

INFORMATION SHEET

PRESIDING: Chair Mitchell, Presiding; Commissioners Brown-Bland, Gray, Clodfelter, Duffley, Hughes, and McKissick

PLACE: Held Via Videoconference

DATE: Friday, January 29, 2021

TIME: 2:00 a.m. – 4:49 p.m.

DOCKET NOS.: E-2, Sub 1262

E-7, Sub 1243

COMPANY: Duke Energy Progress, LLC, and Duke Energy Carolinas, LLC

DESCRIPTION: Joint Petition for Issuance of Storm Recovery Financing Orders (Securitization)

VOLUME NUMBER: 4

APPEARANCES

(See attached)

WITNESSES

(See attached)

EXHIBITS

(See attached)

CONFIDENTIAL TRANSCRIPTS ORDERED: N/A

CONFIDENTIAL EXHIBITS ORDERED: N/A

REPORTED BY: Joann Bunze

TRANSCRIBED BY: Joann Bunze

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PLACE: Held via Videoconference

DATE: Friday, January 29, 2021

TIME: 2:00 p.m. - 4:49 p.m.

DOCKET NO.: E-2, Sub 1262

E-7, Sub 1243

BEFORE: Chair Charlotte A. Mitchell, Presiding

Commissioner ToNola D. Brown-Bland

Commissioner Lyons Gray

Commissioner Daniel G. Clodfelter

Commissioner Kimberly W. Duffley

Commissioner Jeffrey A. Hughes

Commissioner Floyd B. McKissick, Jr.

IN THE MATTER OF:

Joint Petition of Duke Energy Carolinas, LLC,  
and Duke Energy Progress, LLC, for Issuance of Storm  
Recovery Financing Orders

VOLUME: 4



## A P P E A R A N C E S:

FOR DUKE ENERGY CAROLINAS, LLC AND.

DUKE ENERGY PROGRESS, LLC:

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5       Bailey & Dixon, LLP

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9       FOR THE USING AND CONSUMING PUBLIC:

10      William E.H. Creech, Esq.

11      William E. Grantmyre, Esq.

12      Public Staff - North Carolina Utilities Commission

13      4326 Mail Service Center

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**NORTH CAROLINA UTILITIES COMMISSION**  
**APPEARANCE SLIP**

DATE: \_\_\_\_1/25/2020\_\_\_\_ DOCKET NO.:E-2, Sub 1262; E-7, Sub 1243\_

ATTORNEY NAME and TITLE: \_\_Christina D. Cress, Of Counsel\_\_\_\_

FIRM NAME: \_Bailey & Dixon, LLP\_\_\_\_\_

ADDRESS: \_\_PO Box 1351 CITY: \_Raleigh\_\_\_ STATE: NC\_\_

ZIP CODE: 27602-1351

---

APPEARING FOR: \_\_CIGFUR II & III\_\_\_\_\_

---

APPLICANT: \_\_\_ COMPLAINANT: \_\_\_ INTERVENOR: X\_

PROTESTANT: \_\_\_ RESPONDENT: \_\_\_ DEFENDANT: \_\_\_

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**NORTH CAROLINA UTILITIES COMMISSION**  
**APPEARANCE SLIP**

**DATE:** January 28, 2021 **DOCKET NO.:** E-2, Sub 1262 & E-7, Sub 1243

**ATTORNEY NAME and TITLE:** Kristin M. Athens, Associate

**FIRM NAME:** McGuireWoods LLP

**ADDRESS:** 501 Fayetteville St., Suite 500

**CITY:** Raleigh **STATE:** NC **ZIP CODE:** 27601

**APPEARING FOR:** Duke Energy Carolinas, LLC & Duke Energy Progress, LLC

**APPLICANT:** X **COMPLAINANT:** \_\_\_ **INTERVENOR:** \_\_\_

**PROTESTANT:** \_\_\_ **RESPONDENT:** \_\_\_ **DEFENDANT:** \_\_\_

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**NORTH CAROLINA UTILITIES COMMISSION**  
**PUBLIC STAFF - APPEARANCE SLIP**

DATE January 28, 2021 DOCKET #: E-2 Sub 1262 and E-7 Sub 1243

PUBLIC STAFF ATTORNEY William E.H. Creech and William Grantmyre

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LEGAL [zeke.creech@psncuc.nc.gov](mailto:zeke.creech@psncuc.nc.gov); [william.grantmyre@psncuc.nc.gov](mailto:william.grantmyre@psncuc.nc.gov)

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SIGN BELOW.

/s/ William E.H. Creech

/s/ William E. Grantmyre



**NORTH CAROLINA UTILITIES COMMISSION  
APPEARANCE SLIP**

DATE: 1/22/21 DOCKET NO.: E-7, Sub 1243 & E-2, Sub 1262  
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FIRM NAME: Duke Energy  
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CITY: RALEIGH STATE: NC ZIP CODE: 27602  
APPEARING FOR: Duke Energy Carolinas & Duke Energy Program

APPLICANT: ☒ COMPLAINANT: \_\_\_ INTERVENOR: \_\_\_  
PROTESTANT: \_\_\_ RESPONDENT: \_\_\_ DEFENDANT: \_\_\_

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**NORTH CAROLINA UTILITIES COMMISSION  
APPEARANCE SLIP**

DATE: 1/22/21 DOCKET NO.: E-7, Sub 1243 & E-2, Sub 1262  
ATTORNEY NAME and TITLE: Amal Robinson, Associate General Counsel  
FIRM NAME: Duke Energy  
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CITY: Charlotte STATE: NC ZIP CODE: 28202  
APPEARING FOR: Duke Energy Carolinas & Duke Energy Progress

APPLICANT: ☒ COMPLAINANT: ☐ INTERVENOR: ☐  
PROTESTANT: ☐ RESPONDENT: ☐ DEFENDANT: ☐

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Email: Amal.Robinson@duke-energy.com

SIGNATURE: [Signature]

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**NORTH CAROLINA UTILITIES COMMISSION**  
**APPEARANCE SLIP**

**DATE:** January 28, 2021 **DOCKET NO.:** E-2, Sub 1262 & E-7, Sub 1243

**ATTORNEY NAME and TITLE:** James H. Jeffries, Partner

**FIRM NAME:** McGuireWoods LLP

**ADDRESS:** 201 N Tryon Street, Suite 3000

**CITY:** Charlotte **STATE:** NC **ZIP CODE:** 28202

**APPEARING FOR:** Duke Energy Carolinas, LLC & Duke Energy Progress, LLC

**APPLICANT:** X **COMPLAINANT:** \_\_\_ **INTERVENOR:** \_\_\_

**PROTESTANT:** \_\_\_ **RESPONDENT:** \_\_\_ **DEFENDANT:** \_\_\_

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**5. RRB Spread Summary**

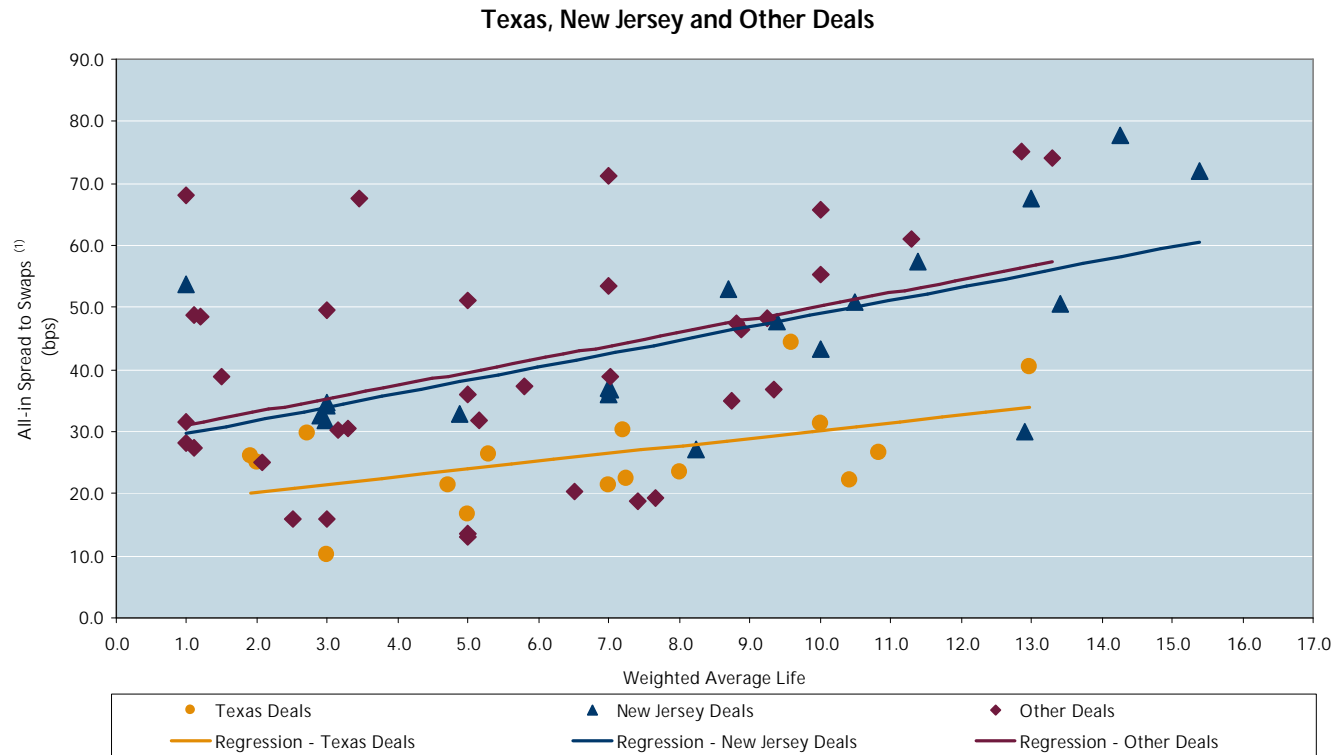


## Offering Spread to Swaps vs. Weighted Average Life





## All-in Spread to Swaps vs. Weighted Average Life



000001

Pre-marked Exhibit 69

Docket Nos. E-2, Sub 1262 and E-7, Sub 1243 BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 150171-EI

PETITION FOR ISSUANCE OF  
NUCLEAR ASSET-RECOVERY  
FINANCING ORDER, BY DUKE  
ENERGY FLORIDA LLC D/B/A DUKE  
ENERGY.

PROCEEDINGS: EMERGENCY MEETING

COMMISSIONERS  
PARTICIPATING: CHAIRMAN JULIE I. BROWN  
COMMISSIONER LISA POLAK EDGAR  
COMMISSIONER ART GRAHAM  
COMMISSIONER RONALD A. BRISÉ  
COMMISSIONER JIMMY PATRONIS

DATE: Thursday, June 16, 2016

PLACE: Brevard County Government Center  
Commission Room, Building C  
1st Floor  
2725 Judge Fran Jamieson Way,  
Melbourne, Florida 32940

TIME: Commenced at 12:33 p.m.  
Concluded at 1:03 p.m.

REPORTED BY: LINDA BOLES, CRR, RPR  
Official FPSC Reporter  
(850) 413-6734

FLORIDA PUBLIC SERVICE COMMISSION

## 1 APPEARANCES:

2 DIANNE M. TRIPLETT, ESQUIRE, and JAVIER  
3 PORTUONDO, 299 First Avenue North, St. Petersburg,  
4 Florida 33701, appearing on behalf of Duke Energy  
5 Florida, Inc.

6 J.R. KELLY, PUBLIC COUNSEL, and CHARLES  
7 REHWINKEL, DEPUTY PUBLIC COUNSEL, Office of Public  
8 Counsel, c/o the Florida Legislature, 111 W. Madison  
9 Street, Room 812, Tallahassee, Florida 32399-1400,  
10 appearing on behalf of the Citizens of the State of  
11 Florida.

12 ROBERT SCHEFFEL WRIGHT, ESQUIRE, Gardner Law  
13 Firm, 1300 Thomaswood Drive, Tallahassee, Florida 32308,  
14 appearing on behalf Florida Retail Federation.

15 SUZANNE BROWNLESS and ROSANNE GERVASI,  
16 ESQUIRES, FPSC General Counsel's Office, and ANDREW  
17 MAUREY, 2540 Shumard Oak Boulevard, Tallahassee, Florida  
18 32399-0850, appearing on behalf of the Florida Public  
19 Service Commission.

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22 Tallahassee, Florida 32399-0850, appearing as advisor to  
23 the Florida Public Service Commission.



ALSO APPEARING:

JOSEPH FICHERA, SABER PARTNERS

DEAN CRIDDLE, ORRICK HERRINGTON

## P R O C E E D I N G S

**CHAIRMAN BROWN:** Okay. Good morning and thank you for joining us here today. This meeting is called to order for the petition for issuance of the nuclear asset-recovery financing order by Duke Energy. And at this time I'd like to have staff read the notice.

**MS. BROWNLESS:** Thank you. By notice dated June 14th, 2016, this time and place has been set for an emergency meeting in Docket No. 150171-EI, petition for issuance of nuclear asset-recovery financing order by Duke Energy Florida, LLC.

**CHAIRMAN BROWN:** Thank you. And as I stated just a second ago, there are people on the phone. I will be taking appearances, so when we go to you, please -- if you're on the phone, please note that you are appearing. We'll take appearances starting with Duke Energy. And I believe the microphone is working right there, Ms. Triplett.

**MS. TRIPLETT:** Thank you. Good morning, Madam Chairman, Commissioners. Dianne Triplett on behalf of Duke Energy Florida.

**CHAIRMAN BROWN:** Thank you. We'll go with Office of Public Counsel at this time.

**MR. REHWINKEL:** Charles Rehwinkel with the Office of Public Counsel.

1           **CHAIRMAN BROWN:** Thank you. And you also have  
2 J.R. Kelly here today.

3           **MR. REHWINKEL:** Yes, we do.

4           **CHAIRMAN BROWN:** Got to mention him.

5           (Laughter.)

6           Retail Federation.

7           **MR. WRIGHT:** Schef Wright on behalf of the  
8 Florida Retail Federation. Thank you.

9           **CHAIRMAN BROWN:** Thank you.

10          PSC staff.

11          **MS. GERVASI:** Good morning. This is Rosanne  
12 Gervasi appearing on behalf of Commission staff.

13          **MS. BROWNLESS:** Suzanne Brownless,  
14 Commission --

15          **MS. HELTON:** Mary Anne Helton is also here with  
16 Rosanne Gervasi on behalf of the Commission.

17          **CHAIRMAN BROWN:** Did you -- I didn't understand  
18 that.

19          **COMMISSIONER BRISÉ:** It's Mary Anne.

20          **COMMISSIONER EDGAR:** Mary Anne.

21          **CHAIRMAN BROWN:** Mary Anne. Thank you. And go  
22 ahead.

23          **MS. BROWNLESS:** Suzanne Brownless on behalf of  
24 Commission staff.

25          **CHAIRMAN BROWN:** Thank you.

1 My understanding also is that we have Dean  
2 Criddle on the phone. Is that correct? Dean Criddle,  
3 are you on the phone?

4 (No response.)

5 And Joe Fichera.

6 **MR. FICHERA:** Joseph Fichera from Saber is  
7 here, yes.

8 **CHAIRMAN BROWN:** Okay. Thank you. Is there  
9 anybody else on the phone?

10 **MS. GERVASI:** Madam Chairman, Dean Criddle  
11 should be appearing momentarily. We'll call him and make  
12 sure he'll be calling in.

13 **CHAIRMAN BROWN:** Thank you. We will proceed,  
14 though, to opening statements and Mr. Maurey.

15 **MR. MAUREY:** Madam Chairman, Commissioners,  
16 thank you. Andrew Maurey on behalf of Commission staff.

17 **CHAIRMAN BROWN:** Andrew, could you please push  
18 that closer and make sure it's on?

19 **MR. MAUREY:** How about this?

20 **CHAIRMAN BROWN:** Not that we can't hear you  
21 right here.

22 **SPEAKER:** I have Dean Criddle on the line now.

23 **CHAIRMAN BROWN:** Thank you. Could you guys  
24 please mute it while we hear opening statements by the  
25 parties?

1           You may proceed.

2           **MR. MAUREY:** Thank you. Pursuant to the  
3           financing order issued in this docket, the Commission has  
4           had an opportunity to consider whether the structuring,  
5           marketing, and pricing of the nuclear asset-recovery  
6           bonds would result in statutory cost objectives, the  
7           lowest nuclear asset-recovery charges consistent with  
8           market conditions at the time of pricing, terms and  
9           conditions of the financing order and other applicable  
10          law, and the greatest possible customer protections.

11                 If the Commission does not issue a stop order,  
12          the Commission, without the need for further action and  
13          pursuant to the authority under the financing order,  
14          shall have determined that the requirements of Section  
15          366.95, *Florida Statutes*, and the financing order have  
16          been satisfied.

17                 This meeting is optional. It will -- the deal  
18          will go forward if we don't do anything, but we wanted  
19          to have this opportunity to explain the work that went  
20          into making this superior result possible. And with --  
21          we have -- are in receipt of the opinion letter from the  
22          financial advisor. I'd like to make a couple of  
23          statements with respect to that.

24           **CHAIRMAN BROWN:** Please go ahead.

25           **MR. MAUREY:** Saber Partners is of the opinion

1 that the proposed structuring, pricing, and financing  
2 cost of the bonds have a significant likelihood of  
3 resulting in lower overall cost or would avoid or  
4 significantly mitigate rate impacts to customers as  
5 compared to the traditional method of financing and  
6 recovering nuclear asset-recovery costs.

7           Saber Partners also is of the opinion that on  
8 a reasonably comparable basis, the actual cost of the  
9 nuclear asset-recovery issuance will result in the  
10 lowest overall costs that were reasonably consistent  
11 with market conditions at the June 15th, 2016, pricing  
12 of the bonds and the terms of the financing order.

13           In addition, Saber Partners is of the opinion  
14 that the transaction has achieved the greatest possible  
15 customer protections reasonably consistent with the  
16 terms of the financing act, the financing order, and  
17 other applicable law.

18           Finally, Saber Partners is not aware of any  
19 action or inaction which Saber Partners believes might  
20 have caused the transaction not to achieve the statutory  
21 cost objectives, the lowest nuclear asset-recovery  
22 charges, and/or the greatest possible customer  
23 protections. In summary, Saber Partners does not  
24 recommend that the Commission issue a stop order.

25           With your indulgence, I would like to go

1 through a few slides that we've distributed prior to the  
2 meeting.

3 **CHAIRMAN BROWN:** Thank you. I think now is the  
4 appropriate time.

5 **MR. MAUREY:** All right. Thank you. Just go  
6 over some of the details of this transaction that  
7 resulted in significant savings to Duke Energy Florida's  
8 customers.

9 On the first slide we talk about the total  
10 financing cost of 2.72 percent. This is the lowest cost  
11 in the history of investor-owned utility rate reduction  
12 bonds. Now these bonds have maturities that went out.  
13 Well, let me give you context. In the settlement that  
14 allowed for the recovery of this regulatory asset, it  
15 was contemplated that these charges would be recovered  
16 over a period of 20 years through base rates. Through  
17 this securitization, we were able to be true to the  
18 20-year recovery period but significantly lowered that  
19 cost to customers.

20 The investors that bought these bonds, they  
21 bought -- did so at interest rates that were in line  
22 with U.S. agency securities such as Tennessee Valley  
23 Authority, Fannie Mae, Federal Home Loan Board, and some  
24 of the largest, highest-rated global corporations such  
25 as Johnson & Johnson and Exxon.

1           The transaction was benefited from an  
2           extensive investor education effort, which included  
3           contact both physically and over the phone with over  
4           110 investors to build demand for this bond. This  
5           effort involved Saber Partners, Commission staff, Duke  
6           Energy Florida, and the underwriters that were brought  
7           in.

8           The next slide shows a graphic presentation of  
9           how this deal compared to other deals in this space. It  
10          looked at all other ratepayer -- rate reduction bonds  
11          that were issued between 2010 and 2015. And you can see  
12          the higher line represents how those priced at the  
13          various maturities relative to government agencies, and  
14          the lower dotted line shows where the DEF bonds priced.  
15          And I want to draw your attention really to the two  
16          squares at the far right. You'll see that there are no  
17          other dots out there for the other deals. That  
18          represents the challenge that we faced in selling bonds  
19          at the 15- and 18-year maturities to be true to the  
20          terms of the settlement but build demand for those bonds  
21          where others have not sold them in the past or at least  
22          in the last five years.

23          The next slide, we wanted to highlight the  
24          18-year maturity specifically because as -- when you  
25          look at this, this is a comparison of how the DEF



1 project finance bonds priced relative to comparable  
2 issues of these other names I mentioned. We priced  
3 right on top of Tennessee Valley Authority. Tennessee  
4 Valley Authority sells billions of debt. They're a  
5 well-known issuer. DEF project finance didn't exist  
6 more than six months ago. So we -- this was almost akin  
7 to an initial public offering. We were able to do so  
8 with the collaborative effort of Duke Energy Florida,  
9 Saber Partners, staff, and the other outside counsels  
10 that came together to make this successful. But this is  
11 a strong signal that those efforts were successful.

12 And then finally I have two final pages. This  
13 transaction was made possible due to a special  
14 legislation that was enacted in 2015. When that  
15 legislative process was ongoing, an illustrative example  
16 was presented. And this page, page 4, is that example  
17 where it was estimated that at that time the charge  
18 would have been, through base rates, approximately  
19 \$5.33 per thousand kWh. And if we did enter  
20 securitization, we would have had a charge of  
21 approximately \$2.91, resulting in nominal savings of a  
22 little over 800 million and net present value savings of  
23 a little over 600 million. Those were the expectations.

24 But on the last slide, when we got into the  
25 issuance, we were able to motivate the underwriters to

1 challenge those spreads, to tighten the interest rates,  
2 and we ended up resulting in a charge of \$2.84 per  
3 thousand kWh, which resulted in comparable nominal  
4 savings but higher net present value savings, net  
5 present value savings of 684 million directly to the  
6 benefit of customers.

7 So this was a, as I say, a very successful  
8 effort. A lot of people were involved. And it -- we  
9 would have not had this result, though, without the  
10 tireless efforts of our financial consultants, Saber  
11 Partners and Joe Fichera in particular, and our outside  
12 counsel, Dean Criddle of Orrick Herrington. And I want  
13 to thank them for their involvement on behalf of this  
14 transaction. I'm available for any questions.

15 **CHAIRMAN BROWN:** Thank you, Mr. Maurey. And  
16 just to close up your summary, your recommendation would  
17 be --

18 **MR. MAUREY:** Oh, my recommendation is that you  
19 do not issue a stop order. Thank you.

20 **CHAIRMAN BROWN:** Thank you. That was just for  
21 the record.

22 And before we get to the parties to give them  
23 an opportunity to speak, I do want to -- I mean, it goes  
24 without saying -- to thank staff, the entire Bond Team,  
25 Duke Energy, Saber Partners. Commissioner Graham has

1 been involved in this too on behalf of the Commission.  
2 And I will tell you, you guys have just worked so  
3 diligently, especially the fact that we had this  
4 emergency meeting, which we really -- it was not  
5 necessary to do, and we appreciate you bringing it forth  
6 for our consideration. I think, even with a bad stock  
7 market this past week, your fine marketing efforts have  
8 really produced just an incredible result.

9 So with that, I'd like to kick this off and  
10 give Duke an opportunity to make some statements.

11 **MR. MAUREY:** Thank you.

12 **CHAIRMAN BROWN:** Thank you, Mr. Maurey.

13 **MS. TRIPLETT:** It's so weird to be standing.  
14 Thank you again. I'll be very brief. As you heard, this  
15 transaction is great. It will save our customers  
16 significant money. And before I start, let me say my  
17 recommendation too is that you not issue a stop order  
18 today.

19 This fantastic outcome is no accident. As you  
20 pointed out, it is the culmination of months of hard  
21 work. And I actually went and looked at my calendar,  
22 and the first bond meeting was at the end of October,  
23 and I don't even think the financing order had been  
24 issued. So everyone hit the ground running. There were  
25 several weeks where we had multiple meetings, lots of

1 emails, lots of review of documents, and I just wanted  
2 to highlight just a few of the things. We included this  
3 in our issuance advice letter that was filed today and  
4 circulated to the parties yesterday, but I think it's  
5 important to note some of the good work that was done.

6 We ensured that the registration statement  
7 contained proper disclosures to communicate the really  
8 superior credit features of these bonds. We hired a  
9 diverse group of underwriters, including underwriters  
10 with international and mid-tier expertise and those with  
11 diverse ownership in order to attract a wide variety of  
12 investors, and also potentially investors that may not  
13 have bought these bonds or these types of bonds before.

14 We attended in-person and telephonic  
15 premarketing investor meetings throughout 2016, in  
16 addition to four road show cities and multiple other  
17 meetings that happened after the marketing, you know,  
18 went live, so to speak. We developed and implemented a  
19 marketing plan designed to encourage each of the  
20 underwriters to aggressively market the bonds to a broad  
21 base of prospective investors, and we also adapted the  
22 bond offering to market conditions and investor demand  
23 at the time of pricing. It was -- it's been an exciting  
24 last few weeks. I've certainly learned a lot. But it  
25 was a great iterative process and, again, it resulted in

1 this great transaction and this great result. And,  
2 accordingly, the company also certifies that the  
3 statutory cost objectives set forth in the financing  
4 order have been satisfied, and that also was included in  
5 the issuance advice letter that was filed today.

6 And as Mr. Maurey noted, we reviewed the  
7 opinion letter from Saber Partners, and it does not  
8 contain any qualifications with respect to the opinions  
9 that he was giving and compliance with the financing  
10 order. So, again, all signs point to no stop order.

11 And I would be remiss if I did not thank your  
12 staff, particularly Mr. Maurey, Mark Cicchetti, and  
13 Rosanne Gervasi. They were in the trenches with us --  
14 lots of late night phone calls, late emails -- really to  
15 get a fantastic result. And also the signatories to our  
16 settlement agreement: Mr. Rehwinkel, Mr. Wright, who  
17 are both here today; Mr. Brew and Mr. Moyle, who could  
18 not be here. But we ran into some things and it really  
19 took -- they stepped up very quickly to address them and  
20 really maintained the good value of the settlement.

21 So I'm available to answer any questions, and  
22 I have Mr. Portuondo in case you want to ask about  
23 numbers. And thank you very much.

24 **CHAIRMAN BROWN:** Thank you, Ms. Triplett. And  
25 we'll go for Mr. Rehwinkel at this time.

1                   **MR. REHWINKEL:** Thank you, Commissioners.

2                   Charles Rehwinkel, Deputy Public Counsel. And on behalf  
3                   of J. R. Kelly, the Public Counsel, who is here at his  
4                   second meeting today, I would like to thank you for the  
5                   opportunity to address you on this matter on behalf of  
6                   all of Duke's customers.

7                   My remarks today are premised on the notion  
8                   that the reasons for the retirement of the CR3 plant  
9                   were put to rest in 2013 when the Commission approved  
10                  the global settlement that resulted in over \$2 billion  
11                  of benefits to the ratepayers. Today we are here  
12                  instead to consider the net present value of  
13                  \$684 million in additional benefits that result from the  
14                  financing of the remaining cost of the retired nuclear  
15                  plant with the nuclear asset-recovery bonds.

16                  The Public Counsel supports the proposal  
17                  contained in the issuance advice letter filed by Duke  
18                  and in the opinion letter filed by your advisor, Saber  
19                  Partners. No action is needed. We -- Mr. Kelly,  
20                  myself -- have been observers at almost all of the Bond  
21                  Team meetings and were allowed unparalleled visibility  
22                  into the pricing of the bonds as an observer on the  
23                  crucial calls in the last two weeks of this transaction,  
24                  all the way up to yesterday at 2:00 p.m. when the bonds  
25                  were finally priced. We have also reviewed thousands of

1 pages of material prepared in support of the transaction  
2 for the Securities and Exchange Commission and European  
3 regulators.

4 For all of these reasons, we can say to you  
5 today that we agree that the transaction appears to have  
6 met the statutory standards of achieving the lowest  
7 overall costs that were reasonably consistent with  
8 market conditions at the time of pricing, are consistent  
9 with the applicable terms of the Revised and Restated  
10 Settlement and Stipulation Agreement, or RRSSA, and will  
11 result in substantially lower costs. As you've heard,  
12 an additional 684 million less cost to the customers as  
13 compared to the traditional method allowed by the RRSSA,  
14 which notably had already a greatly reduced 30 percent  
15 reduction in allowed shareholder profits. So what  
16 you're approving today is a reduction even off of that.  
17 The pricing proposal also results in the greatest  
18 possible customer protections as required by the statute  
19 and your order.

20 For these reasons, the Public Counsel urges  
21 you to either affirmatively approve the pricing, which  
22 you really don't need to do, or to take no action and  
23 refrain from issuing a stop order.

24 Having said that, it's important for us to  
25 thank Duke Florida President Alex Glenn for his

1 leadership in approaching the legislature with the  
2 securitization proposal in the first place. Without him  
3 taking this leadership, we would not be here talking  
4 about saving nearly another \$700 million.

5 We also want to thank Senator Jack Latvala for  
6 championing the effort in the legislature to save these  
7 \$700 million for the customers and for the inclusion of  
8 the provisions that allowed for the Commission to hire  
9 experts in bond finance and bond finance law to advocate  
10 for customers alongside with your staff, your expert  
11 staff, and we also want to thank the legislature and the  
12 Governor for the law.

13 We owe a special thanks to your staff on the  
14 Bond Team led by Andrew Maurey and including Mark  
15 Cicchetti and Rosanne Gervasi. They were vigorous and  
16 very knowledgeable advocates for the customers'  
17 interests and obviously had the full support of the  
18 Executive Director and the General Counsel in their  
19 advocacy, and we deeply appreciate it.

20 But the OPC saved its best thanks for the  
21 Commission's advisor, Saber Partners and especially Joe  
22 Fichera, and the Commission's bond counsel, Dean  
23 Criddle, who brought impressive expertise, experience,  
24 and discipline to the transaction and, without question,  
25 were instrumental in saving many millions of dollars for



1 the customers in current and future costs through their  
2 dogged and expert advocacy to achieve the optimum lowest  
3 cost for customers at the outset. At the outset we  
4 reviewed -- we viewed their deep involvement to be  
5 vital, and having observed firsthand their guidance in  
6 the transaction, we are firmly convinced that they  
7 brought tremendous value to the customers.

8 And I want to thank Duke and the team they put  
9 together, Dianne Triplett, Javier Portuondo, Steve --  
10 Bryan Buckles (sic) -- I think I said that right.

11 **MS. TRIPLETT:** Buckler.

12 **MR. REHWINKEL:** Buckler. I am so sorry. Bryan  
13 Buckler, Tom Heath, Jack Sullivan, and Steve De May to  
14 structure and price and issue these bonds. Their sincere  
15 expert and cooperative efforts greatly facilitated this  
16 transaction, not only the final process, but in the  
17 Commission's proceeding leading up to the financing order  
18 and the amendments to the RRSSA.

19 And finally, we want to thank you, the  
20 Commissioners, for your support for this and your  
21 approval of the pricing today.

22 I would like to also say that I am authorized  
23 by Jay Brew, who represents PCS Phosphate, to state that  
24 he concurs in these remarks. So thank you for your  
25 indulgence.

1           **CHAIRMAN BROWN:** Mr. Rehwinkel, thank you.

2           Those were great remarks, and we appreciate hearing -- I  
3           appreciate hearing all of those. Thank you.

4           **MR. REHWINKEL:** Thank you.

5           **CHAIRMAN BROWN:** Mr. Wright.

6           **MR. WRIGHT:** Thank you, Madam Chair and  
7           Commissioners. I'll be as brief as I can. The real  
8           thing here is that there's so many people to thank, it's  
9           going to take me a bit. I think less than two minutes,  
10          but here we go.

11          **CHAIRMAN BROWN:** The Academy Awards here.

12          **MR. WRIGHT:** Pardon?

13          **CHAIRMAN BROWN:** I'm just saying it's like the  
14          Academy Awards here. Go ahead.

15          (Laughter.)

16          **MR. WRIGHT:** Rather, rather, and appropriately  
17          so, because everybody involved in this process deserves  
18          really, really, really big awards and really big thanks.

19          I'll start by saying that the Florida Retail  
20          Federation strongly supports the staff's recommendation  
21          that you not issue a stop order. Whether you  
22          affirmatively vote to affirm the pricing or just not  
23          issue a stop order is fine. It gets to the same exact  
24          result.

25          We support Duke's issue in its advice letter.

1 We support Saber's opinion letter. We are profoundly  
2 grateful for the \$684 million of additional savings over  
3 and above what you already approved in the 2013 global  
4 settlement.

5 And now here's where the thanks really start.  
6 I thank the legislature, Senator Latvala. Thank the  
7 Governor for signing this into law. Thank you all for  
8 your support; thank you for issuing the financing order  
9 and for hiring the right people to make this happen.  
10 Thank Duke, especially Alex Glenn, Diane Triplett,  
11 Javier Portuondo, and everybody else, the long list that  
12 Charles read off, for their hard work. Big, big, big  
13 thanks, Oscars to your staff, especially Andrew,  
14 Rosanne, and Mark, for their extraordinary hard work and  
15 support for everything throughout this process. Thanks  
16 to Saber Partners. Thanks to Mr. Criddle and Orrick  
17 Herrington for their hard work to bring this in. And  
18 thanks again to y'all for approving it.

19 Again, we would join Duke and the Office of  
20 Public Counsel and PCS Phosphate and others in urging  
21 you to approve the pricing or refrain from issuing an  
22 advice letter.

23 I'm profoundly impressed, the federation is  
24 profoundly impressed with and by all the work that went  
25 into this and even more so by the result. This is just

1 really, really great. I'm going to close with three  
2 words: Wow and thank you.

3 **CHAIRMAN BROWN:** That's great. I appreciate  
4 those words.

5 All right. Mr. Maurey, do you want to  
6 readdress the Commission?

7 **MR. MAUREY:** Only if you have some questions.

8 **CHAIRMAN BROWN:** No. It obviously goes without  
9 saying, a huge thank you. All of you have worked above  
10 and beyond, many, many hours of overtime, driving down  
11 here for this emergency meeting and all that.

12 And I'm going to open it up to the  
13 Commissioners to provide some comments, questions. You  
14 may begin, Commissioner Edgar.

15 **COMMISSIONER EDGAR:** Thank you, Madam Chairman.

16 As always, some of the comments that I wanted  
17 to make have already been made, but I also would like to  
18 acknowledge the foresight of those who worked on the  
19 legislation in providing the resources and the direction  
20 for the Commission to be able to hire outside bond  
21 counsel and outside financial advisor. I do believe  
22 that was a very important part of the process and an  
23 important part of the success of the result, working  
24 closely, of course, with our staff and all of the  
25 involved parties.

1           You know, this is truly a good news story, and  
2           I hope that that goods news gets out that although it is  
3           a complex financial transaction, it is an innovative  
4           financing mechanism to address a very unique situation.  
5           And I do believe that the result that we have before us  
6           is consistent with the statutory objectives, that the  
7           lowest charges consistent with the prevailing market  
8           conditions have been achieved, and that we were also  
9           able to achieve the greatest possible consumer  
10          protections. Lots of moving pieces, lots of moving  
11          parts obviously requiring SEC review, the investor  
12          education effort, but ultimately I do believe that we  
13          have achieved the lower overall cost to mitigate,  
14          minimize costs to the ratepayers and attract capital.  
15          It is my understanding that a vote or a specific formal  
16          action is not required for this to move forward, but I  
17          certainly would like to endorse the process and the  
18          result.

19               **CHAIRMAN BROWN:** Excellent. Thank you,  
20          Commissioner Edgar.

21               I'm going to go to Commissioner Graham and  
22          then Commissioner Brisé.

23               **COMMISSIONER GRAHAM:** Well, first of all, I  
24          want to thank all the parties. My role in all this was  
25          just more impasse resolution than anything else. And I

1 have to say the first couple of -- first couple of  
2 meetings that I listened in to, I thought to myself that  
3 I was going to be very busy. And come to find out, as  
4 things went on, it started to ease itself up.

5 I'm going to steal a line from Charles  
6 Rehwinkel. He said earlier, he says, "It's like sausage  
7 because it's usually real good when you're eating it,  
8 but you don't want to see it getting made." And I think  
9 that's what this process was. A great outcome at the  
10 end of it all, but it wasn't -- sometimes it was very  
11 strained. You know, you're listening on the phone to  
12 the teleconference, so you can hear the stress in the  
13 voices, you can see some of the patience that went into  
14 all of that, but -- and all the work that went into it  
15 all. I mean, basically all I was doing was a fly on the  
16 wall listening to what was going on and it was stressing  
17 me, so I can imagine the people that were actually in  
18 the trenches that were throwing things back and forth.  
19 And I do appreciate the patience. I do appreciate  
20 nobody letting the process stop or halt, that everybody  
21 knew what the desired outcome was going to be and  
22 everybody stayed diligent and made it all happen. It  
23 didn't come easy by any means, but it did get all the  
24 way through.

25 I guess one of the questions I have to staff

1 is I want to make sure that this result, this end result  
2 that we have is -- actually addresses what that law was  
3 that passed, that we're sure that it checks all the  
4 boxes of what we're supposed to accomplish and everybody  
5 is good with that.

6 **MR. MAUREY:** Yes, sir, it does.

7 **COMMISSIONER GRAHAM:** Okay. I just wanted to  
8 make sure. I didn't want for anybody else to come to us  
9 later on and say, well, the law said this and you did  
10 that or the law was quiet to this or what we really  
11 wanted was that. But just as long as we're sure that we  
12 did everything we're supposed to have done, then I think  
13 this is absolutely fantastic, and I thank you all for the  
14 efforts that you put forth.

15 **CHAIRMAN BROWN:** Thank you, Commissioner  
16 Graham.

17 Commissioner Brisé.

18 **COMMISSIONER BRISÉ:** Thank you, Madam Chair.

19 I just want to chime in and thank all the  
20 parties for working together to come to this point. I  
21 think that we have met the statutory requirements,  
22 recognizing this is a good example of the legislature  
23 and the Commission and all the parties working together,  
24 looking at a situation, and trying to figure out what is  
25 the best outcome for the citizens here in the state of

1 Florida, and I think this is a shining example of that  
2 happening.

3 But one thing that is near and dear to my  
4 heart personally is that in addition to meeting the  
5 statutory requirement, we also addressed the issue of  
6 opening the pot so that we can have a diverse group of  
7 financial institutions as participants, and I think that  
8 that's an important factor. And I think we've done all  
9 of that, and that continues the public interest  
10 component of this as well. So I want to commend all of  
11 you and commend our staff because I know that when we  
12 were working on the finance order, that was a lot of  
13 work. And to continue all of that work, we are greatly  
14 appreciative of our staff, of your expertise, and of  
15 your willingness to put all that extra time in to get us  
16 to this point. So thank you.

17 **CHAIRMAN BROWN:** Thank you, Commissioner Brisé.  
18 Commissioner Patronis.

19 **COMMISSIONER PATRONIS:** Thank you, Madam  
20 Chairman.

21 Just mainly thank you to staff. Couldn't  
22 have this been -- this couldn't have been possible  
23 without the efforts and works and fruit of your labor.  
24 And really this is absolutely my best day as a  
25 Commissioner today. I didn't have to do a thing. Thank



1       you.

2                   (Laughter.)

3                   **CHAIRMAN BROWN:** And we get positive results,  
4       positive results. So seeing that we do not need to have  
5       a motion and we don't need any further discussion, if no  
6       one has any further discussion, a big thank you again in  
7       closing, and this meeting is adjourned.

8                   (Meeting adjourned at 1:03 p.m.)

1 STATE OF FLORIDA     )  
2 COUNTY OF LEON       ) :           CERTIFICATE OF REPORTER

3  
4           I, LINDA BOLES, CRR, RPR, Official Commission  
5 Reporter, do hereby certify that the foregoing  
6 proceeding was heard at the time and place herein  
7 stated.

8           IT IS FURTHER CERTIFIED that I  
9 stenographically reported the said proceedings; that the  
10 same has been transcribed under my direct supervision;  
11 and that this transcript constitutes a true  
12 transcription of my notes of said proceedings.

13           I FURTHER CERTIFY that I am not a relative,  
14 employee, attorney or counsel of any of the parties, nor  
15 am I a relative or employee of any of the parties'  
16 attorney or counsel connected with the action, nor am I  
17 financially interested in the action.

18           DATED THIS 20th day of June, 2016.

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*Not Part of Actual Transcript:*

Link to video of June 16, 2016  
Open Meeting of Florida Public  
Service Commission (with  
printed transcript captioned  
throughout):

[https://www.youtube.co  
m/watch?v=Jt0fUs3Ujo  
8&t=3s](https://www.youtube.com/watch?v=Jt0fUs3Ujo8&t=3s)

**State of Florida**



# Public Service Commission

**CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD  
TALLAHASSEE, FLORIDA 32399-0850**

**-M-E-M-O-R-A-N-D-U-M-**

**DATE:** May 8, 2006

**TO:** Director, Division of the Commission Clerk & Administrative Services (Bayó)

**FROM:** Division of Economic Regulation (Maurey, Ballinger, Baxter, Brennan, Draper, Haff, Hewitt, Kaproth, Kummer, Kyle, Lee, Lowe, McNulty, McKay, Marsh, Redemann, Rieger, Romig, Slemkewicz, Springer, Stallcup, Trapp, Willis)  
Office of the General Counsel (Keating, Brubaker, Gervasi, Helton)  
Division of Regulatory Compliance & Consumer Assistance (Vandiver)

**RE:** Docket No. 060038-EI – Petition for issuance of a storm recovery financing order, by Florida Power & Light Company.

**AGENDA:** 05/15/06 – Special Agenda – Posthearing Decision – Participation is Limited to Commissioners and Staff

**COMMISSIONERS ASSIGNED:** All Commissioners

**PREHEARING OFFICER:** Deason

**CRITICAL DATES:** May 15, 2006 (120 days after filing of petition)

**SPECIAL INSTRUCTIONS:** None

**FILE NAME AND LOCATION:** S:\PSC\ECR\WP\060038.RCM.DOC

DOCUMENT NUMBER-DATE

04068 MAY-9 86

FPSC-COMMISSION CLERK

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### **Case Background**

On January 13, 2006, Florida Power & Light Company ("FPL" or "the Company") filed a petition for issuance of a storm recovery financing order or, in the alternative, an order approving the establishment of a storm cost recovery surcharge. This Commission has jurisdiction pursuant to Chapter 366, Florida Statutes, including Sections 366.04, 366.05, 366.06, and 366.8260, Florida Statutes.

### **Historical Background**

Like other Florida investor-owned electric utilities, FPL operates under a self insurance program for its distribution and transmission facilities. This became necessary when insurance became cost prohibitive as a result of the devastation caused by Hurricane Andrew in 1992. In 1993, the Commission authorized FPL to implement this self insurance approach through annual contributions from base rate revenues to its Storm and Property Insurance Reserve Fund (referred to as "Reserve", "Storm reserve", or "Storm damage reserve"). From 1995 until 2005, FPL annually accrued \$20.3 million to its Reserve.

At the start of the 2004 hurricane season, FPL's Reserve balance had reached approximately \$354 million. As a result of Hurricanes Charley, Frances, and Jeanne in 2004, FPL incurred storm-related costs of approximately \$890 million, net of insurance proceeds, which resulted in a deficit of approximately \$536 million in its Reserve at the end of December 2004. In November 2004, FPL filed a petition seeking authority to recover \$533 million of this estimated deficit through a monthly surcharge to apply to customer bills based on a 36-month recovery period. By Order No. PSC-05-0937-FOF-EI, issued September 21, 2005, in Docket No. 041291-EI, In re: Petition for authority to recover prudently incurred storm restoration costs related to 2004 storm season that exceed storm reserve balance, by Florida Power & Light Company ("2004 Storm Order"), the Commission approved the initiation of a surcharge to recover prudently incurred storm restoration costs in excess of FPL's Reserve balance ("2004 storm costs"). For residential customers, this surcharge amounts to \$1.65 for monthly usage of 1,000 kilowatt hours (kWh), with the surcharge expected to last three years or less. The Order did not address the replenishment of FPL's Reserve.

In its 2005 session, the Florida Legislature established a new financing vehicle by which investor-owned electric utilities can quickly recover their storm restoration costs and replenish their Reserve funds. This mechanism, referred to as "securitization," allows utilities to access low-cost funds through "storm-recovery bonds" issued pursuant to financing orders issued by the Commission. This new provision of Florida law is codified in Section 366.8260, Florida Statutes.

Also in 2005, FPL initiated a base rate proceeding before the Commission. The parties to that proceeding ultimately reached a settlement which provided, among other things, that FPL would, as of January 1, 2006, cease making any annual accrual to its Reserve. Instead, FPL would be permitted to recover its reasonable and prudently incurred storm restoration costs and to seek approval to replenish its Reserve (to a Commission-approved level) pursuant to the new securitization law and/or through a more traditional surcharge like the one approved in the 2004 Storm Order. The Commission approved the settlement by Order No. PSC-05-0902-S-EI, issued



September 14, 2005, in Docket No. 050045-EI, In re: Petition for rate increase by Florida Power & Light Company (“2005 Rate Case Order”).

Following approval of the settlement in 2005, FPL’s service territory was impacted by multiple tropical storms and hurricanes, including Dennis, Katrina, Rita, and Wilma. According to FPL’s petition in this docket, FPL incurred storm-related costs of approximately \$879.9 million, net of insurance proceeds.

#### FPL’s Petition

Through its petition in this docket, FPL requests that the Commission approve the issuance of up to \$1.05 billion of storm-recovery bonds pursuant to Section 366.8260, Florida Statutes. According to FPL’s petition, this would enable FPL to: (1) recover the remaining unrecovered balance of its 2004 storm costs; (2) recover its prudently incurred 2005 storm costs, less capital costs and insurance proceeds; and (3) rebuild its Reserve to a level of approximately \$650 million. FPL notes that the bonds would be issued for the after-tax value of these amounts to recognize the tax benefit received when storm restoration costs are deducted for income tax purposes. The following table, reproduced from information in Exhibit A to FPL’s petition, summarizes these amounts:

<b>SUMMARY OF STORM COSTS AND AMOUNT OF PROPOSED BOND ISSUANCE</b> <b>(\$000s)</b>		
	<b>2005 System Amount</b>	<b>2005 Jurisdictional Amount</b>
Total Estimated 2005 Storm-Recovery Costs	\$906,404	
Less: Estimated Insurance Proceeds	(26,533)	
2005 Storm Costs (Net of Insurance Proceeds)	\$879,871	
Less: 2005 Estimated Capital Storm Costs	(63,855)	
Net 2005 Storm-Recovery Costs	\$816,016	\$815,372
Interest Incurred Through Estimated Bond Issuance Date		11,481
<b>Unrecovered 2005 Storm-Recovery Costs</b>		<b>\$826,853</b>
<b>Unrecovered 2004 Storm-Recovery Costs (as of July 31, 2006)</b>		<b>\$213,307</b>
<b>Replenishment of Reserve</b>		<b>\$650,000</b>
<b>Total Storm Costs</b>		<b>\$1,690,160</b>
Estimated Up-front Bond Issuance Costs		11,425
<b>Total Costs Requested for Recovery</b>		<b>\$1,701,585</b>
Less: Income Taxes		(651,979)
<b>Total Amount of Storm-Recovery Bonds</b>		<b>\$1,049,606</b>

Under FPL’s proposal, the amount financed through storm-recovery bonds would be paid over approximately twelve years through charges applied on a per kilowatt-hour (kWh) basis to all applicable customer classes. In addition, any tax liabilities associated with collection of the new charges would be paid through another charge to the extent such liabilities are not recovered

through other rates or charges. In sum, these proposed charges are estimated to be \$1.58 for residential monthly usage of 1,000 kWh. If a financing order is issued to include FPL's unrecovered 2004 storm costs, the surcharge approved in the 2004 Storm Order would be terminated on the effective date of the new charges.

In the event that the Commission issues a financing order and the issuance of storm-recovery bonds is delayed for any reason, FPL asks that the Commission authorize a surcharge to apply to bills rendered on and after August 15, 2006, to recover the 2005 storm costs over approximately three years. FPL estimates that this surcharge would amount to \$2.98 for residential monthly usage of 1,000 kWh, in addition to the existing surcharge for 2004 storm costs. As proposed by FPL, this surcharge would terminate upon issuance of the bonds and the amount of the bonds would be adjusted to reflect collections made under the temporary surcharge.

If the Commission does not grant FPL approval to issue storm-cost recovery bonds, FPL asks that the Commission approve a surcharge effective for bills rendered on and after June 15, 2006, that would allow FPL, over a three year period, to recover its estimated 2005 storm costs plus \$650 million toward the replenishment of its Reserve. FPL estimates that this surcharge would amount to \$5.19 for residential monthly usage of 1,000 kWh, in addition to the existing surcharge for 2004 storm costs.

The following table provides a summary of the rate impacts associated with FPL's primary and alternative requests:

<b>SUMMARY OF RATE IMPACTS</b> <b>(Monthly Residential Bill for 1,000 kWh)</b>		
	<b>Primary Request</b> <b>(Securitization)</b>	<b>Alternative Request</b> <b>(Short-Term Surcharge)</b>
Existing Surcharge for 2004 Costs	No separate surcharge; included in total charge	\$1.65 <sup>1</sup> (approx. 20 months)
New Surcharge for 2005 Costs	No separate surcharge; included in total charge	\$2.98 <sup>2</sup> (approx. 3 years)
New Surcharge for Replenishment of Reserve	No separate charge; included in total charge	\$2.21 <sup>3</sup> (approx. 3 years)
Storm Bond Repayment Charge and Storm Bond Tax Charge	\$1.58 (approx. 12 years)	Not applicable
<b>Total Rate Impact</b>	<b>\$1.58</b> <b>(over approx. 12 years)</b>	<b>\$6.84<sup>(1+2+3)</sup></b> <b>(over approx. 20 months)</b> <b>\$5.19<sup>(2+3)</sup></b> <b>(over remaining approx. 16 months)</b>

### Procedural Background

On March 1-3, 2006, the Commission held customer service hearings in the portions of FPL's service territory that were most affected by the 2005 storm season: Ft. Myers, West Palm Beach, Ft. Lauderdale, and Miami. The Commission took testimony from several persons at these service hearings concerning FPL's restoration efforts, its quality of service, and its petition in this docket.

On April 19-21, 2006, the Commission conducted a technical hearing on FPL's petition. Along with FPL, the Office of Public Counsel ("OPC"), Florida Industrial Power Users Group ("FIPUG"), Florida Retail Federation ("FRF"), AARP, Federal Executive Agencies ("FEA"), and the Office of the Attorney General ("AG") (sometimes referred to collectively as "Intervenors") participated as parties to the proceeding.<sup>1</sup> During the hearing, the Commission accepted the prefiled testimony of 20 witnesses, heard cross-examination of most of those witnesses, and admitted 172 exhibits into evidence. Following the hearing, each party filed a post-hearing brief and/or statement of issues and positions.

Pursuant to Section 366.8260(2)(b)1., Florida Statutes, the Commission is required to make a decision on FPL's petition no later than 120 days after the date the petition was filed. Hence, this matter has been scheduled for a special agenda conference on May 15, 2006. Further, pursuant to the same law, the Commission is required to issue a financing order or an order rejecting FPL's petition no later than 135 days after the date the petition was filed – May 30, 2006, in this case.

### Standard of Review

Section 366.8260(2)(b)1.b., Florida Statutes, provides the standard of review applicable to a petition for issuance of a financing order:

*The commission shall issue a financing order authorizing financing of reasonable and prudent storm-recovery costs, the storm-recovery reserve amount determined appropriate by the commission, and financing costs if the commission finds that the issuance of the storm-recovery bonds and the imposition of storm-recovery charges authorized by the order are reasonably expected to result in lower overall costs or would avoid or significantly mitigate rate impacts to customers as compared with alternative methods of financing or recovering storm-recovery costs and storm-recovery reserve. Any determination of whether storm-recovery costs are reasonable and prudent shall be made with reference to the general public interest in, and the scope of effort required to provide, the safe and expeditious restoration of electric service.*

(Emphasis added.) FPL does not assert that granting its request for a financing order is reasonably expected to result in lower overall costs as compared to imposition of a short-term, "traditional" surcharge. Rather, FPL's petition is based on the mitigating effect that its proposed

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<sup>1</sup> The AG was granted leave to intervene at the Prehearing Conference held April 13, 2006. All other parties, except FPL, were granted leave to intervene by separate orders.

storm-recovery charges would have on rates as compared to continuing the existing surcharge in addition to implementing another short-term surcharge.

### Summary of Recommendation

None of the parties except FIPUG support implementation of a traditional, short-term surcharge. Instead, the parties appear to support the lower but longer-term charges associated with the issuance of storm-recovery bonds. Still, a number of disputed issues remain concerning the appropriate amount to be recovered from ratepayers. To the extent the Commission authorizes FPL to finance any portion of this amount through storm-recovery bonds, several issues remain concerning the process of issuing the bonds.

With respect to the amount to be recovered from ratepayers, there are three main groups of disputed issues, which are outlined in the Table of Contents and addressed below: (1) issues related to the appropriate charges to FPL's Reserve (Issues 1-26); (2) issues related to the prudence of FPL's system maintenance activities prior to and during the 2005 storm season (Issues 27-36); and (3) issues related to the funding of FPL's Reserve (Issues 37-38).

#### *Charges to the Reserve*

An important issue with respect to the first set of issues is the methodology by which 2005 storm costs should be charged to the Reserve (Issue 6). The Commission addressed this issue in its 2004 Storm Order and found that a "modified incremental cost" approach should be used. Under that approach, storm-recovery expenses incremental to those already being recovered through FPL's base rates were charged to the Reserve. Capital items were not charged to the Reserve. In determining the appropriate amount to charge to the Reserve for 2004, the Commission considered that FPL did not collect normal base rate revenues – due to outages resulting from the storms – to cover its normal (i.e., non-incremental) costs during that period. Thus, the Commission allowed FPL to recover those normal costs that it found were not recovered by base rate revenues.

In this case, FPL supports the use of an approach slightly different from the "actual restoration cost" approach it supported last year. Under FPL's approach, all direct and indirect costs incurred to safely restore service and to return plant and equipment to its pre-storm operating condition are charged to the Reserve. FPL's approach in this docket differs from the approach it supported last year in that FPL has not charged capital items to the Reserve for the 2005 storms. Intervenors support use of the modified incremental cost approach used in the 2004 Storm Order, but assert that there should be no adjustment for undercollection of normal base rate revenues because such revenues exceeded budgeted revenues during the affected months in spite of the storm-related outages in 2005.

In this recommendation, staff recommends that the evidence supports continued use of the modified incremental cost approach as suggested by Intervenors (Issue 6). Based on the evidence presented, staff will recommend that there should be no adjustment for "lost revenues" for the Commission to consider in this case (Issue 17). Further, staff will advise that the 2004 Storm Order does not establish a precedent that binds the Commission's determination of the methodology to use in this docket (Issue 5). The table below provides a summary, by issue, of Staff's recommended adjustments consistent with the modified incremental cost approach.

### *Prudence of System Maintenance*

The next set of issues concerns whether FPL adequately inspected and maintained its distribution and transmission system prior to and during the 2005 storm season (Issues 27-33). Intervenor assert that FPL did not adequately inspect and maintain its system for deterioration and overloading of poles, did not adequately control vegetation around its system, and did not adequately maintain facilities on two particular transmission lines that failed during the 2005 storm season. In this recommendation, staff will recommend that certain adjustments should be made under these issues. Staff's recommended adjustments are set forth in the table below.

Another controversial issue concerns whether FPL's 2005 storm-recovery costs should be shared between FPL's ratepayers and shareholders (Issue 35). This issue was addressed in testimony by Staff witness Jenkins, who suggested that shareholders be responsible for up to 20 percent of FPL's prudently incurred 2005 storm costs. Of the Intervenor, only the AG has supported application of this concept. All of the Intervenor were parties to the settlement approved in the 2005 Rate Case Order. As discussed in the recommendation, staff believes that the settlement was clearly intended to preclude the parties from proposing or supporting such a sharing, although the Commission is not entirely bound by the terms of the settlement. Staff believes that the Commission can honor the settlement but still require a sharing of costs by making the adjustments recommended in Issues 27-33 and by not considering "lost revenues" in determining the 2005 storm-recovery costs appropriately charged to the Reserve.

### *Funding of Reserve*

There is also controversy surrounding the appropriate level of funding to replenish FPL's Reserve. FPL requests a level of \$650 million. Intervenor support a level of approximately \$150-200 million. The Commission has wide latitude in determining the appropriate amount. If future storm-recovery costs exceed the balance of FPL's Reserve, nothing prohibits FPL from seeking recovery of those costs through the issuance of storm-recovery bonds or a "traditional," short-term surcharge. In this recommendation, staff will propose that the Reserve should be funded to a level of \$200 million through this proceeding.

<b>Unrecovered 2004 Storm-Recovery Costs (as of July 31, 2006)</b>	<b>\$213,307,000</b>
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Issue 1 – Nuclear Storm Damages	(6,100,000)
- Legal Claims And Lawsuits	(2,664,038)
- Other Parties’ Poles Reimbursements	(5,432,966)

Subtotal	(14,197,004)
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2004 Jurisdictional Factor	99.525%
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Jurisdictional Adjustments (14,129,568)

Issue 3 – Interest Adjustment	(497,000)
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<b>Total 2004 Adjustments</b>	<b>(14,626,568)</b>
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**Adjusted Unrecovered 2004 Storm-Recovery Costs** **\$198,680,432**

Less: Staff Recommended Adjustments

Issue 7 – Condenser Tubes	(2,785,364)
- Hydrolasing	(221,000)
- Proceeds from Others	(3,468,593)

Issue 8 – Payroll Expense	(17,925,918)
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Issue 9 – Exempt Employee Overtime	(768,000)
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Issue 11 – Tree Trimming (1,100,000)

Issue 12 – Fleet Vehicles (5,738,000)

Issue 13 – Telecommunications Expense	(520,264)
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Issue 14 – Advertising (1,143,916)

Issue 15 – Uncollectibles (3,582,000)

Issue 16 – Normal Replacements	(8,745,000)
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Issue 18 – Landscaping	(3,816,864)
Issue 19 – Lawsuit Settlement Charges	(2,849,571)
Issue 20 – Contingencies	(26,253,351)
Issue 22 – Other Entities’ Poles	(10,564,384)
Issue 24 – Employee Assistance	(245,025)
- Warranty Repairs	(316,250)
Issue 27 – Inspect & Maintain System (also \$1,440,000 Rate Base Adj.)	(4,460,000)
Issue 28 – Vegetation Management (also \$850,000 Rate Base Adj.)	(2,550,000)
Issue 33 – Transmission Failures (\$12,000,000 Rate Base Adj.)	<u>0</u>
Subtotal	(97,053,500)
2005 Jurisdictional Factor	<u>99.921%</u>
Jurisdictional Adjustments	(96,976,828)
Issue 34 – 2005 Jurisdictional Interest Adjustment	<u>(1,365,500)</u>
<b>Total 2005 Adjustments</b>	<b><u>(98,342,328)</u></b>
<b>Adjusted 2005 Storm Damage Costs To Be Charged Against Storm Reserve</b>	<b><u>\$728,510,672</u></b>
<b>FPL Requested Level of Reserve</b>	<b>\$650,000,000</b>
<u>Less:</u> Staff Recommended Adjustment – Issue 37	<u>(450,000,000)</u>
<b>Staff Recommended Reserve Level</b>	<b><u>\$200,000,000</u></b>
<b>TOTAL AMOUNT TO RECOVER – PRE-TAX BASIS</b>	<b><u>\$1,127,191,104</u></b>
<b>TOTAL AMOUNT TO RECOVER – AFTER-TAX BASIS</b>	<b>\$692,377,136</b>
Up-Front Bond Issuance Costs	<u>11,425,000</u>
<b>TOTAL AMOUNT SUBJECT TO SECURITIZATION</b>	<b><u>\$703,802,136</u></b>

*Terms and Conditions of Financing Order*

As noted above, all parties but FIPUG appear to support the use of storm-recovery bonds to finance the amounts approved for recovery in this proceeding, and staff is recommending issuance of a financing order in this case. With respect to the terms and conditions to be included in a financing order for these amounts, there is still disagreement among the parties on several issues (see Issues 45-76). The major issues in dispute involve (1) whether or not the Commission should use a "lowest cost" standard with regard to interest rates achieved on the bonds and other issuance costs (Issue 61) and (2) the level of involvement that the Commission should have in the structure, marketing, and pricing of the bonds (Issues 61-68, 71, 74, 74A, and 74B). Staff will recommend that the Commission adopt a lowest cost standard with active Commission involvement in the pre-issuance process through final pricing.



**Discussion of Issues**

**CHARGES TO STORM RESERVE**

**2004 Storm Costs**

**Issue 1:** Did FPL stop charging 2004 storm-related costs to the storm reserve by July 31, 2005, for restoration work related to the 2004 storm season, as required by Order No. PSC-05-0937-FOF-EI? If not, what adjustments should be made?

**Recommendation:** No. The 2004 storm-related costs should be reduced by \$14,197,004. (Slemkewicz)

**Position of the Parties**

**FPL:** Yes. As of July 31, 2005, total storm costs of \$890.0 million were reflected in FPL's accounting records. Subsequent to this date, adjustments were made pursuant to the referenced order to remove \$91.9 million resulting in \$798.1 million of storm costs approved for recovery. As to estimated costs recorded as of July 31, 2005, for work not completed at that date, differences that would result in actual costs exceeding \$798.1 million will be absorbed by the Company. If actual costs are less than \$798.1 million, FPL proposes that the difference be credited to the Storm Reserve.

**OPC:** No. FPL added accruals to the 2004 storm reserve items not requested or identified in testimony, exhibits or other evidence in the record in Docket No. 041291-EI. FPL disregarded the Commission's cut off point for charges to the storm reserve. The Commission should adjust the reserve by \$51,264,919.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC as to appropriate adjustments.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis stated that FPL did stop charging 2004 storm-related costs to the storm reserve by July 31, 2005 as required by the order and that no adjustments are required at this time. (TR 1592)

OPC witness DeRonne presented a schedule (DD-2) in her direct testimony that calculated her recommended reduction of \$51,396,811 to the 2004 storm cost estimates. (EXH 86) However, OPC has accepted FPL witness Davis' rebuttal testimony that OPC's proposed adjustment related to reimbursements for work on poles owned by others should be reduced by \$131,892. (OPC BR at 6) Therefore, OPC's recommended adjustment is a reduction of \$51,264,919. (OPC BR at 1)

### ANALYSIS

OPC's proposed \$51,264,919 adjustment is comprised of the following four components: (1) \$21.7 million charged to the Storm Reserve in the 2004 Storm Cost Recovery Order; (2) \$21,467,915 of various nuclear storm damages; (3) \$2,664,038 of legal claims and lawsuits; and (4) \$5,432,966 for reimbursements for repairs on poles owned by other parties.

#### \$21.7 Million Charged to the Storm Reserve in the 2004 Storm Cost Recovery Order

The 2004 Storm Order included a \$21.7 million (\$21,597,000 jurisdictional) reduction to FPL's requested 2004 storm damage recovery costs. (page 20) The effect of this adjustment transferred the \$21.7 million from storm costs recoverable through the surcharge back to the storm reserve. In essence, the \$21.7 million was deferred, not disallowed.

FPL agrees that \$21.7 million was excluded from the 2004 Storm Restoration Surcharge. However, witness Davis stated that the inclusion of the \$21.7 million in the Reserve, pending recovery, is consistent with the 2004 Storm Order. (TR 604, FPL BR at 18) In its brief, FPL stated that the \$21.7 million was the subject of a special staff supplemental recommendation, to which all parties to the 2004 Storm Cost Recovery proceeding agreed (including OPC), after which the Commission adopted Staff's proposed accounting treatment resulting in the \$21.7 million being charged to the Reserve rather than included in the amounts subject to the 2004 Storm Restoration Surcharge. (FPL BR at 18) Witness Davis testified that the \$21.7 million had been inadvertently removed from the 2004 storm costs. He further testified that rather than going back and revisiting the amount already approved for 2004, the \$21.7 million was charged back to the reserve and was not recovered at that time. (TR 537)

OPC witness DeRonne stated that the 2004 Storm Order indicated the \$21.7 million was included as part of storm restoration costs, but was not included in the calculation of the surcharge approved in that docket. In other words, the Order ultimately resulted in the addition of the \$21.7 million to the allowed charges to the storm reserve for future recovery, but it was not factored into the determination of the surcharge allowed in that case. Once this \$21.7 million is factored in, the net amount that effectively was approved for recovery in the 2004 Storm Cost Recovery Order is \$819,800,000 (\$798,100,000 + \$21,700,000). (TR 980) FPL agreed that the effect of the \$21.7 million adjustment contained in Exhibit 19 sponsored by FPL witness Davis is the same as if that amount were added to the amount contained in the Commission's 2004 Storm Order. (TR 536) Based on the information that she had received from FPL, witness DeRonne testified that it was her opinion that the \$21.7 million had been spent. (TR 1012)

Although the \$21.7 million was not included in the 2004 storm costs to be recovered through the surcharge, it was not disallowed. If it had been deemed to be a disallowance, FPL

would have been required to write off the \$21.7 million as an O&M expense. Instead, the \$21.7 million was charged against the reserve as an incurred storm cost. Staff believes that this is the appropriate time to seek recovery of this amount. In staff's opinion, the \$21.7 million represents 2004 storm costs that were deferred and that are now eligible for recovery. Staff recommends that the 2004 storm costs not be reduced by the \$21.7 million.

Various Nuclear Storm Damages (\$21.5 million)

Witness Davis testified that FPL included approximately \$21.5 million in nuclear storm damage costs as part of the \$890.0 million it requested in Docket No. 041291-EI. (TR 1593) He further stated the \$21.5 million was reduced in February 2006 due to the correction of an error in recording storm costs in 2005. A storm related payment had been incorrectly charged to a non-storm work order due to a transposition error in the work order number. The effect of correcting this error was to reduce the balance available for the uninsured nuclear costs to \$20.5 million. (TR 1594 Davis) Witness Davis testified that a further adjustment was made to reduce the \$20.5 million by \$5.1 million was based on a revised estimate in March 2006. The current estimate of \$15.4 million in uninsured 2004 costs was based on discussions with Nuclear Electric Insurance Limited ("NEIL") concerning the scope of damages to be repaired and the costs subject to insurance. (TR 1595) FPL witness Warner testified that the remaining \$15.4 million for uninsured 2004 nuclear plant storm damage reflects the most accurate and reliable information available concerning 2004 storm cost repairs still to be conducted at the St. Lucie Plant. (TR 388) The necessary adjustment of \$5.1 million is shown in FPL witness Davis' Exhibit 119.

OPC witness DeRonne testified that the 2004 storm costs should be reduced by \$21,467,915 (\$21.5 million) to remove various nuclear storm damages. Witness DeRonne stated that the response to OPC Interrogatory No. 108 (EXH 155) indicated that the costs were an estimate of uncompleted work subject to change based on insurance recoveries. Witness DeRonne further testified that these were future estimated costs that should not be included in the 2004 storm recovery costs. Witness DeRonne also stated that it appears that these costs were not presented in the prior case and were estimated after July 31, 2005. (TR 984-985)

Staff believes the timing of the nuclear unit repairs warrants economic and operating considerations. Because of the high replacement power costs incurred when a nuclear unit is off-line, damage assessment and repairs to certain equipment can only be performed during refueling outages, which occur approximately every 18 months. (Warner TR 389) FPL maintains that the repairs, including repairs to the intake and discharge canals, repair of coatings in various areas of the plant, and canal dredging, are critical to ensure the long-term reliability of plant operations, but due to the nature of nuclear operations it may take several years before the units can be fully restored to pre-storm conditions. (TR 390; FPL BR at 81) Staff believes FPL has justified the reasons for the delay in starting the nuclear unit repairs.

Based on the foregoing discussion, staff recommends that the estimated nuclear storm damage repair costs should be included in the 2004 storm costs. However, staff recommends that the amount be reduced by \$6.1 million to reflect FPL's latest estimate of the uninsured portion of the repairs. This represents the difference between the \$21.5 million original estimate and the \$15.4 million revised estimate.

Legal Claims and Lawsuits (\$2.7 million)

FPL witness Davis testified that the 2004 litigation costs included in FPL's March 31, 2006 accrual are directly related to storm restoration and are thus recoverable storm costs. FPL is a member of the Edison Electric Institute, and the Southeastern Electric Exchange, where the members of these organizations have a mutual aid agreement to help each other when disasters such as hurricanes occur. These organizations have guidelines as to what companies can charge each other for their assistance. The general framework of the mutual aid assistance agreement is that each company is entitled to recover all reasonable costs incurred for providing assistance to the host utility. (TR 1587) In addition, FPL is required to "indemnify, hold harmless and defend" foreign crews assisting FPL in restoration efforts from any and all lawsuits or claims that result from furnishing emergency assistance. (TR 1588) Witness Davis said that this means that FPL is responsible for reimbursing the assisting utility for its costs when that utility's employee causes an accident or injury during storm restoration. (TR 1589)

Witness Davis testified that the removal of these costs from storm cost recovery would attribute them to base rates. He also testified that hurricane litigation reimbursements are extraordinary and non-recurring costs that are excluded when setting base rates, because the hurricanes that give rise to them are extraordinary in nature. (TR 1589) However, witness Davis did testify that the amount of the costs should be reduced by \$635,000. (TR 1590; EXH 119)

OPC witness DeRonne testified that the 2004 storm recovery costs should be reduced by \$2,664,038 for claims outstanding and pending lawsuits. (TR 984) She testified that such costs are not directly related to the storm. (TR 984) She also stated that these costs were not presented previously as part of the storm costs. She further stated that this type of cost is considered in the determination of base rates. (TR 984) OPC stated in its brief that FPL witness Davis testified that he removed \$2.2 million of these costs. (OPC BR at 6; TR 1615) However, a review of the transcript shows that witness Davis was referring to 2005 costs rather than 2004 costs. (TR 1615)

Staff agrees with witness DeRonne that these costs should be not be included in the 2004 storm costs. Although the events associated with these pending actions occurred during storm damage restoration activities, they were not themselves storm damage restoration activities. There is also considerable uncertainty associated with estimating the final outcome of outstanding claims and pending lawsuits. For these reasons, staff recommends that the 2004 storm costs be reduced by \$2,664,038 to remove the outstanding claims and pending lawsuits resulting from the actions of other utilities' employees.

Reimbursements for Work on Other Parties' Poles (\$5.6 million)

FPL billed \$7,419,810 to other parties for replacing joint use poles owned by others. OPC, in Exhibit 86, recommended that 2004 storm costs be reduced by \$5,564,858 based on the assumption that 25 percent of the \$7,419,810 billed to outside parties would have been normal capital costs for the poles removed and thus already excluded from the amounts charged to the storm reserve. On rebuttal, FPL witness Davis identified the amount billed net of the normal capital costs of the poles as \$5,432,996, which is \$131,892 less than OPC's recommended adjustment. OPC has accepted FPL's position that \$5,432,966 is the appropriate amount. (OPC

BR at 6) FPL agrees that the 2004 storm recovery costs should be reduced by \$5,432,966. (FPL BR at 20) Accordingly, staff recommends this adjustment be made.

**CONCLUSION**

Based on the above discussions, staff recommends that the 2004 storm-related costs be reduced by \$14,197,004, calculated as follows:

\$21.7 Million Amount Charged Back to Storm Reserve	\$	0
Various nuclear storm damages		(6,100,000)
Legal Claims and Lawsuits		(2,664,038)
Other Parties' Poles Reimbursements		<u>(5,432,966)</u>
Total Adjustment		<u><u>\$(14,197,004)</u></u>

**Issue 2:** Should the 2004 storm costs be adjusted for other items? If so, what is the appropriate adjustment?

**Recommendation:** This is a moot issue because all of the proposed adjustments have been addressed in Issue 1. (Slemkewicz)

**Position of the Parties**

**FPL:** No. FPL has agreed to certain adjustments specified in Mr. Davis's rebuttal testimony, which should be addressed in a final true-up process. No adjustments other than those specified by Mr. Davis should be made.

**OPC:** Yes, the 2004 storm costs should be adjusted to remove the estimated amounts for reimbursements for repair and restoration of poles owned by other parties.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes. Agree with OPC as to appropriate adjustments.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** This is a moot issue because all of the proposed adjustments have been addressed in Issue 1.

**Issue 3:** Should an adjustment be made to reflect the actual December 31, 2005 storm cost deficiency related to the 2004 costs? If so, what is the amount of the adjustment?

**Recommendation:** Yes. The 2004 reserve deficiency should be reduced by \$14,626,568 (jurisdictional) to match the recommendations made by staff in Issue 1 and the related interest expense. The December 31, 2005 difference between the general ledger and FPL witness Davis' Exhibit 19, along with other month-to-month variances attributable to actual interest accrued and billed revenues, should be addressed as part of a final true-up. (Romig)

**Position of the Parties**

**FPL:** No. There are some small differences between the deficiency balance and General Ledger due to rounding down the amount of 2004 storm costs approved for recovery, and differences between estimated and actual interest incurred and billed revenues as 2004 storm cost amounts have been recovered. Any differences remaining as of July 31, 2006 should be addressed as part of the final true-up.

**OPC:** Yes, the 2004 reserve deficiency should be reduced \$51,264,919 to reflect the adjustments discussed in response to issue 1, with a corresponding reduction in interest expense accrued at the pre-tax commercial paper rate on the account.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes. Agree with OPC that the 2004 reserve deficiency should be reduced by \$51,396,811.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

In his rebuttal testimony, FPL witness Davis stated that FPL believes that adjustments to the 2004 storm costs are appropriate. (TR 1584) As presented on Document No. KMD-11, witness Davis proposed adjustments of \$11,147,166 related to legal claims and lawsuits, various nuclear storm damages, and reimbursement for work on other parties' poles. (EXH 119) Each of these adjustments is analyzed as part of Issue 1, resulting in a \$14,197,004 recommended adjustment to 2004 storm-related costs.

In addition, FPL witness Davis testified that Audit Finding No. 11 of the Commission Staff's Audit Report (EXH 2) states the amount of unrecovered 2004 storm costs on FPL witness Davis' KMD-3 (EXH 19) is different than what is recorded in the general ledger as of December 31, 2005. However, witness Davis does not believe that any action is required at this time. Witness Davis explained the reason for the difference between the \$293,930,364 unrecovered

2004 storm costs in the General Ledger as of December 31, 2005 and the \$294,680,000 amount shown on Exhibit 19. Witness Davis described the \$749,636 difference as being attributable to three factors: The beginning deficiency balance on the general ledger was \$441,634,351, while the amount shown on Witness Davis' Exhibit 19 was \$441,990,525, the amount approved in the 2004 Storm Cost Recovery Order. In turn, this difference is because the beginning deficiency balance reflected in Exhibit 19 is different than what was recorded on the general ledger due to the rounding of actual storm funds available to offset the amount of 2004 storm costs approved for recovery from \$354,357,874 to \$354,000,000. (TR 1584-85; EXH 19) The remaining two factors relate to interest and billed revenues. Witness Davis' Exhibit 19 is based on actual interest and billed revenues to November 30, 2005 and estimated interest and revenues for December 2005, whereas the general ledger is based on actual interest and billed revenues through December 2005. Witness Davis testified that the month-to-month variances between actual and estimated unrecovered storm costs remaining as of July 31, 2006 should be addressed as part of a final true-up. (TR 1585)

In its Brief, OPC states that the reserve deficiency should be reduced by \$51,264,919 to reflect the adjustments discussed in Issue 1, with a corresponding reduction in interest expense accrued at the pre-tax commercial paper rate on the account. (OPC BR at 8)

Staff witness Welch testified that the actual general ledger amount of 2004 storm costs at December 31, 2005 for 2004 storm costs was \$293,930,364, whereas the amount of the ending deficiency on Exhibit 19 was estimated to be \$294,680,000. She also testified that the difference relates to the estimate of the beginning balance from the 2004 Storm Order being different from actual, the December interest calculation being different from actual, and an adjustment for the 2004 Storm Order related to taxes on the interest. (TR 1092)

### **ANALYSIS**

The analyses and conclusions for the individual components of the \$51,264,919 at issue are addressed in Issue 1.

The remaining \$749,636 at issue is related to the difference between the estimated December 31, 2005 balance for 2004 storm costs and the amount recorded on FPL's general ledger on December 31, 2005. As pointed out by witness Davis, this variance was due to a rounding difference between the general ledger and the 2004 Storm Order as well as differences between estimated and actual interest incurred and billed revenues as the 2004 storm surcharge was collected.

In addition, in the 2004 Storm Order the Commission determined, "For the sake of simplicity and administrative efficiency, that annual revisions to storm recovery factors to reflect actual sales are not necessary" and "total revenues will be subject to the cumulative true-up at the end of the recovery period." (2004 Storm Order, p. 38) Finally, no party took a position on the \$749,636 at issue.

### **CONCLUSION**

Based on the foregoing, the 2004 reserve deficiency should be reduced by \$14,626,568 (jurisdictional) to match the recommendation made by staff in Issue 1. Based on removing the



staff's proposed \$14,129,568 adjustment from the \$441,991,000 beginning balance for the unrecovered 2004 storm-recovery costs on Exhibit 19, the amount of interest on the outstanding balance should be reduced by \$497,000. The December 31, 2005 difference between the general ledger and FPL witness Davis' Exhibit 19, along with other month-to-month variances attributable to actual interest accrued and billed revenues, should be addressed as part of a final true-up. Staff's recommended adjustments are calculated as follows:

<u>ISSUE</u>	<u>DESCRIPTION</u>	<u>\$</u>
	Estimated Unamortized Jurisdictional 2004 Storm Costs as of July 31, 2006	<u>213,307,000</u>
1	July 31, 2005 Stop Date for 2004 Costs	
	- Various Nuclear Storm Damages	(6,100,000)
	- Amounts Not Incurred	0
	- Legal Claims and Lawsuits	(2,664,038)
	- Reimbursements for Other Parties' Poles	(5,432,966)
2	Other 2004 Storm Cost Adjustments	<u>0</u>
---	Total Adjustments to 2004 Storm Costs	(14,197,004)
---	Jurisdictional Factor	<u>99.525%</u>
3	Jurisdictional Adjustments to 2004 Storm Costs	(14,129,568)
3	Interest Expense Adjustments	<u>(497,000)</u>
3	Total 2004 Storm Cost Adjustments	<u>(14,626,568)</u>
---	Adjusted Unamortized Jurisdictional 2004 Storm Costs as of July 31, 2006	<u>198,680,432</u>

**Issue 4:** Has FPL properly accounted for the after-tax effects of interest on unrecovered storm costs?

**Recommendation:** Yes, FPL has properly accounted for the after-tax effects of interest on unrecovered storm costs. (Lowe, Kyle)

**Position of the Parties**

**FPL:** Yes. FPL has properly reflected the effect of deferred income taxes related to storm costs in its computation of storm costs to be securitized.

**OPC:** Interest should be reduced to reflect the reduction to the 2004 storm costs included in the reserve as discussed in response to issue 1.

**FIPUG:** Interest should be reduced to reflect the reduction to the 2004 storm costs included in the reserve as recommended by OPC witness DeRonne.

**FRF:** No position as to accuracy of accounting or as to the amount of any adjustment. Agree with OPC that interest should be reduced to reflect the reduction to 2004 storm costs included in the reserve.

**AARP:** Agree with FIPUG.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The Utility and two Intervenors addressed this issue. The Utility argues that it has properly accounted for the after-tax effects of interest on both unrecovered 2004 and 2005 storm costs in the computation of the storm costs to be securitized. FPL witness Davis shows the calculation for the 2004 interest expense (EXH 19) and for the 2005 interest expense. (EXH 20)

OPC argues that adjustments need to be made to the interest expense associated with the 2004 and 2005 storm costs. OPC witness DeRonne testified that the beginning balance of the unrecovered 2004 storm costs should be reduced by \$51,264,919. (OPC BR at 9) However, she did not provide testimony that the interest calculation should be reduced as a result of the adjustment. OPC further argues in its brief that interest on the 2005 storm costs should also be reduced. Again OPC provided no testimony to support this assertion.

FIPUG argues that interest should be reduced to reflect the reduction to the 2004 storm costs included in the reserve, as recommended by OPC witness DeRonne. (FIPUG BR at 11) Again, witness DeRonne did not testify as to the reduction of interest in the calculation of the level of allowable 2004 storm damages. There is no record support for this assertion.

Staff agrees with the Utility. Witness Davis testifies that FPL properly accounted for the after-tax effects of interest on both unrecovered 2004 and 2005 storm costs in the computation of the storm costs to be securitized. (EXH 19 and 20) This testimony was not refuted. However, staff also believes that interest should be adjusted if other adjustments are made to the allowable

Date: May 8, 2006

unrecovered 2004 and 2005 storm damages. We believe these are fall-out mathematical adjustments. Exhibits 19 and 20 show the mathematical calculation.

## **2005 Storm Costs**

**Issue 5:** What is the legal effect, if any, of Order No. PSC-05-0937-FOF-EI on the decisions to be made in this docket?

**Recommendation:** The 2004 Storm Order does not operate as binding precedent with respect to the decisions to be made in this proceeding, including determinations of the appropriate accounting for 2005 storm costs and whether any “sharing” of 2005 storm costs should be required. The decisions in this docket should be made based on the record evidence in this proceeding. (Brubaker, Gervasi, Keating)

## **Position of the Parties**

**FPL:** In accordance with fundamental principles of ratemaking, the Commission approved recovery by FPL of all costs of storm restoration that it deemed to be reasonably and prudently incurred. Nothing has changed that would alter the propriety of approving recovery of all reasonably and prudently incurred storm costs.

**OPC:** Order No. PSC-05-0937-FOF-EI contains some precedent for the Commission's decision in this case. However, the Commission can amend its policy decisions on issues such as lost revenues and the treatment of amounts FPL claims are uncollectible because such changes are supported by expert testimony and other evidence appropriate to the nature of the issues involved.

**FIPUG:** Adopts the position of OPC.

**FRF:** Order No. 05-0937 is non-binding precedent. Because all ratemaking is inherently prospective and legislative, as an exercise of the police power, the Commission is free to make any reasonable decision supported by competent substantial evidence of record with regard to the ratemaking issues (including cost allocation and prudence issues) in this case.

**AARP:** Same position as FIPUG.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

## **Staff Analysis:**

### **PARTIES' ARGUMENTS**

With respect to the accounting methodology to be used in this proceeding, FPL suggests that Order No. PSC-05-0937-FOF-EI (the 2004 Storm Order) established as Commission policy a methodology that can only be modified if a party presents evidence demonstrating a change in circumstances that warrants a modification. FPL asserts that application of the methodology it advocates in this docket – the actual restoration cost approach with an adjustment to remove capital costs – would result in the same total amount of 2005 storm-recovery costs as application

of the modified incremental cost approach used in the 2004 Storm Order, but in a more reliable manner. Thus, FPL argues, it has presented evidence to justify use of its proposed methodology instead of the methodology used in the Commission's 2004 Storm Order. FPL contends that Intervenor, who argue for the use of a different version of the modified incremental cost approach used in the 2004 Storm Order, have not provided evidence justifying use of their proposed methodology. (FPL BR at 23-24)

Further, FPL notes that in the 2004 Storm Order, the Commission rejected arguments that FPL should share some portion of its 2004 storm costs with ratepayers. FPL asserts that the rejection of these arguments demonstrated the Commission's support of "the fundamental principle of recoverability of prudently incurred costs." FPL states that it reasonably relied on this portion of the 2004 Storm Order, and earlier instances where the same principle was recognized, in planning its operations. FPL contends that any change at this point, i.e., a decision to require some sharing, would be retrospective and punitive. (FPL BR at 22-23)

OPC asserts that the 2004 Storm Order contains some precedent for the Commission's decision in this case. However, the Commission can amend its "policy decisions" concerning the appropriate accounting methodology to use in this case to the extent that such amendments are supported by expert testimony and other evidence appropriate to the nature of the issues involved. (OPC BR at 9-10) OPC's position is joined by AARP, FIPUG, FEA, and the AG.

FRF asserts that the 2004 Storm Order is non-binding precedent. FRF contends that because all ratemaking is inherently prospective and legislative, the Commission may make any reasonable decision supported by the evidence of record in this case. (FRF BR at 55)

### ANALYSIS

In the 2004 Storm Order, the Commission addressed several substantive issues. In summary, the Commission determined the following: (1) the manner in which 2004 storm-recovery costs were to be charged to FPL's Reserve; (2) the prudence of the 2004 costs; (3) the recoverable amount of the 2004 costs; and (4) the means by which the 2004 costs would be recovered. Pursuant to the doctrine of administrative finality, these decisions – which related only to 2004 storm costs – may be modified only if there is a significant change in circumstances or if modification is required in the public interest.<sup>2</sup>

Staff's understanding is that this issue was intended primarily to address whether, and to what extent, the Commission may be bound by its determination in the 2004 Storm Order that a particular methodology – the modified incremental cost methodology – was the appropriate manner in which to account for the 2004 storm-recovery costs. As explained below, the Commission is not bound by that determination with respect to the accounting for 2005 storm-recovery costs.

In the 2004 Storm Order, the Commission evaluated different methodologies for charging items to FPL's Reserve. Based on its evaluation of the evidence presented in that case, the

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<sup>2</sup> See *Florida Power Corp. v. Garcia*, 780 So.2d 34 (Fla. 2001), citing *Austin Tupler Trucking, Inc. v. Hawkins*, 377 So.2d 679, 681 (Fla. 1979).

Commission found that a modified incremental cost approach was appropriate for accounting for the 2004 storm-recovery costs. The doctrine of administrative finality provides that this finding should be final with respect to the specific matter at issue – the 2004 storm-recovery costs. The Commission’s decision with respect to the 2005 storm-recovery costs should be based on the evidence of record in this proceeding. Thus, while the Commission may find some guidance in the rationale supporting this finding, the finding does not operate as legally binding precedent with respect to the manner in which 2005 storm-recovery costs should be charged to FPL’s Reserve. This result was envisioned by the Commission when it voted to approve the modified incremental cost approach for 2004 costs, as reflected in the following exchange during the Commission’s July 19, 2005, Agenda Conference:

CHAIRMAN BAEZ: . . . [D]oes our decision today remedy [the fact that there is no established accounting methodology for costs charged to the Reserve] by saying this is the methodology that we are going to be using, or is it still, or does it still continue with the flexibility that I think forms the basis of the recommendation? . . .

COMMISSIONER DEASON: . . . I will be glad to share my views on that. I think until this Commission sets out a policy, preferably in a rulemaking as to what the specific accounting treatment is going to be, we retain our case-by-case flexibility. And that whatever decisions we make on the subsequent issues that follow Issue 1, that that is case-specific, based upon the facts of this record, and that we are not in the process of trying to establish an in-concrete procedure, accounting mechanisms, or whatever you want to call it that are going to be adhered to in the future. I think that really needs to be done in a rulemaking docket.

(Transcript of Item 17, July 19, 2005, Agenda Conference.) No further discussion followed this exchange prior to the Commission’s vote on the issue.

A rulemaking proceeding was initiated in November 2005 to attempt to establish a uniform and standardized methodology for identifying and charging costs of storm damage restoration to the utilities’ reserve accounts. That rulemaking proceeding is ongoing.

For the same reasons that the 2004 Storm Order does not operate as binding precedent with respect to the accounting methodology to be used in this case, it also does not operate as binding precedent with respect to the sharing of 2005 storm costs proposed in this case. As previously noted, the 2004 Storm Order addressed only 2004 storm costs. Thus, the findings in that order could not be reasonably relied upon by any party to be determinative of the treatment of 2005 storm costs.<sup>3</sup>

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<sup>3</sup> Staff witness Jenkins has proposed a sharing of prudently incurred 2005 storm costs. Witness Jenkins’ sharing proposal is addressed in Issue 35 of this recommendation, where the policy and legal questions surrounding the proposal are more fully addressed.

### **CONCLUSION**

Based on its analysis, staff concludes that Order No. PSC-05-0937-FOF-EI does not operate as binding precedent with respect to the decisions to be made in this proceeding, including determinations of the appropriate accounting for 2005 storm costs and whether any “sharing” of 2005 storm costs should be required. The decisions in this docket should be made based on the record evidence in this proceeding.

**Issue 6:** What is the appropriate methodology to be used for booking the 2005 storm damage costs to the Storm Damage Reserve?

