BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company.	DOCKET NO. 080677-EI
In re: 2009 depreciation and dismantlement study by Florida Power & Light Company.	DOCKET NO. 090130-EI

SOUTH FLORIDA HOSPITAL AND HEALTHCARE ASSOCIATION
POST-HEARING BRIEF

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The South Florida Hospital and Healthcare Association ("SFHHA"), pursuant to Order No. PSC-09-0573-PHO-EI and Order No. PSC-09-0731-PCO-EI, hereby files this Post-Hearing Brief in the above-referenced proceeding.

I. Statement of overall position.

A. Summary.

This is a landmark case—perhaps the most important case to ever come before the Commission. In the face of the worst financial crisis to hit this country since the Great Depression, Florida Power & Light Company ("FPL") had the audacity to propose what surely has to be the largest dollar increase in rates ever proposed by a utility in the history of this country. To put that requested rate increase in perspective, with unemployment now exceeding 10% nationally, FPL nonetheless is proposing to increase base rates for some rate classes by a breathtaking 60%.

But this case does not need to be decided based upon an examination of FPL's motives for seeking such an astonishing rate increase. The evidence developed in the lengthy evidentiary hearing in this case shows that FPL has not justified the more than $1.2 billion base rate increase it seeks to implement on January 1, 2010, or the additional $247 million increase it seeks in the

subsequent year. In fact, the evidence supports a result quite the opposite of what FPL is seeking. The evidence supports a *reduction* to FPL's base rates in the amount of $336 million, as supported by SFHHA's witnesses. The individual components of that rate reduction are summarized at page 6 of Mr. Kollen's testimony,[1] and the evidence and arguments supporting that rate reduction are discussed on an issue-by-issue basis herein. The most significant elements that formulate the basis for the required rate decrease are:

- FPL's Return on Equity ("ROE") should be set at 10.4% as proposed by SFHHA witness Baudino, rather than at 12.5% as requested by FPL. A 10.4% ROE is appropriate based upon FPL's risk profile, and will still enable FPL to maintain an A bond rating;

- FPL's requested depreciation allowance should be reduced by $216.144 million to recognize the overstatement of depreciation expense for its combined cycle units, Cape Canaveral and Riviera modernization projects, nuclear uprates, existing meter investment, and economic stimulus grants for advanced meters;

- FPL's requested depreciation allowance should be reduced by an additional $247.556 million annually to effectuate a five-year amortization of FPL's depreciation reserve surplus of $1.245 billion; and

- FPL's request for a $150 million per year to establish a storm damage reserve should be rejected because FPL has no need for such a reserve. FPL already has more cost-effective options for recovering storm damage costs than through base rates.

While these numbers are significant, and certainly attention-grabbing, there are also two other features of FPL's proposal that are of equal importance: (1) the Generation Base Rate Adjustment ("GBRA") and (2) FPL's proposal to adjust cost allocation in a way that FPL claims will bring ratepayers into parity. It has been 25 years since FPL last reset its base rates through a fully litigated proceeding. If these two features of FPL's filing are approved, it will be far longer than 25 years, if ever, before FPL will be back before the Commission seeking to adjust its base rates. FPL will not need to ask the Commission to increase rates because it will have

[1] Tr. at 3110.

mechanisms locked in place to send its rates on a one-way upward trajectory, and it will enjoy ever-increasing returns. And rather than creating parity, as FPL alleges, FPL's cost allocation adjustment will result in commercial class ratepayers over-contributing year after year to FPL's inflated returns.

Under the GBRA, each time FPL places a new generating facility into commercial operation, its rate base will be adjusted in isolation to include the capital cost of the new plant. This will result in higher base rates because there will be no corresponding adjustment for factors that normally work as offsets against rate increases, such as accumulated depreciation and increased billing determinants to reflect customer growth. Therefore, when FPL's load increases, FPL will not only recover more than it needs for its legitimate cost-of-service, but more than it needs for its inflated cost-of-service that does not reflect depreciation and retirement of facilities. And based on FPL's own forecasts, "parity" among rate classes will be skewed because the commercial class will grow exponentially as compared to the residential class. Given these conditions, FPL will never voluntarily return to the Commission for a review of its rates because these mechanisms will automatically adjust rates upward and ensure inflated returns.

Particularly given FPL's filing in this case, it is clear that more, not less, scrutiny of FPL's rates is necessary. One crucial step toward that objective is to reject the GBRA. This mechanism is simply a clever ploy designed to effectively side-step Commission oversight of FPL's rates. Additionally, it is critical to examine the significant flaws in FPL's cost-of-service methodology and to recognize the actual factor that is driving the incurrence of capital costs on FPL's system. A review of the evidence developed at hearing unambiguously shows that FPL's

parity study is unreliable, and that FPL is seeking to shift enormous cost responsibility to the commercial class in order to reap enormous benefits from that class's higher consumption levels.

B. Summary of key issues.

SFHHA will address the record evidence in support of a rate decrease for FPL on an issue-by-issue basis below. Notwithstanding, SFHAA highlights here several key issues that warrant particular scrutiny by the Commission.

1. Parity.

FPL is asking the Commission to authorize a 58.8% base rate increase for customers taking service under the CILC-1D rate schedule. Ratepayers under the CILC-1T rate schedule would receive a 63.2% increase to base rates. GSLDT-1 ratepayers would receive a 50.7% increase. Ratepayers under the HLFT-2 rate schedule would receive a 58.1% increase. Customers under a number of other rate schedules would receive rate increases in a range from 30% to 50%. FPL seeks to justify these enormous increases to base rates by claiming that the ratepayers under these various rate schedules have been subsidized by residential and small commercial customers. FPL seeks to support that assertion through its parity study.

However, SFHHA's witness Baron has shown that FPL's study is unreliable. For instance, FPL's cost-of-service study assigns cost responsibility for secondary poles to commercial class customers under the GSLD-2 rate schedule based on an assumption that almost 19 poles are needed to serve an individual customer. In contrast, FPL's study assumes that only three one-hundredths of a single pole would be needed for each residential customer. No expertise in utility regulation is necessary to recognize that these assumptions in FPL's cost-of-service study cannot possibly be right.

But this is not the only error in FPL's study. FPL's study also shows actual parity results of 0.62 and 0.61 for the HLFT-2 rate schedule in 2006 and 2007, respectively. However, FPL is

projecting that for 2010 and 2011, the parity results for HLFT-2 would be only 0.34 and 0.35. Similarly, FPL's cost-of-service study showed actual parity results of 0.66 and 0.60 for the HLFT-3 rate schedule in 2006 and 2007, respectively. However, for 2010 and 2011, FPL is projecting parity results of just 0.36 in each year. Similar anomalies occur in FPL's results for other rate schedules. As is discussed in detail herein, FPL's purported explanations for these anomalies are not supported by the evidence.

Mr. Baron, for SFHHA, undertook to correct FPL's cost-of-service study. Table 6 of his testimony shows that when cost contribution is properly accounted for, customers under certain rate schedules that FPL claims are under-contributing to costs actually are over-contributing.[2] Customers under all rate schedules also are closer to parity under Mr. Baron's analysis than under FPL's.

As a result, the Commission should not accept at face value FPL's claims that some classes are substantially under-contributing to FPL's costs. Nor should the Commission accept FPL's claim that it is acceptable for the Commission to ignore its long-standing policy that no rate class should receive an increase greater than 1.5 times the total system average increase. The Commission should also reject FPL's incredible claim in support of the argument that its $1.3 billion requested rate increase will somehow produce an overall decrease in total rates.

SFHHA's position is that the evidence in this case supports a decrease in base rates, not an increase as FPL requests. However, if the Commission authorizes any increase in rates, the Commission should adhere to its long-standing policy (most recently applied in the Tampa

[2] Tr. 1731.

Electric Company ("TECO") proceeding),[3] and limit the increase under any rate schedule to no more than 1.5 times the total system average percentage increase.

2. ROE.

The setting of a proper return on equity ("ROE") for FPL is one of the single most important issues in this case. FPL has testified that every 100 basis point reduciton in its allowed ROE results in a reduction of approximately $130 million in annual revenue requirement.[4] FPL has requested a 12.5% ROE, but the evidence in this case shows that request to be significantly higher than the level that is needed to compensate FPL's shareholders or to attract capital. FPL's request should be denied.

FPL enjoys a strong bond rating of "A" by its credit rating agencies. According to Fitch, this is the third-highest credit rating of all integrated utility companies.[5] From the perspective of investor perceived risk, FPL is one of the *least* risky utility investments an equity investor can make. Because of the tradeoff between risk and reward, the relative low-risk of FPL means a lower ROE is appropriate. Furthermore, according to the evidence in this case, no state commission in the country has authorized an ROE of 12.5%.[6] The average commission award is 10.5%.[7] In fact, the highest awarded ROE authorized by a state commission is 11.5%,[8] presumably for a utility with substantially more risk than FPL. Finally, FPL's own ROE analysis does not support the requested 12.5% ROE. As detailed later, Dr. Avera's utility proxy group DCF analysis resulted in a range of 10.5% to 11.7%, well below the requested 12.5%. SFHHA witness Baudino, by contrast, calculated an ROE of 10.4%, in line with what other state

[3] *See In re: Petition for Rate increase by Tampa Electric Company ("TECO")*, Docket No. 08-0317-EI, Order No. PSC-09-0283-FOF-EI at 87, Order Denying and Granting Reconsideration in Part, No. PSC-09-0571-FOF-EI, Amendatory Order, No. PSC-09-0571A-FOF-EI.

[4] Tr. at 4476.

[5] Hearing I.D. No. (hereinafter, "Ex.").

[6] Ex. 462.

[7] *Id.*

[8] *Id.*

commissions have authorized, and properly reflective of FPL's risk. Mr. Baudino's recommendation should be adopted.

3. Depreciation Expense.

The evidence also shows that FPL has systematically overstated its depreciation expense in order to drive up its rates. Scrutiny of the assumptions underlying FPL's depreciation expense reveals that FPL's revenue requirement is overstated by more than $216.144 million associated with depreciation expense for its combined cycle units, Cape Canaveral and Riviera modernization projects, nuclear uprates, existing meter investment, and economic stimulus grants for advanced meters.[9] In addition, FPL has amassed a massive depreciation reserve surplus of at least $1.245 billion, which should promptly be refunded to ratepayers over a five-year period.[10]

FPL's depreciation expense is grossly inflated because the company has proposed arbitrarily short amortization periods that bear no relation to the service lives of the underlying assets. Depreciation expense is not one of the "major drivers" of FPL's rate case, as the utility would have the Commission believe. Rather, if the Commission adopts reasonable service lives for FPL's generation units, approves reasonable amortization schedules for the above-mentioned projects, and refunds FPL's depreciation surplus to the customers who over-paid, FPL's rates would drop significantly without *any impact* on the utility's earnings. Thus, contrary to FPL's request for $266 million in additional revenue requirement associated with depreciation expense, the Commission should actually *reduce* FPL's requested revenue requirement by a total of

[9] Tr. at 3110.
[10] *Id.*

$463.7 million, which is comprised of a $216.144 million reduction in depreciation expense and a $247.556 million annual, five-year amortization of FPL's depreciation reserve surplus.[11]

4. Generation Base Rate Adjustment.

FPL's proposal to institutionalize the GBRA represents a dramatic shift in ratemaking that, if approved, would have a significant negative rate impact for its customers. The evidence conclusively establishes that the GBRA would guarantee increasing cost recovery and profits for FPL, while ignoring decreasing costs in FPL's rate base. Stated differently, if the GBRA were implemented, FPL's ratepayers would pay a higher price for new generation because the cost of that generation would not be offset by cost reducing factors that typically mitigate the price of new plant investment. FPL admits that accumulated depreciation, plant retirements, changes in sales growth and billing determinants, and other cost-reducing measures would be wholly ignored by the GBRA.[12] As the mechanism is designed, FPL's annual accumulated depreciation of approximately $765 million, for example, would not operate as an offset (as it would in a rate case) against the $3.26 billion that FPL plans to add to rate base through the GBRA for West County Unit 3 and the Cape Canaveral and Riviera modernization projects.[13] Thus, if the GBRA were approved, FPL would enjoy increased rates and a return on new investment, as well as base rates that are set to recover declining rate base.

At the hearing, the harm that the GBRA would cause for ratepayers was highlighted by the testimony of FPL witness Deason, who readily agreed that *increased* capital costs of approximately $800 million represent a level of magnitude that would have a material impact on rate base.[14] Indeed, Mr. Deason testified that $800 million was not a magic threshold and that

[11] SFHHA will address the depreciation surplus in response to Issue 19F.
[12] Ex. 292.
[13] *See* Exs. 488, 490; *see also* Tr. at 4289.
[14] Tr. at 6716.

"any dollar" that was properly incurred should be accounted for in a utility's cost-of-service and recovered through rates.[15] In contrast, however, FPL's proposed GBRA would have the Commission ignore the impact that a $765 million *decrease* in costs would have on the utility's cost-of-service. The GBRA is plainly inequitable and must be rejected. It constitutes an unreasonable cost recovery mechanism that, if approved, would significantly harm FPL's ratepayers.

5. Storm Reserve.

FPL's request for storm damage expense is yet another example of how FPL has artificially inflated its revenue requirement. Section 366.8260, Florida Statutes, permits FPL to recover its reasonable and necessary storm restoration costs and to replenish the storm damage reserve through a surcharge pursuant to securitization financing. This mechanism of storm financing guarantees cost recovery for FPL and provides ratepayers with the benefits of low-cost securitization financing.[16] Despite guaranteed cost recovery for storm restoration, however, FPL has requested accrual of $148.667 million of annual storm damage expense, which has a revenue requirement impact of $149.162 million.[17] Considering that ratepayers have a cheaper method of financing storm costs, it should be a no-brainer that FPL does not need to accrue additional storm damage reserves. FPL should not be permitted to reestablish an annual storm damage accrual in base rates, including establishment of a storm damage reserve while it continues to collect a storm damage surcharge for the very same purpose.

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[15] *Id.*

[16] Tr. at 3146.

[17] Tr. at 3142.

ISSUES AND POSITIONS

2010 PROPOSED TEST PERIOD

ISSUE 1: Does the Commission have the legal authority to approve a base rate increase using a 2010 projected test year?

POSITION: No position.

ISSUE 2: Is FPL's projected test period of the 12 months ending December 31, 2010, appropriate?

POSITION: No position.

ISSUE 3: Are FPL's forecasts of customers, kWh, and kW by revenue and rate classes for the 2010 projected test year appropriate?

POSITION: No position.

ISSUE 4: Does the Commission have the legal authority to approve a subsequent year base rate adjustment using a 2011 projected test year?

POSITION: *Supports the position of FRF.*

ISSUE 5: Should the Commission approve in this docket FPL's request to adjust base rates in January 2011?

POSITION: *No. The Commission cannot determine at this time what the reasonable revenues and costs will be in 2011. Further, there is no evidence that there will be actual savings to ratepayers resulting from avoidance of a separate proceeding sometime in 2010 for rates that would be effective in 2011.*

DISCUSSION:

Both the evidence and sound public policy weigh against approval of FPL's proposed January 2011 base rate increase. Given the present economic uncertainty, as well FPL's own changes to its originally proposed revenue requirement for 2010 and 2011, it is clear that the Commission cannot determine at this time what FPL's reasonable revenues and costs will be in 2011. FPL's claim that it needs a $239 million rate increase on January 1, 2011, in addition to its

requested $1.3 billion rate increase for January 1, 2010, is simply too speculative.[18] Further, there is no evidence that there will be actual savings from deferring a rate case, and FPL acknowledges that it has the option to come in for another rate case.[19] Because FPL has an adequate remedy if its revenues prove insufficient, and because fluctuations in FPL's costs have rendered its 2011 test year forecast unreliable, the Commission should reject FPL's proposal for a 2011 rate increase.

The evidence demonstrates that FPL's forecast for 2011 is unreliable and should therefore not be used as the basis for a subsequent test year adjustment. FPL's Vice President of Finance, Robert Barrett, admitted that there is uncertainty about the economic conditions that will exist in 2011.[20] The past and current economic uncertainty has also resulted in significant changes to FPL's original rate request. It would therefore be poor public policy to approve a rate increase for 2011 based on a forecast that has proven to be significantly flawed in the short span of time since FPL's rate case was originally filed.

The unreliability of FPL's 2011 rate increase is demonstrated by the revenue requirement adjustments FPL has made since it filed this rate case. FPL's 2011 rate increase is based on a sales forecast for 2011 that was created in 2008.[21] Since the utility filed in March 2009, it has acknowledged that it overestimated its 2010 and 2011 revenue requirement by more than $60.6 million and $68.4 million, respectively.[22] When FPL filed this case, it did not realize the impact that the American Recovery and Reinvestment Act of 2009 ("Stimulus Bill") would have on its rates. Specifically, FPL was unaware that it would have a decreased revenue requirement of at

[18] Tr. at 1260-1261.
[19] Tr. at 1267.
[20] Tr. at 5948.
[21] Tr. at 1262.
[22] Tr. at 1261; *see also* Ex. 358; Tr. at 3721.

least $40.1 million and $35.9 million associated with additional accumulated deferred income tax ("ADIT") for 2010 and 2011.[23] Further, the utility did not know whether it would receive a $200 million Stimulus Bill grant to fund its Energy Smart Florida program for advanced meter deployment that, when implemented, would result in increased operational savings in 2011.[24] FPL did not quantify any of the benefits of its requested $200 million grant award on its cost-of-service.[25] In addition, FPL admitted that it made several errors in calculating its necessary revenue requirement, including a failure to adjust its 2010 and 2011 revenue requirement by $3.12 million and $6.31 million for Department of Energy ("DOE") funds associated with a nuclear fuel settlement agreement.[26] FPL also admitted that it improperly included depreciation expense on a Computer Information System ("CIS") replacement project that is not scheduled to go live until 2012.[27] An additional example of the unreliability of FPL's forecast is FPL's request in rebuttal testimony that the Commission should *increase* its 2010 and 2011 revenue requirement by $11 million based on conjecture that the company will not receive distributions from Nuclear Electric Insurance Limited ("NEIL"), even though NEIL has made annual distributions to its members for the last decade.[28] FPL admits that it is speculating regarding the loss of the distributions.[29] If the Commission removes the distributions from FPL's revenues and FPL's speculation proves wrong, customers would lose the benefits of those distributions to FPL's shareholders.[30]

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[23] Ex. 358.

[24] *See* Ex. 310 (describing operational savings of advanced meter deployment). *See also* Issue 47.

[25] *See* Issue 47.

[26] Ex. 358.

[27] Tr. at 3714.

[28] Tr. at 3715; Ex. 468; Tr. at 3766.

[29] Tr. at 3765; Ex. 468.

[30] Tr. at 3788.

The revenue requirement adjustments that FPL has identified since it filed its rate case in March 2009 underscore the unreliability of FPL's projected 2011 test year, which was created three years prior to the actual test year. FPL's Vice President of Finance Robert Barrett testified that sales forecasts are generally more reliable the closer in time they are to the present period.[31] While he attempted to bolster the veracity of his 2011 sales forecast, even he acknowledged that he had to change his forecast assumptions several times during the budget review process because the economic factors kept changing.[32] The significant changes in FPL's revenue requirement since March 2009 prove that FPL's 2011 forecast is unreliable.

Furthermore, there is no evidence that ratepayers would receive any savings by avoiding a separate rate proceeding sometime in 2010 for rates that would be effective in 2011. At the time of the Prehearing Order, FPL estimated that its rate case expenses were $3.7 million.[33] Mr. Barrett admitted that FPL did not perform a cost-benefit analysis to examine whether the costs of a rate case outweighed savings that could result from re-examining changing costs.[34] He also admitted that an upturn in the economy would mean more sales growth than currently projected by the company.[35] He agreed that, in the past, "significant productivity improvements in cost management and increased efficiency of its operations has been a significant contributor to why [FPL has] been able to stay out of the rate increase arena."[36]

Because of unpredictable changes in the economy, it is certainly possible that FPL's perceived need for a 2011 base rate increase could be offset by changes in sales growth, billing determinants, additional Stimulus Bill benefits, and other cost-decreasing measures. At a time

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[31] Tr. at 1286, 5836.
[32] Tr. at 1262.
[33] Order No. PSC-09-0573-PFO-EI ("Prehearing Order") at 188.
[34] Tr. at 1266.
[35] Tr. at 5944.
[36] Tr. at 5947.

when Florida's ratepayers have been hit hard by the downturn in the economy, it makes sense to wait and see if a subsequent rate case is justified. FPL's claim that it will need a rate increase in 2011 simply is too speculative, and should be rejected.

ISSUE 6: Is FPL's projected subsequent year test period of the 12 months ending December 31, 2011, appropriate?

POSITION: *See response to Issue 5.*

ISSUE 7: Are FPL's forecasts of customers, kWh, and kW by revenue and rate classes for the 2011 projected test year appropriate?

POSITION: *No position.*

GENERATION BASE RATE ADJUSTMENT

ISSUE 8: Should the Commission approve a Generation Base Rate Adjustment (GBRA) mechanism which would authorize FPL to increase base rates for revenue requirements associated with new generating additions approved under the Power Plant Siting Act, at the time they enter commercial service?

POSITION: *No. The GBRA would allow FPL to over-recover costs because it fails to consider cost reductions that FPL may achieve in other areas, such as increases in accumulated depreciation or plant retirement. The GBRA would also allow FPL to retain savings from ongoing recoveries of existing plant investment through depreciation, cost-free capital resulting from ongoing accelerated tax depreciation, increases in revenues due to sales growth, and reductions to capital expenditure and expense costs. *

DISCUSSION:

I. Background.

FPL's proposed GBRA offers ratepayers a "heads-I-win, tails-you-lose" proposition, and should be rejected for the same reasons the Commission rejected the Transmission Base Rate Adjustment Mechanism ("TBRA") in the recent *TECO* case.[37] FPL admits that accumulated depreciation, plant retirements, changes in sales growth and billing determinants, and other cost-

[37] Order No. PSC-09-0283-FOF-EI.

reducing measures would be wholly ignored by the GBRA.[38] Thus, if the GBRA were implemented as FPL proposes, the utility would enjoy increased rates and a return on new investment, as well as base rates that are set to recover declining rate base. The GBRA would significantly harm ratepayers by eroding the traditional model of ratemaking, which recognizes that, over time, some of a utility's costs increase while others decrease. In short, the GBRA will guarantee a rate increase for Florida ratepayers whether FPL's total costs and revenues justify that increase or not.

II. The GBRA does not account for declining costs that offset new plant investment.

As proposed, the GBRA would guarantee cost recovery and profit for FPL's new plant investment, while institutionalizing a cost recovery mechanism that permits FPL to over-recover its base rate costs. Throughout the hearing, FPL made the disingenuous claim that the GBRA would not permit the utility to over-recover its costs.[39] This claim, however, rests on the presumption that the Commission should only examine new plant investment that would be recovered through the GBRA. *This is a faulty premise.* While FPL's operating costs may increase over time as a result of inflation or new plant investment, the evidence in the record clearly demonstrates that the book value of FPL's investment and required return would decrease significantly as a result of depreciation.[40] In addition, FPL pointedly acknowledges that the GBRA would not take into account other cost-reducing items such as plant retirements or changes in sales growth and billing determinants.[41]

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[38] Ex. 292.

