST**
21 **RECOVERY CLAUSE?**

22 A. The danger is that which OPC witness Merchant points out in her discussion of
23 fundamental ratemaking principles. If PEF passes the entire project costs through

1 the fuel clause when base rate revenues are adequate to cover some or all of the
2 costs and provide a fair return, then customers' total bills will be too high. PEF
3 will have circumvented the primary means of ensuring its rates are fair and
4 reasonable, and will have realized a windfall.

5
6 **Q. IN THE PAST, HAS THE COMMISSION ALLOWED CERTAIN BASE**
7 **RATE COSTS TO BE RECOVERED THROUGH A FUEL CLAUSE?**

8 A. Yes. However, the Commission requires that consideration of requests for clause
9 treatment "of such costs should be made on a case by case basis." (Order 14546
10 at page 5, item 10.) The Commission did not set forth a blanket acceptance
11 associated with the fuel saving exception to the fuel rule, but instead stated the
12 Commission would consider requests on a case by case basis. Given it is a case
13 by case standard – precedent has little value. For example, the only other case
14 that involved a nuclear plant uprate was FPL's Turkey Point facilities. (Order No.
15 PSC-96-1172-FOF-EI, Docket No. 960601-EI, September 19, 1996). The Turkey
16 Point uprate involved an investment of \$10 million, where this case entails over
17 \$448 million of investment including plant modifications. Also, FPL customers
18 received savings in the first year. These are not comparable uprate projects.

19
20 **Q. FROM A RATE SETTING PERSPECTIVE, IS THERE A**
21 **REQUIREMENT TO LOOK AT THE TIMING OF EXPENDITURES?**

22 A. Yes. For example, only the \$6 million MUR related expenditures are estimated to
23 be incurred during the current time frame. The vast majority of the Company's

1 requested expenditures are associated with projected costs to be placed into
2 service during 2009 to 2011. This is important, since the Company has the
3 opportunity and capability of returning to the Commission for base rate relief, if
4 and when, it determines that such base rate relief is necessary. Thus, the concerns
5 set forth in Commission Order 14546 relating to expenditures not reflected in the
6 last base rate proceeding also have to take into consideration that the vast majority
7 of the CR3 uprate expenditures can be captured appropriately through a base rate
8 proceeding that could occur in the 2009 time frame without the Company
9 incurring the potential loss of return in the interim.

10 The traditional rate setting process is well equipped to handle the
11 Company's proposed expenditures without undue concern for whether customers
12 are receiving benefits or the Company will be receiving benefits in the interim.
13 The bulk of the investment proposed can be properly tested along with all other
14 expenditures to make sure that the dynamic rate setting process stays in
15 equilibrium after such expenditures are incurred or, if necessary, the base rates
16 can be modified either upward or downward to once again establish an
17 equilibrium operation from a financial standpoint.

18
19 **SECTION 5: INAPPROPRIATE COMPONENTS OF PEF'S REQUEST**

20
21 **A. Depreciation**

22 **Q. OVER WHAT PERIOD OF TIME DOES A UTILITY NORMALLY**
23 **DEPRECIATE PLANT ASSETS?**

1 A. Capital investment is recovered through depreciation over the useful life of the
2 asset. In this way, costs and benefits are matched over the life of the asset. This
3 treatment is fair to both customers and investors.

4

5 **Q. HOW DOES PEF PROPOSE TO RECOVER ITS INVESTMENT FOR**
6 **THE CR3 UPRATES?**

7 A. PEF proposes a depreciation or amortization process. (PEF's response to OPC's
8 1-4 e).

9 **Q. WHAT INVESTMENT RECOVERY PERIOD IS PEF PROPOSING?**

10 A. PEF proposes to recover its investment over either a 1-year or 10-year assumed
11 life or amortization period. (PEF's response to Interrogatory 12, Attachment 1). I
12 will note that PEF's petition and PEF's testimony did not disclose PEF's intent in
13 this regard.

14

15 **Q. IS THE COMPANY'S PROPOSED DEPRECIATION OF CAPITAL**
16 **INVESTMENT REASONABLE OR APPROPRIATE?**

17 A. No. The depreciation proposal does not match costs and benefits over the useful
18 life of the asset and therefore gives rise to intergenerational inequities. The term
19 intergenerational inequity refers to the fact that today's ratepayers would be
20 required to pay for the total cost of the Uprate plant in 1 or 10 years that will
21 provide benefits to current and future ratepayers over the next 29 years. The
22 inequity is that some of today's customers that pay too much will not be around in

1 15 years and new customers will connect in 15 years that receive the service at no
2 incremental cost. The Company's proposal is unreasonable, goes beyond normal
3 regulatory parameters of matching benefits and costs, and is not consistent with
4 the FERC USOA requirements.

5

6 **Q. WHAT SPECIFIC ASPECTS OF THE COMPANY'S REQUEST EXCEED**
7 **REGULATORY PARAMETERS?**

8 A. The most striking overreaching aspect of the Company's request is its proposed 1-
9 year or 10-year depreciation life or amortization period. Normal ratemaking
10 requires the recovery of investment over the useful life of the facility so as to
11 eliminate intergenerational inequity and to comply with the traditional matching
12 principle.

13 The Company admits that it expects a 20 year license extension for CR3
14 so that its license will expire in 2036. (Mr. Roderick's Amended Testimony at
15 page 13). Moreover, PEF states that MUR equipment "is designed for the
16 extended life of the plant." (PEF's response to OPC 1-5 a). Therefore, the life
17 expectancy for the MUR will be in 29 years (2036-2008), while later portions of
18 the uprate projects are now expected to have 25-27 year lives (2036-2011 or
19 2036-2009). Thus, there is no credible basis for the Company's position as it
20 relates to depreciation/amortization of this investment.

21

22 **Q. HOW IS THIS REQUEST INCONSISTENT WITH THE FERC USOA?**

23 A. The USOA states that depreciation:

1 As applied to depreciable electric plant, means the loss in service
 2 value not restored by current maintenance, incurred in connection
 3 with the consumption or perspective retirement of electric plant in
 4 the course of service and causes which are known to be in current
 5 operation and against which the utility is not protected by
 6 insurance. Among the causes to be given consideration are wear
 7 and tear, decay, actions of the elements, inadequacy, obsolescence,
 8 changes in the art, changes in demand and requirements of public
 9 authorities. (18 Code of Federal Regulation Part 101 definition
 10 12). (Emphasis added).

11
 12 If depreciation must capture the loss of service in value in the course of
 13 service, than it must do so over the service life of the facility. OPC
 14 witness Merchant addresses additional aspects of the FERC USOA
 15 requirements.

16
 17 **Q. DOES THE USOA DEFINE AMORTIZATION?**

18 A. Yes. Definition 4 of the USOA states:

19 Amortization means the gradual extinguishment of an amount in
 20 an account by distributing such amount over a fixed period, over
 21 the life of the asset or liability to which it applies, or over the
 22 period during which it is anticipated the benefits will be realized.
 23 (Emphasis added).

24
 25 Based on these definitions under which PEF must operate, there can be no doubt
 26 that its request is inappropriate.

27
 28 **Q. DOES THE COMPANY'S DEPRECIATION PROPOSAL GO BEYOND**
 29 **USOA REQUIEMENTS PREVIOUSLY NOTED?**

30 A. Yes. The USOA General Instructions also demonstrate that the Company's
 31 proposal is inconsistent with its requirements. Specifically, General Instruction
 32 22-Depreciation Accounting Subpart A Method states;

1 Utilities must use a method of depreciation that allocates in a
2 systematic and rational manner the service value of depreciable
3 property over the service life of the property. (Emphasis added).
4

5 Further, Subpart B Service Lives states;

6 Estimated useful service life of depreciable property must be
7 supported by engineering, economic, or other depreciation studies.
8 (Emphasis added).
9

10 Obviously relying on a 1-year or 10-year life when a 25 – 29 year life is expected
11 is neither systematic nor rational. Moreover, there are no engineering, economic,
12 or other depreciation studies provided by the Company that support its over
13 reaching request.
14

15 **Q. HOW DOES PEF ATTEMPT TO JUSTIFY ITS PROPOSED**
16 **DEPRECIATION TREATMENT IN LIGHT OF THE USOA**
17 **REQUIREMENTS?**

18 A. PEF claims that it is only recovering costs annually at a level no greater than its
19 expected fuel savings. (PEF’s response to OPC 1.5 b). Thus, PEF appears to
20 propose accumulating all costs in aggregate and then comparing such costs to
21 calculated savings. By employing this “lump sum” comparison approach, it
22 appears that PEF is attempting to mask its inconsistent treatment of the USOA
23 depreciation/amortization requirements rather than comply with acceptable
24 standards.
25

26 **Q. DOES PEF’S “LUMP SUM” APPROACH CURE THE MATCHING**
27 **PROBLEM CREATED BY ITS REQUEST?**

1 A. No. Artificially increasing an annual cost (i.e., depreciation/amortization) by
 2 employing an admittedly short life span for the investment only creates
 3 intergenerational inequities and violates the standard matching principle. The
 4 “lump sum” approach only attempts to hide such problem rather than curing the
 5 problem. Therefore, even if the Commission were to approve PEF’s overall
 6 approach it would still need to adjust the annual cost level to comply with
 7 acceptable ratemaking and accounting standards.

8

9 **Q. IS PEF’S PROPOSAL A FORM OF ACCELERATED DEPRECIATION?**

10 A. Yes.

11

12 **Q. HAS PEF JUSTIFIED THE USE OF ACCELERATED DEPRECIATION**
 13 **OF UPRATE ASSETS FOR RATEMAKING PURPOSES?**

14 A. No, PEF has not justified a departure from the principle that benefits and costs
 15 should be matched over the useful life of the assets.

16 **Q. IS THERE ANY REASON TO ACCEPT PEF’S PROPOSAL AS IT**
 17 **RELATES TO THE RECOVERY OF ITS INVESTMENT?**

18 A. No. PEF’s ill conceived investment recovery proposal must be rejected.

19

20 **B. Accumulated Deferred Income Taxes**

21

22 **Q. DOES THE COMPANY’S PROPOSAL TO COLLECT THE UPRATE**
 23 **COSTS THROUGH THE FUEL CLAUSE OVER A ONE OR TEN-YEAR**

1 **TIME HORIZON HAVE A DETRIMENTAL IMPACT ON CUSTOMERS**
2 **IN THE FORM OF INCOME TAX CONSIDERATIONS?**

3 A. Yes, by denying to customers the benefits of deferred income taxes. In the early
4 years of an asset investment life, accelerated tax depreciation is higher than
5 straight line book depreciation. This accelerated depreciation creates more
6 deductible expense, resulting in lower taxable income and lower current income
7 taxes payable. But, in later years of an asset life, after accelerated depreciation
8 reaches zero (the asset is fully depreciated for tax purposes) the book depreciation
9 exceeds tax depreciation, causing more income (less expense) and more taxes
10 payable to the government.

11 The difference between taxes actually paid and customer rate
12 reimbursements is what is referred to as a deferred tax. It is only a deferred tax
13 because, at some point, the timing difference reverses and tax payments to the
14 government will exceed customer payments for tax expense. While it is a deferred
15 tax, such amount is a cost-free loan from the government to the utility. Deferred
16 taxes are accumulated and recorded on the balance sheet, hence the name
17 “accumulated deferred income taxes”. When deferred taxes are recorded,
18 the rate treatment is to reduce invested capital by the amount of the cost-free
19 loan..