**Recommendation:** The incremental cost approach, including an adjustment to remove normal capital costs, is the appropriate methodology to be used for booking the 2005 storm damage costs to the Storm Damage Reserve. (Slemkewicz)

**Position of the Parties**

**FPL:** FPL recommends using the Actual Restoration Cost Method addressed in Docket No. 930405-EI with an adjustment to remove normal capital costs. It should be noted that FPL's proposed methodology yields the same result as the Modified Incremental Cost Approach approved by the Commission in the 2004 Storm Cost Recovery Order, Order No. PSC-05-0937-FOF-EI.

**OPC:** The risk shouldered by ratepayers in compensating companies for storm damage costs should be limited to the incremental costs incurred by utilities in restoring service to ratepayers that were prudently incurred, reasonable in amount, and otherwise properly charged to the storm reserve account. Because the storm reserve should be limited to incremental costs of restoring the system, so-called "lost revenues" have no place in the Commission's determination, whether directly or indirectly.

**FIPUG:** Adopts the position of OPC.

**FRF:** The appropriate methodology is the incremental cost methodology advocated by the witnesses for the Citizens of the State of Florida.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL filed its case using the Actual Restoration Cost Method with an adjustment to remove normal capital costs. As stated by witness Davis, this methodology includes all of the costs that were incurred to restore electric service or return assets to their pre-storm condition. These costs, however, have been reduced by insurance proceeds and by the normal cost of capital items. The remaining costs represent the operations and maintenance expenses that were incurred to restore service to FPL's customers. (TR 437) The intervenors support OPC's position that an incremental cost recovery method should be utilized in this proceeding. Witness Larkin testified that this methodology would limit recovery to those additional costs incurred to restore service that exceeded costs that were already considered and reflected in rates. (TR 890)



### ANALYSIS

In prior proceedings concerning the recovery of storm damage restoration costs, the Commission approved variations of the incremental cost approach. This is true whether the methodology was approved after an adversarial proceeding<sup>4</sup> or was the result of a stipulation.<sup>5</sup> However, the methodologies used in those dockets did not establish any precedence for use in later dockets or as a continuing standard for charging costs to the storm reserve.

FPL's proposed methodology is the Actual Restoration Cost Method with an adjustment to remove normal capital costs. Witness Davis testified that some of the key attributes of this methodology are as follows:

This method, excluding an adjustment to capital costs, was utilized by the Company between 1993 and 2003 to determine the storm restoration costs to be charged against the Reserve. For this proceeding, FPL's proposed method includes all costs which are incurred to safely restore electric service or return plant and equipment to its pre-storm condition. The adjustment to remove capital costs will be at "normal cost" and recorded to rate base. What is left after adjusting for insurance recoveries represents the operations and maintenance expenses the Company has incurred to restore service to its customers.

(TR 437)

Witness Davis stated that:

FPL believes that its proposed method should be adopted for several reasons. First and foremost, this method is by far the most accurate way to account for storm restoration costs. Also, it is totally consistent with sound and commonly accepted cost accounting principles, procedures and practices. Accordingly, it results in accounting and recovery of the actual costs incurred to restore electric service.

(TR 438)

As witness Davis testified, the purpose of FPL's proposed method is to replicate the cost recovery that FPL would receive under a hypothetical third party replacement cost insurance policy. (TR 439)

On rebuttal, FPL witness Gower supported FPL's proposed Actual Restoration Cost Method with an adjustment to remove normal capital costs. Witness Gower also refuted the individual adjustments proposed by OPC witnesses Larkin and DeRonne. (TR 1516-1563)

OPC's proposed methodology is the incremental cost approach including an adjustment to remove normal capital costs. OPC witness Larkin testified that:

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<sup>4</sup> Docket No. 041272-EI, Progress Energy Florida, Inc.; Docket No. 041291-EI, Florida Power & Light Company.

<sup>5</sup> Docket No. 050093-EI, Gulf Power Company; Docket No. 050225-EI, Tampa Electric Company.

The Company's cost accumulation under storm damage work orders results in the accumulation of all payroll and all materials, supplies and other costs charged to the work order being accumulated as storm damage costs. This is so even though some of the payroll costs and some material and other costs are reflected in rates and collected from ratepayers during the normal course of business or are costs that are part of the business risk which the Company should bear.

(TR 892-893)

In essence, witness Larkin is stating that the recovery from ratepayers should be limited to incremental costs incurred to restore service. Witness Larkin also stated that "... incremental cost should reflect only those additional costs incurred by the company in restoring service which exceed costs already considered and reflected in rates." (TR 890)

Commenting further on incremental costs, witness Larkin testified:

FPL storm accounting system does not account for only incremental costs. It accounts for total cost of any employee, material, contract cost, supplies, etc. charged to a storm work order. The accounting process utilized by FPL does not account or attempt to account for the portion of the cost charged to storm work orders that are incremental to the Company's normal operating expense. The accounting process, which FPL labels as accurate, merely charges every cost associated with employees' work on the storm, rather than trying to segregate only that cost which is incremental to normal payroll, maintenance and other expense.

(TR 894-895)

Witness Larkin stated that granting FPL's requested storm costs would result in customers paying twice for the same cost: once in base rates, and once through a storm restoration charge. (TR 932) Witness Larkin stated that the approach advocated by OPC, on the other hand, allows FPL to recover all reasonable and prudent incremental storm costs, but only once. (OPC BR at 12)

### **CONCLUSION**

The purpose of this issue is to establish the basic methodology to be utilized to determine the amount of storm damage restoration costs that should be charged against the storm reserve. The validity and appropriateness of the amounts, and the method for developing those amounts, in any of the individual adjustments addressed in the subsequent issues must be decided on their own merits.

Staff agrees with FPL that its cost accounting system tracks all of the costs that it believes are incurred for storm damage restoration activities. Some of these costs, by necessity, are estimates until the activities can be completed. The cost accounting system, however, is driven by the activities and costs that FPL specifies are to be included as storm damage restoration costs. Reasonable people can disagree whether any particular cost or activity is actually related to storm damage restoration. The issue at hand, however, is not whether the costs were actually

incurred, but how those costs should be apportioned for recovery. FPL's Actual Restoration Cost Method, with capital cost adjustment, assumes that none of the costs have been recovered through base rates. Therefore, all costs not recovered through base rates are to be charged to the reserve and any significant shortfalls should be recovered from the ratepayers. Staff believes that OPC has demonstrated that some of the storm damage restoration costs are already being recovered through base rate revenues, resulting in a double recovery. Although staff does not agree with all of OPC's proposed adjustments, staff does agree that the use of an incremental cost approach, with an adjustment for normal capital costs, is the appropriate methodology to use in this proceeding.

**Issue 7:** Has FPL charged to the storm reserve any costs associated with replacements or improvements that would have been needed in the absence of 2005 storms, and so should be charged to regular O & M or placed in rate base and accounted for accordingly? If so, what adjustments should be made?

**Recommendation:** Yes. The 2005 storm-related costs should be reduced by \$6,474,957. (Slemkewicz, Haff)

**Position of the Parties**

**FPL:** No. FPL has only charged storm-related costs to the Storm Reserve. Therefore, no adjustments should be made.

**OPC:** Yes. FPL has charged several items to the 2005 storm recovery costs that were maintenance projects planned prior to the damage incurred in 2005 by the storms, normal maintenance costs or offsets to O&M expenses which are recovered through base rates. These items include condenser tube repairs, hydrolasing costs, and amounts received from other utilities.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes. Agree with OPC as to the amounts to be adjusted for such items, including condenser tube repairs, hydrolasing, and loan of FPL personnel and equipment to other utilities.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that only storm restoration costs and costs needed for repairs to return the Company's equipment and facilities to pre-storm condition were charged to the storm reserve. (TR 452) Therefore, no adjustments need to be made.

OPC witness DeRonne testified that FPL had charged several items, totaling \$6,474,975, to the 2005 storm recovery costs that were planned maintenance, normal maintenance, or offsets to base rate O&M expenses. Witness DeRonne said that these costs should be removed from the 2005 storm costs.

### ANALYSIS

#### Condenser Tube Repairs (\$2.8 million)

FPL witness Davis testified that the condenser tube repair costs of \$2,785,364 are a capital item and should be removed from the 2005 storm costs. (TR 1610) OPC witness DeRonne agreed that the condenser tube repairs should not be included in the 2005 storm costs. (TR 970) Therefore, staff recommends that the 2005 storm costs be reduced by \$2,785,364 to remove the condenser tube repair costs.

#### Hydrolasing Costs (\$221,000)

FPL witness Davis testified that FPL's review of necessary repairs identified the need for hydrolasing the condenser tubes. The need for this work was caused by storm debris passing through the tubes, and was necessary to enable a proper assessment of the condition of the tubes after the hurricane. As such, the \$0.2 million in hydrolasing costs were not part of normal maintenance activities and are properly included in FPL's 2005 storm costs. (TR 1611)

OPC witness DeRonne said that FPL's 2005 storm cost estimate also includes \$144,000 for hydrolasing the Martin Unit 1 and 2 condenser tubes and \$77,000 for hydrolasing the Martin Units 3 and 4 condenser tubes. The hydrolasing was conducted to clean the tubes to prepare for testing and is a normal, recurring maintenance item included in base rate recovery. Even without any storm activity, FPL had projected to perform condenser tube hydrolasing at Martin Units 1 and 2 in the spring of 2006, at Unit 3 in Fall of 2007 and Unit 4 in Spring 2008. (TR 971-972)

Based on the evidence presented, the hydrolasing would have been done in any event, so it should be treated as regular maintenance and not charged to the storm reserve. Staff recommends that the 2005 storm costs should be reduced by \$221,000 to remove the hydrolasing costs.

#### Proceeds from Other Power Companies (\$9,095,845)

During 2005, FPL billed \$9,095,845 for the loan of Company personnel and equipment to other power companies for storm restoration activities. FPL witness Davis said that FPL has properly accounted for costs and reimbursements for emergency aid it provided to other utilities during 2005. These costs and reimbursements have nothing to do with the 2005 storm restoration costs charged to the Reserve. Because FPL's costs for sending employees to help other utilities were never charged to FPL's Reserve, it is not proper to seek to disallow such costs or to seek to apply reimbursements for any such costs against the Reserve charges for the 2005 storms. (TR 1618-20)

Witness Davis further testified that:

When FPL sends its personnel to assist others, it captures actual costs incurred in a job order. When the assistance is complete, FPL applies appropriate loaders to the job order, as it would for any third party billing, and then provides an invoice to the host utility. Under the terms of the mutual aid agreements, FPL is not

allowed to bill the host utility for overtime it pays its remaining crews to maintain work schedules due to the absence of personnel sent to assist the utility. Those costs are charged to normal operations and maintenance expenses by FPL and offsets the payments received from other utilities.

(TR 1618-1619)

OPC witness DeRonne said that the majority of the reimbursements received by FPL for assisting other utilities in storm recovery efforts should be used as an offset to FPL's restoration costs. If this offset is not made, then FPL would recover the costs both in base rates and from the other utilities' reimbursements. Witness DeRonne would reduce the \$9,095,845 by the \$2,227,252 pertaining to travel and other costs not considered in base rates. (TR 975-976) In its brief, OPC agreed with another reduction to the \$9,095,845 in the amount of \$3,400,000. According to FPL witness Davis, the \$3,400,000 represents overtime payroll and materials that were not included in base rates or the 2005 budget. (TR 1620) This would leave a net adjustment of \$3,468,593. Witness Davis said that a further reduction of \$300,000 was warranted for back-fill work. (TR 1620)

Although FPL does not agree that this adjustment should be made, it did propose reductions to the adjustment if it was made. Staff agrees with OPC that this adjustment should be made in the amount of \$3,468,593. As discussed in Issue 17b, staff does not believe that back-fill work should be included.

### CONCLUSION

Based on the above discussion, staff recommends that the 2005 storm costs be reduced by \$6,474,957, calculated as follows:

Condenser Tube Repairs	\$(2,785,364)
Hydrolasing Costs	(221,000)
Proceeds from Other Utilities	<u>(3,468,593)</u>
Total Adjustment	<u>\$(6,474,957)</u>

**Issue 8:** Has FPL quantified the appropriate amount of non-management employee labor payroll expense that should be charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. Non-management employee labor payroll expense and the employee benefits charged to the storm reserve for 2005 should be reduced by \$17,925,918. The Company should also be required to provide substantiation of the reassignment of the \$2,730,000 from clause activity to the storm reserve in its clause true-up filings. (Romig, Willis)

**Position of the Parties**

**FPL:** Yes. FPL correctly quantified and included all regular payroll as a direct result of the 2005 storms for exempt, non-exempt and bargaining personnel, subject to an adjustment to remove normal capital costs. Because FPL tracks payroll costs by exempt, non-exempt and bargaining unit personnel, FPL does not separately quantify amounts of "non-management employee labor payroll expense." No adjustments should be made.

**OPC:** No. Adjustments are necessary to ensure that the amount of payroll and labor related costs already recovered by FPL through base rates is not also recovered a second time through the recovery of the 2005 storm costs. The following adjustments are appropriate:

Remove Estimated Regular Employee Salaries	(\$26,092,000)
Less: Payroll Normally Charged to Clauses	2,730,000
Less: Capital Payroll in Regular Salaries	8,000,000
Remove Employee Benefits - Already in Base Rates	(9,213,514)
Total Incremental Salary/Payroll Related Adjustments	(\$24,575,514)

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with the \$24,575,514 in adjustments calculated and advocated by OPC's witnesses.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS & ANALYSIS**

Because FPL tracks payroll costs by exempt, non-exempt, and bargaining unit personnel, FPL does not separately quantify amounts of non-management employee labor payroll expense. (TR 1596-97) Based on FPL's "Actual Restoration Cost" method as filed, FPL proposes to include \$26,092,000 in the 2005 storm reserve costs for regular payroll and \$60,334,000 for

overtime payroll. (EXH 13, p. 1) However, FPL concedes that in the event the Commission decides to apply its 2004 Storm Cost Recovery Method, then it should consider offsets to the \$26,092,000 million adjustment of \$2,730,000 for labor ordinarily charged to clauses, \$8,000,000 for labor ordinarily charged to capital, \$2,237,000 of additional capital payroll in regular salaries, and \$2,490,800 of nuclear payroll expected to be recovered through insurance. In addition, FPL agrees that under this method, an adjustment to remove payroll loadings related to the ordinary payroll removed is appropriate. (TR 959; EXH 121; FPL BR at 44-50) FPL testified that a reduction of \$10,634,200, excluding payroll loadings, and \$11,833,766, including a calculated payroll loading of \$1,692,566 to the requested 2005 Storm Costs, should be made if the 2004 Storm Cost Recovery Method is applied.

OPC advocates using the Incremental Cost Approach. (OPC BR at 15) Witness DeRonne testifies that using the incremental approach, the \$26,092,000 in regular employee salaries that should be removed from 2005 Storm Recovery Costs should be offset only for capital payroll of \$8,000,000 and payroll normally charged to clauses of \$2,730,000. (TR 959) Witness DeRonne further testified that in addition to the removal of \$26,092,000 of regular payroll, FPL's 2005 Storm Recovery Costs also should be reduced by incremental employee benefits of \$9,213,514. (TR 960; EXH 85, pp. 1-2) OPC witnesses DeRonne and Larkin testified that a reduction of \$24,575,514 to the requested 2005 Storm Costs should be made.

### SUMMARY

Under the incremental approach, both FPL and OPC agree that ordinary payroll costs included in the petition are \$26,092,000, and that offsets of \$8,000,000 and \$2,730,000 for capital payroll and clause payroll are appropriate. In addition, FPL argues that nuclear payroll expense of \$2,490,800 should offset the \$26,092,000 adjustment, so as not to double-deduct; OPC argues that offsetting is not appropriate as it would give double-recovery. FPL proposed an offsetting adjustment of \$2,237,000 for payroll included in the 2005 estimated capital storm costs as of March 31, 2006; OPC argues that there is no evidence supporting that this is in addition to the \$8,000,000 adjustment for capital payroll and the \$2,237,000 offsetting adjustment should therefore be rejected. OPC argues that payroll loading costs of \$9,213,514 should be in addition to the \$26,092,000 adjustment; FPL argues a payroll loading adjustment of \$1,195,000 is appropriate based on its proposed payroll adjustments that were calculated based on the 2004 cost recovery order approach.

#### 1. Capitalized Payroll Costs (\$8,000,000)

Under the incremental cost approach, FPL and OPC agree that an \$8,000,000 offset to the \$26,092,000 regular payroll adjustment is appropriate. FPL states that regular payroll charged to the storm reserve that would have ordinarily been charged to capital should be allowed to be recovered through the storm reserve since they are not being recovered through base rates. Because normal payroll has a capital component, the assumption that all regular payroll charged to storm is related to operations and maintenance work is incorrect. The regular payroll dollars in the 2005 storm costs include payroll dollars for employees that under normal working conditions would charge their time, or a portion of their time, to capital projects. Therefore, those costs should not be disallowed under the incremental cost methodology. (EXH 126, pp. 1-2) OPC agrees with this offset. (EXH 85) Staff believes that this offset should be accepted. To disallow this offset would effectively disallow recovery as there is no provision to recover it in



base rate operation and maintenance costs and it cannot be assigned to non-existent capital projects. For this reason, staff recommends that the \$26,092,000 regular payroll adjustment be offset by \$8,000,000.

2. Payroll Normally Charged to Clauses (\$2,730,000)

Under the incremental cost approach, FPL and OPC agree that a \$2,730,000 offset to the \$26,092,000 regular payroll adjustment is appropriate. FPL states that regular payroll charged to the storm reserve that would have ordinarily been charged to clauses should be allowed to be recovered through the storm reserve since they are not being recovered through a cost recovery clause or through base rates. (EXH 126, pp. 1-2) OPC agrees with this \$2,730,000 offset. (EXH 85) Staff believes that this offset should be accepted. To disallow this offset would effectively disallow recovery as there is no provision to recover it in base rate operation and maintenance costs and it cannot be assigned to clause activity. For this reason, staff recommends that the \$26,092,000 regular payroll adjustment be offset by the \$2,730,000. However, to insure that the \$2,730,000 is not double-recovered, i.e., recovered through clause activity, staff recommends that follow-up work be accomplished to ascertain that reduced clause costs have been reflected in the clause proceedings. To insure that the \$2,730,000 in normal payroll costs were reassigned from clause activity to storm cost activities, staff recommends that the Company be required to provide substantiation of the reassignment of the \$2,730,000 from clause activity to the storm reserve in its clause true-up filings.

3. Nuclear Payroll Expected to be Recovered through Insurance (\$2,490,800)

FPL witness Davis testified that if the Commission determines that the regular payroll of \$26,100,000 should be removed from the 2005 storm costs, \$2,490,800 should offset these costs. Witness Davis states that nuclear payroll expected to be recovered through insurance should not be included in the regular payroll adjustment. If it is, then it will be subtracted twice from 2005 storm costs: once through the \$26,100,000 adjustment and then again when insurance proceeds are removed from 2005 storm costs. Witness Davis contends that this would be a double disallowance. Further, in its response to the Staff Audit Report (EXH 126, pp. 1-2) FPL stated:

The amount of regular employee salaries charged to the Reserve of \$26,092,000 included an estimate of \$2,490,800 related to nuclear Powerblock repairs, which is expected to be recovered through insurance. Under the incremental cost approach, nuclear payroll expected to be recovered through insurance should not be included in any such payroll adjustment. If it is, then it will be subtracted twice from the total amount of 2005 storm cost to be recovered.

(TR 1603; EXH 121; EXH 126; OPC BR at 46)

FPL witness Warner testified that removal of the \$2,490,800 from 2005 storm recovery costs associated with nuclear employee base salaries is not appropriate, since the \$2,490,800 is not part of the \$17.9 million of nuclear division storm costs requested in this proceeding. Therefore, this amount should not reduce FPL's storm costs since it is not a part of those costs. (TR 391)

On cross-examination, staff witness Welch agreed that FPL adjusted the amount of regular payroll charged to the reserve to account for amounts that it expected to recover through insurance. She agreed that the \$2,490,800 of nuclear payroll expected to be recovered through insurance was not charged to the reserve and that the \$26,100,000 regular payroll adjustment should be reduced by the \$2,490,800. (TR 1100-01)

Witness DeRonne testified that FPL's calculations under the incremental cost approach included a \$2,490,800 offset to the regular employee salary adjustment to reflect the fact that a portion of these payroll costs had already been removed from the 2005 estimated storm recovery costs in the adjustment to remove the estimated insurance proceeds. (TR 959) Witness DeRonne does not believe that the \$2,490,800 offset to the regular employee salaries is appropriate. She testified that if this adjustment is reflected, FPL would recover the associated amount twice, once from the insurer and again from ratepayers. Witness DeRonne believes that the regular employee salary amount included in FPL's storm recovery costs that is being removed under the incremental cost approach, totaling \$26,092,000, is already being recovered in base rates. If the Company both recovers the \$2,490,800 of nuclear employee base salaries from insurers and also offsets the adjustment to remove base salaries from the storm costs by the same \$2,490,800, it will recover these costs both from the insurer and from the customers in base rates. (TR 960)

Staff believes that even though the \$2,490,800 has been removed from the reserve, FPL is still going to recover the amount twice, once from the insurer and once from the ratepayer. The issue of double recovery of the normal payroll due solely to the storms still exists because it is now being recovered through the insurer. Staff is persuaded by witness DeRonne's testimony and therefore the \$2,490,800 should be credited to the reserve and used to reduce storm costs.

#### 4. Additional Capital Offset (\$2,237,000)

FPL witness Davis testified that the \$8,000,000 offset to normal payroll costs of \$26,100,000 that both FPL and OPC agreed was appropriate and was understated by \$2,237,000. FPL witness Davis represents that as of March 31, 2006, the total amount of estimated capital expenditures recorded by FPL is \$72,553,747. Of this amount, \$2,237,000 has been categorized as FPL regular payroll. (EXH 123) Witness Davis has shown this amount as an additional offset to the \$26,100,000 normal payroll cost adjustment. (EXH 121, p. 2)

OPC argues that there is no evidence that the capital offset proposed by FPL has not already been factored into FPL's \$8,000,000 adjustment to offset the salary adjustment by the amount of payroll normally charged to capital. OPC states that the additional \$2.2 million offset under the incremental approach proposed by FPL should not be accepted by the Commission. (OPC BR at 16)

Although staff is unable to ascertain whether the \$2,237,000 is part of the \$8,000,000 capital payroll offset, staff has found no evidence that the \$2,237,000 was not factored into the \$8,000,000 offset. Therefore, staff is uncertain whether the \$2,237,000 should be an offset. Further, staff calculates that the \$8,000,000 capital payroll offset agreed to by both FPL and OPC represents 31 percent of the normal payroll charged to 2005 storm costs. Based on this uncertainty as well as the percentage of capital payroll represented by the \$8,000,000, staff recommends that this offset not be made.

5. Applied Pensions and Welfare (OPC, \$9,213,514; FPL, \$1,195,000)

OPC witness DeRonne proposed an additional adjustment reducing FPL's storm costs based on a claim that FPL has erroneously included \$9,213,514 in "Applied Pensions and Welfare." (TR 960-61) Witness DeRonne states that these costs are already included in base rates and budgets and "would not increase as a result of a storm event," and therefore, should not be included in the 2005 storm costs. She also states that the \$9,213,514 in benefits are not incremental costs resulting from the storms and therefore should not be allowed. (TR 960-61)

FPL witness Davis contends that OPC witness DeRonne's claimed adjustment is incorrect, and the supposition upon which it is based is faulty, even if one were to implement the "incremental approach" advocated by OPC. (TR 1606)

On rebuttal, witness Davis provided a calculation to support that the sum of payroll loadings included in the 2005 storm costs is \$8,391,100, not \$9,213,514. Witness Davis states that the difference of \$822,414 is attributable to adjustments either not reflected or not fully explained in FPL's response to OPC's 9<sup>th</sup> Set of Interrogatories, No. 184. FPL witness Davis claimed that the \$8,391,100 consists of \$4,354,755 of payroll overhead related to regular payroll based on an overhead rate of 16.69 percent and \$4,036,345 pertaining to overtime payroll based on an overhead rate of 6.69 percent. FPL also claimed that in addition to the items included in the response to OPC for pensions, welfare and insurance, the payroll overheads also include payroll taxes. With regard to the application of payroll overheads associated with overtime payroll, FPL claims that the 6.69 percent overhead rate is lower as it only includes social security taxes. (TR 1606-07; EXH 124)

Witness Davis testified that the payroll overhead applicable to regular payroll included in the 2005 storm costs is \$4,354,755 (\$2,610,000 at 16.69 percent), which is the same overhead rate applied to regular payroll in the ordinary course of business. The payroll overhead applicable to overtime payroll included in the 2005 storm costs is \$4,036,345 (\$60,334,000 at 6.69 percent). The lower overhead applied to overtime payroll is based on the assumption that only social security taxes apply to overtime payroll. (TR 1606-07; EXH 124)

Witness Davis testified that therefore, if the Commission disallows recovery of any portion of the regular payroll, then the applicable payroll overheads associated with this amount should be computed and reduced using the appropriate percentage discussed above instead of removing the entire amount. The applicable percentage should also be applied to any regular payroll offsets approved by the Commission. (TR 1607)

OPC contends that the appropriate adjustment to 2005 storm recovery costs is \$9,213,514. (OPC BR at 18)

Based on the arguments set forth by both FPL and OPC, the 2005 storm recovery costs include an amount for payroll loading related to normal and overtime payroll. Staff believes that there is persuasive evidence indicating that the payroll loading costs related to normal payroll approximate \$4,354,755 (16.69 percent of \$26,092,000) and the payroll costs for overtime payroll approximate \$4,036,345, (6.69 percent of \$60,334,000).

In general, payroll loadings follow the payroll. If payroll is capitalized, the payroll loadings are also capitalized. If payroll is charged to a clause, the payroll loadings are charged to the clause. Therefore, if one removes a piece of payroll from the 2005 storm recovery costs, it follows that the related piece of the payroll loading should also follow and be removed. In this issue, staff is recommending removal of a net \$15,362,000 in regular payroll (\$26,092,000 – (\$8,000,000 + \$2,730,000)). Applying 16.69 percent to the amount of normal payroll that staff is recommending be removed results in the recommended decrease of \$2,563,918 for the related payroll loadings ( $.1669 * \$15,362,000$ ).

### **CONCLUSION**

In conclusion, the normal payroll of \$26,092,000 should be removed with offsets for capital payroll of \$8,000,000 and clause payroll of \$2,730,000. This results in allowing \$10,730,000 in regular payroll in the 2005 storm recovery costs, and excluding \$15,362,000. In addition, related payroll loadings of \$2,563,918 should be removed. The payroll loadings were calculated consistent with FPL's .1669 factor. Therefore, staff's recommended adjustment to 2005 storm costs is \$17,925,918.

**Issue 9:** Has FPL quantified the appropriate amount of managerial employees payroll expense that should be charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. Managerial employees payroll expense charged to the storm reserve for 2005 should be reduced by \$768,000 to remove exempt employee overtime pay. (Romig)

**Position of the Parties**

**FPL:** Yes. FPL correctly quantified and included all regular payroll as a direct result of the 2005 storms for exempt, non-exempt and bargaining personnel, subject to an adjustment to remove normal capital costs. Because FPL tracks payroll costs by exempt, non-exempt and bargaining unit personnel, FPL does not separately quantify amounts of “managerial employees payroll expense.” No adjustments should be made.

**OPC:** No. The storm recovery cost is not a basis on which to provide extra compensation to employees who are salaried and have accepted that salary as full compensation for all time that they are required to put in. The 2005 storm costs should be reduced by \$768,000 to remove exempt employee overtime incentives.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that FPL's 2005 storm costs should be reduced by \$768,000 to remove exempt employees' overtime incentives.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

Because FPL tracks payroll costs by exempt, non-exempt, and bargaining unit personnel, FPL does not separately quantify amounts of management labor payroll expense. (FPL BR at 50) In its 2005 storm recovery costs, FPL included \$768,000 for exempt employee overtime incentives. FPL witness Davis explained that the salaries of the exempt employees who received the overtime pay are based on normal job requirements, not extraordinary storm restoration. Prohibiting any incentive payments made to employees who are involved in storm restoration that do not get paid overtime is inappropriate. These payments were determined in a manner consistent with the manner in which overtime payments were computed for other employees and was limited to the amount necessary to avoid inequities. (TR 1617)

FPL states that its policy for paying overtime to these employees during certain storm restoration efforts is a reasonable and appropriate storm cost. FPL witness Williams testified that, in general, the decision to pay or not pay for overtime is primarily based on the length of the

restoration effort. For Wilma, an eighteen-day restoration effort, many of FPL's employees worked sixteen-hour days continuously for the entire restoration period. During storm work, it is possible for two people, who normally are in different pay grade classifications, to be performing the same function during the restoration period. As a result of their normal pay grade classification, one might be eligible for overtime while the other is not. It would not be reasonable for only one to be compensated for their extraordinary overtime. These overtime payments were limited to the amount necessary to avoid inequities, and accounted for only 1.3 percent of total storm related overtime. (TR 1403-04)

FPL witness Davis testified that the record shows that the \$768,000 of overtime costs are reasonable and directly caused by the need to perform storm restoration duties and, accordingly, should be approved by the Commission. (TR 1617) Moreover, witness Davis testified that the exclusion of overtime pay proposed by OPC would provide management level personnel with a disincentive to work on storm restoration. The nature of storm restoration is such that all available personnel, without regard to pay grade classification, are asked to report for storm duty to ensure the prompt restoration of service to FPL's customers. (TR 1617)

FPL concludes that this is an equity issue to compensate employees that performed the same storm duties, but who are compensated differently per "contract."

OPC witness Larkin claims that exempt employee overtime pay should be removed from FPL's 2005 storm costs because an assertion that such employees' regular pay is "full compensation for all time that they are required to put in." (TR 915-16) Witness Larkin testified that salaried employees receive their compensation for the level of work that is required of them. They are not compensated based on a fixed number of hours of work. When overtime is required of salaried employees, they are responsible for providing that additional work for the salary they agreed to accept. The Company does not compensate these employees for additional time they might put in when work load requires that they spend additional hours, such as month end accounting closings or special projects with short due dates. The storm recovery cost is not a basis on which to provide extra compensation to employees who are salaried and have accepted that salary as full compensation for all the time that they are required to put in. (TR 916)

### ANALYSIS

Staff agrees with OPC that salaried exempt employees generally should not be compensated for overtime that is charged to the ratepayers. Staff also believes that there can be an equity issue during hurricanes, which are extraordinary events. Hurricanes can cause day-to-day job duties to differ from one's normal duties. However, staff agrees with witness Larkin that salaried employees are not compensated based on a fixed number of hours of work and they are responsible for providing that additional work for the salary they agreed to accept. For this reason, staff recommends that 2005 Storm Recovery Costs be reduced by the \$768,000 for exempt employee overtime.

**CONCLUSION**

Based on the foregoing, staff recommends that managerial employees payroll expense charged to the storm reserve for 2005 be reduced by \$768,000 to remove exempt employee overtime pay.

**Issue 10:** WITHDRAWN

**Issue 11:** Has FPL properly quantified the cost of tree trimming that should be charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. The cost of tree trimming charged to the storm reserve for 2005 should be reduced by \$1,100,000. (Romig, Lee)

**Position of the Parties**

**FPL:** Yes. FPL's storm restoration costs only include the reasonable costs of removing vegetation as a result of the storms. Routine tree trimming is not charged to the Storm Reserve. No adjustments should be made.

**OPC:** No. Adjustments are necessary to ensure that costs recovered by FPL through base rates are not recovered a second time through recovery of storm costs. A \$1,100,000 reduction to the tree trimming costs is appropriate to reflect that FPL's actual expenditures for non-storm related tree trimming were less than it included in its budget for 2005 tree trimming.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that FPL's claimed tree-trimming costs should be reduced by \$1.1 million.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

Based on the 2004 Storm Restoration Costs Order approach, one of FPL's 2005 adjustments to its 2005 storm costs removes \$1,100,000 for incremental tree trimming expenses. (EXH 121) Although the basis for the 2005 tree trimming adjustment is consistent with the basis for the tree trimming adjustment made by the Commission in the 2004 Storm Order, FPL does not believe the 2005 adjustment for \$1,100,000 is appropriate. The basis for the 2004 adjustment and the 2005 adjustment relies on FPL's actual tree trimming expenditures being less than budgeted. FPL does not believe the adjustment is appropriate because the reasons for the variance between budget and actual are not known. (TR 1020-21)

FPL argues that relying upon the budget variance as a basis for the proposed disallowance lacks logic and should be rejected, as the reason for the budget variance may be



attributable to the change in scope of tree trimming or other reasons that may have been discussed in budget meetings concerning vegetation management. (FPL BR at 54; TR 1020-21)

According to FPL:

OPC's overall theory of denying storm cost recovery based upon the so-called incremental approach has been discussed elsewhere in this brief, and shown to be unsound and unnecessary because of the absence of any double recovery of costs by FPL. In addition, it is clear that at the detailed implementation level of OPC's disallowances using the so-called incremental method, there is an utter lack of logical connection between the costs sought to be disallowed and whether the budget variance was caused by the storm.

Where, as here, OPC's proposed adjustment is contrary to extensive evidence in the record that FPL's storm vegetation removal expenses were reasonably managed and prudently incurred, the Commission should allow FPL's storm costs and deny OPC's requested adjustment.

(FPL BR at 54-55)

OPC witness DeRonne testified that in its Incremental Cost Methodology calculation provided in its supplemental response to OPC Interrogatory No. 30, and as shown on Exhibit 121, p. 2, FPL witness Davis included a reduction to tree trimming costs for the amount under budget. (TR 958)

FPL's actual expenditures for non-storm related tree trimming were \$1.1 million less than it included in its budget for 2005. (TR 961) Witness DeRonne testified that the \$1.1 million adjustment is reasonable and should be made. (TR 958; EXH 85) OPC argues that since customers have already paid for the full level of FPL's budgeted tree-trimming expense in base rates, an adjustment of \$1.1 million should be made to storm related tree-trimming expense so that customers do not pay twice for the same expense: once through base rates, and a second time through a hurricane surcharge. (OPC BR at 20)

### ANALYSIS

As stated by FPL, the reason for the 2005 tree trimming budget variance is unknown and may be attributable to the change in scope of tree trimming or other reasons that may have been discussed in budget meetings concerning vegetation management. (FPL BR at 54; TR 1020-21) Disallowing a cost from recovery based solely on budget variances may not be preferred. However, absent evidence concerning the reason for the variance, it cannot be determined with certainty if the variance was attributable to hurricane activity. FPL offered no evidence to substantiate that it was not attributable to the hurricane activity. Therefore, staff recommends that 2005 Storm Costs be reduced by \$1,100,000. This is consistent with the 2004 treatment.

**CONCLUSION**

Based on the foregoing, staff recommends that 2005 Storm Recovery Costs be reduced by \$1,100,000, the amount under budget for 2005 tree trimming costs.

**Issue 12:** Has FPL properly quantified the costs of company-owned fleet vehicles that should be charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. Staff recommends that \$5,738,000 should be removed from the 2005 storm costs. (Marsh)

**Position of the Parties**

**FPL:** Yes, the actual costs have been correctly quantified. No adjustments should be made.

**OPC:** No. Adjustments are necessary to ensure that costs recovered by FPL through base rates are not recovered a second time through recovery of storm costs. A \$5,738,000 reduction is appropriate to remove a portion of the vehicle costs FPL indicates would have been incurred in the normal course of business, even absent the storms.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that FPL's claimed costs should be reduced by \$5,738,000 to ensure that vehicle costs are not inappropriately recovered through both base rates and through storm surcharges.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Williams testified that actual 2005 costs for fleet vehicles exceeded the budget by \$3.2 million. (TR 1408) She stated that about \$1.2 million of that amount was due to increased maintenance as a direct result of the 2005 storms. (TR 1408) She said that the incremental work was performed through the addition of a second shift and through the use of overtime hours at FPL's maintenance facilities. (TR 1408) She also testified that more parts and materials were also needed above the budgeted amount. (TR 1408)

FPL witness Davis testified that the incremental cost approach would include an adjustment to remove fleet vehicle costs that are included in base rates, as well as an adjustment to remove the normal cost of capital from the amount of storm costs to be recovered. (TR 1607) He stated that both adjustments include an amount for the estimated capital portion of fleet vehicle costs. (TR 1607) He said that if both the fleet vehicle costs and the capital amounts are adjusted, the capital portion of fleet vehicle costs will be removed twice. (TR 1607-1608) He testified that FPL applied the same "capital/operations and maintenance split" that FPL normally uses to determine the \$2.8 million capital amount associated with the storm costs. (TR 1608) He

stated that the adoption of OPC's budget-based incremental cost approach would necessitate consideration of the year-end operations and budget variances for Fleet Services. (TR 1608) Witness Davis also testified that the \$1.2 million in additional maintenance costs discussed by witness Williams partially offsets fleet vehicle costs as shown in his exhibits. (TR 1608; EXH 121, p. 2)

OPC witness DeRonne stated that she removed \$5,738,000 of vehicle costs because FPL would have incurred these costs during the normal course of business. (TR 961) She testified that her calculation represents only a portion of the total vehicle costs included in the storm recovery amounts and that the number is based on the monthly vehicle rates charged to the storm accounts. (TR 961-962) She said that certain incremental vehicle costs will remain in the storm recovery amount for both company owned and non-company owned vehicles after her adjustment is applied. (TR 962)

Witness DeRonne testified that FPL, in determining the vehicle costs using the incremental approach, offset the vehicle costs that would have been incurred in the normal course of business by 48 percent, or \$2,767,000 that FPL argues would otherwise have been charged to capital costs and not to base rates. (TR 962) She testified that she did not reflect this offset because it was not supported by FPL. (TR 962) The witness stated that a similar offset was proposed in FPL's 2004 storm recovery case. (TR 962) She said that the Commission recognized that OPC objected to FPL's rationale in the 2004 Storm Order. (TR 962) She testified that the Commission did not reflect FPL's proposed capital offset in that case, but removed "the entire amount identified by FPL as costs it would have incurred for the Company owned vehicles whether or not the storm occurred." (TR 962)

### ANALYSIS

There are three pieces to the figure to be determined in this issue.

#### Amount Of Normal Costs

FPL indicates in its brief that \$5,738,000 is the amount to remove fleet vehicle costs from base rates and that OPC uses the same figure, so there is no dispute on that point. (FPL BR at 55) Staff believes the record is clear that this cost would have been included in base rates but for the storms. Accordingly, since it is already covered by the rates FPL's customers pay, staff agrees with OPC that it should be removed from the storm costs.

#### Incremental Maintenance Costs

It appears to staff that some amount of incremental costs may have been incurred by FPL for vehicles. FPL witness Williams stated that \$1.2 million was incurred due to increased maintenance as a result of the storms. There may be support for additional costs in FPL's response to Staff's Interrogatory No. 96, where FPL states that, in addition to the amount included in storm costs ". . . there are also incremental fuel and maintenance costs incurred in direct support of storm restoration efforts which are not forecasted nor included [in the figure]." (EXH 4, p. 64) Staff notes that the additional amount is not stated in the exhibit. FPL argues that this adjustment is not disputed in the record. (FPL BR at 55)

OPC witness DeRonne testified that there are incremental vehicle cost amounts remaining in the record after her adjustment of \$5,738,000. (TR 962) Further, OPC argued in its brief that FPL did not “demonstrate that the \$1.2 million for additional maintenance was not included in the vehicle costs included in the 2005 storm recovery costs presented by FPL.” (OPC BR at 21) Staff disagrees with FPL that this amount is undisputed. Although she does not state a dollar amount, OPC witness DeRonne makes it clear that she believes her adjustment leaves other vehicle costs remaining in storm costs. (TR 962)

Staff believes that if the incremental amount was included in FPL’s original filing, as OPC believes, it should remain in the storm recovery costs. However, if it was not included, given there is no explanation as to why it was not included, staff does not believe it should be added back to the vehicle costs as proposed by FPL. Staff does not believe it is plausible that FPL would have included only the normal amount of vehicle costs without including the amount that was over budget. Accordingly, no offsetting adjustment should be made.

#### Capital Costs

FPL witness Williams testified:

Under the incremental cost approach, there is an adjustment to remove fleet vehicle costs that are already included in base rates and another adjustment to remove the normal cost of capital from the amount of storm costs to be recovered. Included in both of these adjustments is an amount for the estimated capital portion of fleet vehicle costs. Therefore, if both the total amount of fleet vehicle costs and capital adjustments are made, then the estimated amount of the capital portion of fleet vehicle costs has been subtracted from the amount of storm costs to be recovered twice.

(TR 1607-1608)

Staff notes an apparent discrepancy in the amount of capital cost associated with vehicles. While FPL witness Davis indicated that an allocation of \$2,767,000 was made to capital costs, his exhibits show only \$1,525,159 of capital associated with vehicles. (TR 1608; EXH 123) The record is silent as to the reason for the difference. (EXH 121, p. 2; EXH 123) The most recent exhibit amount shows the breakdown of the total capital adjustment proposed by FPL, but does not indicate which amounts were included in the original filing, nor does it show whether the capital adjustment for vehicles is a part of the \$2,767,000. (EXH 123)

FPL’s EXH 123 shows only \$1,525,159 in capital adjustments associated with vehicles. Further, staff cannot determine whether this figure is part of the original filing. Staff agrees with FPL witness Williams that if the total fleet vehicle costs and FPL’s proposed total capital adjustment are both made, it would result in double counting. Nevertheless, in this circumstance, staff believes it is inappropriate to add back the capital cost when it is not clear whether it was part of the filing in the first place.

**CONCLUSION**

Staff recommends that \$5,738,000 should be removed from the 2005 storm costs.

**Issue 13:** Has FPL properly quantified the costs of call center activities that should be charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. An adjustment of \$520,264 should be made to reduce telecommunications expense. No other adjustment to call center expense should be made. (Marsh)

**Position of the Parties**

**FPL:** Yes. FPL's has quantified and charged to the Reserve call center incremental costs directly related to storm restoration. No adjustment should be made.

**OPC:** No. The actual operation and maintenance expenses for telecommunications costs in 2005 were \$520,264 less than budgeted. The proposed 2005 storm recovery costs should be reduced by this \$520,264 so that only the incremental telecommunications costs beyond those factored into base rates are included.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that FPL's claimed costs should be reduced by \$520,264.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** There are two components to this issue: call center costs and telecommunications costs.

**PARTIES' ARGUMENTS**

FPL witness Davis testified that the call center budget appears to be overspent for October and underspent for November 2005. (TR 593) He said that there was misbudgeting of payroll for that period. (TR 593) He explained that certain months have two biweekly payrolls, while other months have three. (TR 593) The witness testified that the budget was planned for three payrolls in November when there were three in October instead. (TR 593) He stated that FPL's normal costs exceeded the budget for September, October, and December, but he did not know the specific reason for the September and December variances. (TR 594)

Witness Davis stated that the variances in telecommunications costs include amounts for local and long distance service, cellular service, leased lines, pagers, and equipment maintenance. (TR 1609) He testified that the variances were not associated with the storm restoration during 2005. (TR 1609) He said that two specific items that reduced telecommunications costs were the negotiation of a lower long-distance contract rate, and a revision of FPL's cellular phone policy. (TR 1609) He stated that "FPL should not be penalized for its efforts at managing costs solely because storms affected its service territory." (TR 1609)

OPC witness DeRonne testified that she did not take issue with FPL on call center amounts because FPL indicated only incremental costs were included in the filing. (TR 958) She stated that a comparison of budget to actual costs did not show the company was under budget for the call center during the storm period. (TR 958)

Witness DeRonne testified that FPL's proposed 2005 storm recovery costs for telecommunications expenses were \$520,264 less than budgeted. (TR 962-963) She said that the storm recovery amount should be reduced "so that only the incremental telecommunications costs beyond those factored into base rates are included." (TR 963)

OPC witness Larkin testified that FPL "... had a savings associated with telephone rates that had nothing to do with any productivity gains, rates were just decreased." (TR 941) He stated that FPL wants to keep a gain that they "did nothing for" but expects ratepayers to pay for any communications with the company about storms. (TR 941) He said that any under-budget spending for 2005 should automatically be considered a storm savings. (TR 940)

OPC argued that, because the full budgeted amounts are already included in base rates, FPL customers would pay twice: once in base rates and once through the hurricane charge. (BR at 22) OPC argued that customers should be credited for the full amount included in base rates. (BR at 23)

### ANALYSIS

Staff's comparison of FPL's 2005 call center costs to the budget for September through December 2005 shows that the normal costs were \$9,033,776, while the budget was \$8,535,211. Staff noted similar variances for other months during the year. The amount of \$6,187,253 that FPL included in its storm costs is incremental to the normal costs of \$9,033,776. Thus, staff agrees that only an incremental amount of call center costs is included in the storm costs. (EXH 4, p. 188)

The record is not clear whether the telecommunications expense amount of \$520,264 that OPC recommended for removal is included in storm costs. Staff has identified amounts of telecommunications expenses that are included. (EXH 4, pp. 180-183) Staff agrees with OPC that the inclusion of the \$520,264 in storm costs would mean that customers pay twice. (OPC BR at 23) Staff notes that, while FPL provides plausible reasons for the fact that the normal telecommunications expense was under budget, no FPL witness denied that it was included in the storm costs. FPL's approach for other costs has been to include those storm costs that were above the "normal" costs, as discussed for the call center portion of this issue. Where the normal costs are less than budget, this would translate to an amount being recovered both through base rates and through the storm costs. Staff agrees with OPC that it is inappropriate to require the ratepayers to pay twice. Thus staff believes that \$520,264 of telecommunications expense should be deducted from the storm costs.

### CONCLUSION

Staff recommends that an adjustment of \$520,264 should be made to reduce telecommunications expense. No other adjustment to call center expense should be made.



**Issue 14:** Has FPL appropriately charged to the storm reserve any amounts related to advertising expense or public relations expense for the 2005 storms? If not, what adjustments should be made?

**Recommendation:** No. The Commission should disallow \$1,143,916 in image enhancing and conservation expenses that FPL charged to the 2005 storm reserve. This amount represents \$577,272 in thank you ad expenses, \$144,068 in public relations expenses and \$422,576 in employee campaign radio, web cam, and conservation advertisements. (Kaproth)

**Position of the Parties**

**FPL:** Yes. FPL has identified an adjustment of \$422,576 and recommends that this amount be included as part of the final true-up process. No other adjustments should be made.

**OPC:** No. Advertising costs for safety and other customer services are incorporated into the determination of base rates. Additional expenditures made informing the public of the Company's efforts to restore service are either covered in base rates or do not provide a direct benefit to ratepayers and are not directly related to the storm restoration efforts. As such, advertising and communications costs of \$2,528,196 and \$144,068 for a public relations invoice should be removed from the 2005 storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** FPL has inappropriately charged advertising and public relations costs to its 2005 storm costs. Agree with OPC that \$2,528,196 in advertising and communications costs, and \$144,068 for public relations costs, should be removed from FPL's claimed 2005 storm costs.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** FPL included \$2,528,196 in advertising costs and \$144,068 in promotional costs in the 2005 storm reserve costs. This information was provided in response to Staff's Second Set of Interrogatories, Interrogatory No. 100 and Audit Finding No. 7. (TR 972-973)

OPC witness Larkin testified that only costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. Witness Larkin further explains that other costs the Company may claim to relate to storm recovery should be excluded such as advertising costs. (TR 912-913)

OPC witness DeRonne, testified that advertising, media relations or public relations costs should not be included in storm restoration costs because these costs are generally image

building type expenditures and are not related to the restoration of service to the customers. (TR 972)

Witness DeRonne further states that in response to Staff Interrogatory No. 100 (EXH 4), FPL identified \$2,528,196 of advertising and public relation costs included in the 2005 storm recovery costs. (EXH 4) The response shows that \$506,507 was included for print ads, \$2,021,689 for radio ads and no public relation costs were included. Witness DeRonne stated that Staff Audit Report, Audit Control No. 05-292-4-1, under Audit Finding No. 7, provided information that the print ads consisted of newspaper ads addressing expected electric turn on dates and "Thank You" ads. (EXH 89) Witness DeRonne states that the radio ads appeared to be for safety tips or image enhancing. Therefore, witness DeRonne removed the \$2,528,196 of advertising costs from the 2005 storm restoration costs. (TR 972-73)

Lastly, witness DeRonne removed an additional \$144,068 that was included as a "Public Relations Invoice" in Staff's Audit Report, under Finding No. 7, as Public Relations costs charged to the storm recovery costs. (TR 973; EXH 89)

Staff witness Welch testified that advertising expenses in the amount of \$2,630,218, appears to be image enhancing. Witness Welch explained that some of these expenses were for radio safety ads, some for newspaper ads informing the public of expected restoration times, and some for newspaper ads thanking the public, employees, and contractors, etc. Witness Welch stated that a detailed list was compiled and included in Audit Finding No. 7. (TR 1089)

In rebuttal, witness Davis testified that public outreach advertising, including communications designed to keep customers informed of the status of FPL's restoration efforts and to inform customers of the extraordinary dangers that exist during storm restorations should be encouraged and not discouraged. Witness Davis further explains that these communications meet a critical customer need for restoration and safety-related information after a natural disaster and therefore, public safety and public outreach advertising costs should be allowed. Further, witness Davis states that thank you advertising designed to recognize foreign crews who assist in restoration efforts should be allowed in order to encourage their continued support. Finally, witness Davis states that these expenses are highly volatile and extraordinary and would ordinarily not be included in the cost of service for purposes of setting base rates. (TR 1611-12)

Witness Davis does agree that FPL has included in its 2005 storm costs, \$404,627 in image enhancing expenses on an employee campaign radio and web advertisement and these expenses were reversed from the storm reserve during March 2006. FPL also removed \$17,949 related to conservation advertising in March 2006. (TR 1612; EXH 121)

In rebuttal, FPL witness Williams does not agree with witness DeRonne's adjustments that removed all utility advertising, media relations, or public relations costs because these costs would not have been incurred had it not been for the storms and the necessity of keeping customers informed of storm restoration status and extraordinary dangers that exist during storm restoration. (TR 1407)

Witness Williams testified that the one key lesson learned was that our customers want and expect FPL to communicate more often with them during these events. In addition this information facilitates restoration efforts. In addition, witness Williams states that the thank you

advertising, designed to recognize foreign crew that assisted in restoring service, helps to encourage their continued support. Therefore, these costs are appropriately charged to the storm restoration effort. (TR 1407)

### **ANALYSIS**

In Commission proceedings, advertising expenses are generally examined on a case-by-case basis. If the utility's advertising expenses are found to be informational, educational or safety-related in nature and beneficial to its ratepayers, the Commission generally allows recovery. If, on the other hand, advertising expenses are found to be institutional, image-building, or provide no benefit for the regulated ratepayer, the Commission generally disallows recovery. See Order No. PSC-05-0748-FOF-EI, issued July 14, 2005, In re: Petition for approval of storm cost recovery of extraordinary expenditures, related to Hurricanes Charley, Frances, Jeanne, and Ivan, by Progress Energy Florida, Inc.; Order No. PSC-02-0787-FOF-EI, Docket No. 010949-EI, issued June 10, 2002, In re: Request for rate increase by Gulf Power Company.

Staff believes that the advertising expenditures for the thank you ads are image enhancing, specifically the ads in the Wall Street Journal. The thank you ads do not benefit the ratepayers and do not give safety information needed during the hurricane or information needed during the storm restoration. Staff also believes that the public relations expenses are image enhancing and that conservation expenses should not be recovered through the storm reserve. The total of the thank you ad expenses in Audit Finding No. 7 is \$577,272 and the public relations expenses in Audit Finding No. 7 is \$144,068. (EXH 89)

On the other hand, staff believes that the advertising expenses for giving additional information related to the safety of the ratepayers and the time schedule for the restoration of service is beneficial to the ratepayers during this stressful and potentially dangerous time period. Therefore, staff believes because of the nature and volatility of these expenses they should be included in the storm reserve.

Staff agrees with the FPL proposed adjustment of \$422,576, which removes \$404,627 of image enhancing expenses for an employee campaign radio and web advertisement and \$17,949 related to conservation advertising. (TR 1612) Staff believes that the proposed adjustment should not be removed through the true-up process because staff has the information to make the adjustment at this time.

### **CONCLUSION**

Staff recommends the Commission disallow \$1,143,916 in image enhancing and conservation expenses that FPL charged to the 2005 storm reserve. This amount represents \$577,272 in thank you ad expenses, \$144,068 for public relations expenses, and \$422,576 in employee campaign radio, web cam, and conservation advertisements.

**Issue 15:** Has uncollectible expense been appropriately charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. The uncollectible account expense of \$3,582,000 should be removed from the storm reserve. (Kaproth)

**Position of the Parties**

**FPL:** Yes. Storms result in increases in uncollectible expense that FPL estimates based on incremental usage during the collection policy suspension period and incremental usage during the period where collection workers reduce the collection work backlog caused by the storms. No adjustment should be made.

**OPC:** No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. It would be difficult, if not impossible, to relate uncollectible accounts directly to the effects of a storm. Even if it could be done, these expenses are not directly related to the restoration of service. They are in the nature of risk, for which the Company is compensated through the rate of return on equity.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that FPL's claimed 2005 storm costs should be reduced by \$3,582,000 to remove uncollectible expense included in FPL's storm cost recovery request.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

In his prefiled direct testimony, FPL witness Davis' KMD-4 included a footnote that "estimated 2005 Storm-Recovery Costs, per Ms. Williams' Testimony includes uncollectible write-off expense." However, neither FPL witness Williams' or witness Davis' prefiled testimony quantified the amount of uncollectible expense that was included in the 2005 Storm Costs. But, the amount, \$3,582,318, was provided in Attachment 1 of FPL's response to Staff's Interrogatory No. 92. (EXH 125)

OPC witness Larkin testified that it would be difficult, if not impossible, to relate uncollectible accounts directly to the effects of a storm. He testified that even if it could be done, these expenses are not directly related to the restoration of service. He also testified uncollectible expenses are in the nature of risk, which the Company is compensated for through the rate of return on equity and is a type of business risk so it should not be compensated for

through the storm recovery costs. Consequently, OPC witness DeRonne's DD-1, which summarized OPC's proposed 2005 Storm Cost adjustments, included \$3,582,000 as a reduction to FPL's estimated 2005 Storm Costs. (EXH 85)

In his rebuttal testimony, FPL witness Davis stated that he does not agree with witness Larkin's statement that uncollectible accounts expense should not be included in the 2005 storm costs, as they are difficult to directly relate to the effects of a storm. Witness Davis testified that since FPL mobilizes a large portion of its workforce to restore service to customers as quickly and safely as possible, a majority of the resources that would be utilized to mitigate uncollectible bills are reassigned to storm restoration. He testified that base rates assume that these mitigation efforts are in place and are working. Therefore, delinquent customers receive additional days to pay and if they do not ultimately pay, the amount of uncollectible write-off expense becomes higher as a direct result of hurricane activity. Witness Davis testified further that, but for the restoration effort resulting from the storms, these additional costs would not have been incurred.

In addition, in his rebuttal testimony, witness Davis pointed to Page 16 of the 2004 Storm Order as confirmation that the Commission acknowledged the cause and effect relationship. In the 2004 Storm Order, the Commission found that there was a direct relationship between hurricane activity and the amount of uncollectible, or bad debt, expense incurred. (TR 1613-14)

Staff witness Welch, during cross-examination by FPL, also testified that it was her understanding that the Commission allowed uncollectible accounts expense in the 2004 Storm Order to acknowledge that bill collectors weren't able to go out and do the work they normally do, so FPL was not able to collect as much revenue as they normally do. She stated that it was her understanding that uncollectible accounts expense was allowed because the Commission believed FPL had to write off more than normal revenues. However, witness Welch also stated that that was her understanding only and because she was not actively involved in the hearing, she really couldn't say why the Commission decided to do it. (TR 1098)

Staff witness Jenkins testified that FPL's shareholders should share in the adverse effects of the 2005 hurricanes. (TR 1252, 1256)

### ANALYSIS

FPL provided its computational support for the net write-off of \$3,582,318. (EXH 125) Also, staff acknowledges that the Commission determined in the 2004 Storm Order that there is a relationship between the increase in uncollectible expense and hurricane activity and believes that this relationship does exist. However, because the amount of the estimated uncollectible account expense for the 2004 storms was \$5.6 million and the actual uncollectible account expense that materialized was only \$1.4 million, staff has reservations about the ability to reasonably project the incremental amount that is attributable to storm activity. Although staff does not agree with witness Larkin that it is impossible to relate uncollectible accounts directly to the effects of a storm, staff does believe that the amount of uncollectible expense, is difficult, if not impossible, to accurately project. The inability to reasonably estimate the amount of uncollectible expense directly attributable to storm activity was proven to be true, as shown if the estimated \$5.6 million is compared to the actual \$1.4 million that materialized for the 2004 storm activity.

Further, staff believes that OPC witness Larkin makes a good point in his conclusion that uncollectible expenses are risks, and the Company is compensated for risk through the rate of return on equity and therefore should not be compensated through storm recovery costs. Also, as addressed in Issues 17 and 35, staff also agrees with staff witness Jenkins who testified that FPL's shareholders should share in the adverse effects of the 2005 hurricanes. (TR 1252, 1256) Finally, as OPC witness Larkin testified, these costs are not directly related to the restoration of service. (TR 915) Although this is a departure from the Commission's treatment in the 2004 Storm Order, staff believes the departure is justified due to the reasons detailed.

### **CONCLUSION**

Based on the foregoing analysis, staff recommends that uncollectible expense of \$3,582,000 should be removed from the storm reserve.

**Issue 16:** Has FPL properly charged the normal cost of replacement to rate base and the normal cost of removal to the cost of removal reserve for the 2005 storms? If not, what adjustments should be made?

**Recommendation:** No. The 2005 storm-related costs should be reduced by \$8,745,000 to reflect the increased estimate for capital expenditures. (Slemkewicz, Kaproth, Haff)

**Position of the Parties**

**FPL:** Yes. FPL removed capital costs at “normal cost” and recorded them to rate base. What is left after adjusting for insurance recoveries represents the operations and maintenance expenses the Company has incurred to restore service to its customers. No adjustments should be made.

**OPC:** No. The capital portion total 2005 storm cost has increased from the original estimated amount of \$63,855,000 to \$72,600,000. This additional \$8,745,000 offset to the 2005 storm recovery costs should be made to reflect the higher portion of storm costs anticipated to be capital related, which would not be recovered from the storm reserve.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that an additional \$2,964,000 adjustment to 2005 storm recovery costs charged to the storm reserve is necessary to reflect the higher proportion of storm costs that are presently expected to be capital-related.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that FPL properly charged the normal cost of replacement to rate base and the normal cost of removal to the cost of removal reserve for the 2005 storms. After adjusting for insurance recoveries, the remainder represents the operations and maintenance expenses the Company incurred to restore service to its customers. (TR 437) Therefore, no adjustment is necessary.

OPC witness DeRonne testified that FPL increased its original estimate of capital expenditures by \$2,964,000. The witness recommended that 2005 storm costs be reduced by that amount. (TR 974)

### ANALYSIS

FPL witness Davis testified that FPL properly charged the normal cost of replacement to rate base and the normal cost of removal to the cost of removal reserve for the 2005 storms. After adjusting for insurance recoveries, the remainder represents the operations and maintenance expenses the Company incurred to restore service to its customers. (TR 437) Witness Davis described the capital cost estimating process:

Each Business Unit is responsible for preparing an estimate of capital work as a result of storm damage to its assets. FPL estimates storm damages related to its Transmission and Distribution assets at normal cost utilizing the Company's estimating systems. Storm damages to all other assets are estimated individually by each Business Unit. These estimates are then reviewed by FPL's Accounting Department (Accounting) to ensure these costs are capital costs, not operating or maintenance costs. Accounting also ensures the correct amount of additions, retirements, removal, and salvage will be recorded on the Company's books. Based on the estimates developed, the capital costs are adjusted out of storm-recovery costs and are charged to rate base.

(TR 448-449)

Witness Davis also testified that the estimated amount of normal capital costs to be removed from the 2005 storm costs increased from \$63,855,000 to \$72.6 million. (TR 1604-1605)

OPC witness DeRonne testified that FPL increased its original estimate of capital expenditures by \$2,964,000. (TR 974) Subsequently, FPL increased the amount for estimated capital expenditures to \$72,600,000, an increase of \$8,745,000 from the original estimated amount of \$63,855,000. (TR 1605) Witness DeRonne testified that the increased estimate for capital expenditures should be removed from the 2005 storm costs. (TR 974)

### CONCLUSION

As explained by FPL witness Davis, FPL has a sophisticated system for estimating the amount of storm repair costs that should be removed from the storm reserve and be included in rate base. Witness Davis testified that FPL's most recent estimate of capital expenditures that should be removed from the 2005 storm costs was \$72,600,000. Instead of using this latest estimate to reduce the amount of 2005 storm costs to be recovered through securitization, FPL would prefer to wait and true it up at some later date. The higher costs, however, would be the costs reflected in the securitization revenues to be recovered from the customers.

Staff agrees with OPC that the latest known estimate for the amount of capital expenditures should be used now to lower the amount of the 2005 storm costs. Staff recommends that the 2005 storm-related costs should be reduced by \$8,745,000 to reflect the increased estimate for capital expenditures.



**Issue 17:** If the Commission applies in this docket the methodology applied in Order No. PSC-05-0937-FOF-EI, should the Commission take into account:

- a. Amounts not recovered through base rates due to the disruption of service due to the 2005 storm season or the absence of customers after the storms;
- b. Overtime incurred by Company personnel in work areas not directly affected by the storm due to loss of some personnel to storm assignments (backfill work);
- c. Costs associated with work that must be postponed due to the urgency of storm restoration and accomplished after the restoration was completed (catch-up work);
- d. Uncollectible accounts receivable write-offs directly related to the storms;
- e. Incremental contractor, outside professional services and temporary labor costs due to work postponed due to the urgency of storm restoration and accomplished after the restoration was completed;
- f. Costs that would have otherwise been charged to clauses;
- g. Costs that would have otherwise been charged to capital;
- h. Vacation Buy-Backs; and
- i. Nuclear Payroll Expected to be Recovered Through Insurance.

**Recommendation:**

No for Issues 17a, 17b, 17c, 17d, 17e, and 17h. These factors do not represent reasonable and prudent costs that were or planned to be charged to the storm damage reserve. They do not directly relate to storm restoration. Consistent with the staff recommendation for Issue 35, these amounts should be borne by FPL's shareholders.

Issue 17d is addressed in Issue 15. Issues 17f, 17g, and 17i are addressed in Issue 8. (Devlin, Stallcup)

**Position of the Parties**

- FPL:**
- a. As previously stated, if one were to utilize an incremental cost approach, under which adjustments are based on the theory that certain storm restoration costs have already been recovered through base rates, then base revenues not achieved due to service interruptions from hurricanes must be considered, as they were in the 2004 Storm Cost Recovery Order. FPL's base revenues not achieved due to the 2005 hurricanes were \$51,354,000.
  - b. Incremental backfill costs of \$0.8 million are incremental costs that would not have otherwise been incurred in the absence of the 2005 storms, and they are not being recovered in base rates. These costs are also not being charged to the storm reserve by FPL. Under the 2004 Storm Cost Recovery Order Approach, an

adjustment for the backfill work is appropriate since, otherwise, there would be no cost recovery for these incremental storm related costs.

c. FPL incurred catch-up costs of \$7.8 million due to storm restoration activities. These costs represent additional overtime hours or contractor work incurred until the catch-up work is completed. These incremental costs were directly caused by 2005 storms, are not recovered in base rates, and are not charged to the storm reserve by FPL. Like backfill, under the 2004 Storm Cost Recovery Method, an adjustment is necessary, otherwise there would be no cost recovery of these incremental storm costs.

d. FPL's bill collectors help restore service to customers. Base rates assume bill collection is taking place. Because of storms, delinquent customers receive additional days of service causing uncollectible expenses to increase. But for the restoration effort, these additional costs would not have been incurred. Uncollectible accounts expense directly related to the 2005 storms of \$3.6 million should be allowed to be recovered consistent with the reasoning of the 2004 Storm Cost Recovery Order.

e. See response provided for part c.

f. Regular payroll charged to the storm reserve that would have ordinarily been charged to clauses of \$2.7 million should be allowed to be recovered through the storm reserve since they are not being recovered through a cost recovery clause or through base rates. Simply stated, they are not being recovered twice from customers and, therefore, should not be disallowed under the incremental cost methodology.

g. Regular payroll charged to the storm reserve that would have ordinarily been charged to capital of \$8.0 million should be allowed to be recovered through the storm reserve since they are not being recovered through base rates. These costs should not be disallowed if the 2004 Storm Cost Recovery Method is adopted.

h. FPL purchased \$1.2 million of vacation from employees who were unable to use earned vacation due to their work supporting storm restoration. Many employees worked through November to make repairs to FPL's storm-damaged infrastructure. Normal workloads will not enable employees to take missed vacation days in the future. Customers benefited from these employees performing storm restoration duties instead of taking vacation, and compensation for vacation time should be permitted if the 2004 Storm Cost Recovery Order methodology is adopted.

i. Under the 2004 Storm Cost Recovery Method, nuclear payroll expected to be recovered through insurance of \$2.5 million should not be included in the regular payroll adjustment. This is because these amounts are already removed through the adjustment for amounts expected to be recovered through insurance.

**OPC:**

- a. No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. Lost revenues are not a cost of restoring service. In any event, FPL's revenues exceeded budgeted amounts during the 2005 hurricane season, even including the impact from outages caused by hurricanes, so there are no "lost revenues" in this case.
- b. No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. Backfill work is part of daily utility operations and maintenance of the Company's system and are included as part of base rates. These costs are not extraordinary nor related to storm recovery, and as such should not be used as an offset in the incremental approach to storm reserve accounting or recovery.
- c. No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. Catch-up is part of daily utility operations and maintenance of the Company's system and are included as part of base rates. These costs are not extraordinary, nor related to storm recovery and as such should not be used as an offset in the incremental approach to storm reserve accounting or recovery.
- d. No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals and recovered from ratepayers. It would be difficult, if not impossible, to relate uncollectible accounts directly to the effects of a storm. Even if it could be done, these expenses are not directly related to the restoration of service. They are in the nature of risk, which the Company is compensated for through the rate of return on equity.
- e. No. Only those costs that are directly related to restoring facilities should be included in the storm restoration cost accruals. These costs are similar to those described as catch-up work, which is part of daily utility operations and maintenance of the Company's system and included as part of base rates. These costs are not extraordinary, nor related to storm recovery and as such should not be used as an offset in the incremental approach to storm reserve accounting or recovery.
- f. The Citizens agree that these costs should be offset against the regular salaries removed from the 2005 storm recovery costs.
- g. The Citizens agree that these costs should be offset against the regular salaries removed from the 2005 storm recovery costs.
- h. Vacation Buy-Backs are generated by the Company's vacation policy and not as a direct result of storm restoration activities. It reflects a discretionary action by FPL and shouldn't be charged to customers.

i. In FPL's Incremental Cost Approach adjustment it includes a \$2,490,800 offset to the regular employee salaries for nuclear payroll costs that it already removed from the 2005 estimated storm recovery costs in the adjustment to remove the estimated insurance proceeds. If this adjustment is reflected, FPL would recover the associated amount twice, once from insurers and again from ratepayers. Therefore, this offset is inappropriate.

**FIPUG:**

a. No. During the storm period, FPL sold more electricity to retail customers than it anticipated it would sell according to documents filed in Docket No. 050001-EI. The estimated sales provided enough money to meet ordinary O&M expenses. In calculating retail revenues, the revenues from all retail customers is the controlling factor, not the revenues received from a relatively small number of customers whom FPL was unable to serve during the period of storm restoration. FIPUG also agrees with OPC.

b. – i. Agree with OPC.

**FRF:**

a. No. Only those costs that are directly related to restoring facilities should be included in allowable storm restoration costs and recovered from ratepayers. The PSC should reject FPL's effort to shift additional business risk – substantively, the risk of lost revenues - onto its customers.

b. No. Only those costs that are directly related to restoring storm-damaged facilities should be included in allowable storm restoration costs and recovered from FPL's customers.

c. No. Only those costs that are directly related to restoring storm-damaged facilities should be included in allowable storm restoration costs and recovered from FPL's customers.

d. No. Only those costs that are directly related to restoring storm-damaged facilities should be included in allowable storm restoration costs and recovered from FPL's customers. FPL's claimed storm costs should be reduced by \$3,582,000.

e. No. Only those costs that are directly related to restoring storm-damaged facilities should be included in allowable storm restoration costs and recovered from FPL's customers.

f. Agree with OPC.

g. Agree with OPC.

h. Agree with OPC that "vacation buy-backs" are a result of FPL's vacation policy and not a direct result of storm restoration activities. Such amounts should not be charged to the storm reserve, nor should they be allowed to offset any adjustments made as a result of the incremental cost approach.

- i. Agree with OPC that this offset proposed by FPL is inappropriate.

**AARP:** The same as the Office of Public Counsel.

**FEA:** a. – i. Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** Issue 17 and its subparts a thru i represent FPL's alternate position in the event the Commission rejects its primary "Actual Cost" method and adopts the "modified incremental" cost recovery method as applied in the 2004 Storm Order. Issue 17h was proffered by OPC.

#### Lost Revenue

Issue 17a relates to amounts not recovered in base rates due to disruption of service and loss of customers in the wake of hurricane activity. This issue relates to lost revenue. In the 2004 case, the Commission authorized recovery of amounts (normal costs) to the extent there was lost revenue. The premise is that certain normal costs were not recovered in base rates in times when base rates were not generating adequate revenue to cover these costs.

In the 2004 storm case, FPL requested recovery for lost revenue. In this case, FPL requests that any adjustments relating to the use of the "incremental" method be offset up to the amount of lost revenue or \$51.4 million. FPL states that this is consistent with the Commission ruling in the 2004 Storm Order. FPL also points out that recognition of "lost revenue" is permitted under the newly adopted securitization law, Section 366.8260(1)(n), Florida Statutes.

OPC takes the position that "lost revenue" is not a cost of restoring service and states that all revenue is subject to variation due to weather. This phenomenon is part of business risk and is inherent in the determination of a fair and reasonable rate of return. In fact, FPL experienced a positive revenue effect on account of warm weather in 2005.

FPL witness Green testified that the amount of energy sales not realized due to the 2005 storm season was 1.6 Million mWh. (TR 726) According to witness Green, this quantity was estimated by obtaining the number of customers without electrical service on a daily basis and multiplying that number by the usage those customers would be expected to consume on those specific days. (TR 724) No party presented testimony that this methodology of estimating the amount of mWh sales not realized was in error.

OPC witness Larkin testified that although FPL may not have realized a certain amount of energy sales during the days following the storms of 2005, the company had in fact sold more electricity during the July through October time period than it had budgeted. (TR 909) These calculations were based upon the actual verses budgeted mWh sales reported in the last fuel docket. (EXH 84) No party challenged the accuracy of the monthly actual and budgeted mWh sales data contained in this exhibit.

In his rebuttal testimony, FPL witness Green contends that OPC witness Larkin made two errors in reaching his conclusion that actual energy sales exceeded budgeted sales during the months of the hurricanes. (TR 731) First, witness Green points out that witness Larkin erroneously assumes that any variance between actual and budget is solely explained by the effects of hurricanes in any given month. Second, witness Green points out that the billed sales for the July through October time frame used by witness Larkin would include unbilled sales from June 2005 and would not include some sales from October 2005. Witness Green attributes this error to the lag between the time electricity is consumed and when it is billed. (TR 732)

FPL witness Green goes on to testify that the appropriate time frame to consider in measuring the impact on sales due to the 2005 hurricane season is July through December 2005. (TR 733) He further notes that the billed sales for July need to be adjusted downward to account for the unbilled sales coming from June. FPL witness Green concludes by calculating that instead of actual sales exceeding budgeted sales for this time period as OPC witness Larkin contends, FPL's actual sales for the period were below forecast by approximately 1 million kWh.

Staff believes that the methodology used by FPL witness Green is appropriate for estimating the amount of energy sales not realized during the days following the hurricanes of 2005. However, staff also acknowledges OPC witness Larkin's concern that FPL had already recovered sufficient revenue from customers during the remainder of the 2005 hurricane season to cover its budgeted O&M expenses.

Staff also agrees with OPC's view that lost revenue is part of "weather" related business risk for any utility. Business risk is captured in the determination of a fair and reasonable rate of return. Consumers should not bear all of the adverse effects of business risk of FPL while FPL is able to earn a rate of return that takes into account business risk. This is a form of double recovery. For these reasons, staff recommends that FPL absorb the effects of lost revenue.

### Backfill Costs

Issue 17b relates to an estimated \$.8 million of backfill costs. According to FPL, this amount represents unbudgeted costs associated with compensated overtime, temporary labor, and/or contractors, which were incurred to satisfy job accountabilities of other employees while they were assigned to storm duty. (TR 1602) FPL alleges that these are incremental costs that would not have otherwise been incurred in the absence of the 2005 storms, and, therefore, are not being recovered in base rates.

OPC witness Larkin states that FPL's adjustment for backfill costs is a back door method of requesting lost revenue. (TR 906) OPC believes that these costs do not directly relate to storm restoration.

Staff concedes that incremental costs such as backfill costs may result as FPL employees are reassigned during storm restoration. However, staff agrees with OPC that such costs are not directly related to storm restoration and only direct costs should be recoverable in this proceeding. Backfill costs represent an indirect adverse effect of the storms. Based on factors mentioned in Staff witness Jenkins' testimony, staff believes that FPL's shareholders should share in the adverse effects of the 2005 hurricanes and absorb backfill costs.

### Catch-up work

Issue 17c relates to an estimated \$7.8 million of catch-up work. According to FPL, these costs represent additional overtime hours or contractor work incurred until the catch-up work is completed. FPL uses the same points to justify this cost as it used in its justification of backfill costs. OPC points out that these costs do not directly relate to storm restoration.

For the same reasons staff recommended disallowance of backfill costs, staff recommends disallowance of costs associated with catch-up work.

### Incremental Contractor Work

Issue 17e relates to estimated costs of incremental outside contractor services and is part of the catch-up amounts addressed in Issue 17c. For the same reasons staff recommended disallowance of backfill costs, staff recommends disallowance of costs associated with incremental contractor work.

### Vacation Buy-Backs

In its incremental approach, FPL offset regular payroll costs with vacation buy-back costs of \$1,209,000, which represents the purchase of unused vacation from employees that could not take vacation due to the length of storm restoration efforts and subsequent catch-up work. FPL witness Davis points out that many employees worked through November to make repairs to FPL's damaged infrastructure. As such, certain employees were unable to take all the vacation they were entitled to and normal workloads will not allow these employees to take those days in the future. Witness Davis states that these payments were a direct result of the 2005 storms and should be allowed as an offset to the \$26.1 million regular payroll adjustment, if the Commission determines this adjustment is necessary. (TR 1603; EXH 121)

OPC witness Larkin testified that vacation buy-backs are generated by the Company's vacation policy and not as a direct result of storm restoration activities. He also stated that FPL's policy which was applied for the year 2005 only, is that employees will be paid for any remaining unused vacation in excess of 120 hours. Witness Larkin testified that FPL could have changed its carryover policy and allowed employees to carryover any and all vacation which could not be taken in 2005. Instead the Company chose to limit the carryover hours to 120 and reimburse employees for any vacation which could not be taken in 2005. Witness Larkin stated that this 2005 vacation policy is a management decision. These costs are not directly related to the restoration of service, but are directly related to FPL's vacation policy. In addition, part of this cost may be the result of buy-backs from employees who have purchased additional vacation hours and were unable to take those hours as vacation in 2005 because of restoration activities. Regardless of whether the vacation buy-back is a result of unused vacation or vacation which the Company is purchasing from employees who had previously purchased those vacation hours, it is not a legitimate cost to be recovered from ratepayers. (TR 913-14, 920)

Staff agrees that the change in vacation carryover policy was a management decision and that it should not affect the amount charged to the 2005 storm recovery costs. Therefore, staff recommends that FPL's proposed \$1,209,000 offsetting adjustment not be accepted.



**Issue 18:** Have landscaping costs been appropriately charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. Landscaping costs of \$3,816,864 should be removed from the storm costs. (Marsh)

**Position of the Parties**

**FPL:** Yes. Only landscaping restoration costs necessary to comply with local land use and zoning requirements have been charged to the Reserve. Failure to comply with code requirements would result in local jurisdictions initiating code enforcement actions.

**OPC:** No. Landscaping is not covered by insurance and should be covered as part of base rates. Accordingly, landscaping charges of \$1,503,250 should be removed from 2005 storm costs to be recovered through the storm reserve.

**FIPUG:** Adopts the position of OPC.

**FRF:** No.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis stated that landscaping costs were necessary to return landscaping to its pre-storm condition to comply with local code requirements. (TR 1623; EXH 126, p. 4) He testified that FPL was in compliance with all requirements before the storms, and if it were not for the storms, these costs would not have been incurred. (TR 1623-1624; EXH 126, p. 4) He said that the costs would be included under either FPL's proposed methodology or under the incremental cost approach. (TR 1624) He stated that code enforcement actions would result if FPL failed to restore the landscaping. (TR 1624; EXH 4, p. 397)

FPL witness Jaindl testified that landscaping at substations is necessary due to local development orders or code requirements. (TR 1333) She stated that any landscaping shown on the approved plans must be planted and maintained by FPL to avoid code enforcement actions. (TR 1333) She advised that such actions take the form of Notices of Violation and/or monetary fines. (TR 1333)

OPC argued in its brief that landscaping costs should be recovered through base rates, not through the storm reserve. (OPC BR at 36) OPC based its position on statements of staff witness Welch. As discussed further below, witness Welch testified that insurance does not cover

landscaping, and expressed concern as to whether it should be charged to the reserve. (EXH 157, p. 49)

Staff witness Welch testified that FPL included \$1,413,250 for substation landscaping and \$90,000 for Service Center landscaping totaling \$1,503,250 for Hurricane Wilma. (TR 1087; EXH 89, p. 7) She stated that other landscaping costs may have been incurred but were not examined by the auditors. (TR 1087)

Witness Welch stated that she did not find evidence to contradict FPL's assertion that it needed to replace landscaping due to the 2005 storms. (EXH 157, p. 48) The witness said that landscaping required by local authorities is a cost of providing service, but although she expressed concern, she did not make a specific recommendation. (EXH 157, pp. 49-50)

Witness Welch stated that insurance does not cover landscaping, regardless of whether it is required by zoning. (EXH 157, p. 49) She explained that:

My understanding of the reason the storm reserve was set up to begin with was to replace insurance. And if most people's insurance isn't covering it, then I'm just not sure it should be recovered.

(EXH 157, p. 49)

### ANALYSIS

Although landscaping is a cost of service, OPC argued that it is more appropriate to recover the costs through base rates than to charge it to the storm reserve. Staff witness Welch testified that the reserve is essentially a replacement for insurance. The basic premise espoused by witness Welch and by OPC is that items that would not have been recoverable through insurance should be recovered through means other than the reserve. (OPC BR at 36) Under OPC's recommended approach, FPL would not be denied recovery; the means of such recovery simply would not be the storm charge.

Staff believes that much of the landscaping cost was associated with general cleanup, such as tree trimming, limb removal, sweeping of parking lots, and removal of damaged trees. (EXH 4, pp. 191-226) This type of work is a part of routine maintenance of landscaping. While the amount of work may have been increased by the storms, FPL presented no evidence that the costs incurred exceeded the normal budget for landscape maintenance. Accordingly, staff believes such costs should not be treated as storm costs.

As explained by staff witness Welch, landscaping costs were incurred in addition to those sampled by the staff auditors. (TR 1087) Staff notes that the total amount for all landscaping costs included in the storm costs, based on FPL estimates, is \$3,816,864. (EXH 4, p. 191) The amount recommended for removal by OPC represents only a portion of the landscape costs.

**CONCLUSION**

Staff recommends that landscaping costs of \$3,816,864 should be removed from the storm costs.

**Issue 19:** Have lawsuit settlement charges been appropriately charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. The 2005 storm costs should be reduced by \$2,849,571 for lawsuit settlement charges. (Marsh)

**Position of the Parties**

**FPL:** Yes. Litigation and settlement costs that are directly related to 2005 storm restoration have been charged to the Storm Reserve. But for the 2005 storms, these costs would have not been incurred. [sic] Further, FPL is legally obligated to indemnify and hold harmless foreign crews against claims which are brought as a result of their providing assistance to FPL.

**OPC:** No. FPL originally included \$2,849,571 for estimated property damage and personal injury costs for 2005 storm costs. These are not costs directly related to the storm recovery efforts or for the restoration of electric service to customers and should not be included in the costs to be recovered. Additionally, these types of costs are already considered in the determination of base rates and should not be recovered via the recovery of storm restoration costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Lawsuit settlement charges are not directly related to storm recovery efforts or for restoring service to customers, and such costs, which are already considered in determining FPL's base rates, should not be included in allowable costs in this docket. This is another inappropriate effort by FPL to shift as much risk as possible onto its customers. FPL' [sic] claim for \$2,849,571 in such costs as 2005 storm costs should be disallowed.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that "[a]ny property damage and personal injury costs that are directly related to storm restoration should be recoverable." (TR 1614) He stated that "but for the restoration effort associated with the 2005 storms, these costs would not have been incurred." (TR 1614) He said that the effect of removing lawsuit costs from the storm recovery would be to treat them as if they were recoverable in base rates. (TR 1614) He explained that the Commission eliminates non-recurring costs when setting base rates, so these extraordinary costs would not be recovered through that mechanism. (TR 1614) Witness Davis stated that FPL has removed \$2.2 million of property damage and personal injury costs from the storm recovery

amount. (TR 1615; EXH 121) He testified that the remaining \$0.6 million is a direct result of the storm restoration. (TR 1615)

Witness Davis testified that \$2.2 million in legal costs for 2005 were removed after FPL's attorneys determined that some items did not meet the "but for" criteria; that is, "but for the storm restoration these costs would not have been incurred." (TR 1637) He stated that the amounts were removed because FPL concluded that the condition which led to the legal expense could have existed outside of a hurricane. (TR 1638-1639) He explained that the condition did not change; rather, FPL made a different decision regarding the appropriate treatment of the costs. (TR 1638) The witness said that he was not aware of certain facts, but upon learning of them, agreed with the FPL attorneys that certain legal expenses should be removed. (TR 1639)

In its response to the staff audit, FPL stated that it must indemnify foreign utilities for the uninsured portions of any lawsuits that result as a result of storm restoration activities as part of its mutual aid agreements. (EXH 126, p. 5) FPL stated that such costs should be charged to the reserve "to encourage, not discourage, mutual aid." (EXH 126, p. 5)

FPL witness Gower testified that nonrecurring expenses would either be excluded from operating expenses or included on a levelized basis in setting rates. (TR 1526) He provided as an example the settlement of litigation. (TR 1526-1527) The witness said that such expenses are "necessary, reasonable and prudent costs of providing utility service." (TR 1528) He stated that the appropriate methods to recover nonrecurring items include amortization over a period of years, or the application of separate billing factors. (TR 1528)

OPC witness DeRonne stated that FPL has included \$2,849,571 for estimated property damage and personal injury costs in the 2005 storm recovery amount. (TR 973) She testified that these costs are not directly related to restoration of service after the storms. (TR 973) She stated that such costs are already considered in setting base rates. (TR 973)

Staff witness Welch testified regarding a confidential audit finding regarding lawsuits. (TR 1088; EXH 158) In her discussion of lawsuits generally, she stated that extraordinary items are typically not included in the setting of base rates. (EXH 157, p. 47)

### **ANALYSIS**

Staff's examination of the record yielded no evidence that there were any incidents in 2005 that would result in FPL making payment for litigation or settlement costs. Staff notes that FPL witness Davis' testimony regarding the examination of these costs and discussion with FPL legal staff refers specifically to a staff audit finding for 2004. (CONFIDENTIAL EXH 158) No such item was identified for 2005, yet the amount and circumstances discussed by witness Davis are the same. Further, staff agrees with OPC witness DeRonne that these costs are not directly related to restoration of service after the storms. (TR 973) Therefore, all 2005 litigation and settlement costs should be removed.

**CONCLUSION**

Staff recommends that the 2005 storm costs should be reduced by \$2,849,571 for lawsuit settlement charges.

**Issue 20:** Have contingency portions of estimated storm costs been appropriately charged to the storm reserve for 2005? If not, what adjustments should be made?

**Recommendation:** No. Storm costs should be adjusted by \$26,253,351 to remove remaining contingencies. (Marsh)

**Position of the Parties**

**FPL:** Yes. FPL included contingencies in the 2005 storm cost estimate consistent with its standard project management practices. Contingencies formally recognize uncertainty concerning factors such as scope of work, material costs, contractor availability and pricing, or the length of time for completion. Any unused contingency will be reflected in the final true-up process proposed by FPL. The only remaining contingency for 2005 storm costs is \$7,478,495. No adjustments should be made.

**OPC:** No. The remaining contingencies should be removed from the storm cost estimates. FPL is treating upward adjustments to estimated "contingencies" as a way of maintaining its request at the level of its original petition, instead of lowering that request as actual figures come in below original estimates. The estimates in FPL's petition were a starting point subject to adjustments based on actual figures, not an entitlement.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that \$26,253,351 of contingencies remaining at the end of February 2006 should be removed from FPL's 2005 storm cost estimates.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis stated that "[e]stimates are an inherent part of the accounting process and must be based on reliable information, not mere speculation regarding future events." (TR 1628) He testified that FPL's estimates are based on reliable information. (TR 1628) He said that the use of contingencies in estimates are a standard practice used to accommodate unidentified but likely additional costs. (TR 1628-1629) The witness explained that contingencies will change or be eliminated as costs become known. (TR 1616, 1629)

Witness Davis stated that the original amount of the contingencies included in FPL's filing was \$44.5 million. (TR 1616) He testified that this was reduced to \$26.3 million by February 28, 2006, and the portion associated with Hurricanes Dennis and Rita were reduced to

\$7.5 million by March 2006. (TR 1616) He said that any unused contingencies will be reflected in the final true-up process. (TR 1616)

FPL witness Williams also stated that, as of March 31, 2006, the remaining estimated amounts included \$7.5 million of contingency. (TR 1406; EXH 106) Of this amount, she testified that \$6.9 million is associated with Hurricane Wilma distribution follow-up restoration work being performed by contractors. (TR 1406)

OPC witness DeRonne stated that a contingency amount of \$26,253,351 remained in FPL's costs as of February 28, 2006. (TR 965) She said that this amount should be removed from storm costs, because any over-estimated amounts will cause ratepayers to pay higher amounts than necessary over the recovery period. (TR 966) She testified that:

[t]he general premise that if the costs are overestimated they will be trued-up and serve to increase the available reserve funds for future storms is not a reasonable premise and is not the attitude the Commission should adopt in evaluating the proposed 2005 storm recovery costs in this case.

(TR 966)

The witness testified that some 27 percent of the proposed storm recovery costs is still based on estimates. (TR 966) She stated that removal of the contingencies would not have an appreciable impact on the amount of estimated costs proposed for recovery. (TR 966)

OPC argued that over-estimated amounts would cause ratepayers to be locked into paying more than is necessary for the next twelve years under FPL's proposal. (OPC BR at 39) OPC argued that the amount of variability in FPL's estimates for contingencies lead OPC to believe the amounts are used as a plug figure. (OPC BR at 39)

Staff witness Welch stated that FPL included contingencies in many of the accruals for storm costs. (TR 1088) She testified that FPL moves contingencies that are unused to other categories. (EXH 157, p. 58) She stated that the Commission should be aware of this practice and make certain in the future that the contingencies were used in the manner that FPL represents. (EXH 57, p. 58)

### ANALYSIS

While staff agrees that the record shows a marked reduction in contingencies, staff's adjustments in this recommendation are made to the original filing amount. According to FPL witness Davis, the original contingencies totaled \$44.5 million. (TR 1616) By March 2006, the amount had been reduced to some \$7.5 million. (TR 1616)

Staff believes it is clear from the record that not all contingencies will be used. The amount of contingencies is small in relation to the overall amount requested by FPL. Staff agrees with OPC that the removal of contingencies will not have an appreciable impact on the remaining estimated costs. Staff does not believe it is appropriate to expect ratepayers to pay for



costs that may never be realized for the next twelve years. Therefore, staff believes the remaining contingencies should be removed.