[39] Tr. at 3739.

[40] Ex. 490.

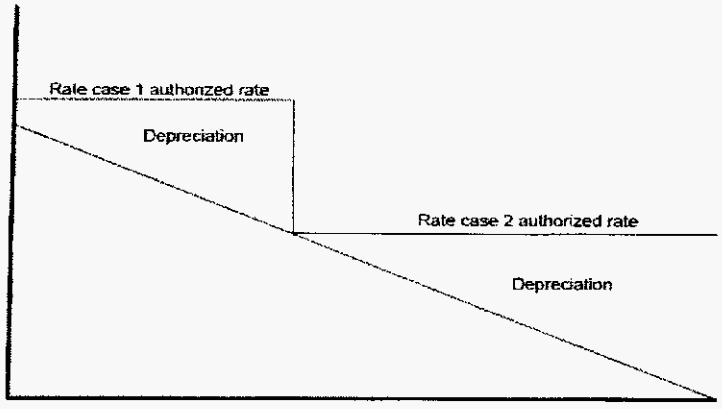
[41] Ex. 485; Tr. at 4280.

To put this issue in perspective, FPL plans to add approximately $3.26 billion to rate base through the GBRA through 2015 for West County Unit 3 and the Cape Canaveral and Riviera modernization projects.[42] FPL's 2009 Surveillance Report reveals that its annual accumulated depreciation is approximately $765 million,[43] which under traditional base ratemaking practices could be used to offset plant investment that FPL would make for these projects. Presuming that there will continue to be approximately $765 million in depreciation for the years 2012 through 2015, and all other things being equal, depreciation would offset rate base by approximately $2.3 billion. Further, FPL Vice President of Finance Robert Barrett admits that, historically, sales growth and productivity improvements have been significant contributing factors that have kept the utility from filing rate cases.[44] In short, if the Commission were to approve the GBRA, Florida's ratepayers would be saddled with paying for each and every dollar of FPL's new plant investment plus profits, yet ratepayers would not receive the corresponding benefit of FPL's declining costs from depreciation, changes in billing determinants, and productivity improvements.[45]

As a matter of general ratemaking, once a rate is set it remains in effect until a subsequent rate change is approved.[46] Consistent with this basic ratemaking concept, the illustration in exhibit 486 demonstrates that depreciation would decrease FPL's cost-of-service in between rate cases, all other things being equal:

[42] Ex. 490; Tr. at 4289.
[43] Ex. 488.
[44] Tr. at 5947.
[45] Ex. 485.
[46] Tr. at 4268.

RATE CASE WITH NO ADDITION TO RATE BASE



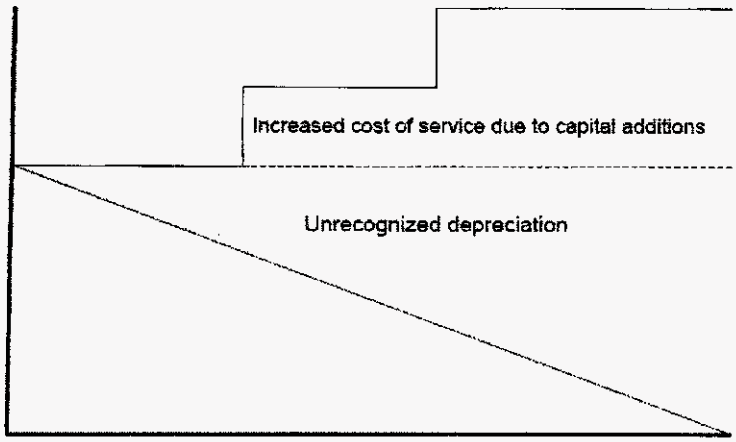
As illustrated above, depreciation will occur, accumulate, and reduce rate base, but that depreciation does not impact the actual rate that is in effect at that time.[47] Based on the above illustration, FPL witness Renae Deason agreed that, if no rate base were added, a subsequent rate case would indeed result in lower rates.[48] Ms. Deason also testified that "if accumulated depreciation has gone up and there is no addition to rate base, then total revenue requirements will be lower and rates will be lower."[49] As illustrated by exhibit 487, however, the GBRA would not recognize depreciation:

[47] *Id.*

[48] Tr. at 4268-4269.

[49] Tr. at 4269.

GBRA



As a result, if FPL puts West County 3 into the GBRA, FPL would have lower rate base that could be offset by unrecognized depreciation when ratepayers begin to pay for the West County Unit 3 through the GBRA. If the unit were recovered in base rates, the benefit of this depreciation would manifest itself as lower rates than if the unit were recovered through the GBRA. The GBRA, however, would ignore the decline in rate base caused by depreciation.

III. The Commission should reject the GBRA for the same reasons that it rejected TECO's TBRA.

The Commission should reject the GBRA for the same reasons that it rejected TECO's TBRA earlier this year. The TBRA was modeled after the GBRA, except its purpose was to allow recovery of transmission investment rather than generation investment.[50] Intervenors argued against the TBRA for the same reasons that they now oppose the GBRA.[51] FIPUG's witness, for example, described the TBRA as single-issue ratemaking that ignored potentially offsetting changes in other costs not subject to the rider.[52] The Commission rightly rejected the TBRA on the basis that "given the long-term horizon that transmission projects appear to have, it

[50] Order. No. PSC-09-0283-FOF-EI at 122.

[51] *Id.* at 125.

[52] *Id.*

appears more prudent to continue to consider such costs in the context of a ratemaking."[53] The Commission also held that the TBRA considers only "the cost of constructing new transmission facilities in isolation, without considering potential increases in revenues from additional sales or decreases in rate base due to retirements or depreciation that may offset the impact of construction costs."[54] The same is clearly true of the GBRA, and it too should be rejected.

IV. It should not be a policy goal to avoid rate cases that would fully scrutinize costs of new plant investment and existing base rates.

FPL touts the GBRA as an "efficient" mechanism because it would avoid costly rate cases.[55] Considering the opportunity for cost over-recovery that the GBRA would institutionalize for FPL, the GBRA would certainly decrease the likelihood that FPL would file future rate cases. However, avoiding rate cases is not a rational or appropriate policy goal. It is no wonder that FPL did not do a cost-benefit analysis to test whether the cost of conducting a rate proceeding would outweigh potential rate reductions resulting from declines in rate base.[56] Considering the declining costs that would not be recognized by the GBRA, the only benefits of avoiding a rate case would belong to the utility.

Specifically, FPL would benefit because rates for new plant recovered through the GBRA would be set based on FPL's first year estimate of the revenue requirement for the new generation and related transmission, when that revenue requirement is at its peak level.[57] Base revenues would not be adjusted downward until the next comprehensive base rate proceeding (as depicted in exhibit 486), which FPL would have no incentive to file. Historically, the onus has been on the utility to file a rate case when its rates are no longer sufficient to allow it to earn a

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[53] *Id.* at 126.
[54] *Id.* at 127.
[55] Tr. at 3718; Tr. at 3796.
[56] Tr. at 1266.
[57] Tr. at 3115.

reasonable return. Shifting the burden to the Commission Staff and stakeholders to actively police whether FPL is over-recovering would represent a dramatic shift in the regulatory paradigm, shift substantial risk to customers, and likely result in additional administrative burdens for the Commission. The GBRA would therefore result in less, rather than more, administrative efficiency.

V. The 2005 Settlement is not precedent in support of FPL's proposed GBRA.

The facts and circumstances that led to the GBRA that was approved as part of the 2005 Settlement in Docket Nos. 050045-EI and 050188-EI ("the 2005 Settlement") do not exist here. The prior GBRA was the result of give-and-take in settlement negotiations that created benefits for both customers and FPL. For example, ratepayers received the benefit of a base rate freeze for the next four years, except for costs recovered through various adjustment mechanisms.[58] In addition, the GBRA was temporary until FPL's next base rate proceeding. Here, FPL's proposed 2010 and 2011 rate increase does not even include the costs for West County Energy Center Unit 3,[59] and FPL would have the GBRA approved indefinitely. FPL also seeks a higher return on equity than that approved in the 2005 Settlement.[60] The expiring GBRA that was implemented in conjunction with the 2005 Settlement simply should not be considered as precedent for FPL's currently proposed GBRA.

VI. The needs determination proceedings are not designed to examine whether a base rate increase is necessary for new plant investment.

FPL also has tried to build support for the GBRA by noting that the Commission has already approved the prudence of costs for West County Unit 3 and the Cape Canaveral and

[58] Tr. at 3114.

[59] Tr. at 3109.

[60] Tr. at 3794.

Riviera modernization projects in a needs determination proceeding. At the hearing, for example, FPL witness Ousdahl asserted that the Commission carefully scrutinized the costs of the units in its needs determination proceeding, and that "the language in [Rule 25.22082] certainly implies that there is a level of review on the prudence of those dollars associated with the need determination activities."[61] What Ms. Ousdahl failed to mention is that the Commission's order approving the West County Unit 3 and Cape Canaveral and Riviera projects (Order No. PSC-08-0591-FOF-EI) did not make any determination regarding how FPL's rates should be set to recover the costs of new plant investment. In examining the need for an electric power plant, Section 403.519(3), Florida Statutes, requires the Commission to compare the costs of the new plant to other options. The statute and the Commission's rule do not, however, require the Commission to fully examine a utility's cost-of-service to determine exactly how much of a rate change will be necessary as a result of the new investment.

Moreover, FPL never provided evidence of the full bill impact of the GBRA. Ms. Ousdahl testified that FPL did not estimate the impact on customers' bills of West County 3, Canaveral and Riviera as a part of this base rate filing.[62] It is therefore illogical for FPL to assert that the Commission, as part of a needs determination proceeding that took place in 2008, contemplated that FPL's rates would be adjusted upward to recover the costs of the projects without a concomitant examination of offsetting cost reductions.

Indeed, the Commission has often approved new plant investment for FPL that did not result in any change in rates. FPL witness Deaton, for example, testified that FPL added several plants in the 1990s and early 2000s without changing rates.[63] Thus, the claim that the

[61] Tr. at 3789

[62] Tr. at 3793.

[63] Tr. at 6023.

Commission's needs determination findings with respect to West County Unit 3 and the Cape Canaveral modernizations support the reasonableness of the rates that would result from FPL's proposed GBRA does not withstand scrutiny.

Finally, ratepayers would pay more for assets that are recovered through the GBRA. For example, West County Unit 3 would cost ratepayers more if passed through the GBRA because the company's schedules reflect a 6.43% cost of debt for the unit's revenue requirement, compared to a 5.81% weighted average cost of debt for the 2011 subsequent test year revenue requirement. Mr. Kollen testified that FPL's proposed rate of return on the GBRA is "overstated due to the company's use of the so-called incremental cost of debt rather than the weighted average cost of debt outstanding."[64] The use of the incremental cost of debt for the GBRA is yet another reason it should be rejected.

VII. Conclusion.

The GBRA is an exceptional form of ratemaking that was approved under unique circumstances as part of the 2005 Settlement. Absent the attendant benefits that justified the that settlement, the GBRA is not a reasonable form of cost recovery for new plant investment. The GBRA would significantly harm ratepayers and undermine the traditional regulatory paradigm, and must be rejected.

ISSUE 9: If the Commission approves a GBRA mechanism for FPL, how should the cost of qualifying generating plant additions be determined?

POSITION: *Supports OPC's position.*

ISSUE 11: If the Commission approves a GBRA mechanism for FPL, how should the GBRA be designed?

[64] Tr. at 3117.

POSITION: *The GBRA revenue requirement methodology should be set forth in a formula and in the form of a GBRA tariff. In the formula, the Commission should require the use of a capital structure, cost of debt and return on equity that is consistent with the SFHHA recommendations to adjust these components for base ratemaking purposes. Depreciation expenses also should be adjusted to reflect a 40-year service life for new combined cycle facilities.*

DISCUSSION:

FPL proposes that the GBRA be implemented as described in the 2005 Settlement Agreement and in the testimony of FPL witness Deaton.[65] The Commission should not, however, approve the GBRA without a tariff that sets forth the methodology for the GBRA revenue requirement.[66] SFHAA witness Kollen testified that FPL's proposal to continue the GBRA as the mechanism is described in paragraph 17 of the settlement agreement is "not sufficiently detailed for permanent self-implementing base rate increase mechanism."[67] If the Commission were to approve the GBRA, which it should not, it must order FPL to provide an actual tariff that would expressly describe the methodology for the GBRA revenue requirement.

Further, several capital structure, cost of debt and return on equity adjustments should be recognized so that the GBRA does not award excessive revenues to FPL. Mr. Kollen testified that the GBRA would provide FPL with "excessive revenues" based on several factors.[68] First, the proposed rate of return is overstated due to an excessive common equity ratio of 55.80%.[69] According to SFHHA witness Baudino, a reasonable capital structure consists of 50.0% common equity and 50.0% debt for rating agency reporting purposes, and 53.46% common equity and

[65] Prehearing Order at 33.
[66] Tr. at 3115.
[67] Tr. at 3116.
[68] *Id.*
[69] *Id.*

46.54% debt for ratemaking purposes.[70] SFHAA's response to Issue 73 addresses this issue in more detail.

Second, Mr. Kollen testified that FPL's proposed rate of return on the GBRA is "overstated due to the company's use of the so-called incremental cost of debt rather than the weighted average cost of debt outstanding."[71] Stated another way, West County Unit 3 would cost ratepayers more money if recovered through the GBRA because the company's schedules reflect a 6.43% cost of debt for the unit's revenue requirement, compared to a 5.81% weighted average cost of debt for the 2011 subsequent test year revenue requirement. Third, FPL's proposed rate of return does not include low-cost short-term debt in the capital structure.[72] In addition, the rate of return is overstated because it does not include any cost-free ADIT.[73] Finally, the depreciation expense for the West County Unit 3 facility is overstated because it is based on a 25-year service life, as opposed to a 40-year service life, as described in SFHHA's response to Issue 19C. Each of these capital structure issues must be remedied if the Commission implements the GBRA.

ISSUE 12: If the Commission approves a GBRA mechanism for FPL, should the maximum amount of the base rate adjustment associated with a qualifying generating facility be limited by a consideration of the impact of the new generating facility on FPL's earned rate of return ("earnings test")? If so, what are the appropriate financial parameters of the test, and how should the earnings test be applied?

POSITION: *Yes. The GBRA should not be used to circumvent the comprehensive review of all revenue and cost components in a base rate proceeding. An earnings test provides a real-time proxy to capture any other revenue increases and cost reductions in the absence of a comprehensive base rate proceeding. Any earnings in excess of the authorized return on equity, as measured by FPL's earnings reported on surveillance reports, should be used to reduce the GBRA.*

[70] *Id.*
[71] Tr. at 3117.
[72] *Id.*
[73] *Id.*

DISCUSSION:

As described in SFHHA's response to Issues No. 8 and 9, the GBRA harms ratepayers because, as proposed, it gives FPL *carte blanche* to set excessive rates. If the Commission approves the GBRA, it should institutionalize a comprehensive earnings test that would capture any other revenue increases and cost reductions in FPL's cost-of-service, and ensure that those savings are passed on to ratepayers. To the extent that FPL has earnings in excess of its authorized return on equity, as measured by its earnings reported in its surveillance reports, these over-earnings should be used to reduce rates passed through the GBRA. For example, FPL's 2009 Surveillance Report reveals that its annual accumulated depreciation is approximately $765 million.[74] Under traditional base-ratemaking practices, reductions in cost-of-service associated with accumulated depreciation, increased billing determinants, and plant retirements could be used to offset new plant investment. These cost savings should be captured in FPL's earnings test, if the Commission is to approve the GBRA. In addition, Commission Staff and stakeholders should be given the opportunity to examine FPL's cost-of-service to ensure that all reductions have been realized.

ISSUE 13: If the Commission approves a GBRA mechanism for FPL, how should FPL be required to implement the GBRA?

POSITION: *See response to Issue 12.*

ISSUE 14: If the Commission chooses not to approve the continuation of the GBRA mechanism, but approves the use of the subsequent-year adjustment, what is the appropriate adjustment to FPL's rate request to incorporate the revenue requirements reflected in the West County Unit 3 MFR Schedules?

[74] Ex. 488.

POSITION: *FPL's proposed capital structure, cost of debt and return on equity should be adjusted, consistent with the SFHHA recommendations to adjust these components for base ratemaking purposes. Depreciation expenses also should be adjusted to reflect a more reasonable service life for new generation facilities than proposed by FPL.*

DISCUSSION:

FPL's request to have rates for West County Unit 3 approved through a subsequent-year adjustment suffers from many of the same infirmities as the GBRA. If West County Unit 3 is incorporated into rates without a rate proceeding, the Commission would have no opportunity to examine bill impacts or determine whether cost savings in other areas would help mitigate the rate impact. For example, FPL witness Ousdahl testified at the hearing that FPL has not quantified the bill impact resulting from the GBRA.[75] She stated that the actual bill impact of the new FPL units would be based on sales projections for the first twelve months of operation, and "that sales information is not data that's been presented as part of this base rate filing."[76] Therefore, the Commission does not have a clear idea of what the bill impact of FPL's new generation units will be, and it would be unreasonable to provide a subsequent-year adjustment without this critical information. Notwithstanding, if the Commission approves a subsequent-year adjustment for West County 3, it should make the same corrections to FPL's proposed capital structure and cost of capital that SFHAA identified in response to Issue 11. In addition, the Commission should also make corrections for FPL's excessive depreciation expense that results from its proposed 25-year service life for its combined cycle units (see discussion related to Issue 19C).

[75] Tr. at 3793.
[76] *Id.*

JURISDICTIONAL SEPARATION

ISSUE 15: Does FPL's methodology of including its transmission-related investment, costs, and revenues of its non-jurisdictional customers when calculating retail revenue requirements properly and fairly identify the retail customers appropriate revenue responsibility for transmission investment? If no, then what adjustments are necessary?

POSITION: No position.

ISSUE 16: What is the appropriate jurisdictional separation of costs and revenues between the wholesale and retail jurisdictions?

POSITION: No position.

QUALITY OF SERVICE

ISSUE 17: Is the quality and reliability of electric service provided by FPL adequate?

POSITION: No position.

DEPRECIATION STUDY

ISSUE 19A: What are the appropriate capital recovery schedules?

POSITION: *See response to 19C.*

ISSUE 19B: Is FPL's calculation of the average remaining life appropriate?

POSITION: *No. FPL has systematically overstated depreciation rates and expense by understating the life spans of its generating units. FPL's combined cycle plants should have minimum forty year service lives for depreciation purposes. See Response to 19C.*

ISSUE 19C: What are the appropriate depreciation parameters (remaining life, net salvage percentage and reserve percentage) and resulting rates for each production unit (including but not limited to, coal, steam, combined-cycle, etc)?

POSITION: *FPL has overstated depreciation expense by understating the life spans of its generating units. FPL's combined cycle plants should have forty-year service lives for depreciation purposes. Adjustments to FPL's depreciation expense

should also be made for FPL's Customer Information System, capital expenditure reductions, and changes to amortization schedules for Cape Canaveral and Riviera, nuclear uprates, and AMI meters. Also, FPL's existing depreciation reserve surplus of $1.245 billion should be amortized over five years.*

DISCUSSION:

I. Background.

FPL's assertion that depreciation expense is one of the "major drivers" of FPL's rate case does not add up.[77] FPL would have Florida ratepayers pay an increase of $266 million associated with depreciation expense.[78] The evidence, however, demonstrates that FPL's revenue requirement is overstated by more than $216.144 million associated with depreciation expense for its combined cycle units, Cape Canaveral and Riviera modernization projects, nuclear uprates, existing meter investment, and economic stimulus grants for advanced meters.[79] In addition, FPL has amassed a depreciation reserve surplus of at least $1.245 billion, which SFHAA recommends be refunded to ratepayers over a five-year period (see response to Issue 19F).[80] What the evidence demonstrates is that FPL's depreciation expense is grossly inflated because the company has systematically overstated its depreciation expense by proposing arbitrarily short amortization periods that bear no relation to the service lives of the underlying assets. Contrary to FPL's request for $266 million in additional revenue requirement associated with depreciation expense, the Commission should actually *reduce* FPL's requested revenue requirement by a total of $463.7 million, which is comprised of a $216.144 million reduction in

[77] Tr. at 1234.
[78] Tr. at 1234, 1235.
[79] Tr. at 3110.
[80] *Id.*

depreciation expense and a $247.556 million annual, five-year amortization of FPL's depreciation reserve surplus.[81]

The Commission should also note that any resulting reduction in FPL's revenue requirement associated with depreciation expense would have no impact on FPL's earnings. FPL's Vice President of Finance testified to this fundamental and very important point at the hearing: if the Commission determines that depreciation expense should be lower, then it follows that FPL's revenue requirement associated with that depreciation expense would decrease and the reduction would have no impact on FPL's book earnings.[82] In response to cross-examination, Mr. Barrett testified:

> Q. Because we're setting base rates, if it were determined by the Commission that depreciation expense should be lower than it is, then it follows that FPL's revenue requirement associated with that depreciation expense would come down and the reduction would have no impact on FPL's book earnings, correct?
>
> A. That is correct.[83]

Put simply, FPL's earnings would not be harmed by a change in the amortization periods, but its ratepayers would benefit from lower rates.[84]

As set forth below, the Commission should decrease FPL's revenue requirement by $463.7 million associated with the following:

- 40-year service life for Combined Cycle Gas Units - $123.730 million
- Development of new CIS - $0.506 million
- Capital cost reductions - $26.719 million
- No acceleration of capital recovery costs - $63.605 million

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[81] SFHHA will address the depreciation surplus in response to Issue 19F.

[82] Tr. at 1274.

[83] *Id.*

[84] *Id.*

- Economic stimulus for AMI deployment - $1.584 million
- 5-year amortization of depreciation reserve surplus - $247.556 million.

II. Depreciation rates for FPL's combined cycle units should be based on a 40-year, not 25-year, average service life.

FPL has inflated its revenue requirement by calculating its depreciation expense based on arbitrarily short service lives for its combined cycle units. FPL's proposal to adopt a 25-year service life for its combined cycle units—when the weight of the evidence supports a 40-year service life—inflates its depreciation expense and revenue requirement by $123.319 million and $123.730 million, respectively.[85] FPL's proposed 25-year service life for combined cycle units is inconsistent with industry norms and FPL's own experience running its units, whereas the 40-year service life proposed by SFHHA witness Kollen is consistent with prior testimony of FPL's own third-party depreciation expert in another rate proceeding.[86]

FPL's proposed service life for its combined cycle units does not reflect its own experience in maintaining combined cycle units. FPL has had combined cycle units in service since the late 1970s. FPL's Putnam Unit 1 went into commercial operation in 1977, and its Putnam Unit 2 went into operation in 1978.[87] The current actual service lives of these units are 31 and 32 years respectively—already significantly longer than FPL's 25-year proposal. Further, FPL has no plans to retire those units,[88] and FPL's depreciation study slates 2020 as the probable retirement date of the Putnam plants for depreciation purposes.[89] Based on a probable retirement date of 2020, the service lives of these combined cycle units would be 42 and 43 years,

[85] Tr. at 3162.
[86] Ex. 450 at 5; Tr. at 2848, 2859.
[87] Ex. 451.
[88] *Id.*
[89] Ex. 115 at 39.

respectively.[90] Thus, FPL's own experience shows that a 25-year service life for combined cycle units is not reasonable. The probable 2020 retirement date for the units demonstrates that the 40-year service life proposed by Mr. Kollen is a more reasonable service life estimate than a 25-year life.