20

21 **Q. PLEASE EXPLAIN HOW THE COMPANY’S PROPOSAL TO EMPLOY**
22 **A ONE OR TEN-YEAR DEPRECIABLE LIFE FOR BOOK**

1 **RATEMAKING PURPOSES DENIES TO CUSTOMERS THE BENEFITS**
2 **OF DEFERRED TAXES.**

3 A. The tax depreciation life for the uprate Phase 1 & 2 plant is 15 years, while the tax
4 depreciation life for the transmission and POD plant is 20 years. (PEF's response
5 to Interrogatory 12). Under the Company's proposal to shorten the book
6 depreciation life there are no upfront tax benefits, deferred tax balances, to affect
7 investment levels. Rather, the Company's proposal creates an upfront cost to
8 customers and increases revenue requirements.

9

10 **Q. HAVE YOU QUANTIFIED THE IMPACT ON CUSTOMERS IN TERMS**
11 **OF INCREASED REVENUE REQUIREMENTS RESULTING FROM THE**
12 **LOSS OF DEFERRED TAX BENEFITS?**

13 A. Yes. Included in my Exhibit (DJL-2) is an estimate of the deferred tax impact on
14 revenue requirements comparing the Company's proposal to a result that
15 amortizes book depreciation over the expected life of the facilities. Under PEF's
16 proposal, customers would pay about \$3.9 million NPV in additional revenue
17 requirements because of the impact of accelerated depreciation on deferred taxes.

18

19 **C. Cost of Capital Impact**

20

21 **Q. EARLIER YOU STATED THAT THE COMPANY'S PROPOSAL**
22 **WOULD LEAD TO EXCESSIVE RATES RESULTING**
23 **FROM THE REQUESTED RETURN ON INVESTMENT. PLEASE**

1 **EXPLAIN.**

2 A. The Company has requested an equity return of 11.75% to be earned on
3 investment for the Uprate assets. An equity return includes a risk premium over
4 and above debt costs for the compensation of the risk of not earning the full
5 return. But, in this case, there is no additional risk, as the full amount ultimately
6 authorized will be reconciled and collected through the fuel clause. There is no
7 basis for including an equity return of 11.75% when all the risk has been removed
8 by the fuel clause recovery.

9

10 **Q. WHAT IS THE IMPACT ON CUSTOMERS RESULTING FROM THE**
11 **EXCESSIVE EQUITY RETURN?**

12 A. I have included in Exhibit __ (DJL -3) an estimate of the impact of the excessive
13 return included in rates by substituting a debt rate for the 11.75% equity return
14 request. This analysis shows the Company's proposal would result in \$54.93
15 million of excessive revenue requirements on a NPV basis.

16 **Q. FROM A CUSTOMER PERSPECTIVE, IS THE COMPANY'S**
17 **PROPOSAL TO ACCELERATE RECOVERY OF THE UPRATE COSTS**
18 **THROUGH THE FUEL CLAUSE FAIR AND REASONABLE?**

19 A. The simple and short answer is no. The Company's proposal allows the Company
20 to collect a majority of costs before customers see one dollar of fuel savings.
21 Customers must wait until 2016 to see fuel benefits of about \$19.3 million, but
22 shareholders will have enjoyed about \$105 million in increased equity return by
23 that time. The Company collects its investment and shareholder returns quickly

1 while customers must wait until at least 2016 to see any cash flow fuel benefits. I
2 have included a summary of this analysis in my Exhibit ____ (DJL- 4).

3 As can be seen from Exhibit 4, cumulative fuel savings become a positive
4 \$19.28 million in 2016 and equity shareholders have earned over \$119 million off
5 this project by 2016. The cumulative fuel savings do not exceed total return until
6 the Company has completely recovered its investment, i.e., after 2021. Given that
7 the project costs are only preliminary estimates, the delay of fuel savings may be
8 even longer.

9 The above analysis shows the Company receiving a guaranteed return and
10 receiving that return on an accelerated basis. Customers foot the bill and must
11 wait in line behind shareholders to enjoy the benefits of the project. This is not a
12 fair and reasonable proposal to share the risks and benefit of the project.

13

14 **D. Timing Considerations**

15

16 **Q. HAS PEF RELIED ON INAPPROPRIATE ASSUMPTIONS IN ITS**
17 **QUANTIFICATION OF COSTS AND NET SAVINGS TO CUSTOMERS?**

18 **A.** Yes. Not only has the Company front end loaded the cost to customers but it also
19 relied on a requested return level inconsistent with its risk exposure.

20

21 **Q. WHAT TYPES OF INAPPROPRIATE ASSUMPTIONS HAS THE**
22 **COMPANY INCORPORATED IN ITS ANALYSIS THAT RESULTS IN**
23 **FRONT END LOADING OF COSTS?**

1 A. As discussed elsewhere in my testimony, the Company's proposal in the area of
2 depreciation is inequitable and inconsistent with the USOA. However, the
3 Company's revised net savings calculation goes a step further. It now proposes
4 that the MUR related investment be recovered in its first year of operation. In
5 other words, the Company is seeking a 100% depreciation rate for that particular
6 investment. This 100% depreciation rate is requested even though the Company
7 admits that the instrumentation and other costs are designed to last for the
8 remaining 29 year lifespan of CR3. (Mr. Roderick's May 23, 2007 deposition at
9 page 22).

10 In addition to the one year depreciation assumption for the MUR
11 investment, the Company also assumes a 10-year book depreciation for the
12 remaining CR3 uprate investment. This artificially short capital recovery period
13 is inequitable and is inconsistent with the USOA. Finally, given the timing of the
14 Company's proposed depreciation, there is also a corresponding impact associated
15 with deferred taxes.

16 The Company's proposed timing of fuel savings, revenue requirements
17 and the resulting net savings are set forth in my Exhibit ___ (DJL-5).

18 As can be seen from Exhibit 5, the Company has front loaded the revenue
19 requirements over the life of the facility to such an extent that customers during
20 the last 15 years of expected operation (2021-2036) incur basically no revenue
21 requirements. This is inconsistent with the traditional matching principle. In
22 other words, costs and benefits should be aligned.

23

1 **Q. GIVEN THE PATTERN OF FUEL SAVINGS AND REVENUE**
2 **REQUIREMENTS PROPOSED BY PEF, IS THERE ANY CERTAINTY**
3 **TO ITS OVERALL PROPOSED SAVINGS CALCULATION?**

4 A. No. As with any estimate or projection, values estimated further out into the
5 future are less reliable. A review of PEF's proposed net savings clearly
6 demonstrates that over the near term planning horizon (2007-2015) when the
7 projected values are probably more accurate, customers receive no net savings,
8 rather they are assigned a net loss associated with the proposed Uprate. In fact, it
9 is not until 2016 that the Company's proposal provides net savings in nominal
10 dollars for customers.

11
12 **Q. WHAT CAUSES THIS LEVEL OF NEGATIVE NET SAVINGS?**

13 A. The front end loading of expenses along with the back end loading of savings
14 dramatically reduces the net present value savings for customers over the entire
15 life but clearly highlights the "softness" in the Company's entire presentation for
16 net savings. In fact, if non-nuclear fuel costs were to decrease during the next
17 decade from the levels projected by PEF, then the level of savings proposed by
18 the Company would shrink, and possibly shrink dramatically. PEF's proposed net
19 savings over the projected life of CR3 do not begin to materialize for at least
20 another 10 years. Moreover, what appears to be significant fuel savings in the
21 future are minimized on a NPV basis. What is certain from the Company's
22 presentation is that it will recover its costs on an accelerated basis compared to

1 traditional ratemaking while customers will be forced to wait for savings that may
2 not come at the proposed level.

3 **Q. DO ADDITIONAL CONSIDERATIONS SUPPORT AVOIDING**
4 **INTERGENERATIONAL INEQUITIES AND MAINTAINING THE**
5 **MATCHING PRINCIPLE AS IT RELATES TO THE COMPANY'S**
6 **PROPOSED DEPRECIATION PRACTICE?**

7 A. Yes. As noted elsewhere in my testimony, the Company admits that it expects the
8 useful life of the investment to be through CR3's license expiration in 2036.
9 Changing the depreciation pattern to be in compliance with traditional rate setting
10 principles and to bring it into compliance with the USOA, not only changes the
11 level of net savings, but more importantly, changes the timing and pattern of the
12 net savings.

13 The synchronization of the depreciable life with the expected useful life
14 would reduce both the nominal and NPV savings from that proposed by PEF over
15 the entire period. However, the nominal dollar and NPV savings through 2015
16 would increase. Again, it is worth emphasizing that the accuracy of future
17 projections diminishes as time progresses into the future. Thus, a higher degree
18 of certainty or probability of accuracy should be assigned to the near term
19 calculations and a lower level of accuracy or certainty should be afforded the out
20 or later years in the analysis. Moreover, NPV savings for customers are greater
21 under the standard depreciation approach than under PEF's proposal until the year
22 2026. Clearly it is unreasonable to select a process that may only become

1 beneficial to customers if values forecasted more than 20 years into the future are
2 accurate.

3
4 **Q. PLEASE SUMMARIZE THIS PORTION OF YOUR TESTIMONY.**

5 A. There can be no doubt that the Company's proposal in this proceeding is one
6 sided in favor of shareholders in comparison to standard regulatory treatment.
7 The Company's proposal is presented in a format that glosses over the pattern of
8 requested revenue requirements and resulting net savings. Even if one could
9 always rely on the accuracy of forecasts 20 to 30 years into the future, the
10 Company's request is still inequitable and one sided. However, it is simply not
11 realistic or appropriate to rely on savings for customers 20 to 30 years into the
12 future while cost recovery for shareholders are front end loaded during the near
13 term future as proposed by the Company.

14
15 **SECTION 6: TRANSMISSION AND POD PROPOSALS**

16 **Q. IN YOUR OPINION, SHOULD THE POINT OF DISCHARGE (POD) \$51**
17 **MILLION ESTIMATE BE INCLUDED AS PART OF THE UPGRADE**
18 **PROJECT AND RECOVERED THROUGH THE FUEL CLAUSE?**

19 A. No. As I understand the Company's analysis, the additional 140 MWe's
20 associated with the extended power uprate will increase the point of discharge
21 temperature and the proposed POD facilities are necessary to reduce the
22 incremental temperature increases to the temperature level prior to the uprate.
23 (Roderick Deposition Testimony at 32: 13-25). The Company has yet to

1 determine the most cost effective option to accomplish the goal of reducing
 2 temperature. (Id. At 34: 20-21). Thus, cost estimates and even the preferred
 3 option to solve the problem have yet to be determined. Cost estimates are
 4 extremely preliminary and may change significantly.

5 The key basis or reason why the POD facilities should not be included in
 6 the fuel clause is that such inclusion is not necessary or reasonable. First, these
 7 costs can easily be included in the base rates, as the project will be completed in
 8 the 2009-2011 period. Second, the Company has failed to identify a reasonable
 9 cost estimate or even the option it will employ to address the POD issues.
 10 (Roderick Deposition Testimony 35:5-14). Given the above, by waiting to
 11 include these facilities in base rates – the Company will have sufficient time to
 12 identify the option and quantify the costs and benefits of such base rate option.

13 Third, and most important, the POD facilities-- like transmission facilities--
 14 - are not facilities that should be recovered through the fuel clause. The proposed
 15 POD facilities (“cooling towers”) are not fossil-fuel related facilities and the
 16 related costs are not volatile.

17
 18 **Q. IN YOUR OPINION SHOULD THE TRANSMISSION UPGRADE**
 19 **INVESTMENT BE INCLUDED AS PART OF THIS UPGRADE PROJECT**
 20 **AND RECOVERED THROUGH THE FUEL CLAUSE?**

21 A. No. The transmission upgrade, which amounts to about \$101 million (as updated
 22 from \$89 million since PEF filed its testimony) of the proposed project cost, is not
 23 related to fuel savings. Instead, the transmission investment is necessitated for

1 reliability reasons. Company witness Roderick deposition testimony makes clear
2 that transmission investment is for reliability when he states:

3 Q. Bear with me for a moment while I find a reference. You
4 have identified an estimate of \$89 million associates with
5 transmission upgrades made necessary by the higher output of the
6 unit, is that correct?