Staff agrees with OPC that \$26.25 million is the amount to be removed. Although FPL indicates that a large portion of the contingencies either have already been realized or have been eliminated as reflected in amounts proposed for reduction elsewhere by FPL, staff does not see in the revised exhibits where such adjustments have been made. Further, the starting point for staff's adjustments is FPL's original filing. Removal of this amount rather than the full \$44.5 million of original contingencies gives recognition to the possibility that some amount of contingencies was actually realized. The record is silent on how much was realized and how much was eliminated by FPL.

### **CONCLUSION**

Staff recommends that storm costs be adjusted by \$26,253,351 to remove remaining contingencies, the total amount requested by FPL in its petition.

**Issue 21:** Should FPL be required to true-up approved 2005 storm related costs? If so, how should this be accomplished?

**Recommendation:** Yes. The true-up mechanism for the approved 2005 storm related costs should be based on the cut-off dates approved in Issue 26. These approved cut-off dates should be the basis for determining whether any costs should be charged to base rates rather than the storm reserve. FPL should be required to provide an annual true-up report by March 1<sup>st</sup> of each year for the preceding year ended December 31<sup>st</sup> until the repairs are completed. (Slemkewicz)

**Position of the Parties**

**FPL:** Yes. There should be a final true-up when all work has been completed and all costs are known.

**OPC:** Yes. FPL should be required to true-up the actual costs incurred and not continue to increase the amount of contingency costs as a plug amount to keep the storm cost equal to the original amount requested or to the estimated amount approved by the Commission. A cut-off date of December 31, 2006 should be established for charging 2005 storm restoration costs to the reserve.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes. Agree with OPC that FPL should be required to true up the actual costs incurred and continue to increase its contingency estimates. Further agree with OPC that a cut-off date of December 31, 2006 should be established for charging 2005 storm restoration costs to the reserve.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that a final true-up of 2005 storm related costs be performed when the actual costs for outstanding projects are known. (TR 1627) In its brief, OPC recommended that FPL should be required to true-up the actual costs incurred and not continue to increase the amount of contingency costs as a plug amount to keep the storm cost equal to the original amount requested or to the estimated amount approved by the Commission. A cut-off date of December 31, 2006 should be established for charging 2005 storm restoration costs to the reserve.

### **ANALYSIS**

FPL witness Davis testified that a final-true-up be conducted for 2005 storm costs when final costs for the 2005 storm repair projects are known and can be compared and reconciled against the estimates. At a minimum, any cut-off date for 2005 storm charges to the Reserve should recognize the projects listed by witness Williams in Exhibit 107, and when the actual costs for these projects are known, any necessary adjustments to true-up these estimates should be allowed. (TR 1627)

OPC witness DeRonne recommended a December 31, 2006 cut-off date. Witness DeRonne testified that "It is not appropriate to allow an indefinite period for charging costs associated the 2005 storms to the reserve." (TR 990) Witness DeRonne also proposed some parameters that should be applied to the cut-off date. Only projects that have been identified in this docket and for which physical construction has begun on or before December 31, 2006 should be allowed to be charged to the storm reserve for 2005 storm costs. (TR 990) In its brief, OPC proposed a true-up mechanism. All costs should be trued-up to the actual amounts incurred and as adjusted by the Commission. Any projects started after the OPC recommended December 31, 2006 cut-off date should be charged to base rates, not the storm reserve. Further, OPC recommends that the staff should audit the actual amounts to ensure compliance with the Commission's order. (OPC BR at 41)

### **CONCLUSION**

Staff agrees with FPL and OPC that some type of true-up should be approved for the 2005 storm costs. The true-up mechanism for the approved 2005 storm related costs should be based on the cut-off dates approved in Issue 26. These approved cut-off dates should be the basis for determining whether any costs should be charged to base rates rather than the storm reserve. FPL should be required to provide an annual true-up report by March 1<sup>st</sup> of each year for the preceding year ended December 31<sup>st</sup> until the repairs are completed.

**Issue 22:** Have the costs of repairing other entities' poles been charged to the storm reserve for 2005? If so, what adjustments should be made?

**Recommendation:** Yes. Storm costs should be reduced in the amount of \$10,564,384 for the costs of replacing other entities' poles. Of that amount \$4,156,615 should be booked to capital, and offset when reimbursement is received. (Marsh)

**Position of the Parties**

**FPL:** Yes. An estimate for the total cost of replacing other entities' poles has been appropriately charged to the Reserve. Reimbursements will result in appropriate credits to the Reserve. FPL has estimated the total amount to be billed and the portion relating to normal capital costs, and has credited the Reserve for the difference. However, FPL recommends that the actual amount be reflected in the final true-up of 2004 and 2005 storm costs.

**OPC:** Yes. However, FPL has not yet billed the outside parties for the repairs or replacements. The 2005 storm costs should be reduced by a minimum of \$7,923,288 to reflect an estimate of the amounts billed to other parties. This represents a placeholder adjustment of 75% of the estimate provided by FPL witness Williams of \$10,564,384 to provide an offset for capital costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes. Agree with OPC that a minimum of \$7,923,288 should be removed from FPL's claimed 2005 storm costs, and that FPL should be required to true up final costs to ensure that billings to outside parties for pole repair and replacement costs incurred by FPL are based on actual costs, and that they are appropriately credited to the benefit of FPL customers.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that FPL must complete its 2005 pole survey before preparation of the billing for pole replacements can begin. (TR 1621) He stated that while the survey was not completed as of March 31, 2006, FPL estimated that the total to be reimbursed by other parties would be \$10.6 million. (TR 1621) He stated that the estimated capital amount at normal cost would be \$4.2 million, with the estimated difference of \$6.4 million credited to the storm reserve account. (TR 1621) He said that any difference between actual and estimated amounts would be reflected during the true-up of 2005 storm costs. (TR 1621)

Witness Davis disagreed with OPC witness DeRonne's adjustment of \$7,923,288 for 2005 pole replacements. He testified that the correct number is derived by subtracting the estimated normal cost of capital for the poles of \$4,156,615 from the estimated reimbursement amount of \$10,564,384, yielding a difference of \$6,407,769. (TR 1621; EXH 121, p. 1) He stated that once the actual amount of normal capital is determined, the amount will be credited to plant-in-service. (TR 1622) He said that removal means that the amount will not be included in FPL's rate base for any future proceedings. (TR 1622)

OPC witness DeRonne stated that FPL had not included an offset to its 2005 storm recovery cost estimates for amounts to be recovered from third parties for pole repairs and replacements. (TR 966) She testified that FPL's request "includes many estimates which increase the projected cost, but does not include estimated offsets to such costs, other than for insurance recoveries." (TR 966-967) She stated that FPL expects to complete the 2005 storm pole survey in May 2006, after the hearings in this case. (TR 967)

Witness DeRonne stated that the proceeds to be collected from third parties would reduce the 2005 storm recovery costs. (TR 967) She testified that "any incremental amounts billed beyond the amounts capitalized by FPL should serve to reduce the estimated 2005 storm recovery costs to be recovered from ratepayers." (TR 967) The witness said that a review should be made in FPL's next rate case to ensure that the capital amounts reimbursed by third parties do not increase rate base. (TR 967)

Witness DeRonne stated that FPL's estimate of the costs to replace third party poles is \$10,546,384 for 2005. (TR 968) She testified that a 75 percent factor should be utilized to determine the amount of adjustment to be made because she believes that "the majority of the projected storm recovery costs are expenses as opposed to capital amounts." (TR 969) Thus, she removed \$7,923,288 from the amount to be recovered for 2005. (TR 969; EXH 85, p. 1) She also recommended a future review to ensure that FPL has billed other parties the appropriate amounts. (TR 988)

Staff witness Welch testified that the 2005 pole replacement survey had been initiated, but not completed. She stated that "FPL's total unrecovered storm costs should be reduced by the amount billed to other companies less the amount capitalized for the related poles." (Welch TR 1089)

Witness Welch testified that FPL's joint use agreements with other companies require that:

Whenever, in any emergency, the Licensee replaces a pole of the Owner, the Owner shall reimburse the Licensee all reasonable costs and expenses that would otherwise not have been incurred by the Licensee if the Owner had made the replacement.

(TR 1088; EXH 89, p. 10)

Witness Welch stated that she is making a specific recommendation to the Commission on Audit Finding No. 5. (EXH 157, p. 61) She testified that "any costs in addition to the normal costs that were capitalized for the pole [sic] really should reduce storm costs, because FPL is

recovering those costs from BellSouth.” (EXH 157, p. 61) Witness Welch said that the auditors did not find a credit to the storm reserve for amounts billed to other companies over the amount capitalized for 2005. (EXH 157, p. 62) She agreed with FPL that it would not be appropriate to make an additional adjustment if FPL had already credited the reserve account. (EXH 157, p. 62)

### ANALYSIS

Staff agrees with OPC and with staff witness Welch that it is inappropriate to include costs to be reimbursed by others in the amount to be paid by ratepayers. Staff believes that inclusion of third-party pole costs only serves to inflate the amount that is to be borne by ratepayers during the recovery period. Accordingly, staff believes an adjustment should be made. Witness Davis’ calculations are close to those of witness DeRonne, and appear to be more credible, because witness DeRonne simply used a flat 75 percent factor. (TR 969) Accordingly, staff believes FPL’s figure of \$6,407,769 should be accepted.

Moreover, staff believes that the amount FPL has separated as capital costs should also be removed from the storm costs. FPL witness Davis’ exhibits show a number of capital expenditures to remove from the starting figure. (EXH 121, p. 2) These adjustments were not part of the original filing. Thus, in order to capture FPL’s adjustment, it is necessary to include it in the adjustments recommended by staff. Therefore, an additional \$4,156,615 should be removed from the storm costs. (Davis TR 1621) The total of the two figures is \$10,564,384 (\$6,407,769 + \$4,156,615).

Upon removal of the amount from storm costs, staff does not believe it will be necessary to conduct a follow-up review of the amounts of other entities’ pole repairs in association with the storm proceeding. Staff agrees with OPC that any review that is needed would be more appropriate in FPL’s next rate proceeding to make certain that FPL has billed the amounts to third parties and has made the appropriate adjustments.

### CONCLUSION

Staff recommends that storm costs should be reduced in the amount of \$10,564,384 for the costs of replacing other entities’ poles. Of that amount \$4,156,615 should be booked to capital, and offset when reimbursement is received.

**Issue 23:** WITHDRAWN

**Issue 24:** Has FPL charged any other costs to the storm reserve that should be expensed or capitalized? If so, what adjustment should be made?

**Recommendation:** Yes. The 2005 storm-related costs should be reduced by \$561,275. However, FPL should be authorized to charge the storm reserve to the extent that any of the disallowed \$316,250 in repair costs is not recovered through an existing warranty. (Slemkewicz)

**Position of the Parties**

**FPL:** No.

**OPC:** Yes. Additional adjustments should be made to the requested 2005 storm costs should be made for employee assistance costs and repair costs under warranty.

**FIPUG:** The Commission should make an adjustment to offset FPL's storm damage costs by the proceeds received from assisting other utilities with storm restoration since 2003. In the future, FPL should credit such revenues to the storm damage reserve. Agree with OPC as to any other adjustments.

**FRF:** Yes. Agree with OPC as to additional adjustments for employee assistance costs and repair costs under warranty.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

In its brief, FPL takes the position that no adjustments are necessary. OPC witnesses Larkin and DeRonne testified that the 2005 storm costs should be reduced by \$561,275 to remove employee assistance costs and repair costs under warranty.

**ANALYSIS**

OPC's two proposed reductions are \$245,025 for employee assistance costs and \$316,250 for repair costs under warranty.

Employee Assistance Costs

FPL witness Davis testified that after a storm passes, FPL provides assistance for things such as roof tarps, ice, water, etc. that allow the employee to immediately leave his or her home and report to work. If the Company does not provide this assistance, the employee is going to have to take care of these issues before reporting for storm duty which could impact their ability to report to work as quickly as they otherwise would, delaying the start of restoration. These costs would not have been incurred, but for the need to restore service due to outages caused by the 2005 storms as soon as possible. (TR 1611) Witness Davis also said that under either an incremental cost approach or FPL's proposed methodology, these costs are appropriate for recovery as they are directly related to storm restoration and are not a cost that would be budgeted or reflected in base rates. (TR 1612)

OPC witness Larkin testified that costs provided to assist FPL employees to secure their personal damaged property should be removed. These are employee benefit costs and are not directly related to restoring FPL facilities. Customers are not in a position to pass their costs on to third parties, and neither should employees of FPL be allowed to pass their personal costs related to the hurricane on to customers through FPL. (TR 914-915)

Staff agrees with OPC that these employee assistance costs are for the benefit of the employee and are not directly related to storm damage restoration activities. Staff recommends that the 2005 storm damage costs be reduced by \$245,025 to remove the employee assistance costs.

Repair Costs Under Warranty

FPL witness Davis testified:

FPL has included this amount [\$316,250] in its 2005 storm costs because the warranty claim is being contested by the manufacturer. If FPL is successful in recovering an amount under the warranty, then FPL will adjust the 2005 storm costs by this amount. Until this has been finalized, FPL believes this amount has been appropriately included in the 2005 storm costs and should not be adjusted at this time. If the Commission determines that this amount should be removed from storm cost recovery, then FPL requests that specific provision be made to allow FPL to charge the storm reserve to the extent any of the costs are not recovered through the warranty.

(TR 1609-1610)

OPC witness DeRonne testified that FPL included an estimated \$316,250 for a cooling tower fan repair at Martin Unit 8 even though a warranty claim is being pursued. Although the estimated amounts charged to the reserve will be trued-up to actual as the amounts become known, it is not appropriate to include such costs in the estimates. (TR 964)

Staff agrees with OPC that these repair costs subject to a warranty claim should not be included in the 2005 storm costs at this time. Staff recommends that the 2005 storm costs be



reduced by \$316,250 disputed warranty claim. However, staff believes that FPL's request to charge the storm reserve to the extent any of the costs are not recovered through the warranty is reasonable and should be approved.

**CONCLUSION**

Based on the above discussion, staff recommends that the 2005 storm costs be reduced by \$561,275, calculated as follows:

Employee Assistance Costs	\$(245,025)
Repair Costs Under Warranty	<u>(316,250)</u>
Total Adjustment	<u>\$(561,275)</u>

**Issue 25:** Taking into account any adjustments identified in the preceding issues, what is the appropriate amount of 2005 storm related costs to be charged against the storm reserve, subject to a determination of prudence in this proceeding?

**Recommendation:** The appropriate amount of 2005 storm related costs to be charged against the storm reserve, subject to a determination of prudence, is \$725,398,982 (\$725,972,500 system). (Slemkewicz)

**Position of the Parties**

**FPL:** The appropriate amount of 2005 storm related costs to be charged against the Storm Reserve, subject to a determination of prudence in this proceeding, is \$816,016,000 (rounded) as adjusted in the final true-up. (See issue 42).

**OPC:** This is a fall-out issue.

**FIPUG:** Adopts the position of OPC.

**FRF:** Fall-out issue.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** This is a fall-out issue based on the resolution of other issues. Staff recommends that the appropriate amount of 2005 storm related costs to be charged against the storm reserve, subject to a determination of prudence, is \$725,398,982 (\$725,972,500 system). This amount was calculated as follows:

Date: May 8, 2006

<u>ISSUE</u>	<u>DESCRIPTION</u>	<u>\$</u>
	2005 Total Storm Costs	906,404,000
	Capital Expenditures	(63,855,000)
	Insurance Proceeds	<u>(26,533,000)</u>
	Net 2005 Storm Costs	<u>816,016,000</u>
	STAFF ADJUSTMENTS	
7	Normal Replacements and Improvements	
	- Condenser Tube Repairs	(2,785,364)
	- Hydrolasing Costs	(221,000)
	- Proceeds from Other Power Companies	(3,468,593)
8	Non-Managerial Payroll	(17,925,918)
9	Managerial Payroll	(768,000)
11	Tree Trimming	(1,100,000)
12	Company-Owned Fleet Vehicles	(5,738,000)
13	Call Center Costs	(520,264)
14	Advertising Expenses	(1,143,916)
15	Uncollectible Expense	(3,582,000)
16	Normal Replacement and Cost of Removal	(8,745,000)
17	a – Amounts Not Recovered	0
	b – Backfill Work	0
	c – Catch-Up Work	0
	d – Uncollectible Accounts	See Issue 15
	e – Outside Hires	0
	f – Clause Payroll	See Issue 8
	g – Capital Payroll	See Issue 8
	h – Vacation Buy-Backs	0
	i – Nuclear Payroll	See Issue 8
18	Landscaping	(3,816,864)
19	Lawsuit Settlement Charge	(2,849,571)
20	Contingencies	(26,253,351)
22	Other Entities' Poles	(10,564,384)
24	Costs to be Capitalized or Expensed	
	- Employee Assistance	(245,025)
	- Warranty Repairs	<u>(316,250)</u>
---	TOTAL ADJUSTMENTS	<u>(90,043,500)</u>
25	ADJUSTED TOTAL – 2005 STORM COSTS	725,972,500
---	Jurisdictional Factor	99.921%
25	JURISDICTIONAL 2005 STORM COSTS	<u>725,398,982</u>

**Issue 26:** At what point in time should FPL stop charging costs related to the 2005 storm season to the storm reserve?

**Recommendation:** Only the projects already identified in this proceeding related to damage from the 2005 storm season on which construction has physically begun by December 31, 2006, should be allowed to be charged to the storm reserve. However, FPL has justified the reasons for the delay in starting some of the nuclear unit repairs and should be allowed to charge those costs to the storm reserve for projects on which construction has physically begun by December 31, 2008. A true-up should be performed when the projects are completed. FPL should submit a schedule of the allowable projects in progress as of December 31, 2006, by February 15, 2007. This schedule should include the amount actually spent to date, the estimated total cost, the start date and the estimated completion date. (Slemkewicz, Lee)

**Position of the Parties**

**FPL:** Consistent with its approach to 2004 storm costs, FPL has charged the full amount of its storm costs to the Reserve as of March 31, 2006, including an estimate for uncompleted work. When all work has been completed and final costs are known, a final true-up should be performed.

**OPC:** The Commission should order that only projects that have been identified in this docket and physical construction has begun on or before December 31, 2006 should be allowed to be charged to the storm reserve for 2005 storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC that only the costs for projects that have been identified in this docket and for which physical construction has begun on or before December 31, 2006 should be allowed as charges to the storm reserve for 2005 storms.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL witness Davis testified that an arbitrary cut-off date for 2005 storm charges should not be established. Witness Davis said that when all of the work has been completed and final costs are known, a final true-up should be performed. However, if a cut-off date is established, it should recognize the projects listed in Exhibit 107. (TR 1627) FPL witness Warner said that FPL should be allowed to continue to charge nuclear storm damage repairs to the reserve through 2008. That is the anticipated completion date for all storm-related repairs. (TR 391)

OPC witness DeRonne testified that December 31, 2006, should be the cut-off date for charging 2005 storm restoration costs to the reserve. (TR 990)

### **ANALYSIS**

FPL witness Williams testified that "All projects and associated costs directly related to restoring FPL's facilities to their pre-storm condition should be charged to the Storm Reserve, whether they are known now or not. FPL attempts to quickly identify storm follow-up projects in order to restore storm-affected facilities to their pre-storm condition as soon as possible." (TR 1406) Nonetheless, there are unique circumstances and good business reasons to delay the timing of restoring FPL's damaged generating unit facilities to later dates that coincide with planned overhaul schedules. (TR 1406) Witness Davis said that "There are many reasons for the extended timing including when plants come down for outages, and availability of contractors or other resources." (TR 1627)

FPL Witness Warner testified that:

After a storm strikes, FPL's priority is to return the low cost nuclear units back to service as safely and quickly as possible. The units can sometimes be brought back online without repairing all storm-related damage. However, the repairs are still critical to ensure the long-term reliability of plant operations and must be made at the earliest possible opportunity. Again, due to the nature of nuclear operations, it may take several years to restore the nuclear plants to pre-storm conditions.

(TR 392)

FPL witness Williams sponsored Exhibit 107 (GJW-10), which provides a listing of projects for the 2005 storm season that are yet to be completed, their total current estimated costs, and their project start and completion dates. FPL witness Davis testified that the final, actual cost of these projects should be charged to the reserve when they are ultimately completed. (TR 1627) FPL witness Warner said that because of FPL's limited opportunities even to inspect some components of its nuclear units, it should be permitted to charge the reserve with the cost of repairs to those units that are related to the 2005 storm season until 2008. (TR 391-392)

In recommending a December 31, 2006 cut-off date, OPC witness DeRonne testified that "It is not appropriate to allow an indefinite period for charging costs associated with the 2005 storms to the reserve." (TR 990) Witness DeRonne also proposed some parameters that should be applied to the cut-off date. Only projects that have been identified in this docket and for which physical construction has begun on or before December 31, 2006 should be allowed to be charged to the storm reserve for 2005 storm costs. (TR 990)

### **CONCLUSION**

Staff agrees with OPC that a specific cut-off date should be established for charging the reserve for 2005 storm costs. Staff believes that a December 31, 2006, cut-off date allows FPL

sufficient time to fine-tune its estimated costs for projects that have been identified already in this docket. Staff also agrees with OPC's proposed limitation that construction must be started by December 31, 2006 for the costs to qualify for being charged to the reserve. Staff also believes that FPL should submit a schedule of the allowable projects in progress as of December 31, 2006, by February 15, 2007. These provisions would apply to all repair projects except those related to the nuclear units.

Staff believes the timing of the nuclear unit repairs warrants economic and operating considerations. Because of the high replacement power costs incurred when a nuclear unit is off-line, damage assessment and repairs to certain equipment can only be performed during refueling outages, which occur approximately every 18 months. (Warner TR 389) FPL maintains that the repairs, including repairs to the intake and discharge canals, repair of coatings in various areas of the plant, and canal dredging, are critical to ensure the long-term reliability of plant operations, but due to the nature of nuclear operations it may take several years before the units can be fully restored to pre-storm conditions. (TR 390; FPL BR at 81) Staff believes that FPL has justified the reasons for the delay in starting the nuclear unit repairs.

The costs and the true-up should be subject to staff review. In addition, FPL has to work with its nuclear property insurer, NEIL, to ensure that FPL and NEIL agreed on the scope of damage prior to commencing the repair work. These additional requirements should mitigate OPC's concern of the potential pressures for FPL to seek out additional projects to somehow tie to the 2005 storms in order to result in a certain final cost level.

Staff recommends that only the projects already identified in this proceeding related to damage from the 2005 storm season on which construction has physically begun by December 31, 2006, should be allowed to be charged to the storm reserve. However, FPL has justified the reasons for the delay in starting some of the nuclear unit repairs and should be allowed to charge those costs to the storm reserve for projects on which construction has physically begun by December 31, 2008. A true-up should be performed when the projects are completed. FPL should submit a schedule of the allowable projects in progress as of December 31, 2006, by February 15, 2007. This schedule should include the amount actually spent to date, the estimated total cost, the start date and the estimated completion date.

### **PRUDENCE OF 2005 STORM CHARGES**

**Issue 27:** Did FPL adequately inspect and maintain its distribution and transmission system for deterioration and overloading of poles prior to June 1, 2005? If not, what amount, if any, should be adjusted from the costs that FPL proposes to charge to the storm reserve and recover through securitization or a surcharge?

**Recommendation:** No. A downward adjustment of \$5,900,000 is warranted because: (1) some 2004 repair had not been completed prior to June 1, 2005, (2) FPL does not know whether it met the requirements of the National Electrical Safety Code (NESC) at each failed pole, (3) FPL has not shown that an increased level of pole inspection and maintenance was not prudent and funded by its base rates, and (4) FPL has not shown that its level of pole inspection and maintenance did not contribute to higher hurricane restoration costs in 2005. The recommended capital offset adjustment amount is \$1,440,000. The recommended expense adjustment amount is \$4,460,000. No other fines or penalties are recommended because there is no evidence that FPL refused to comply with or willfully violated any lawful rule or order of the Commission, or any statute administered by the Commission. (Breman)

#### **Position of the Parties**

**FPL:** Yes. FPL's pole inspection and maintenance program was reasonable, and produced excellent results. Pole related outages during non-storm events have been negligible for over a decade, contributing only about 0.1% of all outages annually. Pole performance during the 2004 and 2005 storm seasons also shows that FPL's pole inspection and maintenance program is reasonable and has produced excellent results.

**OPC:** FPL's pre-storm pole inspection process was inadequate. Osmose, the only valid inspection, covers less than 1% of poles annually. Thermovision inspections exclude 845,000 lateral poles, and detect only conspicuous external damage. Hazard assessments aren't recorded in a meaningful data base. Lacking actual data, KEMA invented the term "touchpoint opportunities", and substituted convoluted, speculative "probabilities." This effort failed to mask FPL's deficiencies. The Commission should adopt OPC's estimate of poles that failed from deterioration, based on FPL's own post-storm data.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. FPL's inspection activities with respect to the deterioration of wood distribution poles were inadequate. Agree with OPC as to amounts of claimed repair costs that should be disallowed. Additionally, because FPL's activities were inadequate due to FPL's intentional cost-cutting efforts, they were imprudent and FPL should be penalized pursuant to Chapter 350 for the resulting failures, which resulted in excessive outages and losses being sustained by FPL's customers.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** No. The AG adopts and agrees with the position of the OPC. Additionally, this Commission should not permit recovery of costs resulting from inadequate infrastructure maintenance, nor reward FPL for its failure to adequately plan and prepare for the storm season. FPL's position on this issue is based on negligent or arrogant indifference to known risks, incomplete or inaccurate data, and/or a willingness to allow the consumer to absorb infrastructure maintenance costs through the storm docket.

**Staff Analysis:** Issue 33 addresses FPL's inspection and maintenance of transmission towers. In the following analysis, all references to FPL's pole inspection and maintenance pertain to FPL's distribution pole inspection and maintenance.

### **PARTIES' ARGUMENTS**

FPL asserts its distribution pole inspection and maintenance actions have been reasonable and prudent for both hurricane and non-hurricane conditions prior to and during 2005. (TR 1386) FPL witness Williams testified that "our 2004 efforts and costs were determined by this Commission to be prudent and reasonable. Because the '05 efforts and results are very similar for the number of customers affected, for the days to restore service, and for the total restoration costs, I would conclude that FPL's 2005 restoration efforts and costs are likewise reasonable and prudent." (Williams TR 199; EXH 14) Prior to and during 2005, FPL's pole inspection program consisted of three initiatives: – (1) a targeted pole inspection program that specifically addresses one of FPL's older pole types, (2) visual inspection of main-trunk feeder poles on a five year cycle, and (3) inspections conducted as part of daily work activities. (Williams TR 191; TR 1390-1391; Brown TR 257; EXH 15, pp. 31-32) FPL asserts its actions have been reasonable because pole outages for reasons other than hurricanes are almost nonexistent. For example, during the period 1999-2004, pole related outages accounted for approximately 130 outages per year, or just 0.1 percent of all outages experienced by FPL's customers. (Williams TR 191, 199; EXH 104) A survey of other utility standards and practices was performed by KEMA and included in Exhibit 15. FPL witness Brown states that the survey conclusions are: (1) FPL designs and constructs distribution facilities to a more stringent standard than most other companies, (2) none of the companies are required by their regulatory authority to place facilities underground in response to storm damage, and (3) most of the responding companies have a systemic pole inspection and treatment program in place with inspection cycles ranging from 10 to 15 years for older poles. (TR 260; EXH 15, pp. 81-83, 86-97) Additionally, FPL's hurricane pole replacement data from 1992 through 2005 compares favorably with that of other utilities because FPL's pole replacement rates have been consistently lower than those of other utilities. (Williams TR 1387; EXH 105)

Witness Williams believes FPL's management decisions from 1998-2004 resulted in good non-hurricane performance, which translates into good hurricane performance. (Williams TR 187-190) With respect to declines in budget levels for FPL's Pole Inspection Program (EXH 140), witness Williams stated:

[t]here's no such thing as a legacy program, so every single year when you're looking at your budget and your reliability plans, all these programs are looked at



with the fresh perspective of what kind of value can they deliver the following year. So just because you've been funded in the past does not mean that you automatically get funded in the future.

So as I look at these various funding levels from year to year, it could very well be that other programs came to the table that had a bigger benefit for the dollars to be expended. And I have to believe that, considering the excellent reliability that we've provided to our customers and really the very good pole performance that we've had throughout the time in question here.

(TR 220)

FPL witness Williams, while not agreeing that a disallowance was appropriate or supported, recalculated OPC witness Byerley's methodology using alternative assumptions that she believed to be more realistic resulting in an amount of \$1,800,000. (TR 1396-1397)

FPL's inspection and maintenance practices did not change significantly between 2004 and 2005, and no intervenor testimony focuses on differences between those years. FPL finds it curious that historical inspection and maintenance practices that were deemed acceptable last year and that have not changed significantly since then, are now suddenly the subject of close scrutiny. (FPL BR at 82-83)

OPC witness Byerley believes FPL's pole inspections, prior to the 2005 storms were not adequate based on his review of FPL's 1998 pole inspections, five respondents to KEMA's survey of other utilities (EXH 15, pp. 86-97), Rule 214.A.2 of the National Electrical Safety Code, and a review of Rural Utilities Services Bulletin 1730B-121. (TR 802-809) Witness Byerley believes the KEMA Report, fails to recognize that past pole failure rates themselves were the result of a long period of insufficient pole inspection and maintenance practices. (TR 813) He was not surprised that FPL's pole performance during hurricanes has not improved over the past 14 years because FPL did no pole inspections from 1991 to 1999. (TR 813; EXH 81, p. 1) FPL suspended its pole inspection program in 1991 as a cost-cutting measure. (EXH 76, p. 4) The inspections resumed after 1999 were, in witness Byerley's opinion, inadequate. Initially, FPL performed approximately 28,000 pole inspections. (TR206)

OPC witness Byerley recommended an adjustment of \$18,319,872 for inadequacies he believed existed in FPL's inspection and maintenance of poles. (TR 811-812; EXH 152, p. 10) When questioned regarding the appropriateness of including or excluding approximately 600 poles with streetlights, he indicated that he had no recollection of seeing any FPL wooden street lighting poles that did not also have other distribution attached. (TR 860-866) He agreed that a 28% percentage was more appropriate to use in his calculations rather than a 45% percentage if one was looking at the FPL-owned poles that are creosote. (TR 870) Also, he assumed that by multiplying a normal pole replacement cost of \$1,700 per pole by a factor of four, he would approximate the higher overall costs likely to occur during the 2005 storm restoration activities. (TR 871; EXH 76, p. 17) FPL witness Williams suggested that a more reasonable estimate would be the price of \$2,000 which FPL was using for purposes of billing telephone companies for pole replacement costs incurred in 2005. (TR 1441)

FRF asserts that Hurricane Wilma was predominately a Category 1 storm. (FRF BR at 3-5, 22-28, 32) FRF references FPL's statements that its system performed as expected and designed. (TR 218) FRF concludes that FPL designs for outages to 75 percent of its total customer base in Category 1 storms. (FRF BR at 32) FRF also points to asserted cost cutting activities by FPL and concludes that FPL's long-term planning is not reasonable and prudent. (FRF BR at 5, 32; EXH 140)

FRF supports the position of OPC and the methodology for calculating the adjustment. (FRF BR at 17) FRF disagrees with witness William's estimate of \$2,000 per pole replacement because her proffered value is unsupported by any analysis in the record. (FRF BR at 17) The majority of the total 2005 storm costs for transmission and distribution of \$782 million was related to distribution costs. (TR 1420-1422) Thus, FRF believes the opinion of witness Byerley is reasonable as representative of the total costs incurred including overtime, and living expenses for visiting workers, and contractors. (FRF BR at 18)

With respect to Issues 27, 28, 30, and 31, FRF argues that penalties pursuant to Chapter 350, Florida Statutes, should be assessed. In Issues 30 and 31, FRF urges the Commission to assess a \$5,000 per day penalty from January 1, 2006 through October 23, 2006. FRF suggests the Commission could begin assessing penalties as early as 2002 when FPL began cutting its pole inspection program. (FRF BR at 5)

## ANALYSIS

### Standard of Performance

FPL witness Williams' apparent premise is that FPL was reasonable and prudent in its pole inspection and maintenance activities during 2005 because FPL was found to be reasonable and prudent in 2004. (TR 199) Staff disagrees with FPL because the facts in this case are substantially different. In the 2004 Storm Order, on pp. 23-24, the Commission found that:

We find that the costs that we found to be appropriately charged to the storm reserve, as set forth in the table above (in Section II.D.), are reasonable and prudent. At the customer service hearings in this docket, extensive testimony was offered in praise of FPL's storm restoration efforts. No party has challenged the reasonableness or prudence of these efforts. More importantly, no party has challenged the reasonableness or prudence of any specific cost among those that we found to be appropriately charged to the storm reserve. Thus, based on the record established, it appears that the costs that we found to be appropriately charged to the storm reserve are reasonable and prudent.

We do not, however, make a finding of reasonableness or prudence for those costs that FPL booked to its storm reserve other than listed in the table above (in Section II.D.). We believe it is unnecessary to make such a finding with respect to costs that are not being proposed for cost recovery at this time or that the Commission believes were not appropriately charged to the storm reserve and thus not appropriate for recovery through the surcharge proposed by FPL (i.e., the costs disallowed in the previous issues). Such a finding could bind this Commission in a future proceeding concerning recovery of those costs, such as a

proceeding initiated under the recently signed securitization bill or the rate case pending at the time of our decision in this docket. (emphasis added)

In this case, concerns regarding the long term consequences of FPL's past decisions have been raised both at the customer service hearings and at the technical hearing. Eleven direct statements from a total of 127 direct statements taken at the service hearings expressed concerns related to the level of FPL's pole maintenance activities, lack of responsiveness in addressing pole issues and wire down conditions, and an apparent decline in FPL's reliability performance. (Palm Beach TR 29, 37, 59, 70, 72; Ft. Lauderdale TR 62, 70, 79, 109; Miami TR 50, 81, 84) The balance of the service hearing testimony addressed matters such as corporate relations with communities, prospective infrastructure design improvements, prospective underground projects and credits, vegetation practices, potential for cost sharing, and requests for the Commission to avoid further bill increases. At the technical hearing, OPC witness Byerley and a report by KEMA (EXH 15) raised questions with respect to the level of FPL's pole inspection and maintenance programs and the level of pole performance data FPL retains. Staff concludes that in this case, there is testimony that criticizes FPL for its pole inspection and maintenance activities.

FPL must show that FPL has been prudent in each instance where FPL's 2005 charges for storm restoration activities are being challenged.

#### Concerns Raised

FPL's pole inspection program is sometimes referred to as the Osmose program because Osmose is the contractor. (TR 201; EXH 15, p. 25). Both FPL-owned and non-owned poles are inspected. (EXH 15, p. 31) For each pole inspected, Osmose provides a database to FPL containing: (1) pole location, by street address or other means, (2) GPS coordinates, (3) pole brand, date, month, and year, (4) pole length and class, (5) species of wood, (6) original treatment, (7) pole supplier, (8) FPL grid number if available, (9) ground line circumference, (10) condition of pole above ground line, (11) condition of attachments, (12) last year inspected, (13) last year treated, (14) decay this cycle, (15) evaluations, and (16) work performed. (TR 202; EXH 15, p. 26)

OPC witness Byerley believes that FPL's distribution pole inspection and maintenance practices have not been adequate because from 1991 through 1997, FPL did not fund such pole inspections. (TR 803; EXH 76, p. 9) In 1998, FPL conducted a study showing that 26 percent of its creosote poles were defective, yet FPL's implementation program in 1998 appeared limited. (TR 802-803; EXH 76, p. 9) The number of pole inspections declined over the years. (TR 219, 306, 307, 819; EXH 81, p. 3) KEMA, in its review of FPL's current pole inspection and maintenance program, concluded that FPL's current pole inspection program is very small in scope and focuses on specific areas. (TR 343; EXH 15, pp. 31-32) KEMA also found that FPL does not have a process in place to track what third parties do to the non-FPL owed poles when the inspections indicate remediation is needed. (EXH 15, p. 31)

Since 1998, FPL has also performed visual inspections of distribution FPL-owned and non-owned poles that comprise the main-trunk feeders. The visual inspections are performed in conjunction with another form of inspection known as the Thermovision program. (TR 200; EXH 15, p. 32) The objective of a visual pole inspection is to record any obvious outward

damage to poles. (TR 210) Witness Byerley noted that because FPL's visual pole inspection program is limited to main-trunk feeders it does not address approximately 65 percent of FPL's poles. (TR 805; EXH 15, pp. 31-32, 58). Similar to the pole inspections, FPL does not have a process in place to track what third parties do to the non-FPL owned feeder poles when the visual inspections indicate remediation is needed. (EXH 15, p. 31)

FPL field personnel perform hazard assessments of poles in the course of normal business. These assessments are estimated to address 80-90 percent of FPL's non-feeder poles over a 15-year period. (EXH 15, pp. 32, 35) Witness Byerley notes that a workman generates a report only if a condition is observed to be hazardous to the assigned task and that FPL does not maintain a database of such information for purposes of assessing pole specific performance. (TR 814) FPL did not rebut this assertion.

Collectively, FPL's distribution pole inspection and maintenance programs do not target 100 percent of the distribution poles. The pole inspection program appears focused on creosote poles because the life expectancy of creosote poles is 27 years. By 2001, creosote poles composed 48 percent of FPL's total distribution pole population of 1,300,000. Most of the creosote poles at that time were known to be over 27 years old. (EXH 76, p. 9) FPL's visual inspection activity specifically excludes 65 percent of the distribution poles. FPL's field hazard assessments, if such data were tracked, would not capture 10-20 percent of the remaining 65 percent.

Based on level of FPL's distribution pole inspections and associated maintenance, witness Byerley believes many of the poles that fell during Hurricane Wilma did so not because of high winds but because of their deteriorated condition. (TR 807) Staff agrees.

#### Strength of Hurricane Wilma

There is no record of wind speeds specific to each location where FPL replaced distribution poles. A wind speed assumption is necessary to perform forensic analysis. KEMA assumed that the intensity of Hurricane Wilma was initially a Category 3 and later a Category 2 hurricane. (EXH 15, p. 80; EXH 143, pp. 2, 4) However, the maximum wind speed recorded throughout Florida varied by location and not all of FPL's impacted area experienced Category 3 and Category 2 wind speeds. (EXH 143, pp. 10-14).

Wind speed assumptions are used throughout KEMA's assessment of pole failures. KEMA relied on FPL's forensic data to perform its engineering analysis. (TR 259; EXH 15, p. 50) Thus, the wind assumptions made by FPL's forensic team at each site during their respective surveys are the most significant and controlling assumptions.

Staff believes that FPL's forensic team members were sufficiently qualified to consider the variability of weather at each inspection location during their respective field surveys based on the representation of witness Williams. (TR 1458) It would not be good management practice to ignore the comments made by the forensic team members. (TR 1459) Consequently, staff recommends reliance on the opinions of FPL's forensic team with respect to the causes of pole failures because the forensic data is expected to include expert judgments as to local wind speeds and resulting damage to FPL facilities.

### FPL's Industry Benchmarks

FPL witnesses Williams and Brown provided industry benchmark comparative information intended to show that FPL has taken reasonable actions and that its level of performance was at least adequate or good when compared to other utilities. (EXH 105; EXH 15, pp. 81-83, 86-97; TR 1308-1313) However, FPL's witnesses Williams and Brown did not provide any substantive assessment of the costs other utilities incur for pole inspection, the level or type of inspections, maintenance activities, and storm restoration. FPL witness Williams believes such data is necessary to perform a complete analysis. (TR 1387) Staff concludes that FPL has not shown that the industry benchmark comparative provides a complete analysis consistent with the testimony of FPL's witness. Furthermore, the industry benchmark data are in no way informative of the level of service expected by FPL's retail customers and the resultant costs.

FPL witness Williams testified that incremental utility costs, (for example: costs for more aggressive inspections and costs for pre-storm detection and replacement), need to be considered. (TR 1387) However, FPL's witnesses Williams and Brown did not provide any assessment of the costs other utilities incur for pole inspection, the level or type of inspections, maintenance activities, and storm restoration such that complete analysis could be made consistent with the testimony of FPL witness Williams. Furthermore, FPL witnesses did not show that FPL's base rates were not already set to level sufficient to address any such incremental costs.

Staff concludes that the industry benchmark comparative information does not show that FPL was reasonable and prudent to provide the level of service it did prior to and during 2005. The industry benchmarks do not show that FPL's base rates were not sufficient to address costs to implement distribution pole inspection and maintenance activities at a higher level than that set by FPL.

### FPL's Performance

Beginning in 1998, FPL's pole inspection program and FPL's visual pole inspection programs can be viewed as an annual program even though FPL does not implement programs on a legacy basis. Every year since 1998, these programs have been reviewed and budgeted. (Williams TR 220) An annual renewal since 1998 means FPL found merit in the programs. The limited scope of the programs, as previously identified by KEMA and witness Byerley, means FPL repeatedly elected not to materially increase program funding subsequent to 1999 and prior to 2005.

FPL's annual review of pole inspection and maintenance activities and funding levels has resulted in approximately 125 non-hurricane related pole failures per year. (EXH 104) FPL witness Williams characterizes such events as negligible, apparently, because FPL is a large utility and the total number of outages on its system is a large number. (TR 191, 1386, 1410) In 2001, FPL did not replace poles due to budget constraints in their North Florida management area. (TR 1450; EXH 81, p. 6) Also, going into the first storm of 2005, FPL still had pending repairs to complete associated with the hurricane events of 2004. (TR 1455-1456) FPL witness Williams agreed that it is possible that some of FPL's facilities prior to the 2005 storm season were attached to poles that may not have met the requirements of the NESC or of FPL's

Distribution Engineering Reference Manual. (Williams TR 1461-1463; EXH 153, pp. 9, 12, 13) At least ten percent of FPL's distribution poles were not likely to be inspected. (EXH 15, p. 36) Additionally, KEMA notes that FPL's hurricane restoration efforts appear to cause the system to become slightly weaker because some of FPL's pole replacements were of lower strength. (EXH 15, p. 76)

FPL witness Williams believes it is not good management policy to ignore the comments made by FPL's forensic team, yet, at the same time she substantially ignores or dismisses 11 instances where the forensic team noted possible pole failures due to design overloading. Her rationale for discounting the opinions of the forensic team appears based on a view that Hurricane Katrina was a relatively low wind storm. (TR 1458-1459) It is especially disconcerting that witnesses Williams and Brown would be inclined to dismiss comments made by the well-qualified assigned experts who collected and reviewed the field data because FPL has not shown it maintains detail records regarding pole inspections and the status of remedial actions when inspections were made. (EXH 15, pp. 32-34, 51)

In 1999, when FPL began funding of a pole inspection program, that program provided FPL with the ability to develop a database of pole specific information, inspection results, and pole performance data. FPL witness Williams indicated that the same program existed in the 1980s. (TR 201-202) Yet, KEMA, in Exhibit 15, at pages 32-34 and 51, points out that FPL does not track or retain pole inspection results and pole performance data. When FPL witness Williams was asked regarding a recent Commission decision to step up FPL's recently proposed ten-year pole inspection program, she responded in part with the following:

I fully intend, now that we're going to be capturing some very specific data on our poles, both old poles as well as new poles, that if in time it does not look like those costs are prudent because they're not resulting in real, tangible benefit to the customers, then I certainly will be coming back to the Commission whenever that time is and may be asking to reduce that cycle.

(TR 1436-1437)

The above statement is clear and unambiguous. FPL has no facts to support a finding that FPL has been prudent and responsive to the level of service its customers expect. FPL does not know if FPL's distribution pole inspection and maintenance practices are prudent. FPL had the ability to implement more distribution pole inspection and maintenance activities as early as the 1980s but elected not to do so. In light of the above testimony by witness Williams, FPL has not shown that, in any way, its past distribution pole inspection and maintenance practices avoided incurring higher costs during 2005 hurricane restoration activities.

Furthermore, FPL has not provided any evidence suggesting that its base rates prior to and during 2005 were not sufficient to address any incremental costs FPL may have had to incur for increased pole inspection and maintenance activities.

#### Estimating the Adjustment

A downward adjustment is warranted because: (1) some 2004 repair had not yet been completed, (2) FPL does not know whether it met the requirements of the NESC at each failed

pole, (3) FPL has not shown that an increased level of pole inspection and maintenance was not prudent and funded by its base rates, and (4) FPL has not shown that its level of pole inspection and maintenance did not contribute to higher hurricane restoration costs in 2005.

A downward adjustment is calculated by OPC witness Byerley. His approach focuses on the program FPL initiated in 1998/99. (TR 811; EXH 152, p. 10) FPL's program was triggered by its expectation that creosote poles were subject to failure and expected to fail at an increasing rate. (TR 802-803)

Staff believes the methodology provided by OPC witness Byerley, with certain modifications, can be used as a regulatory tool that provides a test of the effectiveness of FPL's implemented programs. In following this approach it is understood that this effort is not intended to be a calculation of the exact impact of FPL's long term pole inspection and maintenance practices on the storm restoration costs of 2005.

Staff's modification to the methodology provided by witness Byerley is an effort to recognize non-FPL owned assets are also used to provide retail service. Staff notes that FPL has electrical facilities attached to at least 72,283 creosote poles owned by telephone companies. (EXH 81, p. 2) FPL incurs the cost to inspect poles it does not own. (EXH 15, p. 31) Further, FPL's overall quality of service is affected by the reliability of the poles it does not own.

The record supports different factors and weights than those proposed by witness Byerley. However, such efforts may be an exercise in false precision given the uncertainty of FPL's distribution pole specific data and because hurricanes are indiscriminate destroyers. Additionally, post-storm statistical inferences about damages not specifically studied by forensic review teams are not highly reliable because FPL has not maintained pole-specific performance data. Each key factor and weight used by witness Byerley that is specifically rebutted by FPL witness Williams is addressed below.

#### Number of Poles

Discussion regarding the number of poles with which to begin an adjustment calculation focused on whether approximately 600 streetlight poles should be included. Witness Byerley explained that he did not find evidence that wooden pole with streetlights did not also have other distribution facilities attached. (TR 860-866; EXH 152, p. 10; EXH 153, p. 10) Staff observes that KEMA reported 5,286 FPL-owned broken poles in Exhibit 15, at page 61. FPL witness Williams asserts that witness Byerley over-estimated the number of FPL distribution poles replaced by approximately 900 poles based on her estimate of 6,500. (TR 1396) She does not indicate whether her estimate includes or excludes streetlight poles. FPL is still in the process of determining which replaced poles were FPL-owned. (EXH 4, p. 236) Consequently, the precision of the number of FPL-owned poles is not known.

As previously discussed, staff believes any adjustment made in this issue should recognize that FPL has an obligation with respect to ensuring the poles it places facilities on are properly maintained regardless of ownership. Also, the adjustment should recognize FPL's practice of including the cost of replacing non-owned poles count in its estimated storm restoration costs. (TR 1419, 1441) Staff concludes that the replaced pole count of approximately

11,400 be used because FPL replaced approximately 11,400, poles in 2005 due to hurricane damage. (TR 1419; EXH 15, p. 58)

#### FPL Owned and Non-Owned Creosote Poles

On cross examination, witness Byerley agreed that a 28 percent weight was more appropriate to use in his adjustment calculation rather than the 45 percent weight if one was looking at the FPL poles that are creosote. (TR 820)

As previously discussed, staff does not believe FPL's obligation to serve associated with its use of non-owned creosote poles should be adjusted out as a matter of policy. Staff recommends use of a weight that represents FPL's obligations associated with using both FPL owned and non-owned creosote poles. The combined weight of both FPL owned and non-owned creosote poles is 45 percent. (EXH 152, p. 10; EXH 153, p. 10)

#### Pole Replacement Cost During Storm Restoration

OPC witness Byerley suggested an estimated FPL's per-pole replacement cost to be \$6,800, because he believes storm restoration costs could be approximately four times FPL's average per-pole replacement cost of \$1,700. (TR 871; EXH 76, p. 17) FPL witness Williams suggested an estimate of \$2,000 because \$2,000 is the price that FPL was using to bill telephone companies for each pole replacement that incurred in 2005. (TR 1441) In March 2006, FPL revised its method of calculating the billed amount from approximately \$6,000 to approximately \$2,000. (TR 219-220; EXH 4, p. 279) Consequently, the apparent concern with witness Byerley's testimony is his four times multiplier. Whether use of the four times multiplier results in overestimating or understating the exact impact of FPL's long term pole inspection and maintenance practices on the storm restoration costs of 2005 is not known.

Staff recommends that use of the \$2,000 per pole replacement cost is reasonable, because FPL is billing telephone companies based on an average of \$2,000 per pole replaced.

#### Conductor Replacement Costs

Witness Byerley calculated a factor of 0.88 for conductor replacement costs per replaced pole cost. The ratio is derived from FPL's 2004 total conductor replacement costs of \$8.3 million (Account 365) for 2004 and FPL's 2004 total pole replace costs of \$9.4 million (Account 364). (TR 812) It is important to note the factor recommended by witness Byerley is on a per dollar basis of all conductor replacements and all pole replacements for 2004. By using the 2004 pole replacement costs, he is consistent with his assumption of \$6,800 per pole replacement because that was the level of costs incurred in 2004.

FPL witness Williams believes his methodology overstates the conductor costs associated with pole replacements because she believes 90 percent of the conductor damage was due to wind, trees, and debris. (TR 1397) Thus, she suggests that a factor of 10 percent should be used. (TR 1397, 1401) Witness Williams recommends a factor that, by definition, should only be applied to the amount or cost of conductor replacements and not the cost of replacing failed poles. Nevertheless, this is apparently what was done to arrive at her estimated \$1.8 million adjustment.



Staff recommends a factor lower than the 0.88 offered by witness Byerley because staff believes FPL's pole replacement price in 2004 was approximately 3.4 times ( $\$6,800/\$2000=3.4$ ) more than what FPL shows for 2005. Staff accepts witness Byerley's judgment regarding the relative cost relationship between replaced conductors and replaced poles because it is the only one in the record. Staff recommends use of an estimated conductor replacement cost fact of 0.26 per pole replaced ( $0.88 \div 3.4 = 0.26$ ).

#### Table of Adjustments

A summary of the differences between the calculations of witnesses Byerley, Williams and staff's recommendation is provided below in Table 27-1. Staff recommends using OPC witness DeRonne's 25 percent capital offset assumption to estimate the respective rate base and expense amounts of the adjustment. (EXH 85)

TABLE 27-1  
Calculation of Distribution Pole Inspection and Maintenance Adjustment

	OPC Witness <u>Byerley</u>	FPL Witness <u>Williams</u>	<u>Staff</u>
Number of Pole Failures	6,925	6,500	11,400
Percent Creosote	28	28	45
Percent due to Deterioration	46	46	46
\$/pole Replaced	\$1,700	\$2,000	\$2,000
Escalation due to all price increases during storm restoration	4	1	1
Pole Replacement Cost	\$6,065,600	\$1,674,000	\$4,720,000
Conductor Cost per replaced Pole Cost	0.88	.10	.26
Total Adjustment (Rounded)	\$11,400,000	\$1,800,000	\$5,900,000
25 % Capital Offset Amount	\$ 2,850,000	\$ 450,000	\$1,440,000
Expense Amount	\$ 8,550,000	1,350,000	\$4,460,000

#### Penalties

The imposition of fines and comparable penalties pursuant to Chapter 350, or, more appropriately, Section 366.095, Florida Statutes, is limited to instances where a utility refuses to comply or willfully violates any rule, order, or statute administrated by the Commission. In this case and issue, no one has identified a rule, order or statute administrated by the Commission that FPL failed to implement or comply with. Hence, no fines are recommended.

### **CONCLUSION**

A downward adjustment of \$5,900,000 is warranted because: (1) some 2004 repair had not yet been completed, (2) FPL does not know whether it met the requirements of the National Electrical Safety Code at each failed pole, (3) FPL has not shown that an increased level of pole inspection and maintenance was not prudent and funded by its base rates, and (4) FPL has not shown that its level of pole inspection and maintenance did not contribute to higher hurricane restoration costs in 2005. The recommended capital offset adjustment amount is \$1,440,000 and the recommended expense adjustment amount is \$4,460,000. No other fines or penalties are recommended because there is no evidence that FPL refused to comply with or willfully violate any lawful rule or order of the Commission, or any statute administered by the Commission.

**Issue 28:** Did FPL adequately control vegetation around its distribution and transmission system prior to June 1, 2005? If not, what amount, if any, should be adjusted from the costs that FPL proposes to charge to the storm reserve and recover through securitization or a surcharge?

**Recommendation:** A downward adjustment of \$3,400,000 is warranted because: (1) in 2004 and 2005, FPL was aware of avoidable tree-related customer outages, (2) in 2004 and 2005 FPL limited the implementation of a program that contributes to decreased tree-related customer outages, (3) FPL has failed to show that its reduction to the level of vegetation management, which was included in its last rate case, was prudent, and (4) FPL has failed to demonstrate that its reduced level of vegetation management did not contribute to higher hurricane restoration costs in 2005. The recommended capital offset adjustment amount is \$850,000 and the recommended expense adjustment amount is \$2,550,000. No other fines or penalties are recommended because there is no evidence that FPL refused to comply with or willfully violated any lawful rule or order of the Commission, or any statute administered by the Commission. (Bremar)

### **Position of the Parties**

**FPL:** Yes. The reasonableness of FPL's approach to managing vegetation is supported by excellent operating results, demonstrating improved performance over time. This performance has been achieved despite some difficult challenges. Tree density in FPL's service territory is twice the national average. Additionally, Florida's climate and twelve-month growing season result in some of the highest tree re-growth rates in the nation. FPL's vegetation management program is an important component of FPL's overall maintenance and reliability program, which has also achieved excellent results.

**OPC:** FPL's Vegetation Management Program is inadequate. Vegetation related outages have been increasing steadily since 1999. This concurs with the Staff Report in July 2005. The slight decrease in 2004 is due to excluding hurricane related outages. Internal studies show that FPL opted to repair damage after hurricanes rather than take preventive measures. If FPL had done preventive clearing before the hurricanes, many more consumers would have had power afterward. The Commission should adopt OPC's estimate of preventable tree-related damage.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. FPL's pre-storm vegetation management activities were inadequate. Agree with OPC as to amounts of claimed repair costs that should be disallowed. Additionally, because FPL's activities were inadequate due to FPL's intentional cost-cutting efforts, they were imprudent and FPL should be penalized pursuant to Chapter 350 for the resulting failures, which resulted in excessive outages and losses being sustained by FPL's customers.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** No. The AG adopts and agrees with the position of the OPC. Additionally, this Commission should not permit recovery of costs resulting from inadequate infrastructure maintenance, nor reward FPL for its failure to adequately plan and prepare for the storm season. FPL's position on this issue is based on negligent or arrogant indifference to known risks, incomplete or inaccurate data, and/or a willingness to allow the consumer to absorb infrastructure maintenance costs through the storm docket.

**Staff Analysis:** Issue 33 addresses FPL's inspection and maintenance of transmission towers. In the following analysis, all references to FPL's vegetation program pertain to FPL's distribution vegetation management.

### **PARTIES' ARGUMENTS**

FPL asserts its large size should dictate the proper evaluation of FPL's vegetation management program. (FPL BR at 92) Tree density in FPL's service territory is twice the national average and the growing season results in some of the highest tree re-growth rates in the nation. (TR 1398-1399) Vegetation-related outages decreased in 2004 and 2005. (TR 1398) FPL's overall System Average Interruption Duration Index ("SAIDI") compares favorably within the state and ranks in the top quartile nationally. (TR 1399) Focusing on increased vegetation outages in the 1999-2003 period ignores the improvements that occurred in 2004 and 2005 and FPL's SAIDI performance. (TR 815, 1398-1399)

FPL asserts that OPC witness Byerley inappropriately uses a November 2005 hurricane hardening review to conclude that FPL should have implemented a more aggressive vegetation program in years prior to 2005. (FPL BR at 94) The FPL review used by witness Byerley presents various levels of vegetation maintenance activities, estimates of implementation costs and estimates of avoided hurricane costs. (EXH 82, pp. 26-28) FPL argues that Exhibit 82 is not evidence of FPL's vegetation management decisions prior to 2005. (FPL BR at 94)

FPL asserts that OPC witness Byerley misunderstands FPL's use of the term "preventable" in categorizing vegetation-related pole damage. (TR 1400; FPL BR at 95) Witness Williams defined the term "preventable" to mean "that where there was pole damage, it was the opinion of the person that went out there, the forensics engineer, that standard trimming could have prevented the pole damage that actually occurred." (TR 217) FPL must often seek permission from the owners of trees in order to trim them, and that permission is often denied. (TR 1400) Clearly it would be unfair to penalize FPL for damage caused by vegetation that it has been denied permission to trim as implied by the calculations of witness Byerley. (TR 1400)

FPL asserts that another error by witness Byerley was using conductor breakage for Hurricane Katrina to estimate preventable vegetation pole breakages for Hurricane Wilma. (TR 815-816; EXH 82, p. 11) FPL asserts that the appropriate statistic is in the KEMA report. (EXH 15, p. 78; TR 876) Other errors FPL believes to exist in witness Byerley's calculations are addressed in Issue 27. FPL witness Williams, while not agreeing that a disallowance was appropriate or supported, recalculated OPC witness Byerley's methodology using alternative assumptions resulting in an amount of \$10,000. (TR 1396-1397)

FPL believes that any calculated adjustments pursuant to this issue should be netted against the incremental cost of the level of vegetation maintenance that witness Byerley believes should have occurred. (TR 1401-1402; FPL BR at 97)

OPC witness Byerley believes FPL is not entitled to recover costs associated with preventable tree damage because he believes FPL's decisions to fund its vegetation management is based on what is most economical for FPL. (TR 816)

Witness Byerley believes Exhibit 82, pages 26-28, further supports his conclusion that FPL budgets programs based on what is most economical to FPL, because the FPL analysis is based on costs incurred by FPL before and after storms. The FPL analysis shows it is not cost effective to FPL to improve the vegetation management program. (TR 815; EXH 82, pp. 26-28)

He concluded that FPL's vegetation management program may not be adequate based on a review of Commission staff reports and FPL's Annual Distribution Reliability Reports. (TR 804-815) The reports showed decreasing reliability through 2003 with an improvement in 2004. (TR 815) He believes that the apparent improved performance in 2004 could be in part due to adjustments to exclude 2004 hurricane outages. (TR 815)

Thus, witness Byerley believes FPL is not entitled to recover costs associated with preventable tree damage because FPL's decisions are based on what is most cost-effective to FPL. The costs are preventable. (TR 816) OPC witness Byerley recommended an adjustment of \$11,300,000 for inadequacies he believed existed in FPL's vegetation management practices and were preventable. (TR 816) OPC urges the Commission to adopt the \$11,300,000 adjustment recommended by witness Byerley. (OPC BR at 55)

With respect to Issues 27, 28, 30, and 31, FRF argues that penalties pursuant to Chapter 350 should be assessed. In Issues 30 and 31, FRF urges the Commission to assess a \$5,000 per day penalty from January 1, 2006 through October 23, 2006. (FRF BR at 5)

## ANALYSIS

### Standard of Performance

As presented in Issue 27, FPL carries the burden of proof in this case and must show that the Company has been prudent in each instance where FPL's 2005 charges for storm restoration activities are being challenged.

### Concerns Raised

FPL's vegetation related outages steadily increased from 1999 through 2003. (TR 814, 1399) FPL's activities related to improving vegetation management since 2003 are presented in Exhibits 152 and 153, at page 16 in both documents. Exhibits 152 and 153 state that prior to 2004, FPL did not have a systematic program to trim lateral circuits. Trimming of lateral circuits began in 2004 with a 4-5 year plan to ramp up to a three year trim cycle.

Lateral poles comprise approximately 65 percent of FPL's distribution system. (TR 209; EXH 15, p. 58) Therefore, prior to 2003, FPL did not have a vegetation management program to systemically address tree growth issues on approximately 65 percent of its system. Additionally,

in 2004 and 2005, it was not FPL's plan to trim all circuits on the lateral poles within a 3-year cycle but to phase in the 3-year cycle program over 4-5 years. Furthermore, Exhibit 153, page 16, also states joint users typically do not trim trees or remove vines. Thus, FPL has not shown that its vegetation practices were complete or thorough because FPL elected to fund activities at lower levels.

During 2005, FPL developed an estimate of FPL's costs and customer outage benefits associated with the lateral circuit vegetation program. (EXH 82, pp. 37-38) Staff finds it difficult to believe FPL was not capable of performing a similar analysis in years prior to 2005. Furthermore, staff believes this analysis would be one of the various types of analysis that FPL should have performed in its project funding review.

OPC witness Byerley's testimony, taken as a whole, asserts that FPL made decisions based on the costs it incurred rather than the costs to prevent damage to facilities that FPL could have avoided. The damages would be the preventable damages that standard trimming could have prevented during non-hurricane events as well as hurricane events. Thus, FPL's charges to the storm reserve should be adjusted downward because FPL's vegetation management programs resulted in charges to the storm reserve that FPL knew were avoidable. (TR 814-816) Staff agrees.

#### FPL's Industry Comparative

FPL witness Williams asserts that FPL's vegetation-related outage performance improvements in 2004 and 2005 were achieved despite difficult challenges such as high tree density and high tree re-growth rates. (TR 1398) The high tree density and re-growth rates are with respect to the national average. (TR 1398) Witness Williams does not provide other utility costs pertaining to their respective performance levels. FPL has not shown that the national industry comparison in any way informs the Commission of the level of service expected by FPL's retail customers and the resultant costs.

FPL witness Williams indicated that incremental utility costs, (such as costs due to more aggressive vegetation management) need to be considered to determine the incremental costs associated with a different level of activity. (TR 1402) However, FPL witnesses failed to show that FPL's base rates were not already set to a level sufficient to address any such incremental costs.

Staff concludes that FPL's industry comparative information is inconclusive in showing that FPL was reasonable and prudent in providing the level of service it did prior to and during 2005. The industry comparatives do not show that FPL's base rates were insufficient to address costs to implement vegetation management activities at a higher level than that set by FPL.

#### FPL's Performance

Vegetation management is an important component of FPL's overall maintenance and reliability program. (Williams TR 137) Every year, reliability programs such as vegetation management have been reviewed and budgeted. (Williams TR 220) An annual renewal indicates FPL found merit in the program.

In 2004, FPL elected to phase in a 3-year cyclical vegetation program for 65 percent of its distribution system. The vegetation-related customer outages declined during 2004 and 2005. Some of the improved performance may be attributable to adjustments for hurricane events. Improved performance may also be attributable to the new lateral circuit vegetation program.

The post-Wilma survey of 1,741 poles by FPL's forensic team reported three pole failures that could have been avoided had FPL cleared the vegetation from the circuits. (EXH 15, pp. 58, 78; EXH 153, p. 9) As discussed in Issue 27, post-storm statistical inferences about damages not specifically studied by forensic review teams are not highly reliable because FPL has not maintained pole specific performance data. Therefore, the exact number of avoidable pole failures due to lack of vegetation management is not certain. Nevertheless, avoidable pole failures occurred and contributed to the overall 2005 hurricane restoration costs.

#### Estimating the Adjustment

A downward adjustment is warranted because: (1) in 2004 and 2005, FPL was aware of avoidable tree-related customer outages, (2) in 2004 and 2005 FPL limited the roll-out of a program that appear to contribute to decreased tree-related customer outages, (3) FPL has failed to show that its reduction to the level of vegetation management, which was included in its last rate case, was prudent, and (4) FPL has failed to demonstrate that its reduced level of vegetation management did not contribute to higher hurricane restoration costs in 2005.

A downward adjustment is calculated by OPC witness Byerley. His approach builds on the methodology used for pole inspection and maintenance addressed in Issue 27. Staff believes the methodology provided by OPC witness Byerley is a well reasoned regulatory tool that provides a test of the effectiveness of FPL's implemented program. In following this approach, it is understood that this effort is not intended to be a calculation of the exact impact of FPL's long-term vegetation management practices on the storm restoration costs of 2005.

Staff is concerned with adjustments witness Byerley makes for non-FPL-owned assets because they may lead one to an erroneous conclusion that all third-party contracts for services and use of facilities should be removed from all reviews of FPL's overall level of service to customers. Staff notes that FPL has electrical facilities attached to at least 72,283 creosote poles owned by telephone companies. (EXH 81, p. 2) FPL incurs the cost to inspect poles it does not own. (EXH 15, p. 31) FPL has not represented that pole ownership is a factor in the vegetation management programs. Therefore, as a matter of regulatory policy, approval of the adjustment recommend by witness Byerley should not be construed to mean that FPL's obligation to provide reliable service excludes the effects of FPL's contracts and agreements with third-parties.

As discussed in Issue 27, the record supports different factors and weights than those proposed by witness Byerley. However, such efforts may be an exercise in false precision given the uncertainty of FPL's distribution pole specific data and because hurricanes are indiscriminate destroyers. Additionally, post-storm statistical inferences about damages not specifically studied by forensic review teams are not highly reliable because FPL has not maintained pole-specific performance data.

Staff notes that the adjustments in Issue 27 and in this issue do not count the same failed poles twice because the weights used separately identify the various causes of pole failures. (EXH 152, p. 11; EXH 153, p. 11)

For purposes of completeness, the key factors and weights used by witness Byerley to estimate the number of avoidable pole failures that are specifically rebutted by FPL witness Williams is addressed below. All other factors and weights are addressed in Issue 27.

#### Number of Avoidable Pole Failures

Witness Byerley estimates 888 avoidable pole failures occurred due to Hurricane Wilma. (TR 816) He did not use the value of three pole failures that appears Exhibit 15, page 78, because that “the number seemed pretty unreasonable.” (TR 876) FPL’s preliminary review of Hurricane Wilma data indicated that 24 percent of the broken poles were tree related. (TR 815; EXH 83) Witness Byerley then assumed that at least half the pole failures due to trees were preventable because over 62 percent of the conductor damage was preventable. (TR 816; EXH 82, p. 11) Thus, he estimates 12 percent of the pole failures were due to FPL preventable tree damage. (TR 816) Witness Byerley applies the 12 percent rate to a pole count of 7,400.

Witness Williams believes only three avoidable pole failures occurred which she calculates to be 0.3 percent preventable pole failure rate. (TR 1401) She also believes 21 percent of the broken poles were tree related. (TR 1401) She applies both these factors to an FPL owned pole count of 6,400. Using these steps, staff finds witness Williams’ estimate of tree-preventable pole failures due to Hurricane Wilma is 4. It is notable that FPL’s forensic team made a total of 1,944 observations. (EXH 153, p. 6) However, witness Williams does not explain how the site specific observations translate to system averages. This portion of testimony is of specific concern because, as discussed in Issue 27, FPL did not have pole specific performance data. The absence of data and support for the opinion of witness Williams does not mean she is wrong. However, to agree with her testimony requires substantive factual support that is lacking in the record. Therefore, staff believes the more credible estimate of preventable pole failure rate is provided by witness Byerley.

Staff notes that if witness Byerley’s approximation of an preventable pole failure rate of 12 percent is reasonable then as many as 1,368 avoidable poles failures may have occurred.  $(11,400 \times 0.12 = 1,368)$  Staff’s purpose in using a pole count of 11,400 is an effort to recognize that FPL’s obligation to provide service includes all reliability consequences associated with using third-party poles consistent with staff’s analysis in Issue 27. Staff’s recommended adjustments in Issue 27 are incorporated into Table 28-1 below.

#### Table of Adjustments

A summary of the differences between the calculations of witnesses Byerley, Williams and staff’s recommendation is provided in Table 28-1. Staff recommends using OPC witness DeRonne’s 25 percent capital offset assumption to estimate the respective rate base and expense amounts of the adjustment. (EXH 85)



TABLE 28-1  
Calculation of the Vegetation Adjustment

	OPC Witness <u>Byerley</u>	FPL Witness <u>Williams</u>	<u>Staff</u>
Number of Poles Failures	7,400	6,500	11,400
Percent due to Trees	24	21	24
Percent Avoidable	50	0.3	50
\$/pole Replaced	\$1,700	\$2,000	\$2,000
Escalation due to all price increases during storm restoration	4	1	1
Pole Replacement Cost	\$6,038,400	\$8,000	\$2,736,000
Conductor Cost per replaced Pole Cost	0.88	0.10	0.26
Total Adjustment (Rounded)	\$11,400,000	\$10,000	\$3,400,000
25 % Capital Offset Amount	\$ 2,850,000	\$ 2,200	\$ 850,000
Expense Amount	\$ 8,550,000	\$ 6,600	\$ 2,550,000

### Penalties

The imposition of fines and comparable penalties pursuant to Chapter 350, or Section 366.095, Florida Statutes, is limited to instances where a utility refuses to comply or willfully violates any rule, order, or statute administrated by the Commission. In this case and issue, no one has identified a rule, order or statute administrated by the Commission that FPL failed to implement or comply with. Therefore, no fines are recommended.

### CONCLUSION

A downward adjustment of \$3,400,000 is warranted because: (1) in 2004 and 2005, FPL was aware of avoidable tree-related customer outages, (2) in 2004 and 2005 FPL limited the roll-out of a program that contributes to decreased tree-related customer outages, (3) FPL has failed to show that its reduction to the level of vegetation management, which was included in its last rate case, was prudent, and (4) FPL has failed to demonstrate that its reduced level of vegetation management did not contribute to higher hurricane restoration costs in 2005. The recommended capital offset adjustment amount is \$850,000 and the recommended expense adjustment amount is \$2,550,000. No other fines or penalties are recommended because there is no evidence that FPL refused to comply with or willfully violate any lawful rule or order of the Commission, or any statute administered by the Commission.

**Issue 29:** WITHDRAWN

**Issue 30:** Did FPL adequately inspect and maintain its distribution and transmission system for deterioration and overloading of poles prior to October 23, 2005? If not, what amount, if any, should be adjusted from the costs that FPL proposes to charge to the storm reserve and recover through securitization or a surcharge?

**Recommendation:** This issue is duplicative of Issue 27. No one identified a rule, order or statute administrated by the Commission and specific to inspection and maintenance of distribution and transmission poles that FPL failed to implement or comply with for the period January 1, 2005 through October 23, 2005. Hence, no fines or penalties are recommended. (Bremen)

**Position of the Parties**

**FPL:** This issue is essentially identical to Issue 27. FPL's position from Issue 27 applies here equally. There is no basis for penalizing FPL under Chapter 350, as the FRF has proposed.

**OPC:** Please see Citizens' position and argument on issue 27.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. FPL's inspection activities with respect to the deterioration of wood distribution poles were inadequate. Agree with OPC as to amounts of claimed repair costs that should be disallowed. Additionally, FPL should be penalized pursuant to Chapter 350 for the resulting failures, which in turn resulted in excessive outages and losses being sustained by FPL's customers. The date through which such penalties should be imposed is the day before Wilma struck South Florida, October 23, 2005.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** No. The AG adopts and agrees with the position of the OPC. Additionally, this Commission should not permit recovery of costs resulting from inadequate infrastructure maintenance, nor reward FPL for its failure to adequately plan and prepare for the storm season. FPL's position on this issue is based on negligent or arrogant indifference to known risks, incomplete or inaccurate data, and/or a willingness to allow the consumer to absorb infrastructure maintenance costs through the storm docket.

**Staff Analysis:** This issue was raised by FRF. The only difference in scope between Issues 27 and 30 is the potential for assessment of penalties through October 23, 2005, pursuant to Chapter 350, or, more appropriately, Section 366.095, Florida Statutes. All other matters are already addressed in Issue 27.

In its brief, FRF argues that penalties pursuant to Chapter 350 should be assessed. A \$5,000 per day penalty from January 1, 2006 through October 23, 2006 is suggested. FRF also suggests the Commission could begin assessing penalties as early as 2002 when FPL began cutting its pole inspection program. (FRF BR at 5)

The imposition of fines and comparable penalties pursuant to Chapter 350, or, Section 366.095, Florida Statutes, is limited to instances where a utility refuses to comply or willfully violates any rule, order, or statute administrated by the Commission. No one identified a rule, order or statute administrated by the Commission and specific to inspection and maintenance of distribution and transmission poles that FPL failed to implement or comply with for the period January 1, 2005 through October 23, 2005. Therefore, no fines or penalties are recommended.

**Issue 31:** Did FPL adequately control vegetation around its distribution and transmission system prior to October 23, 2005? If not, what amount, if any, should be adjusted from the costs that FPL proposes to charge to the storm reserve and recover through securitization or a surcharge?

**Recommendation:** This issue is duplicative of Issue 28. No one identified a rule, order or statute administrated by the Commission and specific to vegetation around distribution and transmission facilities that FPL failed to implement or comply with for the period January 1, 2005 through October 23, 2005. Therefore, no fines or penalties are recommended. (Bremar)

**Position of the Parties**

**FPL:** This issue is essentially identical to Issue 28. FPL's position from Issue 28 applies here equally. There is no basis for penalizing FPL under Chapter 350, as the FRF has proposed.

**OPC:** Please see Citizens' position and argument on issue 28.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. FPL's pre-storm vegetation management activities were inadequate. Agree with OPC as to amounts of claimed repair costs that should be disallowed. Additionally, because FPL's activities were inadequate due to FPL's intentional cost-cutting efforts, they were imprudent and FPL should be penalized pursuant to Chapter 350 for the resulting failures. The date through which such penalties should be imposed is the day before Wilma struck South Florida, October 23, 2005.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** No. The AG adopts and agrees with the position of the OPC. Additionally, this Commission should not permit recovery of costs resulting from inadequate infrastructure maintenance, nor reward FPL for its failure to adequately plan and prepare for the storm season. FPL's position on this issue is based on negligent or arrogant indifference to known risks, incomplete or inaccurate data, and/or a willingness to allow the consumer to absorb infrastructure maintenance costs through the storm docket.

**Staff Analysis:** This issue was raised by FRF. The only difference in scope between Issues 28 and 31 is the potential for assessment of penalties through October 23, 2005, pursuant to Chapter 350, or Section 366.095, Florida Statutes. All other matters are addressed in Issue 28.

In its brief, FRF argues that penalties pursuant to Chapter 350 should be assessed. A \$5,000 per day penalty from January 1, 2006 through October 23, 2006 is suggested. FRF also suggests the Commission could begin assessing penalties as early as 2002 when FPL began cutting its pole inspection program. (FRF BR at 5) It appears that FRF associates vegetation management with pole inspections.

The imposition of fines and comparable penalties pursuant to Chapter 350, or Section 366.095, Florida Statutes, is limited to instances where a utility refuses to comply or willfully violates any rule, order, or statute administrated by the Commission. No one identified a rule, order or statute administrated by the Commission and specific to inspection and maintenance of distribution and transmission poles or vegetation management that FPL failed to implement or comply with for the period January 1, 2005 through October 23, 2005. Therefore, no fines or penalties are recommended.

**Issue 32:** WITHDRAWN

**Issue 33:** What adjustment, if any, should the Commission make associated with the failure of 30 transmission towers of the 500 KV Conservation-Corbett transmission line and the failure of six structures on the Alva-Corbett 230 transmission line?

**Recommendation:** The resolution of this issue does not impact the ultimate decision in this case because rate base allocations are removed from the storm restoration charges. Staff recommends an adjustment of \$12,000,000 to rate base because: (1) in 1998 FPL knew that a bolt problem existed, (2) FPL's 1998 analysis called for a revised construction standard for tower bolts, and (3) FPL failed to implement the revised construction standard prior to the 2005 hurricane events. The \$12,000,000 adjustment includes an estimate of \$11,900,000 for storm restoration costs of the Conservation-Corbett 500 KV transmission line and \$100,000 for storm restorations costs for the Alva-Corbett 230 KV transmission line. (Breman)

**Position of the Parties**

**FPL:** None. FPL's actions in building, inspecting and maintaining Conservation-Corbett were reasonable based upon available information. FPL reasonably concluded that the loose and missing bolts discovered in 1998 were caused by excessive conductor vibration and that reducing the vibration eliminated the cause of the bolt loosening. From 1999 to 2003, FPL conducted several detailed inspections, which confirmed FPL's expectation that this issue had been resolved. Essentially all damage to Alva-Corbett transmission structures was the direct result of Conservation-Corbett structures collapsing.

**OPC:** FPL's pre-storm maintenance was inadequate. Cross-brace bolts, critical to structural integrity, were loose or missing on 31 towers in 1998. Given the risks known then, FPL shouldn't have "assumed" that measures to reduce conductor vibration would prevent future loose bolt problems. FPL should have secured the nuts on all cross-brace bolts, and documented the 1998 discovery adequately. FPL did neither, even when it discovered another bolt missing in 2002. FPL must bear full responsibility for \$10.4 million of restoration costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC that \$10,411,000 should be removed from both the total projected storm restoration costs and from the capital cost offset, and that the Commission's final order in this case should state that these costs are being disallowed and should not be included in plant in service.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** The AG adopts and agrees with the position of the OPC. Additionally, this Commission should not permit recovery of costs resulting from inadequate infrastructure maintenance, nor reward FPL for its failure to adequately plan and prepare for the storm season. FPL's position on this issue is based on negligent or arrogant indifference to known risks, incomplete or inaccurate data, and/or a willingness to allow the consumer to absorb infrastructure maintenance costs through the storm docket.

**Staff Analysis:** The resolution of this issue does not impact the ultimate decision in this case because rate base allocations are removed from the storm restoration charges.

### **PARTIES' ARGUMENTS**

FPL asserts that its transmission lines are designed in accordance with the requirements of the NESC. (TR 257, 1317; EXH 15, p. 45) FPL has a maintenance program consisting of climbing inspections, visual inspections, and special assessments. (EXH 15, p. 39) FPL argues that by designing its transmission lines to NESC extreme wind requirements and performing regular maintenance on those lines, FPL believes it has ensured that the transmission system is extremely resilient in hurricane conditions. (FPL BR at 99) FPL maintains it achieved good performance in light of Hurricane Wilma's strong winds and that only 100 transmission structure failures out of a total of 64,000 in FPL's system. (FPL BR at 99; TR 1330)

KEMA, in its post-Hurricane Wilma review of the Conservation-Corbett transmission line failure, raised questions about FPL's inspection practices and reliance on manual tightening of cross-brace bolts. (EXH 15, pp. 38, 41, 43) The inspection practice called into question was FPL's reliance on a climbing inspection of 10 percent of the towers every four years. (EXH 15, p. 44) FPL witness Brown testified that after learning of additional FPL inspection activities he revised his opinion of how FPL responded to the serious situation. (TR 274)

KEMA's concern with respect to the manual tightening practice was two-fold. First, KEMA noted that manually tightening the bolts on such large structures would be difficult. Secondly, any movement in the structure would cause the bolts to loosen. (EXH 15, p. 43) FPL witness Brown of KEMA testified that manual tightening is an industry standard and appropriate for this application. (TR 266, 270) Witness Brown also testified that for at least 20 or 25 years, the industry standard has been to allow weathering steel to secure the nut once it is fastened. (TR 267) Thus, FPL appears to be implementing accepted industry practices. Nevertheless, the focus in this case has been on why FPL did not do more when it discovered that bolts were missing and loose on its transmission line.

Loose or missing bolts were detected in 1998 as a result of an outage investigation and follow-up inspections. (TR 1320; EXH 15, p. 43) During these inspections, FPL observed excessive vibration on the conductors. The root cause of the loose/missing bolts was determined to be excessive conductor vibration. (TR 1320; EXH 15, p. 42) The conductor vibration causing the bolts to loosen was due to five to fifteen miles per hour winds and not tropical force winds. (TR 1372) The loose and missing bolts discovered in 1998 were caused by conductor vibration before the weathering steel patina could secure the bolts and nuts together. (TR 1320) FPL's use

of this locking mechanism on more than 1,000 miles of 500 KV structures has proven to be effective, even under hurricane conditions. Since 1978, FPL installed 98 percent of its 3,100 weathering steel structures without lock-nuts. (TR 1339) FPL has no history of loose or missing bolts on any other structure than the Conservation-Corbett 500 KV line. (TR 1320)

In 1998, FPL added vibration dampers to reduce the conductor vibration of the Conservation-Corbett transmission line to within industry standard limits. After a follow-up conductor condition analysis, FPL installed additional vibration damping upgrades on the entire line in 1999. (TR 1322, 1363) FPL increased the frequency of inspection after the repairs. Helicopter inspections for evidence of a continuing vibration were performed in 2001 and 2003. A Thermovision inspection in 2003 also included assessing the visual condition of the structures. These inspections occurred in addition to the climbing inspection on 10 percent of the structures in 2002 and routine ground patrols. (TR 1325-1326, 1363) One missing bolt was found in 2002, during a ground patrol, as a result of all these inspections. No specific cause was identified. Witness Jaindl believes FPL reasonably concluded that the single missing bolt was an anomaly. (TR 1326)

Witness Jaindl explains that FPL was responsive to the bolt problem in 1998 because less than half of the loose and missing bolts recorded in 2005 were the same locations as the ones recorded in 1998. (TR 1323) Also, subsequent to Hurricane Wilma, FPL continues to evaluate the Conservation-Corbett transmission line but has not yet found a definitive cause for the loose and missing bolts. (TR 1326)

Prior to June 1, 2006 FPL believes it will have completed peening bolt threads and tightening all cross brace bolts and cross arm bolts to provide additional locking security beyond the natural patina. (TR 1327) Peening bolt threads is not the most desirable method of securing nuts because the nuts cannot be subsequently removed without destroying the bolt. (TR 796; FPL BR at 105) In 1998/99, one of FPL's actions was to leave the bolt alone if the nut was frozen. In hindsight, this was not adequate. (TR 1322-1323) FPL believes criticism is being made only with the benefit of 20/20 hindsight and no adjustments are supported by the record. (FPL BR at 103, 105)

Damage to a section of the Alva-Corbett transmission line occurred when the adjacent Conservation-Corbett transmission line collapsed on top of it. (EXH 15, p. 41) The Alva-Corbett transmission line was an "innocent bystander" damaged by the collapse of the Conservation-Corbett line.

FPL asserts that it responded reasonably to the loose/missing bolt issue discovered on the Conservation-Corbett transmission line in 1998. FPL argues there is no basis to find FPL imprudent or otherwise justify an adjustment to FPL's recovery of the costs associated with its repair of the Conservation-Corbett and Alva-Corbett transmission lines. (FPL BR at 106)

The interveners argue that the costs incurred to repair the Conservation-Corbett line and Alva-Corbett line should not be considered storm restoration costs and should be disallowed from recovery through base rates because: (1) in 1998 FPL knew that a bolt problem existed, (2) in 1998 FPL's analysis called for a revised construction standard for tower bolts, and (3) FPL failed to implement the revised construction standard prior to the 2005 hurricane events. They



also argue that Hurricane Wilma was not sufficiently strong to cause wind loads exceeding the design criteria of FPL's transmission towers.

Witness Williams testified that the NESC extreme wind criteria are approximately equal to hurricane Category 3 wind gusts for coastal areas in southeast, south, and southwest Florida. (TR 1414) FPL witness Brown testified that FPL designs its tower to specifically address extreme wind loading. (TR 262, 1296; EXH 15, pp. 9, 12, 37) Secured cross braces are necessary to withstand extreme wind loads. (TR 1354) FRF argues that the maximum gust wind speeds during Hurricane Wilma were within the range of a Category 1 hurricane throughout FPL's service area. (FRF BR at 20; EXH 143) The implication is that FPL's Conservation-Corbett transmission line was not compliant with the NESC extreme wind criteria because there is no record of extreme wind speeds exceeding the applicable edition of the NESC. OPC witness Byerley opined that wind load due to Hurricane Wilma was less than the applicable extreme wind load requirements for facilities built prior to 2002. (TR 790) Thus, he concludes that equipment failure due to inadequate inspection and maintenance practices resulted in the failure of the transmission line. (TR 790)

FPL's 1998 Analysis Techniques of the 500 KV fastener problem states "Revise specification for construction of overhead transmission lines. Require brace, arm and OHGW mast bolts to have peened threads after nut is tightened." (EXH 71, p. 24) FPL witness Jaindl admitted that FPL staff was aware of the 1998 revised bolt specification. (TR 1323)

There is no record that details the exact actions FPL took in 1998 and 1999 to address the bolt problem. (EXH 15, p. 43) However, FPL witness Jaindl agreed with OPC witness Byerley that FPL did not follow the revised bolt specification in 1998 and 1999. (TR 796, 1323) The testimony of OPC witness Byerley relies in part on a November 14, 2005, memorandum of C. J. Wong which presents FPL's investigation of the Conservation-Corbett 500 KV line failure. (EXH 70). FPL's report on the transmission line failure states "there is no evidence that the loosened boles were retightened during the retrofit construction." (EXH 70, p. 9)

The interveners collectively argue that FPL did not implement reasonable measures to address the loose/missing bolt problem on the failed 500 KV transmission line prior to 2005 because FPL failed to observe its own 1998 assessment and recommendation.

## **ANALYSIS**

### **Standard of Performance**

Staff believes that a finding of prudence should be based on what FPL knew, or reasonably should have known, at the time FPL implemented its 1998/99 repairs to the Conservation-Corbett 500 KV transmission line. Additionally, any additional remedial actions that FPL took prior to the 2005 transmission line to address the bolt problem should be considered.

### **FPL's 1998 Response to the Loose Bolt Problem**

The discovery of missing and loose bolts was made as a result of FPL's response to an outage event on the transmission line and an insulator failure in 1998. (TR 1320, 1322, 1335;

EXH 15, p. 43; EXH 71, p. 2) FPL witness Jaindl asserts that FPL concluded that the outage and bolt problem were both due to excessive conductor vibration. (TR 1320) The conductor vibration program was addressed in 1998/99. (TR 1294, 1320, 1335) Subsequent inspections showed no further evidence of conductor vibration or ongoing bolt problems. (TR 1325, 1335) Witness Jaindl explains that FPL was responsive to the bolt problem in 1998, because less than half of the loose and missing bolts recorded in 2005 were the same locations as the ones recorded in 1998. (TR 1323) The bolts are assumed to have come loose or fallen off within the first months of service because of conductor vibration. This assumption is based on the amount of time required for weathering steel patina to sufficiently develop and lock the nuts in place. (TR 1320, 1374)

FPL's witnesses Brown and Jaindl were not aware of any utility that had experienced bolts coming loose on transmission towers. (TR 1307, 1360) FPL had no history of bolts coming loose on any of its other transmission towers. (TR 1339, 1360) The implication is that FPL had no basis to be concerned with bolts coming loose on its transmission towers prior to 1998. Staff agrees.

However, the specific actions FPL took regarding loose and missing bolts are not known. (EXH 15, p. 43) Witness Byerley references FPL's Conservation-Corbett line failure analysis and noted that FPL's structural engineer reported there was no evidence that the loosened bolts were retightened during retrofit construction. (TR 794; EXH 70, p. 9)

Staff concludes that FPL's response in the bolt problem in 1998 resulted in some of the loose bolts not being retightened, other loose bolts being replaced, and replacement of the missing bolts. FPL did not peen any of the bolts in its 1998/99 response to the bolt problem.

#### FPL's 1998 Analytical Techniques

The only documentation of FPL's 1998 review of the bolt problem is FPL's "1998 Analytical Techniques", Exhibit 71. OPC witness Byerley believes FPL did not properly address the bolt problem because FPL did not implement the revised standard of peening the tower bolts. (TR 796, 818; EXH 71, p. 24)

Witness Jaindl believes FPL took reasonable actions to address the conductor vibration problems. (TR 1322-1323) She further believes that resolving conductor vibration problems was expected to also resolve the bolt problem because the loosening of the bolts was associated with conductor vibration. (TR 1320) One could argue that there would be no need to peen bolts if the bolt problem was, in fact, due to the conductor vibration problem. Witness Jaindl could not confirm whether FPL knew that the bolt problem was fully addressed in 1998/99 because FPL did not assume the conductor vibration was fully addressed until 2003. (TR 1325)

FPL witness Jaindl admitted that FPL did not follow the revised bolt specification in 1998 and 1999. (TR 796, 1323) She specifically references Exhibit 71, page 8, which states: "try to tighten with wrench - if nut is frozen, then leave as is." In hindsight, she now believes this criterion was not adequate. (TR 1323) If her testimony has weight with respect to FPL's efforts to tighten bolts in 1998, then her testimony should be supported with forensic evidence that FPL did take steps to re-tighten bolts. Yet the extent of FPL's efforts to tighten loose bolts is

questionable, because FPL's review of the transmission line failure reports no evidence that bolt retightening occurred. (EXH 70, p. 9)

Staff concludes that FPL did not follow its own recommendation to revise the bolt tightening standard, and that FPL has no record of retightening the 1998 loose bolts. FPL's 1998 Analytical Techniques contains no statement that revision of the construction standard should not occur if the conductor vibration problem is resolved. FPL's revised bolt fastening standard was not conditioned on failure of achieving reduced conductor vibration. Rather, staff believes that the remedy of the bolt problem was contemporaneous with the remedy of the conductor vibration problem. To do otherwise would unnecessarily compromise or risk reliable transmission tower performance.