The evidence also shows that FPL's proposal does not comport with industry norms. The author of FPL's depreciation study, Richard Clarke, admitted at the hearing that, just over two years ago, he testified before the Public Utilities Commission of Nevada that the range of lives in the industry for combined cycle units was "35-45" years.[91] Obviously, the 40-year service life proposed by Mr. Kollen would be the midpoint of this range, and the 25-year service live proposed by FPL does not even fall within the range. At the hearing, Mr. Clarke attempted to resuscitate his 25-year service life proposal by claiming that the cycling practices of FPL necessitated a shorter life span for FPL's seemingly state-of-the art combined cycle units.[92] However, Mr. Clarke acknowledged that this was a *post-hoc* rationalization for the 25-year service life because he did not take into account the manner in which the utility cycled or maintained its units when he made his proposal.[93] Thus, the evidence shows that the 25-year service life proposal was not based on FPL's experience, industry experience, or any other rational basis, but was instead designed to inflate FPL's rate request.

Cross-examination of FPL witness Hardy also revealed that FPL plays fast and loose with the services lives it proposes for its units. For example, Mr. Hardy admitted that FPL would have the Commission approve a shorter service life for its Plant Scherer unit than Georgia Power

[90] Tr. at 2859.
[91] Ex. 450 at p. 5; Tr. at 2855.
[92] Tr. at 2849.
[93] Tr. at 2854.

uses for units at the same site.[94] This admission undermines the credibility of FPL's forecasts of its service lives for depreciation purposes. Because the conditions at the site are the same for either unit, one can only assume that FPL's shorter lifespan is a ploy for greater depreciation expense. For obvious policy reasons, such tactics should be discouraged, and the Commission should approve a more reasonable service life for FPL's units, including a 40-year life for calculating FPL's depreciation expense associated with its combined cycle units.

III. Depreciation expense associated with FPL's new Customer Information System should not be included in rates.

FPL's revenue requirement improperly included depreciation expense on capitalized plant in service for a new customer information system ("CIS"), which is not scheduled to go live until June 2012.[95] In rebuttal testimony, FPL acknowledged its error and admitted that it had overstated depreciation expense by $0.5 million in 2010 and $4.9 million in 2011.[96] As a result, it is now undisputed that FPL's revenue requirement must be revised to reflect adjustments associated with this project. The Commission should therefore acknowledge that depreciation expense associated with FPL's CIS should not be included in rates.

IV. FPL has failed to demonstrate the reasonableness of an accelerated 4-year amortization of Cape Canaveral and Riviera conversion costs, nuclear uprates and advanced meters places.

The Commission should reject FPL's proposed four-year amortization of (1) costs to convert FPL's Cape Canaveral and Riviera units to combined cycle units; (2) nuclear uprates for St. Lucie and Turkey Point units; and (3) account 370 meters made obsolete by advanced meters.[97] Typically depreciation expense is calculated based on amortizing an asset over its

[94] Tr. at 6280.
[95] Tr. at 3152.
[96] Tr. at 3714.
[97] Tr. at 3157.

estimated useful life.[98] Given that principle, FPL has not provided sufficient rationale for its proposal to accelerate depreciation of certain capital costs over four years, when that period has no relation to the estimated service lives of the underlying asset after modernization of the generating units or, with respect to meters, the expected service lives of existing meters absent the planned systemwide deployment of AMI. SFHHA's proposal to adjust the useful lives of these assets for depreciation purposes would reduce FPL's revenue requirement by $63.605 million.

Mr. Kollen's recommended amortization periods for these assets are based on the principle that the amortization period of an asset should mirror its estimated service life after modernization.[99] With respect to the Cape Canaveral and Riviera modernization costs to convert the units to combined cycle, Mr. Kollen testified that the Commission "should direct FPL to cease depreciation on the facilities, add the remaining net book value to the costs of modernization, and then depreciate the costs along with the modernization costs over the estimated service lives of the modernized facilities."[100] With respect to the nuclear uprate costs for St. Lucie Units 1 and 2 and Turkey Point Units 3 and 4 and common, Mr. Kollen likewise testified that the Commission should depreciate the costs over the remaining extended license life of the nuclear units.[101] Mr. Kollen's testimony that the uprate costs are "capital costs that were incurred to substantially improve and increase the output of the nuclear facilities over their extended lives" was not disputed by FPL.[102] Rather than separating the costs of the modernization and uprates over four years, these costs would be considered interim retirements

[98] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 10.
[99] Tr. at 3157-3158.
[100] *Id.*
[101] Tr. at 3159.
[102] *Id.*

and recovered through depreciation expense over the remaining lives of the assets that gave rise to the retirements.[103]

With respect to meter retirements, Mr. Kollen similarly testified that undepreciated non-AMI meter investment that will be replaced by advanced meters under FPL's advanced metering initiative should be depreciated at the same rate as the non-AMI meters that will not be replaced.[104] Because the company's revenue requirement already includes the cost of advanced meters, there is no need to accelerate the depreciation of old non-AMI investment.[105] The AMI deployment is the cause of the premature retirements of the existing non-AMI meters. It is therefore reasonable to direct FPL to reclassify the existing non-AMI meters as a regulatory asset and amortize the cost over the lives reflected in the existing depreciation rates.[106] FPL's proposal would also require ratepayers to simultaneously pay for existing non-AMI meter investment and the new meter investment. Under the AMI deployment, nearly all of the company's existing non-AMI deployment will be replaced in a one-time undertaking over a four-year period. Thus, FPL's proposal would "double-up" recovery for meters over the next four years.[107]

Further, FPL's broad assertion that Mr. Kollen's recommendation does not comport with Generally Accepted Accounting Principles ("GAAP") and Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA") procedures is incorrect.[108] Once the modernization is complete, FPL would recover both the modernization costs and the accumulated depreciation related to retired assets over the expected service lives of the new

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[103] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 14a.
[104] Tr. at 3159.
[105] *Id.*
[106] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 14a.
[107] Tr. at 3159.
[108] Tr. at 6417.

facilities.[109] This comports with FERC USOA Electric Plant Instruction 10(F), which states in part: "The book cost less net salvage of depreciable electric plant retired shall be charged in its entirety to Account 108. Accumulated Provision for Depreciation of Electric Plant in Service."[110] Mr. Kollen's recommendation also comports with general ALG procedure, which essentially averages the effects of both actual and projected interim retirements over the remaining average life of the underlying assets included in the depreciable property account or subgroup within the account.[111] The plant that would be retired would no longer remain as plant in service on FPL's accounting books.[112] However, in the absence of extraordinary retirements, the FERC USOA requires that such retirements be debited to accumulated depreciation and credited to plant in service, consistent with FERC USOA Plant Accounting Instruction 10.[113]

FPL's argument in favor of a four-year capital recovery schedule does not merit support. FPL claims that Order No. PSC-05-0902-S-EI in Docket No. 050188-EI supports similar treatment of recovery schedules. However, FPL fails to note that the parties entered into a settlement in that docket and that the Commission's approval of such treatment does not constitute precedent. Further, the facts of this proceeding are very different. First, the capital recovery schedules are contested. In addition, the unrecovered cost of assets retired before their average service lives is not primarily caused by or for the benefit of current customers, but rather for future customers who would receive service from new facilities placed into service because of interim retirements.[114] Thus, intergenerational equity concerns, as well as the impact of the

[109] Tr. at 3158.

[110] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 14b.

[111] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 14c.

[112] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 15.

[113] *Id.*

[114] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 16.

current recession, warrant deviation from the policy of recovering retired equipment costs before new equipment costs are included in rates.

V. FPL should reduce its revenue requirement by $1.584 million associated with economic stimulus grants related to advanced metering.

SFHHA's recommendation regarding economic stimulus grants results in a $1.584 million reduction to the revenue requirement associated with depreciation expense. This adjustment is discussed in response to issues 133 and 147.

VI. FPL should reduce its revenue requirement by $26.719 million associated capital cost reductions.

SFHHA's recommendation regarding capital cost reductions creates a $26.717 million reduction to the revenue requirement associated with depreciation expense. See SFHHA's response to Issue 150 for discussion of this adjustment.

ISSUE 19D: What are the appropriate depreciation parameters (remaining life, net salvage percentage and reserve percentage) and resulting rates for each transmission, distribution, and general plant account?

POSITION: No position.

ISSUE 19E: Based on the application of the depreciation parameters that the Commission has deemed appropriate to FPL's data, and a comparison of the theoretical reserves to the book reserves, what are the resulting imbalances?

POSITION: *FPL currently has a depreciation reserve imbalance of at least $1.245 billion.*

DISCUSSION:

SFHHA bases its recommendation with respect to amortization of FPL's depreciation reserve surplus on the company's computation of the reserve imbalance. SFHHA's position is that the depreciation reserve imbalance is at least $1.245 billion.[115]

[115] Ex. 316 (excerpt from Exhibit CRC-1).

ISSUE 19F: What, if any, corrective reserve measures should be taken with respect to the imbalances identified in Issue 19E?

POSITION: *The depreciation reserve surplus should be amortized to ratepayers as a reduction of depreciation expense over no more than 5 years.*

DISCUSSION:

FPL's depreciation reserve surplus of at least $1.245 billion should be amortized to ratepayers over no more than 5 years. The effect of this recommendation would be to reduce depreciation expense by $246.735 million and to reduce the revenue requirement by $247.556 million.[116] In addition, there is an offsetting increase of $14.559 million in the revenue requirement for the rate of return on rate base, which will be more than FPL projected due to the reduction in accumulated depreciation.[117]

The magnitude of FPL's depreciation reserve surplus is unequivocal evidence that FPL's previous recovery of depreciation expense has been excessive, considering present expectations regarding service lives and other depreciation parameters.[118] FPL acknowledges that the significant surplus necessitates a corrective action,[119] yet it fails to propose a remedy that would return overpayments of depreciation expense to the customers who over-paid. Instead, FPL proposes to refund over-paid depreciation expense over 22 years. Intergenerational inequity principles dictate that this significant surplus must be refunded to customers over a period that will allow the refund to go to the customers that funded the surplus. The claim that future ratepayers would see an increase in rate base as a result of the refund simply does not negate the fact that past and current customers have significantly over-paid depreciation expense. FPL admits that, if the reserve surplus is returned to customers over 22 years, it is likely that many of

[116] Tr. at 3155.
[117] Tr. at 3155-3156.
[118] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 9.
[119] Tr. at 6443.

the customers who were on the system at the time the reserve surplus was created will not be on the system during the time corrective action is taken.[120] FPL's excessive refund period also violates the matching principle, which dictates that one should match the benefits of a plant with the collection of costs related to a plant. For that reason, SFHHA proposes a reasonably short amortization period of five years, based on historical intergenerational inequity and the magnitude of the reserve surplus.[121]

At the hearing, FPL witness Davis made the incredible claim that it is appropriate for current and past customers to pay more depreciation expense than future customers because future customers will benefit less from FPL's generating units as the units age.[122] Mr. Davis admitted, however, that Commission Rule 25-6.0436 requires that the remaining life method be used to set depreciation rates, and that this method does not take into account any fluctuations in plant output over time.[123] Further, FPL did not attempt to provide evidence of the benefit that current plants will provide ratepayers in 22 years, yet Mr. Davis's reasoning would have the Commission take into account unquantified and theoretical changes in future plant output in order to justify its proposal. FPL's justification of its excessive amortization period amounts to poor public policy.

Despite the required reduction of FPL's reserve surplus over the last four years by $500 million ($125 million annually from 2006 through 2009) as the result of the settlement reached in Docket Nos. 05-0045-EI and 050188-EI, FPL will still have an estimated reserve surplus of at least $1.245 million as of January 1, 2010. This significant reserve provides FPL substantial cash flow, yet it provides the past and current ratepayers who over-paid very little benefit.

[120] Tr. at 6453.

[121] Ex. 35, Item No. 39, SFHHA Response to Staff Interrogatory No. 11.

[122] Tr. at 6466.

[123] *Id.*

Accordingly, the Commission should amortize the surplus to ratepayers over no more than five years.

ISSUE 19G: What should be the implementation date for revised depreciation rates, capital recovery schedules, and amortization schedules?

POSITION: *The implementation date for revised depreciation rates, capital recovery schedules, and amortization schedules should correspond with the implementations of rates resulting from this proceeding.*

FOSSIL DISMANTLEMENT COST STUDY

ISSUE 40: Should the currently approved annual dismantlement provision be revised?

POSITION: No position.

ISSUE 41: What, if any, corrective reserve measures should be approved?

POSITION: No position.

ISSUE 42: What is the appropriate annual provision for dismantlement?

POSITION: No position.

ISSUE 43: Does FPL employ reasonable depreciation parameters and costs when it assumes that it must restore all generation sites to "greenfield" status upon their retirement?

POSITION: No position.

ISSUE 44: In future dismantlement studies filed with the Commission, should FPL consider alternative demolition approaches?

POSITION: No position.

RATE BASE

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent-year adjustment.)

ISSUE 46: Should the net over-recovery/under-recovery of fuel, capacity, conservation, and environmental cost recovery clause expenses be included in the calculation of working capital allowance for FPL?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Adopt OPC's position.*

ISSUE 47: Are the costs associated with Advanced Metering Infrastructure (AMI) meters appropriately included in rate base?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *No. The company has failed to reflect grants available from the U.S. Department of Energy as a reduction in the AMI meter costs.*

DISCUSSION:

FPL's revenue requirement should be reduced to reflect a $200 million grant award from the U.S. Department of Energy ("DOE") to fund its Energy Smart Florida program.[124] At the time of the hearing, FPL had not yet received notice of the award, although FPL witness Bennett testified that the amount of the grant award would be known and measurable by the October/November timeframe.[125] FPL has since received notice that it was awarded the $200 million grant. SFHHA therefore requests that the Commission take judicial notice of the award.[126] SFHHA also urges the Commission to acknowledge the benefits that the grant will

[124] *See* Ex. 36, FPL's Supplemental Response to Staff's 4th POD 55A, FPL 160331-160370; Ex. 464; Tr. at 3163-3166.

[125] Tr. at 3418.

[126] *See* 90.202, Florida Statutes, listing "matters which may be judicially noticed," including "...(5) Official actions of the legislative, executive, and judicial departments of the United States ...(11) Facts that are not subject to dispute because they are generally known within the territorial jurisdiction of the court. (12) Facts that are not subject to dispute because they are capable of accurate and ready determination by resort to sources whose accuracy cannot be questioned." *See also* Order No. PSC-04-0395-PCO-TP at 3, n.2 (April 14, 2004) (holding "we reserve the right to reopen the record if at the conclusion of the proceeding we determine that the record is insufficient").

create that should be passed on to ratepayers. These benefits include increased operational savings from additional advanced meter deployment, as well as potential funding for the data management applications and infrastructure necessary to support the meters.[127] As recommended by SFHHA witness Kollen, the Commission should exclude at least $20 million from FPL's rate base and related depreciation expense to reflect the award, which has the effect of reducing the company's revenue requirement by $3.846 million.[128]

FPL's reluctance to quantify the benefits of the $200 million grant should not deter the Commission from adopting a reasonable proxy for its benefits. At the hearing, Mr. Bennett agreed that the grant award would result in increased operational savings for FPL, although he would not quantify those savings because they were not "known and quantifiable at this point."[129] One can, however, examine the operational savings estimates for FPL's currently planned advanced meter deployment to ascertain the reasonableness of Mr. Kollen's recommended revenue requirement adjustment. For example, FPL currently plans to deploy approximately 4.3 million advanced meters for residential and small/medium business customers by 2013,[130] which would result in operational savings of approximately $36 million annually (see SFHHA's response to Issue 95).[131] Among other things, advanced meters will allow FPL to reduce its meter reading-related expenses, which FPL has identified as the primary source of AMI-related savings.[132] These savings would naturally increase with additional advanced meter deployment.[133] Mr. Bennett testified that FPL's grant application called for deployment of an

[127] *See* Ex. 36, FPL's Supplemental Response to Staff's 4th POD 55A, FPL 160331-160370.
[128] Tr. at 3166.
[129] Tr. at 3426-3426.
[130] *See* Tr. at 1551-1552.
[131] *See* Ex. 310; *see also* Tr. at 6050.
[132] *See* Tr. at 1553; 1574-1575.
[133] Tr. at 3425-3426.

additional 2.6 million advanced meters by the end of 2011, as well as funding for the data management applications and interfaces necessary to support the meters.[134] It logically follows that deployment of additional advanced meters will create additional operational savings.

In addition, FPL's customers should benefit from the grant to the extent it can be used to fund currently planned investment. The funding announcement for the grant did not preclude FPL from using the award to pay for currently planned smart grid activities.[135] FPL made the assertion that each and every dollar of the grant award would fund incremental investment, but this assertion rings hollow when one examines FPL's actual grant application. FPL's grant application stated that FPL would use the award to fund the basic framework for the meters, including the data management systems and interfaces to support the meters and customer communications necessary to market the program.[136] Because FPL already planned widespread meter deployment, costs for customer education programs and data management would be contemplated in FPL's revenue requirement. Although FPL may have to expand upon its planned framework in order to accommodate the full magnitude of its AMI initiative, it does not make sense that FPL could not use the award to fund currently planned data management systems for advanced meters. The Commission should therefore take this into consideration when estimating the impact the grant award would have on FPL's revenue requirement.

In summary, the claim that the revenue requirement impact of the grant should be ignored because the grant would fund incremental investment does not pass scrutiny, considering the operational savings that will result from that investment and the potential for FPL to use the grant award to offset currently planned investment. The Commission should reduce FPL's

[134] Tr. at 3398.

[135] Ex. 464.

[136] *See* Ex. 36, FPL's Supplemental Response to Staff's 4th POD 55A, FPL 160370; *see also* Ex. 464.

revenue requirement by excluding $20 million from the company's rate base for advanced meter deployment as recommended by SFHHA.

ISSUE 50: Are FPL's requested levels of Plant in Service appropriate?
A. For the 2010 projected test year in the amount of $28,288,080,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $29,599,965,000?

POSITION: *No. FPL has cut its planned capital expenditures in 2009 and a rate base adjustment is necessary to reflect these cuts. Therefore, FPL's plant investment included in rate base should be reduced to reflect these capital expenditure reductions on an annualized basis, both for the annualized 2009 reductions carried forward into 2010 and for reductions of similar magnitude in 2010 carried forward into 2011. This results in a $784 million reduction to rate base for the 2010 test year and an additional $523 million reduction to rate base in the 2011 subsequent projected test year, assuming the annualized 2009 and 2010 reductions carried forward into 2011 and reductions of similar magnitude in 2011. The net result of SFHHA recommendation is that plant in service for the test year should be $27,504,000,000.*

DISCUSSION:

FPL has cut its actual capital expenditures significantly from its originally approved budget levels for 2009.[137] For the first four months of 2009, FPL cut its capital expenditures by $170 million from budget levels—from $897 million to $727 million.[138] This is a 19% reduction.[139] A rate base adjustment is therefore necessary to reflect these cuts. FPL's plant investment included in rate base should be reduced to reflect capital expenditure reductions on an annualized basis, both for the annualized 2009 reductions carried forward into 2010 and for reductions of similar magnitude in 2010 carried forward into 2011. Based on FPL's capital expenditure reductions through April 2009, this results in a $784 million reduction to rate base for the 2010 test year and an additional $523 million reduction to rate base in the 2011

[137] Tr. at 3167; *see also* Ex. 325, FPL response to SFHHA Int. No. 279; Ex. 418.

[138] Tr. at 3167; *see also* Ex. 325, FPL response to SFHHA Int. No. 279.

[139] Tr. at 3167; *see also* Ex. 325, FPL response to SFHHA Int. No. 279.

subsequent projected test year, assuming the annualized 2009 and 2010 reductions carried forward into 2011 and reductions of similar magnitude in 2011.[140] For 2010, the revenue requirement impact would be a decrease of $92.520 million based on the company's proposed rate of return, plus an attendant depreciation expense reduction of $26.719 million.[141] The net result of SFHHA's recommendation is that plant in service for the test year should be $27.504 million. In addition, there is an offsetting reduction to accumulated depreciation that increases rate base by $31.080 million and increases the revenue requirement by $3.668 million.[142]

FPL witness Barrett testified that the reductions that were experienced in the first four months of 2009 were not representative of the test-year budget.[143] Mr. Barrett testified that the under-runs in capital expenditures in 2009 were almost entirely related to renewable projects recoverable through a clause, and should have no impact on projected retail rate base in this proceeding.[144] Mr. Barrett's testimony is not persuasive. Mr. Barrett's Exhibit REB-22 examines projected, rather than actual, variances in capital expenditures.[145] The actual variances, unlike FPL's projected variances, are known and measurable and should be relied upon by this Commission in determining whether FPL's stated Plant in Service is accurate.

ISSUE 51: Are FPL's requested levels of accumulated depreciation appropriate?
A. For the 2010 projected test year in the amount of $12,590,521,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $13,306,984,000?

POSITION: *No. FPL's rate base should be reduced by the net effects of SFHHA recommendations to adjust depreciation expense. See response to Issues 19C and 19E.*

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[140] Tr. at 3168.

[141] Tr. at 3110, 3168.

[142] Tr. at 3168; *see also* Ex. 315.

[143] Tr. at 5910-5912.

[144] *Id.*

[145] Ex. 338.

ISSUE 52: Is FPL's proposed adjustment to CWIP for the Florida EnergySecure Line (gas pipeline) appropriate?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 55: Are FPL's requested levels of Construction Work in Progress (CWIP) appropriate?
A. For the 2010 projected test year in the amount of $707,530,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $772,484,000?

POSITION: No position.

ISSUE 56: Are FPL's requested levels of Property Held for Future Use appropriate?
A. For the 2010 projected test year in the amount of $74,502,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $71,452,000?

POSITION: No position.

ISSUE 58: Is FPL's proposed accrual of Nuclear End of Life Material and Supplies and Last Core Nuclear Fuel appropriate?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 59: Should nuclear fuel be capitalized and included in rate base due to the dissolution of FPL Fuels, Inc.?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 60: Are FPL's requested levels of Nuclear Fuel appropriate
A. For the 2010 projected test year in the amount of $374,733,000?

B. If applicable, for the 2011 subsequent projected test year in the amount of $408,125,000?

POSITION: No position.

ISSUE 61: Should the unamortized balance of the FPL Glades Power Park (FGPP) be included in rate base?

POSITION: No position.

ISSUE 62: Are FPL's requested levels of Working Capital appropriate?
A. For the 2010 projected test year in the amount of $209,262,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $335,360,000?

POSITION: No position.

