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Sent: Friday, November 30, 2012 4:27 PM
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Subject: Hendricks' Settlement Issues and Positions and Post-Hearing Brief
Attachments: Hendricks Settlement Brief & Positions Final.pdf

Electronic Filing

a. Person responsible for this electronic filing:

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b. Docket No. 120015-EI

In re: Petition for rate increase by Florida Power & Light Company

c. Documents being filed on behalf of John W Hendricks

d. There are a total of 2 pages, plus 2 pages for the Certificate of Service.

e. The document attached for electronic filing is: Electronic Filing

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b. Docket No. 120015-EI

In re: Petition for rate increase by Florida Power & Light Company

c. Documents being filed on behalf of John W Hendricks

d. There are a total of 9 pages, plus 2 pages for the Certificate of Service.

e. The document attached for electronic filing is HENDRICKS' SETTLEMENT ISSUES AND POSITIONS AND POST-HEARING BRIEF.

Thank you for your attention to this request.

DOCUMENT NUMBER-DATE
07950 NOV 30 ≌
FPSC-COMMISSION CLERK

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11/30/2012

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company.	DOCKET NO. 120015-EI FILED: November 30, 2012

John W. Hendricks, pursuant to Order No. PSC-12-0143-PCO-EI and ORDER No. PSC-12-0439-PCO-EI, files this Statement of Settlement Issues and Positions and Post-Hearing Brief.

BASIC POSITION

The proposed settlement package does have some desirable features, such as the GBRA's administrative efficiency and the Incentive Mechanism's focus on optimizing power and fuel assets that are in the rate base. Unfortunately, analysis of the proposed settlement reveals critical flaws which disqualify it from being in the public interest. It is not economically efficient and it is unbalanced in favor of the utility over its ratepayers, exposing ratepayers to hundreds of millions of dollars in excessive costs during the four year term of the proposed settlement, as described in the following pages.

The proposed settlement also favors large ratepayers over small ones. The most obvious symptom of this imbalance is that the Office of Public Council (representing the citizens of Florida) opposes the proposed settlement, and is joined in opposition by the Florida Retail Federation (representing many small, mid-sized and large businesses), while the three parties joining FPL in support of the settlement represent a very small number of large institutional power users, who would benefit disproportionately as the settlement shifts costs to residential and other smaller ratepayers. It is unlikely to be good public policy to accede to a take-it-or-

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leave-it settlement offer from very narrow special interests when it is opposed by representatives of the vast majority of ratepayers. Even if we leave aside all questions about legal or procedural issues and recognize that OPC (or any other participant in this case) cannot be an infallible guide to the public interest, this proposed settlement still merits a high level of skepticism by the Commission and Staff. Consider what the public and political reaction might be a few years from now, if a settlement approved in these circumstances turns out to deliver windfall profits to the utility at the expense of average ratepayers, or even appears to do so.

Before stating positions on the individual issues, I will summarize the negative financial effect on ratepayers of the proposed settlement that can be expected over the four year term as specified. I was prompted to offer this summary after listening to Commissioner Balbis' questions near the end of the hearing about "... what concessions is FPL getting with the settlement, that you would have not gotten through the regular process ...?,"[1] and Mr. Dewhurst's thoughtful response which included "So, again, I come back to saying that there is a degree of clarity over a multiple year period with the settlement agreement, including, in particular, the resolution of how the three, you know, roughly billion dollar each projects are going to be handled. I think there's value in that." [2]

This summary is intended to assemble the evidence in this case into building blocks for assessing the companion to the above question, "What would be the cost to ratepayers of implementing the proposed settlement, both incrementally in relation to the original FPL proposal and as a complete package including the unchanged terms of the original proposal?" It addresses the costs to ratepayers of the GBRA and incentive mechanism as specified in the proposed settlement. Note that all costs in this table are the estimated total over the four year

[1] Tr. at 6322.
[2] Tr. at 6324.

term of the agreement, except where otherwise specified.