#### FPL's Response To Missing and Loose Bolts After 1998

FPL increased the frequency of inspections after the 1998/99 repairs. Helicopter inspections were performed in 2001 and 2003. A Thermovision inspection in 2003 included visual checks of the structures. Additionally, a climbing inspection and ground patrol occurred in 2002. (TR 1325-1326, 1363) One missing bolt was found in 2002 as a result of all these inspections. No specific cause was identified. There was no evidence of excessive conductor vibration. Witness Jaindl believes FPL reasonably concluded that the single missing bolt was an anomaly. (TR 1326) FPL's testimony represents that specific inspection for ongoing missing bolts essentially stopped after 2003. Consequently, it is not known whether additional bolt loosening events occurred subsequent to 2003 and prior to the 2005 storms. (TR 337)

Missing or loose bolts were uncharacteristic events for FPL's other transmission lines. (TR 1320) FPL's 1998 analysis supported a revision to the bolt tightening standard that had not been implemented by 2002. Staff is concerned by the lack of FPL testimony and documentation regarding the one additional bolt, because such an event should have called into question FPL's decision not to implement a revised bolt tightening standard for the Conservation-Corbett transmission line. There is no record indicating the extent of FPL's 2002 review.

#### Finding of Prudence

The only record evidence that FPL may have been prudent with respect the bolt problem prior to the failures that occurred in 2005 is the testimony of FPL witness Jaindl. (TR 1316-1327) To conclude that FPL was prudent based on the testimony of witness Jaindl requires one to conclude that FPL was prudent in 1998, when it ignored FPL's 1998 Analytical Techniques that recommended a revised bolt tightening standard.

Staff is not persuaded by the testimony of witness Jaindl because FPL's 1998 Analytical Technique does not provide for options such as the actions supported by witness Jaindl. (TR 1316-1327) Also, FPL's 2005 review of the failed Conservation-Corbett transmission line found no evidence that bolt retightening occurred as suggested by witness Jaindl. (TR 1322)

Staff recommends an adjustment of \$12,000,000 to rate base because: (1) in 1998 FPL knew that a bolt problem existed, (2) FPL's 1998 analysis called for a revised construction standard for tower bolts, and (3) FPL failed to implement the revised construction standard prior to the 2005 hurricane events.

The \$12,000,000 adjustment includes an estimate of \$11,900,000 for storm restoration costs of the Conservation-Corbett 500 KV transmission line, and \$100,000 for storm restoration costs for the Alva-Corbett 230 KV transmission line. (EXH 4, p. 239)

### **CONCLUSION**

Staff recommends an adjustment of \$12,000,000 to rate base because: (1) in 1998 FPL knew that a bolt problem existed, (2) FPL's 1998 analysis called for a revised construction standard for tower bolts, and (3) FPL failed to implement the revised construction standard prior to the 2005 hurricane events. The \$12,000,000 adjustment includes an estimate of \$11,900,000 for storm restoration costs of the Conservation-Corbett 500 KV transmission line and \$100,000 for storm restoration costs for the Alva-Corbett 230 KV transmission line.

**Issue 34:** Should FPL be authorized to accrue and collect interest on the amount of 2005 storm-related costs permitted to be recovered from customers? If so, how should it be calculated?

**Recommendation:** FPL should be allowed to charge interest at the applicable 30-day commercial paper rate on the balance of storm damage restoration costs permitted to be recovered from ratepayers. To the extent FPL has already accrued interest on a balance of storm damage restoration costs that has not been deemed to be reasonable and prudently incurred, the incremental interest should be netted against the amount approved for recovery. Based on the staff's recommendations in the prior issues, the interest should be reduced by \$1,365,500 (jurisdictional). (Springer, Lowe, Slemkewicz)

**Position of the Parties**

**FPL:** Yes. Section 366.8260(1)(n) expressly provides that “[s]torm-recovery costs shall include the costs to finance any deficiency or deficiencies in storm-recovery reserves until such time as storm-recovery bonds are issued....” The jurisdictional amount of un-recovered pre-tax 2005 storm-recovery costs proposed by FPL includes monthly interest at a commercial paper rate, consistent with the method approved by the Commission in the 2004 Storm Cost Recovery Order, Order No. PSC-05-0937-FOF-EI.

**OPC:** FPL should accrue and collect interest on the actual costs incurred as adjusted by the Commission. Interest should not be accrued on any estimated amounts. The accrual of interest should begin in November, 2005 and cease when the first bonds are issued at the pre-tax commercial paper rate.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC that FPL should only be allowed to accrue and collect interest on the actual amount of reasonable and prudent storm costs, net of any penalties or other adjustments, as determined by the Commission in this proceeding, and that interest accrual should begin in November 2005 and cease as of the time that the first bonds are issued (assuming securitization).

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES’ ARGUMENTS**

FPL proposes to accrue and collect interest at a commercial paper rate on the amount of 2005 storm-related costs. All other parties agree with OPC that FPL should be allowed to accrue and collect interest beginning in November 2005 on only actual costs incurred and adjusted by the Commission, and cease upon the issuance of the bonds. (OPC BR at 67)

### ANALYSIS

FPL estimated an \$11.5 million interest amount accrued on unrecovered 2005 storm recovery costs through July 31, 2006 as determined by Section 366.28260(1)(n), Florida Statutes. (Davis TR 448) FPL proposes the calculation of interest charges on the 2004 and 2005 storm costs by multiplying the average monthly unrecovered balance by the current estimated after-tax commercial paper rate. (Davis TR 429) This treatment is consistent with the calculation of the existing storm restoration surcharge by the 2004 Storm Cost Recovery Order. (Davis TR 429; FPL BR at 106) All parties agree that FPL should be authorized to accrue and collect interest on the amount of 2005 storm related costs. (FPL BR at 106; FRF at BR at 64; OPC BR at 67) However, OPC proposes that the interest be applied to only actual amounts less adjustments made by the Commission, and accrual of interest should begin in November 2005 and cease when the first bonds are issued at the pre-tax commercial paper rate. (FRF BR at 64; OPC BR at 67)

### CONCLUSION

Staff recommends that FPL should be allowed to charge interest at the applicable 30-day commercial paper rate on the balance of storm damage restoration costs permitted to be recovered from ratepayers. However, staff recommends that any adjustments to the total by the Commission, less the incremental interest, should be netted against the amount approved for recovery.

Based on the staff's recommendation to reduce the 2005 storm costs by \$96,976,828 (\$97,053,500 system), the related interest should be reduced by \$1,365,500 (jurisdictional). This amount was calculated as follows:

Total Staff Jurisdictional Adjustments	\$96,976,828
Net 2005 Jurisdictional Storm Recovery Costs per Exhibit 20	<u>\$815,372,000</u>
Ratio	11.894%
2005 Jurisdictional Interest per Exhibit 20	<u>\$11,481,000</u>
2005 Jurisdictional Interest Adjustment	<u>\$(1,365,500)</u>
Allowable 2005 Jurisdictional Interest (\$11,481,000 - \$1,365,500)	<u>\$10,115,500</u>

**Issue 35:** Should the Commission require FPL's storm recovery costs for 2005 be shared between FPL's retail customers and FPL and, if so, to what extent?

**Recommendation:** Yes, FPL shareholders should share in the adverse effects of the 2005 hurricane season and they will by virtue of the various adjustments made in earlier issues to this recommendation, to the extent they have an adverse effect on FPL's return on equity. The following table depicts the adverse impacts to be borne by FPL's shareholders:

Issue Number	Description	Amount in millions
15	Uncollectibles	\$3.6
17a	Revenues not earned due to storm outages	51.4
17b	Backfill Work	.8
17c	Catch-up Work	7.8
17h	Vacation buy back	1.2
27	Pole Adjustment	5.9
28	Vegetation Management Adjustment	3.4
33	Corbett Transmission Line	12.0
	Total	\$86.1

(Devlin, Keating)

**Position of the Parties**

**FPL:** No. FPL is regulated on a cost-of-service basis. Such costs are a part of the costs to provide electric service and are not recovered in base rates. Accordingly, all such costs should be recovered in this proceeding. Requiring FPL to bear a portion of reasonable and prudently-incurred costs would be inconsistent with Florida regulatory law and policy and would require the Commission to unwind the 2005 Stipulation and 2005 Settlement Agreement.

**OPC:** No position.

**FIPUG:** FIPUG generally supports reasonable risk/reward sharing between utilities and their customers. In the as-of-yet undocketed storm damage rule review, FIPUG argued that the Commission should adopt a sharing approach. Nevertheless, FIPUG is bound by the settlement agreement in FPL's last base rate case (Docket 050045-EI), where the parties agreed that for the period of the agreement FPL

“will be permitted to recover prudently incurred costs associated with events covered by Account No. 228.1 [the storm damage account]. . . .”

**FRF:** Understanding this issue to address the possible sharing of costs that are determined by the Commission to be reasonable and prudent costs, the FRF's position is "No position."

**AARP:** Same position as FIPUG.

**FEA:** Agree with FIPUG.

**AG:** Yes. FPL has no inherent right to foist upon the backs of Florida's consumers the full cost of storm recovery. Sound regulatory policy must take into account current circumstances and adapt to a changing environment. This Commission must consider the impact on the consumer of an unprecedented series of hurricanes and embrace unprecedented solutions like sharing. Sharing is not inconsistent with nor prohibited by the Settlement Agreement. Even if it were, the Commission is not bound by the Agreement.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

Staff witness Jenkins proffered sharing of storm restoration costs between shareholders and consumers. Sharing was often requested by consumers at the service hearings in this docket. Witness Jenkins noted in his testimony that sharing has been used in other situations such as the sharing of wholesale revenue, and pursuant to statute and the sharing of economic development costs. (TR 1254)

Witness Jenkins believes that sharing is appropriate in this case because of the significant financial hardship placed on consumers in recent months due to the sharp increase in fuel costs and additional storm related costs being addressed in this case. Witness Jenkins notes that rates for FPL's consumers have increased by 56 percent since 2000 and 19 percent since 2005. (TR 1253)

Witness Jenkins asserts that sharing contravenes the rate case settlement in Docket No. 050045-EI but points out that the Commission was not a signatory to that settlement. (TR 1255) Witness Jenkins notes that the settlement states that FPL will be permitted to recover prudently incurred costs but fails to explicitly state that this means "all" prudent costs. (TR 1272)

As FPL pointed out with its cross examination, a Commission decision that is inconsistent with the settlement is unprecedented. (TR 1273) The Commission has, in recent times, promoted the use of settlements. (TR 1277) FPL witness Dewhurst states that adoption of the sharing method would contravene longstanding regulatory policy, increase investors' perception of risk, and therefore cost of capital, and have a chilling effect on possible future settlements. (TR 1662) FPL also pointed out in its cross examination that the rate case settlement incorporates a form of sharing. This involves revenue sharing. (TR 1266-1269)



FPL Witness Dewhurst goes on to say that sharing is bad public policy in that it would deny FPL the opportunity to recover prudently incurred costs. (TR 1665) Witness Dewhurst opines that sharing may result in over-investing in infrastructure to the detriment of ratepayers. (TR 1669) He also testified that the Commission clearly rejected sharing in FPL's 2004 storm docket and to change now is punitive and unfair to FPL. (TR 1670) Finally, witness Dewhurst notes that the Commission has a long history of encouraging and honoring settlements. (TR 1675)

The AG does not believe that sharing contradicts the rate case settlement. The AG points out that there is no express prohibition against sharing mentioned in the settlement. It should be noted that the AG, but not Staff witness Jenkins, was part of settlement discussions and is in a better position to opine whether sharing contradicts the settlement. (TR 1258) However, this also holds true for the other parties to the docket.

On cross-examination from the AG, witness Dewhurst acknowledged that sharing would not harm ratepayers since the increased associated risk and concomitant cost of capital roughly offsets the lower amount of costs paid by consumers. (TR 1737) Witness Dewhurst conceded under the AG's cross examination that FPL would attempt to continue to provide safe and rapid restoration of power in the wake of storms irrespective of sharing (TR 1740) and therefore, it is questionable whether sharing creates a disincentive to provide quality service. Also, witness Dewhurst admitted on cross-examination that the rate settlement does not explicitly prohibit sharing and does not speak to "total" prudently incurred costs. (TR 1751) Witness Dewhurst believed specific mention of sharing in the rate case settlement was not necessary and, by virtue of other provisions in the settlement (recovery of prudently incurred costs), sharing is prohibited.

### ANALYSIS

At paragraph 10, the stipulation and settlement approved in the FPL 2005 Rate Case Settlement Order addresses the recovery of storm costs. That paragraph states in full:

10. No Party to this Stipulation and Settlement shall appeal the FPSC's Final Order in Docket No. 041291-EI. Further, Parties agree to the following provisions relative to the target level and funding of Account No. 228.1 [the Reserve] and recovery of any deficits in such Account:

- a. The target level for Account No. 228.1 shall be as established by the Commission, whether on its own motion, upon petition by FPL, or in conjunction with a proceeding held in accordance with Section 366.8260, Florida Statutes. FPL will be permitted to recover prudently incurred costs associated with events covered by Account No. 228.1 and replenish Account No. 228.1 to a target level through charges to customers, that are approved by the Commission, that are independent of and incremental to base rates and without application of any form of earnings test or measure. The fact that insufficient funds have been accumulated in Account No. 228.1 to cover costs associated with events covered by that Account shall not be evidence of imprudence or the basis of a disallowance. Replenishment of Account No. 228.1 to a target level approved by the Commission and/or recovery of any costs incurred in excess of funds accumulated in Account No. 228.1 and

insurance shall be accomplished through Section 366.8260, Florida Statutes, and/or through a separate surcharge that is independent of and incremental to retail base rates, as approved by the Commission. Parties to this Stipulation and Settlement are not precluded from participating in such a proceeding, nor precluded from challenging the amount of such target level or whether recovery should be accomplished either through Section 366.8260, Florida Statutes, or through a separate surcharge.

- b. The current base rate accrual to Account No. 228.1 of \$20.3 million is suspended effective January 1, 2006.
- c. No revenues contemplated by this Section 10 shall be included in the computation of retail base rate revenues for purposes of revenue sharing under this Stipulation and Settlement.

2005 Rate Case Order, pp. 16-17.

In this case, Staff witness Jenkins has proposed that FPL not be permitted to recover up to 20 percent of its prudently incurred 2005 storm-recovery costs from customers. FPL and the AG differ with regard to whether the sharing concept proposed by witness Jenkins is consistent with the stipulation and settlement. FPL contends that the settlement reflects an agreement that 100 percent of FPL's prudently incurred storm costs would be recovered through a surcharge and/or securitization without the application of any form of earnings test or measure. Thus, FPL argues, witness Jenkins' sharing proposal is not consistent with the settlement. The AG notes that the settlement contains no reference to a prohibition on sharing storm costs and argues, therefore, that witness Jenkins' sharing proposal is not inconsistent with the settlement.

The language used in a contract or agreement is the best possible evidence of the intent and meaning of the contracting parties and is controlling regardless of the intention existing in the minds of the parties.<sup>6</sup> It is necessary to read a contract's provisions harmoniously in order to give effect to all portions of the contract without negating some of its provisions.<sup>7</sup> Further, no term or word of an agreement should be treated as surplusage if any meaning reasonable and consistent with other parts can be given to it.<sup>8</sup> For the reasons set forth below, staff believes that FPL's position is supported by the plain language of the settlement and that the AG's construction inappropriately treats a term of the contract as surplusage.

As noted above, paragraph 10 of the settlement provides that "FPL will be permitted to recover prudently incurred costs associated with events covered by Account No. 228.1 . . . without application of any form of earnings test or measure." Paragraph 10 goes on to state that "recovery of *any* costs incurred in excess of funds accumulated in Account No. 228.1 and insurance shall be accomplished through Section 366.8260, Florida Statutes, and/or through a

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<sup>6</sup> See, e.g., Bill Heard Chevrolet v. Wilson, 877 So. 2d 15 (Fla. 5<sup>th</sup> DCA 2004), reh. den. July 12, 2004.

<sup>7</sup> See, e.g., City of Homestead v. Johnson, 760 So. 2d 80, 84 (Fla. 2000); Paladyne Corporation v. Weindruch, 867 So. 2d 630 (Fla. 5<sup>th</sup> DCA 2004).

<sup>8</sup> See, e.g., Aucilla Area Solid Waste v. Madison County, 890 So. 2d 415, 416-17 (Fla. 1<sup>st</sup> DCA 2004); Peoples Gas System v. City Gas Co., 147 So. 2d 334, 336 (Fla. 3<sup>rd</sup> DCA 1962); Siedle v. Nat'l Assoc. of Sec. Dealers, Inc., 248 F. Supp. 2d 1140 (M.D. Fla. 2002).

separate surcharge.” (Emphasis added.) These provisions place no limitation on recovery of prudently incurred storm restoration costs. Indeed, the second of these provisions provides for “recovery of *any* costs incurred in excess of funds accumulated in [the Reserve].”<sup>9</sup> In ordinary usage, the word “any” can mean “all” or “any one of a number” depending on the context. In the context of this provision, the usage of the term “any costs” clearly connotes the concept of “all costs.” The alternative – that recovery of any one of a number of costs incurred shall be made through securitization and/or a surcharge – makes no sense in this context. Because the Reserve has carried a negative balance since the 2004 hurricane season, all of FPL’s 2005 storm-recovery costs were incurred in excess of funds accumulated in the reserve. Thus, construing the settlement as a whole, the plain language of the settlement given its ordinary meaning reflects an agreement that FPL will be permitted to recover all of its prudently incurred costs associated with events covered by its Reserve. The AG’s construction of the settlement would inappropriately render use of the term “any” as extraneous.

Because the settlement, given the ordinary meaning of its plain language, provides for recovery of all prudently incurred storm costs, the Commission need not attempt to interpret the settlement by ascertaining the intent of the parties.<sup>10</sup> As noted above, the language used in a contract is the best possible evidence of the intent and meaning of the contracting parties and is controlling regardless of the intention existing in the minds of the parties. Further, by giving effect to the ordinary meaning of the plain language of the settlement, the absence of any provision prohibiting storm cost sharing becomes inconsequential. Indeed, the absence of such a provision is evidence of an intent to exclude sharing rather than include it.<sup>11</sup>

Staff notes that OPC, FRF, and AARP, consumer advocates who were parties to the settlement, have taken no position with respect to witness Jenkins’ sharing proposal. FIPUG, whose position is joined by FEA, takes the position that in general it supports a risk/reward sharing between utilities and their customers but that the parties to the stipulation and settlement agreed that, for the term of the agreement, FPL would be permitted to recover prudently incurred storm costs. FIPUG states that it is bound by that agreement in this case to the extent that storm costs are prudent and do not constitute double recovery. Staff believes it is fair to imply from FIPUG’s position that FIPUG does not believe the settlement allows for any sharing of prudently incurred costs.

Regardless of whether witness Jenkins’ proposed sharing is or is not consistent with the settlement, all parties have recognized that the Commission itself is not entirely bound by the stipulation and settlement. The Commission is not a signatory to the stipulation and settlement and retains the authority to set fair and reasonable rates on a prospective basis. Pursuant to the doctrine of administrative finality, the Commission may modify its final order approving the stipulation and settlement if there is a significant change in circumstances or if modification is required in the public interest.<sup>12</sup>

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<sup>9</sup> Reading this provision together with the first, it is clear that “recovery of any costs” is limited to recovery of any prudently incurred costs.

<sup>10</sup> See, e.g., Walgreen Co. v. Habitat Development Corp., 655 So. 2d 164 (Fla. 3<sup>rd</sup> DCA 1995), reh. denied, (June 21, 1995).

<sup>11</sup> See, e.g., Jacobs v. Petrino, 351 So. 2d 1036 (Fla. 4<sup>th</sup> DCA 1976).

<sup>12</sup> See Florida Power Corp. v. Garcia, 780 So.2d 34 (Fla. 2001), citing Austin Tupler Trucking, Inc. v. Hawkins, 377 So.2d 679, 681 (Fla. 1979).

Staff agrees with FPL that the Commission has encouraged settlements recognizing certain inherent benefits such as reduced litigation costs and regulatory certainty. It is true that the Commission has never altered, terminated, or otherwise changed the conditions of a settlement.

Staff believes it is good policy not to second guess the reasonableness of a settlement after its approval. All the parties found the settlement reasonable. Undoubtedly, there was much give and take on all sides. There were benefits for consumers and benefits for FPL. Therefore, the question is not whether the settlement was good or bad but whether conditions have materially changed since August 2005 to the point where action contradictory to the rate case settlement is in order.

When the Commission approved the rate case settlement in August of 2005, it specifically stated that it is not a signatory to the settlement. Staff disagrees with FPL's assertion that a Commission action contrary to the rate case settlement is punitive and detrimental to the public interest. The Commission can not abrogate its statutory responsibilities by way of a settlement. Therefore, it should not be of complete surprise if the Commission considers some alteration of a settlement if believed necessary and in the public interest. For instance, if FPL unexpectedly started gaining exorbitant profits, staff believes it would be appropriate to alter this settlement in an effort to preserve reasonable profits and therefore, reasonable rates.

The most significant event since approval of the settlement was devastation caused by Hurricane Wilma. Not only did this storm cause over \$700 million of storm costs in FPL's service territory, it was a major contributor to the drastic increase in fuel costs that resulted in the significant increase in fuel rates effective January 2006. Staff believes that because of the significant hardship consumers have faced, some level of sharing is warranted to ameliorate the effects to consumers. Unfortunately, this is difficult to do outside of an earnings review which would conflict with the rate case settlement. (TR 1255)

Staff believes by adopting the staff recommendations in Issues 15, 17, 27, 28, and 33 the Commission will effectively endorse the sharing concept without contradicting the rate case settlement. These recommendations, if adopted, will adversely impact FPL. The magnitude of making these adjustments is both significant to FPL shareholders and consumers. The total effect of these adjustments is \$86.1 million compared to 2005 storm costs of over \$700 million. This means that FPL shareholders will assume over 10 percent of the adverse effects of the 2005 storms.

It is equally important that the aggregate effect of all Commission decisions in this docket leave FPL in a financially sound basis so, in the event of another catastrophic storm or storms, it will have the financial capability to restore power in a timely fashion. Staff believes that even though FPL's profits will be negatively affected in the event the Commission adopts the staff recommendations in this case, FPL's financial status will remain viable. For instance, the use of "securitized" storm bonds, as opposed to continuance of the storm surcharge, will serve to strengthen FPL's financial position.

### **CONCLUSION**

Staff recommends sharing of the adverse effects of the storms between ratepayers and FPL shareholders. Staff does not recommend sharing based on an arbitrary allocation factor. Rather, sharing should be based on assigning costs or other adverse effects to shareholders that are 1) not directly related to storm restoration and, 2) imprudently incurred costs.

**Issue 36:** Taking into account any adjustments identified in the preceding issues, what is the amount of reasonable and prudently incurred 2005 storm related costs that should be recovered from customers?

**Recommendation:** The amount of reasonable and prudently incurred 2005 storm related costs that should be recovered from customers is \$728,510,020 (Jurisdictional). (Slemkewicz)

**Position of the Parties**

**FPL:** The amount of reasonable and prudently incurred 2005 storm related costs that should be recovered from customers is \$816,016,000 (rounded) (provided on KMD-4) plus interest in accordance with Section 366.8260, Florida Statute (2005) in the amount of \$11,490,000 for a total of \$827,507,000, as adjusted in the final true-up. (See Issue 42).

**OPC:** This is a fall-out issue.

**FIPUG:** The appropriate amount of adjustments should be the total of OPC's proposed adjustments.

**FRF:** Agree with OPC that the maximum amount of allowable 2005 storm costs is approximately \$705,000,000 on a jurisdictional basis, pending other adjustments.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** This is a fall-out issue based on the resolution of other issues. Staff recommends that the amount of reasonable and prudently incurred 2005 storm related costs that should be recovered from customers is \$728,510,020 (Jurisdictional). This amount was calculated as follows:

<u>ISSUE</u>	<u>DESCRIPTION</u>	<u>\$</u>	<u>RATE BASE EFFECT (\$)</u>
25	ADJUSTED TOTAL – 2005 COSTS BEFORE JURISDICTIONALIZATION	<u>725,972,500</u>	
	ADDITIONAL STAFF ADJUSTMENTS		
27	Distribution & Transmission System Inspection & Maintenance (Pre 6/1/05)	(4,460,000)	(1,440,000)
28	Vegetation Management (Pre 6/1/05)	(2,550,000)	(850,000)
30	Distribution & Transmission System Inspection & Maintenance (Pre 10/23/05)	See Issue 27	
31	Vegetation Management (Pre 10/23/05)	See Issue 28	
33	Transmission Structure Failures	<u>0</u>	(12,000,000)
---	TOTAL ADJUSTMENTS	<u>(7,010,000)</u>	
36	ADJUSTED TOTAL – 2005 COSTS BEFORE JURISDICTIONALIZATION	718,962,500	
---	Jurisdictional Factor	<u>99.921%</u>	
36	NET ADJUSTED JURISDICTIONAL 2005 TOTAL COSTS	718,394,520	
34	2005 Jurisdictional Interest	<u>10,115,500</u>	
36	TOTAL JURISDICTIONAL 2005 STORMS INCLUDING INTEREST	<u>728,510,020</u>	

### **STORM DAMAGE RESERVE**

**Issue 37:** What is the appropriate level of funding to replenish the storm damage reserve to be recovered through a mechanism approved in this proceeding?

**Recommendation:** FPL has not shown that a \$650 million replenishment of the storm damage reserve is appropriate. A \$200 million replenishment will (1) reduce the incidental costs associated with securitization, (2) provide more critical review of FPL's storm charges, and (3) reduce customer bills associated with FPL's request to replenish the storm damage reserve. (Bremen)

### **Position of the Parties**

**FPL:** FPL believes that establishing a storm damage Reserve level of approximately \$650 million is reasonable at this time.

**OPC:** The Commission should approve a reserve that meets the historically-stated threshold of covering the costs of most, if not all, storms. The appropriate level of funding for the storm reserve should be \$150 million. However, based on the projected increase in hurricane activity, the Commission could reasonably include a "safety margin" raising the approved reserve to \$200 million.

**FIPUG:** \$150 million.

**FRF:** Agree with OPC that the appropriate level of funding for FPL's storm reserve is \$150 million.

**AARP:** There is a "new day" for storm cost recovery closely akin to a recovery clause with the potential for interim rate relief prior to evidentiary hearing. Consequently, there should be \$0 for a storm reserve funded through securitization, a process involving borrowing money to invest it at a lower rate. Reserve funding, if by surcharge, should be no more than \$200 million, if a reserve is funded and at a level not to exceed the current surcharge.

**FEA:** Agree with OPC.

**AG:** \$200 million. The AG adopts the position of OPC. A lower reserve means lower bond and issuance costs, lower consumer rates and more Commission control over storm recovery costs. If storm damage exceeds reserve levels, the Commission can address that issue. A negative balance reserve has never impaired FPL's ability to restore power. Additionally, FPL must not profit by collecting taxes from the consumer based on a statutory rate then paying taxes based on a lower effective rate.



**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL proposes a replenishment amount of \$650 million to support future storm restoration activities. (TR 64-65) This amount should be large enough to address storm damage costs from most but not all storm seasons. FPL witness Dewhurst considered a number of factors including (1) an expected average annual cost for windstorm losses of approximately \$73.7 million as determined by FPL witness Harris, (2) the possibility that Florida is in the midst of a much more active hurricane period relative to average levels of activity over the much longer term, (3) the potentially diminished availability of non-T&D property insurance, (4) the impact of the recent severe and unprecedented storm seasons on customer bills in the near term, and (5) the opportunity to revisit this issue in future proceedings. (TR 65)

FPL witness Dewhurst testified that, in 1998, the Commission agreed that the storm damage reserve level should be large enough to absorb another 'Andrew type event,' and that 'a reasonable level for the reserve is \$370 million in 1997 dollars.' Further, the Commission recognized that even this level would not cover all realistically possible events but would afford a high degree of protection against any one bad year. Simply escalating the cost of Hurricane Andrew from \$370 million in 1997 dollars would be equivalent to a Reserve level of approximately \$460 million in 2006 dollars. A \$650 million increase to the Reserve recognizes that under the current rate agreement there is no ongoing accrual, that FPL's system has grown in extent by 30-40 percent since 1997, and gives some recognition to the conclusion of many meteorological experts that Florida is in a multi-decade cycle with more frequent incidence of tropical storms. (TR 1068, 1676-1677)

FPL witness Dewhurst testified that OPC and AARP witness Stewart incorrectly believes a \$200 million storm damage reserve level is reasonable. Witness Stewart's estimate of FPL's average annual loss of \$147 million per year means the Reserve would last approximately one year. (TR 1679) A lower storm damage reserve level will simply shorten the expected time before it becomes necessary to return to the Commission and seek recovery of additional restoration costs. All things being equal, this will lead to greater rate volatility. In the extreme, with no Reserve and an annual process with an annual surcharge, customers could see rates fluctuate from year to year by the equivalent of \$0 to \$8 or so per month on the typical 1,000 kWh bill. (TR 1678)

FPL contends that the passage of securitization legislation does not change the overall framework for recovery of storm restoration costs; instead, it provides the Commission with an additional tool to use. On the positive side, securitization provides the ability to replenish the storm damage reserve more rapidly than through an annual accrual or a surcharge. However, transaction costs associated with securitization bonds are higher than those associated with a surcharge. Thus, securitization is not as efficient as a surcharge coupled with an existing reserve to cover ongoing costs, and in the extreme it clearly would not be cost effective to issue bonds in small amounts on a continuing basis. If FPL is to securitize, FPL believes that it makes a great deal of sense to take advantage of this opportunity to replenish the reserve to a reasonable level. (TR 1679-1780)

A storm damage reserve replenishment of \$200 million is large enough to withstand the storm damage from most but not all storm seasons over the last 16 years because the annual average is \$147,120,000. Any storm damage reserve deficiencies resulting from excessive losses could be dealt with by a separate surcharge. Keeping the storm damage reserve replenishment as low as is reasonably possible will reduce interest and bond issuance costs and minimize the financial impact on customers' rates, while still allowing FPL and the Commission the flexibility to address recovery of FPL's prudently incurred costs from year to year. (TR 1045-1048; EXH 87)

FPL Witness Dewhurst admitted that the level of the storm damage reserve has no impact on FPL's hurricane exposure. (TR 1678) The Securitization legislation guarantees the recovery of reasonable and prudent expenses for storm damage. Therefore, no matter the amount of storm damage, FPL is statutorily guaranteed recovery of its storm expenses as long as they are deemed prudent by the Commission. (TR 1051-1054)

History indicates that the review of storm damage expenses are less stringent when the expenses are paid from an existing Reserve versus when the utility must document the expenses in an evidentiary hearing addressing an additional recovery mechanism. From 1996 to 2002 when FPL covered storm damage expenses with funds from the existing storm damage reserve, there were no hearings and consequently little chance for review of expenses by affected parties. Forcing a hearing for all but the minimal storm damage occurrences guarantees a more thorough review and the reduced likelihood that inappropriate expenditures will be charged to the storm damage reserve. (TR 1053)

FIPUG and FRF urge the Commission to set a replenishment level of \$150 million, because that is the smallest amount supported by the record. Exhibit 87, sponsored by witness Stewart, shows that the annual average cost for the past 16 years has been \$147,120,000. (FIPUG BR at 8; FRF BR at 45)

By Order No. PSC-05-1252-FOF-EI, issued December 23, 2005, in Docket No. 050001-EI, In re: Fuel and purchased power cost recovery clause with generating performance incentive factor, the Commission denied Florida Public Utilities Company's request to begin recovery of future costs associated with a 2008 change in wholesale power purchases. The request was made in part as a means to avoid future rate shock and rate volatility. (FRF BR at 38-39) FPL is similarly requesting recovery of costs it has not yet incurred and should be denied on the same basis as stated in Order No. PSC-05-1252-FOF-EI. (TR 1054; FRF BR at 38-39)

The intervenors contend that keeping the storm damage reserve replenishment as low as is reasonably possible will reduce interest, bond issuance costs, underwriting fees, legal fees, taxes, and minimize the financial impact on customers' rates. (TR 1053, 1765) The Commission should minimize the amount of money that customers must prepay to FPL to recover those costs. (FIPUG BR at 10)

### **ANALYSIS**

Prior to the 2005 Rate Case Order, FPL's base rates provided for an annual contribution to the storm damage reserve of \$20.4 million. (TR 473) The \$20.4 million accrual was suspended due to the ability of FPL to seek recovery through a surcharge or securitization. (TR

55) The suspension of the storm damage reserve accrual was a change in fact and policy with respect to FPL's hurricane damage self-insurance program. (TR 1061, 1071) Thus, prior orders on storm damage reserve levels and accrual amounts provide little guidance as to the storm damage reserve replenishment level at issue in this case.

The interveners support a lower Reserve level while FPL supports a comparatively higher storm damage reserve replenishment level.

#### Lower Reserve Replenishment Level

The storm damage reserve replenishment level supported by AARP, AG, FEA and OPC is \$200 million as calculated by witness Stewart. Witness Stewart calculates \$200 million by adding approximately \$50 million to his estimate of annual storm costs of \$147.1 million based on the projected increase in hurricane activity. (TR 1053, 1059; EXH 87) Witness Stewart testified that a lower replenishment is appropriate because: (1) a lower replenishment reduces the incidental costs associated with securitization, (2) a lower replenishment provides more critical review of FPL's storm charges, (3) a lower replenishment is believed to reduce payment for costs that have not yet been incurred, and (4) because FPL can come in and get a surcharge rather quickly. (TR 046, 1051-1053, 1060, 1062, 1064, 1069, 1080) Additionally, FPL witness Dewhurst admitted that the level of the storm damage reserve has no impact on FPL's hurricane exposure. (TR 1062, 1079, 1678)

Witness Stewart opined that the Securitization legislation guarantees the recovery of reasonable and prudent expenses for storm damage. Therefore, no matter the amount of storm damage, FPL is statutorily guaranteed recovery of its storm expenses as long as they are deemed prudent by the Commission. (TR 1051-1054) The potential of a diminished availability of non-T&D property insurance doesn't lead to the conclusion that customers should support a \$650 million Reserve. The opportunity to revisit this issue in future proceedings should argue for approving a smaller, not larger, Reserve. (TR 1051)

Due to the various changes over time, it is the view of witness Stewart that the risk is completely with the consumers at this point. (TR 1073, 1074) Thus, witness Stewart concludes that a storm damage reserve replenishment should be as low as possible. (TR pp. 1072-1073)

FIPUG and FRF support a Reserve level of \$150 million apparently because it is the smallest amount supported by the record and for the reasons presented by witness Stewart. (FRF BR at 45; EXH 87)

Staff concludes that the interveners appear willing to pay a lower bill associated with a lower replenishment and risk the potential for future rate volatility because of a perceived benefit of increased review of storm charges and the lack of certainty of when the next major storm event will occur. The interveners apparently perceive the risk associated with a low Reserve level to be completely with the customers, not FPL. Whether the interveners will continue to support these views in subsequent proceedings is unknown.

Higher Reserve Replenishment Level

In proposing a replenishment level of \$650 million, FPL Witness Dewhurst testified that he considered a number of factors including (1) an expected average annual cost of approximately \$73.7 million, (2) the possibility that Florida is in the midst of a much more active hurricane period relative to average levels of activity over the much longer term, (3) the potentially diminished availability of non-T&D property insurance, (4) the impact of the recent severe and unprecedented storm seasons on customer bills in the near term, and (5) the opportunity to revisit this issue in future proceedings. (TR 65)

FPL Witness Harris developed an annual storm damage estimate of \$73.7 million based on a pure premium concept used by the insurance industry, a 103 year history of hurricane data, 100,000 simulated hurricane events, and geo-located cost estimates of the FPL facilities at risk. (TR 621-623; EXH 26, pp. 7-9) The same analysis, with minor editorial revisions and corrections, was provided in Docket No. 050045-EI, which was resolved by the FPL 2005 Rate Case Order. (TR 618) Table 37-1 is a summary of FPL witness Harris estimates of annual average storm costs.

Table 37-1  
Summary of Expected Annual Storm Costs  
(Source: Exhibit 26 p. 19)

Expected Annual Losses	\$ Millions	Comments
Transmission and Distribution Assets	64.4	a) Hurricanes - Category 1 through 5 b) Tropical Storms - 39-74 mph. c) Winter storms
Storm Staging Costs	3.5	FPL Pre-storm mobilization
Non T&D Assets	5.8	Losses arising from payment of deductibles on insurance policies
Totals	73.7	

The distribution assets at risk total \$9.530 billion. The transmission assets at risk total \$2.309 billion. Non-T&D assets are insured for storm losses. The deductibles under the current policies are \$25 million per event. (EXH 26, pp. 7-9)

In defense of FPL's higher replenishment level, FPL witness Dewhurst notes that witness Stewart's conclusions are not consistent with past Commission practice. (TR 1677) Yet he also admits that the level of the storm damage reserve has no impact on FPL's hurricane exposure and goes on to say:

Accordingly, a lower reserve will simply shorten the expected time before it becomes necessary to return to the Commission and seek recovery of additional restoration costs. Other things equal, this will lead to greater rate volatility. In the extreme, with no reserve and an annual process with an annual surcharge, customers could see rates fluctuate from year to year by the equivalent of \$0 to \$8 or so per month on the typical 1,000 kWh bill. In addition, a smaller reserve will, other things equal, mean more frequent regulatory proceedings, each of which carries an administrative cost and burden for all parties.

(TR 1678)

Thus, FPL's rebuttal testimony does not challenge the notion that the risk associated with a low replenishment level to be completely with the customers, inclusive of the five factors considered by FPL witness Dewhurst.

Staff concludes that FPL's proposed high Reserve level addresses Commission policy prior to the 2005 Rate Case Order. The approved settlement constituted a departure from the past policy which included an annual accrual to the Reserve. Staff also concludes that FPL has not shown that it requires a \$650 million Reserve to address specifically or collectively, the five factors Witness Dewhurst considered.

#### Selecting the Replenishment Level

FPL has not shown that a \$650 million replenishment of the storm damage reserve is needed. However, this finding does not mean that FPL's request for \$650 million to replenish the storm damage reserve is unreasonable.

Witness Stewart expressed concerns with respect to the level of review associated with large storm damage reserve balances. In his opinion, there should be more critical and frequent review of FPL's storm charges to the storm damage reserve. These concerns can be addressed by requiring FPL to make specific filings whenever storm restoration costs exceed a threshold amount such as \$200 million. Such requirements can be made part of the Commission's decision or by rule. Therefore, there is no need to reduce the replenishment amount to address an apparent request by the intervenors for more hearings regarding FPL's charges to the storm damage reserve.

However, the record clearly establishes that the level of the storm damage reserve has no impact on FPL's hurricane exposure. It is also clear that the risk associated with a high or low replenishment level, at this time, is completely with the customers. A benefit of a lower replenishment amount is a reduction in the securitization costs, and resultant customer bills associated with this case. Two large use customer groups, FIPUG and FRF, seek the lowest storm damage reserve replenishment supported by the record. The only testimony addressing a replenishment amount lower than \$650 million is that of Witness Stewart. Therefore, staff recommends a replenishment level of \$200 million, which is supported by witness Stewart.

**CONCLUSION**

FPL has not shown that a \$650 million replenishment of the storm damage reserve is needed. A \$200 million replenishment will (1) reduce the incidental costs associated with securitization, (2) provide more critical review of FPL's storm charges, and (3) reduce customer bills associated with FPL's request to replenish the storm damage reserve.

**Issue 38:** What portion, if any of the Reserve must be held in a funded Reserve and should there be any limitations on how the Reserve may be held, accessed or used?

**Recommendation:** The amount of the storm damage reserve that should be placed in a fund is the amount, after any applicable taxes, of the replenishment amount credited to the storm damage reserve as determined in Issue 37. The use of the fund should be restricted to purposes consistent with Rule 25-6.0143, Florida Administrative Code, for Account No. 228.1, Accumulated Provision for Property Insurance. This treatment would be the same whether the replenishment is accomplished through either securitization or a surcharge. (Slemkewicz, Springer, Breman)

**Position of the Parties**

**FPL:** FPL proposes a funded Reserve of \$650 million, and that the Reserve should be used for all of the purposes provided for in and consistent with Rule 25-6.0143, Florida Administrative Code for Account No. 228.1, Accumulated Provision for Property Insurance.

**OPC:** Once the reserve regains a positive balance, the reserve should continue to be held in a funded account with the interest earned accruing to the benefit of the ratepayers. By law, funds obtained through securitization must be restricted to storm recovery activities caused by named tropical storms or hurricanes.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC that once FPL's storm reserve attains a positive balance, the reserve should continue to be held in a funded account with interest accruing to the benefit of FPL's customers.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL has proposed that the reserve (Account 228.1) be funded. The monies in the fund would be available for use pursuant to the provisions of Rule 25-6.0143, Use of Accumulated Provision Accounts 228.1, 228.2, and 228.4, Florida Administrative Code. In its brief, OPC agrees that the reserve should be funded. However, OPC believes that the use of the monies in the fund obtained through securitization should be used only to finance storm-recovery costs. (OPC BR at 70)

### ANALYSIS

FPL has maintained Account No. 228.1<sup>13</sup>, Accumulated Provision for Property Insurance, on a funded basis since 1958. FPL's proposal to continue funding this reserve is consistent with its prior practices. The monies to be placed in the fund would be the after-tax amount of the reserve replenishment amount. Based on FPL's request, the reserve replenishment amount would be \$650 million and the after-tax monies placed into the fund would be \$400 million. (TR 57) In its brief, FPL states that the monies in the fund can be used for any purposes provided for in Rule 25-6.0143, F.A.C. (FPL BR at 120)

OPC agrees that the reserve should be maintained on a funded basis. In its brief, however, OPC states that funds obtained through securitization may be used only to finance costs that have, or will be, incurred to undertake storm-recovery activities related to named tropical storms or hurricanes. OPC cites sections 366.8260(1)(j), (k), and (n), Florida Statutes, as its basis for that opinion. (OPC BR at 70)

Rule 25-6.0143(1), F.A.C., states that the purpose of Account No. 228.1 is to provide for property losses through accident, fire, flood, storms, nuclear accidents and similar type hazards that are not covered by insurance, as well as insurance deductible amounts and nuclear accident retrospective premiums. To date, it appears that the major use of Account No. 228.1 has been to provide for property losses resulting from storms. Rule 25-6.0143, F.A.C., however, does not provide any guidance, restrictions or limitations regarding the use of any monies that may be placed into a fund related to the reserve.

### CONCLUSION

Staff agrees with the parties that the reserve should be maintained on a funded basis. Although the balance in Account No. 228.1 is commonly referred to as the "storm reserve," its stated purpose in Rule 25-6.0143(1), F.A.C., is to cover all uninsured property losses regardless of the cause. Account 228.1 is currently depleted and the \$20.3 million annual accrual to the reserve has been suspended pursuant to the terms of the Stipulation approved in Order No. PSC-05-0902-S-EI, issued September 14, 2005, in Docket No. 050045-EI, In re: Petition for rate increase by Florida Power & Light Company and 050188-EI, In re: 2005 comprehensive depreciation study by Florida Power & Light Company. There is no evidence in the record to support OPC's contention that any provisions of Section 366.8260, Florida Statutes, place any restrictions on the use of the reserve or the monies in the fund.

Based on the foregoing, staff recommends that the reserve be funded on an after-tax basis. Staff further recommends that the use of the fund should be restricted to purposes consistent with Rule 25-6.0143, F.A.C., for Account No. 228.1, Accumulated Provision for Property Insurance. This treatment would be the same whether the replenishment is accomplished through either securitization or a surcharge.

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<sup>13</sup> This account was previously identified as Account 261, Property Insurance Reserve, prior to 1985.



### **RECOVERY MECHANISM**

**Issue 39:** Is the issuance of storm-recovery bonds and the imposition of the Storm Charge, as proposed by FPL, reasonably expected to result in lower overall costs or avoid or significantly mitigate rate impacts to customers as compared with alternative methods of financing or recovering storm-recovery costs and storm-recovery reserve?

**Recommendation:** The issuance of storm recovery bonds for the recovery of reasonable and prudently incurred storm damage restoration costs and the replenishment of the storm damage reserve as proposed by FPL is not expected to result in lower overall costs to ratepayers. However, the issuance of storm recovery bonds is expected to mitigate rate impacts to ratepayers as compared with alternative methods of recovery of these costs and replenishment of the storm damage reserve. (Springer, Draper)

### **Position of the Parties**

**FPL:** Yes. This statutory standard adopted by the legislature in Section 366.8260(2)(b)2.b., Florida Statutes (2005), is met by FPL's proposal, a primary benefit of which is to immediately replenish the Reserve and to "smooth out" the significant rate impact of an extreme sub-period of storm activity, making it a useful tool for recovery of existing deficits and replenishment of the Reserve.

**OPC:** Yes, but only if the Commission takes an active role in the bond issuance process and does not approve FPL's proposed methodology. To ensure that the issuance of storm-recovery bonds results in the lowest overall cost to ratepayers compared with the alternative methods of financing, the "best practices" outlined in Commission staff witness Fichera's direct testimony should be adopted including active participation by the Commission, its staff, and financial advisors which ensures ratepayer protection.

**FIPUG:** No. Securitization will result in higher overall costs for the customer, which outweigh the value of securitization to mitigate rate impacts.

**FRF:** No position.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

### **Staff Analysis:**

### **PARTIES' ARGUMENTS**

FPL's proposed issuance of storm-recovery bonds and the imposition of the Storm Charge is designed to mitigate rates. FIPUG believes that securitization will result in higher overall cost for the customer, which outweighs the value to mitigate rate impacts with

securitization. FRF takes no position. The remaining parties agree with OPC that securitization will result in the lowest overall cost to ratepayers compared with the alternative methods if the Commission takes an active role in the bond issuance.

### ANALYSIS

FPL witness Dewhurst testified that the issuance of storm recovery bonds in this case is based on an assertion that there would be rate mitigation associated with the issuance of the bonds as compared to another alternative. (TR 113) In his summary of his direct testimony, witness Dewhurst stated:

[T]here is no clear analytical way of saying which alternative is better. The choice comes down to policy judgment. Securitization will produce a smaller monthly charge. The surcharge proposal has a shorter recovery period. Under the current circumstances, we believe the securitization approach makes sense, even though the charge will be in place for a longer period, but we can appreciate that some customers might prefer the alternative.

(TR 81)

Witness Dewhurst testified that FPL did not conduct a net present value analysis to compare the overall total cost of the ratepayers of the primary recommendation and the alternative. (TR 111-113) Witness Dewhurst did note that "if you strictly took a 'what's the fewest dollar approach,' that would say we should use the alternative." However, witness Dewhurst continued, the alternative would produce a much higher monthly charge for a shorter period of time. (TR 113)

Witness Morley testified that compared to the proposed storm charges, the alternative would result in significantly higher typical bills. (TR 766) The current 1,000 kWh residential bill is \$108.61, which includes the current 2004 storm charge. With the implementation of the proposed storm charge and termination of the current charge, the same residential bill would be \$108.53. Under FPL's alternative request, the 1,000 kWh residential bill would be \$113.93, which includes the current surcharge, surcharge for 2005 costs, and surcharge for replenishment of reserve.

OPC supports the lower but longer-term charges associated with the issuance of storm-recovery bonds as long as the Commission adopts the "best practices" outlined in Commission staff witness Fichera's direct testimony, including active participation by the Commission, its staff, and financial advisors which ensures ratepayer protection. (OPC BR at 70-71) OPC believes that with the goal of avoiding or significantly mitigating rate impacts to customers, the Commission must use every tool available to ensure that the ultimate costs are the lowest costs that can be achieved.

### CONCLUSION

Staff believes that the issuance of storm recovery bonds is expected to mitigate rate impacts to ratepayers as compared with alternative methods of recovery of these costs and replenishment of the storm damage reserve. However, the issuance of storm recovery bonds as

proposed by FPL is not expected to result in lower overall costs to ratepayers, as addressed in Issue 68.

**Issue 40:** WITHDRAWN

**Issue 41:** Should the unamortized balance of 2004 storm costs continue to be recovered through the current surcharge or should the balance be added to any amounts to be securitized?

**Recommendation:** The unamortized balance of the adjusted 2004 storm costs should be added to any amounts to be securitized. This treatment is dependent on the Commission's decision to approve the issuance of storm recovery bonds. (Slemkewicz, Springer)

**Position of the Parties**

**FPL:** FPL's primary recommendation is that the unamortized balance of 2004 storm costs be added to any amounts to be securitized, so as to enhance the rate impact "smoothing" benefit of issuing bonds.

**OPC:** If the Commission approves securitization, FPL's 2004 storm costs should be reduced by \$51,264,919 as addressed in Issue 1. Corresponding reductions should be made to interest accrued based on actual storm costs, interest rates, and the most recently available revenue collections.

**FIPUG:** The unamortized balance of the 2004 storm costs should continue to be recovered via a surcharge. Securitization will result in higher overall costs for the ratepayer.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL proposes to add the unamortized balance of 2004 storm costs to any amounts to be securitized as a rate mitigation. AARP, AG, and FRF agree with OPC that FPL's 2004 storm costs should be reduced by \$51,264,919 with corresponding reductions made to interest accrued based on actual storm cost, interest rates, and the most recently available revenue collections. (OPC BR at 73) FEA agrees with FIPUG that the unamortized balance of the 2004 storm costs should continue to be recovered via a surcharge, and securitization will result in higher overall costs for the ratepayer. (FIPUG BR at 13)

### **ANALYSIS**

FPL's bond issuance would be used to fund the balance of unrecovered 2004 and 2005 storm-recovery costs, replenish the Reserve and pay upfront bond issuance costs. (Dewhurst TR 55) FPL states that the recovery of the 2004 storm deficiency would result in the termination of the Storm Restoration Surcharge. (Morley TR 762) FPL proposes that upon issuance of the storm-recovery bonds, the storm bond repayment charge and tax charge would replace the existing 2004 Storm Restoration Surcharge. (Dewhurst TR 56) OPC states that a separate surcharge for 2004 storm costs combined with securitization of the 2005 storm costs and replenishment of the Reserve would result in a higher monthly charge than if the Commission permitted all of the storm costs to be recovered through a monthly securitization charge. (OPC BR at 74) FIPUG proposes that the 2004 storm costs should continue to be recovered through a surcharge, since it believes that securitization results in higher overall costs. (FIPUG BR at 13)

### **CONCLUSION**

To ensure that the issuance of storm recovery bonds significantly mitigates rate impacts to customers, staff recommends that the unamortized balance of the adjusted 2004 storm costs should be added to any amounts to be securitized for rate mitigation. Based on the staff's recommendation in Issue 3, the amount of adjusted 2004 storm costs to be recovered through securitization would be \$198,680,432 on a pre-tax basis. However, this treatment is dependent on the Commission's decision to approve the issuance of storm recovery bonds.

**Issue 42:** Based on resolution of the preceding issues, what amount, if any, should the Commission authorize FPL to recover through securitization?

**Recommendation:** The amount to be approved for recovery would be determined by the amounts approved in Issue 3 for 2004 storm-related costs, Issue 36 for 2005 storm-related costs, and Issue 37 for the appropriate level of the storm damage reserve. Based on staff's recommendations in those issues, the amount to be recovered through securitization is \$1,127,190,452 on a pre-tax basis, plus \$11,425,000 in up-front bond issuance costs. The total after-tax amount is \$703,801,734. (Slemkewicz, Springer, Breman)

**Position of the Parties**

**FPL:** The total amount of storm-related costs that the Company should be authorized to recover through storm-recovery financing is \$1,690.2 million, which includes the proposed \$650 million replenishment of the Reserve, 2005 jurisdictionalized unrecovered storm-recovery costs of \$826.9 million, 2004 jurisdictionalized unrecovered storm-recovery costs of \$213.3 million.

**OPC:** FPL's requested storm-related costs of \$1,690,160,000 should be reduced by all of the adjustments set forth in response to preceding issues. Corresponding reductions should also be made to interest and income taxes related to the adjustments recommended and to reflect that interest should only be calculated on the actual not estimated amounts.

**FIPUG:** The Commission should not authorize FPL to recover via securitization. However, if securitization is granted, the appropriate amount to be securitized should be based on the following: (1) the recovery of the unamortized balance of the 2004 storm costs; (2) the replenishment of the storm reserve to \$150 million, and; (3) the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments.

**FRF:** Based on resolution of the preceding issues, if the Commission approves securitization, FPL's requested storm-related costs of \$1,690,160,000 should be reduced by at least \$660,000,000, and further reduced to reflect any penalties or other adjustments determined to be appropriate by the Commission.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** As noted in the positions above, all of the parties except FIPUG have recommended the Commission approve FPL's primary recommendation to use securitization to recover reasonable and prudently incurred storm damage restoration costs and replenish the storm damage reserve. FIPUG argues that due to tax considerations, reduced interest expense, a reduction in the amount of storm damage restoration costs FPL is allowed to recover, and a lower storm reserve level, ratepayers are better off if the Commission approves a new storm

surcharge over a three year period compared to recovery through securitization over a period of 12 years. (FIPUG BR at 5–10) To the extent the Commission decides in other issues that the amount of reasonable and prudently incurred storm damage restoration costs and replenishment of the storm reserve are less than the respective amounts FPL has requested, the amount FPL will be allowed to recover from ratepayers will be the same whether FPL pursues securitization or a surcharge. (Dewhurst TR 110) In addition, taxes are assessed based on actual customer consumption of electricity. FIPUG has not demonstrated that total taxes paid by ratepayers will be significantly greater if a small charge is spread over 12 years compared to a significantly larger charge spread over three years. Finally, with respect to the issue of the interest rate, staff acknowledges in Issues 39 and 68 that securitization is more expensive than alternative methods of recovery. (TR 113–114) While FIPUG's members may prefer a substantial monthly surcharge for the next three years, the groups representing all other FPL ratepayers have expressed a strong preference for a significantly smaller storm charge even if this charge extends for several years. (See positions above) For these reasons, staff recommends the Commission issue a financing order as recommended in Issues 61 and 74B permitting FPL to issue storm recovery bonds instead of imposing a new storm surcharge for the recovery of reasonable and prudently incurred storm damage restoration costs and replenish the storm damage reserve.

The amount to be securitized is a fall-out issue based on the resolution of other issues. Staff recommends that the amount to be approved for recovery would be determined by the amounts approved in Issue 3 for 2004 storm-related costs, Issue 36 for 2005 storm-related costs, and Issue 37 for the appropriate level of the storm damage reserve. Based on the staff's recommendations in those issues, the amount is \$1,127,190,452 on a pre-tax basis. Staff has also included FPL's \$11,425,000 estimate of up-front bond issuance costs. The total after-tax amount is \$703,801,734. This amount was calculated as follows:

<u>ISSUE</u>	<u>DESCRIPTION</u>	<u>\$</u>
36	NET ADJUSTED 2005 TOTAL JURISDICTIONAL COSTS	728,510,020
	ADDITIONAL STAFF ADJUSTMENTS	
37	Storm Reserve Replenishment	200,000,000
3, 41	Unamortized 2004 Storm Costs	<u>198,680,432</u>
---	TOTAL STORM COSTS SUBJECT TO STORM RECOVERY FINANCING	1,127,190,452
---	Less: Income Taxes @ 38.575%	<u>(434,813,718)</u>
---	AFTER-TAX COSTS SUBJECT TO RECOVERY FINANCING	692,376,734
51, 53	Up-Front Bond Issuance Costs	11,425,000
---	Rounding	<u>0</u>
42	TOTAL BOND ISSUANCE AMOUNT	<u>703,801,734</u>



**Issue 43:** Based on resolution of the preceding issues, what amount, if any, should the Commission authorize FPL to recover through a traditional surcharge or other form of recovery?

**Recommendation:** No. However, if the Commission approves recovery other than through securitization as set forth in Issue 42, the amount to be approved for recovery would be determined by the amounts approved in Issue 3 for the 2004 storm-related costs, Issue 36 for the 2005 storm-related costs and Issue 37 for the appropriate level of the storm damage reserve. Based on the staff's recommendation in those issues, the amount to be recovered is \$1,127,190,452 on a pre-tax basis. (Slemkewicz, Springer, Lowe, Kyle, Breman)

**Position of the Parties**

**FPL:** The total amount of storm-related costs proposed for recovery through a traditional surcharge or other form of recovery is approximately \$1.7 billion, which includes the 2005 storm costs, proposed replenishment of the Reserve and the remaining balance of 2004 unrecovered storm costs. If the 2004 storm surcharge is continued, the recovery amount in this proceeding should be reduced accordingly. If FPL's primary recommendation is rejected, the Commission should authorize FPL to recover approximately \$1.5 billion through a conventional surcharge.

**OPC:** Based on the resolution of the preceding issues in accordance with the recommended adjustments advocated by Citizens, no amount should continue to be collected through a surcharge or other form of recovery if the Commission approves the securitization methodology set forth in the "best practices" standard.

**FIPUG:** The Commission should grant recovery via a surcharge. The surcharge should be designed to recover the following: (1) the replenishment of the storm reserve to \$150 million and; (2) the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments.

**FRF:** Based on resolution of the preceding issues, if the Commission approves recovery through traditional surcharges or another form of recovery, FPL's requested storm-related costs of \$1,690,160,000 should be reduced by at least \$660,000,000 and further reduced to reflect any penalties or other adjustments determined to be appropriate by the Commission.

**AARP:** The same as the Office of Public Counsel.

**FEA:** FEA supports recovery through securitization. We agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** This is a fall-out issue based on the resolution of other issues. Staff recommends that the amount to be approved for recovery, other than by securitization, would be determined by the amounts approved in Issue 3 for the 2004 storm-related costs, Issue 36 for the 2005 storm-related costs and Issue 37 for the appropriate level of the storm damage reserve.

Based on the staff's recommendation in those issues, the amount to be recovered is \$1,127,190,452 on a pre-tax basis. This amount was calculated as follows:

<u>ISSUE</u>	<u>DESCRIPTION</u>	<u>\$</u>
36	NET ADJUSTED 2005 TOTAL JURISDICTIONAL COSTS	728,510,020
37	Storm Reserve Replenishment	200,000,000
41	Unamortized 2004 Storm Costs	<u>198,680,432</u>
43	TOTAL STORM COSTS SUBJECT TO STORM RECOVERY SURCHARGE	<u><u>1,127,190,452</u></u>

**Issue 44:** Should the Commission approve FPL's alternative request to implement a surcharge to be applied to bills rendered on or after June 15, 2006, for a period of three years for the purpose of recovering its prudently incurred 2005 storm costs and attempting to replenish the Reserve? If so, how should the Commission determine the following:

- a. The amount approved for recovery; and
- b. The cost allocation to the rate classes.

**Recommendation:** No, the Commission should not approve FPL's alternative request to implement a surcharge and subparts a. and b. are moot. However, if a surcharge is approved, then a. and b. need to be addressed and are discussed below.

a. The amount to be approved for recovery would be determined by the amounts approved in Issue 36 for 2005 storm-related costs and in Issue 37 for the appropriate level of the storm damage reserve. Based on staff's recommendation, the amount would be \$928,510,020 on a pre-tax basis. (Slemkewicz)

b. If the Commission approves an amount for recovery, the allocation to the rate classes should be made as proposed by FPL witness Morley and as discussed in Issue 80. The surcharge should be applied to bills rendered on or after June 15, 2006, for a period of three years, unless all approved costs are recovered sooner. (Draper)

#### **Position of the Parties**

**FPL:** In the event that the Commission decides not to approve the requested storm-cost financing, the Commission should grant FPL's alternative request, as detailed in Dr. Rosemary Morley's testimony. If the alternative request is approved, then the allocation of costs to the rate classes should be consistent with the manner in which equivalent costs were treated in the last filed cost of service study as provided by FPL in Exhibits 57 and 58.

**OPC:** Based on the resolution of the preceding issues in accordance with the recommended adjustments advocated by Citizens, no amount should continue to be collected through a surcharge or other form of recovery if the Commission approves the securitization methodology set forth in the "best practices" standard.

**FIPUG:** The Commission should grant recovery via a surcharge. The surcharge should be designed to recover the following: (1) the replenishment of the storm reserve to \$150 million, and; (2) the recovery of FPL's 2005 storm costs minus Pock's proposed adjustments. Costs should be allocated based on the cost of service methodology last filed with and approved by the Commission in Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

**FRF:** No position.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' POSITION**

FPL's primary request is to issue storm-cost recovery bonds. OPC, AARP, AG, and FEA agree with FPL. FIPUG recommends that the Commission grant recovery via a surcharge designed to recover the replenishment of the storm reserve to \$150 million and the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments. FRF takes no position.

**STAFF ANALYSIS**

If the Commission approves FPL's primary request for securitization of its 2005 storm costs and replenishment of the storm reserve (Issue 42), this issue is moot. FIPUG's recommended reduction of the storm reserve from \$650 to \$150 million is addressed in Issue 37. FPL's reasonable and prudently incurred 2005 storm costs are addressed in Issue 36, with adjustments identified in preceding issues.

However, if a surcharge is approved, then the appropriate amount and the cost allocation to the rate classes need to be addressed and are discussed below. The amount to be approved for recovery would be determined by the amounts approved in Issue 36 for 2005 storm-related costs and in Issue 37 for the appropriate level of the storm damage reserve. The allocation to the rate classes should be done as proposed by FPL witness Morley in her direct testimony and as discussed in Issue 80. FIPUG's position regarding the allocation of the costs is also addressed in Issue 80. The surcharge should be applied to bills rendered on or after June 15, 2006, for a period of three years, or until such time as all approved costs have been recovered. (FPL BR at 127) Prior to implementation of the surcharge, FPL should file tariff sheets and associated storm charges by rate class for administrative approval by staff.

**CONCLUSION**

If the Commission approves FPL's primary request, i.e., securitization, then this issue is moot. If the Commission approves FPL's alternative request, then the amount approved for recovery and cost allocation should be done as discussed in the staff analysis. The \$928,510,020 amount represents \$728,510,020 for the 2005 storm costs (Issue 36) plus an additional \$200 million to replenish the storm reserve (Issue 37).

**Terms and Conditions of Financing Order for Securitized Amounts**

**Issue 45:** What adjustment, if any, should be made so that the treatment of the deferred tax liability is revenue neutral from the ratepayer's perspective?

**Recommendation:** No adjustment is necessary for the deferred tax liability. However, the deferred tax debits related to the funded storm damage reserve should be removed for AFUDC and earnings surveillance purposes. (Lowe, Kyle)

**Position of the Parties**

**FPL:** No adjustment is necessary since FPL would calculate interest on the storm costs on an after-tax commercial paper rate basis.

**OPC:** All effects of the funded reserve should be eliminated for base rate, AFUDC and surveillance purposes. Accounts specifically removed should be the regulatory asset not sold to the SPE and the associated credit deferred taxes, the storm reserve fund, the storm reserve and associated debit deferred taxes. The current AFUDC rate should be investigated to ensure that the increase in credit deferred taxes for 2004-2005 storm losses has been applied to current plant construction projects.

**FIPUG:** For the benefit of future customers, the Commission should order FPL to adjust the monthly AFUDC rate to reflect the changes in the deferred tax balance resulting from the storm charge. The Commission can protect current customers by ordering FPL to use part of the deferred tax account to pay current taxes.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** No position.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The utility argues that no adjustment is necessary to insure that the treatment of deferred tax liability is revenue neutral from the ratepayer's perspective. Witness Davis testifies that the deferred tax liability arises from the fact that the utility has deducted or will deduct the storm damage costs on its tax return, but has not yet recovered those costs from its customers. (TR 498, 518-519) He further testifies that as revenues to recover the storm costs are received from customers, the deferred tax liability associated with those storm losses will decrease. (TR 498) In addition, he testifies that the deferred tax liability account would be properly included in the capital structure at zero cost. (TR 501)

OPC expands the issue to argue that all effects of the funded reserve should be eliminated for base rates, AFUDC, and surveillance purposes. OPC put on no evidence regarding this expansion of the issue and provided no position or testimony with respect to the revenue neutrality of the utility's treatment of deferred tax liability resulting from this case.

FIPUG also argues that the utility's AFUDC rate should be adjusted. It also expands the issue to state the Commission can protect current customers by ordering FPL to use part of the deferred tax account to pay current taxes. FIPUG put on no evidence with respect to either of these expanded positions.

Staff believes that the utility's position with respect to the issue as stated is correct. The utility witness is correct with respect to how the deferred tax liability arises and its proper accounting treatment. The utility had storm damage expenses that it wrote-off on its tax returns in 2004 and 2005. Presuming that the utility will be allowed to recover these costs from the customers in the future, this creates a deferred tax liability equal to the amount of the deductible expense times the tax rate.

In future years, assuming allowable recovery, FPL will collect revenues from its customers that have no corresponding expense. In each of those future years FPL will pay taxes on those revenues. In other words, FPL has an expense deductible in one year and recoverable over future years. It is a timing difference subject to normalization. FPL gets the benefit of the deduction now, but will have to pay the taxes over future years.

The Commission has historically included net deferred income tax liabilities in the capital structure with a zero cost of capital. Witness Davis testifies, that this is the appropriate treatment. (TR 501)

Staff believes that the utility's position is the correct one with respect to the issue as stated. With respect to the expanded issue, FPL witness Davis under cross examination, testified that the deferred tax assets would be included in the utility's rate base. (TR 493-494) He further testified when questioned by Commissioner Deason, that the Commission could order the utility to remove it from the utility's rate base. (TR 524-525) We understand that accounting requirements establish the deferred tax asset. Since FPL's storm damage reserve is funded and earns interest; the reserve, the fund and the debit deferred taxes should all be removed for AFUDC and earnings surveillance.

**Issue 46:** Is the recovery of income taxes a financing cost eligible for recovery under Section 366.8260, Florida Statutes?

**Recommendation:** Yes. The recovery of income taxes is a financing cost eligible for recovery under Section 366.8260, Florida Statutes. (Lowe, Kyle, Springer)

**Position of the Parties**

**FPL:** Yes. Section 366.8260(1)(e)(1) defines “financing costs” to include “any income taxes resulting from the collection of storm-recovery charges in any such case whether paid, payable, or accrued.

**OPC:** No position.

**FIPUG:** Yes, but the storm reserve account balance should reflect the total sum collected from customers for the reserve via the Storm Bond Repayment Charge and the Storm Bond Tax Charge.

**FRF:** Yes.

**AARP:** Same position as FIPUG.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** No party disagrees that the recovery of income taxes is a financing cost eligible for recovery under Section 366.8260(1)(e)5., Florida Statutes. The statute defines “financing costs” to include “[a]ny income taxes resulting from the collection of storm-recovery charges in any such cases whether paid, payable, or accrued . . .”

**Issue 47:** If recovery of the taxes assessed on the storm recovery charges are not securitized, should the tax charge be included in the irrevocable financing order?

**Recommendation:** Yes. The recovery of income taxes should be allowed and included in the irrevocable financing order. (Lowe, Kyle, Springer)

**Position of the Parties**

**FPL:** Yes. Recovery of taxes is provided for in Section 366.8260, Florida Statutes, and is an integral part of recovery of storm costs.

**OPC:** No position.

**FIPUG:** Yes, but the storm reserve account balance should reflect the total sum collected from customers for the reserve via the Storm Bond Repayment Charge and the Storm Bond Tax Charge. However, if storm recovery charges are not securitized, there is no need for an irrevocable financing order.

**FRF:** No. It would be inappropriate to include charges that are not part of the securitized amounts within the scope of an irrevocable financing order.

**AARP:** Same position as FIPUG.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC. (Also discussed below is the AG's proposal to eliminate the "tax effect.")

**Staff Analysis:** All parties, except FRF, either take no position or agree with the Company's position. FRF's position is that it is inappropriate to include charges that are not part of the securitized amounts within the scope of an irrevocable financing order. FRF does not present any arguments or references for its position. As there is no evidence contrary to the company's position, staff recommends that the company's position be accepted.

FIPUG expands the issue to include a statement about what the storm reserve account balance should reflect and a separate statement that if storm recovery charges are not securitized, there is no need for an irrevocable financing order. What the storm reserve balance should reflect is included in other issues and should not be addressed in this issue. Although there is no argument or evidence on this issue with respect to the need for an irrevocable financing order when storm recovery charges are not securitized, staff agrees with the assertion.

In addition, in their brief, the AG proposes to eliminate the "tax effect." It states that the tax effect refers to the profit derived by FPL by collecting federal taxes from the consumer based on a statutory rate but ultimately paying out to the federal government based on a much lower effective rate.

The AG presented no witnesses for this proposal. It attempted to establish a record for this adjustment through cross examination of FPL witness Davis. Witness Davis was asked about the



difference between the statutory federal tax rate used in FPL's tax calculations and the effective rate that FPL Group paid to the federal government. (TR 578-579) Witness Davis explained that the differences were caused by several items. He explained that for FPL the differences between the marginal rate and the effective rate would be for items like the amortization of the investment tax credit and any tax exempt income. (TR 579) In addition, he explained that some of the differences for FPL group would be associated with energy tax credits associated with the wind energy that is produced by a nonregulated subsidiary as part of the federal government's inducement to build those wind farms as renewable energy. (TR 580)

Witness Davis also testified that it has been the policy of the Commission to calculate income taxes on a stand-alone basis so that the customer is insulated from any tax issues on the nonregulated side. (TR 578) Staff is persuaded by Witness Davis' testimony. We would note that using the statutory tax rate has been the Commission's practice. See, e.g., Gulf Power Company, Docket No. 71342-EU, Order No. 5471, P. 22, (6/30/72).

**Issue 48:** Should FPL indemnify its ratepayers against an increase in the servicer fee in the event of the servicer's default due to negligence, misconduct, or termination for cause?

**Recommendation:** Yes. FPL in its role as servicer has control over any action that could cause an increase in the servicer fee. Therefore, the Commission should require the Company to indemnify ratepayers against an increase in the servicer fee in the event of the servicer's default due to negligence, misconduct, or termination for cause. (Maurey)

**Position of the Parties**

**FPL:** No. Under the servicing agreement, FPL commits to service the storm recovery property in material compliance with applicable law and regulations and using the same degree of care and diligence that it exercise with respect to the collection of its other charges.

**OPC:** Yes. FPL should indemnify ratepayers against an increase in the servicer fee to protect the ratepayers from any potential negligence, misconduct, or termination for cause by FPL as FPL is in the best position to prevent such misconduct by its own actions.

**FIPUG:** Yes.

**FRF:** Yes.

**AARP:** Adopt same position as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The proposed form of servicing agreement prohibits FPL from resigning as servicer unless FPL determines that it can no longer legally perform its servicing functions. (TR 136) Witness Dewhurst testified that the basic functions in the servicing arrangement are tightly bound up with the Company's day-to-day operations and that FPL would never intentionally default under the servicing agreement. (TR 136-137) When asked, witness Dewhurst could not provide any examples of why FPL would no longer be able to legally perform the servicer functions. (TR 136)

Staff witness Fichera testified that the proposed servicing agreement is essentially an agreement between affiliated parties with all the liabilities associated with the agreement falling to FPL ratepayers. (TR 1190) Because FPL shareholders do not directly bear the burden of issuance costs, including servicing fees, and because the economic burden of an increase in fees would be recognized through operation of the true-up mechanism, FPL ratepayers would be responsible for any increase in the servicing fee. (Dewhurst TR 1693; Fichera TR 1157) FPL witness Olson acknowledged that if FPL were to default as servicer, the servicing fee could increase from the proposed level of \$525,000 a year (annualized amount equal to 0.05 percent of the initial principal amount of the storm recovery bonds) to over \$6 million a year (0.6 percent of the initial principal amount) without the need for additional Commission approval. (TR 674)

Witness Fichera testified that commissions in other states have required the sponsoring utility acting as servicer to indemnify its ratepayers against an increase in the servicer fee in the event of default due to negligence, misconduct, or termination for cause. (TR 1157) FPL has suggested that the Commission could instead impose penalties on FPL for defaulting as servicer pursuant to Section 366.8260(15), Florida Statutes. (Dewhurst TR 1707) This provision allows the Commission to impose penalties pursuant to Section 366.095, Florida Statutes, or such other penalties as the Commission deems appropriate. Section 366.095, Florida Statutes, only authorizes the Commission to penalize a utility up to \$5,000 per occurrence for a violation of a statute or Commission rule or order. A fine of \$5,000 would be insufficient to compensate ratepayers for bearing up to \$5.5 million in additional annual costs due to default. (Fichera TR 1213; Dewhurst TR 1707; EXH 4, p. 267) Further, imposition of any penalty would likely require an adversarial proceeding.

In conclusion, requiring FPL to indemnify its ratepayers for any increase in the servicer fee caused by FPL's default properly puts the burden of the cost of default on the party whose actions would lead to default, rather than place the burden on the Commission to pursue through an adversarial proceeding penalties that may not sufficiently protect ratepayers. Therefore, the Commission should require the Company to indemnify ratepayers against an increase in the servicer fee in the event of the servicer's default due to negligence, misconduct, or termination for cause.

**Issue 49:** WITHDRAWN

**Issue 50:** What is the appropriate up-front and ongoing fee for the role of servicer throughout the term of the bonds?

**Recommendation:** The appropriate up-front servicer set-up fee is \$350,000. The appropriate ongoing servicer fee is 0.05 percent of the initial principal amount of the bonds. Based on the amount of storm recovery bonds FPL has proposed be issued, this fee would be \$525,000 per year. These fees are necessary to ensure an “arms-length” transaction for bankruptcy law considerations. (Springer, Slemkewicz)

**Position of the Parties**

**FPL:** To obtain the requisite bankruptcy opinions, FPL must be paid an amount that is deemed to cover its actual costs. FPL as the initial servicer should be paid its upfront costs incurred to make necessary system modifications to enable FPL to bill and collect the Storm Charges and an annualized amount equal to 0.05% of the initial principal amount of the storm-recovery bonds for the ongoing cost of servicing the bonds. This rate is at the lower end of a range of such fees that have been approved in other utility securitizations, and attempting to track actual costs likely would not be cost effective.

**OPC:** The appropriate up-front and ongoing fee for FPL’s role as the servicer throughout the term of the bond is the incremental cost to FPL for performing the servicer duties. The difference between the servicing fee necessary to create an arms-length transaction and FPL’s approved incremental costs should be used to increase the storm reserve available for recovery of future storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES’ ARGUMENTS**

FPL’s form of servicing agreement provides up-front and ongoing fees for FPL’s role as servicer in the amount of \$350,000 and 0.05 percent (\$525,000), respectively. The intervenors concur that those amounts are appropriate to create an arms-length transaction, but assert that the difference between these amounts and the incremental cost of providing the services required by the agreement should be used to increase the storm reserve. Staff’s recommendation regarding the intervenors’ latter point is discussed in Issue 51.

### **ANALYSIS**

The servicer calculates, bills, and collects storm recovery charges for the respective storm-recovery bonds on behalf of the Special Purpose Entity (SPE) and remits them to the bondholders' trustee. (Fichera TR 1155) Additionally, the servicer prepares, files, and processes the periodic Storm Bond Repayment Charge true-up adjustments. (Olson TR 673) These related duties are designed to ensure that collections are sufficient to timely satisfy the payment of principal and interest on the bonds as well as other ongoing costs. (Dewhurst TR 75; Fichera TR 1155) Periodically, the servicer will prepare reports detailing the results of remitting the collections to the trustee for deposit into the collection account. (Olson TR 673)

It is important for the servicer to be adequately compensated for the services it provides to create an "arms-length" relationship between FPL and the SPE. (Fichera TR 1155; Olson TR 674) This type of arrangement is a requirement of bankruptcy law to preserve the integrity of the bankruptcy-remote structure of the SPE and thus ensure the high credit quality of the bonds. (Fichera TR 1155; Olson TR 674) An upfront servicer set-up fee of \$350,000 and the ongoing servicer fee of 0.05 percent (\$525,000 annually) of the principal amount of the storm recovery bonds are the fees proposed by FPL for its role as servicer. (EXH 8) No party disagrees that FPL should be allowed to collect a servicing fee that is necessary to establish an arms-length transaction. (FPL BR at 131; FRF BR at 69; OPC BR at 85)

### **CONCLUSION**

Staff recommends that the appropriate up-front and ongoing fees for FPL's role as servicer in the amount of \$350,000 and 0.05 percent of the principal amount of the storm recovery bonds, respectively. These fees were set to ensure an arms length transaction for bankruptcy law considerations between FPL and the SPE. The amounts FPL should be permitted to receive from ratepayers for its role as servicer are discussed in Issue 51.

**Issue 51:** How much should FPL be permitted to recover from ratepayers for its role as servicer in this transaction?

**Recommendation:** FPL should be permitted to collect the servicer set-up and on-going servicing fees that are necessary to establish an arms-length transaction for purpose of creating an independent SPE as discussed in Issue 50. FPL should be allowed to recover the \$350,000 servicer set-up fee it estimates would be necessary to adapt its existing systems to bill, collect, and process the storm charge and set up the reporting function. However, with respect to the on-going servicing fee, FPL should be allowed to keep only its incremental costs for performing the servicing function. Because FPL has not justified the \$525,000 annual fee it proposes to collect and because the activities appear to be extremely closely related to activities the Company already performs in the normal course of its operations, staff recommends the annual fee of 0.05 percent of the initial principal amount of the storm recovery bonds be used to increase the storm reserve available for recovery of future storm costs. (Maurey)

**Position of the Parties**

**FPL:** To obtain the requisite bankruptcy opinions, FPL must be paid an amount that is deemed to cover its actual costs. FPL should recover the up-front costs to bill and collect the Storm Charges and annual fees paid by the SPE under the servicing agreement. Separate tracking and identification of such costs is not likely to be cost effective; however, if FPL is required to do so, any excesses or deficiencies should be credited to or withdrawn from the Reserve.

**OPC:** FPL should be permitted to collect from ratepayers the servicing fee that is necessary to establish an arms-length transaction for purpose of creating an independent SPE. However, FPL should be allowed to keep only its approved incremental costs for servicing the bonds. The difference between the servicing fee necessary to create an arms-length transaction and any approved incremental costs should be used to increase the storm reserve available for recovery of future storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** Staff incorporates by reference the discussion under Issue 50 for a description of the servicer function and an explanation of why it is important to set the related fee at a level necessary to establish an arms-length transaction for bankruptcy law considerations. (Fichera TR 1155; Olson TR 674; EXH 4, p. 252) FPL witness Dewhurst testified that the activities of billing the customer, collecting the storm charge from the customer, accounting for the collections accurately, and making sure the funds are remitted to the SPE are “very tightly bound

up” with the Company’s day-to-day operations. (TR 115–119, 136–137) He also testified that FPL did not provide any analysis or support for the incremental cost of performing the servicer function. (TR 116–117) Finally, FPL witness Davis acknowledged that many of the activities involved in developing the storm charge and performing the servicer function are already done by FPL in the normal course of its operations. (TR 589–590; EXH 4, pp. 258, 264–266)

FPL provided support for the \$350,000 it estimates would be necessary to adapt its existing systems to bill, collect, and process the charge and set up the reporting function. (EXH 171, pp. 20-25; EXH 4, pp. 248–249) However, because FPL has not justified the \$525,000 annual fee it proposes to collect from ratepayers for performing the servicer function and because the servicer activities appear to be extremely closely related to activities the Company already performs in the normal course of its operations, staff recommends the annual fee of 0.05 percent of the initial principal amount of the storm recovery bonds be used to increase the storm reserve available for recovery of future storm costs.

**Issue 52:** What is the appropriate up-front and ongoing fee for the role of administrator throughout the term of the bonds?

**Recommendation:** The appropriate up-front and ongoing fee for the role of administrator should be \$125,000 per year. This fee is necessary to ensure an “arms-length” transaction for bankruptcy law considerations. (Springer, Slemkewicz)

**Position of the Parties**

**FPL:** To obtain the requisite bankruptcy opinions, FPL must be paid an amount that is deemed to cover its actual costs. FPL as Administrator should be paid the actual costs incurred to set up the SPE from bond proceeds and an annual fee of \$125,000 plus expenses to perform the administrative functions necessary to maintain the SPE. This amount is comparable to the administration fees paid in similar transactions. Attempting to track actual costs likely would not be cost effective.

**OPC:** The appropriate up-front and ongoing fee for FPL’s role as the administrator throughout the term of the bond is the incremental costs to FPL for performing the administrator duties. The difference between the administration fee necessary to create an arms-length transaction and FPL’s incremental costs should be used to increase the storm reserve available for recovery of future storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES’ ARGUMENTS**

FPL’s form of administration agreement provides for an ongoing fee for FPL’s role as administrator in the amount of \$125,000 plus expenses on an annual basis. The intervenors concur that this amount is appropriate to create an arms-length transaction, but assert that the difference between the requested amount and the incremental cost of performing administrator duties should be used to increase the storm reserve.

**ANALYSIS**

FPL, in its role as administrator, establishes the SPE and performs the administrative duties necessary to maintain the SPE. (FPL BR at 133; Olson TR 674; OPC BR at 87) FPL estimates that the up-front costs to establish the SPE will be \$15,000, but is willing to be reimbursed for the actual costs incurred subject to Commission review subsequent to the



financing. (FPL BR at 133; EXH 8) However, FPL believes that the appropriate up-front and ongoing fee for the role of administrator is \$125,000 per year. (FPL BR at 133) Similar to the Servicing Agreement, bankruptcy law considerations require that the administration agreement reflect an arms-length transaction to ensure that the SPE is a bankruptcy remote entity. (Olson TR 674; FPL BR at 133) OPC has proposed that the administrator fee should be fixed at \$125,000 with no future increase of this amount through the true-up mechanism. (OPC BR at 87) All parties agree that FPL should be allowed to collect an administration fee of \$125,000 annually to allow for an arms-length transaction between FPL and SPE. (FPL BR at 133; FRF BR at 69; OPC BR at 87)

### **CONCLUSION**

Staff recommends that the appropriate ongoing fee for the role of administrator should be \$125,000 per year. The amount FPL should be permitted to receive from ratepayers for its role as administrator is discussed in Issue 53.

**Issue 53:** How much should FPL be permitted to recover from ratepayers for its role as administrator in this transaction?

**Recommendation:** FPL should be permitted to collect the administration fee necessary to establish an arms-length transaction for purposes of creating an independent SPE as discussed in Issue 52. However, FPL should be allowed to keep only its incremental costs for performing the administration function. Since FPL has not provided or supported any incremental costs of performing this function, the full amount of the proposed \$125,000 annual administration fee should be used to increase the storm reserve available for recovery of future storm costs. (Maurey)

**Position of the Parties**

**FPL:** To obtain the requisite bankruptcy opinions, FPL must be paid an amount that is deemed to cover its actual costs. FPL should recover up-front costs incurred to establish the SPE and the annual fees paid by the SPE under the administration agreement. Separate tracking and identification for these expenses is not likely to be cost effective. If FPL is required to separately identify and track actual costs, any excesses or deficiencies should be credited to or withdrawn from the Reserve.

**OPC:** FPL should be permitted to collect from ratepayers the administration fee that is necessary to establish an arms-length transaction for purpose of creating an independent SPE. However, FPL should be allowed to keep only its approved incremental costs for administering the bonds. The difference between the administration fee necessary to create an arms-length transaction and approved incremental costs should be used to increase the storm reserve available for recovery of future storm costs.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** Staff incorporates by reference the discussion under Issue 52 for a description of the administration function and an explanation of why it is important to set the related fee at a level necessary to establish an arms-length transaction for bankruptcy law considerations.

FPL proposes an annual fee of \$125,000 for performing certain activities under the administration agreement. (EXH 8) FPL has not provided or justified any incremental costs it will incur for performing this function. (EXH 171, pp. 20–25; EXH 4, pp. 256–258, 265) In its brief, OPC argues “since FPL has not supported its incremental costs by the time of the hearing where those costs would be subject to examination, the full amount of the administration fee should be used to increase the storm reserve available for recovery of future storm costs.” (OPC

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BR at 89) Staff agrees with OPC on this point and recommends the Commission order FPL to pay the \$125,000 annual administration fee into the storm damage reserve.

**Issue 54:** STIPULATED: How frequently should FPL in its role as servicer be required to remit funds collected from ratepayers to the SPE?

**Recommendation:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue: “FPL will remit funds deemed collected from customers to the SPE on a daily basis, pursuant to the terms of an agreement between FPL and the SPE. Any earnings on funds transferred will be used to reduce future charges.” Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue: “FPL will remit funds deemed collected from customers to the SPE on a daily basis, pursuant to the terms of an agreement between FPL and the SPE. Any earnings on funds transferred will be used to reduce future charges.” Staff recommends approval of this Stipulation.

**Issue 55:** In the event any amounts remain in the Collection Account after all storm recovery bonds have been retired, what should be the disposition of these funds?

**Recommendation:** Any amounts remaining in the Collection Account, and any additional storm recovery charges that have been incurred but not yet collected and deposited to the Collection Account, after all storm recovery bonds have been retired should be credited to current consumers' bills in the same manner that the storm charges were collected. However, if it is not cost effective to credit the remaining amount, the residual amount could either be applied to the storm reserve or returned to customers through a credit to the capacity clause. (Springer)

**Position of the Parties**

**FPL:** Upon repayment in full of the Storm Bonds and all related financing costs, any remaining amounts held by the SPE (exclusive of the amounts in the capital subaccount, representing the equity contribution, and any interest earnings thereon) should be remitted to FPL and added to the Reserve if the amount is insignificant and the process of applying a credit to customer rates is not cost effective due to customer billing program changes.

**OPC:** The amounts should be reflected as a credit on each customer's bill as a refund allocated among customer classes in the same manner that the storm charges were collected.

**FIPUG:** The funds should be added to the storm reserve or refunded to FPL's customers.

**FRF:** Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL requests that any amounts remaining in the collection account after all bonds have been retired be added to the storm reserve if the amounts are insignificant and to the point that crediting consumers' bills would not be cost effective due to customer billing program changes. (FPL BR at 134–135) The AG, AARP, and FRF agree with OPC that the remaining amounts should be reflected as a credit on each customer's bill allocated in the same manner the charges were collected. (OPC BR at 90) FEA agrees with FIPUG that the funds should be added to the storm reserve or refunded to FPL's customers. (FIPUG BR at 15)

**ANALYSIS**

FPL proposes that upon payment in full of the storm bonds and all related financing costs, if there are any remaining amounts held by the SPE (exclusive of the amounts in the capital subaccount, representing FPL's equity contribution, and any interest earning thereon) FPL will remit a like amount to the Reserve, or in the alternative, will allow a like amount to be applied as a credit to customer rates. (Davis TR 459) FPL proposes that any amount above \$10 million should be applied as a credit to customer rates if it is cost effective to do so, but that any amount below this threshold be added to the Reserve. (FPL BR at 134) OPC has proposed that any remaining amounts should be applied as a credit to each customer bill as a refund allocated among customer classes in the same manner that the storm charges were collected. (OPC BR at 90) It has been an accepted practice in other states to return excess revenues to consumers. This is consistent with a "best practice" to establish procedures that ensure all savings flow to ratepayers. (TR 1186) Staff believes this same treatment should apply to any additional storm recovery charges that have been incurred but not yet collected and deposited to the Collection Account as of the date when all storm recovery bonds have been retired. This can be accomplished by requiring the Collection Account be kept in place until all storm recovery charges have been collected.

**CONCLUSION**

Staff recommends that any amounts remaining in the Collection Account after all storm recovery bonds have been retired should be applied as a credit to each current customer in the same manner that the storm charges were collected. However, if it is not cost effective to credit the remaining amount, the residual amount could either be applied to the storm reserve or returned to customers through a credit to the capacity clause. This determination will be made when the bonds are retired and the amount is known. In addition, staff recommends the Collection Account be kept in place until all storm recovery charges have been collected.

**Issue 56:** How should the Commission determine that the upfront bond issuance costs are appropriate?

**Recommendation:** It is not necessary for the Commission to determine that FPL's estimated upfront bond issuance costs are appropriate at this time. In accordance with Section 366.8260(2)(b)5., Florida Statutes, FPL is required to file for the Commission's review actual bond issuance costs within 120 days after the bond issuance. In its review, the Commission must determine if such costs resulted in the lowest overall costs that were reasonably consistent with market conditions at the time of the issuance and the terms of the financing order. If the Commission determines at that time that the estimated issuance costs included in the determination of the initial storm charge were overstated, the Commission should require FPL to increase the storm damage reserve by the amount of the difference in accordance with the statute. (Maurey)

**Position of the Parties**

**FPL:** In accordance with Section 366.8260(2)(b)5., Florida Statutes, within 120 days after the bond issuance, FPL shall file supporting information on the actual upfront bond issuance costs. The Commission shall review such costs to determine compliance with Section 366.8260(2)(b)5., Florida Statutes; however, if FPL has selected the lowest cost qualified provider for bond issuance services as a result of competitive solicitation, FPL should be deemed to have satisfied the statutory standard.