ISSUE 63: Is FPL's requested rate base appropriate?
A. For the 2010 projected test year in the amount of $17,063,586,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $17,880,402,000?

POSITION: *No.
A. FPL's rate base for the 2010 projected test year should be reduced by $552 million based on SFHHA recommendations.
B. FPL's rate base for the 2011 subsequent projected test year should be reduced by an additional $523 million based on SFHHA recommendations.*

DISCUSSION:

FPL's proposed rate base of $17,063,586,000 for the 2010 projected test year should be reduced by $552 million to $16,511,804,000 based on the following SFHHA recommendations:

- Reflect Capitalization/Deferral of CIS O&M Expenses - $3.625[146]
- Reflect Capital Cost Reductions - ($784.000)[147]
- Restate Accum Depr to Reflect Capital Cost Reductions - $31.080[148]

[146] See Issue 19C, section III.

[147] See Issue 50.

[148] See Issue 50.

- Restate Accum Depr for Five Year Amortization of Depreciation Reserve Surplus- $123.367[149]
- Restate Accum Depr to Adjust Amortization Periods for Undepreciated Costs - $31.697[150]
- Restate Accum Depr to Reflect Service Lives for Combined Cyle Gas Units - $61.660[151]
- Restate Accum Depr to Reflect Economic Stimulus for AMI Deployment - ($19.210)[152]

COST OF CAPITAL

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent-year adjustment.)

ISSUE 64: What is the appropriate amount of accumulated deferred taxes to include in the capital structure?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *ADIT is jurisdictional to the FPL retail ratepayers and should not be reduced for "pro rata adjustments" to reconcile the company's capitalization to rate base. FPL should include $3,313.373 million of accumulated deferred income taxes in its jurisdictional capital structure for the 2010 projected test year.*

DISCUSSION:

I. Background.

FPL has improperly understated the amount of non-investor supplied capital in its capital structure by significantly understating the accumulated deferred income taxes ("ADIT") in its jurisdictional capital structure for the 2010 projected test year. FPL proposes to include only $2,723.327 million of ADIT in its capital structure for the test year,[153] when it should have

[149] See Issue 19F.
[150] See Issue 19C; Ex. 318.
[151] See Issue 19C, section II.
[152] See Issue 47.
[153] Prehearing Order at 70.

included $3,313.373 million.[154] This increase to ADIT is based on three recommendations of SFHHA witness Kollen. First, Mr. Kollen identified that FPL "inappropriately has reduced the ADIT included in its capital structure by $168.598 million for the effects of FIN 48."[155] By increasing the amount of ADIT (or reversing the FPL's FIN 48 adjustment), there will be more non-investor supplied capital in the capital structure, which would result in a decrease in the cost of capital. This adjustment would reduce FPL's revenue requirement by $17.643 million.[156] Second, the ADIT in FPL's capital structure should be increased by $334.472 million to correct pro rata adjustments FPL made when reconciling total capitalization to rate base.[157] This adjustment would reduce FPL's revenue requirement by $48.695 million.[158] Third, it is necessary to change the ADIT included in the capital structure to reflect the changes in depreciation expense and accumulation based on SFHHA's recommendations.[159] This adjustment results in an increase of $88.180 million of ADIT, which reduces the revenue requirement by $8.909 million.[160]

II. FIN 48 Adjustment.

FIN 48 is a new accounting standard that was implemented by FPL in 2007. FIN 48 requires the company to establish a "reserve" for future income tax audit adjustments that may increase the company's income tax liability, and thus reduce the ADIT recorded on its accounting books.[161] The FIN 48 adjustment reduces the net liability ADIT reflected in the

[154] Ex. 326.
[155] Tr. at 3170.
[156] Tr. at 3110. *See also* Ex. 326.
[157] Tr. at 3172. *See also* Ex. 326.
[158] Tr. at 3172. *See also* Ex. 326.
[159] Tr. at 3173. *See also* Ex. 326.
[160] Tr. at 3173. *See also* Ex. 326.
[161] Tr. at 3170. *See also* Ex. 327.

company's proposed capital structure as cost-free capital.[162] Mr. Kollen testified that "[t]he company inappropriately has reduced the ADIT included in its proposed capital structure by $168.598 million for the effects of FIN 48."[163] The company provided this amount in response to SFHHA Interrogatory No. 278.[164]

As Mr. Kollen testified, FPL's quantification of the FIN 48 adjustment "is nothing more than the company's educated guess at the outcome of future tax audits for deductions that already have been taken and that are already are reflected in its tax returns."[165] This quantification is not based on any actual notice of tax liability. Thus, if FPL's guess is wrong, ratepayers lose out on the benefit of the ADIT cost-free capital.[166] To the extent FPL experiences any future audit adjustments that actually reduce ADIT amounts, then the effects may be examined in future rate proceedings based on information that is certain, rather than mere guesswork.[167] The Commission has never permitted a utility to adjust ADIT for FIN 48, and it should not do so now.

On rebuttal, FPL witness Ousdahl testified that FPL did not reduce the ADIT in the capital structure based on a FIN 48 adjustment.[168] However, the evidence that Ms. Ousdahl relied on to support her testimony is unclear. Ms. Ousdahl merely referred to FPL's response to SFHHA Interrogatory No. 278, which is the very response that Mr. Kollen relied on to make his recommendation. That discovery response provides that "... the deferred taxes associated with the temporary differences related to the FIN 48 liabilities were included in the accumulated

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[162] Tr. at 3170. *See also* Ex. 327.
[163] Tr. at 3170. *See also* Ex. 327.
[164] Ex. 327.
[165] Tr. at 3170-3171.
[166] Tr. at 3171.
[167] *Id.*
[168] Tr. at 3664.

deferred income taxes in the capital structure, rather than including them with long-term liabilities in rate base."[169] Ms. Ousdahl did not, however, refer to any accompanying schedules or MFRs to support the company's ADIT calculation. FPL's rebuttal evidence therefore does nothing to provide clarity regarding whether FPL made a FIN 48 reduction to the ADIT in the capital structure.

III. Pro rata adjustments.

FPL has also improperly reduced the amount of low-cost capital in the capital structure provided by customer deposits and the cost-free capital provided by ADIT by allocating the sum of its pro rata adjustments to all capital components, rather than limiting adjustments to investor sources of capital.[170] Historically, it has been the Commission's practice "to make specific adjustments where possible and to prorate other rate base adjustments over investor sources only."[171] Here, FPL made no attempt to follow that practice. Rather, FPL made pro rata adjustments over all sources of capital, relying on the general claim that the sources of capital that were used to fund its rate base cannot be traced solely to investor-supplied sources of capital.[172]

Mr. Kollen testified, however, that customer deposits and ADIT were not used to finance the amounts that comprise the total of the pro rata adjustments detailed on MFR Schedule D-1B.[173] The pro rata adjustments detailed on MFR Schedule D-1B are primarily to reconcile the total capitalization to rate base, which excludes certain construction work in progress and the

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[169] *See* Tr. at 3664; *see also* Ex. 327.

[170] Tr. at 3172.

[171] *In re: Request for Rate Increase by Gulf Power Company ("Gulf Power Co.")*, Docket No. 010949-E1, Order No. PSC-02-0787-FOF-EI at 24.

[172] Tr. at 3665.

[173] *Id.*

capital costs recovered through various riders.[174] Mr. Kollen therefore reallocated the pro rata adjustments to all capital components except customer deposits, ADIT and investment tax credits. He then computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return reflecting prior SFHHA capital structure recommendations, and multiplied this difference times the rate base he recommended. The effect of this recommendation is to reduce FPL's revenue requirement by $48.695 million, which is calculated in exhibit 326.[175] Mr. Kollen's recommendation is consistent with Commission practice to limit pro rata adjustments to investor sources of capital where possible.[176]

FPL's primary basis for disagreeing with this recommendation was that it would result in a double-counting of the low-cost customer deposits and zero-cost ADIT.[177] Ms. Ousdahl's contention was that "[h]is adjustments would be appropriate only if FPL were financing the clause-related plant and CWIP that is excluded from rate base differently than it is financing the plant and CWIP included in base rate recoverable rate base."[178] This contention raises the issue of whether the entirety of ADIT, customer deposits and investment tax credits ("ITCs") should be allocated among the base rate recoverable rate base and other forms of recovery, such as the GBRA rate base. For example, if the entirety of the total company ADIT, ITC and customer deposits were directly assigned to base rate-recoverable rate base, and not the GBRA, then there would be no double counting of the ADIT, ITC, and customer deposits. FPL's contention that double-counting of ADIT would then be moot.

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[174] *Id.*

[175] *Id. See also* Ex. 326.

[176] *See, e.g.,* Order No. PSC-02-0787-FOF-EI at 24; Order No. PSC-09-0375-PAA-EI; Order No. PSC-08-0436-PAA-GU.

[177] Tr. at 3665.

[178] *Id.*

IV. ADIT related to changes in depreciation expense.

If depreciation expense and accumulated depreciation are reduced as SFHHA has proposed, then there also must be a corresponding increase to the related ADIT compared to the levels proposed by the company in the capital structure.[179] In other words, a reduction in depreciation expense results in an increase in deferred income tax expense and thus, an increase in ADIT.[180] The effect is to reduce the company's revenue requirement by $8.909 million in addition to the reductions due to the SFHHA capital structure recommendations that Mr. Kollen also proposed.[181]

ISSUE 66: What is the appropriate amount and cost rate of the unamortized investment tax credits to include in the capital structure?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *ITCs are jurisdictional to the FPL retail ratepayers and should not be reduced for "pro rata adjustments" to reconcile the company's capitalization to rate base. The appropriate amount of the unamortized investment tax credits to include in the capital structure is $63.212 million, and the appropriate cost rate for that amount is 9.05%.*

DISCUSSION:

ITCs are jurisdictional to the FPL retail ratepayers and should not be reduced for "pro rata adjustments" to reconcile the company's capitalization to rate base, as discussed in response to Issue 65. The appropriate amount of the unamortized investment tax credits to include in the capital structure is $63.212 million, and the appropriate cost rate for that amount is 9.05%.[182]

ISSUE 67: What is the appropriate cost rate for short-term debt?
A. For the 2010 projected test year?

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[179] Tr. at 3173-3174.
[180] *Id.*
[181] *Id. See also* Ex. 326.
[182] Ex. 326.

B. If applicable, for the 2011 subsequent projected test year?

POSITION: *The appropriate cost rate for short term debt is 0.60%.*

DISCUSSION:

As stated in the direct testimony of SFHHA witness Baudino, the appropriate cost rate for short-term debt is 0.60%.[183] This is a generous short-term debt cost, which should be more than compensatory. Three-month commercial paper, which FPL uses for short-term financing, was yielding 0.26% at the time of testimony.[184]

In addition, as described further in the testimony of Mr. Baudino, FPL understated the amount of short-term debt that should be included in its capital structure. Short-term debt is typically carried at a lower cost than long-term debt. Therefore, if FPL understates the amount of short-term debt, this artificially increases its cost of capital. Based on a review of the last several years of data, rather than solely the most recent year, substantially more short-term debt should be included in the company's capital structure for ratemaking purposes than recommended by FPL. For example, FPL had $630,000 of short-term debt in its capital structure in 2006, in $842,000 in 2007, and in $772,934 in 2008. Thus, the proper amount of short-term debt to be included in the 2010 capital structure is not $161 million as recommended by FPL.[185] Because short-term debt can be carried at a lower cost, the more short-term debt that is included in the capital structure, the lower the revenue requirement will be, and the less ratepayers will be required to pay. It is therefore imperative to use a historically accurate amount of short-term debt rather than an inflated amount based only upon recent data.

[183] Tr. at 2617.

[184] *Id.*

[185] Tr. at 2616; *see also* Ex. 286.

ISSUE 68: What is the appropriate cost rate for long-term debt?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 69: Have rate base and capital structure been reconciled appropriately?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *No. Customer deposits, ADIT and ITC should not be reduced for prorata adjustments to reconcile the company's capitalization to rate base. FPL should include Customer Deposits of $626.383 million at a cost of 5.98%, ADIT of $3,313.373 million at a cost of 0%, and ITC at a cost of 9.05%. See discussion of Issue 66.*

ISSUE 70: Has FPL appropriately described the actual 59.6% equity ratio that it proposes to use for ratemaking purposes as an "adjusted 55.8% equity ratio" on the basis of imputed debt associated with FPL's purchased power contracts?

POSITION: *No. See response to Issue 69.*

DISCUSSION:

FPL has not appropriately or accurately described the actual 59.6% equity ratio it proposes to use for ratemaking purposes. It continues to insist that the "actual adjusted" common equity ratio is 55.8%.[186] FPL's use of phrases like "actual adjusted" does little more than muddle an issue that should be fairly straightforward. "Actual adjusted" is an oxymoron because something that has been "adjusted" can no longer be characterized as "actual." The true amount of FPL's common equity expressed on a percentage basis is 59.6%. This is the ***actual*** equity percentage that the company seeks to include in its rates in this proceeding—not the lower 55.8% "actual adjusted" figure described in the testimonies of Mr. Pimentel and Dr. Avera.

FPL has referenced the lower 55.8% value in an apparent attempt to mask the true amount of common equity in its capital structure because the more accurate expression of 59.6%

[186] *See* Tr. at 4846.

is inarguably too high an amount of equity for a regulated utility with FPL's relative risk factors. In order to make the 59.6% figure appear to be 55.8%, FPL had to increase the amount of total capital in the denominator of the percentage calculation. The calculation of a percentage is simply a numerator divided by a denominator. The actual equity *dollars* in the numerator remains the same at $9.188 billion.[187] The expression of these dollars in the form of a percentage, whether 59.6% or 55.8%, can be reduced to a smaller number if the denominator is increased. In order to increase the denominator FPL imputed approximately $949 million of debt as a result of its existing purchased power agreements.[188]

Thus, the question of whether FPL's true common equity ratio is 59.6% or 55.8% is really a question of whether FPL's PPAs should be treated as debt. SFHHA urges that they should not. In contrast, FPL has taken the position that the PPAs should be treated as debt in the capital structure based on the questionable statement by Mr. Pimentel that "the financial community commonly takes into account obligations associated with purchased power agreements (PPAs)."[189] Mr. Pimentel goes on to say that it is appropriate to treat PPAs like debt because of the "long-term contractual commitment" to purchase firm capacity in the PPAs and that such commitments behave "much like debt."[190]

There are several significant problems with FPL's treatment of PPAs as debt in its capital structure. First, Mr. Pimentel gives the impression that the "financial community" is in agreement with how PPAs should be treated in the capital structure, but this is untrue. Mr. Pimentel, for example, states that he agrees with the "judgment of the financial

[187] MFR Schedule D-2.
[188] Tr. at 4852.
[189] Tr. at 4850.
[190] *Id.*

community."[191] However, the "financial community" is not in agreement about how the PPAs ought to be treated. While S&P sometimes treats PPAs with certain characteristics like debt, neither Moody's nor Fitch credit rating agencies do so. Thus, Mr. Pimentel's statement implying that the "financial community" treats PPAs like debt is incorrect. Two out of the three credit rating agencies that currently rate FPL's debt do *not* treat FPL's PPAs like debt.[192]

Second, Mr. Pimentel is even incorrect about the way S&P itself treats PPAs. S&P does *not* impute "short-term contracts" of less than one year as debt, and until recently it did not impute contracts with durations of less than three years. According to FPL's Security and Exchange Commission Form 10-K, exhibit 459, some of FPL's PPAs will expire in less than one year[193] and therefore would not be treated as debt even under the S&P methodology relied upon by Mr. Pimentel.

Finally, the Commission recently refused to authorize a pro forma adjustment to TECO's amount of common equity based on the existence of PPAs.[194] In refusing to allow the adjustment, the Commission noted that "the capital structure and resulting rate of return authorized in FPL's 2005 settlement do not include an imputed equity adjustment."[195] While an imputed equity adjustment is not precisely what FPL is seeking in this case, the reasons the Commission relied upon for refusing to treat PPAs like long-term debt commitments in the TECO case—such as the fact that PPAs *benefits* utilities by shifting construction risk and operating risk—apply equally in the present case.[196]

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[191] Tr. at 4851.

[192] *See* Ex. 508 at Bates 495.

[193] The Form 10-K states that 870 MW of PPAs have expiration dates "ranging from 2009 through 2012."

[194] Order No. PSC-09-0375-PAA-GU at 35-36.

[195] *Id.* at 36.

[196] *Id.* at 35.

It is no surprise that Mr. Pimentel included significantly more PPAs as debt than he should have because he conducted no specific analysis of the PPAs at all. He did not determine which of the PPAs have capacity payments that are above or below market and he did not examine the terms of the PPAs.[197] Apparently, he simply summed the amount of capacity payments due under the PPAs and imputed a significant portion of those payments as debt.

Again, FPL treated the PPAs as debt, and thus inflated the amount of overall capital (or the denominator in the percentage calculation), apparently in order to calculate a lower common equity percentage. By including the PPAs as imputed debt in the capital structure FPL is able to say that its actual 59.8% common equity ratio is an "actual adjusted" common equity ratio of 55.6%. SFHHA strongly encourages the Commission to recognize the true, actual and accurate amount of common equity that FPL is proposing, which is 59.8%. As discussed in response to Issue 71, 59.8% common equity is significantly above the amount required for FPL or supported by analysis of FPL's peer group.

ISSUE 71: What is the appropriate equity ratio that should be used for FPL for ratemaking purposes in this case?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *FPL should be using a 41.07% equity ratio for ratemaking purposes in this proceeding after consideration of other non-investor supplied cost-free or lower cost sources of capital.*

DISCUSSION:

An excessive common equity ratio will result in ratepayers paying too much in regulated rates and may have the effect of subsidizing FPL Groups unregulated affiliate activities. As noted in the direct testimony of SFHHA witness Baudino, FPL Group Capital is extremely

[197] Tr. at 5122-5123.

highly leveraged but still maintains an A credit rating.[198] In the face of such extensive debt at FPL Group Capital, FPL Group relies upon the common equity at FPL to offset the risk and burden of the overall debt. Thus, it is imperative that a proper and non-excessive amount of common equity be approved for ratemaking purposes to ensure that FPL Group is not overly dependent upon the equity at FPL to offset the debt within the FPL Group.

FPL's common equity level should be reduced to a level that is more within the range of its peer group and consistent with an "A" credit profile. Mr. Baudino recommends the approval of an adjusted equity ratio of 50% which is at the low end of the 50% to 65% range observed in FPL's peer group.[199] FPL continues to have an "excellent" business risk profile that supports this level of common equity. The 50% equity ratio recommended by Mr. Baudino is equal to a 53.5% equity ratio for ratemaking purposes. This is achieved by recapitalizing approximately $845 billion from equity into debt, while also increasing the amount of short-term debt by $600 million as discussed in Issue No. 69. When all sources of capital are considered, including both investor and non-investor supplied capital, the appropriate amount of common equity is 41.07%.

FPL has made numerous claims about the need to maintain a high equity ratio and a high ROE based upon its supposed "risks."[200] Yet, it is worth noting that FPL is the *third highest rated* integrated utility company in the nation.[201] Fitch maintains an "Issuer Default Rating" or "IDR" on FPL at "A" with a stable outlook.[202] Among 59 separately rated integrated utility companies, FPL has the third highest rating, surpassed only by Mississippi Power Company and Oklahoma Gas and Electric Company. Ratepayers have paid regulated rates that have been set

[198] Tr. at 2619.
[199] Tr. at 2618- 2619.
[200] *See, e.g.*, Tr. at 4881-4885.
[201] Ex. 503.
[202] *Id.*

sufficiently high to allow FPL to maintain these exceptional ratings. It is almost inconceivable that FPL now asks for even more.

ISSUE 73: What is the appropriate capital structure for FPL for the purpose of setting rates in this docket?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *The appropriate capital structure for FPL in this proceeding is 41.07% common equity; 32.38% Long Term Debt; 3.62% Customer Deposits; 3.44% Short Term Debt; 19.13% Deferred Income Taxes; 0.36% Investment Tax Credits. Customer Deposits, Deferred Income Taxes and Investment Tax Credits are jurisdictional to the FPL retail ratepayers and should not be reduced for "prorata adjustments" to reconcile the company's capitalization to rate base.*

DISCUSSION:

The appropriate capital structure is described in SFHHA's statement of position above. The most significant changes recommended by SFHHA from FPL's proposed capital structure are the following two issues: (1) reduce the common equity ratio from 47.9% to 41.07%, and (2) increase short-term debt from 1.0% to 3.44%. These percentages are expressed on the basis of all sources of capital, both investor and non-investor supplied capital.

ISSUE 80: What return on common equity should the Commission authorize in this case?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *The Commission should authorize a 10.4% return on equity in this case.*

DISCUSSION:

The appropriate level of return on common equity ("ROE") for FPL is one of the single largest issues in this rate case. FPL has testified that for every 100 basis point reduction to the ROE, the revenue requirement impact is approximately a $130 million decrease.[203] Thus, a 2.5% reduction to FPL's requested 12.5% ROE would result in a revenue requirement decrease

[203] Tr. at 4476.

of approximately $325 million annually. The evidence in this case, including the numerous cost recovery mechanisms that FPL continues to enjoy, establishes that an ROE no higher than 10.4% is sufficient to allow FPL to attract capital and provide a reasonable return to shareholders.

Despite the low risk of operating a monopoly utility company providing a basic human need such as electricity, FPL has requested an astounding 12.5% ROE. This request is exceedingly high, is not supported by the analysis of FPL's peer groups, is not supported by any of the intervenors in this case or the Staff, and is not supported by Dr. Avera's own utility peer group analysis. Dr. Avera conducted three types of quantitative analyses: a discounted cash flow analysis ("DCF"), a capital asset pricing model ("CAPM"), and an expected earnings analysis. He achieved a range of results from 11% to 13%. He recommended an ROE closer to the top end of his range, 12-13%, in part to reward FPL's management for so-called "exemplary" management. Mr. Pimentel, the CFO, then selected the midpoint of the upper range, or 12.5%, as FPL's requested ROE.

I. Is FPL more risky than TECO?

Much of the testimony in this case regarding FPL's ROE has been devoted to the issue of equity investors' risk in FPL. For example, Mr. Pimentel makes the dubious argument in his rebuttal testimony that FPL is a more risky company than TECO.[204] This is an overstatement that is not borne out in the evidence. The most objective measure of a company's riskiness is the bond rating assigned to it by the credit rating agencies. A company like Berkshire Hathaway with a "AAA" bond rating is generally viewed to be a much safer or less risky investment than a company with a "BBB" bond rating. FPL has enjoyed an "A" bond rating for many years, indicating that it is solidly within the realm of investment-grade companies. In contrast, TECO

[204] *See* Ex. 365.

suffers under a "BBB" bond rating that places it only two steps away from non-investment grade, or "junk" status. The Commission recently approved a 11.25% ROE for TECO,[205] which is 125 basis points lower than FPL's requested ROE in this case. It is unreasonable and inconsistent with investor perceptions that a company with an "A" bond rating is *more* risky than a company with a "BBB" bond rating like TECO, and would therefore require a higher ROE.