7 A. Yes. The transmission upgrades—I'm going to change part
8 of your questions there. It wasn't necessarily due to the output of
9 the unit. It had to do with the unit would not be the largest single
10 load or generator in Florida. And from a transmission standpoint,
11 that change purely due to the power uprate means that we have to
12 have the capability to respond to the loss of that single largest load
13 or single largest generation unit, you know, within the stability of
14 the grid. So those are really more the driving factors of
15 transmission, not just output. (Roderick Deposition 24:14 - 25:5).
16

17 The transmission investment is necessary for reliability of the system. The
18 need for transmission reliability investment is collateral to the uprate issue. These
19 transmission investment costs should not qualify for inclusion in the fuel clause.
20

21 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

22 A. There is no good reason to include the Company's proposed Uprate costs in the
23 fuel clause. These estimated costs can be recovered through base rates and the
24 Company will suffer no detrimental impacts. But, as discussed earlier, if the
25 Company's fuel cost proposal is adopted – customers will be unnecessarily,
26 detrimentally impacted in the early years of the Uprate project. Further,
27 shareholders would receive unwarranted benefits under the Company's proposal.
28 All these problems can be cured by including the Uprate costs in base rates.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes.

1 BY MR. MCGLOTHLIN:

2 Q. Have you prepared a summary for the
3 Commissioners?

4 A. Yes, I have, a short summary.

5 Q. Please proceed.

6 A. Thank you. Good morning, Commissioners. I've
7 been retained by the Office of Public Counsel to review
8 the company's proposal to collect \$448 million of
9 nuclear upgrades, point of discharge facilities, and
10 transmission reliability enhancements associated with
11 this project that the company proposes to collect on an
12 accelerated basis with a guaranteed return. That's the
13 company's proposal. I've not questioned the company's
14 estimates of the project, whether there will be fuel
15 savings resulting from the project.

16 But I frame the issue in my testimony
17 basically in the following way: The Commission has
18 before it currently two options if it wants to accept
19 this project. The first option is to include it in base
20 rates, as all other assets of utilities that are base
21 rate related are recovered. Alternatively, the company
22 has come forward with a proposal to include this project
23 in the fuel clause and allow recovery through fuel.

24 Now, based on framing the issue that way, my
25 testimony goes through and describes what happens under

1 each alternative. If you accept the company's approach
2 and you include their proposal in the fuel clause, in
3 years 1 through 10 and possibly beyond, the customers
4 will pay for the project. In other words, there are no
5 fuel savings for customers, and those customers in years
6 1 through 10 receive no benefits from the project.
7 After that period of time, customers will begin to
8 receive benefits from the proposed projects.

9 Now, what does the company get under its
10 proposal? First, the company gets accelerated recovery
11 above and beyond what normal traditional ratemaking
12 would allow. That is, the company gets cash flow.
13 Second, the company gets a guaranteed return on equity,
14 currently estimated at 11.75 percent. Third, the
15 company gets enhanced shareholder value. This is a
16 platform to enhance shareholder value.

17 The alternative in the issues I frame is that
18 you include this as an ordinary asset under base rates.
19 What happens in that alternative? Under a base rate
20 proposal, all customers, years 1 through 10, all the way
21 through 29, all customers will pay their pro rata share
22 of the costs of the projects. Second, all customers,
23 customers from year 1 through year 29, will receive the
24 benefits from the project. In a base rate scenario, all
25 customers pay costs, all customers receive benefits, and

1 we have a matching principle occurring.

2 Third, the company will recover all its
3 prudent costs. The company will recover its capital,
4 its return in each and every year throughout the life of
5 the asset. So in that second scenario, under a base
6 rate recovery, the company recovers its costs, and the
7 customers pay the costs, and also the customers, all
8 customers receive benefits.

9 Based on that analysis, I've come to the
10 following findings and conclusions: Number one, the
11 facts and circumstances of this case do not fit the Item
12 10 exception proposed by the company. Moreover, the
13 Commission certainly has the discretion to address each
14 of these cases on a case-by-case basis.

15 Next, the company should be indifferent,
16 absolutely indifferent whether they collect their costs
17 on the fuel clause or through traditional base rates
18 unless, unless the company has a shareholder goal here
19 or an earnings test to increase cash flow, to get a
20 guaranteed return, because you're not going to find many
21 investments in this country, or any investments in this
22 country where you have a guaranteed 11.75 percent return
23 after taxes. None exist.

24 The enormous size of this investment makes it
25 quite different from all other considerations under this

1 exception to the fuel clause. This is a nuclear plant
2 of \$448 million. The company's proposal to impose costs
3 on early year customers or the first third of the years
4 of the project is the inequitable. It creates an
5 intergenerational inequity. All those customers for the
6 first ten or possibly up to 12 years will receive no
7 benefits. And remember, the key thing here is,
8 customers pay these costs. Fuel savings don't pay
9 costs. Customers pay them. Customers forgo the fuel
10 savings.

11 The company's proposed treatment internally in
12 its proposal with regard to deferred taxes penalizes
13 customers. The company's requested return in its
14 proposal is excessive. And the company's proposal to
15 shift risks, all risks, and get a 100 percent guarantee
16 is just not fair to customers.

17 Given that all these problems can be avoided
18 and the project can go forward, it is my recommendation
19 that the Commission treat this like other assets and
20 treat it in -- pay for it through base rates.

21 And that completes my presentation, Madam
22 Chairman.

23 MR. MCGLOTHLIN: Mr. Lawton is available for
24 cross-examination.

25 CHAIRMAN EDGAR: Thank you. Mr. Wright.

1 MR. WRIGHT: Thank you. I do have a few
2 questions. Is everybody else clear?

3 CHAIRMAN EDGAR: I just generally go this way.
4 Mr. Twomey, will you have questions?

5 MR. TWOMEY: No, I don't think so.

6 CHAIRMAN EDGAR: Okay. Mr. Wright.

7 MR. WRIGHT: Thank you, Madam Chairman.

8 CROSS-EXAMINATION

9 BY MR. WRIGHT:

10 Q. Good morning, Mr. Lawton.

11 A. Good morning, sir.

12 Q. As you may know, I represent Florida Retail
13 Federation, another group of large consumers.

14 I wanted to just inquire a little bit about
15 your testimony on page 34 -- and I don't think you need
16 to look at it; I'm sure you're familiar with it -- where
17 you talk about the front end loading of expenses
18 highlighting the softness of the company's presentation
19 for net savings. That's the context in which I'm asking
20 you these questions.

21 A. Sure.

22 Q. Now, I noted from your resumé that you're an
23 economist. You would agree that if the demand for
24 nuclear fuel increases, other things equal, the price
25 will increase?

1 **A.** Yes.

2 **Q.** Are you familiar with current market
3 conditions for nuclear fuel costs?

4 **A.** The actual prices I do not track, so I --

5 **Q.** Are you familiar --

6 **A.** I do know that in recent cases, that future
7 fuel, nuclear fuel contract prices were going up.

8 **Q.** Are you familiar with projections of the
9 number of nuclear plants that are being talked about to
10 be constructed in the world over the next 30 to 50
11 years?

12 **A.** Thirty to 50 years, the answer is no. The
13 more immediate future, less than 30 to 50 years, yes, I
14 am quite familiar, because Legislatures across the
15 country are changing laws and statutes to make it more
16 easy to build nuclear projects across the country, and I
17 think the Florida Legislature recently addressed that
18 very issue.

19 **Q.** Would it be your general understanding of the
20 market that you would expect there to be a significant
21 increase, a trivial increase, no increase in the number
22 of nuclear plants in relevant markets?

23 **A.** Absent the problems that occurred in the
24 previous go-round with nuclear plant construction, there
25 ought to be a significant increase in the requests for

1 nuclear and other solid fuels moving away from fossil
2 fuels.

3 Q. If there are cost overruns in the construction
4 of the project, will that reduce benefits to customers?

5 A. Cost overruns always reduce benefits if the
6 benefits are calculated based on an initial projected
7 cost.

8 Q. If the spread or differential between future
9 prices of fossil fuels, coal, oil, and gas, and the
10 future price of nuclear fuel is less than projected by
11 the company, will that lead to the benefits being less
12 than, greater than, or equal to those projected by the
13 utility?

14 A. The fossil fuel spread to nuclear power, to
15 the extent it diminishes, all benefits diminish, because
16 that's what you're comparing against.

17 Q. And if these things were to come to pass,
18 would that illustrate the softness of the company's
19 presentation as to benefits that you're talking about?

20 MR. WALLS: Can I object here? One, it calls
21 for speculation, and I think we're well beyond the
22 foundation of this witness. Now he's speculating about
23 the future gas, nuclear, and oil prices and the
24 comparative outcomes of those. And I think we're well
25 beyond the friendly cross exception as well.

1 MR. WRIGHT: Madam Chair, these are
2 hypothetical questions directed to the witness's
3 expertise as an economist, asking him what happens if
4 prices are different than those projected by the
5 company. I think it directly flows and relates to his
6 testimony as to the softness of the company's
7 projections and benefits.

8 CHAIRMAN EDGAR: I'll allow.

9 THE WITNESS: Now I forget the question.

10 BY MR. WRIGHT:

11 **Q.** I think the question, I think the last
12 question that I asked you was, do these possibilities --
13 does the possibility that benefits will be less than
14 projected, based on the conversation you and I have been
15 having in hypothetical terms about what happens if fuel
16 prices are less than or greater than, if the spread is
17 less, if there are cost overruns, does that illustrate
18 the softness of which you speak in your testimony?

19 **A.** Absolutely. And I just went through an
20 analysis of this. I had a case less than a month ago
21 where forecasted savings were based on \$7 gas prices,
22 and many of the issues were with regard to whether or
23 not a \$7 gas price escalated with some inflation factors
24 was a reasonable estimate, because that would change the
25 dynamics or the savings of going forward with the

1 project. The same issues are applicable to this case.

2 Q. And finally, Mr. Lawton, does the softness of
3 which you've directly testified of the company's
4 estimated net benefits support the company's proposal
5 for cost recovery in this case or your proposal for cost
6 recovery in this case?

7 A. I think it supports a base rate recovery, my
8 proposal, because under my proposal, whatever the
9 savings are they are, and all customers share in them.
10 Moreover, the costs are paid by all customers over the
11 29-year life. Therefore, to the extent future forecasts
12 are wrong -- and we all know they'll be wrong; we can
13 never forecast perfectly -- you will have a situation
14 where the first 10 or 11 years, customers paid for all
15 the costs, and then when it's time to get benefits,
16 those benefits are gone or substantially diminished.
17 And that's the point of my testimony.

18 MR. WRIGHT: Thank you, Mr. Lawton. Thank
19 you, Madam Chair.

20 CHAIRMAN EDGAR: Mr. Walls.

21 MR. WALLS: Yes. Thank you.

22 CROSS-EXAMINATION

23 BY MR. WALLS:

24 Q. Good morning, Mr. Lawton.

25 A. Good morning, Mr. Walls. How are you, sir?

1 **Q.** I'm doing fine. Do you have a copy of your
2 deposition with you?

3 **A.** I think I brought it.

4 **Q.** Okay. Good. First, though, I want to ask you
5 a few questions about Mr. Wright's examination.

6 **A.** Sure.

7 **Q.** Based on what you said about the future
8 projections of fuel prices and nuclear and nuclear plant
9 construction, is it your position then that the company
10 shouldn't go forward with this uprate?