**OPC:** The Commission should adopt the "best practices" standard. The Commission's financial advisor should make an independent evaluation regarding lowest cost and that evaluation should be made available to the parties. If there is a dispute as to whether the lowest costs for the front costs were obtained based on the independent evaluation or other means, the matter should be brought before the Commission for resolution in the 120 day proceeding.

**FIPUG:** Adopts the position of OPC.

**FRF:** If the Commission determines to approve securitization, then the Commission should adopt the "best practices" standards applicable to reviewing and approving issuance costs.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** All of the upfront bond issuance costs proposed by FPL are estimates. (EXH 8). There is no statutory standard or requirement that the Commission pre-approve FPL's estimated upfront bond issuance costs. In addition, there is reason to believe certain of these estimated costs are subject to revision based on future negotiations during the structuring, marketing, and

pricing of the storm recovery bonds. (Olson TR 1494; EXH 167, pp. 23–24; Noel TR 1118–1123; Fichera TR 1178–1182)

Section 366.8260(2)(b)5., Florida Statutes, states

The Commission shall review such information [the actual issuance costs] to determine if such costs incurred in the issuance of the bonds resulted in the lowest overall costs that were reasonably consistent with market conditions at the time of the issuance and the terms of the financing order. The Commission may disallow any incremental issuance costs in excess of the lowest overall costs by requiring the utility to make a contribution to the storm reserve in an amount equal to the excess of actual issuance costs incurred, and paid for out of storm-bond proceeds, and the lowest overall issuance costs as determined by the Commission.

Pre-approval of FPL's estimated bond issuance costs is not required, and in fact could impede the Commission in carrying out its statutory responsibility with regard to these costs.

To afford the Commission an opportunity to make an informed decision with regard to the reasonableness of the upfront bond issuance costs, the Commission should participate in the proposed transaction as discussed in Issue 74B. (Klein TR 1233–1236; Noel TR 1120–1123; Fichera TR 1185–1190; Olson TR 1480–1482) A cursory review of FPL's estimated upfront bond issuance costs shows that underwriting fees is the single largest line item cost. (EXH 8) There is evidence in the record that this cost may be overstated. (TR 1494; EXH 167, pp. 23–24) As part of the Commission's review of this cost, the competitive solicitation and selection of underwriters should be overseen by the Commission to ensure that the process is truly competitive and will result in the selection of transaction participants that have experience and ability to achieve an efficient and lowest cost transaction. (TR 1123; 1179–1181)

Rather than make a determination at this time regarding the appropriateness of FPL's estimated upfront bond issuance costs, staff recommends the Commission review the actual issuance costs as required by Section 366.8260(2)(b)5., Florida Statutes. If the Commission determines at that time that the estimated issuance costs included in the determination of the initial storm charge were overstated, the Commission should require FPL to increase the storm damage reserve by the amount of the difference in accordance with the statute.

**Issue 57:** How should the Commission determine that the on-going costs associated with the bonds are appropriate?

**Recommendation:** It is not necessary for the Commission to determine that FPL's estimated on-going costs associated with the storm recovery bonds are appropriate at this time. In accordance with Section 366.8260(2)(b)5., Florida Statutes, FPL is required to file for the Commission's review supporting information on actual bond issuance costs within 120 days after the bond issuance. In its review, the Commission must review the actual issuance costs to determine if such costs resulted in the lowest overall costs that were reasonably consistent with market conditions at the time of issuance and the terms of the financing order. If the Commission determines at that time that the estimated costs included in the determination of the initial storm charge were overstated, the Commission should require FPL to increase the storm damage reserve by the amount of the difference in accordance with the statute. (Maurey)

**Position of the Parties**

**FPL:** FPL's testimony and exhibits provide support for the conclusion that FPL's estimated ongoing financing costs will be reasonable, and that they are consistent with similar rate reduction bond transactions.

**OPC:** The Commission should adopt the "best practices" standard. The actual on-going costs should be flowed through the storm-recovery bonds charged to ratepayers through a true-up mechanism. But FPL should be required to increase the storm-reserve for any on-going costs that do not meet the lowest costs standard and that are higher than the estimated on-going costs in this docket. On-going fees should be limited as described in the previous issues.

**FIPUG:** Adopts the position of OPC.

**FRF:** If the Commission determines to approve securitization, then the Commission should adopt the "best practices" standards applicable to reviewing and approving ongoing costs associated with the bonds.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** It is not necessary for the Commission to determine that the estimated on-going costs associated with the storm recovery bonds are appropriate at this time. Section 366.8260(2)(b)5., Florida Statutes, states:

The Commission shall review such information [the actual issuance costs] to determine if such costs incurred in the issuance of the bonds resulted in the lowest overall costs that were reasonably consistent with market conditions at the time of the issuance and the terms of the financing order. The Commission may disallow any incremental issuance costs in excess of the lowest overall costs by requiring



the utility to make a contribution to the storm reserve in an amount equal to the excess of actual issuance costs incurred, and paid for out of storm-bond proceeds, and the lowest overall issuance costs as determined by the Commission.

Pre-approval of FPL's estimated on-going costs associated with the storm recovery bonds is not required, and in fact could impede the Commission in carrying out its statutory responsibility with regard to these costs.

In its brief, OPC contends FPL should be required to ensure that the on-going costs meet "the lowest overall costs based on market conditions" standard identified above. OPC continues that while the actual amount of on-going costs will be flowed through the true-up mechanism, if FPL fails to demonstrate that an increase in on-going fees meets the lowest cost standard, FPL should be required to apply any unjustified increase to the storm damage reserve for recovery of future storm costs. (OPC BR at 93-94)

To afford the Commission an opportunity to make an informed decision with regard to the reasonableness of the on-going costs associated with the storm recovery bonds, the Commission should participate in the proposed transaction as discussed in Issue 74B. (Klein TR 1233-1236; Noel TR 1120-1123; Fichera TR 1185-1190; Olson TR 1480-1482) Rather than make a determination at this time regarding the appropriateness of FPL's estimated on-going costs, staff recommends the Commission review the actual costs as required by Section 366.8260(2)(b)5., Florida Statutes. If the Commission determines at that time that the estimated costs included in the determination of the initial storm charge were overstated, the Commission should require FPL to increase the storm damage reserve by the amount of the difference in accordance with the statute. To the extent any on-going costs increase in the future (beyond the 120-day look-back review period), and FPL is unable to justify the increase to its flowing through the true-up mechanism, FPL should be required to increase the storm damage reserve by the amount of the excess.

**Issue 58:** Is FPL's process for determining whether the upfront bond issuance costs satisfy the statutory standard of Section 366.8260(2)(b)5., Florida Statutes, reasonable and should it be approved?

**Recommendation:** No. The Commission should not predetermine that upfront bond issuance costs resulting from a competitive solicitation, or within a certain range of estimates, meets the statutory standard of Section 366.8260(2)(b)5., Florida Statutes. Accordingly, FPL's proposed process should not be approved. (Maurey)

**Position of the Parties**

**FPL:** Yes, for the reasons explained with respect to Issue 56 above.

**OPC:** No. The process outlined by FPL in its petition, proposed order, and testimony, does not allow the active participation of the Commission. FPL's process does not afford independent protection for the ratepayers to ensure that the up-front costs, on-going costs, and interest rates achieve the lowest overall cost based on real time market conditions. Therefore, FPL's proposed process is not reasonable and should not be approved.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Because the process proposed by FPL in its filings does not provide for the active participation of the Commission, FPL's process does not afford adequate, independent protection for its customers with regard to up-front costs, issuance costs, ongoing costs, and interest rates. Accordingly, FPL's proposed process should not be approved.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The proposed process for determining whether the estimated upfront bond issuance costs satisfy the statutory standard articulated in FPL's position in Issue 56 is not reasonable and should not be approved. Contrary to FPL's position, a standard of documented expenditures falling within a range of estimates is not the standard articulated in Section 366.8260(2)(b)5., Florida Statutes. Moreover, a predetermination of reasonableness by the Commission would not provide the appropriate incentive to FPL to attain the lowest upfront bond issuance costs. (Fichera TR 1199–1202, 1205–1207, 1213–1215)

The Commission should not predetermine that upfront bond issuance costs resulting from a competitive solicitation, or within a certain range of estimates, meet the "lowest cost" standard of Section 366.8260(2)(b)5., Florida Statutes. Whether a competitive solicitation results in the lowest cost depends on how the solicitation is conducted and how negotiations that result from the solicitation are conducted. (Fichera TR 1175–1180) That determination can best be made through active oversight of the proposed transaction as discussed in Issue 74B. (Klein TR 1233–

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1236; Noel TR 1120–1123; Fichera TR 1185–1190; Olson TR 1480–1482) In addition, as discussed in more detail in Issue 65, FPL should be required to demonstrate in the issuance advice letter that its competitive solicitation and negotiation process resulted in a package of fees and services that will result in the lowest cost consistent with prevailing market conditions and the terms of the financing order.

In conclusion, there is no statutory standard or requirement the Commission predetermine that FPL's upfront issuance costs resulting from a competitive solicitation, or within a certain range of estimates, are reasonable. Accordingly, FPL's proposed process for seeking Commission approval of its estimated upfront bond issuance costs is unnecessary and should not be approved.

**Issue 59:** Is FPL's process for determining whether the on-going costs satisfy the statutory standard of Section 366.8260(2)(b)5. reasonable and should it be approved?

**Recommendation:** No. FPL's proposed process for determining whether the estimated on-going costs associated with the issuance of the storm recovery bonds satisfy the statutory standard is inconsistent with the express language of Section 366.8260(2)(b)5., Florida Statutes, and should not be approved. (Maurey)

**Position of the Parties**

**FPL:** While the standard set in Section 366.8260(2)(b)5 does not apply to ongoing costs, FPL's testimony and exhibits provide support for the conclusion that FPL's estimated ongoing financing costs will be reasonable, and that they are consistent with similar rate reduction bond transactions.

**OPC:** No. The process outlined by FPL in its petition, proposed order, and testimony, does not allow the active participation of the Commission. FPL's process does not afford independent protection for the ratepayers to ensure the up-front costs, on-going costs, and interest rates achieve the lowest overall cost based on real time market conditions. Therefore, FPL's proposed process is not reasonable and should not be approved.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Because the process proposed by FPL in its filings does not provide for the active participation of the Commission, FPL's process does not afford adequate, independent protection for its customers with regard to up-front costs, issuance costs, ongoing costs, and interest rates. Accordingly, FPL's proposed process should not be approved.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** As discussed in Issues 56, 57, and 58, Section 366.8260(2)(b)5., Florida Statutes, explains the statutory requirement regarding Commission review of "the actual costs of the storm recovery bond issuance." This Section of the statute draws no distinction between upfront costs and on-going costs associated with the issuance of the storm recovery bonds. Moreover, there is no statutory standard requiring the Commission to pre-approve the estimated on-going costs associated with the issuance of the storm recovery bonds as requested by FPL. Approximately 75% of the estimated on-going fees are comprised of the servicing fee (discussed in Issue 50) and the administration fee (discussed in Issue 52). (EXH 8; EXH 171, pp. 40-43)

A determination by the Commission whether on-going costs associated with the issuance of the storm recovery bonds are reasonable can best be made through active oversight of the proposed transaction as discussed in Issue 74B. (Klein TR 1233-1236; Noel TR 1120-1123;

Fichera TR 1185–1190; Olson TR 1480–1482) The statutory requirement is for Commission review of actual costs, not for Commission approval of estimated costs. Since there is no statutory standard or requirement that the Commission predetermine that FPL’s estimated on-going costs associated with the storm recovery bonds are reasonable, FPL’s proposed process for seeking Commission approval of these costs is unnecessary and should not be approved.

**Issue 60:** If the issuance of storm recovery bonds is approved, should the bonds be sold through a negotiated or competitive sale?

**Recommendation:** It is premature for the Commission to make this decision at this time. Both methods for the sale of storm recovery bonds should be considered to determine the most cost effective means of issuing the bonds based on prevailing market conditions near the time of issuance. However, based on the particular characteristics of these types of bonds and the method that has been used in previous transactions, both FPL and the Commission's financial advisor believe a negotiated sale will likely be preferable. (Springer)

**Position of the Parties**

**FPL:** Normally an assessment of whether bonds should be sold through a competitive bidding process or a negotiated sale would be made near the time of issuance based on factors such as issue size, complexity of issue, and current market conditions. Given the size of this offering, the risk premium that underwriters would require in a competitive bidding process would likely be greater than the underwriting fee in a negotiated sale. Therefore, a negotiated sale likely is preferable under the circumstances.

**OPC:** The methodology that is employed should be that which produces the lowest overall cost based on real time market conditions.

**FIPUG:** Adopts the position of OPC.

**FRF:** The sale method that produces the lowest overall cost based on real-time market conditions should be the method that is used to determine allowable costs. If the Commission allows FPL the discretion, after the Commission issues its order in this case, to decide which sale mechanism to use, then any such decisions by FPL must be subject to further prudence review, in subsequent proceedings in which all substantially affected parties have a point of entry.

**AARP:** No position at this time.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL proposes that a negotiated sale is preferable based on the fee for a higher risk premium that underwriters would require for a competitive sale compared to a lower underwriting fee for a negotiated sale. However, FPL proposes that this decision be made near the time of issuance based on factors such as issue size, complexity of issue, and current market conditions. The intervenors posit that the methodology employed should be that which produces the lowest overall cost based on real time market conditions. FRF proposes that if the

Commission grants FPL the flexibility to choose the methodology, that FPL should be subject to a prudency review in which all affected parties have a point of entry.

### **ANALYSIS**

FPL Witness Dewhurst testified that “the decision as to which method may be preferable is dependent on factors such as issue size, complexity of issue, and current market conditions, some of which are not known with certainty.” (TR 76) FPL asserts that, given the size of this offering, underwriters would likely require a higher risk premium for a competitive sale as compared to the fee for a negotiated sale, thus a negotiated sale would be preferable. (FPL BR at 138) OPC states that the parties should be given some flexibility to choose the methodology that will result in the lowest overall costs to ratepayers based on market conditions, but that this flexibility is predicated on the Commission adopting the “best practices” standard and being active in the transaction. (OPC BR at 99) In his testimony, witness Noel states that all options should be evaluated, but that this issue should probably be sold through a negotiated offering. (TR 1117-1118) This is based on witness Noel’s evaluation that investor education is needed to inform investors of the unique characteristics of Florida’s first securitization issuance, the first issuance of storm recovery bonds, the effectiveness of the state’s pledge of safety, and the applicability of the true-up mechanism. (TR 1118)

### **CONCLUSION**

Staff believes it is premature for the Commission to decide the manner in which the storm recovery bonds should be sold. Staff recommends both methods, competitive or negotiated sale, should be considered to determine the most cost effective means of issuing the bonds based on prevailing market conditions.

**Issue 61:** What additional terms, conditions or representations should be made in the financing order to enhance the marketability of the bonds and achieve the lowest possible cost?

**Recommendation:** The financing order should include ordering paragraphs, findings of fact, and conclusions of law that will give appropriate comfort to investors about the high quality of storm recovery bonds as a potential investment. Examples include:

1. A finding that the Commission anticipates stress case analyses will show that the broad nature of the State pledge under Section 366.8260(11), Florida Statutes, and the automatic true-up mechanism under Section 366.8260(2)(b)2.e. and 4., Florida Statutes, will serve to effectively eliminate for all practical purposes and circumstances all credit risk associated with the storm recovery bonds;

2. A finding and an ordering paragraph directing that the automatic true-up mechanism is to be applied at least semi-annually, as discussed in Issue 83;

3. A finding and an ordering paragraph that the automatic true-up mechanism will be implemented within 60-days after a filing by the servicer, as discussed in Issue 82;

4. A finding and conclusion of law that the broad nature of the State pledge under Section 366.8260(11), Florida Statutes, and the automatic true-up mechanism under Section 366.8260(2)(b)2.e. and 4., Florida Statutes, constitute a guarantee of regulatory action for the benefit of investors in storm recovery bonds;

5. A conclusion of law that any interest rate swap counterparty is to be treated as a “financing party” for purposes of Section 366.8260(1)(g), Florida Statutes;

6. A conclusion of law that storm recovery property is not a receivable under Section 366.8260(5)(a)1., Florida Statutes;

7. An ordering paragraph directing that partial payments shall be allocated first to storm recovery charges, including past due storm recovery payments;

8. A conclusion of law that the Commission’s obligation under the financing order relating to storm recovery bonds, including the specific actions the Commission guarantees to take, are direct, explicit, irrevocable, and unconditional upon the issuance of storm recovery bonds, and are legally enforceable against the Commission, a United States public sector entity; and

9. A conclusion of law and an ordering paragraph that the financing order is irrevocable under Section 366.8260(2)(b)4. and (11), Florida Statutes.

In addition, the financing order should require fully accountable certifications from the lead underwriter(s), FPL, and the Commission’s financial advisor that the actual structure, marketing, and pricing of the storm recovery bonds in fact resulted in the lowest storm recovery charges consistent with then-prevailing market conditions and the terms of the financing order and other applicable law. (Maurey)



**Position of the Parties**

- FPL:** No additional terms, conditions or representations are necessary. The utility asset-backed bond market is mature and highly liquid, and trading spreads are extremely tight. Issuing a financing order in substantially the form submitted by FPL will enable an efficient, low cost transaction. If the Commission wishes particular statements regarding the quality of the securities to be included in the offering documents, such statements should be included in the financing order as findings of fact or conclusions of law.
- OPC:** To enhance marketability of the bonds and to achieve the lowest overall cost to ratepayers, the “best practices” outlined in witness Fichera’s testimony should be adopted. In addition, the bonds should be marketed broadly with active education regarding the nature of the bond issuance.
- FIPUG:** Staff witnesses have recommended criteria that will result in greater marketability and lower costs, these recommendations should be adopted, except the bonds cannot pledge the full faith and credit of the state or any local government.
- FRF:** The financing order should prescribe the ratepayer protections described in Staff witness Fichera’s testimony, especially the provisions by which the Commission would be actively involved at all times and in all stages of the structuring, marketing, and pricing of the storm-recovery bonds.
- AARP:** No position at this time.
- FEA:** Agree with FIPUG.
- AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The Commission is being asked to use its regulatory authority in a way that has never been previously done in Florida. (Fichera TR 1198) To achieve the maximum benefits of the storm recovery financing under Section 366.8260, Florida Statutes, and to minimize the financial burden on ratepayers, FPL should include an accurate and complete description of the credit risk of this investment in the marketing materials and offering documents. (Noel TR 1126–1127)

The storm recovery bonds that will be issued for the recovery of reasonable and prudently incurred storm damage restoration costs and the replenishment of the storm damage reserve that are the subject of this proceeding are very different from the typical bonds issued by FPL. (TR 1120) The Commission is being asked to forego future regulatory oversight in order to create a financing instrument of superior quality and a completely separate credit from the sponsoring utility. (TR 1198) Section 366.8260, Florida Statutes, requires the Commission to issue an irrevocable financing order in which the sponsoring utility is insulated from any and all costs associated with the financing. (Klein TR 1229) The Commission is also required to approve a true-up mechanism that commits the Commission to periodically adjust the storm recovery charge that supports the storm recovery bonds to whatever level is necessary to pay the bonds’

principal and interest on time. (TR 1230) In addition, the State and the Commission are required to pledge to the bondholders never to take or permit any action to be taken that would interfere with their right to payment. The irrevocable nature of the financing order, the direct broad-based storm charge applied to all FPL ratepayers, the unconditional Commission guarantee to adjust the storm charge as necessary, and the explicit pledge of the State not to interfere with the bondholders' rights to repayment result in an incredibly strong credit independent of FPL. (TR 1159)

Another difference between typical FPL bonds and storm recovery bonds is the degree of Commission oversight after the issuance. In typical utility debt financings the Commission retains the right to disallow any costs for ratemaking purposes, including adjustments for the interest rate. For the proposed issuance of storm recovery bonds, while the issuance costs are subject to review under Section 366.8260(2)(b)5., Florida Statutes, FPL argues that the interest rate on the bonds is not an issuance cost and is not subject to Commission review. (EXH 4, p. 445) Without conceding to FPL's interpretation of Section 366.8260(2)(b)5., Florida Statutes, regarding whether Commission review extends to the interest rate, the statute does state "the Commission may not make adjustments to the storm recovery charges for any such excess issuance costs."

The final difference between typical utility bonds and storm recovery bonds is how these bonds impact the Company's financial position. In more typical debt offerings, FPL has a strong incentive to negotiate hard with underwriters for the lowest possible interest rates as well as the lowest possible underwriting fees. FPL also has a strong incentive to minimize other issuance costs. Between rate cases, the benefit from a low net cost of funds is enjoyed at least in part by FPL's shareholders and the detriment from a high net cost of funds is borne at least in part by these same shareholders. These same checks and balances do not exist for the issuance of storm recovery bonds. (TR 1120) While typical utility bonds directly impact FPL's financial ratios, storm recovery bonds are not direct obligations of FPL and are non-recourse to FPL. (TR 1147–1149) Storm recovery bonds will not be recognized in the determination of FPL's debt coverage or other financial ratios. For these reasons, the same incentives and consequences for pursuing a lowest cost of funds with regard to FPL's typical utility bonds are not present with respect to the proposed storm recovery bonds. (TR 1120) Unless the superior credit quality of these bonds is accurately reflected in the marketing materials, the storm recovery bonds will not achieve the lowest cost of funds. (TR 1126–1127)

While FPL concedes that attaining low total cost, including both upfront and on-going issuance costs, is the single most important objective in judging the success of a securitization issuance, the Company does not agree that a lowest cost standard under prevailing market conditions and consistent with the terms of the financing order is a necessary or permissible standard to apply to the proposed issuance of storm recovery bonds. (Dewhurst TR 1684–1686)

FPL argues that the Commission should not impose a lowest cost of funds standard in this docket because the Legislature considered and rejected such a standard. FPL states that an early House version of the securitization law included language that explicitly provided a lowest cost of funds standard,<sup>14</sup> but that this language was removed in a subsequent House version,<sup>15</sup>

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<sup>14</sup> Committee Substitute 1 for House Bill 303, p. 11 of 32. (EXH 133)

<sup>15</sup> Committee Substitute 2 for House Bill 303, p. 10 of 31. (EXH 134)

was not present in the Senate's companion bill (SB 1366), and did not survive the legislative process. (FPL BR at 142-143) Citing Section 366.8260(2)(b)2.b., Florida Statutes, FPL asserts that the Legislature instead chose to impose a standard requiring the Commission to "[d]etermine that the proposed structuring, expected pricing, and financing costs of the storm-recovery bonds are reasonably expected to result in lower overall costs or would avoid or significantly mitigate rate impacts to customers . . . ." FPL claims that a lowest cost of funds standard is inconsistent with this standard, thus it cannot be adopted by the Commission.

Section 366.8260(2)(b)2.a.-j., Florida Statutes, sets forth the matters that the Commission is required to address in a financing order issued to an electric utility. Subparagraph g. of this section provides that the Commission, in its financing order, shall "[s]pecify the degree of flexibility to be afforded to the electric utility in establishing the terms and conditions of the storm-recovery bonds, including, but not limited to, repayment schedules, *interest rates*, and other financing costs." (Emphasis added.) Further, subparagraph j. of this section provides that the Commission shall include in its financing order "any other conditions that the commission considers appropriate and that are not otherwise inconsistent with this section." These provisions clearly provide the Commission with the authority to establish and apply a lowest cost of funds standard with respect to the issuance of storm-recovery bonds.

Contrary to FPL's arguments, adopting a lowest cost of funds standard as a condition to the financing order is entirely consistent with the law. First, FPL has mistakenly identified the standard for reviewing the costs of this type of transaction. FPL suggests that the standard is whether the proposed structuring, expected pricing, and financing costs of the storm-recovery bonds are reasonably expected to result in lower overall costs or would avoid or significantly mitigate rate impacts to customers. This is not the standard for reviewing the costs of the transaction; rather, it is the standard by which the Commission must determine whether to issue a financing order at all.<sup>16</sup> Notably, in the early House Bill cited by FPL, the standard asserted by FPL appears just prior to the "lowest cost" language FPL claims was rejected by the Legislature. (EXH 133) Accepting FPL's assertion, the early House Bill would have been at odds with itself because it would have included two different standards, side-by-side, for reviewing the same thing – cost of funds.<sup>17</sup> Clearly, as demonstrated by the early House Bill, there can be a standard for judging cost of funds that is different from, but not inconsistent with, the standard for determining whether to issue a financing order at all.

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<sup>16</sup> See Section 366.8260(2)(b)1.b., Florida Statutes, which provides that "[t]he commission shall issue a financing order authorizing financing of reasonable and prudent storm-recovery costs, the storm-recovery reserve amount determined appropriate by the commission, and financing costs if the commission finds that the issuance of storm-recovery bonds and the imposition of storm-recovery charges authorized by the order *are reasonably expected to result in lower overall costs or would avoid or significantly mitigate rate impacts to customers* as compared with alternative methods of financing or recovering storm-recovery costs and storm-recovery reserve." (Emphasis added.)

<sup>17</sup> Further, staff believes that the standard cited by FPL cannot be applied to cost of funds. FPL would have the Commission judge the cost of funds on the basis of whether the cost achieved is reasonably expected to result in lower overall costs, which leaves the obvious question: Lower than what? Or under FPL's analysis, the Commission could judge the cost of funds on the basis of whether the cost achieved is reasonably expected to mitigate rate impacts to customers, which again leaves the question: Mitigated as compared to what? These criteria are clearly at issue in determining whether to approve a financing order versus a more traditional surcharge, but cannot be applied with any meaning in judging cost of funds.

Second, FPL fails to point out that the “lowest cost” standard in the early House Bill was not eliminated. The early House Bill provided that in a financing order issued to a utility, the Commission was required, among other things, to “[e]nsure that the marketing, structuring, pricing, and financing costs of the storm recovery bonds will result in the lowest cost of the funds and the lowest storm recovery charges that are consistent with market conditions and the terms of the financing order.” (EXH 133) In the subsequent House version of the bill, this language was removed from subparagraph (2)(b)2. of the proposed law, but a “lowest cost” standard was added in subparagraph (2)(b)5. of the proposed law which provides for a post-issuance review of “the actual costs of the storm-recovery bond issuance.”<sup>18</sup> The law as enacted retained the new language. The law provides for the Commission to determine if “the actual costs of the storm-recovery bond issuance . . . resulted in the *lowest overall costs* that were reasonably consistent with market conditions at the time of issuance and the terms of the financing order.”<sup>19</sup> Staff believes this language provides evidence of the Legislature’s intent that the Commission ensure the transaction be conducted at the lowest cost.

FPL asserts in a conclusory fashion that interest rates on the storm-recovery bonds are not issuance costs under the securitization law and thus are not subject to the “lowest overall costs” criteria specified in subparagraph (2)(b)5. of the law. (FPL BR at 135). Yet the securitization law does not define “issuance costs,” and staff can find nothing in the law that supports the limited definition of issuance costs asserted by FPL.<sup>20</sup>

Also puzzling about FPL’s resistance to the use of a lowest cost standard with regard to the issuance of its proposed storm recovery bonds is the fact that FPL’s financial advisor in this proceeding has provided this exact form of certification on the behalf of Credit Suisse as the underwriter for other recent transactions involving the issuance of similar ratepayer-backed bonds. (EXH 167, pp. 64–67) In the most recent ratepayer-backed bond transactions in Texas and New Jersey, the sponsoring utilities, the lead-underwriter (in each case Credit Suisse), and the respective Commission financial advisors (in each case Saber Partners), each issued a certification to the effect that the respective transaction achieved the lowest ratepayer charges consistent with market conditions and the terms of the applicable financing order. (EXH 167, pp. 64–67) FPL will receive the same amount of money from the issuance of storm recovery bonds regardless of the level of the interest rates or other issuance costs, and regardless of the degree of Commission involvement in the issuance process. (TR 1214) To minimize the financial burden on FPL’s ratepayers, staff recommends use of the same lowest cost standard and degree of

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<sup>18</sup> Committee Substitute 2 for House Bill 303, p. 13 of 31.

<sup>19</sup> Section 366.8260(2)(b)5., Florida Statutes.

<sup>20</sup> Section 366.8260(1)(e), Florida Statutes, defines “financing costs” to include, among other things, “interest . . . payable on storm-recovery bonds” (subparagraph (1)(e)1.) and “any other cost related to issuing, supporting, repaying, and servicing storm-recovery bonds, including, but not limited to, servicing fees, accounting and auditing fees, trustee fees, legal fees, consulting fees, administrative fees, placement and underwriting fees, capitalized interest, rating agency fees, stock exchange listing and compliance fees, and filing fees, including costs related to obtaining the financing order” (subparagraph (1)(e)3.). Although “issuance costs” are not defined in the statute, FPL appears to define issuance costs as those items set forth in subparagraph(1)(e)3. (FPL BR at 135-137). Staff believes that this limited definition is not consistent with the language of the statute. The use of the word “other” to modify those costs “related to issuing, supporting, repaying, and servicing storm-recovery bonds” in subparagraph (1)(e)3. necessarily implies that the costs listed in prior subparagraphs, including interest as specified in subparagraph (1)(e)1., are also costs related to issuing, supporting, repaying, and servicing storm-recovery bonds. Hence, FPL’s definition of issuance costs fails to appreciate that the statute considers “interest payable on storm-recovery bonds” to be an issuance cost.

accountability for FPL's proposed transaction that has been successfully employed in ratepayer-backed bond transactions in these other recent ratepayer-backed bond transactions. (TR 1182, 1188, 1200–1202)

This said, having the principal transaction parties certify that they achieved the lowest cost under prevailing market conditions and consistent with the terms of the financing order with regard to the issuance of ratepayer-backed bonds by itself is not sufficient to ensure that ratepayers receive the greatest benefit of this special form of financing. (TR 1164) Unless the sponsoring utility is committed to pursuing a lowest cost transaction by accurately communicating the unique and high quality characteristics of the proposed ratepayer-backed bonds, the bonds will not trade at the spreads commensurate with the value and safety of these bonds. (TR 1126–1127; 1164) Despite an explicit lowest cost standard in the New Jersey statute, the results have not always been the lowest cost relative to the value of comparable securities. From 2001 – 2004, the utilities, underwriters, and the New Jersey Commission's financial advisors were allowed to place significant qualifications on the lowest cost standard in their certifications. Rather than being strictly held to a lowest cost standard in the certification process, the utilities and their underwriters were allowed to qualify certain aspects of their certifications with terms such as "reasonable" and other means to avoid accountability for their certifications. In contrast, for the 2005 transaction for the benefit of Public Service Electric & Gas (PSE&G), the New Jersey Commission and its financial advisor eliminated these provisions by adopting the Texas Commission financing order certification model. As shown on Exhibit 100, the spread for the 2005 PSE&G transaction was considerably tighter (i.e., less expensive to ratepayers) than any previous ratepayer-backed bond transaction completed in New Jersey. (TR 1126–1127; EXH 100)

To achieve the maximum benefits of the storm recovery financing under Section 366.8260, Florida Statutes, and to minimize the financial burden on ratepayers, FPL should include an accurate and complete description of the credit risk of the storm recovery bonds in the marketing materials and offering documents. (TR 1126–1127) To this end, the financing order should include ordering paragraphs, findings of fact, and conclusions of law that will give appropriate comfort to investors about the high quality of storm recovery bonds as a potential investment as described in the recommendation statement.

The securitization law provides many important protections for bondholders to enhance the marketability of the bonds and achieve a lowest cost transaction. Pursuant to Section 366.8260(11)(b), Florida Statutes, the state provides a pledge to bondholders to ensure its support of the bonds:

The state pledges to and agrees with bondholders, the owners of storm-recovery property, and other financing parties that the state will not:

1. Alter the provisions of this section which make the storm-recovery charges imposed by a financing order irrevocable, binding, and non-bypassable charges;
2. Take or permit any action that impairs or would impair the value of storm-recovery property; or

3. Except as allowed under this section, reduce, alter, or impair storm-recovery charges that are to be imposed, collected, and remitted for the benefit of the bondholders and other financing parties until any and all principal, interest, premium, financing costs and other fees, expenses, or charges incurred, and any contracts to be performed, in connection with the related storm-recovery bonds have been paid and performed in full.

The law further provides that any entity that issues storm-recovery bonds may include this pledge in the bonds and related documentation.<sup>21</sup>

After storm-recovery property has been transferred to an assignee or storm-recovery bonds have been issued (whichever comes first), the Commission's financing order becomes irrevocable and the Commission is not permitted to "amend, modify, or terminate the financing order" or "reduce, impair, postpone, terminate, or otherwise adjust storm-recovery charges in the financing order." Section 366.8260(2)(b)6., Florida Statutes.

There are only two conditions under which the financing order may be adjusted.<sup>22</sup> First, storm-recovery charges will be adjusted either up or down on a periodic basis pursuant to a formula-based true-up mechanism approved in the financing order.<sup>23</sup> These adjustments "shall ensure the recovery of revenues sufficient to provide for the payment of principal, interest, acquisition, defeasance, financing costs, or redemption premium and other fees, cost, and charges in respect of storm-recovery bonds approved under the financing order." Section 366.8260(2)(b)4. As noted in Issue 83, this true-up mechanism should be used at least every six months. Application of the true-up mechanism is subject to review only for mathematical accuracy.<sup>24</sup> Second, at the utility's request, the Commission may conduct a proceeding and issue a new financing order that provides for retiring and refunding storm-recovery bonds issued under the original financing order if the Commission determines that the new order satisfies the statutory criteria for issuance of a financing order.<sup>25</sup> In that event, the Commission may adjust the related storm-recovery charges as appropriate upon retirement of the refunded bonds and issuance of the new bonds.

In addition, the Commission is required in a financing order to provide that "storm-recovery charges authorized in the financing order shall be paid by all customers receiving transmission or distribution service from the electric utility or its successors or assignees under commission-approved rate schedules or under special contracts, even if the customer elects to purchase electricity from an alternative electric supplier following a fundamental change in regulation of public utilities in the state."<sup>26</sup> Hence, regardless of a change in corporate structure or even a change in regulatory scheme, the securitization law provides for repayment of the bonds through non-bypassable charges.

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<sup>21</sup> Section 366.8260(11)(c), Florida Statutes.

<sup>22</sup> Section 366.8260(2)(b)6., Florida Statutes.

<sup>23</sup> Section 366.8260(2)(b)4., Florida Statutes. See Issue 82 for discussion of the true-up mechanism.

<sup>24</sup> Id.

<sup>25</sup> Section 366.8260(2)(c), Florida Statutes.

<sup>26</sup> Section 366.8260(2)(b)2.c., Florida Statutes.



To enhance the marketability of the storm-recovery bonds, the Commission should find that the investor protections established through the above provisions – the irrevocable nature of the financing order, the broad nature of the state pledge, the required ongoing application of the true-up mechanism, and the required imposition of non-bypassable charges – constitute a guarantee of regulatory action for the benefit of investors in storm recovery bonds. (Fichera TR 1153–1154)

It is clear under the securitization law that such a guarantee does not make the state or the Commission liable in any way for repayment of the bonds. As noted in Section 366.8260(9), Florida Statutes, all storm-recovery bonds must provide a statement on their face to the effect that “Neither the full faith and credit nor the taxing power of the State of Florida is pledged to the payment of principal of, or interest on, this bond.”<sup>27</sup>

In addition, based on the statutory provisions discussed above, the Commission should find that its obligations under the financing order relating to the storm recovery bonds, including the specific actions the Commission guarantees to take (i.e., implementation of the true-up mechanism and adherence to the state pledge), are direct, explicit, irrevocable, and unconditional upon the issuance of storm recovery bonds, and are legally enforceable against the Commission, a United States public sector entity. This finding will enhance the marketability of the bonds and help achieve the lowest possible cost by qualifying the bonds for a 20% risk weighting. A 20% risk weighting can help expand the market for these bonds to an international level, in turn increasing competition and lowering cost. (Fichera TR 1172; EXH 94) In making this finding, the Commission would not be guaranteeing repayment; as noted above, the securitization law makes clear that neither the state nor the Commission shall be liable in any way, directly or indirectly, for repayment of the bonds other than in the state’s capacity as a purchaser of electricity delivered by FPL. Rather, the Commission would find that its obligations under the securitization law are legally enforceable against it, but to no greater extent than those obligations would be legally enforceable absent a separate finding.

Finally, the financing order should require fully accountable certifications from the lead underwriter(s), FPL, and the Commission’s financial advisor that the actual structure, marketing, and pricing of the storm recovery bonds in fact resulted in the lowest storm recovery charges consistent with then-prevailing market conditions and the terms of the financing order and other applicable law. If the Commission determines that all required certifications have been delivered and that the transaction complies with the financing order and other applicable law, the transaction would proceed without any further Commission action, as discussed in Issue 74B. Staff believes that if the transaction proceeds on these terms, any costs, including interest, addressed in the lowest cost certifications likely would not need further review in the post-issuance review under Section 366.8260(2)(b)5., Florida Statutes.

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<sup>27</sup> Section 366.8260(9), Florida Statutes.

**Issue 62:** Should all legal opinions and other transaction documents and subsequent amendments be filed and approved by the Commission before becoming operative?

**Recommendation:** All transaction documents and subsequent amendments should be reviewed and approved by the Bond Team as discussed in Issue 74B before becoming operative. All legal opinions associated with the proposed storm recovery bond transaction should be submitted to the Commission automatically without requiring the Commission to specifically request the documents. (Keating, Maurey)

**Position of the Parties**

**FPL:** Documents submitted with the Petition include a Storm-Recovery Property Sale Agreement, Administration Agreement, and Storm-Recovery Property Servicing Agreement, Indentures, and Limited Liability Company Agreement. The substance of the agreements should be approved in connection the financing order, subject to changes as part of the Commission Pre-Issuance Review Process. The agreements themselves require Commission approval of amendments. Forms of legal opinions should be delivered for review as requested by the Commission, but should not be subject to Commission approval.

**OPC:** Yes.

**FIPUG:** Adopts the position of OPC.

**FRF:** Yes.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** While it is reasonable to approve the general concept that certain legal opinions and other transaction documents will be necessary elements of the proposed transaction, the specific terms, conditions, covenants, warranties, representations, and specific language contained in the documents will be impacted by the Commission's decisions on other issues and must be reviewed in consideration of the financing order approved by the Commission.

The transaction documents that are the subject of this issue will have a meaningful impact on the structure, marketing, and pricing of the storm recovery bonds. (Fichera TR 1189–1190) The majority of the documents submitted to date for consideration in this proceeding are simply shells or templates of the actual documents. (EXH 33–39) In some cases, there is no substantive information for the Commission to actually consider and approve. (Appendices A and B to Exhibit B of FPL's petition) In other cases, the draft financing order as an example, staff will recommend the Commission make certain additions, deletions, and modifications before the documents become operative. (See discussion in Issues 61 and 74B) For these reasons, staff recommends that all transaction documents and any subsequent amendments be reviewed by the Bond Team and be approved before any of the documents become operative. (TR 1187–1190)



With respect to legal opinions regarding the storm recovery bond transaction, staff recommends the Commission require FPL to submit these opinions automatically to staff without the need for the Commission or its staff to specifically request the documents. (FPL BR at 146) In addition, as part of the review process discussed in Issue 74B, it is recommended that FPL and the Commission (the Bond Team) employ a competitive process in selecting, among equally qualified firms, the various law firms that will ultimately be required for the documentation, marketing, and execution of the proposed financing. (EXH 132, p. 2) Finally, FPL attempts to distinguish legal opinions from other transaction documents and says such opinions do not require Commission approval. (FPL BR at 147) Staff does not agree with FPL on this point. Staff recommends that any transaction documents or legal opinions that will have an impact on the structure, marketing, and pricing of the storm recovery bonds be reviewed and approved by the Bond Team before becoming operative as discussed in Issue 74B.

**Issue 63:** Is FPL's proposed Staff Pre-Issuance Review Process reasonable and should it be approved?

**Recommendation:** No, FPL's proposed staff pre-issuance review process is not reasonable as filed and should not be approved. For the reasons outlined below, the pre-issuance review process discussed in Issue 74B should be approved. (Maurey)

**Position of the Parties**

**FPL:** Yes. FPL believes that the proposed Staff Pre-Issuance Review process will enable the Commission, through its Staff, to ensure that any issuance of bonds pursuant to the financing order is in compliance with that Order. If the Commission wishes to take a more active role in the pre-issuance process, it should adopt a procedure consistent with FPL's proposal submitted in response to new sub-issue (b) under Issue 74.

**OPC:** No. The process outlined by FPL in its petition, proposed order, and testimony, does not allow the active participation of the Commission. FPL's process does not afford independent protection for the ratepayers to ensure that the up-front costs, on-going costs, and interest rates achieve the lowest overall cost based on real time market conditions. Therefore, FPL's proposed process is not reasonable and should not be approved.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Because the process proposed by FPL in its filings does not provide for the active participation of the Commission, FPL's process does not afford adequate protection for its customers with regard to up-front costs, issuance costs, ongoing costs, and interest rates. Accordingly, FPL's proposed process should not be approved.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** FPL has made significant movement with respect to making the proposed storm recovery bond transaction more transparent. From its initial proposal of filing certain documents 30 days in advance and the issuance advice letter five days in advance of the launch date (Olson TR 683–684), the Company has now agreed to the formation of a “bond team” comprised of the Commission and/or staff plus their outside legal counsel and financial advisors to work with the utility, the underwriters, and their respective counsels. (Olson TR 1480–1482) However, there continue to be key differences of opinion regarding how ratepayers' interests will be represented in the actual pricing of the storm recovery bonds, the appropriate standard to apply in determining a successful transaction, and the degree of accountability for the outcome of the transaction. The first point is discussed in Issue 74B. The latter two points are discussed in Issue 61. To afford the Commission an opportunity to make an informed decision with regard to

the reasonableness of the issuance of storm recovery bonds, the Commission should participate in the proposed transaction as discussed in Issue 74B. (Klein TR 1233–1236; Noel TR 1120–1123; Fichera TR 1185–1190; Olson TR 1480–1482)

**Issue 64:** Should the Financing Documents be approved in substantially the form proposed by FPL, subject to modifications as addressed in the draft form of financing order?

**Recommendation:** No. While it is reasonable to approve the general concept that the financing documents will be necessary elements of the proposed transaction, the specific terms, conditions, covenants, warranties, representations, and specific language contained in the documents will be impacted by the Commission's decisions in other issues and must be reviewed in consideration of the financing order approved by the Commission as discussed in Issue 74B. (Maurey)

**Position of the Parties**

**FPL:** Yes. Documents submitted with the Petition include a Storm-Recovery Property Sale Agreement, Administration Agreement, and Storm-Recovery Property Servicing Agreement, Indentures, and Limited Liability Company Agreement. The substance of the agreements should be approved in connection the financing order, subject to changes as part of the Commission Pre-Issuance Review Process. The agreements themselves require Commission approval of amendments. Forms of legal opinions should be delivered for review as requested by the Commission, but should not be subject to Commission approval.

**OPC:** No position.

**FIPUG:** FIPUG supports the testimony of Staff witness Fichera.

**FRF:** If the Commission approves recovery through securitization, the Financing Documents should incorporate, to the extent applicable and practicable, the "best practices" and "financing order recommendations" set forth in Staff witness Fichera's testimony.

**AARP:** No position.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The financing documents that are the subject of this issue are referenced in FPL's position above. While it is reasonable to approve the general concept that the financing documents will be necessary elements of the proposed transaction, the specific terms, conditions, covenants, warranties, representations, and specific language contained in the documents will be impacted by the Commission's decisions in other issues and must be reviewed in consideration of the financing order approved by the Commission. (TR 1186–1187) In addition, FPL notes in its brief that the financing documents shall be subject to additions, deletions, and modifications as may be necessary subject to negotiations regarding the structure, marketing, and pricing of the storm recovery bonds. (FPL BR at 147–148)

It would be premature for staff to spend a large block of time reviewing and making recommendations for substantive changes to the transaction documents until the Commission has issued its financing order in this docket, providing guidance on what terms will be appropriate

for these transaction documents. Thus, it would be inappropriate for the Commission's financing order to approve the transaction documents in substantially the form filed by FPL. Rather, the financing order should authorize FPL and the SPE to enter into the required transaction documents (e.g., the indenture, the storm recovery property sale agreement, the servicing agreement, the administration agreement, and the LLC agreement), but leave the terms of those transaction documents to be approved by the Commission's designated personnel and financial advisor taking into account the requirements of the financing order. For these reasons, staff recommends the Commission approve the general concept of the financing documents but reserve final approval of the actual language until such time the Commission, its staff, its outside counsel, and financial advisor has had an opportunity to review the proposed financing documents relative to the financing order issued by the Commission. Approval of these documents should occur during the review process discussed in Issue 74B.

**Issue 65:** Should the Issuance Advice Letter be approved in substantially the form proposed by FPL?

**Recommendation:** No. The draft issuance advice letter in the form proposed by FPL does not provide sufficient detail for the Commission to make an informed decision regarding the proposed storm recovery bond issuance. (Maurey)

**Position of the Parties**

**FPL:** Yes. The draft issuance advice letter will provide the most current and up-to-date information concerning the final terms and conditions that only becomes available as the launch date for a bond series becomes very near.

**OPC:** No position.

**FIPUG:** FIPUG supports the testimony of Staff witness Fichera.

**FRF:** No position.

**AARP:** No position.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** FPL has proposed filing a draft issuance advice letter at least five days prior to the expected launch date for the sale of the storm recovery bonds. (Olson TR 683) The draft issuance advice letter proposed by FPL will reflect the preliminary bond structuring information for the proposed issuance, the expected and final maturities, over-collateralization levels, any other credit enhancements, and revised estimates of the upfront bond issuance costs proposed to be financed from proceeds of the bonds and estimates of debt service and other on-going costs for the first collection period. (TR 683)

The Commission should require FPL to file the issuance advice letter (IAL) and initial true-up letter (combined into one document) in draft form at least two weeks prior to pricing based upon the best information available at that time, and in final form on the day of pricing or within one business day of pricing. (Fichera TR 1191–1194; 1216) In addition, the final IAL should contain detailed analyses and representations regarding the actual structuring, marketing, and pricing of the bonds, as well as the initial storm recovery charges. (Klein TR 1233) In addition to the information suggested by FPL for inclusion in the IAL, other factors that should be addressed include the actions taken by the Company in the marketing of the bonds; a comparison of the pricing relative to an independent benchmark versus other similar securities historically and at the time of pricing; the amount of orders received and from whom; and other factors the Commission, its staff, and its financial advisor consider in their expert judgment to be necessary. (TR 1234) Finally, the IAL should include certifications from FPL, from the underwriters, and from the Commission's financial advisor that the structuring, marketing, and pricing of the storm recovery bonds resulted in the lowest cost of funds consistent with

prevailing market conditions and the terms of the financing order. (TR 1233–1234) The portion of this filing relating to the initial true-up letter is discussed in Issue 66.

The IALs filed in numerous successful Texas securitization transactions provide the Texas Commission with this level of detail. (TR 1240–1241; EXH 101) In contrast, the draft IAL as proposed by FPL is a simple summary of the key terms of the transaction. (Appendix A to Exhibit B of FPL’s petition) To afford the Commission an opportunity to render an informed decision regarding the outcome of the proposed storm recovery bond issuance, staff recommends the Commission require FPL to file an IAL with sufficient representations and detailed analyses to demonstrate that the parties took all reasonable steps to produce the lowest cost transaction consistent with prevailing market conditions and the terms of the financing order. The proposed draft issuance advise letter filed by FPL is not sufficient.

**Issue 66:** Should the Initial True-up Letter be approved in substantially the form proposed by FPL?

**Recommendation:** No. While it is reasonable to approve the true-up mechanism proposed by FPL, if the Commission adopts staff's recommendation that the issuance advice letter be expanded to include the initial storm recovery charges, there should be no need for a separate initial true-up letter. (Maurey)

**Position of the Parties**

**FPL:** Yes. The Initial True-up letter as proposed by FPL will provide Staff, acting at the Commission's direction, information necessary to ensure that any proposed issuance complies with the financing order.

**OPC:** No position.

**FIPUG:** FIPUG supports the testimony of Staff witness Fichera.

**FRF:** No position.

**AARP:** No position.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The initial true-up letter provides the projected initial storm bond repayment charges and storm bond tax charges for each customer class resulting from the preliminary bond structuring information and the application of the formula approved in the financing order. The initial true-up letter also includes the draft tariff sheets implementing the storm recovery charges. (Olson TR 683-684)

In Issue 82, staff recommends certain additions to FPL's proposed true-up mechanism filing to provide staff with the additional information necessary to conduct a timely review of FPL's future true-up filings. While it is reasonable to approve the true-up mechanism proposed by FPL, if the Commission adopts staff's recommendation in Issue 65 that the issuance advice letter be expanded to include the initial storm recovery charges, there should be no need for a separate initial true-up letter. (Fichera TR 1186)



**Issue 67:** How should the Commission ensure that the structure, marketing, and pricing of the storm recovery bonds result in the lowest possible burden on FPL's ratepayers?

**Recommendation:** The ratepayers should be effectively represented throughout the life cycle of the proposed transaction. The Commission can ensure the structure, marketing, and pricing of the storm recovery bonds resulted in the lowest possible burden on FPL's ratepayers consistent with prevailing market conditions and the terms of the financing order by participating in the transaction as discussed in Issue 74B. (Maurey)

**Position of the Parties**

**FPL:** A financing order in the form submitted with the Petition, including the proposed findings of fact and conclusions of law, contains provisions consistent with the statute and necessary to facilitate triple-A credit ratings, providing the requisite investor confidence in the storm-recovery bond issuance, and resulting in an efficient and cost-effective financing. If the Commission wishes to take an active role in directing and overseeing the issuance process, it should employ the approach recommended by FPL in response to sub-issue 74(b).

**OPC:** The Commission should adopt the "best practices" standard which includes active participation by the Commission, its staff, and financial advisors in the bond issuance process.

**FIPUG:** Adopts the position of OPC.

**FRF:** If the Commission determines to approve securitization, then the Commission should adopt the "best practices" standard.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** The ratepayers should be effectively represented throughout the life cycle of the proposed transaction when information and options are being evaluated and decisions are being made that impact the ultimate cost to ratepayers. It is difficult, if not impossible, to evaluate such decisions after the fact. (Fichera TR 1198–1202; Klein TR 1232–1234) The Commission can ensure the structure, marketing, and pricing of the storm recovery bonds resulted in the lowest possible burden on FPL's ratepayers consistent with prevailing market conditions and the terms of the financing order by including findings of fact, conclusions of law, and ordering paragraphs in the financing order as discussed in Issues 61 and 74B; by participating in the transaction review process as discussed in Issue 74B; and by insisting on accountability of the principal transaction parties by requiring lowest cost certifications as discussed in Issue 65.

**Issue 68:** Is the “proposed structure, expected pricing and financing costs of the storm-recovery bonds reasonably expected to result in lower overall costs or avoid or significantly mitigate rate impacts to customers as compared with alternative methods of recovery?”

**Recommendation:** As discussed in Issue 39, the proposed structure, expected pricing, and financing costs of the storm recovery bonds cannot be expected to result in lower overall costs to ratepayers as compared with alternative methods of recovery of reasonable and prudently incurred storm damage restoration costs and replenishment of the storm damage reserve. However, issuance of storm recovery bonds is reasonably expected to mitigate rate impacts to customers as compared with alternative methods of recovery. By adopting the processes recommended in Issues 61, 65, and 74B, the Commission can maximize the rate mitigation impact of securitization. (Maurey)

**Position of the Parties**

**FPL:** Yes. This statutory standard adopted by the legislature in Section 366.8260(2)(b)2.b., Florida Statutes (2005), is met by FPL’s proposal, a primary benefit of which is to immediately replenish the Reserve and to “smooth out” the significant rate impact of an extreme sub-period of storm activity, making it a useful tool for recovery of existing deficits and replenishment of the Reserve.

**OPC:** Yes, but only if the Commission takes an active role in the bond issuance process and does not approve FPL’s proposed methodology. To ensure that the issuance of storm-recovery bonds results in the lowest overall costs to ratepayers compared with the alternative methods of financing, the “best practices” outlined in Commission staff witness Fichera’s direct testimony should be adopted including active participation by the Commission, its staff, and financial advisors which ensures ratepayer protection.

**FIPUG:** No. FIPUG supports a 3 year surcharge, which will provide considerable savings to customers on interest, taxes and financing costs.

**FRF:** No. Without the ratepayer protections, including the "best practices," described in Staff witness Fichera's testimony, the proposed structure, pricing, and financing costs cannot be reasonably expected to provide appropriate and available benefits to FPL's ratepayers.

**AARP:** Agree with OPC.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** As discussed in Issue 39, the proposed structure, expected pricing, and financing costs of the storm recovery bonds cannot be expected to result in lower overall costs to ratepayers as compared with alternative methods of recovery of reasonable and prudently incurred storm damage restoration costs and replenishment of the storm damage reserve. However, issuance of storm recovery bonds is reasonably expected to mitigate rate impacts to

customers as compared with alternative methods of recovery. (Dewhurst TR 113–114) By adopting the processes recommended in Issues 61, 65, and 74B, the Commission can maximize the rate mitigation impact of securitization. (Fichera TR 1198–1202) To provide the Commission with the access necessary to make informed decisions with regard to the structure, marketing, and pricing of the storm recovery bonds and to ensure ratepayer interests are effectively represented throughout the life cycle of the transaction, the Commission should participate in the proposed transaction as discussed in Issue 74B. (Klein TR 1233–1236; Noel TR 1120–1123; Fichera TR 1185–1190; Olson TR 1480–1482)

**Issue 69:** WITHDRAWN

**Issue 70:** WITHDRAWN

**Issue 71:** What flexibility should FPL be afforded in establishing the terms and conditions of the storm recovery bonds, including, but not limited to, repayment schedules, interest rates, and other financing costs, as well as the use of floating rate securities, interest rate swaps, and call provisions?

**Recommendation:** FPL and the Commission should work together in a collaborative process to allow for flexibility by the principal transaction parties (Bond Team) to ensure that the lowest overall costs consistent with prevailing market conditions and the terms of the financing order are achieved. (Maurey)

**Position of the Parties**

**FPL:** FPL should be afforded flexibility described in the proposed financing order including: issue bonds in one or more series and tranches; reduce the amount of issuance if necessary to maintain the initial average retail charge below the current storm surcharge; recover certain costs through the storm charge subject to true-up; utilize floating rate securities and interest rate swaps; change the amortization period up to one year to accommodate market preferences; and include call provisions.

**OPC:** The Commission and FPL should work together in a collaborative process as described in the “best practices” standard to allow for flexibility by the parties to ensure that the lowest overall costs are obtain for the benefit of the ratepayers.

**FIPUG:** Adopts the position of OPC.

**FRF:** Agree with OPC. Additionally, the Commission should ensure that any post-approval exercise of flexibility is demonstrated, in appropriate proceedings that afford substantially affected parties a point of entry, to provide real, measurable benefits to customers, and that FPL's customers are protected from any adverse consequences of imprudent FPL decisions pursuant to allowed flexibility.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** FPL and the Commission should work together in a collaborative process to allow for flexibility by the principal transaction parties (Bond Team) to ensure that the lowest overall costs consistent with prevailing market conditions and the terms of the financing order are achieved. (Olson TR 1480; Klein TR 1232–1233) A general framework for this collaborative process is discussed in Issue 74B.

**Issue 72:** STIPULATED: If the Commission approves FPL's proposed financing order, should FPL be allowed to establish a regulatory asset for the amount to replenish the Reserve?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "Yes." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation. A regulatory asset should be established for the amount to replenish the Reserve if the Commission approves FPL's proposed financing order.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "Yes." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation. A regulatory asset should be established for the amount to replenish the Reserve if the Commission approves FPL's proposed financing order.

**Issue 73:** STIPULATED: Should the Commission authorize FPL to establish a separate regulatory asset for the storm recovery property sold to the SPE and a separate regulatory asset for income taxes payable on the storm recovery costs to be financed?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "Yes." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation. The Commission should authorize FPL to establish a separate regulatory asset for the storm recovery property sold to the SPE and a separate regulatory asset for income taxes payable on the storm recovery costs to be financed.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "Yes." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation. The Commission should authorize FPL to establish a separate regulatory asset for the storm recovery property sold to the SPE and a separate regulatory asset for income taxes payable on the storm recovery costs to be financed.

**Issue 74:** Based on resolution of the preceding issues, should a financing order in substantially the form proposed by FPL be approved, including the findings of fact and conclusions of law as proposed?

**Recommendation:** No. The form of the financing order, including the findings of fact and conclusions of law, proposed by FPL should be revised to reflect resolution of all issues in this proceeding. (Maurey, Keating)

**Position of the Parties**

**FPL:** Yes. The proposed financing order, including the findings of fact and conclusions of law, contains provisions consistent with the statute and necessary to facilitate AAA credit ratings, providing the requisite investor confidence, and resulting in an efficient and cost-effective financing. FPL's financing order provides the Commission with flexibility to be involved in every critical step of the process; however, if the Commission decides to take a direct and active role, it should adopt measures outlined in sub-issue 74(b).

**OPC:** No, the financing order needs to reflect the Commission's decision in this proceeding including findings of fact and law.

**FIPUG:** Adopts the position of OPC.

**FRF:** No. Agree with OPC that, assuming that the Commission approves securitization such that a financing order is needed, the financing order needs to reflect the Commission's decisions in this proceeding, including findings of fact and conclusions of law.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with OPC.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** This is a fall-out issue based on decisions rendered in other issues. Please see Issues 61 and 74B for a discussion of the terms, conditions, representations, findings of fact, conclusions of law, and ordering paragraphs staff recommends the Commission include in the financing order.

**Issue 74A:** If the Commission votes to issue a financing order, what special procedures (if any) should be used after the Commission vote and before the issuance of the financing order to ensure that the order accurately reflects the Commission's decision and meets the anticipated requirements of the financial community?

**Recommendation:** The Commission staff should hold an informal meeting with the parties and their financial advisors during the week of May 22, 2006, to review and obtain input on the portions of the financing order relating to securitization. Any party who believes that the order as issued does not accurately and properly reflect the Commission's decisions has the right to request reconsideration within 5 days after issuance of the order. (Keating, Maurey)

**Position of the Parties**

NOTE: Only OPC stated a separate position on this sub-issue. The position stated for FPL represents staff's synopsis of its discussion of the sub-issue.

**FPL:** Commission staff should provide FPL with a mark-up of the proposed form of financing order (exclusive of provisions that relate strictly to the prudence issues in this case) on or before May 18. The parties should participate in an informal meeting in Tallahassee on May 22, and if necessary with the Prehearing Officer on May 23, to resolve any disputed issues and work to achieve a financing order than minimizes potential conflict. Any issues that cannot be separately resolved by the parties shall be resolved by the Prehearing Officer.

**OPC:** Commission should hold at least one informal meeting of the parties after the Commission vote and prior to the issuance of the financing order to ensure that the financing order meets all requirements. A draft of the order should be provided to the parties for their comments. Any disputes should be addressed by the Commission at an Agenda Conference.

**FIPUG:** No position.

**FRF:** No position.

**AARP:** No position.

**FEA:** Agree with OPC.

**AG:** No position.

**Staff Analysis:** The customary practice in Commission dockets is for staff to prepare a final order reflecting the Commission's decisions without further input from the parties. In this case, the precise wording chosen to reflect the Commission's decisions regarding the securitization portions of the order may affect FPL's ability to issue securitized bonds on the most favorable terms. Staff, therefore, recommends a collaborative process in which staff, the parties, and their financial advisors and legal counsels would hold an informal meeting during the week of May 22, 2006, to review a draft of the securitization portions of the financing order prior to its issuance.



Staff believes that the Commission's normal post-order procedures for reconsideration and/or clarification provide sufficient opportunity for any party who is concerned about the specific language of the financing order to seek review by the full Commission. By statute, the deadline for filing petitions for reconsideration in securitization proceedings is 5 days after the issuance of the financing order. (Section 366.8260(2)(b)1.b., Florida Statutes) The financing order is scheduled to be issued on Tuesday, May 30, 2006. Under Rule 28-106.103, Florida Administrative Code, when the period of time allowed for an action by any applicable statute is less than 7 days, intermediate Saturdays, Sundays and legal holidays are excluded from the computation. Thus, the deadline for petitions for reconsideration and/or clarification will be Tuesday, June 7, 2006.

**Issue 74B:** If the Commission votes to issue a financing order, what post-financing order regulatory oversight is appropriate and how should that oversight be implemented?

**Recommendation:** The ratepayers should be effectively represented throughout the proposed transaction. The Commission, its staff, its outside counsel, and its financial advisor, along with FPL, FPL's financial advisor, and its counsel should work in a collaborative process to ensure the structuring, marketing, and pricing of the storm recovery bonds result in the lowest cost consistent with prevailing market conditions and the terms of the financing order. The Commission should be represented primarily by its staff, who should be advised by the Commission's financial advisor and outside counsel. Staff should periodically brief the Commissioners and the parties on the progress of the transaction. Issues that arise during the process that cannot be resolved collaboratively should be submitted in writing to a designated Commissioner for guidance. If any party objects to the designated Commissioner's proposed resolution, the matter should be submitted to the Commission for *de novo* consideration. The final structure of the transaction, including pricing, should be subject to review by the full Commission for the limited purpose of ensuring that all requirements of law and the financing order have been met. The Commission should specifically determine that the fees and expenses of its financial advisor and outside counsel in this post-financing order collaborative process are entitled to payment from the bond proceeds. (Maurey, Keating)

**Position of the Parties**

NOTE: Only OPC stated a separate position on this sub-issue. The positions stated for FPL and FEA represent staff's synopsis of their discussion of the sub-issue.

**FPL:** FPL and the Commission should designate the members of a "bond team." The Commission should be represented on the bond team by the Prehearing Officer, who may be advised by the Commission's staff and financial advisor. The bond team should expect to meet by conference call no less than weekly. Any disputes relative to the transaction documents or the issuance, structuring, marketing, and pricing process that the Commission has reserved the authority to resolve shall be heard by the Prehearing Officer. Any party represented on the bond team should have the opportunity to have the Prehearing Officer's decision reviewed *de novo* by the full Commission.

**OPC:** Commission should take an active role in the issuance process. Parties should receive periodic updates on the status of the transaction through designated Commission staff. The Commission should retain final decision making authority. Any disputes should be addressed by the Commission either at an Agenda Conference with shortened recommendation filing as necessary or through the use of a designated Commissioner as a hearing officer. Parties should be provided a point of entry if there are future disputes.

**FIPUG:** No position.

**FRF:** No position.

**AARP:** No position.

**FEA:** Agree with OPC.

**AG:** No position.

**Staff Analysis:**

**Procedural Options for Active Commission Participation**

There are a number of potential options for Commission participation in the review and approval of the final transaction documents and in the collaborative process for structuring, marketing and pricing of the storm recovery bonds. Staff believes that the option selected should balance the need for an efficient process that does not unduly delay the issuance of the bonds with the need to ensure that ratepayer interests are adequately protected. If the Commission decides to use the "Bond Team" approach, there are three basic decisions to be made:

Decision 1: Who should participate on behalf of the Commission in day-to-day activities of the Bond Team? Options include:

- the Commission staff, financial advisor and counsel
- a designated Commissioner, staff, financial advisor and counsel
- a panel of Commissioners, staff, financial advisor and counsel
- the full Commission, staff, financial advisor and counsel

Staff recommends that day-to-day participation should be through the Commission staff, advised by the Commission's financial advisor and counsel. Due to the anticipated frequency of meetings and/or conference calls, staff believes it is impractical for one or more Commissioners to participate in light of other demands on Commissioners' time. In addition, notice requirements under the Sunshine Law could delay the process if a panel of Commissioners (or the full Commission) is designated to participate. If staff's recommendation is adopted, staff can brief Commissioners on the progress of the transaction at whatever frequency individual Commissioners desire.

Decision 2: What process should be used to resolve any issues on which the Bond Team members are unable to reach agreement? Options include:

- decision by the Commission staff and/or financial advisor acting pursuant to authority delegated in the financing order, subject to *de novo* review by the full Commission
- decision by a designated Commissioner, subject to *de novo* review by the full Commission
- decision by a panel of Commissioners, subject to *de novo* review by the full Commission
- decision by the full Commission

Staff recommends that any issue that the Bond Team participants are unable to resolve should initially be presented in writing for resolution by a designated Commissioner, subject to *de novo* review by the full Commission. This approach: (i) avoids any potential concern about the scope of authority that can properly be delegated to the Commission staff and/or financial advisor; (ii) recognizes that if the Commission staff and/or advisor cannot informally resolve the issue with FPL, the issue appropriately should be resolved at a higher level; and (iii) avoids the delay that would be introduced by Sunshine Law requirements and Commissioner scheduling concerns if disputes initially had to be submitted to a panel of Commissioners or the full Commission.

All parties who took a position on this issue indicated that it would be acceptable for a single Commissioner to initially resolve such issues, provided that parties had the right to seek *de novo* review by the full Commission or some other point of entry. (FPL BR at 162; OPC BR at 113) Staff agrees that *de novo* review would be appropriate in this unique situation. The designated Commissioner's decisions could affect the substantive rights of the parties in a way that is fundamentally different from routine Prehearing Officer decisions that are reviewed under the highly deferential reconsideration standard. Staff recommends that all parties to this docket should be provided notice of any dispute taken to the designated Commissioner and provided the opportunity for comment before the designated Commissioner. All parties should also be provided notice of any decision reached by the designated Commissioner.

The parties do not appear to agree on who should have the right to seek full Commission review of a determination made by the designated Commissioner. FPL would limit the right to parties represented on the Bond Team (i.e., FPL and the Commission) whereas the Intervenor would extend the right to all parties. Because the specific features of the securitization transaction can affect the rates to be paid by consumers, and hence the substantial interests of the parties, staff recommends that any party be allowed to seek full Commission review.

Decision 3: How should the pricing of the storm recovery bonds be approved? Options include:

- advance approval by the full Commission contingent upon the final price being supported by fully accountable certifications of lowest cost from FPL, the lead underwriter(s), and the Commission's financial advisor
- advance approval by the full Commission contingent upon the final price being fixed within a specified range (e.g. 1-2 basis points) identified no more than 48 hours prior to final pricing
- pricing subject to limited review by the full Commission after the bonds are priced, but before they are issued

Staff recommends the pricing of the storm recovery bonds be subject to limited review by the full Commission after the bonds have been priced but before the bonds have been issued. FPL will file a proposed form of issuance advice letter with the Commission at least two weeks before the expected pricing date. Within one week of receiving the proposed form of issuance advice letter, the Commission's staff with input from its financial advisor will provide comments and recommendations to FPL regarding the adequacy of information proposed to be provided. Within one business day of pricing, a meeting will be noticed for three business days after

pricing to afford the Commission an opportunity to review the proposed transaction. The first day after pricing is for receipt of the actual details of the transaction including the lowest cost certifications from FPL, the underwriter(s), and the Commission's financial advisor. The second day is for the staff's and the Commission's financial advisor's review of this information. The third day would be for a staff presentation of the results of its review and the Commission's deliberations on the transaction. If the Commission determines that all required certifications have been delivered and the transaction complies with applicable law and the financing order, the transaction proceeds without any further action of the Commission. However, if the Commission were to determine that the transaction fails to comply with applicable law or the financing order, or if FPL, the bookrunning underwriter(s), or the Commission's financial advisor is unable or unwilling to deliver the required certifications in a form acceptable to the Commission, the Commission would have discretion to issue an order to stop the transaction. The Commission would have no authority to issue an order to stop the transaction for any other reason, for example, a change in market conditions after the moment of pricing.

#### Other Matters

FPL's brief suggests a number of specific limitations on the role of the Commission and its financial advisors. FPL states that, as a result of securities law concerns, FPL must retain ultimate editorial control over the statements made in its registration statement and in the materials for an internet-enabled road show. (FPL BR at 160) FPL also states that participation in marketing and sales calls will be limited to FPL and its underwriters for the same reason. (FPL BR at 161). Staff believes that it is premature to address these or other specific limitations. The question of editorial control, for example, will arise only if the Bond Team and FPL disagree about specific disclosure language. Rather than addressing such issues in the abstract, the mechanism recommended above for resolving any future disputes can be used to focus on the specific language in question if a disagreement about such language cannot be resolved informally.

FPL also questions for the first time in its brief whether Section 366.8260, Florida Statutes, contemplates that activities by the Commission's financial advisor and counsel after entry of the financing order and before the post-financing cost review qualify for payment from bond proceeds. (FPL BR at 145; 159 at fn. 50) Staff recommends that the Commission find and direct that such costs are properly payable from bond proceeds.

Section 366.8260(2)(b)2., Florida Statutes, provides:

In performing the responsibilities of this subparagraph [2.] and subparagraph 5., the commission may engage outside consultants or counsel. Any expenses associated with such services shall be included as part of financing costs and included in storm-recovery charges.

Subparagraph 2 identifies the contents of a financing order, and authorizes the Commission to "specify the degree of flexibility to be afforded to the electric utility in establishing the terms and conditions of the storm-recovery bonds" and "include any other conditions that the commission considers appropriate and that are not otherwise inconsistent with this section." Section 366.8260(2)(b)2.g. and j., Florida Statutes. Subparagraph 5 relates to the

Commission's after-the-fact review to determine if the actual costs of the storm-recovery bond issuance "resulted in the lowest overall costs that were reasonably consistent with market conditions at the time of the issuance and the terms of the financing order."

Staff believes that if the financing order (1) specifically limits the flexibility afforded to FPL by requiring active participation by the Commission, its financial advisor, and outside counsel in the structuring, marketing and pricing of the bonds, and (2) imposes conditions on FPL the monitoring of which requires the Commission to rely upon the services of a financial advisor and outside counsel, then the fees and expenses of the advisor and counsel qualify for payment from bond proceeds. To avoid any question about this matter, the Commission's conclusion concerning the recovery of these expenses should be included in the financing order.

#### Staff Analysis of FPL's Proposed Review Process

In its brief on this issue, FPL proposes a review process for active Commission involvement consisting of seven enumerated points. These points are set forth below, each followed by staff's comments and recommendations.

##### 1. Establish Bond Team

FPL and the Commission designate the professionals on their respective teams, representing in-house business, regulatory, finance and legal disciplines as well as outside advisors. The Commission itself shall be represented on the "Bond Team" by and through the pre-hearing officer in this matter, who may be advised by the Commission's staff and financial advisor and other members of the Bond Team. FPL will propose a transaction timeline in consultation with the Bond Team, establishing clear expectations as to all key issuance activities and the responsibility for each. The Bond Team will review the results of competitive solicitations for services for transaction participants. Throughout the process, the Bond Team should expect to meet by conference call no less than weekly for detailed and documented discussion of progress and next steps. (FPL BR at 159)

As previously discussed, staff recommends day-to-day participation in Bond Team activities through Commission staff, advised by the Commission's financial advisor and outside counsel, with a designated Commissioner to resolve any disputes. In addition, the development of the competitive solicitation and selection of underwriters and other transaction participants should be overseen by the Bond Team to ensure that the process is truly competitive and will result in the selection of transaction participants that have experience and ability to achieve an efficient and lowest cost transaction. (TR 1123, 1179-1181, 1185-1186) The underwriters work for the Bond Team but are not on the Bond Team.

##### 2. Transaction Documents, Offering Documents and Legal Opinions

FPL recommends that Staff complete its review of transaction documents filed with FPL's petition on January 13, 2006 and make recommendations for substantive changes in the Staff Recommendation to be filed May 8, 2006 for vote by the Commission at the Special Agenda on May 15, 2006. The transaction documents submitted are in substantially final form and conform to applicable

law. Finalization of transaction documents is a key step to a successful and timely bond issuance. Subsequent changes in the transaction documents necessary to meet rating agency requirements or to conform to final structuring and pricing requirements will be reviewed with the Bond Team. FPL will be responsible for the initial draft of the registration statement and term sheet which will be provided to the Bond Team for comment and review if requested. FPL as issuer and the party with securities law liability for statements made in these documents will retain final editorial control over the document contents. All legal opinions will be submitted to Bond Team for review and comment if requested. (FPL BR at 159-160)

As discussed in Issues 62, 64, 65, and 66, the various documents that are necessary elements of this proposed transaction should be reviewed and approved consistent with the financing order issued by the Commission. It would be premature for staff to spend a large block of time reviewing and making recommendations for substantive changes to the transaction documents until the Commission has issued its financing order in this docket, providing guidance on what terms will be appropriate for these transaction documents. Thus, it would be inappropriate for the Commission's financing order to approve the transaction documents in substantially the form filed by FPL. Rather, the financing order should authorize FPL and the SPE to enter into the required transaction documents (e.g., the indenture, the storm recovery property sale agreement, the servicing agreement, the administration agreement, the LLC agreement), but leave the terms of those transaction documents to be approved by the Commission's designated personnel and financial advisor taking into account the requirements of the financing order. Staff recommends such review and approvals take place as necessary based on when certain decisions are anticipated to occur throughout the transaction timeline discussed by FPL in Paragraph 1 above. (TR 1186) Subsequent changes or amendments to these documents will be reviewed with, and approved by, the Bond Team before becoming operative. (TR 1703, 1190) Any issues that cannot be resolved by the Bond Team would be submitted to the designated Commissioner for initial decision.

Expert outside legal counsel has advised staff that FPL's assertions regarding securities law liability fail to provide a complete description of securities law liability in relevant respects. Although FPL might also have securities law exposure as a "control person", FPL will not be the issuer of the storm recovery bonds. The SPE will be the issuer and in that capacity will have the most direct exposure to securities law liability. The automatic true-up mechanism will place ratepayers at risk for any securities law liability actually incurred by the SPE. Any damage award payable by the SPE would be a revenue requirement in the true-up of storm-recovery charges to be recovered from ratepayers. Even if a claim asserted by investors is ultimately unsuccessful, attorneys' fees and other litigation expenses incurred by the SPE in defending the matter would be a revenue requirement in the true-up of storm-recovery charges to be reflected on all ratepayers' bills. Consequently, ratepayers have a direct interest that the marketing documents do not contain any statements that are false, misleading, or incomplete. In this respect, the interests of ratepayers are aligned with the interests of the SPE issuer and FPL. Further, as a practical matter, in the absence of fraud, the strength of the securitization law, including the broad nature of the state pledge and the true-up mechanism, make any liability arising from the content of the prospectus or other marketing materials remote unless there has

been a default or other event disrupting or threatening to disrupt the timing or amount of payments on the storm-recovery bonds.

The process for writing and reviewing the prospectus and other disclosure documents requires extensive due diligence on the part of all transaction participants. There should be a balancing of competing interests based on rigorous analysis and the making of informed judgments. Thus, while the Commission itself might not be exposed to securities law liability, if the Commission were to believe that disclosure language proposed by anyone is materially false or misleading, it should decline to allow the storm-recovery bonds to be issued so as to avoid exposing ratepayers to the SPE's potential securities liability by means of the true-up. Similarly, if FPL were to believe disclosure language as proposed by anyone is materially false or misleading, FPL would have a responsibility to decline to allow the storm recovery bonds to be issued. To date, this never has been the case in other securitization transactions, and it is extremely unlikely to be the case in connection with storm recovery bonds. To the contrary, after carefully reviewing all disclosure language in the prospectuses, outside legal counsel for both the issuer and the underwriters in connection with each prior issue of publicly offered ratepayer-backed bonds has delivered a letter confirming that nothing has come to its attention that would lead it to conclude that the prospectus disclosure was materially false or misleading.

Staff recommends all legal opinions related to the proposed storm recovery bond transaction be submitted automatically to the Bond Team for review and comment without the requirement that said opinions be specifically requested from FPL. (TR 1186)

### 3. Rating Agency Process

FPL will be responsible for obtaining credit ratings. FPL will review progress and any issues encountered with the Bond Team at scheduled update meetings. (FPL BR at 160)

Staff recommends all rating agency presentations be submitted to the Bond Team for review and comment before the presentations are made to the rating agencies. (TR 1186) In prior ratepayer-backed bond transactions when the state commission has retained an active financial advisor, that financial advisor commonly has been an active participant in interfacing with rating agencies. (TR 1175-1176) Staff recommends the Commission's financial advisor similarly be an active participant in rating agency presentations.

### 4. Structuring and Marketing Process

A detailed marketing plan will be prepared by FPL and the bookrunning underwriter(s) for review and comment by the Bond Team. The bookrunning underwriter(s) will develop a proposed bond structure for marketing purposes reflecting comments of all parties. The structure will be refined over the course of the marketing period and finalized at pricing. In addition to the prospectus and term sheet to be filed with the SEC, a draft set of slides for an internet-enabled roadshow will be provided for review and comment by the Bond Team. FPL will retain ultimate editorial control over these documents as they will likely constitute a "free-writing prospectus" under new SEC rules. Similar to the registration statement, FPL as the party with securities law liability will retain final editorial control over these presentations. During the execution of the marketing plan, it is



anticipated that update calls with the Bond Team to provide market feedback will become more frequent. Alternatively, the Commission's representative and its advisor may choose to observe marketing presentations to potential investors made by the Company and its underwriters. Participation in marketing and sales calls will be limited to FPL and the underwriters as FPL has potential securities law liability for all statements made to potential investors at these meetings. (FPL BR at 160-161)

Preparation of the offering documents and the actual marketing of the storm recovery bonds are very important steps in the issuance process of ratepayer-backed bonds. Staff believes the limitations suggested by FPL over the Bond Team's involvement in the marketing function are unnecessary and will undermine the transparency of the transaction. (TR 1174-1176) The record shows examples of successful ratepayer-backed bond transactions for the benefit of other utilities that have not been subject to these unnecessary restrictions on Commission involvement in the marketing process. (TR 1175-1176) Moreover, these transactions involved the same financial advisors – Credit Suisse on behalf of the sponsoring utilities and Saber Partners on behalf of the respective Commissions – that are present in same roles in this transaction. (TR 1175-1176; EXH 167, pp. 64-67)

As discussed earlier, staff disagrees with FPL's assertions regarding securities law liability. (TR 1204-1205) Staff's comments with respect to Paragraph 2 above apply equally to Paragraph 4.

#### 5. Pricing Process

FPL and the underwriters will consult with the Bond Team on strategy prior to release of pricing indications to the market. As feedback is received, each refinement of price guidance is discussed with the Bond Team. Bookrunning underwriters will develop a "pricing book" containing relevant data to be examined by all parties. It is anticipated that FPL and the Bond Team will assist in the refinement of this document. The Bond Team will discuss and agree on an the estimated range for final spreads that will cause the bonds to clear the market prior to "launching" the transaction with final guidance and scheduling a pricing call. FPL would expect to have the Commission's representative agree that, if we are able to price within that range, that we should execute the transaction, or if not to indicate what alternative the Commission proposes. (FPL BR at 161)

The limitations on the Commission's involvement in the pricing of the storm recovery bonds are unnecessary and will undermine the transparency of the transaction. (TR 1174-1176) The actual interest rate payable on the storm recovery bonds is not fixed until the very last moment. (TR 690) The approach suggested by FPL is fundamentally at odds with the approach used to obtain superior pricing results in the five prior Texas transactions and in the 2005 New Jersey transaction. The Commission's financial advisor needs to be an active and visible participant in the actual pricing process in real time if the Commission is to obtain maximum benefits for ratepayers.

To effectively represent ratepayer interests in this process, staff recommends the full Commission have an opportunity to review the transaction after the bonds have been priced but

before the bonds have been issued. As discussed in Issue 65, FPL will file the issuance advice letter (IAL) and initial true-up letter (combined into one document) in draft form at least two weeks prior to pricing based upon the best information available at that time. FPL will file an IAL in final form with the Commission within one business day of expected pricing at which time a meeting will be noticed for three business days after pricing to afford the Commission an opportunity to review the proposed transaction. The first day after pricing is for receipt of the actual details of the transaction including the lowest cost certifications from FPL, the underwriter(s), and the Commission's financial advisor. The second day is for the staff's and the Commission's financial advisor's review of this information. The third day would be for a staff presentation of the results of its review and the Commission's deliberations. If the Commission determines that all required certifications have been delivered and that the transaction complies with applicable law and the financing order, the transaction proceeds without any further action of the Commission. However, if the Commission were to determine that the transaction fails to comply with applicable law or the financing order, or if FPL, the bookrunning underwriter(s), or the Commission's financial advisor is unable or unwilling to deliver the required certifications in a form acceptable to the Commission, the Commission would have the discretion to issue an order to stop the transaction. (TR 1215-1218) The Commission would have no authority to issue an order to stop the transaction for any other reason, for example a change in market conditions after the moment of pricing.

6. Issuance Advice Letter

As part of the Staff Pre-Issuance Review process proposed by FPL, at least five business days prior to the proposed pricing date for the bonds, FPL will submit to Staff a draft pro-forma issuance advice letter for review by the Bond Team and other responsible parties. This pro-forma issuance advice letter will reflect pricing guidance from the marketplace. At the same time, a draft of the initial true-up letter, reflecting the pro-forma initial bond and tax charges, will be submitted. Not later than 48 hours after the pricing and sale of the bonds, FPL will file with the Commission a final issuance advice letter and a final true-up letter reflecting the final terms of the bonds and the resulting charges. All of the activities described above are contemplated within the scope of FPL's proposed financing order. It is not necessary for the financing order to specify all of the particulars of the due diligence process that the Commission ultimately adopts. Tr. 1506 (Olson). These activities all fall within the Scope of Saber Partners' current contract with the Commission. Ex. 136. (FPL BR at 161-162)

Staff recommends the Commission require the issuance advice letter to contain detailed analyses and representations as discussed above in this issue and in Issue 65. This will obviate the need for a separate initial true-up advice letter. Consistent with staff's comments under Paragraph 5 above, staff recommends the Commission reserve the right to issue a stop order at any time until 5:00 pm Eastern Time on the third business day after pricing if the Commission determines that the transaction fails to comply with applicable law or the financing order, or if FPL, the bookrunning underwriter(s), or the Commission's financial advisor is unable or unwilling to deliver the required certifications in a form acceptable to the Commission.

7. Dispute Resolution

Any disputes relative to the foregoing activities that the Commission has reserved to itself authority to resolve shall be heard before the pre-hearing officer in this matter, with the opportunity for any party represented on the bond team to have the pre-hearing officer's decision reviewed *de novo* by the full Commission. (FPL BR at 162)

Staff's comments under Paragraph 1 above apply equally to Paragraph 7. In addition, staff recommends that any issue that the Bond Team and FPL are unable to resolve should initially be submitted in writing for resolution by the designated Commissioner, subject to *de novo* review by the full Commission. All parties who took a position on this issue indicated that it would be acceptable for a single Commissioner to initially resolve such issues, provided that parties had the right to seek *de novo* review by the full Commission or some other point of entry. Because the specific features of the securitization transaction can affect the rates to be paid by consumers, and hence the substantial interests of the parties, staff recommends that any party be allowed to seek full Commission review.

Summary

The ratepayers should be effectively represented throughout the proposed transaction. The Commission, its staff, its outside counsel, and its financial advisor, along with FPL and its counsel should work in a collaborative process to ensure the structuring, marketing, and pricing of the storm recovery bonds result in the lowest cost consistent with prevailing market conditions and the terms of the financing order.

Based on the evidence presented, staff believes that it is simply not possible to determine, in a review that takes place after issuance of the bonds and under the limited terms of participation suggested by FPL, whether the interest rates achieved on the bond issuance resulted in lowest overall costs consistent with market conditions at the time of pricing. Thus, staff recommends that the Commission, as an appropriate condition of the financing order, ensure its real time involvement in the pricing of bonds at the time of pricing and adopt a lowest cost approach under which FPL, the bookrunning underwriters involved, and the Commission's financial advisor each individually certifies that lowest overall costs were achieved for the storm recovery bonds under then prevailing market conditions and the terms of the financing order.

The Commission should be represented primarily by its staff, who should be advised by the Commission's financial advisor and outside counsel. Staff should periodically brief the Commissioners and the parties on the progress of the transaction. Issues that arise during the process that cannot be resolved collaboratively should be submitted in writing to a designated Commissioner for guidance. If any party objects to the designated Commissioner's proposed resolution, the matter should be submitted to the Commission for *de novo* consideration. The final structure of the transaction, including pricing, should be subject to approval by the full Commission as outlined above. The Commission should specifically determine that the fees and expenses of its financial advisor and outside counsel in this collaborative process are entitled to payment from the bond proceeds.

**Issue 75:** If the Commission approves the substance of FPL's primary recommendation, should the financing order require FPL to reduce the aggregate amount of the bond issuance in the event market rates rise to such an extent that the initial average retail cents per kWh charge associated with the bond issuance would exceed the average retail cents per kWh 2004 storm surcharge currently in effect?

**Recommendation:** Yes. (Draper, Springer)

**Position of the Parties**

**FPL:** Yes. If the Commission approves the substance of FPL's primary recommendation and market rates rise as described above, to ensure that the rate mitigation benefits of securitization are realized, FPL should reduce the aggregate amount of the storm-recovery bond issuance to an amount whereby the initial average retail cents per kWh Storm Charge requested would not exceed the average retail cents per kWh 2004 Storm Restoration Surcharge currently in effect.

**OPC:** No position.

**FIPUG:** No position.

**FRF:** No position.

**AARP:** No position.

**FEA:** No position.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL's position is as stated above. None of the parties took a position on this issue.

**ANALYSIS**

FPL witness Dewhurst testified that the actual average retail storm charge per kWh will vary based on changes in market interest rates that may occur between now and the issuance date of the bonds. (TR 57) If market rates rise to such an extent that the average retail kWh charge associated with the bond issuance would exceed the average retail kWh charge associated with the storm restoration surcharge that is currently in effect, the aggregate amount of the storm-recovery bond issuance would be reduced to an amount whereby the initial average retail kWh storm charge would not exceed the average retail kWh surcharge currently in effect. (TR 57-58)

The current average retail surcharge factor approved in the 2004 Storm Order, effective January 1, 2006, is 0.146 cents per kWh (¢/kWh), which is determined by dividing the total

storm costs by the total retail kWh sales. (EXH 4, pp. 165-166) Witness Morley testified that under FPL's primary recommendation, i.e., issuance of storm-recovery bonds, the average retail storm charge would be 0.138 ¢/kWh. (TR 764, EXH 60, p. 3) Storm charges by individual rate classes vary, with some being below the average retail rate, others above. FPL's proposed storm charge per rate class can be seen in EXH 60, p. 3. The current residential 2004 storm surcharge is 0.165 ¢/kWh. With the implementation of the proposed storm surcharge and simultaneous termination of the current surcharge, the residential storm charge would be approximately 0.158 ¢/kWh. However, FPL stated in its brief that market rates have risen since FPL's January 2006 filing initiating this proceeding and they may further increase before bonds are actually issued. (FPL BR at 162) Witness Dewhurst stated that while FPL's proposal would reduce the amount of reserve replenishment, it strikes a reasonable balance between customer interests in the mitigation of rate impacts and the need to fund the reserve. (TR 58)

Staff notes that FPL's proposal only applies to the **initial** average retail storm charge. As discussed in Issue 82, the storm charges will be subject to true-ups. However, witness Morley stated that FPL's proposal would also tend to reduce subsequent true-up factors to the extent the total amount of the storm bond issuance is reduced. (EXH 4, p. 234)

### **CONCLUSION**

Staff recommends approval of FPL's proposal to reduce the amount of the storm bond issuance if market conditions change to such an extent that the average retail storm charge would exceed the average retail storm surcharge currently in effect. This proposal is designed to mitigate rate impacts to ratepayers in the event market interest rates increase and should therefore be approved.

**Issue 76:** Should the Commission approve FPL's request that a surcharge be applied to bills rendered on or after August 15, 2006 to enable FPL to recover its prudently incurred 2005 storm costs in the event the issuance of storm-recovery bonds is delayed? If so, how should the Commission determine the following:

- a. The amount approved for recovery;
- b. The calculation of the surcharge;
- c. The cost allocation to the rate classes; and
- d. The surcharge's termination date.