Nonetheless, FPL has performed analytical contortions to turn the objective risk measurement of bond rating on its head. For example, FPL has taken the position that a bond rating is just that—a rating for FPL's bonds, and not an overall evaluation of the company's risk.[206] This distinction makes no sense. Bondholders have a more senior call on the company's capital than equity holders. If a bondholder believes that one company is more risky than another company, an equity holder will likely have the same opinion since equity holders are only paid after the bondholders have been paid. On cross-examination, Dr. Avera did acknowledge that there is a "general correlation" between bond ratings and risk to equity holders.[207] It is difficult to conceive under what scenario a bondholder would believe that an "A" rated company is less risky than a "BBB" rated company, while an equity holder would believe that an "A" rated company is *more* risky than a "BBB" rated company. Yet that is exactly what FPL asks this Commission to believe.

II. Critical analysis of Avera's quantitative methodologies.

A. The DCF analysis does not support the requested ROE.

Dr. Avera's discounted cash flow analysis suffers from overly optimistic earnings growth projections, and does not support his recommended ROE. The DCF method is a way to estimate the cash flow some investors expect to receive from a stock through future dividend payments

[205] Order No. PSC-09-0283-FOF-EI at 48.
[206] Tr. at 4487-4489; *see also* Tr. at 4876.
[207] Tr. at 4487.

and capital gains.[208] The formula for the DCF model can be simplified as essentially dividend yield plus growth (D_1 + g), making it highly sensitive to projected growth rates. In the battle of the experts in regulatory proceedings in which ROE is a major topic, the dispute often centers around what growth rates to use in the DCF model. Some experts rely solely on earnings growth rates while others rely on a combination of earnings growth rates and dividend growth rates. Because companies' dividends are not growing at very high rates in the current market, accounting for dividend growth rates in the DCF formula will typically result in a lower ROE.

Dr. Avera ignored dividend growth rates in this case, which made his ROE calculations higher than they would have been if he had considered dividend growth rates. Oddly, the evidence shows that Dr. Avera has included dividend growth rates in his ROE calculations for other jurisdictions.[209] A singular reliance on earnings growth rates has the effect of exacerbating expectations that may already be too rosy. Exhibit 493 is a scholarly article by Steven Kihm, explaining why the earnings estimates provided by Wall Street analysts are often overly optimistic. As Kihm stated, "analyst forecasts . . . are biased to the upside."[210] Dr. Avera relied on earnings growth expectations as reported in various services including Zacks, IBES and Value Line. These services obtained their growth rates by conducting surveys of the earnings growth expectations provided by Wall Street analysts, which scholars like Kihm believe are too "rosy." Although Kihm's article was published in 2002, more recent publications have noted the same phenomena, such as a *Wall Street Journal* article entitled "Study Suggests Bias in Analysts' Rosy Forecasts," published on March 21, 2008.[211]

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[208] Tr. at 4411.
[209] Tr. at 4512.
[210] Ex. 493 at 98.
[211] Tr. at 4510.

Setting aside the methodological error of excluding dividend growth rates, Dr. Avera's DCF analysis results still do not support his 12-13% ROE range. Dr. Avera relied on two separate sets of proxy groups in conducting his DCF analysis: a utility proxy group, and a non-utility proxy group. After applying the infirm DCF model to the utility proxy group, the range of average resulting ROEs was 10.6-11.5%, as noted on WEA-7.[212] Astonishingly, the highest of these results (11.5%) is a full 100 basis points *below* FPL's recommended ROE of 12.5% in this case. Thus, Dr. Avera's utility proxy group DCF analysis does not support FPL's request for a 12.5% ROE.

In order to justify its ROE recommendation, FPL had Dr. Avera rely upon the non-utility proxy group analysis. This group is comprised of 66 non-utility companies listed in Exhibit WEA-9.[213] None of these companies are vertically integrated, regulated monopoly businesses. This group includes companies like Walmart, Walgreens, and the liquor distributor Fortune Brands. These companies are vastly different from an integrated utility company. They do not own and operate fossil fuel-fired generation or transmission and distribution systems. They do not develop solar generation and receive 100% cost recovery with interest for any amounts expended in developing solar generation. They do not have a $200 million hurricane reserve fund involuntarily funded by their customers plus statutory authority to sell bonds to recover restoration costs from their customers.[214] The point is that these companies from disparate industries have little in common with FPL, and are inappropriate to use as a proxy group to determine FPL's ROE. When FPL's CEO, Armando Olivera, was questioned regarding comparing executive compensation at FPL with executive compensation at PUBLIX, Mr.

[212] Ex. 136.
[213] Ex. 138.
[214] Tr. at 4538.

Olivera insisted that it was inappropriate to compare FPL to a retail chain because the two companies were not in the same peer group.[215] Yet Dr. Avera seems content to compare FPL to Walgreens or Walmart for purposes of supporting his over-reaching ROE recommendation.

III. CAPM

Dr. Avera's CAPM methodology similarly suffers from a shaky foundation. The basic theory behind the CAPM approach is that investors will diversify away individual company risk through portfolio investing. To achieve such diversification, an investor examines the risk of an individual investment as compared to the risk of the market as a whole. Dr. Avera, however, has attempted to measure investment in FPL against only a *subset* of the market, rather than the market as a whole. Dr. Avera has excluded all non-dividend paying companies from his CAPM method. While it may seem reasonable to exclude non-dividend paying companies since FPL pays a dividend, this is a fundamental flaw in the application of the CAPM model. Again, the CAPM model attempts to measure the risk associated with an individual investment compared to the market *as a whole*. Dr. Avera's CAPM model is therefore a non-starter.

IV. Summary of Avera's utility proxy group analyses.

As demonstrated in exhibit 496, none of Dr. Avera's utility proxy group analyses even come close to supporting FPL's requested ROE in this case. In fact, the results are much closer to Mr. Baudino's recommendation than to Dr. Avera's recommendation:

[215] Tr. at 554, 558, 562.

DCF:	**10.6% - 11.5%** (WEA-7)[216]
Expected Earnings:	**11.7%** (WEA-13)[217]
Forward CAPM:	**10.5%** (WEA-11)[218]
Range:	**10.5% - 11.7%**

The upper end of Dr. Avera's range is still 80 basis points below FPL's request in this case.

Not only is FPL's 12.5% ROE unsupported by Dr. Avera's analysis, it is also totally unsupported by the decisions of regulatory commissions around the nation. Exhibit 462 is a report of regulatory decisions prepared by SNL Financial. It shows that the average authorized ROE is 10.51%, only 11 basis points higher than SFHHA's recommendation. The exhibit also demonstrates that no state regulatory commissions have authorized ROEs of 12.5%. In fact, the highest authorized ROE is 11.5%, and the vast majority are in the range of 10.5%. In addition, not a single commission listed on exhibit 462 has authorized more than 55% common equity in the capital structure. In light of these comparisons, FPL's 12.5% ROE and 59.6% common equity ratio are simply over-reaching.

V. It is inappropriate to provide a bonus for "exemplary management."

Dr. Avera's range of analyses does not support a 12.5% ROE, and it is not appropriate to take into account "exemplary management." FPL's management has a statutory duty to provide adequate and reliable service to FPL's captive customers. The duty of management does not change based on the ROE that this Commission approves. Whether the Commission approves an ROE of 12.5%, 10.4%, or something lower, FPL's management has the same fiduciary duty to

[216] Ex. 136.
[217] Ex. 142.
[218] Ex. 140.

its shareholders, and it has the same statutory duty to provide reliable and adequate electric service to Florida customers.

If Dr. Avera is insinuating that FPL's management will not work as hard or will provide lower quality service if the ROE is not set as high as FPL requests, then FPL's management would be in dereliction of its duties. FPL is a monopoly service provider. It faces no competition in the generation or delivery of retail energy. It is unreasonable to imply that management will do less than its utmost to provide great service unless the company's ROE is set at a particular level. Dr. Avera's suggestion that the high end of his range is appropriate to reward "exemplary management" should be rejected outright. Management has a statutory duty to provide high-quality, reliable service to its customers, regardless of the ROE it is awarded. Further, the evidence in this case establishes that FPL's management is handsomely compensated. Mr. Olivera for example earned a whopping $3.6 million in 2008,[219] and likely stands to earn at least that much in 2009 and 2010. No additional "reward" appears to be necessary.

VI. Equity flotation costs.

Dr. Avera also testified that a utility should be allowed to recover 25 basis points in its ROE for equity flotation costs. Yet FPL equity is wholly owned by FPL Group and FPL has no plans to issue equity any time soon. In support of the 25 basis point equity flotation cost recommendation, Dr. Avera relies on a FERC decision from a case involving PEPCO Holdings, Inc. ("PEPCO").[220] What Dr. Avera fails to note, however, is that in that case FERC only

[219] Tr. at 559.

[220] Tr. at 4583.

allowed PEPCO to recover flotation costs if the issuance of stock is imminent.[221] FPL has no plans to issue stock and should therefore not be allowed to recover any equity flotation costs.

VII. FPL's analysis assumes a continuation of the financial crisis.

Much of Dr. Avera's analysis seems to be informed by the very specific time period in which it was conducted—the fourth quarter of 2008, during which "the nation [was] in the midst of a financial crisis."[222] While it is undisputed that the nation suffered a credit meltdown and a severe financial crisis during that time period, it is also undisputed that the credit markets have thawed significantly and the nation's economy is recovering. For example, credit spreads have narrowed since the fourth quarter of 2008. While FPL's access to commercial paper markets was in threat of being restricted in the fourth quarter of 2008, FPL now enjoys easy access to the capital markets, including the commercial paper market. Dr. Avera even relied upon the Chicago Board Options Exchange's VIX measure of volatility as a proxy for the severity of the nation's financial crisis.[223] While the VIX traded at highly elevated levels in the third and fourth quarters of 2008, it returned to normalcy during the course of the underlying hearing.[224] Thus, if the VIX shows us anything, it is that the financial crisis that caused Dr. Avera to recommend a 12.5% ROE has begun to wane. Moreover, to the extent that the Commission is asked to look forward to 2010 to set an ROE because of the trend line improvements, it appears that 2010 will be better than 2009, which was better than 2008.

VIII. Baudino's 10.4% ROE is appropriate.

Like Dr. Avera, Mr. Baudino began his DCF model by constructing a proxy group of comparable companies. Mr. Baudino focused on companies that have a senior secured bond

[221] Ex. 495 at 38.
[222] Tr. at 4373.
[223] Tr. at 4382.
[224] *See* Ex. 492.

rating in the "A" range from S&P, as FPL does. He then selected companies that had at least 50% of their revenues from electric operations and who also had long-term earnings growth forecasts provided by Value Line, Zacks or First Call. Out of an abundance of caution, Mr. Baudino eliminated companies that had recently cut or eliminated dividends, or who were engaged or recently involved in merger activities. The result was a group of 14 companies with which FPL has not taken issue. Mr. Baudino expressly refused to develop a non-utility proxy group because doing so would not assist in estimating the proper ROE for FPL.

The major difference between Mr. Baudino's DCF analysis and Dr. Avera's DCF analysis, other than examining only a utility proxy group, is that Mr. Baudino included dividend growth rates in his growth rate variable in the DCF formula. As noted on RAB-5,[225] Mr. Baudino weighted the dividend growth rate at only 25%. Thus, Mr. Baudino recognizes that investors may predominately rely upon earnings growth rates, but he did not exclude dividend growth rates all together. This 25% weighting is a fair recognition of investors' relative reliance on dividend growth rates. The result of Mr. Baudino's analysis is a 10.4% ROE recommendation, which the Commission should adopt.

ISSUE 81: What is the appropriate weighted average cost of capital including the proper components, amounts and cost rates associated with the capital structure?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Long-term debt should consist of 32.38% of FPL's capital structure at a cost of 5.55%, resulting in a weighted average cost of 1.80%. Customer deposits should consist of 3.62% of FPL's capital structure at a cost of 5.98%, resulting in a weighted average cost of 0.22%. Short-term debt should consist of 3.44% of FPL's capital structure at a cost of 0.60%, resulting in a weighted average cost of 0.02%. Deferred Income Taxes should consist of 19.13% of FPL's capital structure at a cost of 0%, resulting in a weighted average cost of 0%. Investment tax credits should consist of 0.36% of FPL's capital structure at a cost of 9.05%,

[225] Ex. 283.

resulting in a weighted average cost of 0.043%. Common Equity should consist of 41.07% of FPL's capital structure at a cost of 10.40%, resulting in a weighted average cost of 4.27%.*

DISCUSSION:

The appropriate weighted average cost of capital is as set forth below. See also discussion of Issue 71.

Capital Structure	Jurisdictional Adjusted Capital	Capital Ratio	Cost Rate	Weighted Avg Cost
Long Term Debt	$5,607.724	32.38%	5.55%	1.80%
Customer Deposits	$626.383	3.62%	5.98%	0.22%
Short Term Debt	$595.631	3.44%	0.60%	0.02%
Deferred Income Tax	$3,313.373	19.13%	0.00%	0.00%
Investment Tax Credits	$63.212	0.36%	9.05%	0.04%
Common Equity	$7,112.837	41.07%	10.40%	4.27%
Total Capital	$17,319.161	100.00%		6.34%

NET OPERATING INCOME

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent-year adjustment.)

ISSUE 82: What are the appropriate inflation and customer growth for use in forecasting?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 83: Should FPL's proposal to transfer capacity charges and capacity-related revenue associated with the St. John's River Power Park from base rates to the Capacity Cost Recovery Clause be approved?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 84: Has FPL made the appropriate test year adjustments to remove fuel revenues and fuel expenses recoverable through the Fuel Adjustment Clause?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 85: Has FPL made the appropriate test year adjustments to remove conservation revenues and conservation expenses recoverable through the Conservation Cost Recovery Clause?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 86: Has FPL made the appropriate test year adjustments to remove capacity revenues and capacity expenses recoverable through the Capacity Cost Recovery Clause?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 87: Has FPL made the appropriate test year adjustments to remove environmental revenues and environmental expenses recoverable through the Environmental Cost Recovery Clause?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 88: Should an adjustment be made to operating revenue to reflect the incorrect forecasting of FPL's C/I Demand Reduction Rider Incentive Credits and Offsets?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 89: Is an adjustment appropriate to FPL's Late Payment Fee Revenues if the minimum Late Payment Charge is approved in Issue?
A. For the 2010 projected test year?

B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 90: Are any adjustments necessary to FPL's Revenue Forecast?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 91: Are FPL's projected levels of Total Operating Revenues appropriate?
A. For the 2010 projected test year in the amount of $4,114,727,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $4,175,024,000?

POSITION: No position.

ISSUE 92: Has FPL made the appropriate adjustments to remove charitable contributions?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 93: Should an adjustment be made to remove FPL's contributions recorded above the line for the historical museum?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 94: Should an adjustment be made for FPL's Aviation cost for the test year?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 95: Are the cost savings associated with AMI meters appropriately included in net operating income?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *No, FPL has failed to include the pro rata amount of estimated savings from the installation of the AMI meters.*

DISCUSSION:

FPL plans to deploy approximately 4.3 million integrated solid-state meters ("Smart Meters") for the residential and small/medium business customers it serves by the end of 2013 as part of its Advanced Metering Infrastructure ("AMI") initiative.[226] The AMI initiative is expected to have a total capital cost of $645 million,[227] and will result in operational savings of approximately $36 million annually.[228]

Under the schedule set forth by FPL, 170,000 Smart Meters will be deployed in 2009 and 1,128,000 Smart Meters will be deployed in 2010.[229] The remainder of the Smart Meters will be deployed in 2011-2013.[230] Thus, an average of 734,000 Smart Meters, or 16.9% of the total number of Smart Meters FPL plans to deploy by the end of 2013, will be deployed during the test year.[231] By the end of the test year, FPL will have deployed a total of 1,298,000 Smart Meters, or approximately 30% of the total number of Smart Meters included in FPL's AMI initiative.[232]

As FPL explained, its AMI initiative will result in substantial operational savings.[233] Each Smart Meter is "equipped with two-way communications, remote reading, connection, and disconnection capabilities and will be able to collect data regarding consumption at

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[226] *See* Tr. at 1551-1552.
[227] *See* Tr. at 1552.
[228] *See* Ex. 310; *see also* Tr. at 6050.
[229] *See* Ex. 307.
[230] *Id.*
[231] *See* Tr. at 3138; *see also* Ex. 307.
[232] *See* Tr. at 3138.
[233] *See* Tr. at 1553.

predetermined intervals."[234] These capabilities, among others, will allow FPL to significantly reduce its meter reading-related expenses, which FPL has identified as the primary source of its AMI-related savings.[235]

Notwithstanding the foregoing, FPL plans to allocate only $0.418 million, or approximately 1.2%, of the operational savings resulting from the AMI initiative to the test year.[236] This results in a significant and unreasonable mismatch between the burdens (or costs) and the benefits (or savings) associated with the AMI initiative. FPL claims that this mismatch is justified because "savings are not realized until several complex interdependent components and processes are fully developed, tested and implemented, and deployment is achieved at an [sic] FPL regional work area."[237] However, this claim is belied by FPL's own past experience, and ignores the fact that a basic AMI framework is already in place.

Although FPL did not begin full-fledged deployment of Smart Meters until 2009, it previously deployed approximately 150,000 Smart Meters: 50,000 in 2005, and 100,000 in 2007-2008.[238] As part of these deployments, FPL laid some of the basic framework that it claims is required before any savings will result from its AMI initiative. For example, FPL has already integrated some of the software associated with the Smart Meters into its existing software,[239] created databases to manage and store Smart Meter data,[240] and provided training for some of its employees regarding the processes and systems related to the Smart Meters.[241]

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[234] Tr. at 1551; *see also* Tr. at 1574.
[235] *See* Tr. at 1553, 1574-1575.
[236] *See* Tr. at 3139; *see also* Ex. 307.
[237] *See* Tr. at 6048.
[238] *See, e.g.*, Tr. at 1552-1553.
[239] *See* Tr. at 6181.
[240] *See* Tr. at 6182.
[241] *See* Tr. at 6185.

Although FPL will obviously have to expand upon this existing framework to accommodate the full AMI initiative, this basic framework has already been laid and is currently being used to read and bill FPL's existing Smart Meters remotely.[242] In fact, FPL indicated that the Smart Meters currently in place have been read remotely 99.9% of the time since 2007.[243] Thus, contrary to FPL's assertion, at least some of the basic framework FPL claims is required before any savings will result from its AMI initiative is already in place, and presumably will remain in place and provide incremental benefits in the future.[244]

Other factors FPL claims are imperative to the use of Smart Meters, such as the implementation of cyber security measures to protect the integrity of the customer data and systems, were not completed prior to FPL's use of the Smart Meters deployed prior to 2009 for remote reading and billing,[245] disproving FPL's current claim that such measures must be completed before any Smart Meter-related savings can be realized.

For the reasons discussed herein, FPL's proposal to allocate approximately 16.9% of its total investment in rate base (i.e., the deployment of an average of 734,000 Smart Meters) to the test year, while allocating only 1.2% of the resulting benefit (i.e., the operational savings) to the same period, is inherently unreasonable and results in a significant mismatch between the benefits and the burdens associated with the AMI initiative. Thus, FPL's proposal deprives FPL's ratepayers of the full operational savings to which they are entitled.

FPL is already experiencing operational savings as a result of its use of Smart Meters—savings which should fairly be passed through to FPL's ratepayers. As a result, FPL's proposal to allocate a mere 1.2% of those savings to the test year should be rejected. Instead, the

[242] *See, e.g.*, Tr. at 1552-1553, 1577, 6180.
[243] *See* Tr. at 1599.
[244] *See* Tr. at 6187-6188.
[245] *See* Tr. at 6183.

Commission should require FPL to match the savings with the costs and reflect 16.9% of the annualized O&M expense savings, or $6.084 million, in the test year as proposed by SFHHA.

ISSUE 96: What is the appropriate level of Bad Debt Expense?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 97: Should an adjustment be made to remove the portion of Bad Debt Expense associated with clause revenue that is currently being recovered in base rates and include them as recoverable expenses in the respective recovery clauses?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 100: Are any adjustments necessary to FPL's payroll to reflect the historical average level of unfilled positions and jurisdictional overtime?

POSITION: No position.

ISSUE 101: Should FPL reduce expenses for productivity improvements given the company's lower historical rate of growth in payroll costs?

POSITION: *Yes. The Commission should reduce FPL's O&M expense by at least $36.519 million and the revenue requirement by $36.641 million to properly account for productivity improvements. The recognition of productivity improvements will have the effect of reducing FPL's proposed payroll expense amount by $30.917 million. As a result, there also will be reductions of $1.995 million in the related payroll tax expense and $3.607 million in the related fringe benefits expense.*

DISCUSSION:

The Commission should reduce FPL's proposed test year payroll expense to reflect productivity improvements and, consequently, reductions in payroll and related expenses. In addition to FPL's demonstrated ability to restrain growth in O&M expenses below inflation, the Commission also should consider the company's capital investment incurred to achieve these

savings, which is included in rate base. FPL's ratepayers should receive the full benefit of their investment in rate base. If the Commission does not restate FPL's proposed test year O&M expense to reflect these savings, then FPL either will retain the savings, otherwise increase its actual O&M expenses to the levels included in the revenue requirement, or some combination of the two.

As described in the testimony of SFHAA witness Kollen, the effect of this recommendation to reflect ongoing productivity improvements is to reduce O&M expense by $36.519 million and the revenue requirement by $36.641 million. Mr. Kollen assumed FPL would achieve productivity gains of 2.0% annually, which will offset the company's general inflation assumption of 2.0% annually. He based this assumption not only on FPL's most recent experience at more than offsetting inflation increases in 2008, but also on the most recent national historic trends in productivity improvement, which converge on a 2.0% annual improvement.

The recognition of a 2.0% annual productivity improvement will have the effect of reducing FPL's proposed $765.261 million in payroll expense amount by $30.917 million, or 4.04%, reflecting the cumulative and compounded effect of the 2009 and 2010 productivity improvements compared to 2008. Mr. Kollen obtained the O&M expense portion of the company's projected 2010 payroll expense from the company's response to SFHHA Interrogatory 297, which was submitted as Exhibit LK-10 to his direct testimony.[246]

In addition, there will be reductions of $1.995 million in the related payroll tax expense and $3.607 million in the related fringe benefits expense. To compute these amounts, Mr. Kollen applied the same 4.04% cumulative productivity factor to these expense amounts. He

[246] Ex. 300.

obtained the payroll tax expense from the company's MFR Schedule C-20 and the base recovery portion of the fringe benefits expense from the company's response to SFHHA Interrogatory 297. Mr. Kollen's computations of the reductions in payroll and related expenses are detailed in Exhibit LK-11 to his direct testimony.[247]

ISSUE 102: Is it appropriate for FPL to increase its forecasted Operating and Maintenance Expenses due to estimated needs for nuclear production staffing?