11 **A.** No, I didn't say that at all. That's not my
12 position. I was answering his question that nuclear
13 plants are projected, and they will be built, assuming
14 things go forward without problems. And your project, I
15 think we discussed in the deposition, accepting your
16 assumptions, as soft as some of them are, that this is a
17 good project.

18 **Q.** Okay. And when you were talking about
19 projections about nuclear fuel prices, isn't it also
20 true that there will be variability in fossil prices?

21 **A.** Variability in fossil fuel prices is a likely
22 outcome in the future.

23 **Q.** And what happens, if fossil fuel prices go up,
24 to the net savings projection of the company?

25 **A.** I didn't clearly hear the end of your

1 question, sir.

2 Q. What happens if fossil fuel prices go up
3 compared to the way the company projected? Will the
4 savings increase?

5 A. Savings could increase, assuming that the
6 nuclear construction costs of this project stay in line
7 with your current estimate. But if they were to
8 increase wildly, they could offset even higher fossil
9 fuel prices.

10 Q. And you would agree that this Commission could
11 certainly review those costs, right, and determine
12 whether they were reasonably and prudently incurred;
13 right?

14 A. Well, they would review it for prudence. But
15 once the project has started and it's going forward,
16 then there's not much left for the Commission to do, so
17 they're kind of stuck with it.

18 Q. Are you saying they have to accept the costs,
19 whether they're reasonable and prudent or not?

20 A. No, that's not what I said. I said if they're
21 imprudent, obviously, that's the first criteria. The
22 Commission can always disallow imprudent costs. But,
23 sir, if you've gone forward and you've spent
24 \$250 million on this project, and suddenly other costs
25 start increasing drastically, the Commission is faced

1 with a decision, do I throw away the \$250 million that
2 you've sunk into this project, i.e., the sunk costs, or
3 do I accept these other increases which are going to
4 diminish future savings. It leaves the Commission in a
5 very difficult position.

6 Q. You understand the company's proposal is that
7 they would use fuel savings to offset the costs; right?
8 Were you here yesterday? Did you hear that testimony?

9 A. Yes, I heard that the fuel savings would
10 offset the -- rather than being credited to the customer
11 where they belong, the customer would forgo those
12 savings and pay for this cost.

13 Q. Right, and if there weren't fuel savings, the
14 costs would be deferred until fuel savings were there;
15 right? That's --

16 A. Yes.

17 Q. -- what the company proposed?

18 A. I'm sorry. I didn't mean to speak over you.

19 Q. That's what the company proposed. You heard
20 that; right?

21 A. Yes, that's what they proposed.

22 Q. Now, I want to turn back to your testimony on
23 page 8, which is where you address Commission Order
24 14546, which I'm sure we'll all be familiar with by the
25 end of this proceeding.

1 **A.** I think we'll all still have different
2 interpretations, but that's okay.

3 **Q.** I think so. And you understand that the
4 company's request is under Commission Order 14546 in
5 this case; right?

6 **A.** That's my understanding. You did request it
7 that way, yes, sir.

8 **Q.** And if you look at page 8, in lines 4 through
9 8 of your testimony, you answer the question yes, that
10 the Commission previously established standards that
11 apply to items normally recovered through base rates
12 that may be recovered through the fuel adjustment
13 clause; is that correct?

14 **A.** I guess I'm on a different page. Where are
15 you?

16 **Q.** I'm on page 8 of your testimony.

17 **A.** And could you read that again, sir?

18 **Q.** Yes. The question you ask on your page 8 at
19 line 4, you answered the question yes, to this question.
20 "Has the Commission previously established standards
21 that are applicable to items that are normally base rate
22 items but may be allowed for recovery through the fuel
23 adjustment clauses?"

24 **A.** Yes. You've read that correctly.

25 **Q.** And in fact, you then go on to cite Item 10 of

1 Order 14546; correct?

2 A. Yes, and I added some emphasis.

3 Q. And you read this order for the first time in
4 connection with this proceeding; correct?

5 A. Yes, sir.

6 Q. And then you quote Item 10 on lines 10 through
7 15 of your testimony; right?

8 A. That's correct.

9 Q. And you would agree with me that the first
10 thing that the Commission says in Item 10 is that the
11 fossil fuel-related costs normally recovered in base
12 rates can be included if they were not recognized or
13 anticipated in the cost levels used to determine current
14 base rates?

15 A. That's correct.

16 Q. And then the second thing the Commission says
17 in Item 10 is that those costs can be included if, when
18 they are expended, they result in fuel savings to
19 customers; right?

20 A. Yes. You've read that correctly.

21 Q. Now, I know you point to the last sentence of
22 Item 10 regarding the language regarding a case-by-case
23 review after Commission approval. And as I understand
24 your testimony, you believe that that allows the
25 Commission to consider whatever it wants; right?

1 **A.** Well, yes. If they're going to look at it on
2 a case-by-case basis -- this is a Commission order.
3 It's not a rule or a statute. I mean, the Commission is
4 free to change -- I think Commissioner Skop was talking
5 earlier, was mentioning about precedent. The Commission
6 has the flexibility to change with the facts and
7 circumstances of each case, so the Commission provided
8 itself, and the intervenors or the parties in that case
9 provided the Commission the flexibility to see and
10 adjust to different changes over time.

11 **Q.** Mr. Lawton, when I asked you the question in
12 the deposition about Order 14546, didn't you agree with
13 me that the Commission could consider it on a
14 case-by-case basis as long as it was consistent with the
15 principles stated in Item 10 of Order 14546? Is that
16 right?

17 **A.** Not exactly. You've leaving a few things out
18 that followed that with regard to the facts and
19 circumstances being the same in each case, and I think
20 you're referring to page 24.

21 **Q.** I'm actually referring to page 20 of your
22 deposition.

23 **A.** Okay. Maybe I've got different page numbers.

24 **Q.** Page 20, starting at line 4, I had asked you
25 about Item 10, and you had referenced the case-by-case

1 analysis in that answer. Do you see that?

2 **A.** Sir, it's not on my page 20. Maybe I printed
3 mine out differently. Hold on.

4 Okay. You're at line 4, sir?

5 **Q.** Yes. At line 4 on page 20, I had asked you
6 about Item 10, and that's where you referred to the
7 case-by-case analysis after Commission approval. Do you
8 see that?

9 **A.** Yes.

10 **Q.** And then I asked you at line 15, Question,
11 "Applying the principles identified in Item 10 of Order
12 14546?"

13 Answer, "That would be correct, yes. And I
14 just wanted to make it clear that your global
15 assumptions I do not agree with." Is that answer
16 correct?

17 **A.** That is correct. And again, I was pointing
18 out the global assumptions, because I was referring to
19 the case-by-case basis.

20 **Q.** And you understand the principles expressly
21 stated in Item 10 we just read through and that you
22 quoted on page 8, lines 10 through 15 of your testimony;
23 correct?

24 **A.** That's correct, what we just said.

25 **Q.** Okay. I want to turn to pages 9 and 10 of

1 your testimony where you summarize your opinions.

2 **A.** I'm at 9, sir. What line?

3 **Q.** Okay. And I believe -- I'm just going to try
4 to summarize here. If you disagree, I'm sure you'll
5 tell me. The first one is that, as I understand it,
6 it's your opinion that the utility should include most
7 of the uprate costs in a future base rate proceeding; is
8 that correct?

9 **A.** Future base rate proceeding, yes, sir.

10 **Q.** And you agree that absent a contractual
11 moratorium due to a settlement, any utility making a
12 request under Order 14546 could request those same costs
13 through base rates; right?

14 **A.** That is correct.

15 **Q.** And this was also true at the time Order 14546
16 and Item 10 were developed, right, that utilities could
17 have requested at that time to include those costs in
18 Item 10 in a base rate proceeding?

19 **A.** Yes. But again, you're shorting a more
20 complete answer I gave you in my deposition, which said
21 that there may be times, for example, the Turkey Point
22 uprate that was discussed, where a \$10 million
23 investment may be forgone, because for a company to
24 embark on a base rate proceeding to include those
25 costs -- they would spend many millions of dollars on

1 these huge rate cases, and to avoid that and get
2 customer savings, the Commission has a methodology to
3 allow that to be recovered more quickly and those fuel
4 savings to be quickly passed on without a rate case.

5 Q. Could you turn to page 27 of your deposition?

6 A. Sure.

7 Q. Lines 15 through 23.

8 A. Sure. That's your version; right? Page 27 of
9 your version?

10 Q. Yes. I'm sorry.

11 A. I'm there, sir.

12 Q. And the question I asked was, "Would you agree
13 with me that at the time Order 14546 was developed,
14 including Item 10, that that was also true, that
15 utilities could have requested at that time to include
16 those costs identified in Item 10 in a base rate
17 proceeding?"

18 Answer, "I would agree that they could. With
19 the caveat in my previous answer, to the extent it was
20 economically prohibitive or subject to a moratorium,
21 then they could have asked for it." Is that correct?

22 A. That's correct. And if you look above where I
23 was referring, I was talking about the 5 or \$10 million
24 increase and the rate case problem that I just
25 discussed.

1 **Q.** And in Order 14546, Item 10, that we just read
2 from your testimony, there's no reference in there to
3 future base rates at all, is there?

4 **A.** No. There's reference to very little in Item
5 10. I mean, there's no reference to putting through an
6 uprate project. I mean, there's no reference to the
7 transmission facilities.

8 **Q.** Your second point is that uprate costs are not
9 volatile?

10 **A.** Yes, sir.

11 **Q.** And therefore should not be included. But if
12 we turn back to Item 10 again that you quoted on page 8
13 of your testimony, you would agree with me that there's
14 no reference to the volatility of the costs in Item 10;
15 correct?

16 **A.** That's correct. I think volatility was
17 referred to earlier in that very order with regard to
18 fuel costs.

19 **Q.** And there's nothing in Item 10 that suggests
20 there's any test about the size of the costs incurred;
21 correct?

22 **A.** No. All you have to do is include Commission
23 discretion on a case-by-case basis, and you can
24 eliminate the need for putting in a laundry list.

25 **Q.** And there's no earnings test in Item 10 of

1 Order 14546, is there?

2 A. No, nor have I recommended one.

3 Q. And you would agree with me that Item 10 in
4 Order 14546 was a statement of policy issued by the
5 Commission about what types of costs can be recovered
6 under the fuel clause; correct?

7 A. Yes. It's a Commission policy statement,
8 unlike a rule.

9 Q. And you would agree with me that the statement
10 of policy in Order 14546 is a policy of general
11 application; right?

12 A. Yes. But again, I think Ms. Merchant read a
13 part of the rule earlier in her examination which
14 pointed out that the policy may need not always be
15 followed. The Commission has the discretion.

16 Q. Well, you would agree with me that a policy of
17 general application, the Commission should apply that
18 policy consistently; correct?

19 A. Generally. It would depend on the facts and
20 circumstances. And if you go back to item number 1
21 under background that Ms. Merchant read this morning, it
22 said there may be times when facts and circumstances are
23 similar, and the Commission may go in a different
24 direction. Utilities were put on notice at that time.

25 Q. Mr. Lawton --

1 **A.** Lawton, yes.

2 **Q.** If you go back to Item 10 of Order 14546, that
3 language doesn't appear in Item 10, does it?

4 **A.** No. It appears before that. I mean, you've
5 got to read the whole order.

6 **Q.** Mr. Lawton, if you -- you would agree with me
7 that you also reviewed the cases cited by Mr. Portuondo
8 in his testimony; right?

9 **A.** Yes. And I think there were a couple others
10 you asked me to read for my deposition.

11 **Q.** And you would agree with me that the
12 Commission was developing the policy stated in Order
13 14546 and Item 10 in those cases; correct?

14 **A.** Well, it was developing a policy with regard
15 to the facts and circumstances in each individual case.