**Recommendation:** No. FPL's primary justification for the issuance of storm recovery bonds for the recovery of reasonable and prudently incurred storm damage restoration costs is rate mitigation. Any additional surcharge on top of the 2004 storm charge would negate the benefit of rate shock mitigation to ratepayers avoided by the use of securitization. (Maurey, Draper, Slemkewicz)

**Position of the Parties**

**FPL:** If it becomes necessary to implement such a surcharge due to delay in the issuance of storm-recovery bonds, a new tariff would be proposed and submitted by FPL for administrative approval and calculated so as to recover the total amount of 2005 storm costs approved for recovery in the financing order over approximately three years.

**OPC:**

- a. FPL should not be permitted to initiate an interim rate to begin collecting for 2005 storm costs if the bond issuance is delayed. If the initial bond issuance is delayed beyond the period in which all actual, adjusted 2004 storm costs have been collected, the 2004 storm-surcharge rate should continue until all of the 2005 actual, trued-up, storm costs have been collected or until the first bond is issued. All subsequent bond issuances should be netted for any amounts collected.

- b. See above position under section (a).
- c. No position.
- d. See above position under section (a).

**FIPUG:**

- a. The Commission should grant recovery via a surcharge. The surcharge should be designed to recover the following: (1) the replenishment of the storm reserve to \$150 million, and; (2) the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments. Costs should be allocated based on the cost of service methodology last filed with and approved by the Commission in Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

b. The Commission should grant recovery via a surcharge. The surcharge should be designed to recover the following: (1) the replenishment of the storm reserve to \$150 million, and; (2) the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments. Costs should be allocated based on the cost of service methodology last filed with and approved by the Commission in Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

c. The Commission should grant recovery via a surcharge. The surcharge should be designed to recover the following: (1) the replenishment of the storm reserve to \$150 million, and; (2) the recovery of FPL's 2005 storm costs minus OPC's proposed adjustments. Costs should be allocated based on the cost of service methodology last filed with and approved by the Commission in Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

d. Agree with STAFF.

**FRF:** a. FPL should not be allowed to implement an interim rate for 2005 storm costs if the bond issuance is delayed.

b. See FRF position above.

c. No position.

d. See FRF position above.

**AARP:** The same as the Office of Public Counsel.

**FEA:** a. – d. Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** In its brief, FPL argues "it is critical that a mechanism for recovery is in place before significant new storm or other costs are incurred to free up short-term liquidity to support ongoing operational requirements such as the fuel hedging program, construction program, and clause under recoveries." (FPL BR at 164) FPL witness Dewhurst acknowledged that investment and rating agency analysts report that FPL operates in a constructive regulatory environment. (TR 103–110; EXH 4, pp. 329–330, 332, 439) Witness Dewhurst also testified that the Company went through the entire 2005 hurricane season with a negative balance in its storm damage reserve. (TR 119) If the Commission issues a financing order for the recovery of reasonable and prudently incurred storm damage restoration costs and the replenishment of the storm damage reserve as proposed in FPL's primary recommendation, it is staff's contention that the Company will have a recovery mechanism in place and an interim surcharge for recovery of 2005 storm costs is unnecessary.

In addition, FPL's primary justification for the issuance of storm recovery bonds for the recovery of reasonable and prudent storm damage restoration costs is rate mitigation. (Dewhurst TR 113–114) Any additional surcharge on top of the 2004 surcharge would negate the benefit of

rate shock mitigation to ratepayers avoided by the use of securitization. (EXH 171, pp. 49–50) Moreover, if the Commission were to approve FPL's request for an additional surcharge, such action could have the unintended effect of unduly delaying the transaction by removing FPL's incentive to seek an expeditious issuance of the storm recovery bonds. (Dewhurst TR 1687) For these reasons, staff recommends the Commission deny FPL's request to approve a surcharge to bills rendered on or after August 15, 2006, to enable FPL to recover its prudently incurred 2005 storm costs in the event the issuance of storm recovery bonds is delayed. (OPC BR at 115)

However, if the Commission approves FPL's request to apply a surcharge to bills rendered on or after August 15, 2006, in the event the issuance of storm recovery bonds is delayed, the staff analysis below discusses how the Commission should determine the following:

a. The amount approved for recovery

If the Commission approves FPL's request for a surcharge to recover its 2005 storm costs, the amount would be the amount that was determined in Issue 36. Per the staff's recommendation in Issue 36, the amount would be \$728,510,020.

b. The calculation of the surcharge

Witness Dewhurst testified that the surcharge be applied to bills rendered on and after August 15, 2006, to recover the 2005 storm costs over approximately three years, or until the costs have been recovered. (TR 59) Witness Morley's calculation of the surcharge is shown in her prefiled direct testimony. (EXH 61, p. 1) Based on the Commission's vote in part a) of this issue, the 2005 storm costs for year one should be allocated to the rate classes based on the allocation percentages developed by witness Morley. (EXH 61, p. 1) Each rate class's cost responsibility should then be divided by its projected kWh sales for the period August 2006 through July 2007 to calculate a cents-per-kWh surcharge. With respect to FIPUG's position on the cost allocation, see the staff analysis in Issue 80.

c. The cost allocation to the rate classes

The amount approved for recovery by the Commission in part a) of this issue should be allocated to the rate classes based on the allocation percentages shown in FPL witness Morley's direct testimony. (EXH 61, p.1) As discussed in detail in Issue 80, FPL allocated the total 2005 storm costs based on the amount of damage in each functional area, e.g., transmission, distribution, etc. The allocation of the costs by functional area to the rate classes should be consistent with the way equivalent costs were treated in the last filed cost of service study. (TR 761) With respect to FIPUG's position on the cost allocation, see the staff analysis in Issue 80.

d. The surcharge's termination date

Witness Dewhurst testified that the surcharge should be discontinued when the storm-recovery bonds are issued and that the amount of the bonds issued would be adjusted for the impact of collections of this surcharge. (TR 59) If the Commission approves FPL's request to apply this surcharge in the event the issuance of the bonds is delayed, staff agrees with witness Dewhurst's proposal.



Finally, if the Commission approves FPL's request to implement a surcharge to recover its 2005 costs in the event the issuance of the bonds is delayed, FPL should file for administrative approval tariffs and associated surcharges by rate class based on the amount approved for recovery.

**Terms for Traditional Recovery of Non-Securitized Amounts**

**Issue 77:** If the Commission approves a recovery mechanism other than securitization, should an adjustment be made in the calculation of interest to recognize the storm-related deferred taxes?

**Recommendation:** No adjustment is necessary. In Docket No. 041291-EI, concerning FPL's petition to recover 2004 storm damages through a surcharge, the Commission approved an adjustment to interest expense to recognize storm related deferred taxes. The utility has made the adjustment by applying a net-of-tax rate. (Lowe, Kyle)

**Position of the Parties**

**FPL:** No adjustment is necessary since FPL would calculate interest on the storm costs to be recovered on an after-tax commercial paper rate basis.

**OPC:** Yes. FPL should accrue and collect interest on the actual storm costs incurred less the adjustments ordered. Interest accrual should begin in November, 2005 and the interest rate should be the pre-tax commercial paper rate for each month.

**FIPUG:** Yes. Each month FPL should calculate interest on the outstanding net-of-tax balance of the storm damage account, which shall be the outstanding balance of the storm damage account less 38.575% taxes.

**FRF:** Yes. Agree with OPC.

**AARP:** The same as the Office of Public Counsel.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** In Docket No. 041291-EI (2004 storm damage case), the Commission made an adjustment to the calculation of interest to recognize the storm-related deferred taxes that were not included in the utility's rate case. Customers only benefit if the deferred taxes are included in the capital structure at a zero cost rate and rates set using that new capital structure. As the capital structure was not changing in the 2004 storm damage docket, the Commission used a net-of-tax balance for purposes of calculating the interest carrying charge.

FPL witness Davis testified that the interest charges included in the recovery of the 2004 and 2005 storm costs were calculated by multiplying the average monthly unrecovered balance by the current estimated after-tax commercial paper rate. In addition he stated that "these charges represent the interest expense associated with the debt the Company would incur or has incurred to cover the net-of-tax storm costs." (TR 429) Further, Exhibit 19 (Unrecovered 2004 Storm-Recovery Costs) , footnote (2) states that the interest carrying charges are calculated on a net-of-tax balance. Exhibit 20 (Unrecovered 2005 Storm-Recovery Costs) shows the interest calculation for 2005.

Date: May 8, 2006

No other evidence or testimony on this issue was presented by any other party.

Staff recommends that no adjustment is necessary if the Commission approves a mechanism other than securitization for the calculation of interest to recognize the storm-related deferred taxes.

**Issue 78:** If the Commission approves a recovery mechanism other than securitization, what is the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery?

**Recommendation:** If the Commission approves a recovery mechanism other than securitization, the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery is to record the costs as a regulatory asset in a subaccount of Account 182.1, Extraordinary Property Losses. (Slemkewicz)

**Position of the Parties**

**FPL:** The Commission should authorize the transfer of the unamortized balance of the storm related costs subject to future recovery from the Storm Damage Reserve (Account 228.1) to a deferred Regulatory Asset (Account 182.1) The amount transferred should be amortized consistent with the amounts recovered as revenue through the authorized surcharge recovery factor.

**OPC:** No position at this time.

**FIPUG:** The storm damage account should be credited each month with the actual amount recovered from ratepayers.

**FRF:** No position.

**AARP:** Same position as FIPUG.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:** After an amount is approved for recovery and amortization through a surcharge, it meets the definition of a regulatory asset. In this instance, the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery is to record the costs as a regulatory asset in a subaccount of Account 182.1, Extraordinary Property Losses. In order to assist in the tracking and review of the amounts included in this account and their subsequent amortization, a separate subaccount of Account 182.1 should be established to record these transactions. This is consistent with the treatment of the 2004 storm-related costs that were approved for recovery through a surcharge in the 2004 Storm Order.

Based on the foregoing, staff recommends that if the Commission approves a recovery mechanism other than securitization, the appropriate accounting treatment for the unamortized balance of the storm-related costs subject to future recovery is to record the costs as a regulatory asset in a subaccount of Account 182.1, Extraordinary Property Losses.

## **RATES**

**Issue 79:** STIPULATED: Are the energy sales forecasts used to develop the bond amortization schedules and the recovery mechanism appropriate?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: “Yes. The energy sales forecasts used to develop the bond amortization schedules and the recovery mechanism are appropriate.” All Intervenors maintained “no position” on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: “Yes. The energy sales forecasts used to develop the bond amortization schedules and the recovery mechanism are appropriate.” All Intervenors maintained “no position” on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Issue 80:** If the Commission approves recovery of any storm-related costs through securitization, how should the recovery of these costs be allocated to the rate classes?

**Recommendation:** The jurisdictional costs approved by the Commission for recovery through securitization (Issue 42) should be allocated to the rate classes using the allocation percentages developed in FPL witness Morley’s Direct Testimony, Exhibit No. RM-6, page 2 of 2 (EXH 59). These percentages are based on the amount of storm damage in each functional area (e.g., transmission, distribution, production, etc.) and then allocated by rate class based on the methodology used for each function in FPL’s last filed cost-of-service study. Each rate class’s cost responsibility should then be divided by its projected kWh sales for the period August 2006 through July 2007 (Issue 79) to calculate a cents-per-kWh Storm Bond Repayment Charge and Storm Bond Tax Charge. (Draper, Keating)

### **Position of the Parties**

**FPL:** The allocation of the costs to the rate classes should be consistent with the manner in which equivalent costs were treated in the last filed cost-of-service study as provided by FPL in Document Nos. RM-3, RM-4 and RM-5.

**OPC:** No position.

**FIPUG:** With respect to allocating costs between customer classes, FIPUG endorses the approach that matches revenue collections to storm costs incurred — that is, customers taking service from the transmission system should not be charged for damages to the distribution system. Costs should be allocated based on the cost-of-service methodology last filed with and approved by the Commission in

Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

**FRF:** No position.

**AARP:** Same position as FPL.

**FEA:** Agree with FIPUG.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

This issue addresses the manner in which the total costs that are approved for securitization in Issue 42 are allocated to the rate classes.

**PARTIES' ARGUMENTS**

FPL states that the allocation of the costs to the rate classes should be consistent with the manner in which equivalent costs were treated in its last filed cost-of-service study as provided by FPL in the direct testimony of witness Morley, Document Nos. RM-3, RM-4, and RM-5. (EXH 56-58)

AARP takes the same position as FPL. The AG, FRF, and OPC take no position. FEA and FIPUG argue that customers taking service from the transmission system should not be charged for damages to the distribution system and that the costs should be allocated based on the cost-of-service methodology last filed with and approved by the Commission in Docket No. 830465-EI, consistent with the method used in Docket No. 041291-EI.

**ANALYSIS**

To determine the storm charges by rate class, FPL witness Morley proposed to first allocate the storm-recovery costs based on the actual and expected amount of damage incurred by functional area, i.e., production, transmission, distribution, general plant, and customer service. The general plant category includes costs associated with human resources, general counsel, and marketing. The customer service category includes costs associated with customer call centers and local community support. (EXH 4, p. 160) Allocating the costs incurred by functional area is consistent with the approach the Commission approved in the 2004 Storm Order. (TR 754) FPL performed this functional analysis for the 2004 storm costs, the 2005 storm costs, and future storm costs respectively.

Section 366.8260(2)(b)2.h, Florida Statutes, requires that the storm recovery charges be allocated to the rate classes in the manner in which these costs were allocated in the cost-of-service study approved in connection with the utility's last rate case. The statute further provides that if the utility's last rate case was resolved by a settlement agreement, the cost-of-service methodology filed by the utility in that case shall be used. Witness Morley testified that FPL allocated the functionalized costs consistent with the manner in which equivalent costs were

treated in the cost-of-service study filed in the 2005 FPL rate case. (TR 753, 754) To the extent that the storm charge recovers costs associated with distribution plant, FPL allocated these costs consistent with the treatment of distribution costs in the last filed cost-of-service study. Likewise, to the extent that the storm charge recovers costs associated with transmission plant, FPL allocated these costs consistent with the allocation of transmission costs in the last filed cost-of-service study. (TR 753) This allocation of costs was performed for the 2004 storm costs, the 2005 storm costs, and future storm costs.

In her direct testimony, witness Morley assigned weights to the 2004 storm costs, the 2005 storm costs, and future storm costs based on the amount financed through storm bonds. (TR 755) For example, the \$214 million in proposed unrecovered 2004 storm costs represent 13 percent of the total amount requested through securitization. (EXH 59, p.1) The resulting allocation factors by rate class are shown in the direct testimony of witness Morley, Exhibit RM-6. (EXH 59, p. 2) The allocation factors are applied to the year one storm bond repayment charge revenue requirement. The resulting costs by rate class were then divided by each rate class's forecasted August 2006 – July 2007 sales to calculate a cents per kilowatt-hour storm bond repayment charge. The same steps are performed to calculate the storm bond tax charge. (TR 757; EXH 60, pp. 1-2)

FIPUG contends that the costs should be allocated based on the cost-of-service methodology last filed with and approved by the Commission in Docket No. 830465-EI, the 1983 FPL rate case. In its brief, FIPUG stated the 2005 FPL rate case was settled and that the cost-of-service study was never approved. (FIPUG BR at 11)

Section 366.8260(2)(b)2.h., Florida Statutes, clearly requires that where a utility's last rate case was resolved by a settlement agreement, the cost-of-service methodology filed by the utility in that case shall be used for allocating storm-recovery charges. As previously noted, FPL's last rate case was resolved by settlement agreement.

Nonetheless, FIPUG asserts that application of the statutory requirement would result in a denial of due process to FIPUG because the cost-of-service study filed in FPL's last rate case was "actively disputed" and "never approved." Further, FIPUG asserts that the statutory requirement constitutes an unlawful delegation of authority from the Legislature to FPL to determine the correct cost-of-service to be used in setting storm-recovery charges.

The Commission is not at liberty to ignore the plain language of the securitization law by not using the cost-of-service study filed by FPL in its last case. The statute is clear and unambiguous with respect to which cost-of-service study to use.

Further, the Commission lacks jurisdiction to determine the facial constitutionality of the statute. FIPUG's allegation that the statutory provision at issue constitutes an unlawful delegation of authority from the Legislature to FPL is an attack on the facial validity of the statute. Thus, the Commission is in no position to make the finding suggested by FIPUG or to remedy the constitutional deficiency in the statute alleged by FIPUG.

Likewise, the Commission lacks authority to find that the statute, on its face, denies FIPUG due process by requiring that a cost-of-service study not previously approved by the

Commission must be used in this case. Staff believes it is unlikely that any court could determine that application of the statute would deny FIPUG due process. Well after the time that Section 366.8260, Florida Statutes, became law, FIPUG signed the 2005 FPL rate case settlement which explicitly provided that storm cost recovery could be accomplished through Section 366.8260. Hence, FIPUG should have known that by signing the settlement, it was depriving itself of the opportunity to challenge the cost-of-service study that would be used in any application for securitization filed during the multi-year term of the settlement.

During cross-examination by FIPUG, FPL witness Morley pointed out that in the 2005 rate case, FPL used the same cost-of-service methodology that was approved by the Commission in the 1983 rate case with one exception, the treatment of the St. Lucie Unit 2 production unit. In the 1983 rate case the Commission approved that the majority of the costs for the St. Lucie plant be allocated on an energy basis. In the 2005 FPL rate case, the settlement provided that all production units, including the St. Lucie Unit 2, be allocated on a 12 coincident peak and 1/13 average demand methodology. (TR 776) That is the only difference between the cost-of-service study filed in the 2005 rate case and the cost-of-service study approved by the Commission in the 1983 rate case. (TR 776)

FIPUG also maintains that customers taking service from the transmission system should not be charged for damages to the distribution system. (FIPUG BR at 17). During cross examination by FIPUG, FPL witness Morley explained that the only distribution costs allocated to transmission customers are meters because that portion of distribution costs is required to serve transmission customers. (TR 779) No other distribution costs are allocated to transmission voltage customers. (TR 780) In its brief, FPL further states that the allocation of meter costs to transmission voltage customers is consistent with the cost-of-service approved by the Commission in the 1983 FPL rate case and the cost-of-service filed in the 2005 FPL rate case. (FPL BR at 167). In the 2004 Storm Order, the allocation of distribution costs is not consistent with the way distribution costs were allocated in FPL's last filed cost-of-service study. (TR 780)

### **CONCLUSION**

FPL's proposed allocation of the costs approved for securitization as described in the direct testimony of witness Morley is appropriate and should be approved.



**Issue 81:** If the Commission approves recovery of any storm-related costs through securitization, what is the appropriate recovery period for the Storm Recovery Charge?

**Recommendation:** Based on the amount proposed in FPL's petition, the appropriate recovery period is up to 12 years or until the storm recovery bonds and associated charges have been paid in full, depending on the issuance date of the bonds, maturity of the bonds, and market conditions at the time of the issuance. If the amount approved by the Commission for recovery through securitization is reduced based on Commission decisions on other issues, it may be possible to reduce the maximum maturity of the bonds (and thus the recovery period) and still have a leveled charge that is comparable or less than the current 2004 storm charge. (Draper, Springer)

**Position of the Parties**

**FPL:** The appropriate recovery period is approximately twelve years, subject to the flexibility to accommodate market preferences discussed in Issue 71.

**OPC:** No position.

**FIPUG:** Agree with FPL.

**FRF:** No position.

**AARP:** No position.

**FEA:** FEA supports a 12 year recovery period.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL states that the appropriate recovery period is approximately twelve years. AARP, AG, FRF, and OPC take no position. FEA and FIPUG agree with FPL.

**ANALYSIS**

FPL witness Dewhurst testified that the storm recovery bonds will be issued in multiple tranches (or classes) with varying maturities to attract a greater number of investors. Exact pricing, terms, tranches and other characteristics will be determined at the time of the issuance and will depend on prevailing market conditions. (TR 76) FPL witness Olson also testified on this issue stating that storm-recovery bonds will be issued in multiple tranches, with average lives that range from two to ten years approximately. The scheduled maturity of the bonds will match the intended recovery period at twelve years from the date of issuance. (TR 657) In his prefiled direct testimony, witness Olson provided a table showing a list of the tranches which he would recommend under market conditions as of November 30, 2005. (EXH 30) The table shows four tranches with scheduled maturity dates ranging from 2010 to August 2018.

During cross examination, witness Dewhurst explained that the recovery period could be changed, but FPL has proposed a series of tranches of different maturities that investors typically buy. (TR 1784) He further stated that it would be possible to shorten the period, but that it would be difficult to stretch the recovery period out much further without running into market acceptance problems. (TR 1785)

### **CONCLUSION**

Based on the amount proposed in FPL's petition, the appropriate recovery period is up to 12 years or until the storm recovery bonds and associated charges have been paid in full, depending on the issuance date of the bonds, maturity of the bonds, and market conditions at the time of the issuance. If the amount approved by the Commission for recovery through securitization is reduced based on Commission decisions in other issues, it may be possible to reduce the maximum maturity of the bonds (and thus the recovery period) and still have a levelized charge that is comparable or less than the current 2004 storm charge.

**Issue 82:** Is FPL's proposed Storm Charge True-Up Mechanism appropriate and consistent with 366.8260, Florida Statutes, and should it be approved? If not, what formula-based mechanism for making expeditious periodic adjustments to storm-recovery charges should be approved?

**Recommendation:** Yes. FPL's proposed Storm Charge True-Up Mechanism is appropriate and consistent with Section 366.8260, Florida Statutes. According to the statute, the Commission has to approve the requested true-up or inform FPL of any mathematical errors in its calculation within 60 days. In its true-up filings with the Commission, FPL should also provide workpapers showing all inputs and calculations, including the calculation of the storm bond repayment charges and storm bond tax charges by rate class. (Draper, Slemkewicz)

**Position of the Parties**

**FPL:** Yes, FPL's proposed mechanism is appropriate, consistent with the statute, and should be approved.

**OPC:** No position.

**FIPUG:** Agree with FPL.

**FRF:** No position.

**AARP:** No position.

**FEA:** No position.

**AG:** Adopts and agrees with the position set forth by OPC.

**Staff Analysis:**

**PARTIES' ARGUMENTS**

FPL states that its proposed true-up mechanism is appropriate and consistent with the statute. AARP, AG, FRF, and OPC take no position. FEA and FIPUG agree with FPL.

**ANALYSIS**

FPL witness Davis testified that according to Section 366.8260(2)(b)2.e, Florida Statutes, if the Commission issues a Financing Order to FPL, the Commission will

Include a formula-based mechanism for making expeditious periodic adjustments in the storm-recovery charges that customers are required to pay under the financing order and for making any adjustments that are necessary to correct for any overcollection or undercollection of the charges or to otherwise ensure the timely payment of storm-recovery bonds and financing costs and other required amounts and charges payable in connection with the storm-recovery bonds.

Witness Davis further testified that this true-up mechanism helps to ensure that the customers pay no more or less than what is required under storm-recovery financing and helps mitigate bondholders' exposure to differences in actual and estimated sales forecasts, uncollectible accounts receivable, and cash flow variability. (TR 456)

In addition to prescribing a formula-based mechanism, Section 366.8260(2)(b)4, Florida Statutes, requires FPL to detail in its true-up filing any adjustment made for the undercollection or overcollection of revenues as follows:

Such adjustments shall ensure the recovery of revenues sufficient to provide for the payment of principal, interest, acquisition, defeasance, financing costs, or redemption premium and other fees, costs, and charges in respect of storm-recovery bonds approved under the financing order.

(TR 457)

Witness Davis in his direct testimony provided an exhibit that shows how the true-up mechanism would work. (EXH 24)

In summary, FPL's proposed true-up mechanism would address the overcollection or undercollection of the storm bond repayment charge and the storm bond tax charge for the prior period. (TR 458) That amount would be added or subtracted to the bond revenue requirement to be billed during the upcoming period. Based on forecasted sales for all retail classes for the upcoming period, FPL proposes to calculate an average retail storm bond repayment charge and an average retail storm bond tax charge.

FPL witness Morley explained how the average retail storm bond repayment charge and the average retail storm bond tax charge are broken down to specific charges per rate class. (TR 759) The average retail storm bond repayment charge will be compared to the average retail storm bond repayment charge currently in place. The same comparison will be performed for the storm bond tax charge. To the extent that the two charges differ, proportional adjustments will be made to each rate class's individual charges. (TR 759; EXH 4, p. 173) Witness Morley also testified that each rate class's storm charge should be relatively constant over time barring unexpected sales and cost variations. (TR 760)

As stated in stipulated Issue 83, FPL will file for a storm charge true-up at least every six months, in accordance with Section 366.8260(2)(b)4, Florida Statutes. Witness Davis testified that the Commission should either approve the requested true-up or inform FPL of any mathematical error in its calculation within 30 days of filing the true-up. (TR 456) Staff notes that Section 366.8260(2)(b)4, Florida Statutes states that within 60 days after receiving an electric utility's request pursuant to this paragraph, the Commission shall either approve the request or inform the electric utility of any mathematical errors in its calculation.

### **CONCLUSION**

Staff agrees with FPL that its proposed true-up mechanism is appropriate and consistent with the statute. However, staff does not believe it is appropriate to reduce the Commission's time to review FPL's requested true-up from 60 days as allowed by Section 366.8260(2)(b)4, Florida Statutes, to 30 days as proposed by FPL. Staff will endeavor to review FPL's proposed true-up in a timely manner, but does not believe that the Commission should limit its review time from what is prescribed in the statute. In its true-up filings with the Commission, FPL should also provide workpapers showing all inputs and calculations, including the calculation of the storm bond repayment charges and storm bond tax charges by rate class to allow for a complete and thorough review.

**Issue 83:** STIPULATED: How frequently should the Storm Charge True-up Mechanism be conducted?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "At least every six months." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "At least every six months." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Issue 84:** STIPULATED: If the Commission approves the securitization of unrecovered 2004 storm costs, on what date should the 2004 Storm Restoration Surcharge be terminated?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "The current Storm Restoration Surcharge should be terminated concurrent with the effective date of the proposed Storm Charge." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "The current Storm Restoration Surcharge should be terminated concurrent with the effective date of the proposed Storm Charge." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Issue 85:** STIPULATED: If the Commission approves an amount to be securitized, on what date should the Storm Recovery Charge become effective?

**Recommendation:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "The Storm Charge and its components, the Storm Bond Repayment Charge and the Storm Bond Tax Charge, should be implemented on the first meter reading day after the issuance of the storm recovery bonds." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, FPL and staff agreed to the following position on this issue: "The Storm Charge and its components, the Storm Bond Repayment Charge and the Storm Bond Tax Charge, should be implemented on the first meter reading day after the issuance of the storm recovery bonds." All Intervenors maintained "no position" on the issue but did not object to the Stipulation between staff and FPL. Staff recommends approval of this Stipulation.

**Issue 86:** STIPULATED: Should the Storm Recovery Charge be recognized as a separate line item on the customers' bill?

**Recommendation:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue: "Yes." Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue: "Yes." Staff recommends approval of this Stipulation.

**Issue 87:** STIPULATED: Are revenues collected through the approved mechanism for recovery (securitization or surcharge) excluded for purposes of performing any potential retail base rate revenue refund calculation under the Stipulation and Settlement approved by Commission Order PSC-05-0902-S-EI?

**Recommendation:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue: "Yes." Staff recommends approval of this Stipulation.

**Staff Analysis:** As reflected in the Prehearing Order, the parties Stipulated to the following position on this issue. "Yes." Staff recommends approval of this Stipulation.

**Issue 88:** Should this docket be closed?

**Recommendation:** This docket should remain open throughout the bond issuance process and through the completion of the Commission's post-issuance review of the actual costs of the bond issuance. Prior to implementing the initial storm charges by rate class, FPL should file tariff sheets to be administratively approved by staff within 3 business days. (Brubaker, Gervasi, Keating, Draper)

**Staff Analysis:** This docket should remain open throughout the bond issuance process and through the completion of the Commission's post-issuance review of the actual costs of the bond issuance. After the sale of the bonds and prior to implementation of the initial storm charges by rate class, FPL should file tariff sheets to be administratively approved by staff within 3 business days. FPL proposed in its financing order (EXH B to FPL's Petition, p.3) that staff review the tariff sheets and associated storm charges within 24 hours. Staff will endeavor to review FPL's initial storm charges within 24 hours, but believes that a review time up to 3 business days is more appropriate to allow for a complete and thorough review.



## Survey of Ratepayer-Backed Bond Underwriter Agreements

Investor-Owned Ratepayer- Backed Bond Securitization Transactions 2004- PRESENT	Underwriters	As a result of eToys litigation:  Language from Underwriting Agreement on File with SEC Explicitly Stating that the Underwriters Have No Fiduciary Duty (Best Interests) to the Issuer and Therefore to Ratepayers in a Ratepayer-Backed Bond Public Offering SOURCE: SEC Filings
AEP Texas Restoration Funding LLC (9/11/2019)	Goldman Sachs & Co., LLC, Citigroup Global Markets Inc., Loop Capital Markets LLC, Samuel A. Ramire: & Company, Inc.	<b>“Absence of Fiduciary Relationship.</b> Each of the Issuer and AEP Texas acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and AEP Texas with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or AEP Texas. Additionally, none of the Underwriters is advising the Issuer or AEP Texas as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and AEP Texas shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or AEP Texas with respect thereto. Any review by the Underwriters of the Issuer or AEP Texas, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or AEP Texas.”
PSNH Funding LLC 3 (5/1/2018)	Goldman Sachs & Co. LLC, Citigroup Global Markets Inc. Barclays Capital Inc. Merrill Lynch, Pierce, Fenner & Smith Inc.	<b>“Absence of Fiduciary Relationship.</b> Each of the Issuer and PSNH acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and PSNH with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as an advisor, a fiduciary to, or an agent of, the Issuer or PSNH irrespective of whether one or more of the Underwriters have advised or are advising PSNH and/or the Issuer on other matters. Additionally, none of the Underwriters is advising the Issuer or PSNH as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and PSNH shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or PSNH with respect thereto. Any review by the Underwriters of the Issuer or PSNH, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or PSNH.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Duke Energy  
Florida Project  
Finance LLC  
(6/15/2016)

RBC Capital  
Markets, LLC,  
Guggenheim  
Securities, LLC,  
Drexel Hamilton,  
LLC, Jefferies Inc.  
Mitsubishi UFJ  
Securities (USA),  
Inc., Samuel A.  
Ramirez  
& Company, Inc.,  
SMBC Nikko  
Securities  
America, Inc., The  
Williams  
Capital Group,  
L.P.

**“No Advisory or Fiduciary Relationship.** Each of the Issuer and the Depositor acknowledges and agrees that (a) the purchase and sale of the Bonds pursuant to this Agreement, including the determination of the offering price of the Bonds and any related discounts and commissions, is an arm’s-length commercial transaction between the Issuer and the Depositor, on the one hand, and the several Underwriters, on the other hand, (b) in connection with the offering and the process leading thereto, each Underwriter is and has been acting solely as a principal and is not the agent or fiduciary of either the Issuer or the Depositor, any of their subsidiaries or their respective members, directors, creditors, employees or any other party, (c) no Underwriter has assumed or will assume an advisory or fiduciary responsibility in favor of the Issuer or the Depositor with respect to the offering or the process leading thereto (irrespective of whether such Underwriter has advised or is currently advising the Issuer or the Depositor or any of its subsidiaries on other matters) and no Underwriter has any obligation to the Issuer or the Depositor with respect to the offering except the obligations expressly set forth in this Agreement, (d) the Underwriters and their respective affiliates may be engaged in a broad range of transactions that involve interests that differ from those of the Issuer or the Depositor, (e) any duties and obligations that the Underwriters may have to the Issuer or the Depositor shall be limited to those duties and obligations specifically stated herein and (f) the Underwriters have not provided any legal, accounting, regulatory or tax advice with respect to the offering and each of the Issuer and the Depositor has consulted its own respective legal, accounting, regulatory and tax advisors to the extent it deemed appropriate.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Entergy New  
Orleans Storm  
Recovery  
Funding I  
(7/14/15)

Citigroup

**“Absence of Fiduciary Relationship.** Each of the Issuer and ENO acknowledges and agrees that the Issuer and ENO, respectively, each have arm’s length business relationships with the Underwriters and their affiliates, that create no fiduciary duty on the part of the Underwriters and their affiliates, in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters’ obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and ENO (and each employee, representative or other agent of the Issuer or ENO, as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or ENO relating to such tax treatment and tax structure. For purposes of the foregoing, the term “tax treatment” is the purported or claimed federal, state or local income tax treatment of the sale of the Storm Recovery Property, the collection of the Storm Recovery Charges or the payment on the Bonds, and the term “tax structure” includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby.”

Consumers  
2014  
Securitization  
Funding LLC  
(7/14/2014)

Citigroup/  
Goldman Sachs/  
PNC Capital  
Markets LLC

**“Absence of Fiduciary Relationship.** Each of the Issuer and Consumers acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and Consumers with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or Consumers. Additionally, none of the Underwriters is advising the Issuer or Consumers as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and Consumers shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or Consumers with respect thereto. Any review by the Underwriters of the Issuer or Consumers, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or Consumers.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Appalachian  
Consumer Rate  
Relief Funding  
LLC  
(11/6/2013)

Royal Bank of  
Scotland/ Morgan  
Stanley/  
PNC Capital  
Markets LLC/  
Wells Fargo  
Securities, LLC/  
Bank of America  
Merrill Lynch

**“Absence of Fiduciary Relationship.** Each of the Issuer and APCo acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and APCo with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or APCo. Additionally, none of the Underwriters is advising the Issuer or APCo as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and APCo shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or APCo with respect thereto. Any review by the Underwriters of the Issuer or APCo, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or APCo.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Ohio Phase-In-  
Recovery  
Funding LLC  
(7/23/2013)

Citigroup/ Royal  
Bank of Canada/  
PNC Capital  
Markets LLC/  
Royal Bank of  
Scotland Securities  
Inc./  
Wells Fargo  
Securities, LLC

**“Absence of Fiduciary Relationship.** Each of the Issuer and OPCo acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and OPCo with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or OPCo. Additionally, none of the Underwriters is advising the Issuer or OPCo as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and OPCo shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or OPCo with respect thereto. Any review by the Underwriters of the Issuer or OPCo, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or OPCo.”

FirstEnergy  
Ohio PIRB  
Special Purpose  
Trust  
(6/12/2013)

Citigroup/ CAS/  
Goldman Sachs/  
Barclays Capital  
Inc./  
Royal Bank of  
Scotland Securities  
Inc./  
Bank of America  
Merrill Lynch

**“Absence of Fiduciary Relationship.** The Bond Issuers and the Sponsors acknowledge and agree that: (a) the Representatives have been retained solely to act as underwriters in connection with the sale of Certificates and that no fiduciary, advisory or agency relationship between the Issuing Entity, the Bond Issuers, the Sponsors and the Representatives have been created in respect of any of the transactions contemplated by this Underwriting Agreement, irrespective of whether the Representatives have advised or are advising the Sponsors on other matters; (b) the price of the Certificates set forth in the final term sheet attached as Annex A to Schedule II hereto was established by the Bond Issuers and the Sponsors following discussions and arms-length negotiations with the Representatives and the Bond Issuers and the Sponsors are capable of evaluating and understanding and understand and accept the terms, risks and conditions of the transactions contemplated by this Underwriting Agreement; (c) the Bond Issuers and the Sponsors have been advised that the Representatives and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Bond Issuers and the Sponsors and that the Representatives have no obligation to disclose such interests and transactions to the Bond Issuers or the Sponsors by virtue of any fiduciary, advisory or agency relationship; and (d) the Issuing Entity, the Bond Issuers and the Sponsors waive, to the fullest extent permitted by law, any claims it may have against the Representatives for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Representatives shall have no liability (whether direct or indirect) to the Issuing Entity, the Bond Issuers or the Sponsors in respect of such a fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Issuing Entity, the Bond Issuers and the Sponsors including stockholders, employees or creditors of the Issuing Entity, the Bond Issuers and the Sponsors.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

AEP Texas  
Central  
Transition  
Funding III  
(3/7/2012)

Morgan Stanley/  
Barclays/  
Citigroup/  
Goldman Sachs/  
Samuel A. Ramire:  
& Company, Inc./  
Royal Bank of  
Scotland Securities  
Inc./ Wells Fargo  
Securities, LLC

**“Absence of Fiduciary Relationship.** Each of the Issuer and TCC acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and TCC with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or TCC. Additionally, none of the Underwriters is advising the Issuer or TCC as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and TCC shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or TCC with respect thereto. Any review by the Underwriters of the Issuer or TCC, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or TCC.”

CenterPoint  
Energy  
Transition  
Bond Co. IV  
(1/11/2012)

Goldman Sachs/  
Citigroup/Morgan  
Stanley/  
Bank of America  
Merrill Lynch/  
Barclays Capital/  
J.P. Morgan/  
Loop Capital  
Markets/  
Royal Bank of  
Scotland

**“Absence of Fiduciary Relationship.** Each of the Issuer and the Company acknowledges and agrees that:  
(a) the Underwriters have been retained solely to act as underwriters in connection with the sale of the Bonds and that no fiduciary, advisory or agency relationship between the Underwriters, on one hand, and the Company and/or the Issuer, on the other hand, has been created in respect of any of the transactions contemplated by this Underwriting Agreement irrespective of whether one or more of the Underwriters have advised or are advising the Company and/or the Issuer on other matters;  
(b) the price of the Bonds was established by the Issuer and the Company following discussions and arms-length negotiations with the Underwriters, among others and the Issuer and the Company have each consulted their own legal and financial advisors to the extent it deemed appropriate;  
(c) it has been advised that the Underwriters and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Issuer and Company and that the Underwriters have no obligation to disclose such interests and transactions to the Issuer or the Company by virtue of any fiduciary, advisory or agency relationship; and (d) it waives, to the fullest extent permitted by law, any claims it may have against the Underwriters for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Underwriters shall have no liability (whether direct or indirect) to the Issuer or the Company in respect of such fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Issuer or the Company including stockholders, employees or creditors of the Issuer and/or the Company.”



## Survey of Ratepayer-Backed Bond Underwriter Agreements

Entergy  
Louisiana  
Investment  
Recovery  
Funding I, LLC  
(9/15/2011)

Morgan Stanley/  
Citigroup/  
Morgan Keegan &  
Company, Inc./  
Stephens Inc.

**“Absence of Fiduciary Relationship.** Each of the Issuer and ELL acknowledges and agrees that the Issuer and ELL, respectively, each have arm’s length business relationships with the Underwriters and their affiliates, that create no fiduciary duty on the part of the Underwriters and their affiliates, in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters’ obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and ELL (and each employee, representative or other agent of the Issuer or ELL, as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or ELL relating to such tax treatment and tax structure. For purposes of the foregoing, the term “tax treatment” is the purported or claimed federal, state or local income tax treatment of the sale of the Investment Recovery Property, the collection of the Investment Recovery Charges or the payment on the Bonds, and the term “tax structure” includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby.”

Entergy  
Arkansas  
Restoration  
Funding LLC  
(8/11/2010)

Morgan Stanley

**“Absence of Fiduciary Relationship.** Each of the Issuer and EAI acknowledges and agrees that the Issuer and EAI, respectively, each have arm’s length business relationships with Morgan Stanley & Co. Incorporated and Stephens Inc., and their respective affiliates, that create no fiduciary duty on the part of Morgan Stanley & Co. Incorporated and Stephens Inc., and their respective affiliates, in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters’ obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and EAI (and each employee, representative or other agent of the Issuer or EAI, as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or EAI relating to such tax treatment and tax structure. For purposes of the foregoing, the term “tax treatment” is the purported or claimed federal, state or local income tax treatment of the sale of the storm recovery property, the collection of the storm recovery charges or the payment on the Bonds, and the term “tax structure” includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

MP Environmental Funding LLC (12/16/2009)	Jefferies/ Williams	<p><b>“Absence of Fiduciary Relationship.</b> The Issuer and Mon Power each acknowledge and agree that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and Mon Power with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or Mon Power. Additionally, none of the Underwriters is advising the Issuer or Mon Power as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and Mon Power shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or Mon Power with respect thereto. Any review by the Underwriters of the Issuer or Mon Power, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or Mon Power.”</p>
PE Environmental Funding LLC (12/16/2009)	Jefferies/ Williams	<p><b>“Absence of Fiduciary Relationship.</b> The Issuer and Potomac Edison each acknowledge and agree that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and Potomac Edison with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or Potomac Edison. Additionally, none of the Underwriters is advising the Issuer or Potomac Edison as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and Potomac Edison shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or Potomac Edison with respect thereto. Any review by the Underwriters of the Issuer or Potomac Edison, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or Potomac Edison.”</p>



## Survey of Ratepayer-Backed Bond Underwriter Agreements

CenterPoint  
Energy  
Restoration  
Bond  
(11/18/2009)

Goldman Sachs/  
Citigroup

**“Absence of Fiduciary Relationship.** Each of the Issuer and the Company acknowledges and agrees that:  
(a) the Underwriters have been retained solely to act as underwriters in connection with the sale of the Bonds and that no fiduciary, advisory or agency relationship between the Underwriters, on one hand, and the Company and/or the Issuer, on the other hand, has been created in respect of any of the transactions contemplated by this Underwriting Agreement irrespective of whether one or more of the Underwriters have advised or are advising the Company and/or the Issuer on other matters;  
(b) the price of the Bonds was established by the Issuer and the Company following discussions and arms-length negotiations with the Underwriters, among others and the Issuer and the Company have each consulted their own legal and financial advisors to the extent it deemed appropriate;  
(c) it has been advised that the Underwriters and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Issuer and Company and that the Underwriters have no obligation to disclose such interests and transactions to the Issuer or the Company by virtue of any fiduciary, advisory or agency relationship; and (d) it waives, to the fullest extent permitted by law, any claims it may have against the Underwriters for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Underwriters shall have no liability (whether direct or indirect) to the Issuer or the Company in respect of such fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Issuer or the Company including stockholders, employees or creditors of the Issuer and/or the Company.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Entergy Texas  
Restoration  
Funding  
(10/29/09)

Morgan Stanley/  
Citigroup

**“Absence of Fiduciary Relationship.** Each of the Issuer and ETI acknowledges and agrees that the Issuer and ETI, respectively, each have arm's length business relationships with Morgan Stanley & Co. Incorporated, Citigroup Global Markets Inc., Goldman, Sachs & Co., Royal Bank of Scotland Securities Inc. and Loop Capital Markets, LLC, and their respective affiliates, that create no fiduciary duty on the part of Morgan Stanley & Co. Incorporated, Citigroup Group Global Markets Inc., Goldman, Sachs & Co., Royal Bank of Scotland Securities Inc. and Loop Capital Markets, LLC, and their respective affiliates, in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters' obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and ETI (and each employee, representative or other agent of the Issuer or ETI , as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or ETI relating to such tax treatment and tax structure. For purposes of the foregoing, the term "tax treatment" is the purported or claimed federal, state or local income tax treatment of the sale of the transition property, the collection of the transition charges or the payment on the Bonds, and the term "tax structure" includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Cleco  
Katrina/Rita  
Hurricane  
Recovery  
Funding LLC  
2008  
(2/28/2008)

Credit Suisse First Boston **“Absence of Fiduciary Relationship.”** Each of the Issuer and CPL acknowledges and agrees that the Issuer and CPL, respectively, each have arm’s length business relationships with Credit Suisse Securities (USA) LLC, Wachovia Capital Markets, LLC and DEPFA First Albany Securities LLC, and their respective affiliates that create no fiduciary duty on the part of Credit Suisse Securities (USA) LLC, Wachovia Capital Markets, LLC and DEPFA First Albany Securities LLC, and their respective affiliates in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters’ obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and CPL (and each employee, representative or other agent of the Issuer or CPL, as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or CPL relating to such tax treatment and tax structure. For purposes of the foregoing, the term “tax treatment” is the purported or claimed federal, state or local income tax treatment of the sale of the storm recovery property, the collection of the storm recovery charges or the payment on the Bonds, and the term “tax structure” includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

CenterPoint  
Energy  
Transition  
Bond Company  
III  
(1/29/2008)

Citigroup

**“Absence of Fiduciary Relationship.** Each of the Issuer and the Company acknowledges and agrees that:  
(a) the Underwriters have been retained solely to act as underwriters in connection with the sale of the Bonds and that no fiduciary, advisory or agency relationship between the Underwriters, on one hand, and the Company and/or the Issuer, on the other hand, has been created in respect of any of the transactions contemplated by this Underwriting Agreement, irrespective of whether the Underwriters have advised or are advising the Company and/or the Issuer on other matters;  
(b) the price of the Bonds was established by the Issuer and the Company following discussions and arms-length negotiations with the Underwriters, among others; (c) it has been advised that the Underwriters and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Issuer and Company and that the Underwriters have no obligation to disclose such interests and transactions to the Issuer or the Company by virtue of any fiduciary, advisory or agency relationship; and (d) it waives, to the fullest extent permitted by law, any claims it may have against the Underwriters for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Underwriters shall have no liability (whether direct or indirect) to the Issuer or the Company in respect of such fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Issuer or the Company including stockholders, employees or creditors of the Issuer and/or the Company.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Entergy Gulf  
States  
Reconstruction  
Funding I, LLC  
(6/22/2007)

Citigroup

**“Absence of Fiduciary Relationship.** Each of the Issuer and EGSI acknowledges and agrees that the Issuer and EGSI, respectively, each have arm's length business relationships with Morgan Stanley & Co. Incorporated, First Albany Capital Inc., Loop Capital Markets, LLC and M.R. Beal & Company, and their respective affiliates that create no fiduciary duty on the part of Morgan Stanley & Co. Incorporated, First Albany Capital Inc., Loop Capital Markets, LLC and M.R. Beal & Company, and their respective affiliates in connection with all aspects of the transactions contemplated by this Underwriting Agreement, and each such party expressly disclaims any fiduciary relationship. Nothing in this Section is intended to modify in any way the Underwriters' obligations expressly set forth in the Underwriting Agreement. Notwithstanding any other provision of this Underwriting Agreement, immediately upon commencement of discussions with respect to the transactions contemplated hereby, the Issuer and EGSI (and each employee, representative or other agent of the Issuer or EGSI, as the case may be) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transactions contemplated by this Agreement and all materials of any kind (including opinions or other tax analyses) that are provided to the Issuer or EGSI relating to such tax treatment and tax structure. For purposes of the foregoing, the term "tax treatment" is the purported or claimed federal, state or local income tax treatment of the sale of the transition property, the collection of the transition charges or the payment on the Bonds, and the term "tax structure" includes any fact that may be relevant to understanding the purported or claimed federal, state or local income tax treatment of the transactions contemplated hereby.”

RSB BondCo  
LLC (BG&E  
sponsor)  
(6/22/2007)

Barclays  
/Citigroup/ Royal  
Bank of Scotland/  
Morgan Stanley

**“Absence of Fiduciary Relationship.** Each of the Issuer and BGE acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm's length contractual counterparty to the Issuer and BGE with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or BGE. Additionally, none of the Underwriters is advising the Issuer or BGE as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and BGE shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or BGE with respect thereto. Any review by the Underwriters of the Issuer or BGE, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or BGE.

## Survey of Ratepayer-Backed Bond Underwriter Agreements

FPL Recovery  
Funding LLC  
(5/15/07)

Wachovia

**“Absence of Fiduciary Relationship.** The Issuer and FPL each acknowledge and agree that the Purchasers are acting solely in the capacity of an arm's length contractual counterparty to the Issuer and FPL with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or FPL in connection with the offering of the Bonds as contemplated hereby. Additionally, none of the Purchasers is advising the Issuer or FPL as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. Any review by the Purchasers of the Issuer or FPL, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Purchasers and shall not be on behalf of the Issuer or FPL.”

MP  
Environmental  
Funding LLC  
(4/3/2007)

First Albany Corp/  
Loop Capital  
Markets/ Bear  
Stearns

**“Absence of Fiduciary Relationship.** The Issuer, MP Renaissance and Mon Power each acknowledge and agree that the Underwriters are acting solely in the capacity of an arm's length contractual counterparty to the Issuer, MP Renaissance and Mon Power with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer, MP Renaissance or Mon Power. Additionally, none of the Underwriters is advising the Issuer, MP Renaissance or Mon Power as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer, MP Renaissance and Mon Power shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer, MP Renaissance or Mon Power with respect thereto. Any review by the Underwriters of the Issuer, MP Renaissance or Mon Power, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or Mon Power.”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

PE Environmental Funding, LLC (4/3/2007)	First Albany Corp/ Loop Capital Markets/ Bear Stearns	<b>“Absence of Fiduciary Relationship.</b> The Issuer, PE Renaissance and Potomac Edison each acknowledge and agree that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer, PE Renaissance and Potomac Edison with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer, PE Renaissance or Potomac Edison. Additionally, none of the Underwriters is advising the Issuer, PE Renaissance or Potomac Edison as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer, PE Renaissance and Potomac Edison shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer, PE Renaissance or Potomac Edison with respect thereto. Any review by the Underwriters of the Issuer, PE Renaissance or Potomac Edison, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or Potomac Edison.”
AEP Texas Central Transition Funding II (10/4/2006)	Credit Suisse Securities (USA) LLC, J.P. Morgan Securities Inc., Greenwich Capital Markets Inc., Bear Stearns & Co., First Albany Capital Inc., Loop Capital Markets, LLC, AB AMRO Incorporated, M.R Beal & Company, Samuel A. Ramire & Co., Inc., Sieber Brandford Shank & Co., LLC.	<b>“Absence of Fiduciary Relationship.</b> Each of the Issuer and TCC acknowledges and agrees that the Underwriters are acting solely in the capacity of an arm’s length contractual counterparty to the Issuer and TCC with respect to the offering of the Bonds contemplated hereby (including in connection with determining the terms of the offering) and not as a financial advisor or a fiduciary to, or an agent of, the Issuer or TCC. Additionally, none of the Underwriters is advising the Issuer or TCC as to any legal, tax, investment, accounting or regulatory matters in any jurisdiction. The Issuer and TCC shall consult with their own advisors concerning such matters and shall be responsible for making their own independent investigation and appraisal of the transactions contemplated hereby, and the Underwriters shall have no responsibility or liability to the Issuer or TCC with respect thereto. Any review by the Underwriters of the Issuer or TCC, the transactions contemplated hereby or other matters relating to such transactions will be performed solely for the benefit of the Underwriters and shall not be on behalf of the Issuer or TCC.”



## Survey of Ratepayer-Backed Bond Underwriter Agreements

JCP&L  
Transition  
Funding II  
(8/4/2006)

Goldman, Sachs &  
Co., Morgan  
Stanley, Citigroup,  
The Williams  
Capital Group, L.P

**“Absence of Fiduciary Relationship.** The Companies acknowledge and agree that: (a) the Underwriters have been retained solely to act as underwriters in connection with the sale of the Bonds and that no fiduciary, advisory or agency relationship between the Companies and any Underwriter has been created in respect of any of the transactions contemplated by this Agreement, irrespective of whether any such Underwriter has advised or is advising the Companies on other matters; (b) the price of the Bonds set forth in the Final Term Sheet was established by the Companies following discussions and arms-length negotiations with the Underwriters and the Companies are capable of evaluating and understanding and understand and accept the terms, risks and conditions of the transactions contemplated by this Agreement; (c) the Companies have been advised that the Underwriters and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Companies and that the Underwriters have no obligation to disclose such interests and transactions to the Companies by virtue of any fiduciary, advisory or agency relationship; and (d) the Companies waive, to the fullest extent permitted by law, any claims they may have against the Underwriters for breach of fiduciary duty or alleged breach of fiduciary duty and agree that the Underwriters shall have no liability (whether direct or indirect) to the Companies in respect of such a fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Companies, including stockholders, employees or creditors of the Companies.”

CenterPoint  
Energy Series A  
(12/9/2005)

Lehman Brothers  
Inc., Credit Suisse  
First Boston LLC,  
Greenwich Capital  
Markets, Inc.,  
Barclays Capital  
Inc., Deutsche  
Bank Securities  
Inc., Goldman,  
Sachs & Co., First  
Albany Capital  
Inc., Loop Capital  
Markets, LLC, M.F  
Beal & Company,  
Siebert Brandford  
Shank & Co., LLC.  
Samuel A. Ramire:  
& Co., Inc.,  
SunTrust Capital  
Markets, Inc.

**“Absence of Fiduciary Relationship.** Each of the Issuer and the Company acknowledges and agrees that: (a) the Underwriters have been retained solely to act as underwriters in connection with the sale of the Bonds and that no fiduciary, advisory or agency relationship between the Underwriters, on one hand, and the Company and/or the Issuer, on the other hand, has been created in respect of any of the transactions contemplated by this Underwriting Agreement, irrespective of whether the Underwriters have advised or are advising the Company and/or the Issuer on other matters; (b) the price of the Bonds was established by the Issuer and the Company following discussions and arms-length negotiations with the Underwriters, among others; (c) it has been advised that the Underwriters and their affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Issuer and Company and that the Underwriters have no obligation to disclose such interests and transactions to the Issuer or the Company by virtue of any fiduciary, advisory or agency relationship; and (d) it waives, to the fullest extent permitted by law, any claims it may have against the Underwriters for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Underwriters shall have no liability (whether direct or indirect) to the Issuer or the Company in respect of such fiduciary duty claim or to any person asserting a fiduciary duty claim on behalf of or in right of the Issuer or the Company including stockholders, employees or creditors of the Issuer and/or the Company.”



## Survey of Ratepayer-Backed Bond Underwriter Agreements

PG&E Energy  
Recovery  
Funding LLC  
Series 2005-2  
(11/3/2005)

Morgan Stanley & Co., Inc., Goldman Sachs & Co., Banc of America Securities LLC, PNC Capital Markets, Inc., Pryor, McClelland Counts & Co., Inc

*Final Underwriting Agreement Not Available*

PSE&G 2005-1  
(9/9/2005)

Credit Suisse First Boston, Barclays Capital Inc., M.R. Beal & Company

**“Absence of Fiduciary Relationship.** The Company acknowledges and agrees that:

(a) The Representative has been retained solely to act as underwriter in connection with the sale of the Transition Bonds and that no fiduciary, advisory or agency relationship between the Company has been created in respect of any of the transactions contemplated by this Underwriting Agreement, irrespective of whether the Representative has advised or is advising the Company on other matters; (b) the price of the Transition Bonds was established by the Company following discussions and arms-length negotiations with the Representative and the Company is capable of evaluating and understanding and understands and accepts the terms, risks and conditions of the transaction contemplated by this Underwriting Agreement;

(c) has been advised that the Representative and its affiliates are engaged in a broad range of transactions which may involve interests that differ from those of the Company and that the Representative has no obligation to disclose such interests and transactions to the Company by virtue of any fiduciary, advisory or agency relationship; and

(d) it waives, to the fullest extent permitted by law, any claims it may have against the Representative for breach of fiduciary duty or alleged breach of fiduciary duty and agrees that the Representative shall have no liability (whether direct or indirect) to the Company in respect of such fiduciary duty claim or to any person asserting a investment quality of the Transition Bonds or makes it impractical or inadvisable to market the Transition Bonds, (ii) trading in the Company's Common Stock shall have been suspended by the Commission or the New York Stock Exchange or trading in securities generally on the New York Stock Exchange shall have been suspended or limited or minimum prices shall have been established on such Exchange, (iii) a banking moratorium shall have been declared either by federal, State of New York or State of New Jersey authorities or (iv) there shall have occurred any outbreak or escalation of hostilities, declaration by the United States of a national emergency or war or other calamity or crisis the effect of which on financial markets is such as to make it, in the judgment of the Representative, impracticable or inadvisable to proceed with the offering or delivery of the Transition Bonds as contemplated by the Final Prospectus (exclusive of any supplement thereto).”

## Survey of Ratepayer-Backed Bond Underwriter Agreements

Massachusetts RRB Special Purpose Trust 2005-1 (2/15/2005)	Goldman, Sachs & Co., Lehman Brothers Inc.	NO LANGUAGE
PG&E Energy Recovery Funding LLC Series 2005-1 (2/3/2005)	Morgan Stanley Citigroup Lehman Brothers ABN AMRO Barclays Capital BNP Paribas Deutsche Bank Securities M.R. Beal & Co.	NO LANGUAGE
Rockland Electric Company Transition Funding LLC (7/28/2004)	Citigroup, Goldman, Sachs & Co.	NO LANGUAGE
Oncor (TXU) 2004-1	Merrill Lynch, Pierce, Fenner & Smith Inc., Wachovia Capital Markets, LLC, Banc of America Securities LLC, Bear, Stearns & Co Inc., Credit Suisse First Boston LLC, M.R. Beal & Company	NO LANGUAGE

I/A

Churaman, Mahendra, 12:32 PM 3/30/2004, RE:

Maher Exhibit 2

Page 1 of 2

X-Original-To: jfichera@saberpartners.com

DOCKET NO. E-2, Sub 1262

Delivered-To: jfichera@saberpartners.com

DOCKET NO. E-7, Sub 1243

Subject: RE:

Date: Tue, 30 Mar 2004 11:32:31 -0500

X-MS-Has-Attach:

X-MS-TNEF-Correlator:

Thread-Topic: RE:

Thread-Index: AcQV2bmgmi5Alm9dQ0Cp+i5yE/oUiAAmq+IQ

From: "Churaman, Mahendra" <mchuraman@thelenreid.com>

To: "Joseph Fichera" <jfichera@saberpartners.com>

X-OriginalArrivalTime: 30 Mar 2004 16:32:31.0699 (UTC) FILETIME=[9949E230:01C41674]

Does the following work for you?

"The broad-based nature of the true-up mechanism and the State Pledge serve to effectively eliminate, for all practical purposes and circumstances, any credit risk associated with the transition bonds."

-----Original Message-----

From: Joseph Fichera [<mailto:jfichera@saberpartners.com>]

Sent: Monday, March 29, 2004 5:04 PM

To: Churaman, Mahendra

Subject: Re:

Hmmmm. I think I like it but for the "reasonably foreseeable".

Let me think and tinker but it is a lot better than I expected.  
Progress. Praise the Lord.

-----Original Message-----

From: "Churaman, Mahendra" <mchuraman@thelenreid.com>

Date: Mon, 29 Mar 2004 16:52:22

To: <jfichera@saberpartners.com>

Subject: FW:

What do you think of Neil's proposed language?

-----Original Message-----

From: Miller, Shannon [<mailto:smiller@hunton.com>] On Behalf Of Anderson, Neil

Sent: Monday, March 29, 2004 3:47 PM

To: Churaman, Mahendra; Ronnie Puckett (E-mail)

Subject:

Ronnie and Mahendra - What do you think of this? Mahendra, if it is okay with you, Steve and Ronnie, you can forward it on.

The broad-based nature of the true-up mechanism and the

State Pledge serve to effectively eliminate, for all practical purposes and in all reasonably foreseeable circumstances, credit risks associated with the transition bonds.

Shannon Miller  
Professional Assistant to Neil Anderson  
Hunton & Williams LLP  
214.979.8247

I/A

## CLIENT UPDATE

August 2005

## Contacts

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jmolenkamp@hunton.com

## Does an Underwriter Owe a Fiduciary Duty to an Issuer?

A recent decision<sup>1</sup> by New York's highest court serves as a warning to underwriters and their counsel of the continuing fallout from the "dot-com" bust of the late 1990s. The decision states that the lead managing underwriter in a firm commitment underwriting may owe a fiduciary duty to the issuer to disclose conflicts of interest in connection with the pricing of securities. The court based its decision not to dismiss the breach of fiduciary duty complaint on the allegation that the underwriter assumed an additional "advisory relationship that was independent of the underwriting agreement."

The plaintiff was the unsecured creditors committee of the now defunct eToys, Inc., an internet-retailer specializing in children's products, that conducted an initial public offering in May 1999. eToys filed for bankruptcy in March 2001. The defendant, Goldman, Sachs & Co., was the IPO's lead managing underwriter. Shares in eToys traded up from the offering price of

\$20 to a first day closing price of \$77. In its breach of fiduciary duty claim, the plaintiff alleged that "eToys relied on Goldman Sachs for its expertise as to pricing, and that Goldman Sachs gave advice to eToys without disclosing that it had a conflict of interest." Specifically, the complaint alleged that Goldman Sachs intentionally underpriced the IPO and then allocated shares from the offering to customers who allegedly "were obligated to kick back to Goldman a portion of any profits that they made" from reselling the shares.

The court found that, even while an underwriting agreement did not in and of itself create a fiduciary duty, a breach of fiduciary duty claim may survive for pleading purposes where the plaintiff alleges that the underwriter had an advisory relationship with the issuer. The court found that such a relationship may have existed because the complaint alleged an advisory relationship that was independent of the underwriting agreement. The court reasoned that an underwriter, as an advisor, is required to disclose to an issuer

<sup>1</sup><http://www.courts.state.ny.us/ctapps/decisions/jun05/61opn05.pdf>

“any material conflicts of interest that render the advice suspect.” As the court stated, the “plaintiff alleges eToys was induced to and did repose confidence in Goldman Sachs’ knowledge and expertise to advise it as to a fair IPO price and engage in honest dealings with eToys’ best interest in mind.” Based on this analysis, the court determined that the complaint adequately alleged that Goldman Sachs breached its fiduciary duty to eToys by failing to disclose an alleged conflict of interest stemming from “its profit-sharing arrangements with its clients.”

The court’s finding is troubling because the mere allegation by a plaintiff that the relationship involved something greater than just an underwriting relationship may now be enough to sustain a lawsuit. It is too early to understand the ramifications of this decision, but we believe the court, by finding such a fiduciary relationship, misread the role of lead underwriters in modern public offerings. In the ordinary course of raising capital for clients, lead underwriters almost always advise clients on the market conditions for the offering and the price of the offering. As the dissent stated, the consequences of this deci-

sion “wars with [the court’s] precedent and potentially conflicts with a highly complex regulatory framework designed to safeguard investors.”

As a result of this decision, we recommend that underwriters:

- update their form underwriting agreements to include provisions disclaiming any type of fiduciary relationship with the issuer and making the issuer aware that there is no such type of relationship; and
- adopt internal procedures to make the limited nature of the relationship expressly clear to the issuer.

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I/A



## Fiduciary Standard Resource Center

### Overview

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*A fiduciary relationship is generally viewed as the highest standard of customer care available under law.*

Fiduciary duty includes both a duty of care and a duty of loyalty. Collectively, and generally speaking, these duties require a fiduciary to act in the best interest of the customer, and to provide full and fair disclosure of material facts and conflicts of interest.

Today, financial advisers and broker-dealers are regulated by different laws. The current system, established in the 1940s, leaves states free to develop their own often conflicting definitions of fiduciary standards. This can confuse investors and lead to inconsistent definitions and interpretations under existing state law.

As part of its comprehensive financial regulatory proposal in 2009, the Obama Administration proposed to standardize the care that investors receive from financial professionals, whether financial advisers or broker-dealers at the federal level.

Under the Dodd-Frank Act, Congress directed the Securities and Exchange Commission (SEC) to study the need for establishing a new, uniform, federal fiduciary standard of care for brokers and investment advisers providing personalized investment advice. The Act further authorized the SEC to establish such a standard if it saw fit.

Separate from and conflicting with the definition of fiduciary being contemplated under Dodd-Frank, the Department of Labor (DOL) has proposed a wholesale revision to its regulation that redefines what it means to be a fiduciary under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code.

See SIFMA's resource center on the [DOL Fiduciary Standard](#) >

### Position

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Since early 2009, SIFMA has consistently advocated for the establishment of a new uniform fiduciary standard, and not application of the Advisers Act fiduciary standard to broker-dealers.

The new standard envisioned by SIFMA would: put retail customers' interests first; provide adequate flexibility to preserve and enhance customer choice of and access to financial products and services, and capital formation; provide for conflicts management; apply only to, and be tailored for, those services and activities that involve providing personalized investment advice about securities to retail customers; and not subject financial professionals to other fiduciary obligations (for example, the Advisers Act fiduciary standard, or other statutory standards).

SIFMA, through our member committees and otherwise, continues to engage policymakers and regulators with comprehensive empirical and legal analysis to help inform the process. We are hopeful that our substantive engagement and input will positively impact any rulemaking or other actions on this issue.

I/A



## U.S. Securities and Exchange Commission

### Speech by SEC Staff: Fiduciary Duty: Return to First Principles

*by*

**Lori A. Richards**

*Director, Office of Compliance Inspections and Examinations  
U.S. Securities and Exchange Commission*

Eighth Annual Investment Adviser Compliance Summit  
Washington, D.C.  
February 27, 2006

*As a matter of policy, the SEC disclaims responsibility for any private statement by an employee. The views expressed here today are my own and do not necessarily reflect those of the Commission, the Commissioners or other members of the staff.*

Good morning. I am pleased to be here, as you consider practical methods to address the range of compliance issues that you face. Nothing could be more important to us at SEC than helping to ensure that advisers prevent, detect and correct compliance problems. I want to thank David Tittsworth and Hugh Kennedy for inviting me to speak with you today.

As we look at the compliance environment today, there are some facts worth noting. First, there are a significant number of newly-registered investment advisers. In fact, there are approximately 10,000 advisers registered with the SEC. About 2,000 of these firms, or 20% of the total, have just registered in the last year. These firms vary — they may be recently formed, have simply grown to exceed the 25\$ million assets under management threshold, or have been operational for some time, but are registering with the SEC now because of the Commission's new rules requiring the registration of hedge fund advisers. As new registrants, these firms may be new to the Investment Advisers Act of 1940.

A second fact worth noting is that all advisory firms, whatever their size, type or history in the business, owe their advisory clients a fiduciary duty. Many firms are acutely aware of their fiduciary obligation and ensure that it informs, educates and guides their dealings and decisions. But, one only has to look at our enforcement actions and deficiencies found in exams to draw the conclusion that the application of fiduciary duty is not as embedded in many firms' cultures as it could be. In fact, I'm far from certain that all advisory firms understand their fiduciary obligations, and how they apply in the context of their own operations. Some advisers have seemed to be aware of the fiduciary duty in kind of an ethereal way — "I know it's out there but I don't really know what it is." Others have looked at fiduciary duty as strictly a compliance or legal function — not fully

appreciating its significance to *all* employees of the firm. Either view is dangerous.

## Fiduciary Duty

Understanding "fiduciary duty" is critical, because it is at the core of being a good investment adviser. In a very practical sense, if an adviser and the adviser's employees understand the meaning of fiduciary duty and incorporate this understanding into daily business operations and decision-making, clients should be well served, and the firm should avoid violations and scandal. Indeed, I believe that, even if advisory staff are not aware of specific legal requirements, if their decisions large and small and everyday are motivated and informed by *doing what's right by the client*, in all likelihood, the decision will be right under the securities laws.

This is why, as an examiner, I care about advisers' fiduciary duties. I think that knowledge and familiarity with one's fiduciary duty can help firms *avoid* compliance violations. And, avoidance of violations is in everyone's best interests — yours, your clients and our markets. As examiners, we prefer to find highly compliant firms with strong compliance controls that prevent violations. To demonstrate this point, I wanted to share with you some of the most common deficiencies that we find in our examinations of investment advisers, each of which have fiduciary implications.

But first, I'd like to look more closely at the concept of fiduciary duty. Many different types of professions owe a fiduciary duty to someone — for example, lawyers to their clients, trustees to beneficiaries, and corporate officers to shareholders. Fiduciary duty is the *first principle* of the investment adviser — because the duty comes not from the SEC or another regulator, but from common law. Some people think "fiduciary" is a vague word that's hard to define, but it's really not difficult to define or to understand. Fiduciary comes from the Latin word for "trust." A fiduciary must act for the benefit of the person to whom he owes fiduciary duties, to the exclusion of any contrary interest.<sup>1</sup>

Now, some might wonder why the concept of fiduciary duty came to be applied to advisers. The Investment Advisers Act does not call an adviser a fiduciary. In fact, that word does not appear in the Act. But, the Supreme Court recognized congressional intent and held that the Advisers Act: *"reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship, as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser - consciously or unconsciously - to render advice which was not disinterested."*<sup>2</sup> And, the Court said that: investment advisers are fiduciaries with *"an affirmative duty of 'utmost good faith and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' ... clients."*<sup>3</sup>

I would suggest that an adviser, as that trustworthy fiduciary, has five major responsibilities when it comes to clients. They are:

1. to put clients' interests first;
2. to act with utmost good faith;
3. to provide full and fair disclosure of all material facts;
4. not to mislead clients; and
5. to expose all conflicts of interest to clients.

These responsibilities overlap in many ways. If an adviser is putting clients' interests first, then the adviser will not mislead clients. And, if the adviser is not misleading clients, then it is providing full and fair disclosure, including disclosure of any conflicts of interest.

How do the responsibilities of a fiduciary translate into an adviser's obligations to clients each and every day? This is a key question. Probably no statute or set of rules could contemplate the variety of factual situations and decisions that an advisory firm faces. Can you imagine the number of rules and releases and regulations that this would require? Instead, the Advisers Act incorporates an adviser's fiduciary duty under Section 206, and envisions that, in whatever factual scenario, the adviser will act in the best interests of his clients.

This is a simple statement to make, but one that is more difficult to apply. In thinking about compliance with your fiduciary obligation as an adviser, start by thinking about the areas where there is a conflict of interest — between one's own interests, the interests of the firm, and/or the interests of advisory clients. These are the areas in which compliance with fiduciary obligations are likely to be most challenging. The Compliance Rule envisions this analysis, and the Commission suggested in the release adopting the rule that advisers conduct a risk assessment to identify areas of conflicts of interest.<sup>4</sup>

This is not a one-time effort — the nature of an adviser's relationship with its clients is full of conflicts, and those conflicts change when an adviser's business changes. Addressing and disclosing conflicts of interest is an ongoing process. While some conflicts of interest stand out, others can be very subtle, so an adviser must look, with more than a casual glance, at every aspect of its business, and its relationship with clients, and carefully consider whether it has a conflict of interest. Importantly, at this stage, the question is not whether the adviser acts appropriately in the conflicted situation, but merely whether the conflict itself exists.

The next step, of course, is to disclose material conflicts of interest in a "full and fair" manner and to ensure your clients understand any material conflicts of interest before taking action. Because you are a fiduciary, you should not allow your client to enter the advisory relationship without a clear understanding of all material conflicts.

As I said, and in keeping with the theme of this conference — to provide practical and not just theoretical information on compliance issues — I wanted today to describe the top 5 deficiencies that we find in our exams. It's my hope also that this information may be helpful to newly-registered advisers who are seeking to better understand common compliance pitfalls, conflicts of interest and fiduciary duties. Last year, we examined over 1,500 investment advisers. In those exams, the most common deficiencies were the following:

- **Deficient disclosure** — I'll spend more time talking about disclosure in a minute.
- **Deficiencies in portfolio management** — Problems in this area included inadequate controls to ensure that investments for clients are consistent with their mandates, risk tolerance and goals, and to ensure that required records are kept. Fiduciary duty is implicated in this area because advisers have a duty to ensure that they are

managing their clients' money in a manner that is consistent with the clients' direction.

- **Deficiencies with respect to advisory employees' personal trading** — Problems in this area included a lack of controls, a lack of required codes of ethics, and failure to implement stated procedures to monitor employees' personal trades to prevent employees from placing their own interests above those of their clients, by for example, front-running clients' trades, trading on non-public information, taking investment opportunities for themselves over clients — to ensure that the fiduciary is acting with the loyalty and "utmost good faith" envisioned by the Supreme Court.
- **Deficiencies in performance calculations** — Problems in this area included overstated performance results, comparing results to inappropriate indices, failing to disclose material information about how the performance results were calculated, using prohibited testimonials, and advertising past results in a misleading manner. In this area, a fiduciary must calculate and set forth its past performance in an honest way, and must provide information that is not misleading.
- **Deficiencies in brokerage arrangements and execution** — Deficiencies in this area included poor or no controls to ensure that the adviser obtains "best execution," and secretly using clients' money to pay for client referrals, and for other goods and services that benefit the adviser. Simply stated, because brokerage money belongs to the client and not to the adviser, the adviser has a fiduciary duty to ensure that it is used appropriately and that the client is aware of how his/her money will be and is being spent by the adviser.

## Inadequate Disclosure

Inadequate disclosure has been on the "top 5" list of most frequent deficiencies for some time. And, as it is the most frequently-found deficiency, it's an area that clearly deserves more attention by advisory firms. As such, I'd like to spend some time this morning talking about disclosure and the adviser's fiduciary duty.

Approximately half of the deficiencies that we find in this area relate to inaccurate, incomplete, and even misleading information in Forms ADV, and half include problematic disclosure of business practices and fees charged to clients. Whether you use Form ADV or other disclosure techniques, you should take care to ensure that you are in fact providing full, accurate and complete disclosure, and written in a comprehensible language, designed to be understood by your clients.

So what should you *not* do? Let me illustrate with a few examples from recent examinations.

- Clients were not informed of the real method used to calculate the adviser's fee. Fees appeared to be lower than they were in fact.
- An adviser failed to disclose that he recommends securities to clients in which he has a proprietary interest.

- An adviser failed to disclose the risks to clients that existed by having their assets invested in private investments.
- An adviser failed to disclose that clients with directed brokerage arrangements may not achieve best execution.
- An adviser does not accurately describe the types of products and services it obtains with clients' soft dollars.
- Clients whose assets were invested in mutual funds were not told that they pay both a direct management fee to their adviser and an indirect management fee to the adviser of their mutual funds.
- An adviser stated that it did not have custody of client assets when in fact it did.
- An adviser did not disclose that it receives economic benefit from a non-client in connection with giving advice to clients.
- An adviser did not disclose that even if clients direct that their securities transactions be executed through a certain broker-dealer, the adviser did not actually execute most transactions through that firm.
- An adviser had not amended its ADV for several years although the rules require that it be amended at least annually and more frequently if required, information was therefore out-of-date.
- An adviser incorrectly stated that it did not have discretion to direct trades to specific broker-dealers, when in fact it did.
- Clients were provided with incorrect information about the adviser's review of their accounts, and the frequency of those reviews.

Some of the disclosure deficiencies that we find seem to come from inattention — the failure of the adviser to make sure its Form ADV reflects its current business operations. To my mind, this type of problem stems from lax controls and perhaps from an underfunded infrastructure. Other disclosure deficiencies, however, occur because the adviser either failed to identify a conflict of interest or, having spotted it, chose not to disclose it. In the former case, some advisers appear not to be giving adequate thought to what constitutes a conflict of interest. Importantly, all material conflicts of interest must be disclosed, even if the adviser has taken steps to mitigate those conflicts to ensure that it acts appropriately. And, whether intentional, inattentive or inept, the result is the same — advisory clients are not being provided with accurate information about the adviser.

Disclosure is at the heart of our securities regulatory framework, and as you would assume, it is also at the heart of our examination process. At the start of every exam, SEC examiners review the information that the adviser disseminates about its business, which includes Form ADV, parts I and II. They look at this information to see how an adviser describes its business as well as any business practices that pose potential conflicts of interest between the adviser and its clients. Throughout the exam, the examiners will continue seeking information about how an adviser's business works and what services are provided to clients. When discrepancies or omissions between the firm's written disclosures and its



actual practice are identified, this will trigger heightened scrutiny by the exam staff. As a fiduciary, it is fundamental that what you tell your clients is, in fact, how you conduct your business.

How does an adviser guard against disclosure problems? As you know, the Compliance Rule requires an adviser to adopt and implement policies and procedures to prevent violations, including disclosure violations. To implement this, some firms conduct a periodic in-depth review of the adviser's ADV, along with all other written materials provided to clients and to the public — and then, they compare these disclosures against the firm's actual business operations. The review is conducted by a group of knowledgeable employees who represent all aspects of the firm — from compliance to portfolio management to trading desk to business operations. This is important, because disclosures must reflect actual practice, and who better to know the nature of the firm's actual practices than those who are actually doing it. This practice also helps keep disclosures "real," and not simply aspirational or marketing literature. Then, any required changes to disclosures are made promptly. Some firms also perform this same sort of review of client portfolios to ensure that portfolio transactions are consistent with disclosures to and instructions from the client.

Whatever compliance technique is used, because disclosure is so important in ensuring that advisers meet their fiduciary obligations, I would hope that all advisers spend a considerable amount of time ensuring that they have provided accurate, full and fair information to clients.

Now, and particularly for newly-registered advisers, some "tips" on SEC examinations:

- It warrants saying that the SEC conducts examinations as part of its statutory mandate to protect investors. We conduct exams to help ensure that investors are being treated fairly and that firms operate consistently with the securities laws. Understanding our purpose — and that we're not out to "get you" — may help advisory staff understand the exam process better. Probably no one will ever *like* being examined, but the process is important for the protection of investors. And, it can help firms to identify and take steps to fix smaller problems before they can escalate!
- The best way to "prepare for an exam" is not really to prepare for an exam at all — it is to have a strong compliance infrastructure that is used effectively to prevent, detect and correct problems every day.
- A critical part of our examination process includes gaining an understanding of the firm's compliance history: 1) to evaluate the firm's compliance with the "Compliance Rule," which requires effective compliance programs to prevent, detect and correct violations; and 2) to determine the strengths and weaknesses of the firm's compliance controls to aid examiners' determination of areas to focus on in the examination. Areas where compliance controls are strong will receive relatively less scrutiny than areas that appear to be weak. To understand this, we ask the firm about any material compliance issues that the firm has faced during the examination period. Because in the past we had encountered situations where firms were less than candid in providing this information, we asked that a senior employee of the firm provide this information in writing. With CCOs at all firms now, we will seek this information from the

firm during the examination process.

- While our work on-site will be visible to you, our work off-site will not be. Our exam teams do quite a lot of analysis and other exam work after they return to SEC offices. This includes communicating with relevant SEC staff about any novel facts or interpretive issues to ensure that our findings appropriately reflect the Commission's legal interpretations. In these cases, our deficiency letters reflect the input of relevant legal staff. If you disagree with a deficiency letter, of course, say so in your response!
- Finally, and in the same vein, we urge firms to communicate openly and honestly with exam staff about the firm's operations, its compliance program and any issues or concerns they have about the exam process. We find that most issues, from document production to deficiencies found, can be understood with some honest dialogue. There are lots of opportunities for this at every stage of the exam process, and certainly at the exit interview. If you have questions or concerns, we urge you to talk with the exam staff about them. And, we also have an *ExamHotline* for you to express concerns, anonymously or not. The phone number is: 202-551-3926, or [ExamHotline@sec.gov](mailto:ExamHotline@sec.gov).

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In closing, and returning to *first principles* again — if an adviser incorporates the qualities of a fiduciary as I've discussed here today, and puts the clients' interests first, the adviser will indeed be someone its clients can trust.

Thank you for your time and attention.

## Endnotes

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<sup>1</sup> "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior." *Meinhard v. Salmon*, 249 N.Y. 458, 464 (1928) (Cardozo, B).

<sup>2</sup> *S.E.C. v. Capital Gains Research Bureau*, 375 U.S. 180 (1963).

<sup>3</sup> *Id.*

<sup>4</sup> See 68 FR 74714, 74716 (Dec. 24, 2003), <http://www.sec.gov/rules/final/ia-2204.htm>.

<http://www.sec.gov/news/speech/spch022706lar.htm>



## Technical Note

# Classification of Duke Energy Florida Project Finance, LLC Series A Bonds

Following a formal *consultation* period, the Barclays index group plans to classify index-eligible Duke Energy Florida Project Finance Series A bonds (Ticker: DUK; issued on June 16, 2016) as Corporate > Utility issues.

For any questions, please contact your regional index group or email [index\\_feedback@barclays.com](mailto:index_feedback@barclays.com).

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## Asset Securitization Report

June 21, 2016

# Duke's Utility Fee Securitization Sets Important Precedent

By Allison Bisbey

Duke Energy Florida marketed its \$1.3 billion securitization of utility fees as a corporate bond, and the strategy appears to have paid off. The deal was priced last week at interest rates in line with those of some the highest rated U.S. companies and government agencies.

DEF's bonds are tied to a special charge on the utility's electric delivery and transmission services that is associated with the retirement of the Crystal River Unit 3 nuclear power plant. The bonds are also backed by a guarantee of the state's utility regulator to adjust the charge every six months to whatever level is necessary to pay the bonds on time.

The securities have unusually long durations for this sector; over \$500 million had maturities from 15 to almost 19 years. By comparison, most other deals in the utility sector have original terms under 10 years. The tranche with the longest duration pays a spread over Treasuries similar to those of triple-A rated bonds issued by Johnson & Johnson and the Tennessee Valley Authority.

The all-in duration adjust cost of the \$1.297 billion offering was 2.72%, an all-time low for a bond offering with such long maturities, according to Andrew Maurey, director of the division of accounting and finance at the Florida Public Service Commission.

Even so, DEF may have left some money on the table. That's because it wasn't until Friday, after the deal priced, that Barclays announced it would classify the bonds as corporates for the purposes of its bond indexes – which could attract a broader investment base.

Had this determination been made before the bonds were priced, DEF might have lowered its funding costs even further.

The two-year tranche priced at a spread of 47 basis points over Treasuries, several basis points wide of where similarly rated credit card securitizations from Chase and Citigroup were trading in the secondary market; the five-year tranche priced at Treasuries plus 60 basis points, wide of comparable credit card deals; the 10-year tranche priced at 93 basis points over Treasuries, more than 10 basis points wide of comparable bonds issued by companies like the TVA and Johnson & Johnson.

RBC Capital Markets and Guggenheim Securities served as joint bookrunning managers.

Still, inclusion in Barclays' corporate index could set a precedent for future utility deals structured in a similar manner.



The bonds will be issued by DEF's wholly owned, but bankruptcy remote, subsidiary, Duke Energy Florida Project Finance. The offering prospectus was filed with the Securities and Exchange Commission on a form SF-1, which is designated for asset-backed. Yet this filing describes the bonds as "a type of ratepayer obligation charge bond." It goes on to state that the bonds are "corporate securities," and "are not asset-backed securities as defined by the SEC governing regulations."

Notably, there is no tranching for credit risk; all five tranches of securities issued by DEF Project Finance are rated triple-A by three credit rating agencies: Moody's Investors Service, Standard & Poor's, and Fitch Ratings. That means neither investors nor rating agencies need to analyze how cash flows might be diverted to different classes of bonds under different scenarios. The only difference between the classes is the maturity dates.

The bonds will be included on DEF's consolidated balance sheet and treated as debt of DEF for U.S. corporate income tax purposes.

(Unlike corporate bonds, most asset-backed are subject to a requirement that sponsors retain at least 5% of the credit risk of the collateral. However DEF did not need to argue that its deal is a corporate bond in order to avoid this requirement. Utility fee securitizations already benefit from a carve-out from risk retention rules.)

DEF may have left some money on the table in another respect: it did not market the bonds to European investors, traditionally important buyers of utility fee securitizations.

Maurey said that the Commission did consider the European market, but concluded that the bonds could be priced and sold cost effectively in the US without having to cross the pond.

"Given how the markets reacted to Brexit news at the time of pricing, perhaps a European effort would have produced even better results," he said. "We had a great outcome with this issuance. But if the need to issue these type of bonds arises in the future, expanding the marketing beyond the US should receive stronger consideration."

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### **Member, Advisory Council to the Chairman (Ben Bernanke, Harvey Rosen)**

Princeton University, Economics Department  
1996-2004 (Chairman, 2003)

### **Member, Board of Advisors**

Center for Economic Policy Studies (CEPS), Princeton University  
1999-Present

## Joseph S. Fichera

**Member, Economic Club of New York**  
2007-Present

**Life Member, Council on Foreign Relations**

### Previous Professional Licenses

FINRA/SEC Series 24: Securities Principal and Series 7: Registered Representative

**Author** of articles concerning the interaction between corporate finance and public policy. Published in: *The New York Times*, *Barron's*, *The Wall Street Journal*, *Dow Jones Library of Investment Banking*, *Q2 Yale Management Magazine*. Contributor on *Bloomberg View*, *Fox Business*.

**BA, Princeton, 1976;**  
**MBA, Yale, 1982**

JOSEPH S. FICHERA PUBLISHED WORKS AND AWARDS (as of December 2020)		
Title	Publisher	Date
"Utility Securitization: An Update"	<i>National Regulatory Research Institute</i>	January 2019
<i>Special Achievement in Finance</i>	<i>National Italian American Foundation</i>	April 10, 2018
"The S.E.C. Should Copy the D.M.V."	<i>The New York Times</i>	November 7, 2014
"Were Detroit Swaps Unfair"	<i>Bloomberg View</i>	January 27, 2014
"Price Transparency and the ABS Market"	<i>Asset Securitization Report</i>	September, 2013
"Market Rejuvenation = National Municipal Bond Exchange"	<i>MuniIC newsletter</i>	September, 2011
"Auction Rate Securities Need Reform, Not Just Redemption"	<i>Saber Partners, LLC</i>	June, 2011
"Grid Modernization Monetization: Long-Term Ratepayer Obligation Charge Bonds May Provide Answers" (with Michael E. Ebert)	<i>Intelligent Utility Magazine</i>	March/April 2011
"Securing the Grid: Intelligent Financing Creates New Options for Grid Modernization" (with Michael E. Ebert)	<i>Intelligent Utility Magazine</i>	December 6, 2010
Comment on Municipal Service Rulemaking Board ("MSRB") Auction Rate Securities ("ARS") Transparency Proposal Submitted to SEC	<i>Saber Partners, LLC</i>	April, 2010
Comment on ARS Transparency Proposal Submitted to MSRB	<i>Saber Partners, LLC</i>	July, 2008
"Treasury Should Use New Powers to Invest in Muni ARS"	<i>The Bond Buyer</i>	October 6, 2008

## Joseph S. Fichera

<b>JOSEPH S. FICHERA PUBLISHED WORKS AND AWARDS (as of December 2020)</b>		
<b>Title</b>	<b>Publisher</b>	<b>Date</b>
“Can Environmental Control Bonds Emerge in Europe”	Chapter 6: <i>Thomson Reuters IFR, New Frontiers in European Securitisation: Opportunities in Troubled Times</i>	2008
‘How Can Directors Become Truly Independent”	<i>Directors Monthly</i>	June 2008
“How Can Directors Become Truly Independent”	<i>Q2 Yale Management Magazine</i>	Fall 2007
“Lowering Environmental and Capital Costs with Ratepayer-Backed Bonds”	<i>Natural Gas &amp; Electricity</i>	February 2007
“A Rising Tide: Do Utility Securitizations Have a Future?”	<i>Asset Securitization Report</i>	February 9, 2005
“Deal of the Year”	<i>Asset Securitization Report</i>	December 1, 2003
“The State of Utility Securitization: Stranded Costs and Other Tariff-Based Financings: Opportunities, Risks and Rewards”	<i>Prudential Securities: A Fixed-Income Research Publication</i>	March 1998
“Why Is Wall Street Waiting?”	<i>Electrical World Business Edition</i>	November 1997
“Uncle Sam, Venture Capitalist”	<i>The Wall Street Journal</i>	May 2, 1996
“Street Smart: A Road Map for the Investment Banking Analyst”	<i>Princeton University’s Business Today</i>	May 1996
“You Call That Debt?”	<i>Barron’s</i>	February 26, 1996
“Deal of the Year”	<i>Institutional Investor</i>	1992
“Refinancing High-Coupon Tax-Exempt Debt: Understanding the Benefits and Risks of Alternative Strategies”	<i>Financial Analytics and Structured Transactions, Bear, Stearns &amp; Co., Inc</i>	1991
“Making Matters Worse: The Danger of Dutch Auction Securities”	<i>Bear Stearns &amp; Co, Inc.</i>	1991
“Deal of the Year”	<i>Institutional Investor</i>	1991
“Preferred Stock IV: Advantages of Remarketed Preferred Stock”	Chapter 16, <i>Dow–Jones Irwin, Library of Investment Banking</i>	1989
“Corporate Tax-Exempt Financing”	Chapter 39: <i>Dow–Jones Irwin, Library of Investment Banking</i>	1989
“Of Money and Merit: The Upside Down Effects of Wall Street’s Bonus System”	<i>Smith Barney Harris Upham, Inc.</i>	1988



# Order Book Status

A-1: \$217MM			Whisper Talk			Price Guidance		Final Pricing		
<u>At Announcement</u>	% Subscribed	<u>Swaps -10/-8</u>	<u>At Price Guidance</u>	% Subscribed	<u>Swaps -7/-6</u>	<u>At Pricing - 10/5</u>	<u>Swaps -7</u>	<u>Final Allocation</u>	% Subscribed	
IOI/Orders \$85.0	39%		\$128.3	59%		\$261.8		\$217.0	121%	
A-2: \$341MM			Whisper Talk			Whisper Talk		Final Pricing		
<u>At Announcement</u>	% Subscribed	<u>Swaps -6/-3</u>	<u>At Price Guidance</u>	% Subscribed	<u>Swaps -3/-2</u>	<u>At Pricing - 10/5</u>	<u>Swaps -2</u>	<u>Final Allocation</u>	% Subscribed	
IOI/Orders \$106.0	31%		\$127.7	37%		\$402.6		\$341.0	118%	
A-3: \$250MM			Whisper Talk			Whisper Talk		Final Pricing		
<u>At Announcement</u>	% Subscribed	<u>Swaps + 0/3</u>	<u>At Price Guidance</u>	% Subscribed	<u>Swaps +2A</u>	<u>At Pricing - 10/5</u>	<u>Swaps +3</u>	<u>Final Allocation</u>	% Subscribed	
IOI/Orders \$97.0	39%		\$180.0	72%		\$280.5		\$250.0	112%	
A-4: \$437MM			Whisper Talk			Whisper Talk		Final Pricing		
<u>At Announcement</u>	% Subscribed	<u>Swaps + 3/6</u>	<u>At Price Guidance</u>	% Subscribed	<u>Swaps + 5/6</u>	<u>At Pricing - 10/5</u>	<u>Swaps +6</u>	<u>Final Allocation</u>	% Subscribed	
IOI/Orders \$68.0	16%		\$163.0	37%		\$420.0		\$437.0	96%	
A-5: \$494.7MM			Whisper Talk			Whisper Talk		Final Pricing		
<u>At Announcement</u>	% Subscribed	<u>Swaps + 9/13</u>	<u>At Price Guidance</u>	% Subscribed	<u>Swaps + 11/12</u>	<u>At Pricing - 10/5</u>	<u>Swaps +14.1</u>	<u>Final Allocation</u>	% Subscribed	
IOI/Orders \$25.0	5%		\$167.0	34%		\$648.0		\$494.7	131%	



State of Florida



Fichera Exhibit 3

I/A Docket Nos. E-2, Sub 1262 and E-7, Sub 1243

# Public Service Commission

CAPITAL CIRCLE OFFICE CENTER • 2540 SHUMARD OAK BOULEVARD  
TALLAHASSEE, FLORIDA 32399-0850

**-M-E-M-O-R-A-N-D-U-M-**

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**DATE:** October 13, 2015

**TO:** Carlotta S. Stauffer, Commission Clerk, Office of Commission Clerk

**FROM:** Rosanne Gervasi, Senior Attorney, Office of the General Counsel

**RE:** Docket No. 150171-EI - Petition for issuance of nuclear asset-recovery financing order, by Duke Energy Florida, Inc. d/b/a Duke Energy.