PROPOSED SETTLEMENT COST DRIVER	COST ESTIMATE

- GBRA regulatory lag elimination[3]

  Incremental effect of settlement (Avg. 10.5 mo for RB, PE)[4] **$420 Million**

  Total effect, including Canaveral (Avg. 10.5 mo for CC, RB, PE)[5] **$565 Million**

- GBRA Excess tax-gross-op cost exposure if Federal corporate taxes are cut. (Worst case for excess gross-up is if Pres. Obama's proposed Fed corporate income tax cut to 25% goes into effect shortly after Riviera Beach goes online. Alternatives are shown because of lack of clarity about how adjustments could be handled after the first year revenue requirement is set based on the tax rates in effect when plant goes into service, given the restrictions on modifying rates in the proposed settlement.[6])

  If all rates auto-adjust immediately with a corporate income tax cut: **No Excess**

  If rates auto-adjust in year 2, year 1 excess gross-up for RB alone: **$ 12.5 Million**

  If rates don't auto-adjust, 2.5 yrs of excess gross-up for RB & CC: **$ 53 Million**

  If rates for existing rate base don't auto-adjust, excess gross-up: **$13 Million/Mo.**

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[3] Based on 10.5 months of typical regulatory lag as identified in the EEI report referenced in my settlement direct testimony (Ex. 693) and the revenue requirements provided by FPL (Ex. 676).

[4] Incremental effect of Riviera Beach and Port Everglades only, since Cape Canaveral is already covered by the step increase in the original FPL proposal.

[5] Covering the effects of the GBRA in the settlement as a whole, not just the incremental difference between the cost of the original FPL request and the new terms added by the settlement.

[6] See FPL response to my Data Request No. 13, which states "...the federal and state income tax rates in effect when a plant goes into service will be used to calculate the revenue requirement associated with the GBRA for that plant," and to Data Request No. 6, which states "The proposed Settlement Agreement contains no additional provisions [beyond those described in paragraph 9(b) on page 10 of S&S] under which parties could seek to modify the agreement before 2017. "

- GBRA tax-gross-up cost for excessive equity ratio[7, 8] (CC, RB, PE) **$ 55 Million**

- Incentive Mechanism excessive FPL share of savings vs. a flat 20% sharing:

  (If total savings per year of $100 Million is achieved) **$ 98 Million**

  (If total savings per year of $200 Million is achieved) **$218 Million**

The estimated cost to ratepayers of funding the "GBRA regulatory lag elimination" alone is well above the $400 Million reduction offered in the settlement from reducing the regulatory ROE to 10.7% from the 11.25% that FPL requested in the original rate case, and even exceeds reduction offered by FPL's comparison that includes the optional "performance adder." The cost to ratepayers for excessive equity ratios are also substantial, and any amount of excessive gross-up in the wake of federal corporate income tax reductions during the term of the proposed settlement would be inappropriate and a potentially explosive issue. The incentive mechanism does address what may be an important opportunity to improve efficiency, but the 70% to 50% share for FPL above a relatively low fixed threshold is very dangerous. The argument for broadening the scope of the current incentive is reasonable, but offering a 50% share of gains while ratepayers cover all the incremental expenses and the utility is already earning a 10.7% return on the assets being optimized is practically an invitation to create windfall profits. The "private knowledge" that a utility operator has about his own costs and opportunities makes it

[7] Ex. 693 showing a more tax-efficient 50% equity ratio and assumption that CC is operational 6/2013, RB is operational 6/2014 and PE is operational 6/2016.

[8] The 50% equity ratio is supported by FPLs extensive comparisons of this settlement with the recent Progress Energy settlement, which has a similar ROE paired with an equity ratio of 50.25% , as shown in Order PSC-12-0104-FOF-EI. Also, the average equity ratio for all 2012 US rate cases as shown in Exhibit 689 is 51.35%. The determinations of need for all of the GBRA-eligible facilities also show a lower equity ratio than is specified for the GBRAs in the proposed settlement, indicating it is excessive in this case.

dangerous to accept a proposed unlimited 50% share for an opportunity that could be very large. An expanded incentive mechanism with a 20% share (as in the current mechanism) and a reasonable floating threshold would offer a serious incentive, but direct most of the benefits from using the assets in the rate base to the ratepayers.