POSITION: *No. The company has already increased its nuclear staffing levels in recent years to address attrition and retirements. Since, September, 2008 FPL has actually been reducing its nuclear production staffing. The Commission should reduce FPL's nuclear production O&M expense by $21.852 million to eliminate FPL's request for increased staffing.*

DISCUSSION:

FPL seeks to increase its nuclear production O&M expense by $43.4 million compared to its actual 2008 expenses, from $380.9 million to $424.3 million total.[248] The largest portion of this $43.4 million increase ($18.5 million in 2010) is attributable to increased payroll expenses related to FPL's proposal to increase its nuclear staffing by 270 employees, to "anticipate and ultimately compensate for [future] attrition and retirements."[249] The evidence shows that FPL's request is not justified and should be rejected.

First, and most importantly, FPL's proposal to increase its O&M expense to account for 270 new nuclear employees is inconsistent with its actual circumstances. In contrast to FPL's stated intent and purportedly dire need to hire more employees, the evidence demonstrates that FPL has been consistently *reducing*, rather than increasing, its nuclear staffing levels since

[247] Ex. 301.

[248] Ex. 94.

[249] *See* Tr. at 821; *see also* Ex. 302.

September 2008.[250] Moreover, FPL has admitted that it has deferred or eliminated a number of positions within the Nuclear Business Unit,[251] further reducing the number of employees actually required by FPL.

In addition, FPL is investing capital in a number of assets that will improve productivity. These assets will reduce FPL's maintenance requirements and allow fewer employees to do more in less time, among other things.[252] For example, under its Control Room Digital Upgrade project, FPL will replace older instruments and controls in several critical plant control systems with newer (often digital) technology. This will reduce or eliminate FPL's need to hire or retain personnel specially trained to work on the older equipment.[253] FPL's implementation of the Nuclear Asset Management System ("NAMS") across its entire nuclear fleet by the end of the second quarter of 2010[254] will also result in productivity improvements,[255] further reducing the number of employees needed by FPL.

In addition, FPL's suggestion that it has to add 270 new nuclear employees *now* (and increase its O&M expense to account for those potential employees) in order to "anticipate and ultimately compensate for [*future*] attrition and retirements," is unfounded.[256] FPL's justifications for that claim, such as the "growing competition for talent in the nuclear industry," a "shrinking skilled labor pool," and the "high demand for skilled workers," do not provide a basis for FPL adding positions in 2010 or 2011.[257] FPL should not be permitted to hire

[250] *See* Ex. 303; *see also* Tr. at 2912-2915.
[251] *See* Tr. at 818.
[252] *See* Tr. at 3127.
[253] *See* Tr. at 807.
[254] *See* Tr. at 806-807.
[255] *See* Tr. at 834.
[256] *See* Tr. at 821.
[257] *See* Tr. at 818.

additional, unnecessary nuclear employees *now*, at ratepayers' expense, based solely on a hypothetical future need.

Moreover, FPL should have no difficulty filling positions in the future. FPL's status as one of the largest nuclear operators in the United States, collectively with its affiliates "owning and operating eight nuclear units at five locations,"[258] will give FPL a number of advantages in attracting and retaining qualified personnel over its would-be competitors.[259] In fact, FPL witness Stall noted that "[o]ne of the key benefits of operating a large nuclear fleet is the existence of numerous business opportunities for employees to pursue career advancement in [FPL's] nuclear program in different jobs at different locations."[260]

In addition to offering its employees and potential employees more opportunities for career advancement and more geographic choices than its would-be competitors, FPL offers its employees competitive compensation packages that often include a cash incentive in order to retain skilled employees (such as nuclear operators),[261] and has implemented a retention program with increased compensation and benefits for its nuclear employees in order to attract and retain those employees.[262] FPL also offers non-compensation-related benefits that give it a further advantage vis-à-vis its competition in attracting and retaining qualified personnel.[263] For example, FPL offers a nine-day rotational schedule which allows certain employees to have every other Friday off.[264] Each of these benefits, *inter alia*, will give FPL an advantage in attracting and retaining qualified personnel. In fact, the evidence produced in this proceeding

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[258] *See* Tr. at 192.
[259] *See* Tr. at 793; *see also* Tr. at 829.
[260] *See* Tr. at 792-793; *see also* Tr. at 829.
[261] *See* Tr. at 385-386.
[262] *See* Tr. at 879.
[263] *See* Tr. at 382.
[264] *See* Tr. at 381-382; *see also* Ex. 403.

demonstrates that, while FPL's qualified nuclear personnel may, from time to time, be "poached" by FPL's competitors, FPL is much more often the "poacher" than the "poachee."[265] Thus, it is clear that FPL does not need to begin adding new nuclear employees *now* in order to address a hypothetical future need.

In light of the foregoing, the Commission should reject the increase in nuclear production O&M expense sought by FPL for an additional 270 positions. Instead, the Commission should adopt SFHHA's recommendation that FPL's nuclear production O&M expense be reduced by $21.852 million (including an $18.5 million reduction in O&M payroll expense, a $1.194 million reduction in payroll taxes, and a $2.158 million reduction in employee fringe benefits).[266]

ISSUE 103: Should an adjustment be made to FPL's requested level of Salaries and Employee Benefits?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. The Commission should reflect a productivity adjustment and eliminate the company's proposed increase in nuclear staffing levels.*

DISCUSSION:

See discussion of Issue 102.

ISSUE 106: Should an adjustment be made to Pension Expense?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 107: Is a test year adjustment necessary to reflect FPL's receipt of an environmental insurance refund in 2008?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

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[265] *See, e.g.*, Ex. 404.

[266] *See* Tr. at 3135; *see also* Ex. 304.

POSITION: No position.

ISSUE 108: Is a test year adjustment appropriate to reflect the expected settlement received from the Department of Energy?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. FPL will recover money from the DOE for DOE's failure to dispose of spent fuel from FPL's nuclear generating facilities. The DOE settlement results in FPL receiving ongoing reimbursements. The Commission should reduce FPL's revenue requirement by $9.030 million to reflect that recovery.*

DISCUSSION:

FPL witness Ousdahl testified that FPL erred by failing to include DOE settlement reimbursements in its 2010 and 2011 revenue requirement.[267] FPL's quantification of DOE settlement reimbursements for 2010 and 2011, which offset FPL's revenue requirement, should be adopted.

ISSUE 109: Should adjustments be made for the net operating income effects of transactions with affiliated companies for FPL?

POSITION: No position.

ISSUE 116a: Is an adjustment necessary to reflect the gains on sale of utility assets sold to FPL's non-regulated affiliates?

POSITION: No position.

ISSUE 119: Should the Commission order notification requirements to report the future transfer of the FPL-NED assets from FPL to a separate company under FPL Group Capital?

POSITION: No position.

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[267] Tr. at 3711.

ISSUE 120: Should an adjustment be made to FPL's requested storm damage reserve, annual accrual of $150 million, and target level of $650 million?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. FPL should not be permitted to reestablish an annual storm damage accrual in base rates, including establishment of a storm damage reserve while it continues to collect a storm damage surcharge for these same purposes.*

DISCUSSION:

FPL's request for storm damage expense is yet another example of how FPL has artificially inflated its revenue requirement. Section 366.8260, Florida Statutes, permits FPL to recover its reasonable and necessary storm restoration costs and to replenish the storm damage reserve through a surcharge pursuant to securitization financing. This mechanism of storm financing guarantees cost recovery for FPL and provides ratepayers with the benefits of low-cost securitization financing.[268] Despite guaranteed cost recovery for storm restoration, however, FPL has requested accrual of $148.667 million of annual storm damage expense, which has a revenue requirement impact of $149.162 million.[269] FPL should not be permitted to reestablish an annual storm damage accrual in base rates, including establishing a storm damage reserve, while it continues to collect a storm damage surcharge for the very same purposes.

The Commission has already determined that the surcharge approach coupled with securitization is a more cost effective means of recovering storm damage costs than base rate recovery. In Order No. PSC-06-0464-FOF-EI, the Commission approved a levelized surcharge to recover the securitization and related costs, approved the recovery of only "incremental" costs, despite the company's request for costs that otherwise would have been capitalized to plant in service or that otherwise were already recovered in base rates, approved the securitization

[268] Tr. at 3146.
[269] Tr. at 3142.

financing, and approved the replenishment of the reserve fund in excess of the storm damage reserve deficiency by $200 million, while rejecting FPL's request for a $650 million reserve.[270] Just as the Commission should do here, the Commission rejected FPL's request for a $650 million target reserve, stating:

> Given that FPL has the opportunity to seek recovery of future storm restoration costs through either a surcharge or securitization pursuant to the 2005 Settlement Agreement and applicable law, and given the preference of FPL's customers to face that risk when such costs actually materialize, we decline to approve funding of FPL's Reserve to a level of $650 million through the storm-recovery bonds authorized to be issued under the terms of this Order. We find that funding FPL's Reserve to a level of $200 million is appropriate and will (i) reduce the incidental costs associated with issuance of the storm-recovery bonds authorized to be issued under the terms of this Order, (i) provide more critical review of FPL's charges to its Reserve, and (i) result in lower overall storm-recovery charges at this time.[271]

The Commission correctly held that the storm damage surcharge in conjunction with securitization was a reasonable approach.

The Commission should not revert to the higher-cost base rate approach that was in effect prior to the adoption of the securitization statute. If base rate recovery is again permitted, then the annual accrual should be $0 while the company continues to collect the surcharge. Also, if that base rate recovery is permitted, FPL's reserve surplus target should be set at $200 million, and not at $650 million as proposed by FPL. Like a reduction to depreciation expense, a reduction to FPL's storm damage expense would have no impact on its earnings. The Commission should therefore approve the cost recovery mechanism for storm expense that most benefits ratepayers. Approval of a storm damage expense in base rates would harm ratepayers

[270] Order No. PSC-06-0464-FOF-EI at 5.

[271] *Id.* at 25.

due to the higher rate base return.[272] Thus, it should be a "no-brainer" that FPL's request for storm damage expense must be rejected.

ISSUE 121: What adjustment, if any, should be made to the fossil dismantlement accrual?

POSITION: No position.

ISSUE 122: What is the appropriate amount and amortization period of Rate Case Expense?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 124: Should FPL's request to move payroll loading associated with the Energy Conservation Cost Recovery Clause (ECCR) payroll currently recovered in base rates to the ECCR be approved?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 125: Should an adjustment be made to remove payroll loadings on incremental security costs that are currently included in base rates and include them in the Capacity Cost Recovery Clause?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 126: Should an adjustment be made to move the incremental hedging costs that are currently being recovered through the Fuel Cost Recovery Clause to base rates?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 128: Is FPL's requested level of O&M Expense appropriate?

[272] Tr. at 3149.

A. For the 2010 projected test year in the amount of $1,694,367,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $1,781,961,000?

POSITION: *No. FPL's test year O&M expense should be reduced by $397.648 million. This will reduce FPL's requested test year O&M expense to the $1,306.953 million actual 2008 adjusted downward on a net basis to $1,296.719 million for known and measurable changes.*

DISCUSSION:

Despite the economic downturn, FPL proposes an excessive 31% increase in O&M expense compared to its actual 2008 O&M expense.[273] The testimony of SFHHA witness Kollen properly characterized this increase as "wildly excessive" given the present economic circumstances, FPL's proven ability to implement cost reductions, the effect of productivity improvements through capital investments, ongoing efficiency improvements, and the company's actual cost reductions in 2008, and compared to the budget that FPL has already implemented to-date in 2009. As recommended by Mr. Kollen, FPL's test year O&M expenses should be no more than actual 2008 expenses ($1,306.953 million), except for limited known and measurable changes like the expenses due to the commercial operation of new generation, specifically the West County Energy Center Units 1 and 2 in 2009. The result of Mr. Kollen's recommendations is that FPL's projected 2010 test year O&M expense should be reduced by $397.648 million, from $1,694.367 million to $1,296.719 million.[274] The breakdown of the $397.648 million reduction is as follows:

- "Status quo" reduction based on 2008 O&M expense levels, plus known and measurable changes (168.694)
- DOE Refund (9.000)[275]

[273] Tr. at 3115; *see also* MFR Schedules C-1 and C-36.
[274] Tr. at 3125.
[275] *See* Issue 108.

- Additional AMI Deployment Savings (5.666)[276]
- CIS Development (7.250)[277]
- Storm Damage Accrual (148.667)[278]
- Productivity Reduction (36.519)[279]
- Nuclear Staffing (21.852)[280]

ISSUE 129: Should FPL be permitted to collect depreciation expense for its new Customer Information System (CIS) prior to its implementation date?

POSITION: *No. The new CIS is not scheduled to be completed and operational until June 2012. Depreciation should not commence until the asset is in-service. This has a revenue requirement effect of $0.506 million.*

DISCUSSION:

The rebuttal testimony of FPL witness Ousdahl acknowledged that FPL erred by including CIS depreciation expense in rates prior to the time the new CIS is operational.[281] The adjustment reflected in Exhibit KO-16 for CIS depreciation expense should therefore be reflected in FPL's revenue requirement.[282]

ISSUE 130: Should FPL's depreciation expenses be reduced for the effects of its capital expenditure reductions?

POSITION: *Yes. The reduction in its capital expenditures necessarily will result in less depreciation expense. Therefore, depreciation expense should be reduced by $26.883 million, which will reduce FPL's revenue requirement by $26.719 million. See response to Issue 19C and Issue 50.*

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[276] *See* Issue 95.
[277] *See* Issue 129.
[278] *See* Issue 120.
[279] *See* Issue 101.
[280] *See* Issue 102.
[281] Tr. at 3714.
[282] Ex. 358.

ISSUE 131: Should any adjustment be made to Depreciation Expense?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. See SFHHA's response to Issues 19C and 19E.*

ISSUE 132: Should an adjustment be made to Taxes Other Than Income Taxes for the 2010 and 2011 projected test years?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. Payroll taxes should be reduced according to the SFHHA recommendations to reduce labor expense for productivity improvements and to eliminate the company's proposed increase in labor expense for the addition of 270 nuclear positions. See responses to Issues 101 and 102.*

ISSUE 133: Should an adjustment be made to reflect any test year revenue requirement impacts of "The American Recovery and Reinvestment Act" signed into law by the President on February 17, 2009?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. A $20 million subsidy is available pursuant to the act for advanced meters and smart grid investment, which should be reflected in FPL's revenue requirement. In addition, there may be other benefits resulting from the stimulus bill that FPL should record as a regulatory liability. At a minimum, the Commission should reflect a $20 million grant available to FPL to reduce the costs of advanced meters and other smart grid investment.*

DISCUSSION:

The American Recovery and Reinvestment Act ("Stimulus Bill"), signed into law on February 17, 2009, has resulted in significant revenue requirement impacts that should be reflected for the 2010 projected test year and, if approved, the 2011 test year. First, as FPL now recognizes, the Stimulus Bill resulted in tax benefits for FPL because the bill allowed FPL to extend bonus depreciation and deduct additional tax depreciation in the amount of $884 million.[283] This provision resulted in increased ADIT benefit, which should be recognized in the

[283] Tr. at 3708.

2010 and 2011 revenue requirement. SFHHA supports recognition of the ADIT benefit in any revenue requirement that the Commission approves.

In addition, as SFHHA witness Kollen testified, the Commission should recognize that FPL is likely to receive at least $20 million in benefits from Stimulus Bill grants for the DOE's Smart Grid Investment Program.[284] FPL opposed any recognition of grant funds in its revenue requirement, claiming that receipt of the grants was speculative, and that its grant applications contemplated incremental advanced metering investment over and above what the company currently plans.[285] Although it was not known at the hearing that FPL would receive grant funding for its Energy Smart Florida Program, it has recently been announced that FPL is the recipient of a $200 million grant that would result in widespread advanced meter deployment on a quicker schedule than the company currently proposes. As such, receipt of the grant award is no longer speculative, and the Commission should take notice of FPL's grant award in this proceeding.[286]

Although FPL claims that its Energy Smart Florida programs contemplates incremental investment, it is now clear that, with wider-spread AMI deployment, there will be increased savings resulting from the deployment. It would be inappropriate for the full benefit of those savings to go only to the utility. Accordingly, the Commission should recognize at least a $20

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[284] Tr. at 3164.

[285] Tr. at 3400.

[286] *See* 90.202, Florida Statutes, listing "matters which may be judicially noticed," including "...(5) Official actions of the legislative, executive, and judicial departments of the United States ...(11) Facts that are not subject to dispute because they are generally known within the territorial jurisdiction of the court. (12) Facts that are not subject to dispute because they are capable of accurate and ready determination by resort to sources whose accuracy cannot be questioned." *See also* Order No. PSC-04-0395-PCO-TP at 3, n.2 (April 14, 2004) (holding "we reserve the right to reopen the record if at the conclusion of the proceeding we determine that the record is insufficient").

million reduction to FPL's proposed rate base associated with advanced meters deployment, which has the effect of reducing FPL's revenue requirement by $3.846 million.[287]

ISSUE 134: Should an adjustment be made to Income Tax expense?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: *Yes. Income tax expense should be adjusted for the effects of all other SFHHA recommendations.*

ISSUE 135: Is FPL's projected Net Operating Income appropriate?
A. For the 2010 projected test year in the amount of $725,883,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $662,776,000?

POSITION: *No. The company's proposed Operating Income is understated by the net effect of the revenue and operating expense issues identified by SFHHA, including the effects on income tax expense due to the rate base and capitalization issues identified by SFHHA.*

REVENUE REQUIREMENTS

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent-year adjustment.)

ISSUE 136: What are the appropriate revenue expansion factors and the appropriate net operating income multipliers, including the appropriate elements and rates, for FPL?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 137: Is FPL's requested annual operating revenue increase appropriate?
A. For the 2010 projected test year in the amount of $1,043,535,000?
B. If applicable, for the 2011 subsequent projected test year in the amount of $247,367,000?

POSITION: *No. Rather than increasing FPL's annual operating revenues, the Commission should reduce those revenues by $354.862 million.*

[287] Tr. at 3166.

DISCUSSION:

Rather than increasing FPL's annual operating revenues, the Commission should reduce those revenues by $354.862 million. The summary of SFHHA's recommended revenue requirements are provided on transcript page 3110.

COST-OF-SERVICE AND RATE DESIGN ISSUES

(A decision on the 2011-related items marked as (B) below will be necessary only if the Commission votes to approve FPL's request for a subsequent-year adjustment.)

ISSUE 139: Has FPL correctly calculated revenues at current rates for the 2010 and 2011 projected test year?
A. For the 2010 projected test year?
B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 140: Should FPL use a minimum distribution cost methodology (utilizing either a "zero intercept" or a "minimum size" approach) to allocate distribution plant costs to rate classes?

POSITION: *Yes. Each of the two approaches is designed to measure a "zero load cost" associated with serving customers. For instance, the conceptual basis for the zero-intercept method is that it reflects a classification of the distribution facilities that would be required to simply interconnect a customer to the system, irrespective of the kW load of the customer. Certain distribution costs are incurred due to the presence of a customer on the system, regardless of the demand of such a customer. The MDS methodology recognizes this cost responsibility in the classification and allocation of distribution facilities and expenses to rate classes. A demand related classification of distribution costs overstates the cost responsibility of large general rate schedules. *

DISCUSSION:

FPL currently classifies all distribution plant as demand-related, except for Account 369 Services and Account 370 Meters. Thus, with the exception of those two accounts, FPL charges customers for all distribution costs on per kW basis. Costs associated with Account 369 Services and Account 370 meters are charged on a customer basis.

In reviewing FPL's classification of distribution costs, Mr. Baron, on behalf of SFHHA, found significant problems. The most obvious issue related to FPL's assignment of responsibility for secondary poles. By allocating responsibility for the costs of the poles purely on a demand basis, FPL's cost-of-service study implicitly assigned each residential customer responsibility for the cost of only three one-hundredths of a single pole.[288] At the other end of the spectrum, FPL's cost-of-service study implicitly assigned each commercial class customer under rate schedule GSLD-2 responsibility for almost 19 poles.[289] Obviously, and as Mr. Baron testified, that result "just doesn't make sense."[290]

To more appropriately classify distribution facilities in a manner that will result in a reasonable allocation of costs, Mr. Baron recommended that the Commission adopt a Minimum Distribution System ("MDS") methodology for classifying certain distribution costs. Despite FPL's misleading description of the MDS methodology, it is clear that the MDS methodology would align cost responsibility with cost causation in a far superior method than the demand-related approach that FPL currently uses.

I. Description of the MDS methodology.

In opposing the MDS methodology, FPL witness Ender attempts to have the methodology dismissed as some sort of radical, irrational and incompetent approach to cost classification. For instance, he objects to it on the basis that "no utility builds to serve zero load."[291] So that the record is clear, it would be helpful to first describe the MDS methodology.

The MDS methodology is not a novel approach that Mr. Baron concocted for this case, nor is the MDS method some type of radical approach to cost classification. In fact, it is the

[288] Tr. at 1716.
[289] *Id.*
[290] Tr. at 1773.
[291] Tr. at 4076.

single method suggested for the classification of distribution costs in the Electric Utility Cost Allocation Manual published by the National Association of Regulatory Utility Commissioners ("NARUC") in 1992.[292] One of the leading contributors to that manual was Joe Jenkins, a former Florida PSC Commissioner.[293] Further, Mr. Baron testified that he has personal knowledge of the MDS method being used by public utility commissions in Wisconsin, Ohio, Kentucky, Virginia and Pennsylvania.[294] Clearly, the MDS is a well-accepted methodology.

Perhaps more importantly, the MDS methodology provides a logical approach to cost classification. The methodology "is designed to estimate the component of distribution that is incurred by a utility to effectively interconnect a customer to the system, as opposed to providing a specific level of power (kW demand) to the customer."[295] Thus, in applying the MDS method, there is an assumption that the minimum size of a component (applicable to conductors, poles and transformers) is "required to serve customers, irrespective of the ultimate level of demand of those customers."[296] In other words, the MDS method recognizes that a minimum-sized pole, conductor, cable, and transformer must be installed to provide service to a customer, whether that customer will take service at maximum or minimal levels.[297] Based on that recognition, the cost of the minimum distribution facilities is allocated on a customer basis,[298] and the costs beyond the minimum facilities are allocated on a demand basis.[299] This is a logical approach, because it is the portions of the facilities sized *above* the bare minimum that are installed to

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[292] *See* Ex. 271; Tr. at 1759, 1780. There are two approaches that can be used under the method, *i.e.*, the "zero intercept" or "minimum size" approaches. Tr. at 1714.

[293] *Id.* at p. 3.

[294] Tr. at 1780-81; *see also* Ex. 273.

[295] Tr. at 1714.

[296] Tr. at 1775.

[297] *See, e.g.*, Ex. 271 at 8.

[298] Tr. at 1775.

[299] *Id.*

provide customers with flexibility to increase their consumption, and the incremental costs of those portions of the facilities are properly allocated on a demand basis. This approach, as proposed by Mr. Baron, is significantly different from FPL's approach, which is "premised on an assumption that all distribution costs (except services and meters) vary directly with kW demand, without any fixed component that should be allocated on the basis of the number of customers in each class."[300]

II. FPL's methodology produces anomalous results.

The results of FPL's allocation methodology make clear that it is significantly flawed. As discussed above, FPL's allocation of cost responsibility for secondary poles produces absurd results. It simply cannot be true under any scenario that FPL needs an average of 19 poles to serve an individual commercial class customer under rate schedule GSLD-2, or that it can serve a single residential customer with only three one-hundredths of a single pole.