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Please place the attached Proposed Stipulations on Financing Order Issues in the above-referenced docket file.



**DOCKET NOS. 150148-EI, 150171-EI**

**PROPOSED STIPULATIONS ON FINANCING ORDER ISSUES\***

**LEGAL ISSUE A:** What is the definition of “incremental bond issuance costs” as that term is used in Section 366.95(2)(c)5., Florida Statutes?

**LEGAL ISSUE B:** In determining whether some or all actual bond issuance costs should be disallowed pursuant to Section 366.95(2)(c)5., Florida Statutes, what should the Commission take into account?

If the parties reach stipulations on all the issues as proposed below, these legal issues do not need to be decided by the Commission.

**ISSUE 14:** Do the cost amounts contained in DEF’s CR3 Regulatory Asset meet the definition of “nuclear asset-recovery costs” pursuant to Section 366.95(1)(k), Florida Statutes?

The cost amounts contained in DEF’s CR3 Regulatory Asset meet the definition of “nuclear asset-recovery costs” pursuant to Section 366.95(1)(k), Florida Statutes.

**ISSUE 15:** Do the ongoing financing costs identified in DEF’s Petition qualify as “financing costs” pursuant to Section 366.95(1)(e), Florida Statutes?

The types of ongoing financing costs identified in DEF’s Petition qualify as “financing costs” pursuant to Section 366.95(1)(e), Florida Statutes.

**ISSUE 16:** Has DEF demonstrated that securitization has a significant likelihood of resulting in lower overall costs or would avoid or significantly mitigate rate impacts compared to the traditional method of cost recovery pursuant to Section 366.95(2)(a)6., Florida Statutes?

DEF has demonstrated that securitization has a significant likelihood of resulting in lower overall costs or would avoid or significantly mitigate rate impacts compared to the traditional method of cost recovery pursuant to Section 366.95(2)(a)6., Florida Statutes.

**ISSUE 17:** What amount, if any, should the Commission authorize DEF to recover through securitization?

The amounts that should be authorized for DEF to recover through securitization must meet the criteria set forth in Section 366.95, Florida Statutes. By the nature of this proceeding, that amount will not be known with precision until the bonds are issued. The principal amount of the nuclear asset-recovery bonds should be \$1,283,012,000, representing the projected December 31, 2015 balance of the CR3 Regulatory Asset, subject to true-up to the actual December 31, 2015

balance, plus carrying charges beyond 2015 until the date of the bond issuance, plus upfront financing costs.

**ISSUE 18: What is the appropriate treatment of the deferred tax liability consistent with paragraph 5(j) of the RRSSA?**

No adjustment is necessary for the deferred tax liability. However, consistent with paragraph 5(j) of the RRSSA, the deferred tax liability will be excluded for earnings surveillance purposes.

**ISSUE 19: Should DEF indemnify customers to the extent customers incur losses associated with higher servicing fees payable to a substitute servicer, or with higher administration fees payable to a substitute administrator, as a result of DEF's termination for cause?**

DEF should be required to indemnify customers to the extent customers incur losses associated with higher servicing fees payable to a substitute servicer, or with higher administration fees payable to a substitute administrator, as a result of DEF's termination for cause attributable to its own actions.

**ISSUE 20: What should be the up-front and ongoing fee for the role of servicer throughout the term of the nuclear asset-recovery bonds?**

The up-front fee for the role of servicer is currently estimated to be \$915,000. The actual amount may change based on DEF's final cost. So long as DEF or an affiliate of DEF is servicer, the annual fee for the role of servicer throughout the term of the nuclear asset-recovery bonds is 0.05% of the original principal balance of the nuclear asset-recovery bonds (currently estimated to be approximately \$650,000).

**ISSUE 21: What amount, if any, of DEF's periodic servicing fee in this transaction should DEF be required to credit back to customers through an adjustment to other rates and charges?**

DEF will credit back to customers through the Capacity Cost Recovery Clause all periodic servicing fees in excess of DEF's or an affiliate of DEF's incremental cost of performing the servicer function until the next rate case when costs and revenues associated with the servicing fees will be included in the cost of service.

**ISSUE 22: What should be the ongoing fee for the role of the administrator throughout the term of the nuclear asset-recovery bonds?**

The ongoing fee for the role of the administrator throughout the term of the nuclear asset-recovery bonds will be \$50,000.

**ISSUE 23: What amount, if any, of DEF's periodic administration fee in this transaction should DEF be required to credit back to customers through an adjustment to other rates and charges?**

DEF will credit back to customers through the Capacity Cost Recovery Clause all periodic administration fees in excess of DEF's or any affiliate of DEF's incremental cost of performing the administration function until the next rate case when costs and revenues associated with the administration fee will be included in the cost of service.

**ISSUE 24: How frequently should DEF in its role as servicer be required to remit funds collected from customers to the SPE?**

DEF will remit funds collected from customers to the SPE either on a daily basis based on estimated daily collections or on a monthly basis if certain conditions can be satisfied. These conditions have yet to be determined and will be driven both by rating agency requirements to achieve and maintain the targeted "AAA" rating on the bonds and by investor concerns in the marketing and pricing of the bonds.

**ISSUE 25: If remittances are not daily, should DEF be required periodically to remit actual earnings on collections pending remittance?**

If remittances are not daily, DEF will be required monthly to remit estimated earnings on collections pending remittance. The calculation of earnings will be consistent with the methodology for calculating interest on over- and under-collections associated with DEF's cost recovery clauses.

**ISSUE 26: Is DEF's proposed process for determining whether the upfront bond issuance costs satisfy the statutory standard of Section 366.95(2)(c)5., Florida Statutes, reasonable and should it be approved?**

In accordance with Section 366.95(2)(c)5., Florida Statutes, within 120 days after the issuance of the nuclear asset-recovery bonds, DEF will file supporting information on the actual upfront bond issuance costs, for the categories of costs as reflected on page 1 of Exhibit No. \_\_ (BB-1). The Commission shall review such costs to determine compliance with Section 366.95(2)(c)5., Florida Statutes. As part of this review, the Commission shall only consider actual upfront bond issuance costs, but not ongoing financing costs, interest rate, or pricing of the bonds.

After the issuance of a Financing Order, if DEF decides not to cause nuclear asset-recovery bonds to be issued, then as provided in Section 366.95(2)(c)6., Florida Statutes, DEF may not recover financing costs, as defined in Section 366.95(1)(e), Florida Statutes, from customers.

**ISSUE 27: Issue dropped.**

**ISSUE 28: What additional conditions, if any, should be made in the Financing Order that are authorized by Section 366.95(2)(c)2.i.?**

The Financing Order will include ordering paragraphs, findings of fact, and conclusions of law that will give appropriate comfort to investors about the high quality of the nuclear asset-recovery bonds as a potential investment. Examples include:

1. A finding of fact that the Commission anticipates stress case analyses will show that the broad-based nature of the true-up mechanism under Section 366.95(2)(c)2.d, Florida Statutes, and the State pledge under Section 366.95(11), Florida Statutes, will serve to effectively eliminate for all practical purposes and circumstances any credit risk to the payment of the nuclear asset-recovery bonds (*i.e.*, that sufficient funds will be available and paid to discharge the principal and interest obligations when due);
2. A finding of fact and ordering paragraph directing that the automatic true-up mechanism is to be applied at least every six months;
3. A finding of fact and ordering paragraph that the automatic true-up mechanism will be implemented no later than 60 days after a filing by the servicer;
4. A finding of fact that the credit quality of the nuclear asset-recovery bonds are enhanced by Section 366.95, Florida Statutes, due to the requirements that (1) the nuclear asset-recovery charge in amounts authorized by the Commission are to be imposed on all customer bills and collected in full in the form of a nonbypassable charge separate from the electric utility's base rates, (2) the charge shall be paid by all existing and future customers receiving transmission or distribution services from the electric utility, and (3) following any fundamental change in regulation of public utilities in the State, a customer electing to purchase electricity from an alternate electricity supplier must still pay the charge. Furthermore, through the true-up mechanism, any delinquencies or under-collections in one customer rate class will be taken into account in the application of the True Up Mechanism to adjust the nuclear asset-recovery charge for all customers of DEF, not just the class of customers from which the delinquency or under-collection arose;
5. A finding of fact that the Commission interprets the legislative intent of the true-up mechanism provided for in Section 366.95 for allocating costs among customers rises to the level of joint and several liability among the customers of DEF.
6. A finding of fact and conclusion of law that the broad nature of the State pledge under Section 366.95(11), Florida Statutes, constitutes a contract with the bondholders, the owners of the nuclear asset-recovery property,

and other financing parties that the state will not: (1) Alter the provisions of this section which make the nuclear asset-recovery charges imposed by a Financing Order irrevocable, binding, and nonbypassable charges; (2) Take or permit any action that impairs or would impair the value of nuclear asset-recovery property or revises the nuclear asset-recovery costs for which recovery is authorized; or (3) Except as authorized under Section 366.95, reduce, alter, or impair nuclear asset-recovery charges that are to be imposed, collected, and remitted for the benefit of the bondholders and other financing parties until any and all principal, interest, premium, financing costs and other fees, expenses, or charges incurred, and any contracts to be performed, in connection with the related nuclear asset-recovery bonds have been paid and performed in full;

7. A finding of fact that this Commission guarantees that it will act pursuant to this Financing Order as expressly authorized by Section 366.95, Florida Statutes, to ensure that nuclear asset-recovery charge revenues are sufficient to pay principal and interest on the nuclear asset-recovery bonds issued pursuant to this Financing Order and other costs, including fees and expenses, in connection with the nuclear asset-recovery bonds;
8. A finding of fact that the broad based nature of the State pledge under Section 366.95(11), Florida Statutes, and the irrevocable character of this Financing Order, in conjunction with the true-up adjustment provisions required by Section 366.95(2)(c)2.d, Florida Statutes, and included in this Order, constitutes a guarantee of regulatory action for the benefit of investors in nuclear asset-recovery bonds;
9. A conclusion of law that nuclear asset-recovery property is not a receivable or a pool of receivables;
10. A conclusion of law that the nuclear asset-recovery property is not a financial asset in that it only represents a legally-enforceable regulatory property right under Section 366.95 to bill and collect nuclear asset-recovery charges on persons who receive electric transmission and distribution services from the electric utility or its successors or assignees;
11. A finding of fact that the issuer of the bonds is a special purpose finance subsidiary of DEF and a corporate issuer;
12. A conclusion of law that the Commission's obligation under the Financing Order relating to nuclear asset-recovery bonds, including the specific actions the Commission guarantees to take, are direct, explicit, irrevocable, and unconditional upon the issuance of nuclear asset-recovery bonds, and are legally enforceable against the Commission, a United States public sector entity; and

13. A conclusion of law and ordering paragraph that the Financing Order is irrevocable under Section 366.95(2)(c)6, Florida Statutes.

In addition, the Financing Order will call for the Commission's financial advisor to deliver to the Commission a certification as to whether the structuring, marketing, and pricing of the nuclear asset-recovery bonds resulted in the lowest nuclear asset-recovery charges consistent with prevailing market conditions and the terms of the Financing Order and other applicable law. That certification shall include a report of any action or inaction which the Commission's financial advisor believes might have caused the transaction not to achieve the lowest nuclear asset-recovery charges, regardless of whether DEF's reason for action or inaction was the result of DEF's sole view that it would expose DEF or the SPE to securities law liability. The Financing Order will provide that the Commission will take that certification from its financial advisor, along with any other facts and circumstances, except for a change in market conditions after the moment of pricing, into account in determining whether the remaining requirements of Section 366.95, Florida Statutes, and the Financing Order have been met and whether to issue a stop order no later than 5:00 pm Eastern time on the third business day following pricing, as provided in Ordering Paragraph 54 of the Financing Order.

The parties agree that the Financing Order shall be silent on the issue of whether any judgment or other finding of liability against the SPE(s) constitutes "financing costs" as those costs are defined in Section 366.95. Furthermore, the parties each agree that no party will assert that the Financing Order supports a finding in favor of or against the proposition that any judgment or finding of liability against the SPE(s) constitutes "financing costs" as defined in Section 366.95.

**ISSUE 29: Should all legal opinions be subject to review by the Bond Team?**

All legal opinions should be reviewed by the Bond Team. All legal opinions associated with the Nuclear Asset-Recovery Bonds should be submitted to the Commission automatically without requiring the Commission to specifically request the documents.

**ISSUE 30: Should all transaction documents and subsequent amendments be filed with the Commission before becoming operative?**

All transaction documents and subsequent amendments should be reviewed and approved by the Bond Team before becoming operative.

**ISSUE 31: Is DEF's proposed pre-issuance review process reasonable and should it be approved?**

DEF, its structuring advisor, and designated Commission staff and its financial advisor will serve on the Bond Team. One designated representative of DEF and one designated representative of the Commission shall be joint decision makers in

all aspects of the structuring, marketing and pricing of the nuclear asset-recovery bonds except for those recommendations that in the sole view of DEF would expose DEF or the SPE to securities law and other potential liability (*i.e.*, such as, but not limited to, the making of any untrue statement of a material fact or omissions to state a material fact required to be stated therein or necessary in order to make the statements made not misleading) or contractual law liability (*e.g.*, including but not limited to terms and conditions of the underwriter agreement(s)). The Commission's designated staff and financial advisor will be visibly involved, in advance, in all aspects of the structuring, marketing, and pricing of the nuclear asset-recovery bonds. All Bond Team members will actively participate in the design of the marketing materials for the transactions as well as in the development and implementation of the marketing and sales plan for the bonds. DEF believes DEF and the Commission staff and its financial advisor as Bond Team members, excluding DEF's structuring advisor, should also have equal rights on the hiring decisions for the underwriters and counsel to the underwriters. However, DEF will have sole right to select and engage all counsel for DEF and the SPE. In addition, together with the Bond Team's involvement in the structuring, marketing and pricing of the nuclear asset-recovery bonds, and the Issuance Advice Letter process, the Commission will be able to fully review the pricing of the bonds as the Commission determines whether to issue a stop order no later than 5:00 pm Eastern time on the third business day following pricing, as provided in Ordering Paragraph 54 of the Financing Order.

**ISSUE 32: Should the Financing Documents be approved in substantially the form proposed by DEF, subject to modifications as addressed in the draft form of the Financing Order?**

No. The specific terms, conditions, covenants, warranties, representations, and specific language contained in the Financing Documents may be impacted by the Commission's decisions on other issues and must be reviewed in consideration of the Financing Order approved by the Commission.

**ISSUE 33: Is DEF's proposed Issuance Advice Letter process reasonable and consistent with the statutory financing cost objective contained in Section 366.95(2)(c)2.b., Florida Statutes?**

Yes. DEF, its structuring advisor, and designated Commission staff and its financial advisor will serve on the Bond Team. One designated representative of DEF and one designated representative of the Commission shall be joint decision makers in all aspects of the structuring, marketing and pricing of the nuclear asset-recovery bonds, except for those recommendations that in the sole view of DEF would expose DEF or the SPE to securities law and other potential liability (*i.e.*, such as, but not limited to, the making of any untrue statement of a material fact or omissions to state a material fact required to be stated therein or necessary in order to make the statements made not misleading) or contractual law liability (*e.g.*, including but not limited to terms and conditions of the underwriter agreement(s)), so the Commission will be provided with information in real time

about the transaction. Furthermore, the Commission will have an opportunity to review a draft of the proposed Issuance Advice Letter in advance of pricing the transaction.

**ISSUE 34: Should the Standard True-up Letter be approved in substantially the form proposed by DEF?**

The Standard True-up Letter should be approved in substantially the form proposed by DEF.

**ISSUE 35: Is DEF's proposed process for determining whether the structure, plan of marketing, expected pricing and financing costs of the nuclear asset-recovery bonds have a significant likelihood of resulting in lower overall costs or would avoid or significantly mitigate rate impacts to customers as compared with the traditional method of financing and recovering nuclear asset-recovery costs reasonable and should it be approved?**

Yes. DEF's proposed process for determining whether the structure, plan of marketing, expected pricing and financing costs of the nuclear asset-recovery bonds has a significant likelihood of resulting in lower overall costs or would avoid or significantly mitigate rate impacts to customers as compared with the traditional method of financing and recovering nuclear asset-recovery costs.

**ISSUE 36: Is the degree of flexibility afforded to DEF in establishing the terms and conditions of the nuclear asset-recovery bonds as described in the proposed form of Financing Order, reasonable and consistent with Section 366.95(2)(c)2.f., Florida Statutes?**

Yes, as modified by this Stipulation. DEF, its structuring advisor, and designated Commission staff and its financial advisor will serve on the Bond Team. One designated representative of DEF and one designated representative of the Commission shall be joint decision makers in a collaborative process, except for those recommendations that in the sole view of DEF would expose DEF or the SPE to securities law or other potential liability (*i.e.*, such as, but not limited to, the making of any untrue statement of a material fact or omission to state a material fact required to be stated therein or necessary in order to make the statements made not misleading) or contractual law liability (*e.g.*, including but not limited to terms and conditions of the underwriter agreement(s)). This affords the flexibility that is reasonable and consistent with Section 366.95(2)(c)2f.

**ISSUE 37: What persons or entities should be represented on the Bond Team?**

DEF, its structuring advisor, and designated Commission staff and its financial advisor should be represented on the Bond Team.



**ISSUE 38: Based on resolution of the preceding issues, should a Financing Order in substantially the form proposed by DEF be approved, including the findings of fact and conclusions of law as proposed?**

The Financing Order, including findings of fact and conclusions of law, proposed by DEF should be revised, following consultation with and input from the active parties, to reflect the Commission's resolution of all issues in this proceeding.

**ISSUE 39: If the Commission votes to issue a Financing Order, what post-Financing Order regulatory oversight is appropriate and how should that oversight be implemented?**

DEF's customers will be effectively represented throughout the proposed transaction. DEF, its structuring advisor, and designated Commission staff and its financial advisor will serve on the Bond Team. One designated representative of DEF and one designated representative of the Commission shall be joint decision makers for all matters concerning the structuring, marketing, and pricing of the bonds except for those recommendations that in the sole view of DEF would expose DEF or the SPE to securities law and other potential liability (*i.e.*, such as, but not limited to, the making of any untrue statement of a material fact or omission to state a material fact required to be stated therein or necessary in order to make the statements made not misleading) or contractual law liability (*e.g.*, including but not limited to terms and conditions of the underwriter agreement(s)). The final structure of the transaction, including pricing, will be subject to review by the Commission for the limited purpose of ensuring that all requirements of law and the Financing Order have been met.

**ISSUE 40: Are the energy sales forecasts used to develop the bond amortization schedules and the recovery mechanism appropriate?**

The energy sales forecasts used to develop the bond amortization schedules and the recovery mechanism are appropriate.

**ISSUE 41: If the Commission approves recovery of any nuclear asset-recovery related costs through securitization, how should the recovery of these costs be allocated to the rate classes consistent with Section 366.95(2)(c)2.g., Florida Statutes?**

In accordance with Section 366.95(2)(c)2.g., Florida Statutes, DEF should allocate the nuclear asset-recovery costs recoverable under the nuclear asset-recovery charge consistent with the allocation methodology adopted in the RRSSA approved on November 12, 2013 in Order No. PSC-13-0598-FOF-EI. That approved allocation methodology for DEF is the 12CP and 1/13 AD. Spelled out, that means twelve-thirteenths of the revenue requirement is allocated based on 12 monthly coincident peaks (or demand) and one-thirteenth is allocated based on average demand (or energy).

**ISSUE 42: If the Commission approves recovery of any nuclear asset-recovery related costs through securitization, what is the appropriate recovery period for the Nuclear Asset-Recovery Charge?**

If the Commission approves recovery of any nuclear asset-recovery related costs through securitization, the appropriate recovery period for the Nuclear Asset-Recovery Charge is 240 months or until the nuclear asset-recovery bonds and associated charges and approved adjustments have been paid in full but not to exceed 276 months.

**ISSUE 43: Issue dropped.**

**ISSUE 44: What should be the scheduled final maturity and the legal final maturity of the nuclear asset-recovery bonds?**

The scheduled final maturity and the legal final maturity of the nuclear asset-recovery bonds are to be determined after the issuance of the Financing Order.

**ISSUE 45: Is DEF's proposed Nuclear Asset-Recovery Charge True-Up Mechanism appropriate and consistent with Section 366.95, Florida Statutes, and should it be approved?**

DEF's proposed Nuclear Asset-Recovery Charge True-Up Mechanism is appropriate and consistent with Section 366.95, Florida Statutes, and it should be approved.

**ISSUE 46: How frequently should the Nuclear Asset-Recovery Charge True-up Mechanism be conducted?**

The Nuclear Asset-Recovery Charge True-up Mechanism should be conducted not less than every six months.

**ISSUE 47: If the Commission approves an amount to be securitized, on what date should the Nuclear Asset-Recovery Charge become effective?**

The Nuclear Asset-Recovery Charges should become effective upon the first day of the billing cycle for the month following the issuance of the nuclear asset-recovery bonds.

**ISSUE 48: Issue dropped.**

**ISSUE 49:** If the Commission denies DEF's request for a Financing Order, or if the nuclear asset-recovery bonds are not issued for any reason after the Commission issues a Financing Order, should the Commission approve DEF's alternative request for a base rate increase pursuant to the RRSSA, to be implemented beginning six months after the final order rejecting DEF's request (in the event the Financing Order is not issued) or the date upon which DEF notifies the Commission that the bonds will not be issued (in the event the Financing Order is issued), with carrying costs on the nuclear asset-recovery costs collected from January 1, 2016, through the Capacity Cost Recovery Clause, until such time as the base rate increase goes into effect?

If the Commission denies DEF's request for a Financing Order, or if the nuclear asset-recovery bonds are not issued for any reason after the Commission issues a Financing Order, the Commission should approve DEF's alternative request for a base rate increase pursuant to the RRSSA, to be implemented beginning six months after the final order rejecting DEF's request (in the event the Financing Order is not issued) or the date upon which DEF notifies the Commission that the bonds will not be issued (in the event the Financing Order is issued), with carrying costs on the nuclear asset-recovery costs collected from January 1, 2016, through the Capacity Cost Recovery Clause, until such time as the base rate increase goes into effect.

**ISSUE 50:** Should the form of tariff sheets to be filed under DEF's tariff, as provided in Exhibit \_\_ (MO-6A) of Witness Olivier's testimony, be approved?

The form of tariff sheets to be filed under DEF's tariff, as provided in Exhibit \_\_ (MO-6A) of Witness Olivier's testimony, should be approved.

**ISSUE 51:** In accordance with Section 366.95(2)(c)2.h., Florida Statutes, if the Commission does not issue a stop order by 5:00 p.m. on the third business day after pricing, should the nuclear asset-recovery charges become final and effective without further action from the Commission?

In accordance with Section 366.95(2)(c)2.h., Florida Statutes, if the Commission does not issue a stop order by 5:00 p.m. on the third business day after pricing, the nuclear asset-recovery charges should become final and effective without further action from the Commission.

**ISSUE 52:** Should this docket be closed?

This docket should remain open pursuant to Section 366.95(2)(c)4., Florida Statutes.

\*FIPUG takes no position on these proposed stipulations.



## PUBLIC UTILITY COMMISSION OF OHIO

The following three tables describe the final order book and investor allocations that were made to reflect oversubscription of the trade.

## CLASS A-1 (\$111.971MM) FINAL PRICING LEVELS AND ALLOCATIONS

<u>Investor</u>	<u>Order</u>	<u>Investor</u>	<u>Order</u>
Invesco	\$ 42	Invesco	\$ 42
Wells	30	Wells	30
ING	25	ING	10
Blackrock	12	Blackrock	12
3M	15	3M	10
Thrivent	7	Thrivent	5
Asset Allocation Advisors	5	Asset Allocation Advisors	2
Morley Capital	2	Morley Capital	1
<b>Total Book</b>	<b>\$ 137</b>		<b>\$ 112</b>
<b># of Investors</b>	<b>8</b>		<b>8</b>
<b>Subscription Level</b>	<b>123%</b>		<b>100%</b>

## CLASS A-2 (\$70.468MM) FINAL PRICING LEVELS AND ALLOCATIONS

Indication		Allocation	
<u>Investor</u>	<u>Order</u>	<u>Investor</u>	<u>Order</u>
USAA	\$ 71	USAA	\$ 26
Principal	35	Principal	15
Capital One	25	Capital One	11
Seix Investment Advisors	15	Seix Investment Advisors	6
ADP	10	ADP	4
Ambassador Capital	10	Ambassador Capital	4
Invesco	12	Invesco	4
Avantas	0	Avantas	0
<b>Total Book</b>	<b>\$ 178</b>		<b>\$ 70</b>
<b># of Investors</b>	<b>8</b>		<b>8</b>
<b>Subscription Level</b>	<b>253%</b>		<b>100%</b>

## CLASS A-3 (\$262.483MM) FINAL PRICING LEVELS AND ALLOCATIONS

Indication		Allocation	
<u>Investor</u>	<u>Order</u>	<u>Investor</u>	<u>Order</u>
TIAA-CREF	\$ 150	TIAA-CREF	\$ 100
John Hancock	150	John Hancock	100
USAA	35	USAA	25
Avantus	20	Avantus	11
American United Life	20	American United Life	11
Asset Allocation Advisors	9	Asset Allocation Advisors	6
Kansas City Life Insurance	8	Kansas City Life Insurance	5
Mountain Asset Management	10	Mountain Asset Management	5
<b>Total Book</b>	<b>\$ 402</b>		<b>\$ 263</b>
<b># of Investors</b>	<b>8</b>		<b>8</b>
<b>Subscription Level</b>	<b>153%</b>		<b>100%</b>



July 17, 2013

WELLS  
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SECURITIES

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# ABSolute Value: Rate Reduction Bond ABS Primer An Overview of Utility Receivables Securitization

## Executive Summary

- Securitizations of utility receivables have been known by several names: stranded-asset, rate-reduction and storm-recovery bonds. The market convention is to refer to all bonds in this sector as rate-reduction bonds or RRBs. We follow that convention in this report, which surveys the structural features of and conditions in the market for RRBs.
- RRBs are securitizations backed by the future collections of special charges applied to electric utility bills. The amount of the collection is based on power usage, which can vary from year to year based on weather or economic conditions.
- The bonds issued in this sector are structured with robust legal and regulatory protections to mitigate the potential political risks that may stem from the introduction of the utility tariff on ratepayer bills.
- Internal credit enhancement tends to be relatively low compared to benchmark consumer ABS due to these legal safeguards as well as the presence of the “true-up mechanism.” This procedure allows the utility tariff to be adjusted, either up or down, in the event that tariff collections are significantly different than what would be needed to meet the scheduled amortization of the bonds. It has been used successfully in several cases.
- RRB issuance has been relatively light in recent years, although outstanding bonds stood at \$11.3 billion as of Q2 2013 due to the relatively long average lives of the bonds. RRBs repay principal based on a scheduled amortization, which limits the prepayment risk and may make payments quarterly or semiannually, similar to corporate bonds.
- RRBs have similarities to secured utility bonds, such as first-mortgage bonds, and have found an audience from corporate crossover buyers, in our opinion. However, RRBs have significant legal and regulatory protections not normally found in corporate bonds.
- In our opinion, RRBs offer some of the best relative value in the consumer ABS market for the credit risk taken. Spreads of rate-reduction bond ABS have remained relatively wide throughout the post-crisis period. RRB spreads that trade at +4 bps or more to benchmark credit card ABS represent better relative value opportunities, in our opinion.

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Please see the disclosure appendix of this publication for certification and disclosure information.  
All estimates/forecasts are as of 07/17/13 unless otherwise stated.

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## Utility Receivables – What’s in a Name?

Rate-reduction bond ABS are securitizations backed by the future collections of special charges applied to electric utility bills. The amount of the collection is based on power usage. These utility receivables deals have been identified by different names since first coming on the ABS scene in 1997. The earliest deals were called “stranded assets” because the charges applied to ratepayer bills were meant to defray the costs of nuclear power plants that would no longer be economic in a deregulated power-generation market. The investments were economically “stranded” under the previous regulatory regime and could not be recovered under ordinary market conditions.

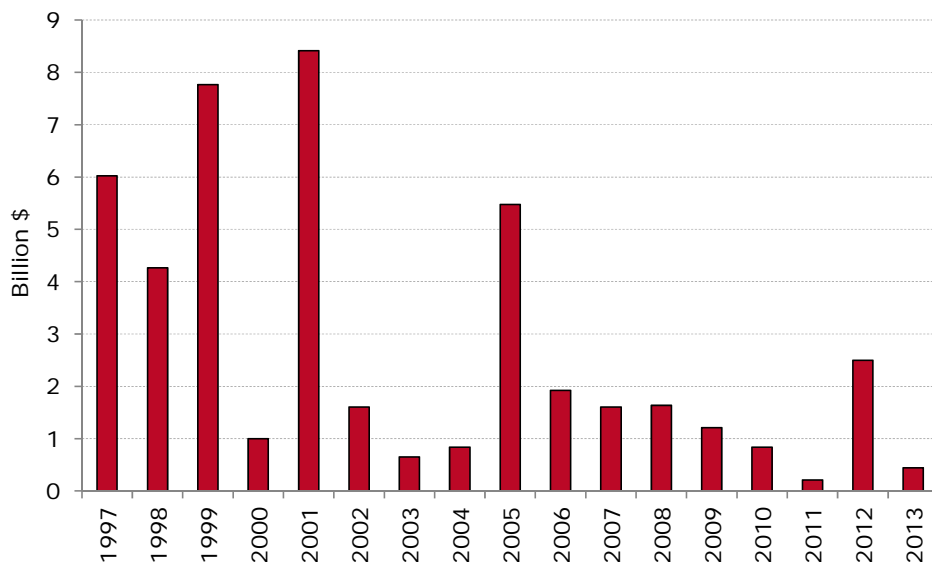
Later deals were termed “rate-reduction” bonds because electric utilities were allowed to recover the costs of certain infrastructure investments and, in turn, pass along lower utility rates to customers. Again, a deregulated power-generation market was intended to bring lower costs to end users. More recent deals have been christened “storm-recovery” bonds because utilities in various states have been allowed to apply a surcharge to bills to help pay for reconstruction and repairs to power networks damaged by hurricanes or other storms.

Despite the different names and reasons for implementation of the utility tariffs, the structural features and credit protections are generally the same. The market convention is to refer to all bonds in this sector *rate-reduction bonds*, or RRBs. We follow that convention in this report, which surveys the structural features of and conditions in the market for RRBs.

## Issuance and Outstanding

The amount of RRB issuance in the early years was substantial, and many market participants expected considerable upside from the sector. Indeed, \$27.5 billion of RRBs were issued in the five years from 1997–2001. However, in the following 12 years, including YTD 2013, the market has averaged just \$1.6 billion per year, and only 2005 exceeded \$5 billion (Exhibit 1). RRBs have become a smaller niche sector than many would have anticipated, but we believe RRBs offer certain characteristics that may not be found in other ABS sectors.

### Exhibit 1: Rate Reduction Bond ABS Issuance



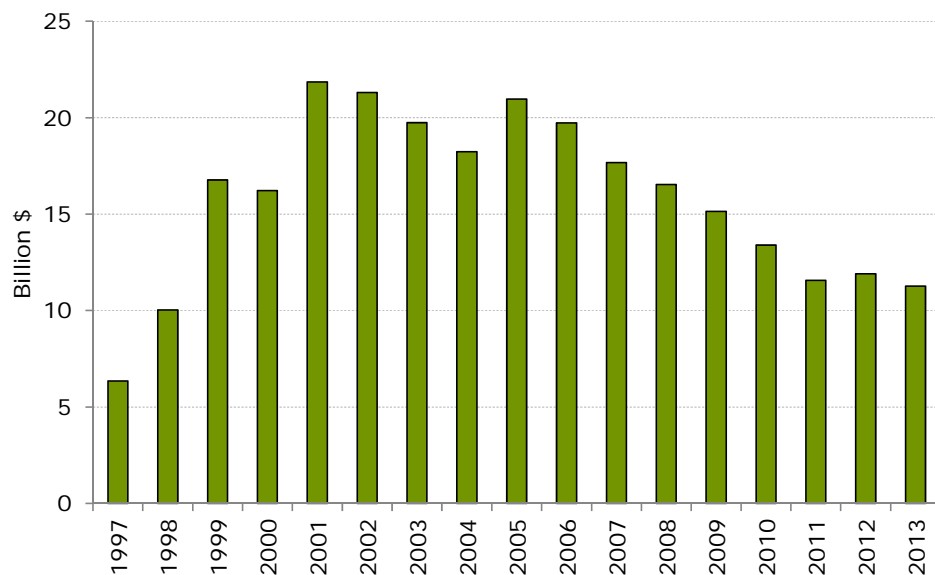
Source: Asset-Backed Alert, Bloomberg, Wells Fargo Securities, LLC.



RRBs repay principal based on a scheduled amortization, which limits the prepayment risk found in many other ABS backed by consumer receivables. Furthermore, the bonds may pay interest and principal quarterly or semiannually, similar to corporate bonds. This feature is one reason that RRBs have found an audience from corporate crossover buyers, in our opinion. RRBs have similarities to secured utility bonds such as first-mortgage bonds.

However, RRBs have significant legal and regulatory protections not normally found in a secured corporate bond. In addition, RRBs, in most cases, offer longer average lives than the typical auto or credit card ABS, with many bonds reaching seven years or more. Bonds with average lives of 10 years or more are not unusual. The longer average lives, combined with fixed-rate coupons offer ABS investors access to longer duration bonds.

## **Exhibit 2: RRB ABS Outstanding**



Source: SIFMA.

Those longer principal windows and average lives are the reasons that the amount of RRBs outstanding is much higher than might have been expected given the dearth of new-issue volume over the past few years. Total RRBs outstanding fell to the \$11 billion–\$12 billion range from 2011–2013 from the most recent peak of \$21 billion in 2005 (Exhibit 2). The RRB sector accounted for about 2% of total consumer ABS outstanding as of Q2 2013. A modest amount of issuance should keep the amount of ABS backed by utility receivables stable.

However, it can be difficult to forecast new-issue volume of RRBs because of the long legislative and regulatory lead times required to complete these deals. The utilities may also find it more advantageous to issue corporate debt instead of ABS. The history of RRB deals and their utility sponsors are listed in Exhibit 3. Deal sizes averaged approximately \$1.1 billion from 1997–2005, but declined to \$575 million after 2005. This average amount was boosted by two deals that weighed in at \$1.7 billion each. Excluding those two deals, the average deal size since 2005 has been \$433 million.

**Exhibit 3: Rate Reduction Bond ABS Deals and Utility Sponsors**

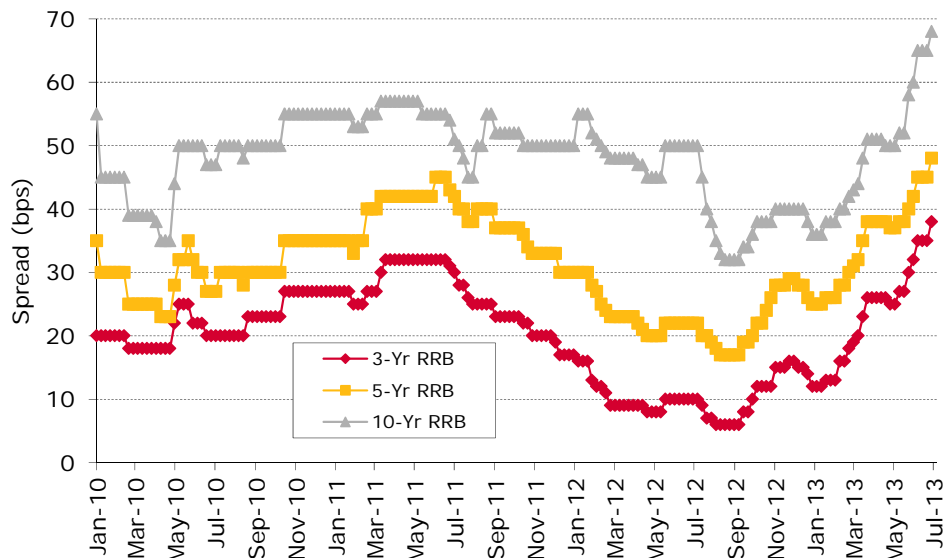
Deal Name	Pricing Date	Original Balance (MM\$)	Trust Name	Utility Sponsor
CIPGE 1997-1	11/25/97	2,901	California Infrastructure PG&E	Pacific Gas and Electric Company
CISDG 1997-1	12/4/97	658	California Infrastructure SDG&E	San Diego Gas and Electric Company
CISCE 1997-1	12/4/97	2,463	California Infrastructure SCE	Southern California Edison Company
COMED 1998-1	12/7/98	3,400	COMED Transitional Funding Trust	Commonwealth Edison Company
IPSP 1998-1	12/10/98	864	Illinois Power Special Purpose Trust	Illinois Power Company
PECO 1999-A	3/18/99	4,000	Peco Energy Transition Trust	Peco Energy Company
SPPC 1999-1	3/30/99	24	Sierra Pacific Power Company	Sierra Pacific Power Company
BECO 1999-1	7/14/99	725	Massachusetts RRB Special Purpose Trust	Boston Edison Company
PPL 1999-1	7/29/99	2,420	PP&L Transition Bond Company LLC	PPL Electric Utilities Corp.
WPP 1999-A	11/3/99	600	West Penn Funding LLC Transition Bonds	West Penn Power
PECO 2000-A	4/27/00	1,000	Peco Energy Transition Trust	Peco Energy Company
PEGTF 2001-1	1/25/01	2,525	PSE&G Transition Funding LLC	Public Service Electric & Gas Co.
PECO 2001-A	2/15/01	805	Peco Energy Transition Trust	Peco Energy Co
DESF 2001-1	3/2/01	1,750	Detroit Edison Securitization Funding LLC	Detroit Edison Company
CTRRB 2001-1	3/27/01	1,438	Connecticut RRB Special Purpose Trust	Connecticut Light & Power
PSNH 2001-1	4/20/01	525	Public Service New Hampshire Funding LLC	Public Service Company of New Hampshire
WMCO 2001-1	5/14/01	155	Massachusetts RRB Special Purpose Trust	Western Massachusetts Electric Company
CNP 2001-1	10/17/01	749	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy Houston Electric LLC
CONFD 2001-1	10/31/01	469	Consumers Funding LLC	Consumers Energy Co
PSNH 2002-1	1/16/02	50	Public Service New Hampshire Funding LLC	Public Service Company of New Hampshire
AEPTC 2002-1	1/31/02	797	AEP Texas Central Transition Funding	Central Power and Light Company
JCPL 2002-A	6/4/02	320	JCP&L Transition Funding LLC	Jersey Central Power & Light
ACETF 2002-1	12/11/02	440	Atlantic City Electric Transition Funding LLC	Atlantic City Electric Company
ONCOR 2003-1	8/14/03	500	Oncor Electric Delivery Transition Bond LLC	Oncor Electric Delivery Co.
ACETF 2003-1	12/18/03	152	Atlantic City Electric Transition Funding LLC	Atlantic City Electric Company
ONCOR 2004-1	5/28/04	790	Oncor Electric Delivery Transition Bond LLC	Oncor Electric Delivery Co.
RCTF 2004-1A	7/28/04	46	Rockland Electric Co Transition Funding LLC	Orange and Rockland Utilities, Inc.
PERF 2005-1	2/3/05	1,888	PG&E Energy Recovery Funding LLC	Pacific Gas & Electric Co.
BECO 2005-1	2/15/05	675	Massachusetts RRB Special Purpose Trust	Boston Edison Co.; Commonwealth Electric Co.
PEGTF 2005-1	9/9/05	103	PSE&G Transition Funding LLC	Public Service Electric and Gas Co.
WPP 2005-A	9/22/05	115	West Penn Funding LLC Transition Bonds	West Penn Power
PERF 2005-2	11/9/05	844	PG&E Energy Recovery Funding L	Pacific Gas & Electric Co
CNP 2005-A	12/9/05	1,851	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
JCPL 2006-A	8/4/06	182	JCP&L Transition Funding LLC	Jersey Central Power & Light
AEPTC 2006-A	9/26/06	1,740	AEP Texas Central Transition Funding	AEP Texas Central Co.
FPL 2007-A	5/17/07	652	FPL Recovery Funding LLC	Florida Power & Light Co
EGSI 2007-A	6/22/07	330	Entergy Gulf States Reconstruction Funding LLC	Entergy Texas Inc
RSBBC 2007-A	6/29/07	623	RSB Bondco LLC	Baltimore Gas & Electric Co
CNP 2008-A	1/29/08	488	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
CLECO 2008-A	2/28/08	181	Cleco Katrina/Rita Hurricane Recovery Funding LLC	Cleco Power LLC
LPFA 2008-ELL	7/22/08	688	Louisiana Utilities Restoration Corp./ELL	Entergy Louisiana LLC
LPFA 2008-EGSL	8/20/08	278	Louisiana Utilities Restoration Corp./EGSL	Entergy Gulf States Louisiana
ETI 2009-A	10/29/09	546	Entergy Texas Restoration Funding LLC	Entergy Texas Inc
CNP 2009-1	11/18/09	665	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
LCDA 2010-EGSL	7/16/10	244	Louisiana Local Gov't Environmental Facilities and Community Development Authority	Entergy Gulf States Louisiana
LCDA 2010-ELL	7/16/10	469	Louisiana Local Gov't Environmental Facilities and Community Development Authority	Entergy Louisiana LLC
EAI 2010-A	8/11/10	124	Entergy Arkansas Restoration F	Entergy Arkansas Inc
ELL 2011-A	9/15/11	207	Entergy Louisiana Investment R	Entergy Louisiana LLC
CNP 2012-1	1/11/12	1,695	CenterPoint Energy Transition Bond Company IV	CenterPoint Energy
AEPTC 2012-1	3/7/12	800	AEP Texas Central Transition Funding	AEP Texas Central Co.
FEOH 2013-1	6/12/13	445	FirstEnergy Ohio PIRB Special Purpose Trust	FirstEnergy Corp.

Source: Asset-Backed Alert, Bloomberg, Wells Fargo Securities, LLC.

## Relative Value Analysis to Benchmark Cards

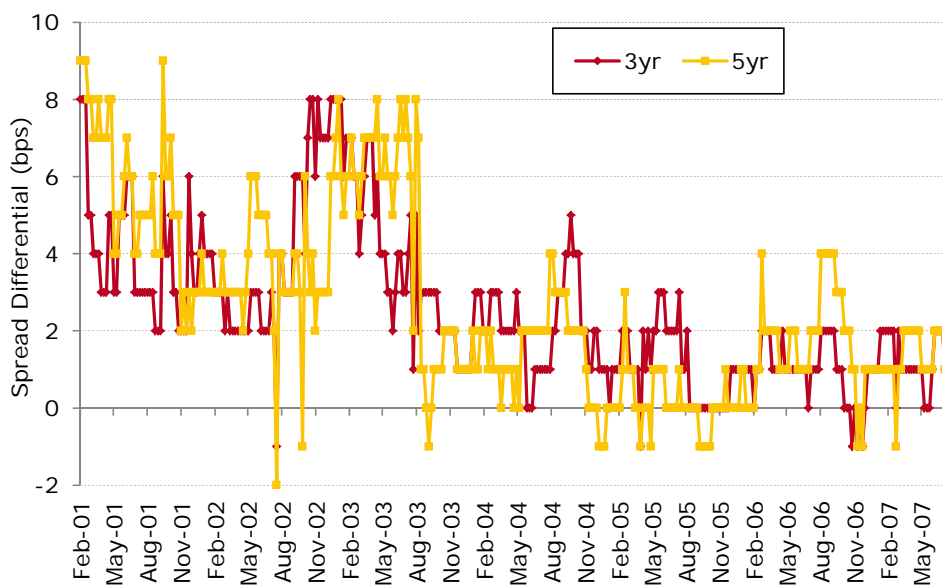
Spreads of rate-reduction bond ABS have remained relatively wide throughout the post-crisis period and have exhibited some wide swings over the past few years. Since hitting their post-crisis lows in September 2012, spreads have widened by about 30 bps through July 12, 2013 (Exhibit 4). We believe that this trend has been influenced by a general widening of spreads in the ABS market during 2012, and increased volatility brought on by the market's reaction to Federal Reserve policy communications. In our opinion, RRBs offer some of the best relative value in the consumer ABS market for the credit risk taken.

### Exhibit 4: RRB Spreads



Source: Wells Fargo Securities, LLC.

### Exhibit 5: RRB / Credit Card ABS Spread Differential – 2001-2007

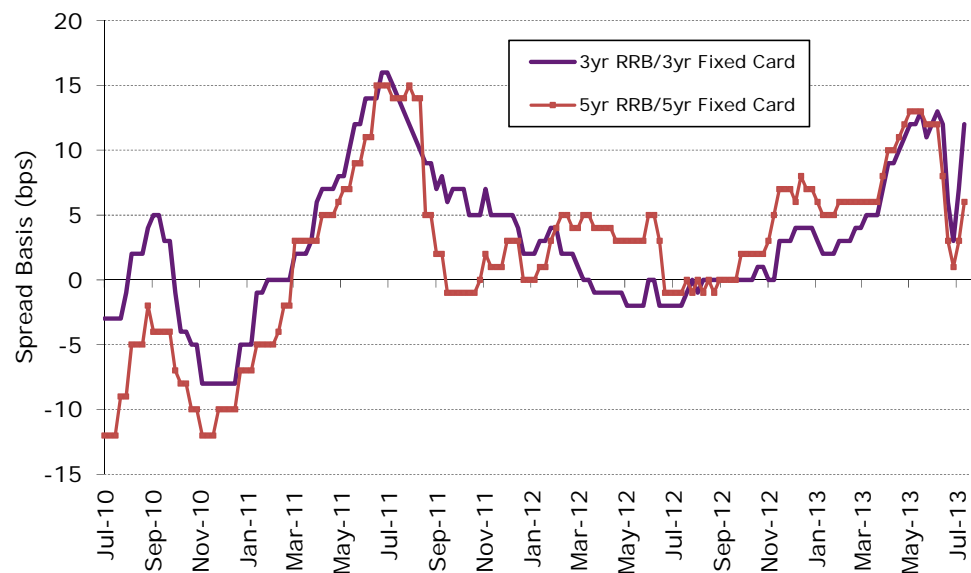


Source: Wells Fargo Securities, LLC.

Wells Fargo Securities has collected generic spreads on the RRB sector back to 2001. In our opinion, assessing relative value in rate-reduction bond ABS can be best accomplished by reviewing the spread differential between RRBs and benchmark credit card ABS. This relationship from 2001 to just before the market dislocation in July 2007 is charted in Exhibit 5. The average weekly difference was +4 bps to +6 bps, depending on the tenor of the bonds from 2001 to June 2003. However, the range of the spread differential was a wider +2 bps to +9 bps for three-year and five-year average life bonds.

After June 2003, the spread differential narrowed to an average weekly level of just about +1 bp, and this difference was stable across the benchmark tenors in RRBs (three-year, five-year and 10-year average lives). We believe that an increase in the amount of bonds outstanding and the number of issuers, as well as increasing investor acceptance, helped push the spread differential tighter. The week-to-week variability was relatively low, and this pattern was consistent with the benchmark auto and credit card ABS sectors. It indicated a meaningful increase in transparency and liquidity, in our view.

**Exhibit 6: RRB / Credit Card ABS Spread Differential – 2010-2013**



Source: Wells Fargo Securities, LLC.

RRBs traded well inside credit card ABS during the depths of the financial crisis in late 2008 and early 2009 (spreads 200 bps–300 bps inside) because investors placed a higher risk premium on large commercial banks and their credit card portfolios during this period. However, it took almost another two years for the spread relationship to normalize by early 2011.

The average weekly spread differential has returned to pre-crisis levels of +2 bps to +3 bps from July 2010 to July 2013. The average is closer to +4 bps, though, if all of 2010 is excluded. Nevertheless, secondary trading levels for RRBs have experienced large excursions away from this long-run average level, and these excursions have had a tendency to persist for a number of weeks.

We view RRB spreads trading at +4 bps or more to benchmark credit card ABS as representing better relative value. In general, RRBs involve less credit risk than credit card ABS, although the smaller size of the RRB sector, wider principal payment windows and somewhat less transparency due to the regulatory nature of the collateral require some spread concession, in our view.

## **Structural Considerations**

Unlike most asset-backed securities, rate-reduction bond ABS are characterized primarily by their legal and regulatory framework. To a large extent, the credit analysis of the underlying obligors, which are the ratepayers in the utility's service area, is a secondary consideration, in our view. The securitization structure of most RRBs is relatively straightforward. The utility would transfer its ownership of the utility charges to a bankruptcy-remote special purpose vehicle (SPV) that would issue the ABS to investors.

The ABS may be issued as a single pass-through security, or there may be several tranches of bonds issued that pay in sequential order. Principal is repaid according to a scheduled amortization that would be consistent with the forecast for power usage and cash flows. Interest payments may be made quarterly or semiannually. The cash flows are stressed in the rating process to determine how much forecast error the deal can withstand and still make payments to investors in a timely manner.

Credit enhancement is provided, in most cases, by a small amount (generally 0.5%–1%) of overcollateralization, reserve fund, or some form of capital account to provide liquidity in the event of short-run cash flow shortfalls. However, the primary form of credit enhancement is a regulatory-mandated "true-up mechanism" that can adjust the amount of the utility tariff charged to the customer. The robust legal and regulatory nature of the true-up mechanism, along with the fundamental character of power usage, allows for the relatively low level of internal credit enhancement in RRBs.

### **A Regulatory Future Flow Receivable**

One of the key considerations in the RRB sector is that the asset securitized is a future flow rather than an existing loan or receivable. The utility tariff is established by a law passed by a state legislature and further put into practice by a financing order from the state's utility regulators. The charge added to the utility bill is established as a property right of the utility that can be transferred or sold and pledged as a security interest similar to other kinds of receivables securitized in the ABS market.

In the event that a utility is subject to a merger or files for bankruptcy, the order to collect the utility tariff remains in place with the successor utility. This provision helps avoid any disruption in billing and collections of the tariff and, therefore, for bondholders. Although the utility has a target amount to be raised from the utility tariff, the periodic amount of the cash flows can only be estimated at origination based on the expectations for usage. Actual utility usage and cash flows may deviate from the forecast amount.

### **Irrevocability and State Pledge**

One of the key legal features of an RRB is that the utility tariff is *irrevocable*. As noted above, the receivables have been created by legal and regulatory actions and are collected over time based on electricity usage. The receivable does not already exist, unlike an auto loan or lease. There is a risk that a future legislature or regulator could act to alter or rescind the utility tariff. In order to mitigate this risk, there is irrevocability language inserted in the legislation to prevent the impairment of the value of the utility tariff without adequate compensation.

The RRBs are not obligations of the state, nor do they carry the full faith and credit of any government or agency. However, the legislation creating the utility tariffs will generally contain a *state pledge* not to limit, alter, or impair the property rights created. There may be challenges from other constituencies over time that oppose the creation of the utility tariff, either through new legislation or ballot initiatives. The state pledges not to make any changes to the law or regulatory environment until the bonds are paid in full to mitigate the potential political risks to an asset created through the political process.

### **Non-bypassability**

The utility receivables generated would be collected based on a customer's usage and the fact that the customer is connected to the utility's deliver system. This delivery, or network, charge should not be avoided, or bypassed, just because a customer contracts with another generator of the power. The utility can collect the charges from existing customers as well as future customers from its service area.

In some states or markets, third-party energy providers may be allowed by regulators to bill customers directly. In these cases, the tariff is collected by the third-party provider and the charges are passed along to the utility. Customers can reduce their exposure to the charge by using less power, or by disconnecting from the service grid entirely. However, they should not be able to avoid paying the utility tariff as long as they are connected to the utility's network.

### **Bankruptcy Remoteness**

Like other types of securitized assets, the utility tariff is established as a property right that can be sold or transferred to another party. The right to the future receivables is sold by the utility to a bankruptcy-remote special purpose vehicle (SPV), which is the issuer of the ABS. This "true sale" of the receivables to the SPV should isolate the payments from being consolidated with the utility in the event that it files for bankruptcy.

The transfer of the utility tariff is a sale, not a pledge or a secured financing. Legal counsel would normally provide a nonconsolidation opinion that a bankruptcy court would not consolidate the SPV with the bankruptcy estate of the utility. This bankruptcy-remote nature of ABS is the standard in the market to provide a separation between the ABS and any potential bankruptcy of the seller/servicer.

### **True-Up Mechanism**

The key credit enhancement feature of RRB deals is the true-up mechanism. This procedure allows the utility tariff to be adjusted, either up or down, in the event that tariff collections are significantly different than what would be needed to meet the scheduled amortization of the bonds, including any fees and replacement of credit-enhancement reserves. The true-up can occur at least annually, as needed, but some deals allow for more frequent changes in the charges, such as semiannually. Regulators cannot alter the true-up, nor do they need to approve its use.

The strength of the legal and structural safeguards, along with the robust nature of the protection provided by the true-up mechanism, affords substantial credit enhancement for ABS investors. Indeed, Fitch Ratings indicated in its "Outlook and Performance Review for U.S. Utility Tariff ABS" (Feb. 1, 2013) that several RRB transactions have successfully used their true-up mechanisms to offset revenue shortfalls.

Weather-related variations in collections have occurred due to system outages from hurricane damage and warmer-than-normal winter temperatures. In addition, six transactions suffered shortfalls from 2008–2010 due to the recession's effects on customers reducing their power usage. Some were residential customers trying to save on monthly expenses, whereas others were commercial and industrial customers cutting production or going out of business, according to the Fitch Ratings report.

### **Credit Analysis**

When rating a new RRB deal and determining the potential variability in cash flows, the rating agencies typically perform a credit analysis of the utility and the service area that is subject to the utility tariff. The major areas of inquiry include the energy usage level and trends of the customer base and its composition, the size of the tariff in relation to the entire utility bill, customer

delinquency and loss trends, national and local economic factors affecting energy usage, and seasonality due to weather conditions.

The rating agencies incorporate various stresses in their cash-flow models to take account of forecast errors or variations in usage based on changing credit conditions. Although the credit analysis of the utility, its customer base and service area are important, they tend to take a position of secondary importance, in our opinion, to the legal and regulatory structure of the utility tariffs and the ability to true-up the charges when collections vary from the forecast.

### **Customer Base**

A utility's customer base typically can be divided into four segments: Residential, Commercial, Industrial, and Government. The most important segments tend to be Residential and Commercial/Industrial. Most service areas have a low concentration of government obligor exposure, although some areas may include state or federal government offices or military bases.

Residential customers offer the most diversification because each household is just a small portion of the overall pool of residential customers. They should also represent the most stable cash flows because households (and smaller commercial customers) tend to be less sensitive to economic cycles in their power usage. It could be assumed that new residents would replace those who move away, providing additional long-run stability. However, reduced demand for housing during recessions may present a potential risk to power usage and the generation of cash flows backing the RRBs.

Commercial and industrial customers are likely to be more concentrated as a group, and the size of individual firms could mean an increase in risk to cash flows in the event of reduced usage from less production, self-generation of power, or the possibility of ceasing business in that service area. For that reason, the rating agencies analyze the power-usage patterns of areas with cyclical industries and emphasize periods of recession in their analysis. This process provides an estimate of the potential variability of cash flows from the amortization schedule of the bonds.

### **Usage Patterns and Seasonality**

Residential and smaller commercial customers normally show greater changes in power usage due to changes in weather patterns. An unusually hot summer or colder-than-normal winter would likely drive power demand higher, and these seasonal patterns tend to be more important for short-run variations in power usage. In the long run, conservation measures, increased use of energy-efficient appliances and technological advances are more likely to play a role in energy-usage patterns. Larger commercial and industrial customers would also be affected by these weather-related and technological advances, although in the near term, they tend to be affected more by fluctuations in economic activity.

### **Size of Utility Tariff**

The rating agencies also consider the size of the utility tariff relative to the overall customer bill. This relationship becomes more important if the true-up mechanism must be used to increase the charge due to variability in the receivables generated. An increase in the overall price of power could be large enough to reduce demand for power if the tariff is a relatively large portion of the bill. This incentive may become particularly intense for larger industrial customers who have more energy alternatives.

## **DISCLOSURE APPENDIX**

**Additional information is available on request.**

**This report was prepared by Wells Fargo Securities, LLC.**

### **Important Information for Non-U.S. Recipients**

#### **EEA**

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\*This Glossary serves as the final exhibit to the testimony of both Public Staff witness Joseph Fichera and Public Staff witness Paul Sutherland, and is the same Glossary as referenced in the testimony of Public Staff witnesses.

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## Glossary

**Asset-Backed Security (ABS)** - A debt security issued by an SPE, the payment of which is backed by a physical asset (e.g., rail cars or airplanes) or a financial asset (e.g., a mortgage or the value of a portfolio of credit card receivables). At least for some purposes, Ratepayer-Backed Bonds are not technically Asset-Backed Securities but often have been treated as such to the detriment of ratepayers.

**Bankruptcy Remote** - An entity designed in such a way that (i) the likelihood of it going into bankruptcy is extremely small, and (ii) it would experience as little economic impact as possible in the event of a bankruptcy of other related legal entities.

**Basis Point (bp)** - One one-hundredth of a percentage point. Often referred to in writing as “bp” (or “bps” in the plural).

**Benchmark** – When pricing a bond, the Benchmark is a security with high price transparency that is agreed upon by all parties so that the Yield on the new issue can be set relative to the Yield on the Benchmark. In that way, if Yields in the market move after agreeing on the spread to Benchmark but before final pricing, the parties do not have to renegotiate the final price/Yield. A Benchmark can also be a similar security used to determine Relative Value when talking to investors.

**Callable/Non-Callable Bonds/Pre-Payment Risk** - In many cases bonds are offered for sale with a “call provision.” For example, a company may want the right to retire a given bond in five years even though it carries a 25-year Maturity date. That bond would be said to carry a five-year call option. Investors who worry their bonds might be called away from them in a relatively short period of time will not pay a high price for those bonds because they can’t rely on earning the bonds’ stated interest rate through Maturity. Also known as Pre-Payment Risk. Non-callable bonds cannot be called away from the investor before the final Maturity date. Ratepayer-Backed Bonds typically are non-callable and have no Pre-Payment Risk.

**Final Legal Maturity Date** – The date by which, if the principal is not fully paid, the bonds will be considered to be in default. Usually, the Final Legal Maturity Date is one to two years after the Final Scheduled Maturity Date.

**Final Scheduled Maturity Date**– The date by which it is expected that the final principal payment on a bond or on a group of substantially identical bonds will be made.

**Financing Order** - An order issued by state regulators authorizing the issuance of Ratepayer-Backed Bonds, which order cannot be changed or revoked at a later date as long as the Ratepayer-Backed Bonds are outstanding, and which (i) segregates a specific component of the retail rate charge throughout the service territory, (ii) causes the right to receive this component to be treated as a present interest in property that can be bought, sold or pledged, (iii) authorizes the utility to sell such property to an SPE, (iv) authorizes the SPE to issue Ratepayer-Backed Bonds secured by such property, and (v) requires the utility which sold the property to use the proceeds of the sale for one or more specific purposes.

**Maturity** - The length of time until the issuer of a bond has to repay specified amounts to the lender / investor.

**Net Present Value (NPV)** - The amount of cash today that is equivalent in value to a payment, or to a stream of payments, to be received in the future. To determine the Net Present Value, each future cash flow is multiplied by a present value factor. For example, if the opportunity cost of funds is 10%, the Net Present Value of \$100 to be received in one year is  $\$100 \times [1/(1 + 0.10)] = \$91$ . Opportunity cost means what a dollar today could earn over a specific period of time.

**Nominal Dollars** or **Nominal Savings** - This type of measure reflects the current situation, not adjusted for the opportunity cost of funds over time. Nominal dollars treat all dollars the same whether received today or 10 years from today. See “Net Present Value” for the way to look at dollars over time.

**Ratepayer-Backed Bond** – Bonds issued by an SPE for the benefit of one or more sponsoring utilities in a Securitization transaction.

**Regression Line** - Regression takes a group of data points and tries to find a mathematical relationship between them. This relationship is typically in the form of a straight line (linear regression) that best approximates all the individual data points. It is the most common type of “trendline” used in Excel.

**Relative Value** - The relationship between two securities. In pricing a new Ratepayer-Backed Bond issue, for example, it is useful to compare the Spread over Swaps of the proposed bond Yield to the Spread over Swaps or over a AAA-rated U.S. agency bond. If the two securities were judged equal in risk with identical terms (not callable, same WAL etc.) but one had a higher Spread, it would be said to have greater Relative Value.

**Road Show** - A formal presentation to potential purchasers of a security, typically organized by Underwriters with the involvement of the issuer and the financial advisor. A team sometimes travels around the U.S. to discuss the features of the security, resulting in the term “Road Show.” Sometimes the team travels to foreign financial centers to make these presentations. In recent years, most Road Shows have been conducted using electronic media over the Internet, reducing or eliminating the need for travel.

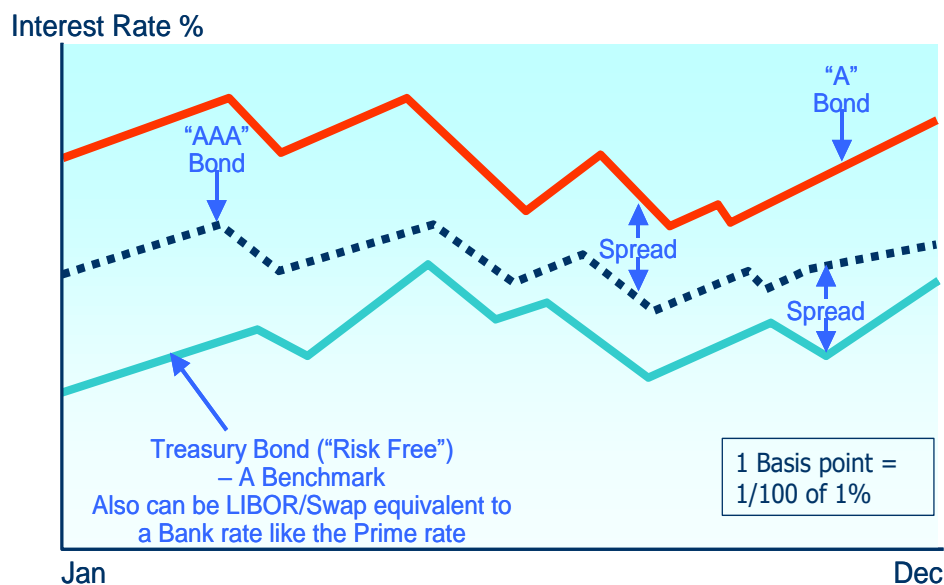
**Secondary Market** – The market in which stocks or bonds are traded after their initial issuance. When a publicly offered bond trades at a substantially higher price (lower Yield) in the Secondary Market immediately following its issuance, this is an indication that the bond was mispriced (priced too low) by the Underwriters in the original public offering.

**Securitization** - The process by which a pool of assets, such as loan receivables, is used as a basis for issuing highly rated (often AAA) bonds. The pool of assets is created and transferred to a trust or, in a utility Securitization, to a Bankruptcy Remote SPE. The entire right, title and interest in the assets are transferred at fair market value to the SPE. The SPE pledges the assets to secure the bonds and the cash flows from those assets are used to pay principal and interest on the bonds. Thus, the risk to the bondholder is just the risk associated with the cash flows from the assets in the SPE. The assets can be physical (such as plant and equipment) or intangible (such as a loan receivable or the right to some other revenue stream).

**Special Purpose Entity (SPE)** – A Bankruptcy Remote legal entity set up for the express purpose of owning the right, title and interest in the assets used to secure the bonds and provide the cash flows to pay interest and principal on the bonds.

**Spread** – The difference between the market Yields of different fixed-income securities of similar maturities, expressed in Basis Points. If a Treasury bond maturing in seven years is trading to Yield 3.87%, and a AAA-rated corporate bond is trading to Yield 4.25%, the corporate bond is said to trade at a 38 Basis Point Spread to the Treasury bond ( $4.25 - 3.87 = .38$ ).

Spread is the easiest way to compare the cost of funds represented by different debt securities. Participants will refer to the spread “relative to Treasuries” or “relative to Swaps” as the most meaningful measure used to compare a given debt security to the most liquid, most secure, and most easily available benchmark for a given Maturity. Spreads are often referred to as either “Tight” or “Wide” to the Benchmark. (See **Tight Spread/Wide Spread** definition below.)



**Swaps, or Interest Rate Swap Agreements** - An interest rate Swap exchanges a floating rate for a fixed rate on bonds. Under certain market conditions, a combination of floating rate bonds and fixed rate Swaps could produce a lower overall “synthetic” fixed interest rate for ratepayers. Certain investors prefer a floating rate, while other investors prefer a fixed rate. For example, many European investors prefer a floating rate. There may be an opportunity to lower overall ratepayer costs and achieve the “lowest storm recovery charges” by issuing floating rate Ratepayer-Backed Bonds and swapping them to a synthetic fixed interest rate.

**Tranche** – A Tranche is a piece of a larger bond offering with its own cash flows, i.e., principal amount, Maturity and interest rate, but governed by the same documents as the larger bond offering, i.e. prospectus, trust agreement, servicing agreement, etc. While Tranche is common nomenclature for ABS type debt, corporate debt usually uses the term “series” for the same purpose.

**Tight Spread/Wide Spread** - If a Spread is considered “Tight,” it is low and closer to the Benchmark rate. If it is “Wide,” it is much higher than the Benchmark rate. Interest rates are composed of the Benchmark plus the Spread. Thus, a Tight Spread means a lower interest rate.

**True-up Mechanism - PSC-Guaranteed True-up Mechanism** or **“True-up Mechanism”** means the mechanism irrevocably mandated by state law and the Financing Order whereby ratepayer charges to pay debt service and ongoing expenses on Ratepayer-Backed Bonds are reviewed and adjusted at least annually or semi-annually (true-up period), depending on the jurisdiction. The rates at which the charges are imposed on ratepayers, to be paid on a joint and several basis, will be adjusted to correct any over collections or under collections from prior periods and to guarantee payment of all principal and interest on a timely basis.

**Underwrite** – This refers to the actions of an investment bank when it initially purchases newly issued bonds with the intention of re-offering or re-selling them to the ultimate investors, thus assuming the market risk for a short period of time.

**Underwriters** - The investment banks that initially purchase the bonds and re-offer the bonds to ultimate investors. A lead Underwriter (sometimes called the “bookrunning” manager and most often called a lead manager) is responsible for assembling and leading a syndicate which generally includes additional investment banks in an effort to reach the widest audience of buyers. A co-lead Underwriter (or “co-manager”) is another firm which also assumes responsibility to purchase bonds from the issuer. Nowadays, in practice, the Underwriters of a bond issue often have orders for 100% of a new issue before it is formally re-sold to anyone, and consequently the Underwriters do not hold the bonds or take any appreciable market risk.

**Weighted Average Life (WAL)** – The amount of time (in years), on average, that the principal amount will remain outstanding. It is calculated by weighting the time each component of the principal is outstanding by the principal amount. Thus, for a bond that pays back all its principal at final Maturity, the WAL is the same as the final Maturity. However, Ratepayer-Backed Bonds amortize principal over a number of years, so the WAL is always less than the Final Scheduled Maturity of each Ratepayer-Backed Bond.

**Yield, Current** - The annual coupon amount of interest on a bond, divided by the selling price (expressed as a percentage). A \$1,000 principal amount bond that sells for \$1,000 with a \$50 annual interest coupon has a 5% Yield. The lower the price, the higher the Yield; the higher the price, the lower the Yield.

**Yield to Maturity** - Yield to Maturity is the discount rate at which the sum of all future cash flows from the bond (interest and principal) is equal to the price of the bond. This measure of Yield takes into account the difference between the current price and the principal value at redemption. This is the Yield referred to when pricing a bond and comparing to the Yield on benchmark securities. It is more reflective of true value because it accounts for the time value of money.



# Investor-Owned Utility Securitization Possibilities, Processes, Pitfalls

1

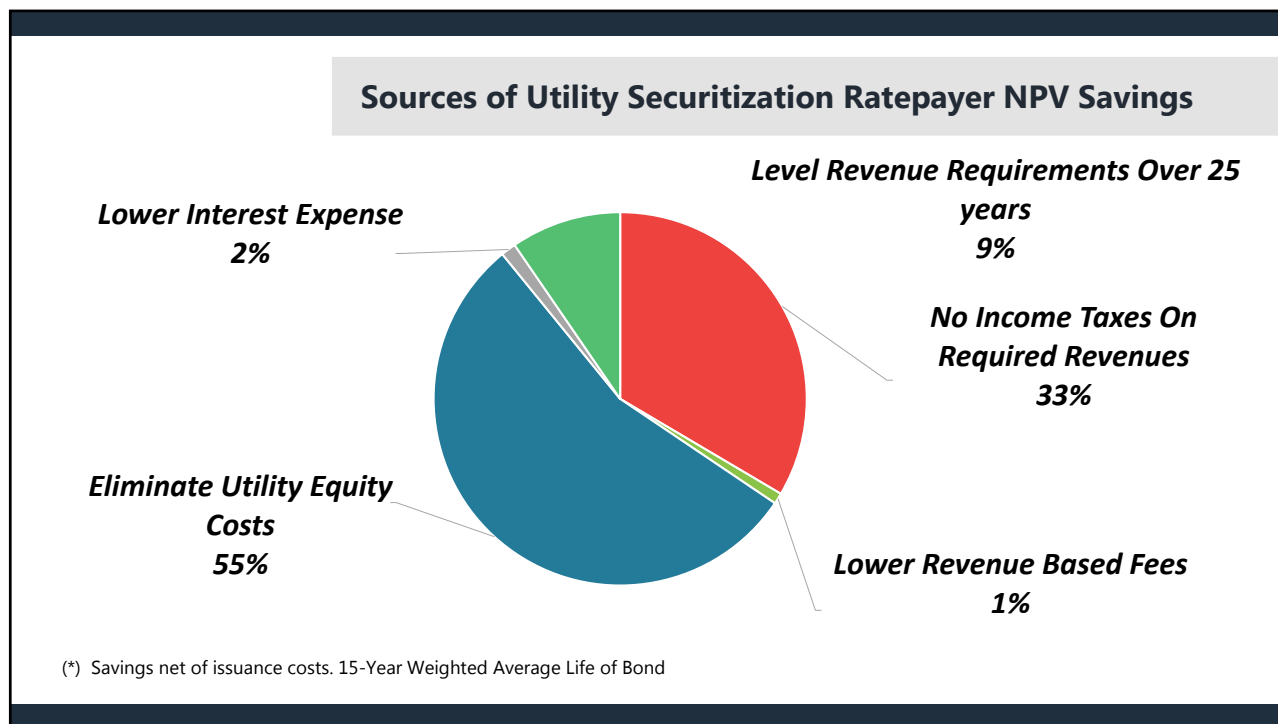
**2000 – Present**  
**\$9,020,000,000**

**Our Experience in Investor-Owned Utility Securitization, Ratepayer-Backed Bonds: 19 years, Multiple Engagements; Same Personnel Have Advised 6 Commissions, 13 Transactions, \$9.02 Billion in Bonds involving 8 utilities, 25+ Underwriters**

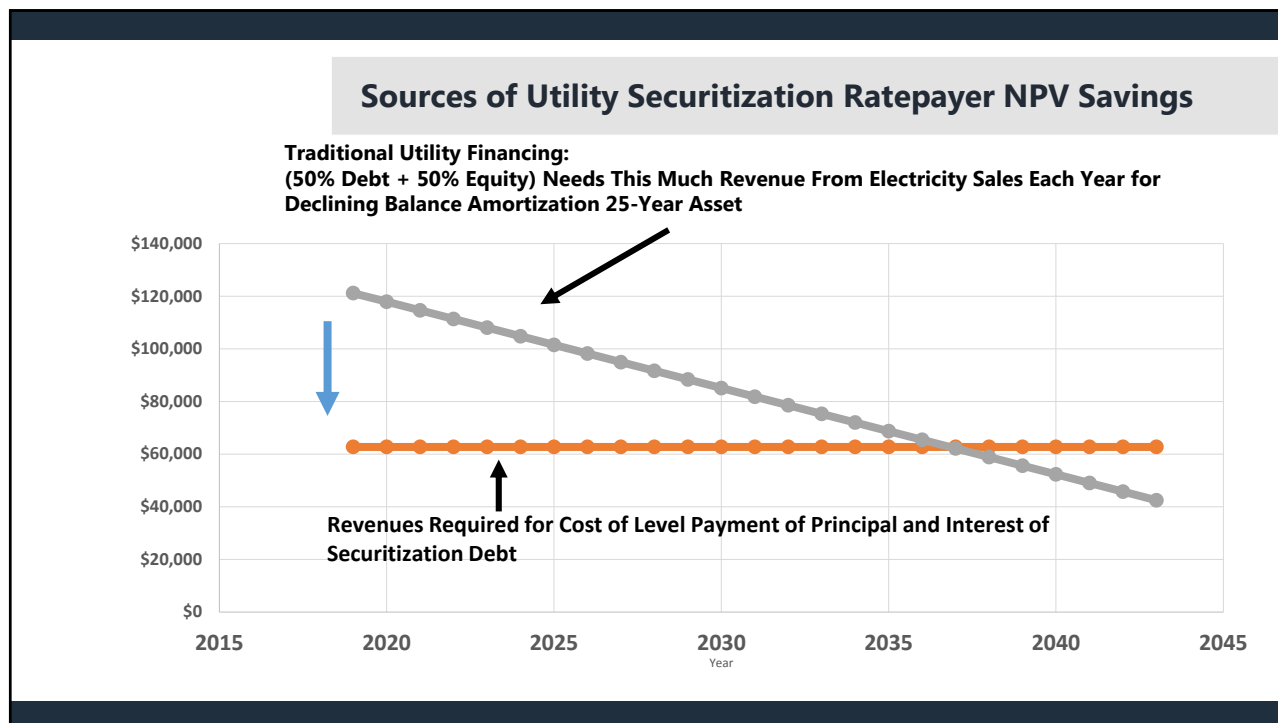
Size of Offering \$ Millions	Saber Partners' Role Involving State Utility Regulatory Agencies, Ratepayers and Securitization
N/A	Financial Advisor to Chairman of New York State Public Service Commission
\$748.9	Financial Advisor to Public Utility Commission (PUC) Texas
\$797.3	Financial Advisor to Public Utility Commission Texas
\$500.0	Financial Advisor to Public Utility Commission Texas
\$789.8	Financial Advisor to Public Utility Commission Texas
N/A	Financial Advisor to Vermont Public Service Board (Purchasing Agent, VEPP, Inc.)
N/A	Financial Advisor to Wisconsin Public Service Commission (PSC)
\$102.7	Financial Advisor to New Jersey Board of Public Utilities
\$1,851.0	Financial Advisor to Public Utility Commission Texas
\$1,739.7	Financial Advisor to Public Utility Commission Texas
\$344.5	Financial Advisor to Public Service Commission of West Virginia
\$114.8	Financial Advisor to Public Service Commission of West Virginia
\$652.0	Financial Advisor to Florida Public Service Commission
\$64.4	Financial Advisor to Public Service Commission of West Virginia
\$21.5	Financial Advisor to Public Service Commission of West Virginia
\$375	Financial Advisor to the Office of the People's Counsel (i.e., Ratepayer Advocate) of the District of Columbia Public Service Commission
\$1,294.0	Financial Advisor to Florida Public Service Commission
	Financial Advisor to California Community Choice Association for financial analysis and testimony before the California Public Utilities Commission Rulemaking (CPUC)17-06-026 Proceeding
	National Regulatory Research Institute (NRRI) Fellow (Joseph S. Fichera) and author of securitization NRRI "Insights" article January, 2019
	Advisor to HEAL Utah (Healthy Environment Alliance) securitization legislation proposal
	Advisor to North Carolina Utilities Commission Public Staff on storm securitization
	<b>\$9,020 Billion</b>

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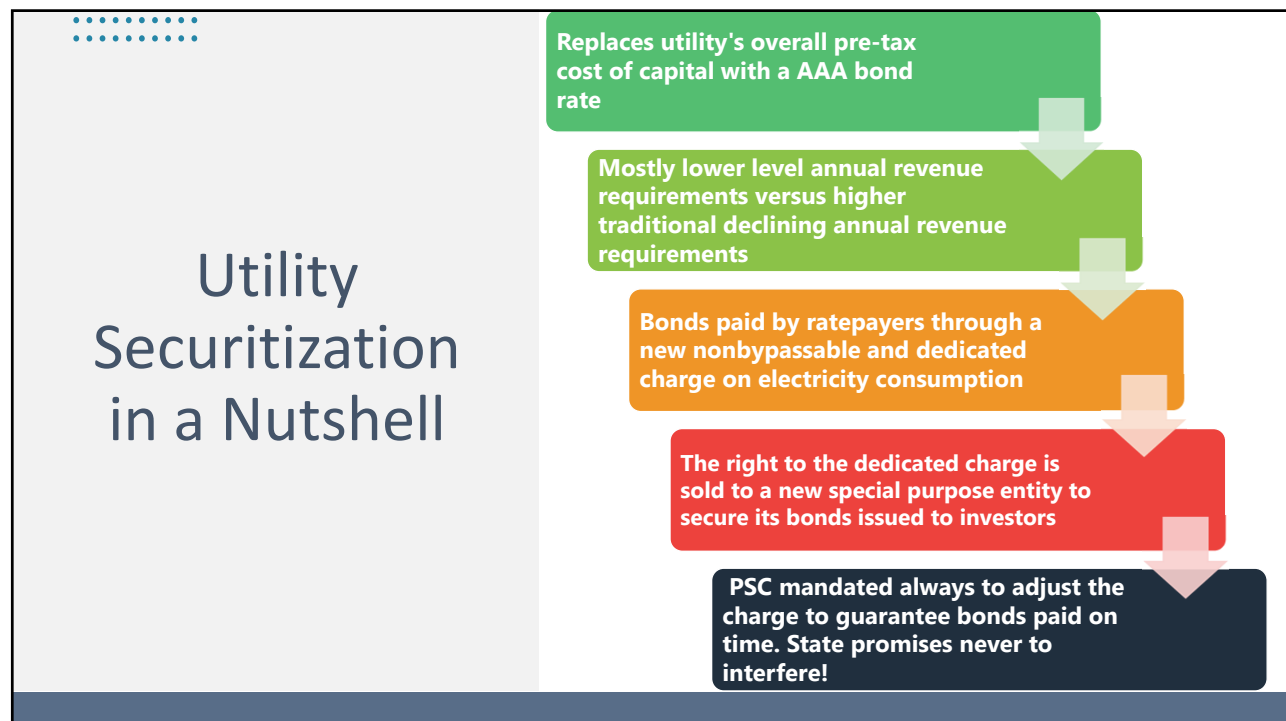
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## WHY SECURITIZATION?

A “financing tool” to recover unique and significant costs in a way that is beneficial to both the utility and ratepayers.