When the cost to ratepayers of the settlement provisions are added up and compared with its advantages, the proposed settlement appears no better, and probably worse than the original FPL proposal. If we assume that the real comparison should not be with 100% of the FPL proposal, but with that proposal as likely to be modified by a fair and reasonable decision of the Commission (after rejecting the take-it-or-leave-it settlement offer), the case for rejecting the settlement is even stronger. A more reasonable version of the incentive mechanism and a GBRA adjusted to recognize the substantial cost to ratepayers and value to the utility of eliminating the average regulatory lag could make a truly win-win result.

Unfortunately, the proposed settlement also favors large ratepayers over small ones. The most obvious symptom of this imbalance is that the Office of Public Council (representing the citizens of Florida) opposes the proposed settlement, and is joined in opposition by the Florida Retail Federation (representing many small, mid-sized and large businesses), while the three parties joining FPL in support of the settlement represent a very small number of large institutional power users, who would benefit disproportionately as the settlement shifts costs to residential and other smaller ratepayers. It is unlikely to be good public policy to accede to a take-it-or-leave-it settlement offer from very narrow special interests when it is opposed by representatives of the vast majority of ratepayers. Even if we leave aside all questions about legal or procedural issues and recognize that OPC (or any other participant in this case) cannot be

an infallible guide to the public interest, this proposed settlement still merits a high level of skepticism by the Commission and Staff. Consider what the public and political reaction might be a few years from now, if a settlement approved in these circumstances turns out to deliver windfall profits to the utility at the expense of average ratepayers, or even appears to do so.

The four issues posed about specific terms of the proposed settlement and the summary issue about the settlement proposal as a whole are all answered in the negative - - they are not in the public interest.

The GBRA would unnecessarily raise the ratepayer costs for financing about $3billion of new generation. It includes very large tax gross-up costs and an equity ratio above that used in the determination of need, and well above the 51.35% average in 2012 rate cases to date and the 50.25% in the Progress Energy settlement that FPL extensively compared to this case. The provisions concerning amortization of reserve accounts will increase the likelihood of ROEs above the mid-point and are an inappropriate use of these reserve accounts. The proposed incentive mechanism's rewards are unbalanced and have the potential to create windfall profits and blowback. Approving them as proposed would ignore much of what we know about the role of asymmetric information in regulation.

Please consider the potential for the Commission to accept some of the terms of the proposed settlement and the original FPL proposal, to modify some of them to achieve a more balanced outcome and to reject those that are clearly not in the public interest. All of the parties need to get beyond "take it or leave it" attitudes. We are fortunate to be in a very promising position today. Thanks to the good work of the Commission, FPL, OPC and the U.S. gas industry we are well positioned to have reliable and relatively low cost electricity that many

other locations will envy. Let's try to rebalance the GBRA and Incentive Mechanism proposals, and move forward with a new rate decision that fairly rewards FPL investors and provides reasonable incentives for optimizing asset management, but is also fairer to ratepayers. The new facilities that FPL is building should be a very good investment for ratepayers, but the proposed GBRA financing and incentives call that into question that value.

This case offers the Commission a real opportunity to go beyond just balancing the competing positions of FPL and the representatives of its various ratepayers. Certainly the Commission is responsible for making decisions where stakeholder interests are in conflict, but some combinations of choices can be more efficient than others. An innovative commission can actively favor balancing the sometimes competing interests of FPL and its ratepayers in ways that are more efficient, and therefore provide a net gain, increasing the size of the pie to be shared instead of just carving it up differently. The capital structure issues and the opportunity to modify and improve the GBRA and incentive mechanism in this case into present the commission with a substantial opportunity to improve the economic efficiency of the results of this rate case and deliver an outcome that is clearly and broadly in the public interest.

ISSUES AND POSITIONS

Issue 1: Are the generation base rate adjustments (GBRA) for the Canaveral Modernization Project, Riviera Beach Modernization Project, and Port Everglades Modernization Project, contained in paragraph 8 of the Stipulation and Settlement, in the public interest?

POSITION: *No. The GBRA as specified in this settlement proposal "short circuits" the expected rate case scrutiny for over $3Billion of new generation. It enshrines a costly and tax-inefficient equity ratio that exceeds the determination of need value and relevant recent examples including the recent Progress Energy settlement, and it could delay ratepayers receiving the benefit of federal corporate income tax reductions.