Further, the record is replete with evidence that explains the anomalous results that occur under FPL's classification methodology. As FPL's records show, it is experiencing inactive accounts at record levels.[301] The same is true of low-usage residential customers, defined as customers using between 1 and 200 kWh per month.[302] Mr. Baron testified that the increase in vacant homes is the primary reason that he proposed the MDS methodology.[303] He explained that the problem of vacant homes, which is the cause of the increase in inactive meters and low usage, has the effect of shifting significant costs to other ratepayers. As he explained:

> These vacant homes required investments by FPL in primary and secondary lines, poles, conduit and transformers. Yet, because the homes are vacant, the kW demand, which FPL's cost allocation method uses to allocate these

[300] Tr. at 1715.
[301] Exs. 405-410.
[302] *Id.*
[303] Tr. at 1757.

> distribution facilities to rate schedules are essentially allocated to other rate classes and not the residential rate class. The cost is not allocated to the residential class because there is little or no kW demand associated with a vacant home.[304]

The hypothetical discussed with Mr. Ender at pages 4144-41445 of the hearing transcript provides further evidence of this point. It shows that, even though FPL has installed certain facilities specifically to serve residential customers, those costs are being shifted to ratepayers in other customer classes under FPL's demand-related methodology due to vacant homes, which result in inactive meters and low usage. This effect violates the principle that cost responsibility should follow cost causation, because large commercial class customers are not responsible for the installation of, and receive no service from, the distribution facilities that FPL installs to serve residential customers.

Further, the hypothetical discussed at pages 4143-44 of the transcript also provides evidence that FPL's demand-related methodology does not result in customers incurring cost responsibility based upon their contribution to FPL's costs for distribution facilities. This hypothetical shows that two similarly situated customers would make different contributions to the cost of a pole based on their energy consumption. The customer using more energy would pay more for the pole than the customer that uses less energy. This is also an illogical result. The same pole would have to be installed regardless of the customers' relative usage levels. The MDS methodology recognizes that fact and allocates costs on that basis. The demand-related methodology used by FPL, however, completely ignores that fact and consequently allocates higher costs to customers with higher consumption levels, even though the higher consumption does not impose additional costs on the system.

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[304] Tr. at 1720.

These two hypotheticals, combined with the other evidence, demonstrate that the MDS methodology proposed by Mr. Baron for distribution facilities is superior to the method used by FPL, which results in a cost allocation that violates established principles of cost causation.

III. FPL's objections to the MDS methodology are invalid.

None of FPL's arguments against the MDS methodology are meritorious. FPL's first argument is that the Commission has never approved the use of the MDS methodology for an investor-owned utility ("IOU").[305] In approving the use of the methodology for Choctawhatchee Electric Cooperative, Inc. ("CHELCO"), the Commission explained that it had rejected the methodology in past cases with respect to IOUs "because of inconsistencies in the methodology and because it does not always reflect the way a utility incurs costs."[306]

The bases upon which the Commission has previously rejected the MDS methodology do not apply here. The specific inconsistency that the Commission referred to in *CHELCO* was discussed in *Gulf Power Co.*[307] In its final order in that case, the Commission noted that "customers served at primary voltage through dedicated substations, and customer[s] served at higher voltages would not pay for any of [the] network path.[308] However, Mr. Baron has not proposed that any customers be excused from paying for their fair share of transmission facilities on a demand-basis, as proposed by FPL. Thus, the apparent inconsistency identified in *Gulf Power Co.* is irrelevant to Mr. Baron's proposal. Also, in contrast to the circumstances the Commission faced in *Gulf Power Co.*, as shown above, Mr. Baron's proposal accurately reflects the way FPL incurs costs. FPL's cost-classification methodology, in contrast, ignores the way that FPL incurs costs for conductors, transformers and poles.

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[305] Tr. at 4075.

[306] Order No. PSC-02-1169-TRF-EC at 3.

[307] Order No. PSC-02-0787-FOF-EI.

[308] *See id.* at 78.

FPL next argues that the MDS method assumes that a certain investment in transformers, conductors and poles is required to connect customers, whereas FPL plans its distribution system based on kW load requirements, not customers served.[309] That argument is doublespeak. Load requirements are an outgrowth of the type and number of customers served. Thus, just as FPL's unique customer base plays a role in generation planning, as confirmed by Mr. Hardy, it implicitly plays a role in FPL's distribution planning as well. Whether the planning process is deemed to take into account "load requirements" or "customers" is simply semantics.

FPL also insinuates that the MDS methodology should not be applied to FPL because FPL serves a dense urban area.[310] However, as Mr. Baron explained, customer density may influence the particular balancing of classification, but customer density does not dictate the method used for classification.[311] Mr. Baron's testimony is corroborated by exhibit 273, which shows that other state utility commissions have applied the MDS methodology to a variety of utilities, including those that serve densely populated urban areas.

FPL also errs in contending that the MDS method would result in double-counting.[312] FPL witness Ender bases this contention on his claim that the RS-1 and GS-1 rate classes would first be allocated their cost of minimum load transformers based on the number of customers in those rate classes, but would then be charged the remaining cost of the transformers based on maximum customer peaks, without any adjustment for the portion of the maximum customer peaks provided by the minimum load transformer.[313] That argument is off-base, however, because it is only the incremental cost *above* the cost of the minimum transformers (the residual)

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[309] Tr. at 4076.
[310] *Id.*
[311] Tr. at 1781-1782.
[312] Tr. at 4077.
[313] *Id.*

that would be charged on a demand basis.[314] And because the charge would be demand-based, the residual costs would be picked up by all customer classes. Thus, there is no double-counting. Rather, the MDS methodology produces results that are consistent with the recognition that customers that contribute to the need for facilities to serve peak load should pay for their portion of the costs of those facilities.

FPL next argues that the fact that the MDS methodology is used in other jurisdictions should not be a decisive factor in favor of applying that method in Florida.[315] Whether it should be the "decisive" factor is not the point. The fact is that the methodology has been applied in Florida only in *CHELCO*, and apparently based on the record developed in past cases, the Commission appears to have been mislead into believing that the MDS methodology is some sort of aberrant theory. This is a misconception, as proven by the fact that the MDS method has been applied by other state utility commissions. And while the Commission is certainly not bound by the rulings of other state commissions, it is entirely appropriate for the Commission to take cognizance of the actions of those commissions and to adopt, where it deems appropriate, the best practices of other commissions.

Finally, FPL criticizes Mr. Baron's proposal because he has not conducted an independent analysis of FPL's distribution plant accounts, and instead relied upon data from other utilities.[316] This argument also should be rejected. By averaging the results of applying the MDS methodology to the other utilities, Mr. Baron has derived a reasonable way to approximate the appropriate classification on FPL's system. FPL introduced no evidence that shows that Mr. Baron's proposed determination of customer and demand charges is unreasonable.

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[314] *See, e.g.*, Tr. at 1775.

[315] Tr. at 4077.

[316] Tr. at 4077-4078.

ISSUE 141: What is the appropriate Cost-of-service Methodology to be used to allocate base rate and cost recovery costs to the rate classes?

POSITION: *FPL has proposed the use of the 12 CP and 1/13th average demand methodology to allocate base rates and cost recovery to FPL's rate classes. Although the Commission has required the use of that methodology in the past, it is clear that the facts do not support its continued use. The undisputed evidence (consisting in major part of the testimony of FPL's own witnesses) establishes that the continued use of that methodology would not align cost responsibility with cost causation. The undisputed evidence, including the testimony of FPL's own witnesses, also establishes that the continued use of 12 CP and 1/13th average demand methodology will send inaccurate price signals. In contrast, the evidence establishes that the summer CP Methodology proposed by SFHHA witness Baron properly will align cost causation with cost responsibility, will send accurate price signals and should be adopted due to the unique circumstances on FPL's system.*

DISCUSSION:

I. Background.

FPL witness Ender testified in support of the 12 CP and 1/13th methodology. Under that methodology, Mr. Ender stated that approximately 92% of the costs of production plant are allocated to individual rate schedules based upon their contribution to the average 12 monthly coincident peaks on FPL's system.[317] The remaining 8% is allocated on the basis of energy, or kWh used.[318] The only support in Mr. Ender's direct testimony for the use of the 12 CP and 1/13th methodology consisted of his statements that MFR E-1 requires the use of a 12 CP and 1/13th methodology for production plant,[319] and that the 12 CP and 1/13th methodology has a significant history of acceptance in Florida.[320]

In his answering testimony, SFHHA witness Baron opposed FPL's use of the 12 CP and 1/13th methodology. Mr. Baron explained that a 12 CP method allocates production costs under

[317] Tr. at 4055, 4110.
[318] *Id.*
[319] Tr. at 4055
[320] Tr. at 4056.

an assumption that each of the 12 monthly coincident peaks contribute equally to the need for FPL's incurrence of the costs of generating units.[321] In other words, a 12 CP methodology presumes that a customer's incremental demand at the time of the annual coincident peak is no more costly to the system than the same amount of incremental demand in a "shoulder" month.[322] Mr. Baron testified that FPL's customer demand peaks during the summer months, and that customer demand during the summer peak months is the primary cause of FPL's need to add generating capacity and incur the associated costs.[323] Accordingly, he concluded that because customer on-peak usage is driving the need for new capacity on the system, customer on-peak usage should form the basis for assigning cost responsibility to FPL's rate schedules.[324] Thus, he recommended that a summer coincident peak method be used to assign cost responsibility because this method would recognize the factors that are actually driving capital expenditures on FPL's system.[325] He testified that the 12 CP and 1/13th methodology, in contrast, incorrectly assumes that customer behavior during any of the 12 months is equally responsible for the need for FPL to acquire new generating facilities to meet demand, which is not supported by FPL's own data.[326]

Mr. Ender addressed Mr. Baron's proposal in his rebuttal testimony. In that testimony, Mr. Ender claimed that "[t]he 12 CP and 1/13th methodology accurately reflects FPL's generation plan . . . ."[327] He sought to justify that claim based on three arguments, claiming that the 12 CP and 1/13th methodology:

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[321] Tr. at 1704.
[322] Tr. at 1704-1705.
[323] Tr. at 1705.
[324] Tr. at 1708.
[325] Tr. at 1711.
[326] Tr. at 1709.
[327] Tr. at 4069.

> (1) recognizes that the type of generation unit selected is influenced by both energy and peak demand, (2) reflects the influence of the summer reserve margin, and (3) recognizes that capacity must be available throughout the year to meet FPL's winter reserve margin and the annual loss-of-load probability (LOLP) criteria in FPL's resource planning process.[328]

He further claimed that the summer CP methodology proposed by Mr. Baron: (1) is inconsistent with FPL's generation planning process; (2) does not send a better price signal than the 12 CP and 1/13th methodology; and (3) would allocate no production costs to certain rate classes (which he suggests is a requirement).[329] Mr. Ender also claimed that a summer CP methodology would suggest a system consisting of nothing but peaking units.

As explained below, the evidence, including live testimony of Mr. Ender himself, unambiguously refutes each of the justifications in support of the 12 CP and 1/13th methodology, and each of the arguments against using a summer CP methodology.

II. FPL is a summer peaking utility.

It is undisputed that FPL is a summer peaking utility, and Mr. Ender admitted that fact at the hearing:

> Q. Historically, has FPL been a summer peak -- summer peaking system?
>
> A. . . . To my knowledge, yes.[330]

Mr. Hardy also volunteered the observation that "FPL is traditionally a—their highest load periods are in the summer,"[331] and Mr. Pollock also confirmed this:

> Q. [Y]ou'd agree with me that FPL is a summer-peaking utility, correct?
>
> A. Absolutely. In fact you can see that on my Exhibit JP-5 very clearly the summer peaks is shown in the bar graph. The summer peaks stand out very, very clearly, making FPL a very strongly summer-peaking utility.[332]

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[328] *Id.*

[329] Tr. at 4070, 4072.

[330] Tr. at 4113.

[331] Tr. at 6301-6302.

[332] Tr. at 3023.

The evidence also supports that conclusion.[333] The cited pages of the attachments to the MFRs establish that for the years 2005 through 2008, the monthly coincident peaks were higher in the months of June through September than in any other months of the year.[334] Further, FPL is forecasting that the same relationship will exist through 2011.[335] FPL is also forecasting that the highest CP in 2010 and 2011 will be in August of each year.[336] Thus, the evidence unequivocally shows that, year after year, FPL experiences and expects to continue experiencing its highest coincident peaks in the months of June, July, August and September. FPL is therefore a summer peaking utility.

III. FPL has no need to add generating capacity to satisfy its winter reserve margin or annual LOLP criteria.

The fact that FPL is a summer peaking utility is significant, and the extent to which FPL has built generating plants to serve that summer peak refutes virtually all of the arguments that Mr. Ender raised in support of the 12 CP and 1/13th methodology, and in opposition to Mr. Baron's proposed summer CP methodology. As indicated above, Mr. Ender bases his support for the 12 CP and 1/13th methodology in part on his claim that it recognizes that capacity must be available throughout the year to meet FPL's winter reserve margin and the annual LOLP criteria in FPL's resource planning process. However, the undisputed evidence refutes Mr. Ender's claim.

The highest coincident peak that has been recorded on FPL's system was 22,361 MW on August 17, 2005.[337] Obviously, FPL had capacity available to serve that peak.[338] The highest

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[333] *See* page 1 of 25 of Attachment 2, page 1 of Attachment 3 and page 1 of Attachment 4 to MFR E-11 for the 2010 test year and page 1 of MFR E-18 for the 2011 subsequent year.

[334] *See also* Tr. at 4115-4117.

[335] *See* MFR Schedule E-18 at 2; Tr. at 4117-19.

[336] MFR Schedule E-18 at 2; Tr. at 4125-4126.

[337] *See* MFR Schedule E-11, Attachment 2 at 1, Attachment 3 at 1, and Attachment 4 at 1 for the 2010 test year; *see* MFR Schedule E-18 at 1 for the subsequent 2011 year; *see also* Tr. at 4121.

winter peak that FPL is forecasting for the 2009-2010 winter is 18,790 MW, and the highest winter peak that FPL is forecasting for the 2010-2011 winter is 19,120 MW.[339] Both forecasts are far below the August 2005 record peak.

More significantly, it is clear that FPL does not need to build any new capacity to serve those winter peaks. Its most recent Ten-Year Site Plan, in fact, shows that FPL will have winter reserve margins of 53.1% for the 2009 winter and 58.2% for the 2010 winter.[340] Both of those margins are far above FPL's 20% reserve margin.[341] Further, FPL is forecasting winter reserve margins between 46% to 38.2% from 2011 through 2018, and that does not include capacity that may be available to FPL through its power purchase agreements ("PPAs").[342]

Based upon this evidence, Mr. Ender admitted that FPL does not need to add new capacity to serve the winter reserve margin through 2018.[343] Thus, it is clear that FPL is not making capital investments in generation plants to serve its winter peak load. On the other hand, Mr. Ender admitted that FPL *is* adding capacity in order to be able to maintain a 20% summer reserve margin.[344] This was also confirmed by Mr. Pollock:

> A. Clearly, when you look at the ten-year site plans and their planning process, the summer peak loads are consistently projected to be the highest in the year and are the driver for determining how much capacity is needed to maintain a reliable system.
>
> Q. Right. So in other words, you'd agree that the capital costs that FPL is incurring to add generation, that those capital costs are to meet the summer coincident peak requirement, right?
>
> A. Certainly the utility needs the capacity to meet the summer peak, yes. . .

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[338] Tr. at 4121.

[339] MFR E-18 at 2 and Tr. at 4125-4126.

[340] Ex. 483 at Bates page 068862.

[341] Order No. PSC-99-2507-S-EU at 3-4.

[342] Ex. 483 at Bates page 068862

[343] Tr. at 4130-4131.

[344] Tr. at 4132.

> Q. FPL is not incurring capital costs to meet the average coincident peak on its system, right?
>
> A. I would agree. I don't believe, when you look at the load characteristics and the maintenance characteristics, it's pretty clear that the winter period -- the non-summer period is not really driving the need for capacity.[345]

Thus, there is no evidentiary support for Mr. Ender's claim that the need to meet FPL's winter reserve margin and the annual LOLP criteria in FPL's resource planning process play a role in FPL's construction of new generating capacity or causes the associated capital costs. In fact, the undisputed evidence (including Mr. Ender's own admissions) shows the exact opposite—that FPL has no need to add generating capacity to satisfy its winter reserve margin or annual LOLP criteria. Instead, FPL's determination that it needs additional capacity is driven solely by FPL's need to satisfy its summer peak requirement.[346]

IV. The 12 CP and 1/13th Methodology does not reflect the influence of the summer reserve margin and sends inaccurate price signals.

The undisputed evidence also refutes Mr. Ender's claims that the 12 CP and 1/13th methodology reflects the influence of the summer reserve margin and sends a price signal that is as accurate as the price signal sent by the summer CP methodology.

Mr. Ender expressly agreed that the 12 CP and 1/13th methodology allocates the cost of production plant to rate classes based upon their contribution to the ***average*** of the 12 coincident peaks.[347] In doing so, the 12 CP method presumes that a residential or general service customer's incremental demand at the time of the August system coincident peak is no more "costly" to the system than the same amount of incremental demand at the time of the October or April FPL peak.[348] Thus, as Mr. Baron explained, the 12 CP and 1/13th methodology "sends

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[345] Tr. at 3024-3025.

[346] Tr. at 1705.

[347] Tr. at 4133-4134.

[348] Tr. at 1704-1705.

price signals to customers that adding demand during any of the monthly peaks throughout the year costs the same to the company."[349] It also "attributes the same impact to peak demand during off-peak months such as October or April as it does during peak summer months, [and as a result] does not recognize the actual causation of the need for capacity additions on the system."[350] Accordingly, the 12 CP and 1/13th methodology masks the significance of the summer peak, ignores the need for generating capacity to meet summer reserve margin requirements, and fails to account for the fact that the need for generating capacity to meet summer reserve margin requirements is *the* factor that is causing FPL to incur billions of dollars in capital costs for new generating plants.

Thus, as Mr. Baron demonstrated, "FPL is 'telegraphing' its customers through cost allocation and rate design that the 'cost' of customer decisions associated with the next unit of consumption during March or October is equally responsible for this new capacity cost as the next unit of consumption during August at the time of the system peak."[351] Accordingly, FPL is not sending an accurate price signal. And in contradiction to Mr. Ender's claim to the contrary, the price signal sent by the 12 CP and 1/13th methodology is not as accurate as the price signal sent by Mr. Baron's proposed summer CP methodology.[352]

V. The 12 CP and 1/13th methodology is inconsistent with FPL's planning process.

The evidence also refutes Mr. Ender's claim that the 12 CP and 1/13th methodology recognizes that the type of generation unit selected is influenced by both energy and peak demand. That claim is refuted by another FPL witness, Mr. Hardy.

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[349] Tr. at 1705.

[350] Tr. at 1706.

[351] Tr. at 1710.

[352] *See infra* Tr. at 3026.

FPL witness Hardy is the Vice President of Power Generation Operations.[353] In that capacity, he is responsible for overall management and direction of FPL's non-nuclear generating fleet.[354] He testified that FPL's unique customer base (largely residential) results in a load profile of high peak loads during the day, and very low loads during evening and early morning hours.[355] He also testified that FPL experiences "very, very low valleys" in shoulder months.[356] He further explained that the phenomenon of high loads during the day, with low loads at night, also results in FPL cycling its units "quite often," even in the summer peak months.[357] Mr. Hardy also testified that that the high number of swings between peaks and valleys causes FPL to cycle its units in an increasing amount,[358] and explained that the high degree of cycling is the driver in FPL's addition of efficient combined cycle generating units.[359]

FPL's planning process, which anticipates the addition of combined cycle units, has no relationship to the 12 CP and 1/13th methodology. As previously indicated, the 12 CP and 1/13th methodology assigns costs based on each rate class's contribution to the average system peak.[360] But the need for FPL to serve its average system peak is not the driving factor behind either FPL's need for generating capacity or the type of generating units it is adding. Instead, the need for additional capacity is driven exclusively by FPL's need to serve its summer peak.[361] Further, FPL's selection of combined cycle units is driven by the need to cycle units on and off, which has nothing to do with serving average peak load. Thus, there is no nexus between FPL's

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[353] Tr. at 6234.
[354] *Id.*
[355] Tr. at 6266; 6296.
[356] Tr. at 6298.
[357] Tr. at 6302.
[358] Tr. at 6296.
[359] *Id.*
[360] Tr. at 4133-34.
[361] *See* Sections II and III, *supra*.

determination to add combined cycle units and Mr. Ender's claim that the 12 CP and 1/13th methodology recognizes that the type of generation unit selected is influenced by both energy and peak demand.

VI. MFR Schedule E-1 does not require the commission to adopt the 12 CP and 1/13th methodology.

Mr. Ender's suggestion that MFR E-1 requires the Commission to adopt a 12 CP and 1/13th methodology is also incorrect. MFR E-1 does require a utility to file a cost-of-service study that allocates production and transmission plant on the average of the 12 CP and 1/13th methodology.[362] However, MFR E-1 also contemplates that a utility is free to propose the use of an alternative methodology.[363] The requirement of MFR E-1 in no way precludes the Commission from adopting an alternative to the 12 CP and 1/13th methodology.

VII. A summer CP methodology is consistent with FPL's planning process and aligns cost causation with cost responsibility.

Every witness who testified in this case on a cost-of-service methodology testified that FPL's need to serve its summer peak is driving the need for new resources on FPL's system. As Mr. Baron testified, "the driving factor in the addition of new generating capacity on the FPL system is the peak demand during the summer months."[364] Mr. Pollock agreed:

> Q. . . . So in other words, you'd agree that the capital costs that FPL is incurring to add generation, that those capital costs are to meet the summer coincident peak requirement, right?
>
> A. Certainly the utility needs the capacity to meet the summer peak, yes.[365]

And even Mr. Ender agreed:

> Q. . . . Would you agree that you have acknowledged . . . that . . . "FPL's projected need for additional resources is currently driven by the summer reserve margin criterion?

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[362] Tr. at 4119-4120; *see also* MFR Schedule E-1 at 1.

[363] Tr. at 4120; MFR Schedule E-1 at 1.

[364] Tr. at 1705.

[365] Tr. at 3024.