16 **Q.** Well, if we could turn to page 17 of your
17 deposition.

18 **A.** Okay.

19 **Q.** Lines 12 through 15.

20 **A.** I'm there.

21 **Q.** Question, "And you would agree with me that
22 the Commission was developing the policy stated in Order
23 14546, Item 10, in those cases?"

24 Answer, "Yes. It was doing different -- a
25 little bit different things in some of those cases,

1 yes." Is that right?

2 **A.** Yes. That's what it says.

3 **Q.** Now, as I understand, you also disagree with
4 PEF including its overall weighted average cost of
5 capital in its current request; correct?

6 **A.** Yes. Under your proposal, I think it's
7 somewhat excessive, given that you've eliminated risk.

8 **Q.** And in the prior cases that you reviewed where
9 the Commission was developing the policy under Order
10 14546, to the extent you saw a reference to it, the
11 utility was awarded the weighted average cost of
12 capital; correct?

13 **A.** That is true.

14 **Q.** And if you could turn to your Exhibit DJL-3.

15 **A.** Three?

16 **Q.** Yes.

17 **A.** Okay. I'm there.

18 **Q.** In this exhibit, you compare the revenue
19 requirements with PEF's weighted average cost of capital
20 and your substituted weighted average cost of capital of
21 7.5 percent; correct?

22 **A.** Yes, the overall cost of capital, yes, sir.

23 **Q.** And you obtained a 7.5 percent weighted
24 average cost of capital by substituting a 5.73 percent
25 debt cost in place of PEF's cost of equity; right?

1 **A.** Yes, sir.

2 **Q.** As a result of your calculation then, there
3 was already debt in the calculation, right, before you
4 made that change?

5 **A.** Yes, that's right. And I didn't put any more
6 debt in. All I did was recalculate the equity cost rate
7 of 11.75 to eliminate all the risk in terms of -- to
8 reflect your guaranteed return. There is no risk, and
9 the Commission would have no basis to put a premium
10 above the debt rate if there's no risk.

11 **Q.** Mr. Lawton, would you agree with me that as a
12 result of your adjustment, it now reflects 100 percent
13 financing at a debt cost of 5.73 percent; correct?

14 **A.** Yes. If you have no risk, then you can get
15 financing at a lower rate. That's what that reflects.

16 **Q.** Would you agree with me that -- isn't it true
17 that PEF is authorized in its settlement agreement to
18 use 11.75 percent as its return on equity in cost
19 recovery clauses?

20 **A.** Yes, until the settlement moratorium is ended.

21 **Q.** And that's what PEF used here in its
22 calculation; correct?

23 **A.** Yes. For 2006 through 2036, I don't see that
24 settlement being applicable for all those years, sir. I
25 mean, I recognize the settlement would be applicable for

1 the early years.

2 Q. Can you point me to an order developing this
3 policy where the Commission granted a request where they
4 granted some recovery at some rate other than the
5 utility's weighted average cost of capital?

6 A. I didn't understand your total question.

7 Q. Okay. I'll repeat it.

8 A. Thank you.

9 Q. Can you point me to an order of this
10 Commission applying the policy developed in Order 14546
11 and granting cost recovery at some rate other than the
12 utility's weighted average cost of capital?

13 A. No. I don't think it has been addressed.

14 Q. Mr. Lawton, I wanted to hand you an order in
15 Docket No. 010001, Order No. PSC-01-2516, dated
16 December 26, 2001, and if you would turn to page 2 of
17 that.

18 A. Sure. Page 2?

19 Q. Yes.

20 A. Okay.

21 MR. MCGLOTHLIN: Mr. Walls, what's your
22 reference again? I want to see if I have that order
23 with me.

24 MR. WALLS: We're bringing it to you.

25 BY MR. WALLS:

1 Q. Mr. Lawton, are you there on page 2?

2 A. I'm on page 2.

3 Q. Do you see Item B?

4 A. B, yes.

5 Q. Regulatory treatment of capital projects
6 expected to reduce long-term fuel costs. Did I read
7 that correctly?

8 A. That's the heading, yes, sir.

9 Q. And then it says below that, quote, "The
10 parties stipulated that the appropriate regulatory
11 treatment for capital projects with an in-service date
12 on or after January 1, 2002, that are expected to reduce
13 long-term fuel costs in the treatment prescribed by this
14 Commission in Order No. 14546 in Docket No. 850001,
15 where we listed the types of costs that are recoverable
16 through the fuel cost recovery clause." Did I read that
17 sentence correctly?

18 A. Yes.

19 Q. And it quotes Item 10 of that order; correct?

20 A. That's correct.

21 Q. And below that it says, quote, "In addition,
22 the parties stipulated that the appropriate rate of
23 return on the unamortized balance of capital projects
24 with an in-service date on or after January 1, 2002, is
25 the utility's cost of capital based on the midpoint of

1 its authorized return on equity." Did I read that
2 correctly?

3 **A.** Yes, you did.

4 **Q.** And did the parties include OPC?

5 **A.** I have a list of the parties on the front, and
6 I would assume they're there, yes.

7 **Q.** And in the quote, the Commission says, "We
8 approve these stipulations as reasonable"; correct?

9 **A.** Yes.

10 **Q.** Now, as I understand, you also disagree with
11 the recovery time period that is shorter than the useful
12 life of the capital assets; correct?

13 **A.** Yes. I think you picked ten years, roughly,
14 one year for one project, but ten years for most.

15 **Q.** And you would agree with me, though, that the
16 Commission in FPL's Turkey Point uprate cost case
17 approved a shorter recovery period compared to the
18 useful life of the assets there?

19 **A.** I believe it was a two-year period in that
20 case to recover the \$10 million of proposed
21 expenditures.

22 **Q.** And you would agree that the Turkey Point
23 uprate fuel savings extended well beyond that two-year
24 period; right?

25 **A.** Yes, they did.

1 **Q.** So for the customers in the first one or two
2 years, the costs would have been paid for by savings,
3 yielding lower net savings than were reflected to
4 customers in the later time period; right?

5 **A.** Not necessarily. The costs were recovered in
6 the first two years. I believe they recovered
7 \$5 million a year, and the savings in each year were
8 estimated at 10 million. But I don't know what the
9 savings would have been in the outer years. Assuming
10 the savings were higher than 5 million, then early year
11 customers would have suffered.

12 **Q.** Could you turn to page 30 of your deposition,
13 lines 6 through 13?

14 **A.** I'm there.

15 **Q.** Where I ask you the question, "And so for the
16 customers in that first one or two years, the costs
17 would have been paid for by the savings, yielding lower
18 net savings than were reflected for customers in the
19 later time period; correct?"

20 Answer, "Yes, that's true. The de minimis
21 amount of costs were recouped in the first years, which
22 is very different from the half billion cost." Correct?
23 That's what you said?

24 **A.** That's what I said, yes.

25 **Q.** And that was correct?

1 **A.** That was correct. And I'm pointing out that a
2 more correct statement would be to the extent savings
3 are higher in later years.

4 **Q.** Mr. Lawton, you would agree with me that even
5 looking at your Exhibit DJL-3, that you show fuel
6 savings in every year from 2008 through 2036; correct?

7 **A.** In my DJL-3, yes. These are just the fuel
8 savings that you've reported.

9 **Q.** Right. And you would agree then that there
10 would be fuel savings represented in each and every year
11 on a gross basis; correct?

12 **A.** Yes, assuming all your assumptions are
13 correct.

14 **Q.** And you would agree that if you defer the
15 instances in this revenue requirements projection you
16 rely on where the costs exceed the savings to later
17 years, by 2016, you would have had cumulative savings in
18 excess of the costs; correct?

19 **A.** Yes.

20 **Q.** A couple of final questions on the recovery
21 period issue. In reviewing the order granting the
22 uprate for the Turkey Point project for FPL, you agree
23 that it is generally a correct statement that the
24 Commission properly applied Item 10 of Order 14546;
25 correct?

1 MR. McGLOTHLIN: May I hear the question
2 again?

3 MR. WALLS: Sure.

4 BY MR. WALLS:

5 Q. In reviewing the order granting the uprate for
6 the Turkey Point project for FP&L, you agree that it is
7 generally a correct statement that the Commission
8 properly applied Item 10 of Order 14546; right?

9 A. Yes, because I believe the Commission stated
10 in the order that its analysis was that to the extent
11 there were fuel savings that were offset here, they were
12 included in this project. And I think they specifically
13 mentioned the order number.

14 Q. You also say in your testimony that shorter
15 recovery periods than the useful life are inconsistent
16 with the Federal Energy Regulatory Commission Uniform
17 System of Accounts; correct?

18 A. That is correct.

19 Q. But you agreed in other orders granting relief
20 under Order 14546 that you reviewed, including the FPL
21 uprate order, that there were shorter recovery periods;
22 correct?

23 A. Yes. That's a fact.

24 Q. And you do not take the position that the
25 Commission was not permitted to do that, allow shorter

1 recovery periods under the Uniform System of Accounts;
2 right?

3 **A.** I didn't -- there were a couple of negatives
4 in there. I'm trying to understand.

5 **Q.** You do not take the position that the
6 Commission was not permitted to do that, allow shorter
7 recovery periods under the Uniform System of Accounts;
8 right?

9 **A.** No. The Commission has its discretion to
10 follow or not.

11 **Q.** And you also agree with me that Paragraph 10
12 of Order 14546 is designed to be an incentive; right?

13 **A.** It incentivizes a company to go forward with a
14 project, sure.

15 **Q.** And the incentive under Item 10 of Order 14546
16 was for utilities to provide low cost fuel sources;
17 correct?

18 **A.** Yes, in facts and circumstances that dictate
19 that this program would work.

20 **Q.** And you would agree with me that nuclear
21 generation from the CR3 uprate is a low cost fuel
22 source; correct?

23 **A.** Well, certainly, compared to other fossil
24 fuels, absolutely, today.

25 **Q.** And if the company says that Item 10 of Order

1 14546 was an incentive for us to do the CR3 uprate
2 project, you certainly aren't in a position to have
3 facts to say otherwise; right?

4 **A.** Could you repeat that?

5 **Q.** Yes, sure. If the company says that Item 10
6 of Order 14546 was the incentive for them to do the CR3
7 uprate project, you certainly aren't in a position to
8 say that it wasn't; right?

9 **A.** You're asking me to speculate, Counsel. I
10 don't know what was in the company's mind.

11 **Q.** I did want to go back to some of the testimony
12 in relation to Mr. Wright's questions about the
13 estimates.

14 **A.** Yes.

15 **Q.** And it's my understanding you would agree that
16 in the prior applications under Order 14546 that you
17 reviewed, the utility's costs and fuel savings were
18 based on estimates; correct?

19 **A.** Yes.

20 **Q.** And as I understand it, you have no reason to
21 dispute the company's projection of fuel savings here;
22 correct?

23 **A.** I did not go back in and redo the model or
24 analyze it. That wasn't part of my assignment.

25 **Q.** And you have no reason to dispute or suggest

1 that the fuel savings calculations are inaccurate from a
2 mathematical standpoint; correct?

3 **A.** Well, they're inaccurate because they're
4 forecasts. Mathematically, if you multiplied 3 percent
5 or 7 percent and trended it, I would have no reason to
6 dispute that.

7 **Q.** And you didn't do a separate cost estimate for
8 the project; correct?

9 **A.** No, no. I didn't add them.

10 **Q.** And you have no basis to disagree with the
11 estimates that are stated by the company; correct?

12 **A.** Well, on some of the costs, no. I did not
13 analyze it. But on other costs, the company doesn't
14 even have an option. It just made some numbers up based
15 on what it could do.