Most importantly the GBRA as specified will cost ratepayers over $500 million by insuring the complete elimination of the typical rate case regulatory lag for three "billion dollar" generation facilities. The GBRA ROE is higher than most recent decisions and the equity ratio is much higher, but they should actually be substantially lower because the GBRA would eliminate the cost of a major revenue delay (regulatory lag) that is built into the average cost of capital for a regulated utility. *

Issue 2: Is the provision contained in paragraph 10(b) of the Stipulation and Settlement, which allows the amortization of a portion of FPL's Fossil Dismantlement Reserve during the Term, in the public interest?

POSITION: *No. This provision and the one covered by Issue 3 below facilitate the use of reserve account amortization as a tool to manage the level of ROE. This will enable FPL to achieve a higher average level of ROE and could be manipulated to reduce the chance of crossing the ROE threshold that would enable a new rate case, while pursuing the highest possible average ROE. This is an inappropriate use of a reserve account. It would not be in the public interest to treat a reserve account as a slush fund to top-up utility earnings.*

Issue 3: Is the provision contained in paragraph 11 of the Stipulation and Settlement, which relieves FPL of the requirement to file any depreciation or dismantlement study during the Term, in the public interest?

POSITION: *No. This provision would block creating or revising any depreciation or dismantlement accounts to protect the ROE management capability described above. It would not be in the public interest because it would put ratepayers at risk of future rate shocks by blocking all studies, including those currently mandated, until after the 4 year term of the proposed agreement. It also contributes to a lack of transparency. Also see position statement on Issue 2 above.*

Issue 4: Is the provision contained in paragraph 12 of the Stipulation and Settlement, which creates the "Incentive Mechanism" including the gain sharing thresholds established between customers and FPL, in the public interest?

POSITION: *No. It is highly desirable to financially optimize the efficient use of FPL's valuable generation, fuel supply, power and transmission resources and to exploit all reasonable sources of net revenue. However, this specific incentive proposal defines fixed threshold values, allocation percentages of 50 % to 70% for FPL, a very broad scope of activities, and contracting/outsourcing provisions that appear to be overly generous to the utility and have the potential to create windfall profits.

The large quantity of new highly efficient natural gas generation coming online, combined with relatively low gas prices and other circumstances, may provide

large and valuable opportunities heretofore unavailable. Given what we know about the information asymmetry between utility operators and regulators concerning the actual costs and opportunities, it would be dangerous to offer such rich and open ended incentives. The incentive mechanism as proposed is not in the public interest, but with substantial modifications to improve balance while still providing effective incentives, it could become very valuable and serve the interest of the public and the utility.*

Issue 5: Is the proposed Settlement Agreement in the public interest?

POSITION: *No. The combination of the provisions described above with the other elements of the settlement is not in the public interest. It is both inefficient and unbalanced, but with appropriate modifications this could be remedied, and deliver a better long term solution for both the utility and the ratepayers

The GBRA would unnecessarily raise the ratepayer costs for financing about $3billion of new generation and includes very large tax gross-up costs. The provisions concerning amortization of reserve accounts will increase the likelihood of ROEs above the mid-point and are an inappropriate use of these reserve accounts. The proposed incentive mechanism's rewards are unbalanced and have the potential to create windfall profits and blowback. *

CONCLUSION

The evidence in this case proves that the rates in the proposed settlement agreement are not fair, just and reasonable, nor are they in the public interest. If the settlement is accepted it will be substantially worse for the ratepayers than the outcome that can be anticipated from a Commission decision based on rejecting the take-it-or-leave-it settlement proposal and reaching a decision based on the evidence in the pre-settlement phase of this case.

The GBRA and incentive mechanism could be modified to make them more fair and reduce the risks of windfall profits, and then incorporated into a decision if the Commission decides this is appropriate, but the evidence shows that settlement as it stands is not in the public interest. If accepted without serious modification it would destroy much of the value that ratepayers should receive from the recent and ongoing investments that the Commission has authorized and FPL is making in modernizing the generation. We can do better than that for all parties.

s/ John W. Hendricks
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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company.	DOCKET NO. 120015-EI DATED: November 30, 2012

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true copy of JOHN W HENDRICKS' STATEMENT OF SETTLEMENT ISSUES AND POSITIONS AND POST-HEARING BRIEF has been furnished to the following by electronic mail this 21th day of September, 2012:

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