A. That is correct.[366]

Every witness who testified in this case regarding the cost-of-service methodology issue also testified that Mr. Baron's proposed summer CP methodology would assign costs to rate schedules based upon each rate schedule's contribution to the summer coincident peak:

> Baron: I recommend a summer coincident peak method because it recognizes the factors that actually are driving capital expenditures on FPL's system.[367]
>
> A. Yes. I'm recommending an alternative method, the summer coincident peak method.
>
> Q. And what is the basis for that?
>
> A. The basis, excuse me, the basis is that the, that the system peak on FPL's system that occurs in the summer during August is the driver for the need for capacity addition. The company has a planning criteria which is comprised of a, meeting a 20 percent summer reserve margin. That's the amount of excess additional capacity over and above the summer peak, a similar reserve margin criterion for the winter peak, and to some extent a, what's called a loss of load probability criterion. But the primary factor based on the information that I have reviewed is the summer peak in driving the need for capacity addition.[368]
>
> Q. (Pollock): Now, would you agree that under Mr. Baron's methodology, FPL would allocate the cost of production plant to each rate schedule based upon that rate schedule's contribution to the summer coincident peak?
>
> A. That's correct.[369]
>
> Q. (Ender): I think you've agreed that Mr. Baron's methodology would allocate the cost of production plant to rate [schedules] based upon their contribution to the summer coincident peak, right?
>
> A. That is what Mr. Baron is proposing.[370]

Thus, the summer CP methodology aligns cost causation with cost responsibility to by reflecting the fact that FPL is adding capacity specifically to meet its summer reserve requirement. As Mr. Baron testified:

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[366] Tr. at 4124; *see also* Tr. at 4071, 4132.

[367] Tr. at 1711.

[368] Tr. at 1749-1750.

[369] Tr. 3023-3024.

[370] Tr. 4132.

> Q. So your position would be that the causer of that summer peak ought to, ought to bear more of the responsibility for that; is that essentially correct?
>
> A. Yes. Yes. From a cost causality standpoint, that's correct.[371]
>
> Q. And just in terms of cost allocation, what's the significance of the fact that, that it's the summer peak that's driving the addition of generation capital additions onto FPL's system?
>
> A. Essentially what it means is that customer usage during the summer months, the on-peak periods during the summer months, is the primary factor that is causing the need for new generating capacity and thus the costs that are, that the company is requesting recovery from in this case among others. And so if you're doing, preparing a cost-of-service study that tries to identify the cost causation of customer behavior versus the actual dollars on the company's books, the summer peak is the predominant factor in my view that drives that need.[372]

This testimony proves that, contrary to Mr. Ender's claim, Mr. Baron's proposed summer CP methodology is consistent with FPL's planning process. It is the 12 CP and 1/13th methodology that does not take FPL's planning process into account.

Further, by allocating an appropriate share of costs to rate schedules that cause high loads during the day and low loads at night, which is the effect of Mr. Baron's summer CP methodology, the summer CP methodology also properly assigns cost responsibility to the rate schedules that cause FPL to install combined cycle units. High load factor customers, like hospitals, that take service on a fairly flat basis over the 24-hour period do not contribute to the need for the extensive cycling that takes place on FPL's system,[373] and the summer CP methodology produces results that are consistent with that understanding.

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[371] Tr. 1750.

[372] Tr. 1785.

[373] *See* Tr. 6368-6369.

VIII. The summer CP methodology would send more accurate price signals than the 12 CP and 1/13th methodology.

Contrary to Mr. Ender's claims, the testimony excerpts in the previous section also show that the price signal sent by the summer CP methodology is more accurate than the price signal sent by the 12 CP and 1/13th methodology. The price signal sent by the 12 CP and 1/13th methodology is inaccurate because it sends the false message that an incremental addition to consumption in a shoulder-month is as costly to the system as an incremental addition to consumption in the summer peak months. The summer CP methodology does not suffer from that same error and therefore sends a far more accurate prices signal. That is because, as shown above, the summer CP methodology assigns cost responsibility to rate schedules based upon their contribution to FPL's need to make capital expenditures to add generation.[374] As a result, Mr. Pollock admitted that the summer CP methodology sends a better price signal that the 12 CP and 1/13th methodology.[375]

IX. Mr. Ender's other criticisms of the summer CP methodology also are invalid.

Mr. Ender's two remaining arguments in opposition to the summer CP methodology are also invalid. One of those arguments is his contention that the summer CP methodology would not allocate any costs of production plant to two rate schedules: OL-1, which applies to outdoor lighting, and SL-1, which applies to street lighting.[376]

While it is true that those rate schedules would not be allocated any costs under the summer CP methodology, it is important to consider both the reasons for and the impact of that result. The reason those classes would not be allocated costs is that their load profile is fairly flat

[374] Tr. at 3026.
[375] *Id.*
[376] Tr. at 4134-4135.

on an annual basis, since their usage is not tied to weather. In addition, because customers under those rate schedules take service mainly at night, they provide a benefit to the system by putting load on the system when customers under other rate schedules are reducing their load. Finally, and most significantly, because of the minimal consumption by the customers under the OL-1 and SL-1 rate schedules, the impact of the allocation on other rate schedules is virtually non-existent. On a combined basis, the OL-1 and SL-1 rate classes would be responsible for a total of $31 million of almost $13 billion under the 12 CP and 1/13th methodology.[377] So the difference between the allocation of costs under the summer CP methodology and the 12 CP and 1/13th methodology is a total of two-tenths of one percent.[378] To treat this as a relevant factor in selecting a methodology, let alone a determinative factor, would truly be a case of the tail wagging the dog.

Finally, the evidence also refutes Mr. Ender's claim that Mr. Baron's proposal suggests that FPL's resources should consist solely of gas turbine peaking units.[379] For starters, Mr. Baron never suggested that FPL, or any electric utility, could operate by running nothing other than combustion turbine peaking units. Such a strategy would not be cost-effective and is implausible. Notwithstanding, Mr. Ender has no qualifications to suggest what type of generating units FPL should add to its system. He admitted that he is not an engineer.[380] He has no responsibilities for deciding how much capacity should be added to FPL's generating fleet.[381] His responsibilities also do not include deciding what type of generation FPL should have.[382] He also admitted that he is not qualified to advise FPL on the type of generation it should add from

[377] Ex. 374.
[378] Tr. at 4136.
[379] Tr. at 4071.
[380] Tr. at 4109.
[381] *Id.*
[382] *Id.*

an operational standpoint.[383] Thus, he has no qualifications or job responsibilities that would allow him to offer an opinion as to what type of generating units would be implicated by one methodology or another. Mr. Baron's proposal assigns costs to ratepayers in a manner that is consistent with FPL's addition of highly efficient combined cycle generating units to meet the swings on FPL's system caused by its unique customer base.

ISSUE 142: How should the change in revenue requirement be allocated among the customer classes?

POSITION: *FPL should be required to implement a measure of gradualism because of the significant increase in its revenue requirement and the economic environment. FPL should be required to limit increases to rates such that no rate schedule receives more than 1.5 times the average percentage increase in base rates and no rate schedule receives a rate decrease in base rates. This is consistent with prior Commission precedent.*

DISCUSSION:

Given the economic conditions that exist in the nation in general, and in Florida in particular, it is unclear whether FPL's proposed $1.3 billion increase to base rates is the product of corporate arrogance or, more benignly, reflects a corporation that is out of touch with its customers (be they big or small). What is clear, however, is that the manner in which FPL has proposed to allocate its proposed increase among rate classes was not simply a coincidental side-effect of FPL's overall request to raise rates. The evidence shows that FPL's proposed cost allocation is part of an attempt by FPL to permanently shift cost responsibility in a fundamental way that, in conjunction with its GBRA proposal, would lead to ever-increasing over-contributions by commercial class customers to FPL's cost-of-service and return, and would create significant over-recoveries for FPL. Thus, if the Commission were to adopt FPL's

[383] *Id.*

proposal, there will be a strategically widening gap in cost allocation among the various rate classes that will create substantial economic benefits for FPL.

Mr. Baron's proposed summer CP methodology and MDS approach offset FPL's desired result to some extent. However, to fully prevent the consequences that FPL seeks, the Commission should follow its long-standing policy to implement a measure of gradualism in resetting rates. Consistent with its ruling in the *TECO* case, the Commission should hold that no rate class will receive an increase greater than 1.5 times the total system average percentage increase.

I. Proposed rate increases by rate class.

FPL's proposed rate increase will have a monumental impact on all customer classes if it is approved. For example, FPL proposes to raise residential rates in 2010 by 20.8%. This is significant by any measure. Yet, the increase for residential customers pales in comparison to FPL's proposed increases to other rate schedules. For instance, FPL is proposing to increase CILC-1D base rates by 58.8%. Ratepayers under CILC-1T would receive a shocking 63.2% increase to base rates under FPL's proposal. GSLDT-1 ratepayers would receive a 50.7% increase. Ratepayers under the HLFT-2 rate schedule would receive a 58.1% increase. The percentage increases under these and all of FPL's remaining rate schedules can be seen in MFR E-13a.[384] The Commission should keep this backdrop in mind when considering whether FPL's proposed class allocation methodology is appropriate.

II. FPL's cost-of-service study is not reliable.

In considering the issue of cost allocation, the Commission should recognize at the outset that the evidence shows FPL's cost-of-service study to be unreliable. Mr. Baron has identified a number of anomalies in FPL's study. As explained previously, FPL's cost-of-service study

[384] *See also* Tr. at 4233-4235.

assigns cost responsibility for secondary poles to commercial class customers under the GSLD2 rate schedule based on an assumption that almost 19 poles are need to serve an individual customer, such that 657 poles would be needed to serve 35 customers under that rate schedule.[385] In contrast, for the residential class, FPL's study assumes that only three one-hundredths of a pole would be needed for an individual customer, or less than a single pole for 35 residential customers.[386] FPL's allocation of cost responsibility for secondary poles is facially absurd. It is simply implausible that FPL needs 19 poles to serve a single commercial class customer, regardless of its size, or that it can serve a single residential customer with only three one-hundredths of a single pole. This single error in FPL's cost-of-service study improperly shifts millions of dollars to commercial class customers.

FPL's parity results also are suspect. FPL's cost-of-service study showed actual parity results of 0.62 and 0.61 for the HLFT-2 rate schedule in 2006 and 2007, respectively.[387] However, FPL is projecting that for 2010 and 2011, the parity results for HLFT-2 would be only 0.34 and 0.35.[388] Similarly, FPL's cost-of-service study showed actual parity results of 0.66 and 0.60 for the HLFT-3 rate schedule in 2006 and 2007, respectively.[389] For 2010 and 2011, however, FPL is projecting parity results of just 0.36 in each year.[390] Similar anomalies occur in FPL's results for other rate schedules. For instance, the CILC-1D rate schedule had actual parity results of 0.87 and 0.83 in 2006 and 2007, respectively.[391] However, FPL is projecting parity

[385] Tr. at 1716.
[386] *Id.*; see also Tr. at 1782-1783.
[387] Tr. at 1722.
[388] *Id.*
[389] *Id.*
[390] *Id.*
[391] Tr. at 1724.

results of just 0.68 and 0.69 in 2010 and 2011.[392] Additional anomalies such as these are present in FPL's cost-of-service study related to the GSLD(T) rate schedules.[393]

Although FPL witness Ender submitted approximately four pages of rebuttal testimony that addresses this issue, he never actually presents evidence to explain any of the anomalies. Rather, he blandly claimed that the massive changes in parity results identified by Mr. Baron were "largely driven by projected changes in retail base rate and expenses."[394] He also claimed that load-related demand allocation factors, billing determinants and GBRA increases had small impacts on parity among rate classes."[395]

In addition to the fact that FPL offered no documents to back up these claims, other evidence produced during the proceeding shows that the claims are implausible. In particular, the evidence shows that consumption by commercial class customers (who would be served under the above-referenced rate schedules) has been growing in recent years, while consumption by residential customers has been shrinking. Specifically, exhibit 409 shows that residential sales in MWh dropped by approximately two percent from 2005 through 2008.[396] During the same time period, commercial class sales increased by almost five percent.[397]

There is no doubt that the Florida economy has played some role in the drop in residential sales. As can be seen from exhibits 405 through 408, FPL experienced negative sales growth for the first time in August 2008. Those exhibits also show that FPL has experienced rises in inactive meters and low-usage residential customers at record levels.[398] However, the economy

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[392] *Id.*

[393] *Id.*

[394] Tr. at 4085.

[395] *Id.*

[396] *See also* Tr. at 1030.

[397] *Id.*

[398] *See also* Tr. at 1015-1020; 1024-1029.

is not the only factor that has caused a drop in FPL's sales to residential customers. Another important factor is higher efficiency impacts that resulted from enhanced federal standards for appliances and lighting.[399] As a result, although FPL is projecting a resumption of cyclical growth by 2012,[400] it nonetheless is forecasting that growth in commercial customer consumption will far outstrip residential customer growth through 2018. In fact, FPL's most recent Ten Year Site Plan shows that FPL is forecasting residential customer growth in GWh sales of just six percent from 2009 through 2018.[401] However, it is forecasting commercial class growth in GWh consumed of about 30% in that same timeframe.[402] Further, FPL's projection of residential customer growth may be overstated, given the very modest population growth being forecasted by the Office of Economic & Demographic Research of the Florida Legislature.[403]

Thus, Mr. Ender's explanation does not correspond with the evidence. In particular, the evidence shows that commercial class customers are increasing their usage relative to residential customers, which translates to an increase in the parity rating for commercial class customers—not the decrease that FPL's study suggests took place. FPL's parity study also fails to account for factors like which classes are responsible for FPL's need to add generating capacity to serve summer peak requirements.[404]

When Mr. Baron ran a parity study to correct the errors in FPL's approach, the changes were significant. Mr. Baron's corrected study shows that the customers under many rate schedules that FPL claimed are under-contributing to FPL's costs are actually over-contributing. For example, FPL shows the CILC-1D rate schedule below parity at 0.67. However, Mr.

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[399] Ex. 410 at 068884.
[400] *Id.* at 068885.
[401] *Id.* at 068892; Tr. at 1035.
[402] *Id.* at 068892; Tr. at 1035-1036.
[403] *See* Ex. 411 at 111340; Tr. at 1037-1039.
[404] *See* discussion under Issue 141.

Baron's corrected study shows the CILC-1D rate schedule *above* parity at 1.16. Another example is rate schedule HLFT1. FPL claimed that rate schedule is below parity at 0.79, whereas Mr. Baron's corrected study shows the HLFT1 rate schedule well above parity at 1.18.

Another error in FPL's study concerns the residential rate class. While FPL concluded that the residential class is over-contributing, Mr. Baron's study, which corrected FPL's errors, actually shows that residential customers are being subsidized by the commercial class.[405] Particularly given that FPL's study is inconsistent with consumption patterns on FPL's system as shown above, the Commission should disregard FPL's cost-of-service study and FPL's claims that commercial class ratepayers are below parity.

III. FPL's proposal, if approved, will distort parity, improperly leading to increased earnings by FPL.

A critical element related to FPL's proposed class cost-of-service study is FPL's request that the Commission disregard its long-standing policy that no rate class should receive an increase greater than 1.5 times the system average percentage increase in total. FPL attempts to justify that request by claiming that it projects an overall decrease for most customers in 2010 and therefore, in its view, its proposal provides an opportunity to address inequities between rate classes at this time.[406]

FPL's reasoning is disingenuous. First and foremost, whether FPL's customers will receive an increase or decrease in their overall bills in 2010 as compared to 2009 is completely beside the point. As no one disputes, the sole reason some FPL customers may receive a decrease in their total 2010 bills as compared to their total 2009 bills is that fuel prices (the price of natural gas in particular) retreated from near record highs in 2008 to prices in 2009 that were

[405] Tr. at 1729.

[406] *See, e.g.*, Tr. at 4208-4209.

lower than they had been in five years.[407] This drop in natural gas prices has absolutely nothing to do with the amount of base rates or the allocation of cost responsibility to FPL's customers.

Mr. Olivera and FPL's other witnesses insist that the Commission should nonetheless take fuel prices into account in setting base rates.[408] While Mr. Olivera and FPL witness Deaton admitted that natural gas prices are volatile,[409] Ms. Deaton nonetheless testified that the Commission should not consider the volatility of natural gas prices in considering whether to approve FPL's proposed base rate increase, or in determining whether to limit increases to rate schedules to 1.5 time the system average increase.[410] This position is completely hypocritical, particularly given that natural gas represents approximately 70 to 80% of FPL's fuel costs.[411] It is even more egregious considering that FPL intends to fully reflect any increased fuel costs in customers' bills.[412] Contrary to FPL's contentions, the Commission should completely disregard fuel prices in making its decision in this case.

The Commission should, however, consider the long-term effects of FPL's proposed allocation of costs by taking into account FPL's forecasts of consumption on its system. As shown above, FPL is forecasting residential customer growth in GWh sales of just six percent, against 30% customer growth in commercial class GWh sales, from 2009 through 2018.[413] Therefore, until FPL files another rate case in which it would increase billing units for the commercial class to reflect the growth of that class's consumption relative to the residential class, the unit rate charged under commercial class rate schedules will be artificially high. This

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[407] Tr. at 338-339.
[408] Tr. at 249.
[409] Tr. at 252; Tr. at 4238.
[410] Tr. at 4239-40.
[411] *See* Tr. at 4237.
[412] Tr. at 4238.
[413] Ex. 410 at 068892; Tr. at 1035-36.

will lead to the commercial class bearing an increasing amount of FPL's costs, with the residential class bearing a much smaller part.[414] The result will be a widening gap between the portion of FPL's cost-of-service borne by commercial and residential customers. FPL's proposed allocation of costs, which fails to take into account the Commission's long-standing policy of limiting rate increases to 1.5 times the average increase on the system, will severely exacerbate that effect, and provides an additional reason for rejecting FPL's proposal.

IV. The Commission should adhere to its long-standing policy of limiting rate increases to 1.5 times the system average.

In its recent *TECO* decision, the Commission adhered to its long-standing policy that "[n]o rate class should receive an increase greater than 1.5 times the system average percentage increase in total, and no class should receive a decrease."[415] The Commission has applied that limitation for at least 30 years, even in the face of claims that some rate classes were far below parity.[416] As is demonstrated above, the evidence does not support FPL's request to depart from that limitation. To the contrary, the evidence shows that adherence to that limitation is all the more important here given the forecasted consumption pattern on FPL's system.

ISSUE 144: Are FPL's proposed service charges for initial connect, field collection, reconnect for non-payment, existing connect, and returned payment charges appropriate?

POSITION: No position.

ISSUE 145: Is FPL's proposal to increase the minimum late payment charge to $10 appropriate?

POSITION: No position.

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[414] *See, e.g.*, Ex. 484.

[415] Order No. PSC-09-0283-FOF-EI at 87, Order Denying and Granting Reconsideration in Part, No. PSC-09-0571-FOF-EI, Amendatory Order, No. PSC-09-0571A-FOF-EI.

[416] *See, e.g., Florida Public Utilities Company*, Docket No. 850172-GU; Order No. 16195, FPSC, 1986 Fla. PUC LEXIS 673, 86 FPSC 60 (June 6, 1986). *See also Florida Power & Light Company*, Docket No. 810002-EU (CR); Order No. 10306, FPSC, 1981 Fla. PUC LEXIS 179, 81 FPSC 240 (Sept. 23, 1981).

ISSUE 148: Are FPL's proposed termination factors to be applied to the total installed cost of facilities when customers terminate their Premium Lighting or Recreational Lighting agreement prior to the expiration of the contract term appropriate? (8.722 and 8.745)

POSITION: No position.

ISSUE 150: Is FPL's proposed Present Value Revenue Requirement multiplier to be applied to the installed cost of premium lighting facilities under rate Schedule Premium Lighting (PL-1) and the installed cost of recreational lighting facilities under the rate Schedule Recreational Lighting (RL-1) to determine the lump sum advance payment amount for such facilities appropriate? (8.720 and 8.743)

POSITION: No position.

ISSUE 152: Should FPL's proposal to close the relamping option on the Street Lighting (SL-1) and Outdoor Lighting (OL-1) tariffs for new street light installations be approved? (8.716 and 8.725)

POSITION: No position.

ISSUE 154: Is FPL's proposed monthly kW credit to be provided customers who own their own transformers pursuant to the Transformation Rider appropriate? (8.820)

POSITION: No position.

ISSUE 155: Is FPL's proposed monthly fixed charge carrying rate to be applied to the installed cost of customer-requested distribution equipment for which there are no tariffed charges appropriate? (10.010)

POSITION: No position.

ISSUE 156: Is FPL's proposed Monthly Rental Factor to be applied to the in-place value of customer-rented distribution substations to determine the monthly rental fee for such facilities appropriate? (10.015)

POSITION: No position.

ISSUE 157: Are FPL's proposed termination factors to be applied to the in-place value of customer-rented distribution substations to calculate the termination fee appropriate? (10.015)

POSITION: No position.

ISSUE 159: What are the appropriate customer charges?

POSITION: No position.

ISSUE 160: What are the appropriate demand charges?

POSITION: No position.

ISSUE 161: What are the appropriate energy charges?

POSITION: No position.

ISSUE 162: What are the appropriate lighting rate charges?

POSITION: No position.

ISSUE 163: What is the appropriate level and design of the charges under the Standby and Supplemental Services (SST-1) rate schedule?

POSITION: No position.

ISSUE 164: What is the appropriate level and design of charges under the Interruptible Standby and Supplemental Services (ISST-1) rate schedule?

POSITION: No position.

ISSUE 165: Is FPL's design of the HLFT rates appropriate?

POSITION: *No. The company's proposed revenue increases to rate Schedule HLFT for 2010 and 2011 are unreasonable, due to: 1) the use of the company's 12 CP and 1/13th average demand cost-of-service methodology to determine the increase, 2) the failure of the company to use a summer CP cost allocation methodology with a minimum distribution system classification method and 3) the failure of FPL to incorporate gradualism into its recommended rate schedule increases through the

use of a 1.5 times average increase limitation to the increase applied to each rate schedule. As proposed by FPL, the HLFT-2 rate would be increased by 58.1%.*

DISCUSSION:

See discussion of Issues 140, 141, and 142.

ISSUE 166: Is FPL's design of the CILC rate appropriate?

POSITION: *No. The company's proposed revenue increases to rate Schedule CILC for 2010 and 2011 are unreasonable, due to: 1) the use of the company's 12 CP and 1/13th average demand cost-of-service methodology to determine the increase, 2) the failure of the company to use a summer CP cost allocation methodology with a minimum distribution system classification method and 3) the failure of FPL to incorporate gradualism into its recommended rate schedule increases through the use of a 1.5 times average increase limitation to the increase applied to each rate schedule. As proposed by FPL, the CILC-1D rate would be increased by 58.8%.*

DISCUSSION:

See discussion of Issues 140, 141, and 142.

ISSUE 167: Is FPL's CDR credit appropriate?

POSITION: No position.

ISSUE 168: What is the appropriate method of designing time of use rates for FPL?

POSITION: No position.

ISSUE 170: Should FPL evaluate the merits of a prepayment option in lieu of monthly billing for those customers who can benefit from such an alternative? If so, how?

POSITION: No position.

OTHER ISSUES

ISSUE 173: Should an adjustment be made in base rates to include FPL's nuclear uprates being placed into service during the projected test years if any portion of prudently incurred NCRC recovery is denied?
A. For the 2010 projected test year?

B. If applicable, for the 2011 subsequent projected test year?

POSITION: No position.

ISSUE 177: Should this docket be closed?

POSITION: No position.

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CERTIFICATE OF SERVICE
DOCKET NO. 080677-EI

I HEREBY CERTIFY that a true and correct copy of **SFHHA'S POST-HEARING BRIEF** has been furnished by electronic mail and U.S. mail on this 16th day of November, 2009 to the following:

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