16 **Q.** Well, let's talk about a couple of them. The
17 POD costs, you would agree with me that you have no
18 reason to doubt that those point of discharge costs are
19 related to anything other than the CR3 uprate water
20 temperature increase; correct?

21 **A.** That's what the costs for the facilities are
22 proposed to take care of, yes. But the company, as
23 stated in my testimony, doesn't even know how it's going
24 to approach that project. So those costs, until you
25 have a definitive solution, it's difficult to come up

1 with a cost estimate.

2 Q. And you would agree on the transmission costs,
3 that they were included because the CR3 uprate will make
4 this unit the largest unit in Florida; correct?

5 A. Yes, and therefore, it's unrelated to the fuel
6 costs.

7 Q. But you would agree that that's the reason for
8 why the transmission costs were included, right, because
9 the unit becomes the largest unit on the system?

10 A. Yes. And as I understand it, the unit would
11 become the largest unit on the system, and you would
12 have to add facilities, transmission facilities,
13 possibly for congestion reasons, because it's the
14 largest unit on the system.

15 MR. WALLS: Thank you, Mr. Lawton. That's all
16 the questions I have.

17 THE WITNESS: Thank you, Mr. Walls.

18 CHAIRMAN EDGAR: Commissioner Carter.

19 COMMISSIONER CARTER: Thank you, Madam
20 Chairman. I'm just trying to figure something out here.
21 You said that this is an initial -- this is an issue to
22 enhance shareholder value.

23 THE WITNESS: Yes, sir.

24 COMMISSIONER CARTER: You said the company
25 should be indifferent as to how it recovers these costs.

1 And then you said it's a good project and Progress
2 Energy Florida should go through with it.

3 THE WITNESS: Yes.

4 COMMISSIONER CARTER: Those don't sound like
5 complimentary things to me. How is that possible?

6 THE WITNESS: Well, let me take them one at a
7 time. Number one, it's a project that produces under
8 the company's estimates savings for the customers in
9 their service area. The company has a duty to provide
10 the lowest cost fuel to its customers. It's a monopoly.
11 So it's a good project based on all those assumptions.
12 I see it going forward.

13 Second, does it enhance shareholder value? Is
14 it a platform for enhancement of shareholder value, the
15 project? Under the company's approach, the answer is
16 yes. The company wants to collect the costs in a short
17 period of time, accelerated recovery, with a guaranteed,
18 in other words, no questions asked, guaranteed return on
19 equity of 11.75 percent. So, Commissioner, if somebody
20 were to offer anybody in this country today a -- you
21 give me 300 million or \$448 million, and I guarantee you
22 the money back in 10 years plus an 11.75 percent return,
23 you cannot find that investment anywhere in this
24 country. That is what enhances shareholder value.

25 And your third point --

1 COMMISSIONER CARTER: Shareholder value?

2 THE WITNESS: Yes.

3 COMMISSIONER CARTER: Regardless of what
4 methodology is --

5 THE WITNESS: No, with regard to the company's
6 proposal --

7 COMMISSIONER CARTER: No, I'm saying you're
8 saying from your perspective on shareholder value,
9 regardless of what methodology is used to recoup the
10 funds, it would be the same.

11 THE WITNESS: That was not my statement. Hold
12 on. I said the company should be indifferent, and I'm
13 going to get to that. That was your third point. I was
14 taking them one at a time, Commissioner.

15 COMMISSIONER CARTER: I was trying to follow
16 you on your shareholder value. You threw me on that.

17 THE WITNESS: Okay. Shareholder value. If
18 I'm a shareholder today and I have an opportunity to --

19 COMMISSIONER CARTER: I understand the short
20 term, but I'm talking about you're going to recoup the
21 resources. The term that you recoup may or may not
22 significant, but you're going to recoup the resources
23 either way.

24 THE WITNESS: Yes.

25 COMMISSIONER CARTER: So regardless of what

1 perspective or what term, there will be a shareholder
2 value, for lack of a better term.

3 THE WITNESS: In finance, a shareholder sits
4 there today. If you're going to buy a share of stock,
5 you're going to look at it from a discounted cash flow
6 method. If I can tell you you're going to be guaranteed
7 an 11.75 percent return on your equity investment,
8 you're going to bid that stock price up, because there's
9 no investment out there that would give you that return,
10 guaranteed, because a Treasury bond today is
11 4.75 percent. Now, that's as close to a guarantee as
12 you're going to get. Now, if you can guarantee --

13 COMMISSIONER CARTER: No, let me go with you.
14 Hang on one second. When people buy shares of utility
15 stocks, they don't buy them to flip them the next day.
16 They buy them for the dividend. Wouldn't you agree with
17 that?

18 THE WITNESS: Some buy them for dividend, some
19 buy them --

20 COMMISSIONER CARTER: Most of them buy them
21 for the dividend, as long-term holdings.

22 THE WITNESS: Yes.

23 COMMISSIONER CARTER: I'm trying to follow
24 you. I'm just trying to follow you.

25 THE WITNESS: I understand. Now, you'll get

1 stock appreciation, and you'll get your dividend, when
2 you finally sell the stock over time. This is through
3 the discounted cash flow. Now, if I can guarantee you
4 an 11.75 return, all the stock, that stock, everybody is
5 going to flow to that stock, and they're going to bid
6 that stock price up. That stock is going to be worth
7 more. The shareholder value in terms of when you sell
8 it is going the increase.

9 If in the alternative you put it in base
10 rates, now shareholders have an opportunity to earn
11 11.75 percent. This is comparable to every other
12 utility stock out there. There's no reason to bid that
13 stock price up for that reason. But once you guarantee
14 the return in a ten-year period, investors are going to
15 -- would flock to an investment like that. And that's
16 what increases shareholder value. That's my point.

17 Now, should the company be indifferent? Yes.
18 And here's why. The company has a monopoly license, as
19 I pointed out, to serve all customers in their service
20 area. This project is a good project, and they have a
21 duty to provide low cost fuel.

22 Now, why should they be indifferent? Because
23 this Commission, if they put this project in base rates,
24 will provide the company, after it proves up its case,
25 ample revenues and rates to support the financing costs

1 of this asset such that this company has an opportunity
2 to earn its cost of capital and recover all its costs.
3 That's what the statutes say. That's what this
4 Commission has historically done for every utility in
5 this state. So they should be indifferent, unless they
6 want a financial advantage, which I pointed out earlier
7 in my testimony, which was the accelerated cash flow,
8 the guaranteed return, and the enhancement of
9 shareholder value.

10 And moreover, Commissioner, the company itself
11 in its own analysis and papers, and I quoted it here,
12 talk about this project as an enhancement to shareholder
13 value. So I'm taking their words. It's not just mine.

14 COMMISSIONER CARTER: Madam Chairman.

15 CHAIRMAN EDGAR: Commissioner Carter.

16 COMMISSIONER CARTER: I'm fascinated by
17 finance, so I appreciate this discussion we're having.
18 However, I do see -- maybe we're saying different
19 things. When you use the term "guarantee" in terms of
20 rate of return, they're going to get the rate of return
21 regardless.

22 THE WITNESS: Yes, sir.

23 COMMISSIONER CARTER: So that's a red herring.
24 Let's put this out of the way. Now, but I think what
25 you're saying is that the way that they're recouping the

1 finances has to do with whether it's going to be
2 recouped in a short term versus a long term. The short
3 term would be based upon the proposal that's sitting
4 before us today. The long term would be with the base
5 rates; correct?

6 THE WITNESS: Yes, the long term would be base
7 rates. But in the short term, the return is guaranteed
8 because its reconcilable in each and every fuel
9 proceeding each and every year, which allows you to get
10 the exact dollars.

11 COMMISSIONER CARTER: If I may.

12 THE WITNESS: I hopefully have --

13 COMMISSIONER CARTER: I'm saying that they're
14 still going to get it. If you go through the base rate
15 proceedings or you go through true-up proceedings,
16 you're still going to get it. It's just the time value
17 of money.

18 THE WITNESS: No, sir. In a base rate
19 proceeding, the way it would work is, let's say you
20 ordered this project to be put in base rates. In five
21 years, over the first five years, the company earns what
22 it earns based on revenues, sales to customers,
23 expenses, keeping its budget in line, and it could earn
24 more than 11.75, or it could even earn less each and
25 every year. That's the risk that the company and its

1 shareholders take. Under a fuel approach, you would
2 reconcile and give them their exact 11.75 return each
3 and every year. That's why I call it guaranteed, sir.

4 COMMISSIONER CARTER: Thank you very much.

5 CHAIRMAN EDGAR: Commissioner Skop.

6 COMMISSIONER SKOP: Thank you, Madam Chair. I
7 appreciate the discussion and Commissioner Carter's
8 questions, because I think it does lend some clarity.
9 Perhaps you would have accelerated cash flows, but in
10 terms of the guaranteed returns that you're speaking of,
11 as opposed to putting something in the fuel clause
12 versus base rates, are you saying that the fuel clause
13 is guaranteed, where the base rate is subject to --

14 THE WITNESS: Yes. The fuel clause is
15 guaranteed in the following way: The company has put in
16 a revenue requirement. What would happen, you would
17 have a revenue requirement, and in a certain year, it
18 would be, say, \$90 million to collect these costs, which
19 includes their return and all the other expenditures.
20 If the company does not collect, does not sell enough
21 kilowatt-hours to collect that 90 million, in its next
22 reconciliation, it comes before this Commission and
23 says, "Look, we only collected 85 million. You owe us
24 another 5 million. We have to surcharge future
25 customers to get that other 5 million back." Each and

1 every year, that will be reconciled and collected.

2 That's how the fuel clause works.

3 In a base rate proceeding, if they were
4 supposed to collect -- if you set rates, they collect
5 100 million a year, just to use a number, sir, and they
6 only collected 80 because sales were way down, that's
7 it. They can't come back to this Commission and say,
8 "We're missing \$20 million. Our budget went up or we
9 didn't sell enough." That's it. They lost it. Or
10 alternatively, they could have collected 120 million.
11 That's the way rates work.

12 COMMISSIONER SKOP: Madam Chair, two quick
13 follow-ups. As a follow-up to that question, how do you
14 contrast that to the statement made to the extent if
15 they're seeking to put this capital project, or this
16 uprate is probably is a better choice of words, into the
17 fuel clause pursuant to Item 10 of the order that is
18 referenced extensively through this proceeding?

19 THE WITNESS: Yes, sir.

20 COMMISSIONER SKOP: I think the statement has
21 been made that if they've not captured sufficient fuel
22 savings, that those costs would be deferred. So am I
23 missing something, or are they not going to get -- I
24 mean, they would probably carry forward the investment.
25 But the consumers, if there's not a fuel savings in a

1 specified period, I think as you specified, wouldn't
2 absorb the costs in that period; is that correct?

3 THE WITNESS: I think I have a chart that
4 might show you exactly how this works if I included it.
5 And I don't know that I did, darn it. Let's see if I
6 did.

7 If you could, let me put it this way. If
8 their first year costs were \$10 million and fuel savings
9 were only \$5 million -- that's my first example -- then
10 the company under its proposal would collect 5 million,
11 because it's only collecting up to the amount of fuel
12 savings. That 5 million of uncollected costs is
13 deferred to the following year or other future years.
14 But Commissioner, it carries a carrying cost of the
15 overall cost of capital, so the company on a financial
16 basis is indifferent to if you're going to pay me a
17 dollar this year or \$1.13 next year with the overall
18 cost of capital added on. So the guaranteed recovery
19 does continue throughout, even though it may not be
20 collected exactly in year 1 or year 2 as projected.

21 COMMISSIONER SKOP: And one additional
22 follow-up. With respect to the guarantee, would it also
23 be your contention that this Commission does have
24 prudence review over fuel clause issues to the extent
25 there were overruns or issues that were --

1 THE WITNESS: Absolutely. If Mr. Walls -- I'm
2 sorry. I don't mean to point at Mr. Walls. He's just a
3 lawyer. I'm a lawyer too. But if the fuel -- if the
4 construction of the facility was estimated to be, you
5 know, 10 million, and they went way over because of
6 mismanagement or some sort of malfeasance, certainly the
7 Commission would have the opportunity to review it as
8 that came in.

9 But it's my view that once you lock yourself
10 into this surcharge approach, fuel collection approach,
11 you're going to be locked into it. Moreover, you're
12 setting a precedent. As I saw yesterday, the company
13 admitted they're going to come back, or they pointed out
14 -- it's in the transcript -- with new power plants that
15 they say are built for economic reasons and try to roll
16 those over. So rather than the proverbial camel's nose
17 under the tent, I would put it as the elephants running
18 over the tent.

19 COMMISSIONER SKOP: Thank you.

20 CHAIRMAN EDGAR: Commissioner Carter.

21 COMMISSIONER CARTER: Thank you. Like I say,
22 I'm fascinated with finance.

23 THE WITNESS: Okay.

24 COMMISSIONER CARTER: You said -- and I go
25 back to it. You said it's a good project, and Progress

1 Energy should go through with it; right?

2 THE WITNESS: Based on their assumptions,
3 absolutely, yes, sir. If you can save customers money,
4 the company should do it, and you should approve it.

5 COMMISSIONER CARTER: Right. Now, let me ask
6 you this. Would you not agree that Item 10 in this
7 order that we've quoted so many times that the numbers
8 are about worn off the pages, wouldn't you say that
9 that's a policy issue that the Commission came about to
10 foster creativity and innovation in the industry?

11 THE WITNESS: Well, it may have been partly to
12 get creativity. I think it was to incentivize. As I
13 answered Mr. Walls' question, the simple example, let's
14 take Turkey Point that has been talked about a bit. The
15 Turkey Point situation came up, and they said, "For
16 \$10 million, we can generate these fuel savings if
17 you'll let us put it in now." Otherwise, the company
18 has an incentive, let's wait until the next base rate
19 case, and we'll put the 10 million in then and have
20 future savings, you know, whether it's four or five
21 years.

22 It makes no economic sense to force a utility
23 to have a base rate case to put these costs in and
24 spend, you know, 20 million or -- I don't know what they
25 charge today. Mr. Walls would be better than I on that.

1 I don't know what a base rate case costs here, but I
2 would think it's more than \$10 million of resources,
3 judicial resources and all the time of all these good
4 folks. So that statute -- not statute. Excuse me.
5 That policy says, if that's the situation you're in, it
6 seems the Commission in Florida, you should be able to
7 just do it and get those savings to the customers where
8 they belong. And that seems to be what has been going
9 on in reviewing these cases.

10 COMMISSIONER CARTER: And that -- excuse me,
11 Madam Chairman. That's actually what this Paragraph 10
12 has done. It has incentivized the industry to do that;
13 correct?

14 THE WITNESS: Sure, yes, absolutely.

15 COMMISSIONER CARTER: But you're saying in
16 this case -- do you see what I'm trying to get here?
17 I'm trying --

18 THE WITNESS: Yes. You're asking me what's
19 different about this case. And what's different is, in
20 my analysis and my view, you're building a \$448 million
21 project, and the company is now saying that if you
22 approve this one, we think that any power plant we build
23 for economic reasons could potentially go through here.
24 Mr. Portuondo said that yesterday. So I don't think
25 that's what the fuel rule was all about when the -- the

1 fuel order was all about when the Commission did it. I
2 think it was for those small projects. These big
3 projects go in base rates as they've historically gone
4 in Florida.

5 CHAIRMAN EDGAR: Commissioner Carter, can I
6 follow up on that point?

7 THE WITNESS: I'm sorry.

8 CHAIRMAN EDGAR: Mr. Lawton, I was going to
9 come back to this question, and I think you're on this
10 point. In your opening summary, I think you made a
11 statement along the lines of, "The size of the
12 investment in this instance distinguishes," or something
13 along those lines. But then I also thought I heard you
14 respond to a question from Mr. Walls that in the orders
15 that we have been citing, that there is not a criteria
16 in there that relates to the amount --

17 THE WITNESS: That's right.

18 CHAIRMAN EDGAR: -- involved in the project.
19 So I'm seeing those two statements as somewhat
20 contradictory. Upon what precedent or basis do you cite
21 for the statement that the size of the investment
22 distinguishes here, which I think was a point you were
23 making in response to Commissioner Carter?

24 THE WITNESS: And I'll do it the following
25 way. What I said to Mr. Walls was, yes, the order and

1 Item 10 does not give you a laundry list. It gives you
2 that last sentence. That last sentence says the
3 Commission will take this up on a case-by-case basis.
4 That means the facts and circumstances -- my God, you
5 couldn't list all the different things that could
6 happen. You don't want to lock yourself in. This order
7 was designed to give you the flexibility. And now I'm
8 coming here as an analyst saying I believe this is what
9 makes the project different, the size.

10 And do you have the right to take that into
11 consideration in this case? And the answer is yes,
12 because that last sentence says on a case-by-case basis,
13 you will evaluate each and every distinguishing item,
14 and that's what I point to.

15 CHAIRMAN EDGAR: Commissioner Argenziano.

16 COMMISSIONER ARGENZIANO: Well, I think to
17 that point, what I'm having difficulty -- I mean, I see
18 what the order says, and I see things that I think are
19 contrary to what I think the company is asking for, but
20 I understand their point and what they're trying to do.
21 But when we set precedent, what I'm looking at is those
22 differences. And the company itself has said this is
23 very different, it's never been done before to this
24 magnitude, it's very large.

25 So in my mind, I say, well, then that can't be

1 -- you can't say that's precedent, because it's not even
2 similar to anything in the past. So to me, I can't use
3 precedent, and especially since precedent has been
4 denied. There's been a denial before. To me, I go back
5 to case-by-case basis. And because of the fact that it
6 is so different, precedent can't be applied to it,
7 because it's not even similar.

8 I don't think that's a question. It's more of
9 just going through your last statement. So if it's not
10 even close or similar or identical, I don't how
11 precedent even comes into play.

12 CHAIRMAN EDGAR: Thank you. Commissioner
13 Carter, I had interjected when you were posing
14 questions. Thank you for letting me do that, and you
15 have the floor.

16 COMMISSIONER CARTER: No, Madam Chairman. I
17 think that was a good discourse here on the bench to
18 have, because I think what this says to us is that in my
19 mind, we need to review every case that we ever made a
20 ruling in pertaining to this 14546, particularly as it
21 related to Paragraph 10, because if we're going to
22 incentivize the industry to do things, we need to have
23 some kind of parameters so that we let the companies
24 know going forward, this is what we expect of you,
25 because the bottom line, no matter how you slice it and

1 dice it, the ratepayers pay.

2 Let's just be -- let's call it the way it
3 really is. There's no magical bullet out there in the
4 sky. The ratepayers pay. So what we need to do is, we
5 need to be up front, and we need to be clear and
6 transparent about what we're actually saying to the
7 industry so when they do come forward, we don't have to
8 go back and reinvent the wheel. We can say, "Okay.
9 Based upon all of the cases we've ever had in this area
10 and every time we've ever applied this Paragraph 10,
11 these are the consistencies, these are the
12 inconsistencies, and this is where we think we need to
13 go."

14 I'm just kind of thinking aloud. I think
15 that's where we really need to be.

16 CHAIRMAN EDGAR: Commissioner Argenziano.

17 COMMISSIONER ARGENZIANO: Thank you. One
18 other question. The difference between short term and
19 the longer term that the company is asking for now, I go
20 back to what you described before as the consumer in the
21 short term may be paying for something that the
22 Commission has decided for on a short-term basis, or
23 reaping the benefit on a shorter term basis. In this
24 case, one of the differences is that the consumer today
25 who is paying may not be even be around to reap any

1 benefits or, you know, may not see a benefit. So the
2 current consumer, it would be very different than maybe
3 some of the other cases that you're using as precedent.
4 It may have been that the consumer then realized the
5 benefit in a much shorter term, where the current
6 consumer today on the company's request may not see
7 that. It would be many years down the road. So that
8 should be --

9 THE WITNESS: Well, as I pointed out,
10 Commissioner, earlier, even under the company's best
11 case proposal, the consumers today and for the next 10
12 and possibly 12 years will see no benefits. And then
13 it's only after that, to the extent there are benefits,
14 they will be reaped by those consumers.

15 COMMISSIONER ARGENZIANO: Madam Chair, my
16 point being that maybe some of the other cases that have
17 been granted on the short term, or whatever they were in
18 the past, may have had a very different outcome to the
19 consumer as far as when the benefit was actually
20 derived.

21 CHAIRMAN EDGAR: Commissioner Carter.

22 COMMISSIONER CARTER: I just think when we
23 start talking about different generations of consumers,
24 when we consider roughly over a thousand people a day
25 moving to Florida, it's always going to be a different

1 group over a given point in time. So I think that, you
2 know, we probably need to look at those orders and see
3 what the parameters were in there, because I think you
4 can make a case either way for the consumers, because
5 there's always going to be one group, and then we have
6 mortality rates that we can't control, and all kinds of
7 things happen. This is a highly mobile society we live
8 in, and Florida probably is the most vibrant society in
9 the entire country in terms of a state.

10 So I think this does bear us looking at -- if
11 we're going to go from the standpoint of Paragraph 10,
12 and even not just Paragraph 10, but 14546, if that's the
13 way for us to incentivize the industry to go forth and
14 do great things and provide savings for the ratepayers,
15 then I think we need to be clear on that, and I think
16 streamlining it would be a good way to do that.

17 CHAIRMAN EDGAR: Commissioner Argenziano.

18 COMMISSIONER ARGENZIANO: Just to respond to
19 Commissioner Carter, the reason I made mention of
20 generational differences is not only because the
21 consumer today may not see anything for a very long
22 time, but the time frame may be different. So the main
23 reason I mentioned that was because that may be part of
24 the case-by-case language, and when we talk about
25 precedent, that may be one of the things that differs in

1 that precedent.

2 COMMISSIONER CARTER: That's fine.

3 CHAIRMAN EDGAR: Commissioner Skop.

4 COMMISSIONER SKOP: Thank you, Madam Chair.

5 Again, I want to touch on a point that Commissioner
6 Argenziano raised. Notwithstanding the
7 intergenerational inequity arguments that she brought
8 up, I do think on page 3, you know, the case -- let me
9 real quick get to my -- in 14546 talks about leveraging
10 or taking advantage of short-term opportunities. So
11 again, I don't think it really -- to my knowledge, this
12 case or this order doesn't speak to when consumers are
13 going to derive a benefit, but it does speak to
14 short-term opportunities.

15 So again, I think those were some interesting
16 points that were raised by Commissioner Argenziano, and
17 I think it's the balancing in not only this order, but
18 the prior precedent, and as Commissioner Carter stated,
19 perhaps taking a holistic approach and looking at all
20 the cases. And I think that that's why the case on the
21 shielding that came up that's really not -- this was the
22 first time I heard about it this morning. Although you
23 could probably distinguish that from the instant case,
24 it's still instructive in terms of looking at how the
25 Commission has guided itself based on these precedential

1 orders in the past, so I think that might have some
2 value in itself. Thank you.

3 CHAIRMAN EDGAR: Commissioners, any other
4 questions at this time? No. Are there questions from
5 staff for this witness?

6 MS. BENNETT: No, Madam Chair.

7 CHAIRMAN EDGAR: Mr. McGlothlin, redirect?

8 REDIRECT EXAMINATION

9 BY MR. MCGLOTHLIN:

10 Q. Mr. Lawton, in response to your testimony
11 regarding your proposal that if the company proposal
12 goes forward, the company should receive not 11.75
13 return, but something that would approximate the cost of
14 debt, counsel for Progress Energy Florida asked you a
15 question relating to how the project would be financed,
16 whether it would be all debt or whether it would include
17 other sources of capital. And in response to questions
18 from the Commissioners, you indicated that in your
19 opinion, the company should be indifferent as to whether
20 it receives recovery of costs through the base rate
21 mechanism or the fuel cost mechanism.

22 Would you address the choices, base rate
23 versus fuel, with respect to the viability of the
24 financing of this project? Are there any differences
25 with respect to the ability to raise capital for the

1 construction of this project under one or the other?

2 **A.** Sure. This project is going to go forward
3 under the company's approach or if this Commission
4 elects to require the company to put it in base rates.
5 The reason it's going to go forward is because it
6 results in such great fuel savings, and the company has
7 already filed, I think, a statement of need that the
8 Commission has ruled on.

9 The financing is -- if you approve this under
10 the company's approach, the company has to go and get
11 the financing, 448 million. And I would assume they
12 would finance it in debt, equity, and preferred, and
13 whatever capital they have for internally generated
14 funds. So they have to go to the capital markets that
15 way.

16 If you say it should go in base rates, they
17 have to go to the same capital markets and collect debt,
18 equity, and preferred, typically in the formation of
19 their current capital structure, or if they have
20 internally generated funds. So either way, the project
21 goes forward.

22 And just final to that question, the reason I
23 put the debt rate in for equity is because the
24 Commissions across the country, including Florida, they
25 set cost of capital equity based upon the debt cost, and

1 then how much more incentive do we have to provide and
2 get a cost of equity to get people to buy this stock.
3 And if it's guaranteed, then all you need is a debt
4 rate. There is no risk. There is no premium, and
5 that's why I included that, sir.

6 Q. Based upon your discussion then, Mr. Lawton,
7 if the Commission were to tell Progress Energy Florida
8 that it will recover its costs of this project through
9 the base rate mechanism and not fuel clause recovery, if
10 that is the decision, will the Commission have
11 restricted or constrained the resources available to
12 Progress Energy Florida to go forward with the project
13 in any way?

14 A. No. The reason --

15 MR. WALLS: Objection. Lack of foundation.

16 MR. MCGLOTHLIN: I believe the last answer is
17 the foundation.

18 MR. WALLS: I believe the question was
19 directed to the company's resources to fund it, and I
20 don't know that Mr. Lawton has ever worked for the
21 company or knows anything about their resources.

22 MR. MCGLOTHLIN: We're talking about access to
23 capital markets, not the company, and he is an expert in
24 that area.

25 MR. WALLS: It depends on the company's

1 financial status.

2 CHAIRMAN EDGAR: Mr. McGlothlin, would you
3 restate the question, please?

4 MR. MCGLOTHLIN: Yes.

5 BY MR. MCGLOTHLIN:

6 Q. Based upon your previous answer, Mr. Lawton,
7 if the Commission were to deny this petition and tell
8 Progress Energy Florida that it will recover the costs
9 of uprate project through the base rate mechanism, not
10 the fuel clause recovery, will that decision have
11 constrained or restricted the ability of the utility to
12 obtain financing for their project?

13 MR. WALLS: Same objection.

14 CHAIRMAN EDGAR: I concur with the objection.

15 BY MR. MCGLOTHLIN:

16 Q. When you said that in your opinion, the
17 company should be indifferent as to the choice of
18 mechanisms, would you elaborate on what you meant by
19 that? In what respect should it be indifferent?

20 A. Well, it should be indifferent to a base rate
21 recovery, because so long as the Commission provides
22 adequate rates and revenues for the company to collect
23 its costs and earn a reasonable return, that's what a
24 monopoly licensed corporation in every state is always
25 allowed. The project is a good project and should go

1 forward under these assumptions, and the company, so
2 long as it is provided the capital or the rates, it
3 should have no problem going forward.

4 The only problem that could occur is, if the
5 company has in mind to have an enhanced recovery and a
6 guaranteed return, then that could not be accomplished
7 under base rates. That would be an earnings test or a
8 provision that the company is proposing to get this
9 project to consumers, and that would be wrong. That
10 would be a wrong thing to do.

11 Q. You were shown or directed to an order in a
12 2001 docket. For purposes of that proceeding, the
13 Commission approved the average overall cost of capital
14 for capital items going through the clause. Do you
15 recall that exchange?

16 A. Yes.

17 Q. On what basis do you testify that the
18 Commission should require a lower return in this
19 proceeding?

20 A. Well, I recognize that this order, their
21 settlement says that the company is supposed to get
22 11.75 for the first -- for whatever period this order is
23 in effect. That's not the basis for which I lowered the
24 return. I mean, it's for the years after. And the
25 Commission accepted this order, and it should be honored

1 through 2009. I mean, there's no problem with that.
2 But if the Commission is going to order or allow a
3 surcharge recovery, then it should recognize the 30
4 years, or 29 years exactly, that this order is not
5 applicable for most of those years, 27 out of the 29.

6 Q. In a series of questions, do you recall that
7 Mr. Walls asked you to agree that in orders subsequent
8 to 14546, the Commission was developing the policy of
9 14546?

10 A. Yes.

11 Q. Do you believe the Commission is continuing to
12 develop that policy in this case?

13 A. Absolutely. It's an ongoing policy that the
14 Commission has given itself lots of room to look at the
15 facts and circumstances of each individual case brought
16 before it. That's what I'm recommending ing you do.

17 MR. MCGLOTHLIN: That's my last question.

18 CHAIRMAN EDGAR: Thank you. Let's take up the
19 exhibits.

20 MR. MCGLOTHLIN: We move Mr. Lawton's --

21 CHAIRMAN EDGAR: Excuse me. I'm so sorry.
22 Before we do that, I didn't realize, Commissioner Skop,
23 do you have another question?

24 COMMISSIONER SKOP: Yes, Madam Chair. Thank
25 you. I'm sorry for this late question. I was just

1 listening to the line of questioning.

2 With respect to the uprates and the manner in
3 which your testimony is developed, Turkey Point,
4 according to the information I have before me, was a
5 stretch uprate, which is basically doing a little bit
6 less than I think what is being recommended here. So
7 under that, and knowing that was previously approved by
8 this Commission, so there is some precedential value
9 there, would you look --if this were simply a MUR, a
10 real short-term MUR project in 2007, which I believe the
11 record testimony supports a 12-megawatt increase, if it
12 were that alone, would you agree that we should grant
13 the requested cost recovery method?

14 THE WITNESS: I haven't analyzed that, but I
15 will tell you this, Commissioner. That MUR, the
16 proposal in this case of approximately 6 or \$7 million,
17 is most comparable to the Turkey Point situation, it
18 truly is, in terms of you have a small megawatt increase
19 and low cost dollars and more savings. That's quite
20 comparable. I don't know that I would disagree if the
21 Commission did something like that. I think it would be
22 consistent with it. But once you get into rolling
23 \$448 million through the fuel clause or a nuclear plant
24 through the fuel clause and calling it fuel, it just
25 doesn't look consistent at all.

1 COMMISSIONER SKOP: And as a follow-up to
2 that, because again, Turkey Point was a stretch, where
3 the MUR is something less than that, I believe the
4 second phase of this is 28 megawatts in December of
5 2009, and that's the balance of plant, if my memory
6 serves me correctly. Would you believe that that phase
7 should be appropriately -- would lend itself well?
8 Because, again, I'm doing some quick calculations, and a
9 stretch is about 7 percent, and I look at those two
10 phases in terms of what they offered to the today
11 generation of that unit, and it's about 4 percent. You
12 know, that's subject to check.

13 THE WITNESS: I don't have my calculator.

14 COMMISSIONER SKOP: But again, I'm trying to
15 put this in perspective.

16 THE WITNESS: I understand.

17 COMMISSIONER SKOP: Again, an uprate is an
18 uprate is an uprate. There is precedent for the uprate.
19 It's just -- I think it's semantics. It's the
20 magnitude, and also bringing in some of the transmission
21 issues that are kind of collateral, as well as the point
22 of discharge. But on that second phase, relating it to
23 Turkey Point, can you give some insight into how you
24 would view that if it were just Phases 1 and 2?

25 THE WITNESS: It would be -- well, first of

1 all, with the MUR, where would we stand, I think I
2 answered your question. I said that's most comparable.
3 That's certainly conceivable under the order.

4 The second phase, the answer is no, because by
5 that time, the company has clearly an opportunity to go
6 put this in base rates. Remember, this rule that we've
7 been talking about, this Section 10 is an exception to
8 the fuel clause as a place to allow companies to get
9 recovery without embarking on a rate case. Here we're
10 talking -- now they know about this project. It's very
11 costly, and it all goes together, and they certainly
12 have an opportunity to file a case and recover those
13 dollars.

14 COMMISSIONER SKOP: Thank you.

15 THE WITNESS: You're welcome, sir.

16 CHAIRMAN EDGAR: Commissioner McMurrrian.

17 COMMISSIONER McMURRIAN: Thanks, Chairman.

18 I'm just a little slow on some of the earlier discussion
19 we had, so I've been trying to think through this.

20 Mr. Lawton, you discussed several times about
21 how the company should be indifferent to the method of
22 recovery, and you talked about unless the company has a
23 goal to increase shareholder value. I think that's how
24 you said it.

25 THE WITNESS: Yes, ma'am.

1 COMMISSIONER McMURRIAN: So you agree that the
2 company does have a fiduciary duty to increase
3 shareholder value?

4 THE WITNESS: Absolutely.

5 COMMISSIONER McMURRIAN: And it's your opinion
6 that's why they chose this recovery method? Or maybe if
7 you didn't say it exactly, you're alluding to the fact
8 that they chose this recovery method because it would
9 increase shareholder value.

10 THE WITNESS: Well, yes. I think I said so in
11 my testimony. If a utility has two options, a
12 guaranteed return or an opportunity to earn a return,
13 I'll go with the guaranteed one every day. I mean,
14 that's -- sure.

15 COMMISSIONER McMURRIAN: This goes a little
16 bit beyond that, but do you think allowing recovery
17 through the fuel clause is a way of providing an
18 incentive to the company to invest in additional nuclear
19 beyond that incentive that would be provided by base
20 rate recovery?

21 THE WITNESS: Yes.

22 COMMISSIONER McMURRIAN: That's all. Thank
23 you.

24 THE WITNESS: Thank you, ma'am.

25 CHAIRMAN EDGAR: Any further questions?

1 Seeing none, okay. Exhibits. Sorry, Mr. McGlothlin.

2 MR. MCGLOTHLIN: Eleven through 15.

3 CHAIRMAN EDGAR: Eleven through 15. Seeing no
4 objection, Exhibits 11 through 15 will be entered into
5 the record.

6 (Exhibits 11, 12, 13, 14, and 15 were admitted
7 into the record.)

8 CHAIRMAN EDGAR: And the witness is excused.
9 Thank you.

10 THE WITNESS: Thank you, Madam Chairman.
11 Appreciate it. Thank you, Commissioners.

12 CHAIRMAN EDGAR: Commissioners, absolutely.
13 We have one witness remaining. Why don't we take a
14 15-minute break stretch, and then we will come back with
15 our remaining witness at that time. Thank you.

16 (Short recess.)

17 (Transcript continues in sequence in
18 Volume 3.)

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CERTIFICATE OF REPORTER


STATE OF FLORIDA:

COUNTY OF LEON:

I, MARY ALLEN NEEL, Registered Professional 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 382 through 548 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 14th day of August, 2007.


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