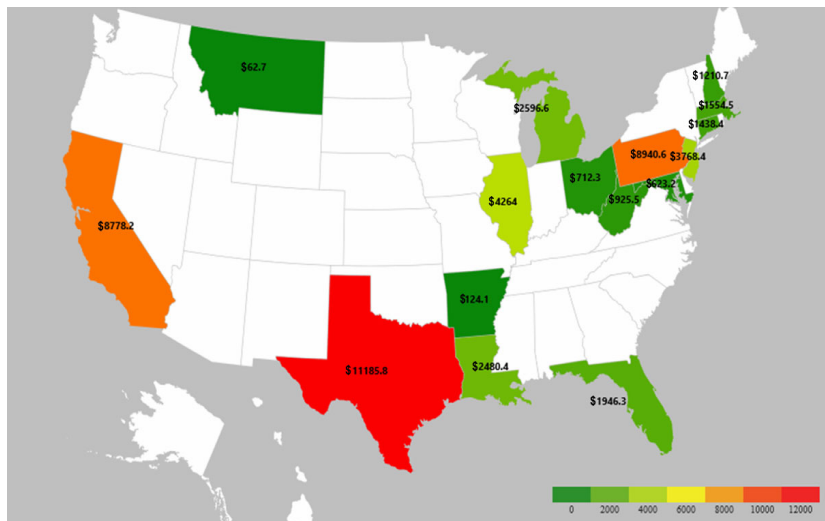
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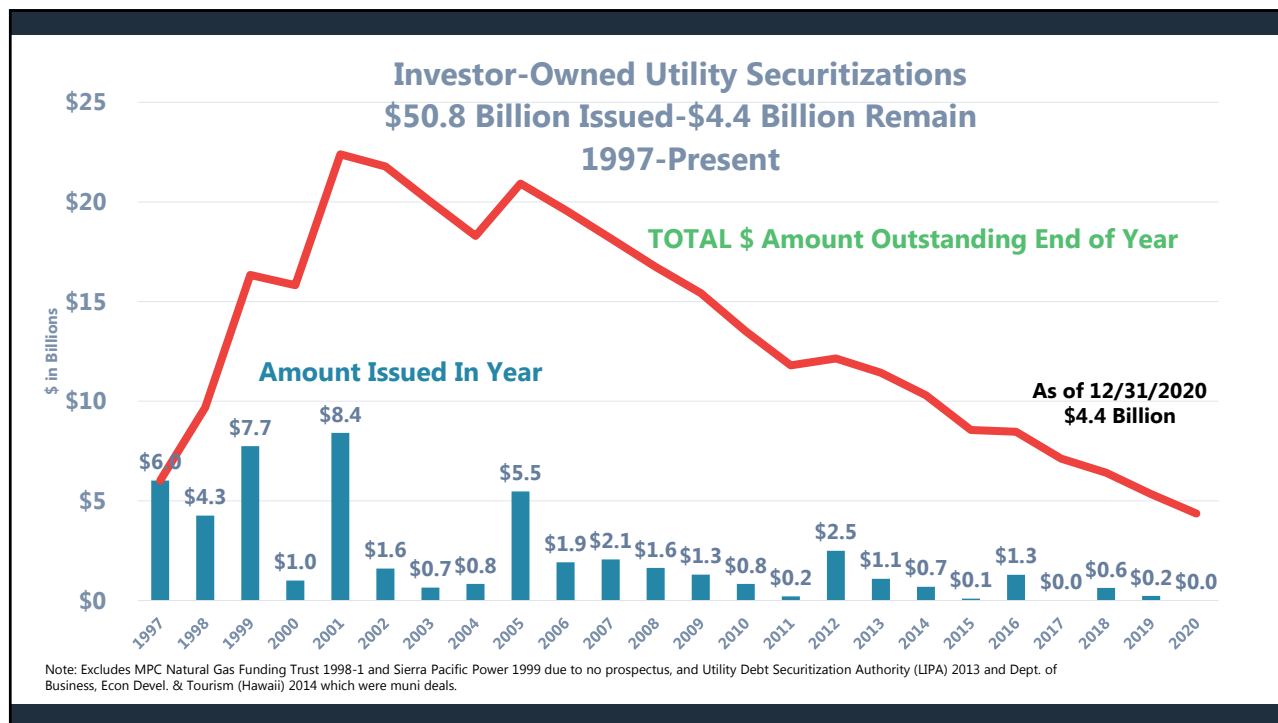
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**Some states  
more active  
than others**

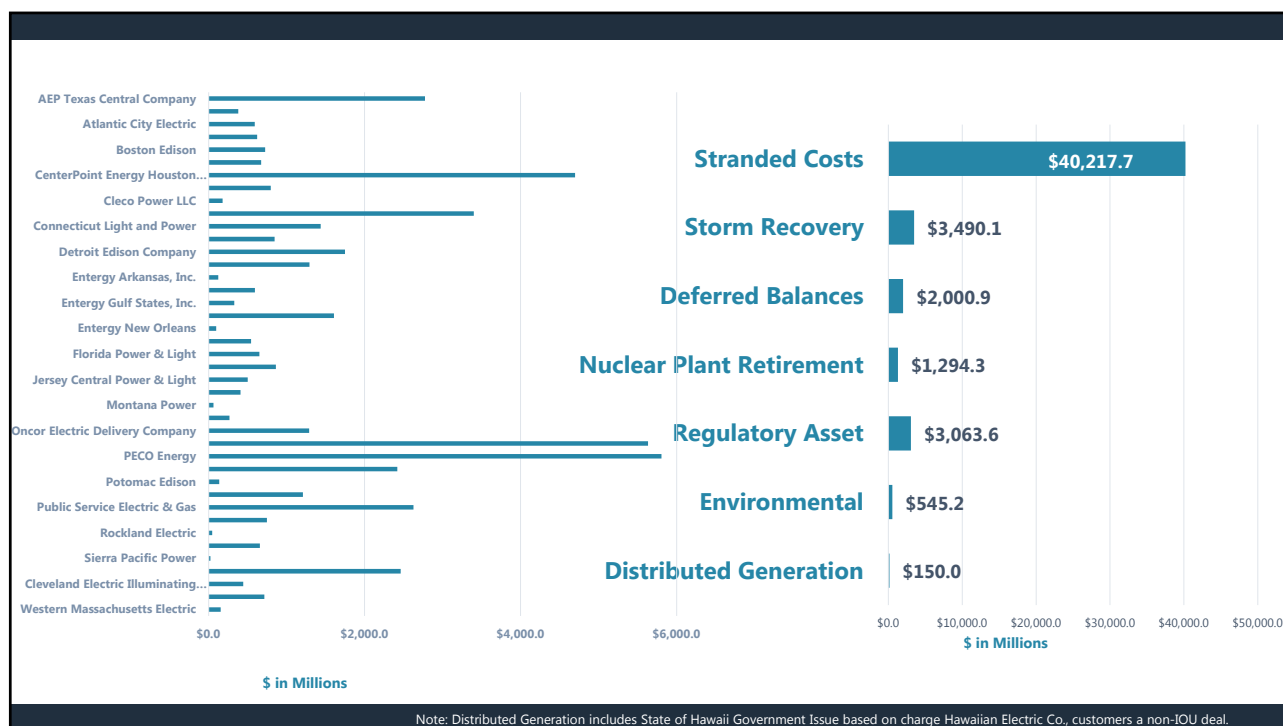
**66 Investor-  
Owned  
Utility  
Transactions**



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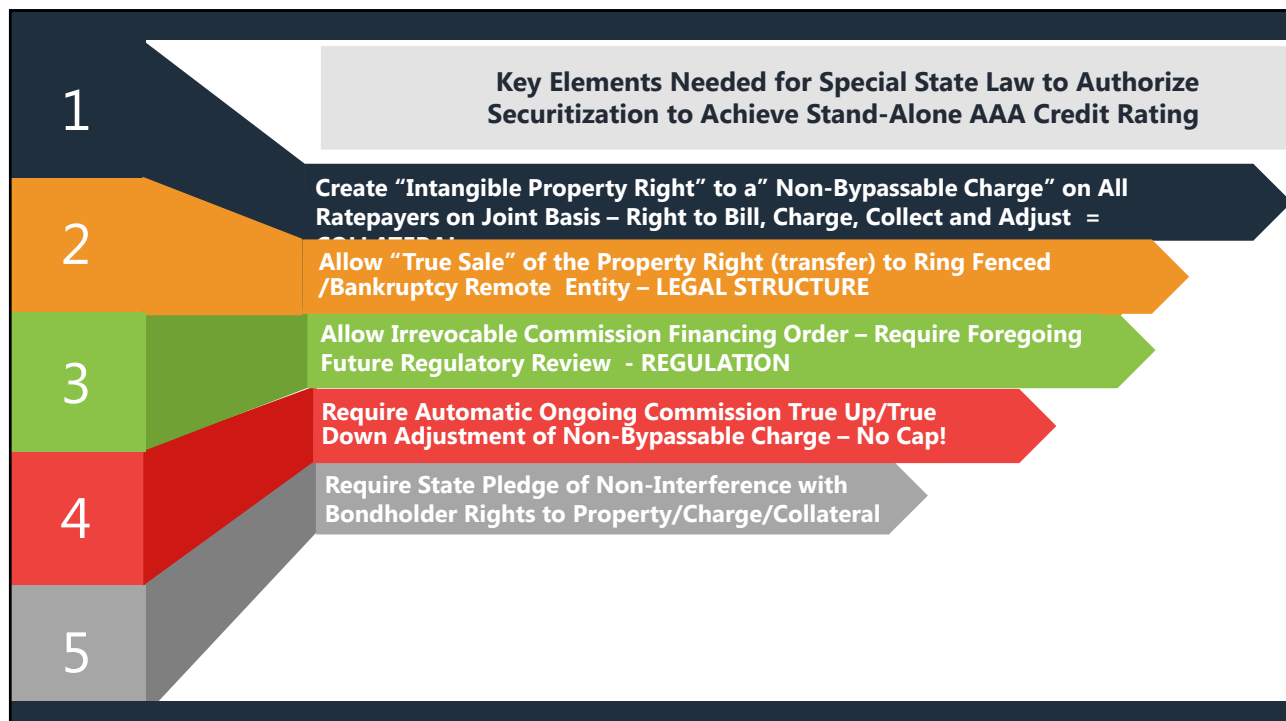
### Eight Primary Uses Over Time 1997 – Present Only After Costs Determined Prudent and Recoverable

- 1. 1997 Rate reduction to facilitate deregulation of energy market**
- 2. 1998-2007 Recovery of stranded costs resulting from electric industry deregulation**
- 3. 2000 Buydown of above market power purchase agreements**
- 4. 2001-2006 Deferred balances and regulatory assets**
- 5. 2004 -2007 Costs of new pollution control equipment**
- 6. 2005 Storm recovery costs**
- 7. 2013 Costs of new renewable distributed generation**
- 8. 2016 Remaining costs of early retired nuclear plant**

10



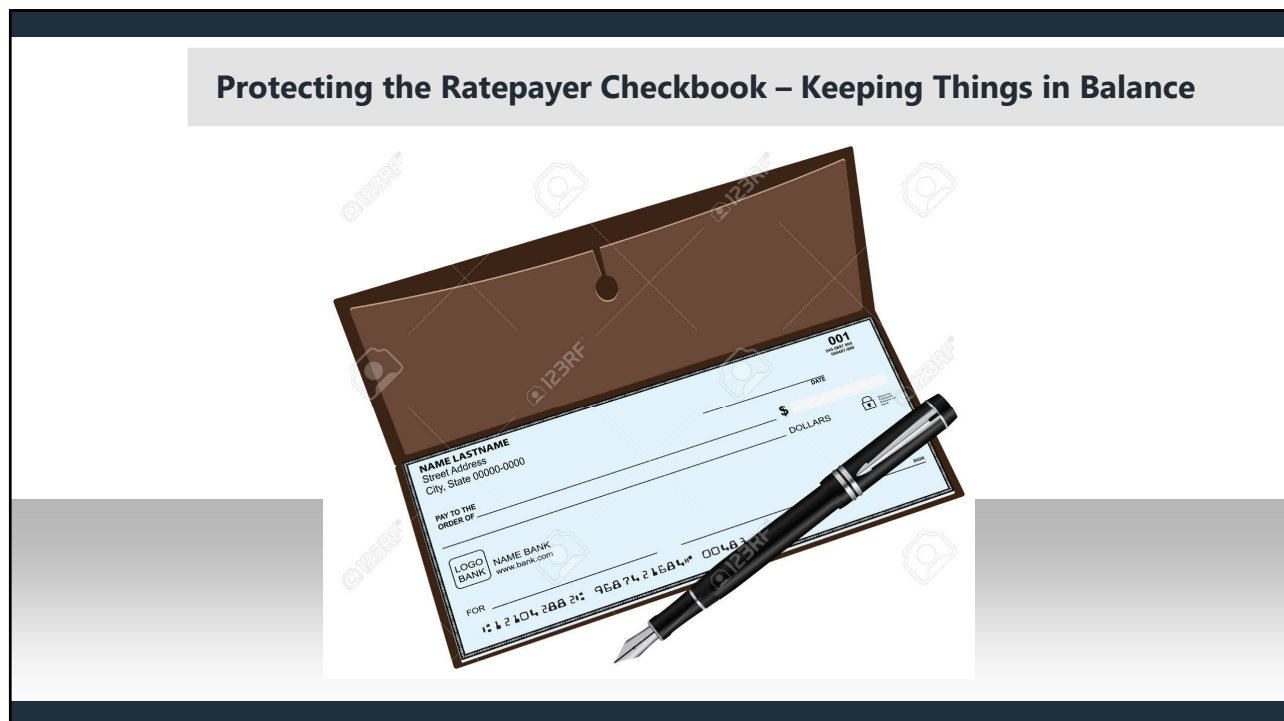
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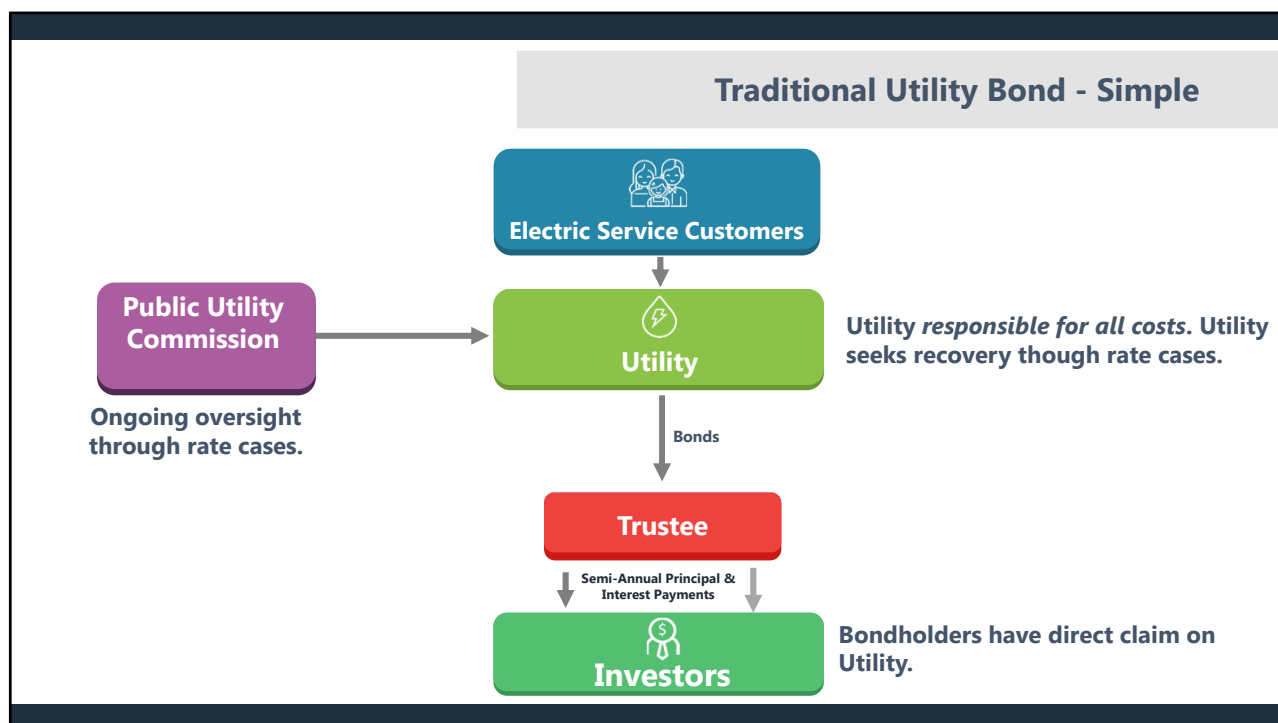
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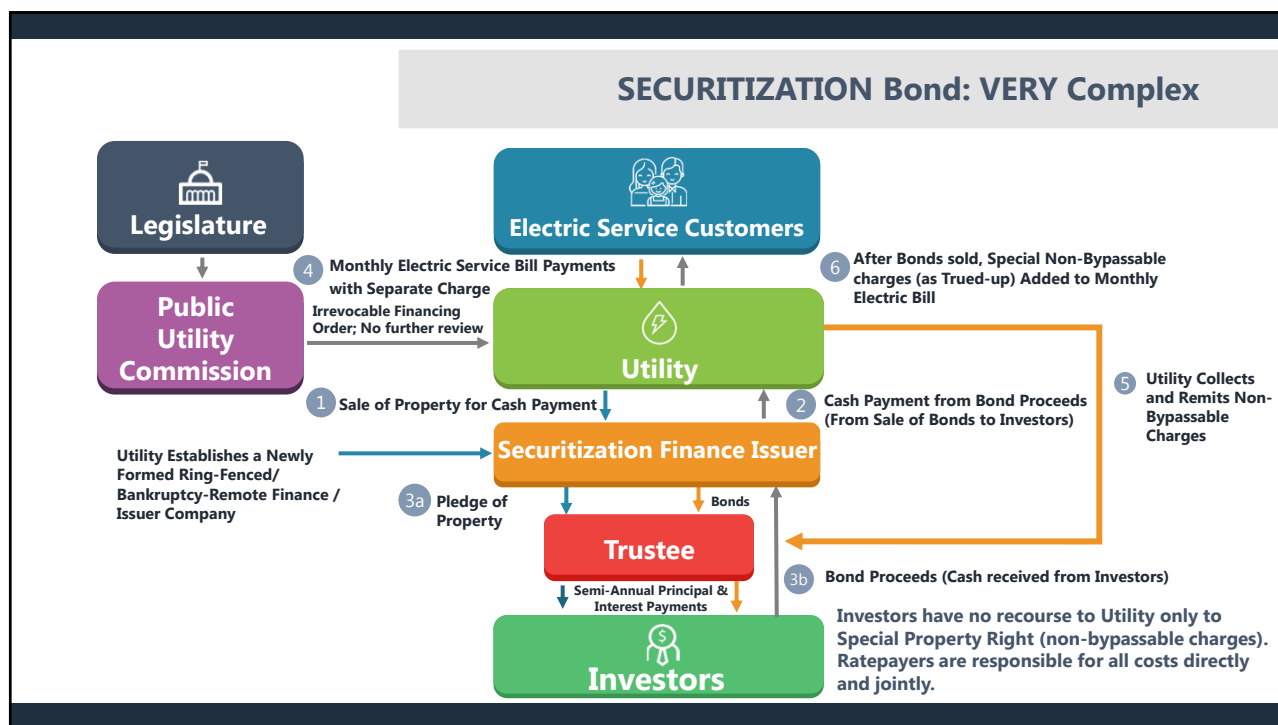
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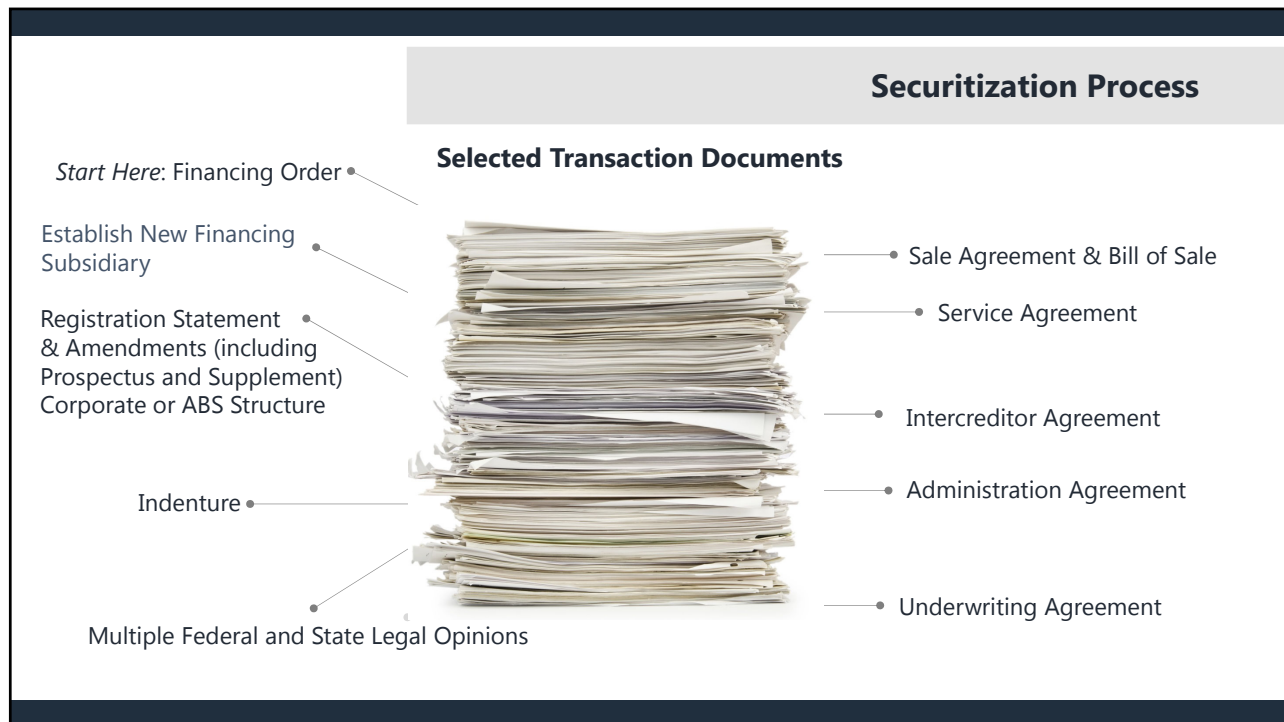


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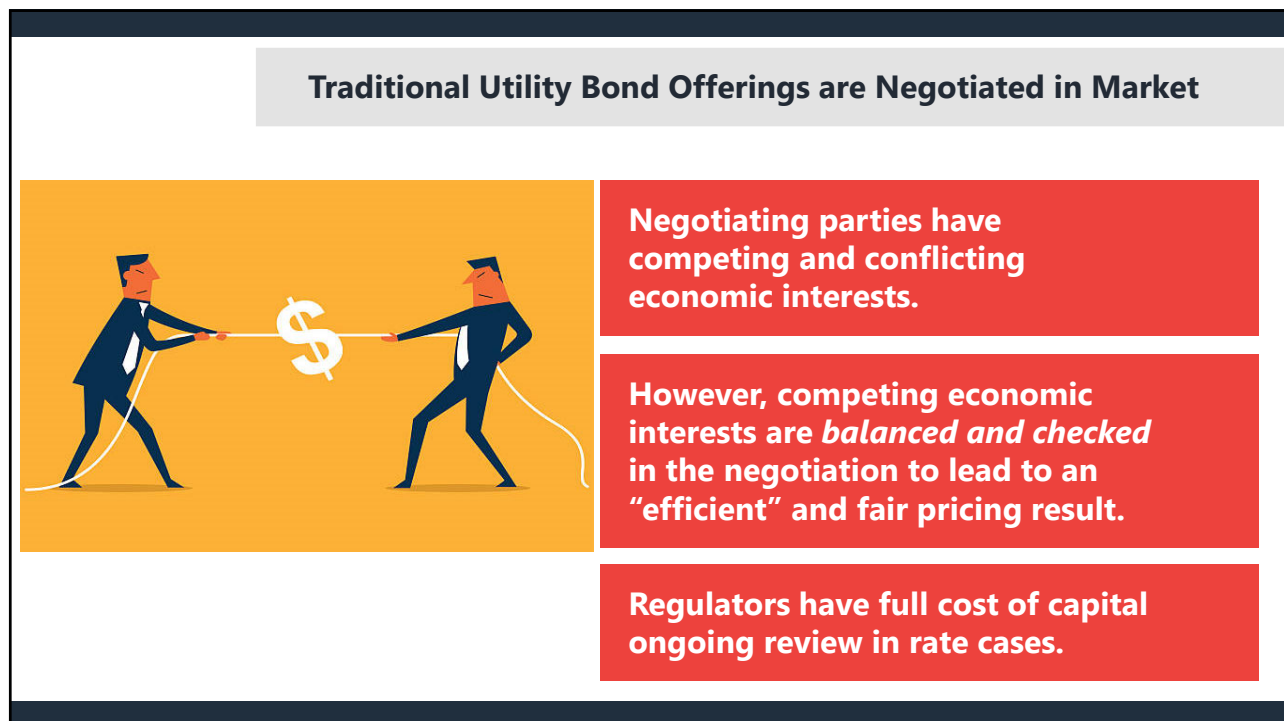


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17



18



## Traditional Utility Bond Negotiation Competing Economic Interests Balanced and Checked with Commission Ongoing Oversight



19

## Each Party Acts in Its Own Economic Interest and Competing Economic Interests Are Balanced and Checked.



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## Bankers/Underwriters Have No Duty to Act in Ratepayers' Best Interests ... Fully Disclosed.



"The primary role of Goldman Sachs, as an underwriter, is to purchase securities, for resale to investors, in an arm's-length commercial transaction between the Issuer and **Goldman Sachs will act in its own interest and has financial and other interests that differ from** those of the Issuer." <sup>1</sup>

<sup>1</sup> See Public Service of New Hampshire d/b/a Eversource Energy Docket No. DE 17-096 Securitization Petition Attachment RR 1-013 Page 2

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## Bankers/Underwriters Have No Duty to Ratepayers nor to Utility nor to Commission

Excerpt from Securitization Bond "Underwriting Agreement" Underwriters Required of an Issuer



### Section Entitled: "Absence of Fiduciary Relationship"

1

[The utility] acknowledges and agrees that the Underwriters are acting solely in the capacity of an **arm's length contractual counterparty to the [utility]** with respect to the offering of the Bonds ... **(including in connection with determining the terms of the offering)** and not as a financial advisor or a fiduciary to, or an agent of, (the utility) ...

2

[The utility will] consult with their own advisors concerning such matters and **shall be responsible for making their own independent investigation and appraisal of the transactions contemplated**, and the Underwriters shall have **no responsibility** or liability to [the utility] with respect thereto.

3

**Any review by the Underwriters ... of the structure and terms of the transactions ... will be performed solely for the benefit of the Underwriters and shall not be on behalf of [the utility] ... ."**

\*See the language quoted above in AEP Texas securitization transaction 2012  
[https://www.sec.gov/Archives/edgar/data/18734/000090514812000765/efc12-292\\_ex11.htm](https://www.sec.gov/Archives/edgar/data/18734/000090514812000765/efc12-292_ex11.htm)

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## Challenges in Structuring, Marketing & Pricing of Utility Securitization: Checks and Balances to Address Pricing Issues



Wide variances in total interest costs to ratepayers.



Wide variances in transaction costs and utility efforts to achieve "lowest cost" versus only "lower costs."



Credit spreads vary dramatically.

- U.S. Agencies + Sovereigns
- Mortgage-Backed Securities
- Pure Corporates + Utilities



Not all AAA's price alike. Debate with underwriters over "relative value" of competing investments with higher yield/costs affects ratepayers long-term.

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## The KEY Issue for Regulators with Securitization



### FIDUCIARY DUTY:

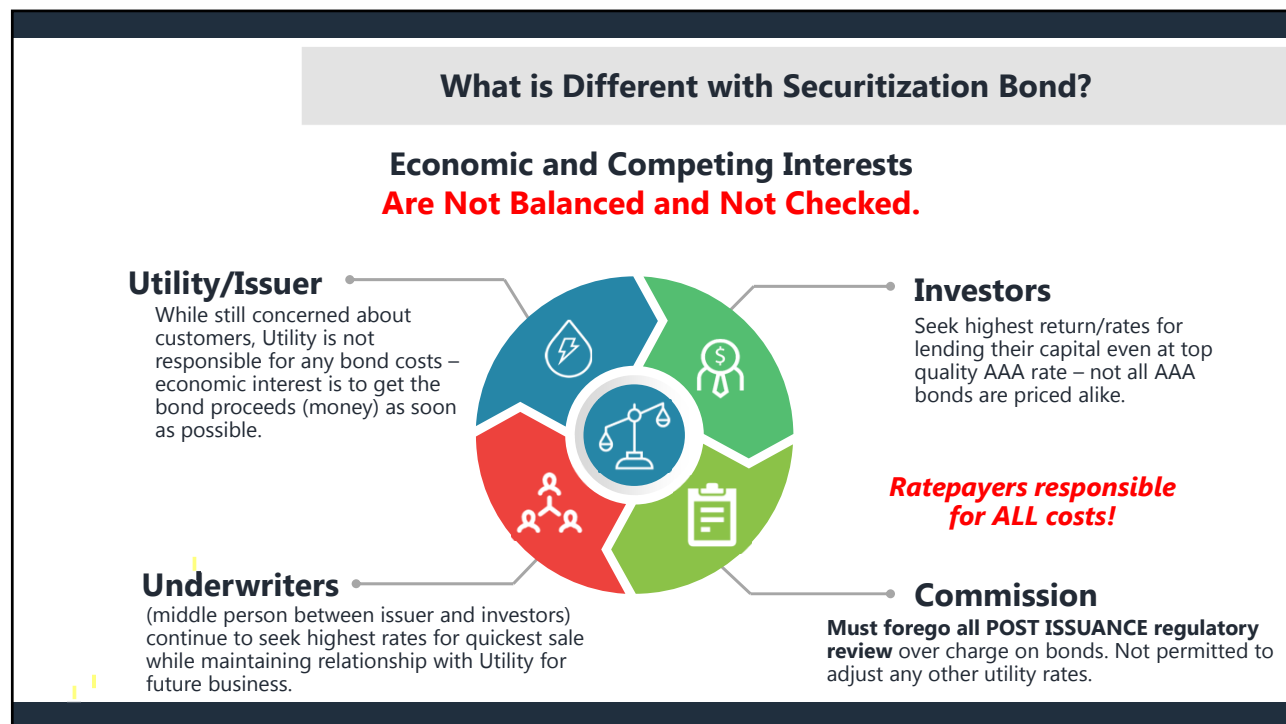
Who protects ratepayers from paying too much since the utility is not responsible for any costs and regulator must give up ongoing review?

**In securitization, every dollar is a ratepayer dollar.**

How negotiated capital markets bond deals work...



24



25



26

## Best Practices in Implementing the Commission's Financing Order

### Fiduciary Duty – Best Interests

Decisions Concerning the Structuring, Marketing and Pricing of Securitization Bonds Need to be Made by an Entity with a Fiduciary Duty – Duty of Care and Loyalty – to Consumers/Ratepayers

### Utility Interests Not Aligned with Ratepayers

Utility and Consumer Interests Are Not Aligned so as to Approach Securitization as "Business as Usual"

### Need for Expertise

Experience and Expertise in Securitized Recovery Bond Issuance is Lacking at the Commission for Evaluation of Capital Market Alternatives

### Best Practices

20 Years of Precedents Support Best Practices for Rigorous Analysis, Commission Oversight as a Joint Decision Maker Supported by an Independent, Experienced Financial Advisor

27

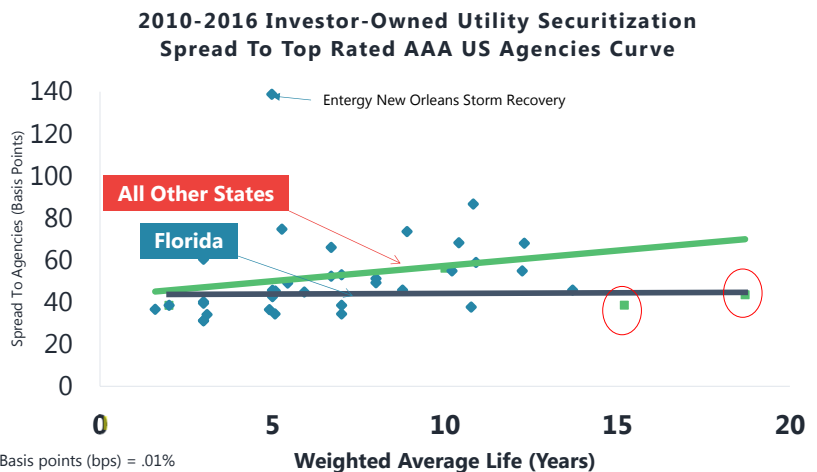
LC14



## Best Practice Example: Florida (Duke Energy Florida (DEF)) Ratepayer Savings From an **Active** Commission Vs. Other States 2010-2016

### 2016 Florida Public Service Commission Actions

- Established **Lowest Cost Objective in Financing Order**.
- Created **Bond Team – Commission and Utility**.
- Sold \$500+ million LONG Duration 15-20 years .
- Largest offering with longest maturity of its kind to date.
- Offering was in untested long-term (>15 years) market.
- Long maturities are most expensive to ratepayers.



28

## Slide 28

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**LC14** JOE- NEED HELP ON THIS ONE.

Laura Cheshire, 11/8/2020

## Besides Lowest Cost Pricing, Emerging Utility Securitization Issues



**Should securitization debt be a permanent part of a utility's ongoing capital structure or "one-off"? If permanent, create smaller balance sheet? Create safer credit?**

**How much securitization is too much?**

**Always used voluntarily, at option of utility or can it be mandated?"**

I/A

**Maness Boswell Exhibit 1**  
**Docket No. E-2, Sub 1219**  
**Docket No. E-7, Sub 1214**



Camal O. Robinson  
Associate General Counsel

Duke Energy  
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March 25, 2020

Ms. Kimberley A. Campbell  
Chief Clerk  
North Carolina Utilities Commission  
4325 Mail Service Center  
Raleigh, North Carolina 27699-4300

**RE: Application of Duke Energy Carolinas, LLC for Adjustment of Rates and  
Charges Applicable to Electric Service in North Carolina, Request for an  
Accounting Order and to Consolidate Dockets  
Docket No. E-7, Sub 1214**

Dear Clerk Campbell:

I enclose the Partial Settlement Agreement between Duke Energy Carolinas, LLC and the Public Staff – North Carolina Utilities Commission for filing in connection with the referenced matter.

If you have any questions, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to be "AR" or similar initials, written over a horizontal line.

Camal O. Robinson

Enclosures

cc: Parties of Record

OFFICIAL COPY

Mar 25 2020



**BEFORE THE NORTH CAROLINA UTILITIES COMMISSION****DOCKET NO. E-7, SUB 1214****DOCKET NO. E-7, SUB 1213****DOCKET NO. E-7, SUB 1187**

In the Matter of:

**DOCKET NO. E-7, SUB 1214**

Application of Duke Energy Carolinas, LLC

For Adjustment of Rates and Charges

Applicable to Electric Service in North Carolina

**DOCKET NO. E-7, SUB 1213**

In the matter of

Petition of Duke Energy Carolinas, LLC for

Approval of Prepaid Advantage Program

**DOCKET NO. E-7, SUB 1187**

Petition of Duke Energy Carolinas, LLC for an

Accounting Order to Defer Incremental Storm

Damage Expenses Incurred as a Result of

Hurricanes Florence and Michael and Winter

Storm Diego

**AGREEMENT AND  
STIPULATION OF  
PARTIAL SETTLEMENT**


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Duke Energy Carolinas, LLC (“DEC” or the “Company”) and the Public Staff, North Carolina Utilities Commission (the “Public Staff”), collectively referred to herein as the “Stipulating Parties” through counsel and pursuant to N.C. Gen. Stat. § 62-69, respectfully submit the following Agreement and Stipulation of Partial Settlement (“Stipulation”) for consideration by the North Carolina Utilities Commission (“Commission”) in the above captioned dockets.

**I. BACKGROUND**

1. In 2018, the Company incurred significant storm expenditures from Hurricanes Florence and Michael and Winter Storm Diego (individually, the “Storm” and collectively, the “Storms”). Subsequently, the Company filed a Petition for an Accounting

Order to Defer Incremental Storm Damage Expenses Incurred as a Result of Hurricanes Florence and Michael and Winter Storm Diego, in Docket No. E-7, Sub 1187 (“Storm Deferral Docket”).

2. On November 6, 2019, Senate Bill 559, An Act to Permit Financing for Certain Storm Recovery Costs (“SB 559”), was signed into law.<sup>1</sup> SB 559 amended Article 8 of Chapter 62 of the North Carolina General Statutes to create a new financing tool that an electric public utility may use to recover storm recovery costs. SB 559 established a process by which an electric public utility in the State may petition the Commission for a financing order authorizing the issuance of storm recovery bonds; the imposition, collection, and periodic adjustments of a storm recovery charge; the creation of storm recovery property; and the sale, assignment, or transfer of storm recovery property. Before issuing a financing order, the Commission must find that the issuance of the storm recovery bonds and the imposition of storm recovery charges are expected to provide quantifiable benefits to customers as compared to the costs that would have been incurred absent the issuance of storm recovery bonds.

3. While SB 559 was pending before the General Assembly but not yet signed into law, on September 30, 2019, DEC filed an application (“Application”) with the Commission in Docket No. E-7, Sub 1214 requesting a general rate increase, pursuant to N.C. Gen. Stat. §§ 62-133 and -134 and Commission Rule R1-17, along with direct testimony and exhibits. The Application requests a non-fuel base rate increase of approximately 9.2 percent in retail revenues, or approximately \$445.3 million. DEC further proposes to partially offset the increase in revenues by refunding \$154.6 million

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<sup>1</sup> S.L. 2019-244.

related to certain tax benefits resulting from the Federal Tax Cut and Jobs Act through a proposed rider. The net revenue increase with the rider is \$290.8 million, which represents an approximate overall 6.0% increase in annual revenues. The revenue increase is based upon a 10.30 percent return on equity (“ROE”) and a 53 percent equity component of the capital structure.

4. The Application also includes a request to consolidate the Storm Deferral Docket with the rate case. In the rate case, the Company seeks to amortize the incremental costs of the Storms over an eight-year period, including a return on the unrecovered balance, and with respect to the capital investments, a deferral of depreciation expense and a return on the investment. In his testimony, Company witness Stephen G. De May, North Carolina President, stated that if SB 559 was passed into law, the Company would pursue securitization if it provided a savings to its customers and would cease the recovery of the remaining storm costs in current rates, and instead begin recovering the remaining unrecovered storm costs as provided for in a securitization financing order.<sup>2</sup>

5. On October 29, 2019, the Commission issued an order establishing a general rate case, suspending rates, scheduling hearings and requiring public notice of the Company’s Application. On November 20, 2019, the Commission issued an order consolidating the general rate proceeding in Docket No. E-7, Sub 1214, with DEC’s request for approval of its Prepaid Advantage Program in Docket No. E-7, Sub 1213.

6. On February 14, 2020, the Company filed supplemental direct testimony and exhibits. On February 18, 2020, the Public Staff, and the other intervenors in this proceeding, filed testimony. Among other things, Public Staff witness Michelle M.

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<sup>2</sup> *De May Direct Testimony* at 10-11.

Boswell made an adjustment to remove all capital and O&M costs associated with the Storms in the present case because the Company indicated that it would seek securitization if authorized by the General Assembly. Witness Boswell also stated that based upon the Public Staff's review of the costs the Company has included in the present case, the Public Staff believes the costs associated with these Storms were prudently incurred.<sup>3</sup>

7. The Public Staff filed first supplemental testimony and exhibits on February 25, 2020, and corrections to certain testimony on February 24, February 29, and March 4, 2020.

8. On March 4, 2020, the Company filed its rebuttal testimony. Among other things, Company witness De May stated in his testimony that the Company looked forward to pursuing securitization at the appropriate time but believed the cost of the Storms should remain a part of the Company's request in this proceeding until the Commission reaches the same determination of the Company and the Public Staff that the costs were prudently incurred, and the Commission subsequently approves a financing petition.

9. On March 25, 2020, the Public Staff filed supplemental testimony and exhibits.

10. The parties to this proceeding have conducted substantial discovery on the issues raised in the Application, as well as on the direct, supplemental and rebuttal testimonies of the Company and the direct and supplemental testimonies of the Public Staff. Prior to the evidentiary hearing, the Stipulating Parties reached a partial settlement with respect to some of the revenue requirement issues presented by the Company's Application, including those arising from the supplemental and rebuttal testimonies and

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<sup>3</sup> Boswell Direct Testimony at 27-28.

exhibits. In addition, the Stipulating Parties have reached a settlement as it relates to the ratemaking treatment of the cost of the Storms. The Stipulating Parties agree and stipulate as follows:

## II. UNRESOLVED ISSUES

The Stipulating Parties have not reached a compromise on the following issues (“Unresolved Issues”):

1. Coal ash costs - Cost recovery of the Company’s coal ash costs, recovery amortization period and return during the amortization period.
2. Deferred Non-Asset Retirement Obligation (“ARO”)  
Environmental Costs Amortization Period – Whether the Company’s proposed amortization period of five (5) years should be approved versus the Public Staff’s proposed amortization period of (10) ten years.
3. Adjustment for Hydro Station Sale: - Whether the Company’s proposed amortization period of seven (7) years of the loss on the sale should be approved versus Public Staff’s recommendation of a twenty (20) year amortization period.
4. Excess Deferred Income Taxes (“EDIT”) – The following components of the Company’s EDIT rider proposal remain contested both in length of amortization period and method of recovery: Unprotected federal EDIT, North Carolina EDIT and Deferred Revenue. The parties agree on the treatment of federal

protected EDIT as described below in the Resolved Issues.

5. Return on Equity (“ROE”) – Whether the Company’s proposed ROE of 10.3% should be adopted versus the Public Staff’s proposed ROE of 9.0%.

6. Capital Structure – Whether the Company’s proposed equity ratio of 53% should be adopted versus the Public Staff’s proposed equity ratio of 50%.

7. Cost of Debt- The appropriate debt cost that should be adopted for the Company.

8. Cost of Service Allocation Methodology – The methodology for allocating the Company’s production demand related costs.

9. Depreciation Rates – The depreciation rates appropriate for use in this case, including whether the Company’s proposal to shorten the lives of certain coal-fired generating facilities should be approved.

10. Grid Improvement Plan - Whether the Company’s request to defer certain categories of costs should be approved as appropriate costs under the Company’s proposed Grid Improvement Plan and whether those costs are eligible for deferral under the Commission’s deferral standards.

11. Clemson Combined Heat and Power facility- Whether it is appropriate for DEC to recover the costs of this facility from North Carolina customers.

12. Any other revenue requirement or non-revenue requirement issue other than those issues specifically addressed in this Stipulation or agreed upon in the testimony of the Stipulating Parties.

### **III. RESOLVED ISSUES**

The Stipulating Parties have reached an agreement regarding the following revenue requirement issues (“Resolved Issues”). The actual amount of the agreed-upon adjustments may differ due to the effects of the Unresolved Issues. The revenue requirement effects of the agreed-upon issues are shown on Boswell Supplemental and Stipulation Exhibit 1. The revenue requirement impacts of this Stipulation provide sufficient support for the annual revenue required on the issues agreed to in this Stipulation. No Stipulating Party waives any right to assert a position in any future proceeding or docket before the Commission or in any court, as the adjustments agreed to in this Stipulation are strictly for purposes of compromise and are intended to show a rational basis for reaching the agreed-upon revenue requirement adjustments without either party conceding any specific adjustment. The Stipulating Parties agree that settlement on these issues will not be used as a rationale for future adjustments on contested issues brought before the Commission. The areas of agreement are as follows:

#### ***Storm Costs***

1. DEC hereby accepts Public Staff’s adjustments to remove the capital and O&M costs associated with the Storms and to reflect a 10-year normalized level of storm expense for storms that would not otherwise be large enough for the Company to securitize.
2. DEC agrees to file a petition for a financing order under N.C. Gen. Stat. §

62-172 no later than 120 days from the issuance of an Order by the Commission in this rate case in which the Commission makes findings and conclusions regarding the costs of the Storms and this Stipulation, unless a party in the rate case appeals the Commission's order as it relates to costs of the Storms or the provisions of this Stipulation related to the costs of the Storms and securitization. If an appeal is filed, the 120-day limit shall be suspended until the Commission decision is affirmed, or if not affirmed, until the issuance of a Commission Order on remand following the decision on the appeal, unless the Company chooses before that time to pursue recovery under subsection (5), in which case the original 120-day limit shall be deemed to have applied. Should DEC fail to file a petition within the time period specified in this paragraph, the parties agree that in any subsequent ratemaking proceeding held to provide for recovery of the costs of the Storms, the parties reserve the right to assert their respective positions regarding the appropriate ratemaking treatment of the cost of the Storms.

3. The Stipulating Parties agree that to demonstrate quantifiable benefits to customers in accordance with N.C. Gen. Stat. § 62-172(b)(1)g., the Company must show that the net present value of the costs to customers using securitization is less than the net present value of the costs that would result under traditional storm cost recovery. For purposes of settlement for the cost of these Storms only, the Stipulating Parties agree that when conducting this comparison in the subsequent securitization docket for the Storms, the following assumptions shall be made:

- a. For traditional storm cost recovery, 12 months of amortization for each Storm was expensed prior to the new rates going into effect;
- b. For traditional storm cost recovery, no capital costs incurred due to the Storms during the 12-month period were included in the deferred balance;



- c. For traditional storm cost recovery, no carrying charges were accrued on the deferred balance during the 12-month period following the date(s) of the Storm(s);
- d. For traditional cost recovery, the amortization period for the Storms is a minimum of 10 years; and
- e. For securitization, the imposition of the Storm recovery charge begins nine months after the new rates go into effect

4. The Stipulating Parties agree that pursuant to N.C. Gen. Stat. § 62-172, the amortization of securitized costs of the Storms shall not begin until the date the storm recovery bonds are issued.

5. The Stipulating Parties agree that a storm cost recovery rider in this proceeding that will be initially set at \$0 should be established in the rate case. Should the Company not file a petition for a financing order or is unable to recover the costs of the Storms through N.C. Gen. Stat. § 62-172, the Company may request recovery of the costs of the Storms from the Commission by filing a petition requesting an adjustment to this rider. In such case, the Stipulating Parties reserve the right to argue their respective positions regarding the appropriate ratemaking treatment for recovering the costs of the Storms.

6. The Stipulating Parties agree to file a joint petition for rulemaking to establish the standards and procedures that will govern future financing petitions under N.C. Gen. Stat. § 62-172 upon the issuance of storm recovery bonds for the Storms.

#### ***Accounting Adjustments***

7. The Company accepts the Public Staff's proposed adjustment to executive compensation to remove 50 percent of the benefits associated with the five Duke Energy executives with the highest amounts of compensation, in addition to the 50 percent of their

compensation removed in the Company's initial application.

8. The Stipulating Parties agree to amortize rate case expenses over a five-year period, but the unamortized balance will not be included in rate base.

9. The Stipulating Parties agree to remove aviation expenses associated with international flights, in addition to the 50 percent of the aviation expenses removed in the Company's initial application.

10. The Stipulating Parties agree that Company employee incentives should be adjusted to remove incentive pay related to earnings per share and total shareholder returns for the top levels of Company leadership.

11. The Stipulating Parties agree that certain sponsorships and donations expenses, including amounts paid to the U.S. Chamber of Commerce, should be excluded.

12. The Stipulating Parties agree that severance expenses should be amortized over a three-year period, but the unamortized balance will not be included in rate base.

13. The Company accepts the Public Staff's recommended adjustments to lobbying, Board of Directors, and retired hydro O&M expenses.

14. The Public Staff agrees to the Company's rebuttal position on credit card fees and advertising expenses.

15. The Company accepts the Public Staff's updated recommended adjustments to weather normalization, growth, and usage as reflected in Boswell Supplemental and Stipulation Exhibit 1.

16. The Stipulating Parties agree to remove the protected federal EDIT from the Company's proposed EDIT rider and return these amounts to customers through base rates.

**IV. AGREEMENT IN SUPPORT OF SETTLEMENT; NON-WAIVER.**

1. The Stipulating Parties shall act in good faith and use their best efforts to recommend to the Commission that this Stipulation be accepted and approved. The Stipulating Parties further agree that this Stipulation is in the public interest because it reflects a give-and take of contested issues and results in rates (with respect to the stipulated issues) that are just and reasonable. The Stipulating Parties agree that they will support the reasonableness of this Stipulation before the Commission, and in any appeal from the Commission's adoption and/or enforcement of this Stipulation.

2. Neither this Stipulation nor any of the terms shall be admissible in any court or Commission except insofar as such court or Commission is addressing litigation arising out of the implementation of the terms herein or the approval of this Stipulation. This Stipulation shall not be cited as precedent by any of the Parties regarding any issue in any other proceeding or docket before this Commission or in any court.

3. The provisions of this Stipulation do not reflect any position asserted by any of the Stipulating Parties but reflect instead the compromise and settlement among the Stipulating Parties as to all the issues covered hereby. No Party waives any right to assert any position in any future proceeding or docket before the Commission or in any court.

4. This Stipulation is a product of negotiation among the Stipulating Parties, and no provision of this Stipulation shall be strictly construed in favor of or against any Party.

**V. RECEIPT OF TESTIMONY AND WAIVER OF CROSS-EXAMINATION**

The pre-filed testimony and exhibits of the Stipulating Parties on Resolved Issues may be received in evidence without objection, and each Party waives all right to cross

examine any witness with respect to such pre-filed testimony and exhibits. If, however, questions are asked by any Commissioner, or if questions are asked or positions are taken by any person who is not a Party, then any Party may respond to such questions by presenting testimony or exhibits and cross-examining any witness with respect to such testimony and exhibits.

**VI. STIPULATION BINDING ONLY IF ACCEPTED IN ITS ENTIRETY.**

This Stipulation is the product of negotiation and compromise of a complex set of issues, and no portion of this Stipulation is or will be binding on any of the Stipulating Parties unless the entire Agreement and Stipulation is accepted by the Commission. If the Commission rejects any part of this Stipulation or approves this Stipulation subject to any change or condition or if the Commission's approval of this Stipulation is rejected or conditioned by a reviewing court, the Stipulating Parties agree to meet and discuss the applicable Commission or court order within five business days of its issuance and to attempt in good faith to determine if they are willing to modify the Stipulation consistent with the order. No Party shall withdraw from the Stipulation prior to complying with the foregoing sentence. If any Party withdraws from the Stipulation, each Party retains the right to seek additional procedures before the Commission, including cross-examination of witnesses, with respect to issues addressed by the Stipulation and shall be bound or prejudiced by the terms and conditions of the Stipulation.

**VII. COUNTERPARTS.**

This Stipulation may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same

instrument. Execution by facsimile signature shall be deemed to be, and shall have the same effect as, execution by original signature.

#### VIII. MERGER CLAUSE

This Stipulation supersedes all prior agreements and understandings between the Stipulating Parties and may not be changed or terminated orally, and no attempted change, termination or waiver of any of the provisions hereof shall be binding unless in writing and signed by the parties hereto.

The foregoing is agreed and stipulated this the 25<sup>th</sup> day of March 2020.

Duke Energy Carolinas, LLC

By: /s/ Stephen G. De May

Public Staff – North Carolina Utilities Commission

By: 

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing Agreement and Stipulation of Partial Settlement, filed in Docket Nos. E-7, Sub 1214; E-7, Sub 1213; and E-7, Sub 1187, was served electronically or via U.S. mail, first-class postage prepaid, upon all parties of record.

This the 25<sup>th</sup> day of March, 2020.

/s/Mary Lynne Grigg

Mary Lynne Grigg

McGuireWoods LLP

501 Fayetteville Street, Suite 500

PO Box 27507 (27611)

Raleigh, North Carolina 27601

(919) 755-6573 (Direct)

*mgrigg@mcguirewoods.com*

*Attorney for Duke Energy Carolinas, LLC*



I/A

**Maness Boswell Exhibit 2**  
**Docket No. E-2, Sub 1219**  
**Docket No. E-7, Sub 1214**

Camal O. Robinson  
Associate General Counsel



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June 2, 2020

Ms. Kimberly A. Campbell  
Chief Clerk  
North Carolina Utilities Commission  
4325 Mail Service Center  
Raleigh, North Carolina 27699-4300

**RE: Application of Duke Energy Progress, LLC for Adjustment of Rates and  
Charges Applicable to Electric Service in North Carolina, Request for an  
Accounting Order and to Consolidate Dockets  
Docket No. E-2, Sub 1219 and Docket No. E-2, Sub 1193**

Dear Clerk Campbell:

I enclose the Partial Settlement Agreement between Duke Energy Progress, LLC and the Public Staff – North Carolina Utilities Commission for filing in connection with the referenced matter.

If you have any questions, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to be "AR" or similar initials, written over a horizontal line.

Camal O. Robinson

Enclosures

cc: Parties of Record

OFFICIAL COPY

JUN 02 2020



## BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. E-2, SUB 1219

DOCKET NO. E-2, SUB 1193

In the Matter of:

**DOCKET NO. E-2, SUB 1219**Application of Duke Energy Progress, LLC For  
Adjustment of Rates and Charges Applicable to  
Electric Service in North Carolina**DOCKET NO. E-2, SUB 1193**Petition of Duke Energy Progress, LLC for an  
Accounting Order to Defer Incremental Storm  
Damage Expenses Incurred as a Result of  
Hurricanes Florence and Michael and Winter  
Storm Diego**AGREEMENT AND  
STIPULATION OF  
PARTIAL SETTLEMENT**

Duke Energy Progress, LLC (“DEP” or the “Company”) and the Public Staff, North Carolina Utilities Commission (the “Public Staff”), collectively referred to herein as the “Stipulating Parties” through counsel and pursuant to N.C. Gen. Stat. § 62-69, respectfully submit the following Agreement and Stipulation of Partial Settlement (“Stipulation”) for consideration by the North Carolina Utilities Commission (“Commission”) in the above captioned dockets.

**I. BACKGROUND**

1. The Company incurred significant storm expenditures from Hurricanes Florence and Michael and Winter Storm Diego in 2018, and from Hurricane Dorian in 2019 (individually, the “Storm” and collectively, the “Storms”). On December 21, 2018, the Company filed a Petition for an Accounting Order to Defer Incremental Storm Damage

Expenses Incurred as a Result of Hurricanes Florence and Michael and Winter Storm Diego, in Docket No. E-2, Sub 1193 (“Storm Deferral Docket”).

2. On November 6, 2019, Senate Bill 559, An Act to Permit Financing for Certain Storm Recovery Costs (“SB 559”), was signed into law.<sup>1</sup> SB 559 amended Article 8 of Chapter 62 of the North Carolina General Statutes to create a new financing tool that an electric public utility may use to recover storm recovery costs. SB 559 established a process by which an electric public utility in the State may petition the Commission for a financing order authorizing the issuance of storm recovery bonds; the imposition, collection, and periodic adjustments of a storm recovery charge; the creation of storm recovery property; and the sale, assignment, or transfer of storm recovery property. Before issuing a financing order, the Commission must find that the issuance of the storm recovery bonds and the imposition of storm recovery charges are expected to provide quantifiable benefits to customers as compared to the costs that would have been incurred absent the issuance of storm recovery bonds.

3. While SB 559 was pending before the General Assembly but not yet signed into law, on October 30, 2019, DEP filed an application (“Application”) with the Commission in Docket No. E-2, Sub 1219 requesting a general rate increase, pursuant to N.C. Gen. Stat. §§ 62-133 and -134 and Commission Rule R1-17, along with direct testimony and exhibits. The Application requests a non-fuel base rate increase of approximately 15.6 percent in retail revenues, or approximately \$585.9 million. DEP further proposes to partially offset the increase in revenues by refunding (a) \$120.2 million related to certain tax benefits resulting from the Federal Tax Cut and Jobs Act through a

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<sup>1</sup> S.L. 2019-244.

proposed rider and the reduction in North Carolina's state-corporate tax rate, through a change to the existing excess deferred income taxes ("EDIT") rider ("EDIT-1") and the proposed implementation of a new EDIT rider ("EDIT-2"); and (b) a rate reduction of \$2.1 million related to the proposed Regulatory Asset and Liability Rider, which results in a proposed net revenue increase of \$463.6 million, or approximately 12.3 percent.. The revenue increase is based upon a 10.30 percent return on equity ("ROE") and a 53 percent equity component of the capital structure.

4. The Application also includes requests (a) for an accounting order to defer incremental storm expenditures from Hurricane Dorian and (b) to consolidate the Storm Deferral Docket with the rate case. In the rate case, the Company seeks to amortize the incremental costs of the Storms over a 15-year period, including a return on the unrecovered balance, and with respect to the capital investments, a deferral of depreciation expense and a return on the investment. In his testimony, Company witness Stephen G. De May, North Carolina President, stated that if SB 559 was passed into law, the Company would pursue securitization if it provided a savings to its customers and would cease the recovery of the remaining storm costs in current rates, and instead begin recovering the remaining unrecovered storm costs as provided for in a securitization financing order.<sup>2</sup>

5. On November 14, 2019, the Commission issued an order establishing a general rate case and suspending rates. On December 6, 2019, the Commission entered an order scheduling hearings, establishing due dates for intervention, discovery, and testimony, and requiring public notice of the Company's Application.

6. On March 13, 2020, the Company filed supplemental direct testimony and

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<sup>2</sup> *De May Direct Testimony* at 10-11.

exhibits. On April 13, 2020, the Public Staff, and the other intervenors in this proceeding, filed testimony. Among other things, Public Staff witness Shawn L. Dorgan made an adjustment to remove all capital and O&M costs associated with the Storms in the present case because the Company indicated that it would seek securitization if authorized by the General Assembly. Witness Dorgan also stated that based upon the Public Staff's review of the costs the Company has included in the present case, the Public Staff believes the costs associated with Hurricanes Florence, Michael, and Winter Storm Diego were prudently incurred.<sup>3</sup> The Public Staff subsequently filed supplemental testimony and exhibits on April 23, 2020. In his supplemental testimony, witness Dorgan stated that based upon the Public Staff's review, the costs associated with Hurricane Dorian were also prudently incurred.<sup>4</sup>

7. On May 4, 2020, the Company filed its rebuttal testimony. Among other things, Company witness De May stated in his testimony that the Company looked forward to pursuing securitization at the appropriate time but believed the cost of the Storms should remain a part of the Company's request in this proceeding until the Commission reaches the same determination as reached by the Company and the Public Staff that the costs were prudently incurred, and the Commission subsequently approves a financing petition.

8. The parties to this proceeding have conducted substantial discovery on the issues raised in the Application, as well as on the direct, supplemental and rebuttal testimonies of the Company and the direct and supplemental testimonies of the Public Staff. Prior to the evidentiary hearing, the Stipulating Parties reached a partial settlement with respect to some of the revenue requirement issues presented by the Company's

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<sup>3</sup> *Dorgan Direct Testimony* at 32.

<sup>4</sup> *Dorgan Supplemental Direct Testimony* at 9.

Application, including those arising from the supplemental and rebuttal testimonies and exhibits. In addition, the Stipulating Parties have reached a settlement as it relates to the ratemaking treatment of the cost of the Storms. The Stipulating Parties agree and stipulate as follows:

## **II. UNRESOLVED ISSUES**

The Stipulating Parties have not reached a compromise on the following issues (“Unresolved Issues”):

1. Coal ash costs - Cost recovery of the Company’s coal ash costs, recovery amortization period and return during the amortization period.
2. Deferred Non-Asset Retirement Obligation (“ARO”)  
Environmental Costs Amortization Period – Whether the Company’s proposed amortization period of five (5) years should be approved versus the Public Staff’s proposed amortization period of (10) ten years.
3. Excess Deferred Income Taxes (“EDIT”) – The following components of the Company’s EDIT rider proposal remain contested both in length of amortization period and method of recovery: Unprotected federal EDIT, North Carolina EDIT, and Deferred Revenue. The parties agree on the treatment of federal protected EDIT as described below in the Resolved Issues.
4. Return on Equity (“ROE”) – Whether the Company’s proposed ROE of 10.3% should be adopted versus the Public Staff’s

proposed ROE of 9.0%.

5. Capital Structure – Whether the Company’s proposed equity ratio of 53% should be adopted versus the Public Staff’s proposed equity ratio of 50%.

6. Cost of Service Allocation Methodology – The methodology for allocating the Company’s production demand related costs.

7. Update revenues, customer growth and weather to February 29, 2020 – Whether revenues, customer growth and weather should be updated beyond February 29, 2020, as described in Company witness Michael Pirro’s rebuttal testimony.

8. Depreciation Rates – The depreciation rates appropriate for use in this case, including whether the Company’s proposal to shorten the lives of certain coal-fired generating facilities should be approved.

9. Grid Improvement Plan - Whether the Company’s request to defer certain categories of costs should be approved as appropriate costs under the Company’s proposed Grid Improvement Plan and whether those costs are eligible for deferral under the Commission’s deferral standards.

10. Nuclear Decommissioning Expense – The appropriate level of nuclear decommissioning expense.

11. Any other revenue requirement or non-revenue requirement issue other than those issues specifically addressed in this

Stipulation or agreed upon in the testimony of the Stipulating Parties.

### **III. RESOLVED ISSUES**

The Stipulating Parties have reached an agreement regarding the following revenue requirement issues (“Resolved Issues”). The actual amount of the agreed-upon adjustments may differ due to the effects of the Unresolved Issues. The revenue requirement effects of the agreed-upon issues are shown on Maness Stipulation Exhibit 1 and Smith Partial Settlement Exhibit 1. The revenue requirement impacts of this Stipulation provide sufficient support for the annual revenue required on the issues agreed to in this Stipulation. No Stipulating Party waives any right to assert a position in any future proceeding or docket before the Commission or in any court, as the adjustments agreed to in this Stipulation are strictly for purposes of compromise and are intended to show a rational basis for reaching the agreed-upon revenue requirement adjustments without either party conceding any specific adjustment. The Stipulating Parties agree that settlement on these issues will not be used as a rationale for future adjustments on contested issues brought before the Commission. The areas of agreement are as follows:

#### ***Storm Costs***

1. The Stipulating Parties agree to remove the capital and O&M costs associated with the Storms and to reflect a 10-year normalized level of storm expense for storms that would not otherwise be large enough for the Company to securitize.

2. DEP agrees to file a petition for a financing order under N.C. Gen. Stat. § 62-172 no later than 120 days from the issuance of an Order by the Commission in this rate case in which the Commission makes findings and conclusions regarding the costs of



the Storms and this Stipulation, unless a party in the rate case appeals the Commission's order as it relates to costs of the Storms or the provisions of this Stipulation related to the costs of the Storms and securitization. If an appeal is filed, the 120-day limit shall be suspended until the Commission decision is affirmed, or if not affirmed, until the issuance of a Commission Order on remand following the decision on the appeal, unless the Company chooses before that time to pursue recovery under subsection (5), in which case the original 120-day limit shall be deemed to have applied. Should DEP fail to file a petition within the time period specified in this paragraph, the parties agree that in any subsequent ratemaking proceeding held to provide for recovery of the costs of the Storms, the parties reserve the right to assert their respective positions regarding the appropriate ratemaking treatment of the cost of the Storms.

3. The Stipulating Parties agree that to demonstrate quantifiable benefits to customers in accordance with N.C. Gen. Stat. § 62-172(b)(1)g., the Company must show that the net present value of the costs to customers using securitization is less than the net present value of the costs that would result under traditional storm cost recovery. For purposes of settlement for the cost of these Storms only, the Stipulating Parties agree that when conducting this comparison in the subsequent securitization docket for the Storms, the following assumptions shall be made:

- a. For traditional storm cost recovery, 12 months of amortization for each Storm was expensed prior to the new rates going into effect;
- b. For traditional storm cost recovery, no capital costs incurred due to the Storms during the 12-month period were included in the deferred balance;
- c. For traditional storm cost recovery, no carrying charges were accrued on the deferred balance during the 12-month period following the date(s) of the Storm(s);



- d. For traditional cost recovery, the amortization period for the Storms is a minimum of 15 years; and
- e. For securitization, the imposition of the Storm recovery charge begins nine months after the new rates go into effect

4. The Stipulating Parties agree that pursuant to N.C. Gen. Stat. § 62-172, the amortization of securitized costs of the Storms shall not begin until the date the storm recovery bonds are issued.

5. The Stipulating Parties agree that a storm cost recovery rider in this proceeding that will be initially set at \$0 should be established in the rate case. Should the Company not file a petition for a financing order or is unable to recover the costs of the Storms through N.C. Gen. Stat. § 62-172, the Company may request recovery of the costs of the Storms from the Commission by filing a petition requesting an adjustment to this rider. In such case, the Stipulating Parties reserve the right to argue their respective positions regarding the appropriate ratemaking treatment for recovering the costs of the Storms.

6. The Stipulating Parties agree to file a joint petition for rulemaking to establish the standards and procedures that will govern future financing petitions under N.C. Gen. Stat. § 62-172 upon the issuance of storm recovery bonds for the Storms.

#### ***Accounting Adjustments***

7. The Company accepts the Public Staff's proposed adjustment to executive compensation to remove 50 percent of the benefits associated with the five Duke Energy executives with the highest amounts of compensation, in addition to the 50 percent of their compensation removed in the Company's initial application.

8. The Public Staff agrees to the rate case expenses in the Company's rebuttal

filing. The Stipulating Parties agree to amortize the rate case expenses over a five-year period, but the unamortized balance will not be included in rate base.

9. The Stipulating Parties agree to remove aviation expenses associated with international flights, in addition to the 50 percent of the aviation expenses removed in the Company's initial application.

10. The Stipulating Parties agree that Company employee incentives should be adjusted to remove incentive pay related to earnings per share and total shareholder returns for the top levels of Company leadership.

11. The Stipulating Parties agree that certain sponsorships and donations expenses as well as certain outside service expenses should be excluded.

12. The Stipulating Parties agree that severance expenses should be amortized over a three-year period, but the unamortized balance will not be included in rate base.

13. The Stipulating Parties agree to remove certain lobbying and Board of Directors expenses.

14. The Stipulating Parties agree to the adjustment to the W. Asheville Vanderbilt 115kV project as reflected in Maness Stipulation Exhibit 1 and Smith Partial Settlement Exhibit 1 (subject to unsettled jurisdictional and class allocation factor methodology differences). The Company appropriately classified the line as transmission in its supplemental filing. The settlement adjustment makes a small correction to the Company's adjustment in its supplemental filing.

15. The Public Staff agrees to the Company's rebuttal position on credit card fees.

16. The Company accepts the Public Staff's adjustment to end-of-life nuclear

materials and supplies reserve expense, reduced as described in the direct testimony of Public Staff witness Dustin Metz.

17. The Asheville CC project is complete, placed in service, and available for economic dispatch. The Stipulating Parties agree to the following:

- a. The appropriate amortization period for the deferred expenses is four years with a levelized return.
- b. The Company's non-fuel variable O&M expense amount should be reduced to account for a production displacement adjustment.
- c. The amount of Asheville CC plant in service appropriate to include in rate base and used for the deferral calculation in this proceeding is the amount reflected in the Company's rebuttal testimony (subject to unsettled jurisdictional and class allocation factor methodology differences). The Public Staff reserves the right to review any actual reimbursements received from the EPC contractor in a subsequent rate case.

18. The Stipulating Parties agree to remove the protected federal EDIT from the Company's proposed EDIT rider and return these amounts to customers through base rates.

19. The Public Staff agrees to withdraw its adjustment related to CertainTeed payment obligation. The Company removed this expense from this proceeding in its supplemental filing. The Stipulating Parties maintain their respective positions on this item in the DEP fuel proceeding in Docket No. E-2, Sub 1204.

20. The Stipulating Parties agree to include annualized accumulated depreciation for the Asheville CC plant not previously included in supplemental or rebuttal

filings.

#### **IV. AGREEMENT IN SUPPORT OF SETTLEMENT; NON-WAIVER.**

1. The Stipulating Parties shall act in good faith and use their best efforts to recommend to the Commission that this Stipulation be accepted and approved. The Stipulating Parties further agree that this Stipulation is in the public interest because it reflects a give-and take of contested issues and results in rates (with respect to the stipulated issues) that are just and reasonable. The Stipulating Parties agree that they will support the reasonableness of this Stipulation before the Commission, and in any appeal from the Commission's adoption and/or enforcement of this Stipulation.

2. Neither this Stipulation nor any of the terms shall be admissible in any court or Commission except insofar as such court or Commission is addressing litigation arising out of the implementation of the terms herein or the approval of this Stipulation. This Stipulation shall not be cited as precedent by any of the Parties regarding any issue in any other proceeding or docket before this Commission or in any court.

3. The provisions of this Stipulation do not reflect any position asserted by any of the Stipulating Parties but reflect instead the compromise and settlement among the Stipulating Parties as to all the issues covered hereby. No Party waives any right to assert any position in any future proceeding or docket before the Commission or in any court.

4. This Stipulation is a product of negotiation among the Stipulating Parties, and no provision of this Stipulation shall be strictly construed in favor of or against any Party.

#### **V. RECEIPT OF TESTIMONY AND WAIVER OF CROSS-EXAMINATION**

The pre-filed testimony and exhibits of the Stipulating Parties on Resolved Issues

may be received in evidence without objection, and each Party waives all right to cross examine any witness with respect to such pre-filed testimony and exhibits. If, however, questions are asked by any Commissioner, or if questions are asked or positions are taken by any person who is not a Party, then any Party may respond to such questions by presenting testimony or exhibits and cross-examining any witness with respect to such testimony and exhibits.

**VI. STIPULATION BINDING ONLY IF ACCEPTED IN ITS ENTIRETY.**

This Stipulation is the product of negotiation and compromise of a complex set of issues, and no portion of this Stipulation is or will be binding on any of the Stipulating Parties unless the entire Agreement and Stipulation is accepted by the Commission. If the Commission rejects any part of this Stipulation or approves this Stipulation subject to any change or condition or if the Commission's approval of this Stipulation is rejected or conditioned by a reviewing court, the Stipulating Parties agree to meet and discuss the applicable Commission or court order within five business days of its issuance and to attempt in good faith to determine if they are willing to modify the Stipulation consistent with the order. No Party shall withdraw from the Stipulation prior to complying with the foregoing sentence. If any Party withdraws from the Stipulation, each Party retains the right to seek additional procedures before the Commission, including cross-examination of witnesses, with respect to issues addressed by the Stipulation and shall be bound or prejudiced by the terms and conditions of the Stipulation.

**VII. COUNTERPARTS.**

This Stipulation may be executed in one or more counterparts, each of which shall

be deemed an original, but all of which together shall constitute one and the same instrument. Execution by facsimile signature shall be deemed to be, and shall have the same effect as, execution by original signature.

#### **VIII. MERGER CLAUSE**

This Stipulation supersedes all prior agreements and understandings between the Stipulating Parties and may not be changed or terminated orally, and no attempted change, termination or waiver of any of the provisions hereof shall be binding unless in writing and signed by the parties hereto.

The foregoing is agreed and stipulated this the 2nd day of June, 2020.

Duke Energy Progress, LLC

By: /s/ Stephen G. De May

Public Staff – North Carolina Utilities Commission

By: 



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# EFFECTS OF CLIMATE CHANGE ON THE SOUTHEAST

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*The Southeast is experiencing climate change. Generally, temperatures are expected to become warmer with more extreme heat waves. Changes in rainfall are less certain. Sea level rise coupled with increased hurricane intensity could be detrimental to Southeastern coastlines.*

**Why do I care?** The climate is changing in the Southeast, and if you live there, these changes will affect you. However, computer models vary in exactly how and when these changes will occur. For example, average rainfall amounts could increase or decrease and the seasonal patterns and timing of precipitation may change.

***I should already be familiar with:*** [Global Warming vs. Climate Change \(/edu/DefineCC\)](#)



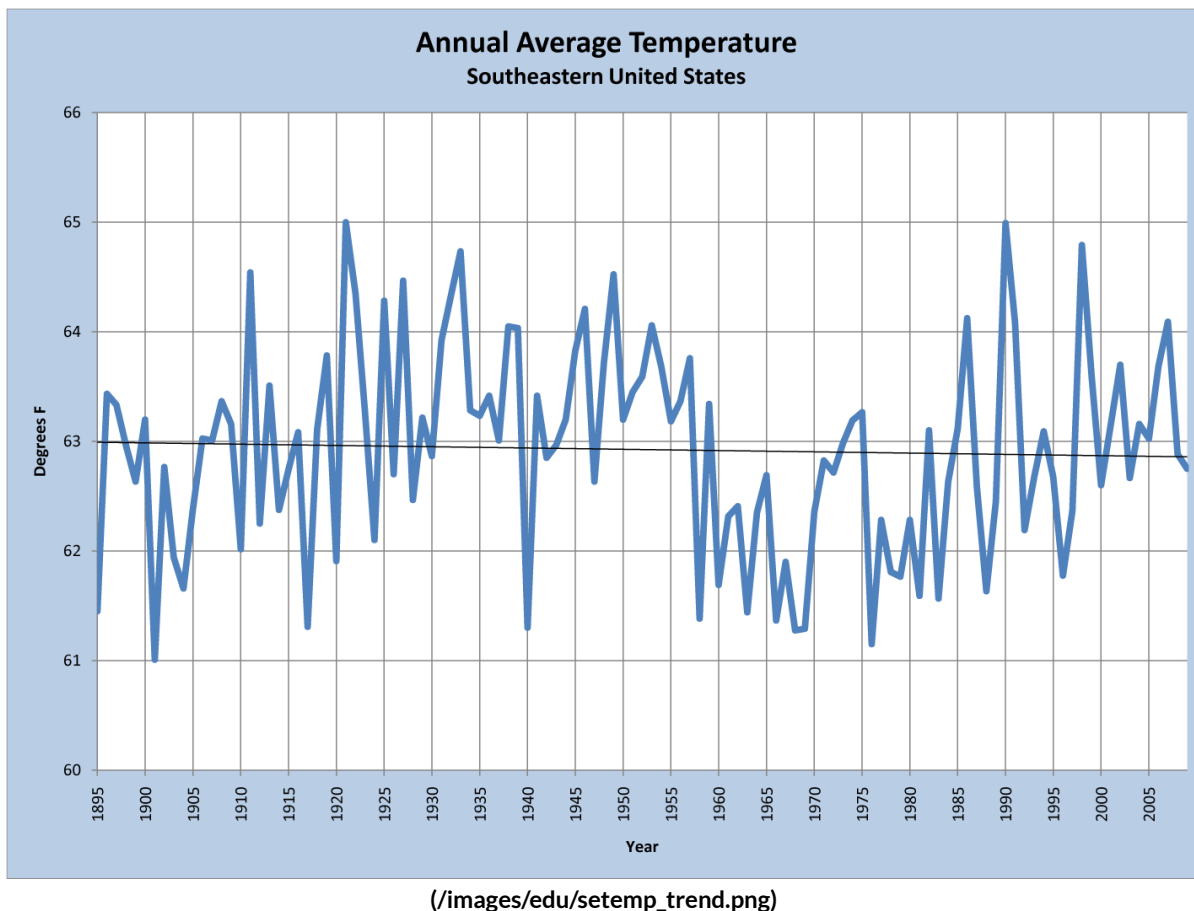


Figure A. Annual average temperature of the southeast United States for the period 1895-2009. The trendline shows a decrease in average temperature.

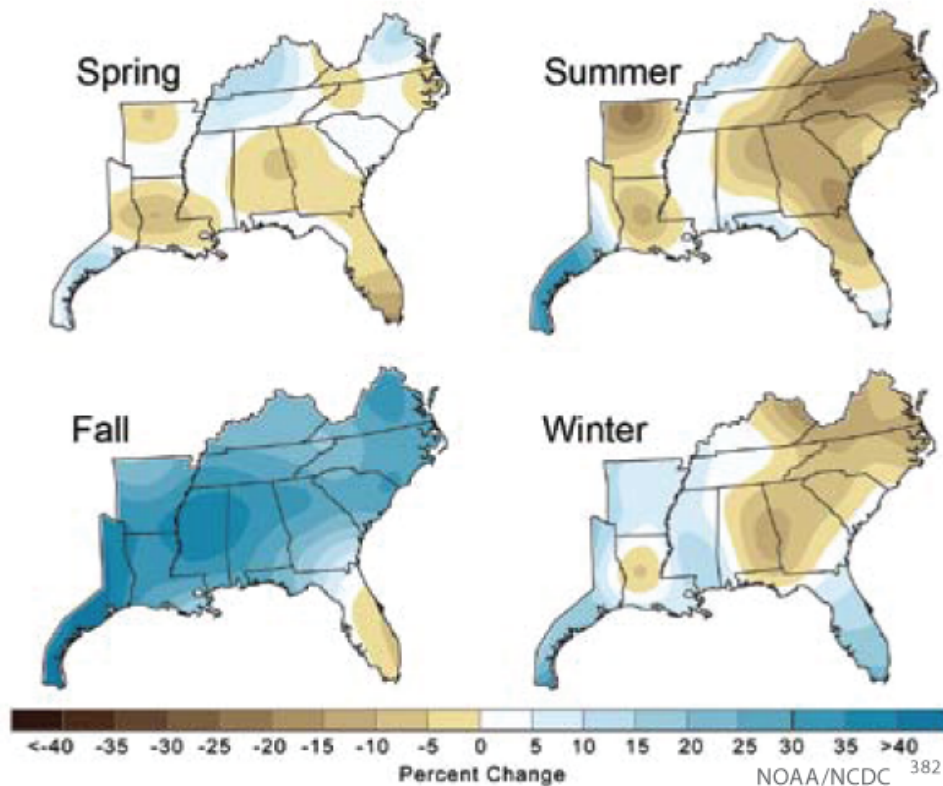
## Temperature Changes

Although annual average temperatures across much of the United States are expected to increase in the future, over the past 100 years annual average temperatures in the Southeast have decreased slightly as shown in Figure A. This cooling has been attributed partially to changes in land use over time from bare fields of cotton and row crops in the early 20th century to the present forest stands, which are cooler and moister than open fields.

Over the last 40 years, however, temperatures have increased throughout much of the Southeast. This is true even in rural areas away from cities and suburbs which are becoming more urban in nature over time. Winters are becoming milder, but the summers are also becoming more sweltering. In parts of the Southeast, like northern Georgia, there are 20 fewer days below freezing each year than there were 40 years ago. The number of days above 90°F is expected to almost triple over the next 100 years. This could cause heat stress not only for humans, but animals and crops as well.

## Precipitation Pattern Changes

## Observed Changes in Precipitation 1901 to 2007



While average fall precipitation in the Southeast increased by 30 percent since the early 1900s, summer and winter precipitation declined by nearly 10 percent in the eastern part of the region. Southern Florida has experienced a nearly 10 percent drop in precipitation in spring, summer, and fall. The percentage of the Southeast region in drought has increased over recent decades.

(/images/edu/precipchanges.png)

Figure B. Map of changes in precipitation by season.

(<http://www.globalchange.gov/publications/reports/scientific-assessments/us-impacts>)

Generally, for everyone outside of Florida fall is becoming wetter and all other seasons are the same or becoming drier. Annual average rainfall in many locations is nearly constant, but the rains have been falling in more intense and short-lived episodes, with longer dry spells in between. In some locations rainfall is becoming heavier, but occurrences of drought have also increased by about 10% in the past 40 years. Global climate models have a difficult time predicting whether the rainfall in the Southeast will increase or decrease in the next 100 years, however, because the physical processes that form clouds and rain in the computer models are highly variable and do not do a good job of simulating even the current rainfall well. While water supply from reservoirs is likely to be adequate under good management practices and conservation efforts, more frequent droughts or large population increases will stress the ability of water utilities to meet everyone's needs.

## Sea Level Rise



(/images/edu/shorelinech.jpg)

Figure C. Changing shoreline over many centuries. (Image from Carrie Thomas).

There is a potential for the sea level to rise by about two feet off the Southeast coast over the next one hundred years. Not only could this flood low lying areas like barrier islands, but it could also increase the salinity in estuaries, wetlands and tidal rivers. It could also increase vulnerability of coastal areas to the damaging effects of storm surge. Low lying areas that currently flood during heavy rains would likely flood more frequently, and others that don't currently flood may start to experience flooding.

## Hurricane Intensity Increases

There is some theory and scientific evidence that hurricanes will increase in intensity in the next hundred years. This would mean more strong hurricanes (CAT3+), and storms that form would have stronger winds and the associated storm surge would be higher, pushing more water inland before and during the storm. This coupled with sea level rise could spell catastrophe for some coastal

communities in the Southeast.

## How does this relate to agriculture?

Warmer temperatures would likely result in a change of the ecosystem. Plants that once grew in certain regions will now thrive farther north. Soil moisture could decrease under the higher temperatures and more intermittent rainfall, even if the total amount of rainfall increases. The growing season could increase in length, leading to longer growing periods. Some crops could benefit from warmer temperatures and increased carbon dioxide while others might not. Crops that are already near their temperature limits will be the most affected in terms of yield and quality if temperatures continue to rise. The crops that are not near their temperature thresholds would benefit from warmer temperatures, and would likely increase their yield and quality. Freezes in Florida would be reduced, leading to decreased loss from cold weather, and citrus crops might be able to migrate north of their current range.

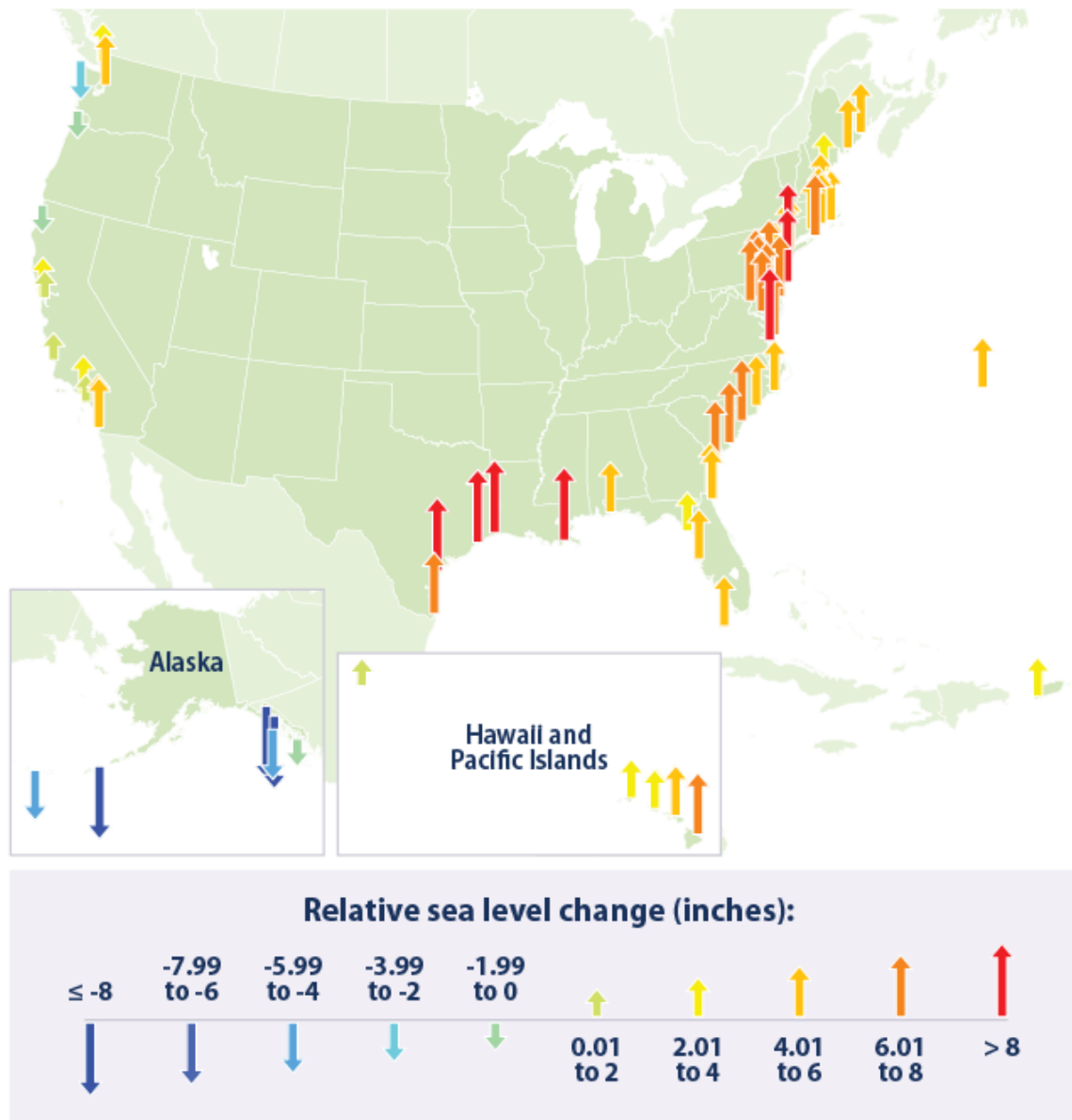
Because of the warmer temperature and potential drying of the soil, irrigation may need to be expanded, or else marginal lands will have to be taken out of production or switched to more suitable crops. Pests could increase in range, necessitating the use of more pesticides. Forests could also die back and change to a more open prairie.

All of these local changes will take place in the context of a world that is also changing in many ways. Economic demands, health issues, coastal changes, energy needs and production methods, and population growth will also be varying in ways that are difficult to predict now. All of these changes will affect the costs of agricultural production and the demand for your products in the future.

## How does this relate to public health?

Some of the biggest climate change concerns for public health include rising temperatures, rising sea levels, and increasing intense precipitation events. Mid-latitude cities, such as those in North Carolina, tend to experience greater summer climate variability. These cities are also expected to experience the greatest increase in summertime heat-related deaths as a result of climate change.<sup>1</sup>

### Relative Sea Level Change Along U.S. Coasts, 1960–2011



Data source: NOAA (National Oceanic and Atmospheric Administration). 2012 update to data originally published in: NOAA. 2001. Sea level variations of the United States 1854–1999. NOAA Technical Report NOS CO-OPS 36. <http://tidesandcurrents.noaa.gov/publications/techrpt36.pdf>.

For more information, visit U.S. EPA's "Climate Change Indicators in the United States" at [www.epa.gov/climatechange/indicators](http://www.epa.gov/climatechange/indicators).

(/images/edu/sealevel.png)

Figure D. Sea level.

Rising average temperatures and more frequent and more intense heat waves due to climate change are affecting human health in several ways. Most directly, warmer average temperatures and more extreme temperatures put more people at risk for heat-related death and disease, such as heat stroke and dehydration.<sup>1</sup> For example, in North Carolina, the number of heat-related visits to the emergency department increases by 15.8 for every 1°F increase in temperature from 98°F to 100°F.<sup>2</sup>

Older adults and young children are vulnerable to heat-related illnesses. However, over the past two summers, North Carolina has seen the greatest number of heat-related visits to the emergency department among men ages 25-64.<sup>3,4</sup> The state of North Carolina has much more rural land mass and less densely populated urban areas than other states, making it less susceptible to the urban heat island effect.<sup>5,6</sup> In fact, research suggests that in North Carolina, heat-related illnesses are more likely to occur in rural areas than in urban areas.<sup>7</sup>

Rising temperatures may facilitate the melting of glaciers and ice caps in the ocean, contributing to rising sea levels. When coupled with more frequent storm surges, more frequent and intense flooding may result.<sup>8</sup> These extreme weather events can reduce the availability of drinkable water, compromise the integrity of public health infrastructure, and cause direct death or injury in coastal communities.<sup>9,10</sup> The North Carolina coast is especially vulnerable to sea level rise, which has risen over a foot in the past 100 years, with large areas of land elevated only a small amount above sea level.<sup>11</sup> A one-foot rise in sea levels is correlated with 200 feet of beach erosion in North and South Carolina.<sup>6</sup>

<sup>1</sup>Portier CJ, et al. 2010. A human health perspective on climate change: a report outlining the research needs on the human health effects of climate change. Research Triangle Park, NC: Environmental Health Perspectives/National Institute of Environmental Health Sciences. doi:10.1289/ehp.1002272 <[www.niehs.nih.gov/climate/report](http://www.niehs.nih.gov/climate/report)> Accessed November 17, 2012.

<sup>2</sup>Rhea, S; Ising, A; Fleischauer, AT; Deyneka, L; Vaughn-Batten, H; Waller, A. 2012. Using near real-time morbidity data to identify heat-related illness prevention strategies in North Carolina. *Journal of Community Health* 37:495-500. DOI 10.1007/s10900-011-9469-0.

<sup>3</sup>North Carolina Division of Public Health, Occupational and Environmental Epidemiology. The 2011 North Carolina heat report. July 2011. <<http://publichealth.nc.gov/chronicdiseaseandinjury/doc/HeatReport-13-2011.pdf>> Accessed November 17, 2012.

<sup>4</sup>North Carolina Division of Public Health, Occupational and Environmental Epidemiology. The 2012 North Carolina heat report. <<http://publichealth.nc.gov/chronicdiseaseandinjury/doc/HeatReport20-2012.pdf>> Accessed November 17, 2012.

<sup>5</sup>Reid CE, O'Neill MS, Gronlund CJ, Brines SJ, Brown DG, Diez-Roux AV, Schwartz J. 2009. Mapping community determinants of heat vulnerability. *Environmental Health Perspectives*. Nov;117(11):1730-1736.

<sup>6</sup>UNC Institute for the Environment, The University of North Carolina at Chapel Hill. 2009. Climate change committee report 2009. <[http://www.ie.unc.edu/PDF/Climate\\_Change\\_Report.pdf](http://www.ie.unc.edu/PDF/Climate_Change_Report.pdf)> Accessed November 17, 2012.

<sup>7</sup>Fuhrmann, C.M., Kovach, M.M., and C.E. Konrad II: Heat-related illness in North Carolina: Who's at Risk? Annual Education Conference of the North Carolina Public Health Association, New Bern, NC, September 20, 2013. <[http://www.sercc.com/sercc\\_projects](http://www.sercc.com/sercc_projects)> Accessed December 22, 2012.

<sup>8</sup>Tebaldi, C., Strauss, B. H., & Zervas, C. E. (2012). Modelling sea level rise impacts on storm surges along US coasts. *Environmental Research Letters*, 7(1):014032.

<sup>9</sup>Environmental Protection Agency. Climate change: Human impacts and adaptation. June 14, 2012. <<http://www.epa.gov/climatechange/impacts-adaptation/coasts.html#impactssea>> Accessed November 17, 2012.


<sup>10</sup>English, PB; et al. 2009. Environmental health indicators of climate change for the United States: Findings from the State Environmental Health Indicator Collaborative. *Environmental Health Perspectives*. Nov;117(11):1673-1681.

<sup>11</sup>RENCI at ECU. 2011-2012 focus: Sea level rise. March 29, 2012. <<http://www.ecu.edu/renci/Focus/SeaLevelRise.html>> Accessed November 17, 2012.


## Want to learn more?

**Greenhouse Effect (/edu/GreenhouseEffect), Greenhouse Gases (/edu/GreenhouseGases)**



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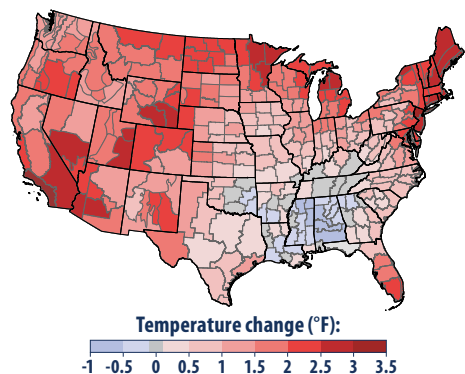


# What Climate Change *Means for* North Carolina

**North Carolina's** climate is changing. Most of the state has warmed one-half to one degree (F) in the last century, and the sea is rising about one inch every decade. Higher water levels are eroding beaches, submerging low lands, exacerbating coastal flooding, and increasing the salinity of estuaries and aquifers. The southeastern United States has warmed less than most of the nation. But in the coming decades, the region's changing climate is likely to reduce crop yields, harm livestock, increase the number of unpleasantly hot days, and increase the risk of heat stroke and other heat-related illnesses.

Our climate is changing because the earth is warming. People have increased the amount of carbon dioxide in the air by 40 percent since the late 1700s. Other heat-trapping greenhouse gases are also increasing. These gases have warmed the surface and lower atmosphere of our planet about one degree during the last 50 years. Evaporation increases as the atmosphere warms, which increases humidity, average rainfall, and the frequency of heavy rainstorms in many places—but contributes to drought in others.

Greenhouse gases are also changing the world's oceans and ice cover. Carbon dioxide reacts with water to form carbonic acid, so the oceans are becoming more acidic. The surface of the ocean has warmed about one degree during the last 80 years. Warming is causing snow to melt earlier in spring, and mountain glaciers are retreating. Even the great ice sheets on Greenland and Antarctica are shrinking. Thus the sea is rising at an increasing rate.



*Rising temperatures in the last century. North Carolina has warmed less than most of the United States. Source: U.S. EPA, Climate Change Indicators in the United States.*

## Rising Seas and Retreating Shores

As the oceans warm, seawater expands and raises sea level. Melting ice adds more water to the ocean, further raising sea level. Along much of the Atlantic Coast, including parts of North Carolina, the land surface is sinking, so the observed rate of sea level rise relative to the land is greater than the global average rise. Sea level is likely to rise one to four feet in the next century along the coast of North Carolina.

As sea level rises, the lowest dry lands are submerged and become either tidal wetland or open water. Most existing wetlands can create their own land and keep pace with a slowly rising sea. But if sea level rises three feet in the next century, most of the wetlands on the Albemarle-Pamlico peninsula are likely to be submerged by the higher water level.

Beaches also erode as sea level rises. A higher water level makes it more likely that storm waters will wash over a barrier island or open new inlets. The United States Geological Survey estimates that the lightly developed Outer Banks between Nags Head and Ocracoke could be broken up by new inlets or lost to erosion if sea level rises two feet by the year 2100. Eroding shores will threaten most coastal towns unless people take measures to halt the erosion.



*Beach houses in Nags Head are vulnerable to severe storms, flooding, and coastal erosion. © James G Titus; used by permission.*

## Coastal Ecosystems

As sea level rises, salt water can mix farther upstream and farther inland in aquifers and wetlands. Increasing salinity can kill some types of trees found in swamps. Salt water also reacts with some wetland soils, which causes the surface of the wetlands to sink below the water, adding to the loss of wetlands.



*Trees killed by increasing salinity near Camden Point. © James G. Titus; used by permission.*

Many species of birds and fish in North Carolina depend on coastal wetlands threatened by rising sea level. Blue crabs, shrimp, and southern flounder use marshes for both feeding and evading larger predators. Larger fish such as sea trout and red drum also feed in these marshes. Many types of birds feed on fish in the marsh, including egrets and herons. Wetlands along the Alligator River are the principal habitat in the wild for the endangered red wolf. Pocosin swamps provide refuge for black bears and bobcats, and they help to maintain water quality in the nearby sounds.

## Storms, Homes, and Infrastructure

Tropical storms and hurricanes have become more intense during the past 20 years. Although warming oceans provide these storms with more potential energy, scientists are not sure whether the recent intensification reflects a long-term trend. Nevertheless, hurricane wind speeds and rainfall rates are likely to increase as the climate continues to warm.



*Water covering front yards near Swan Quarter. © James G. Titus; used by permission.*

Whether or not storms become more intense, coastal homes and infrastructure will flood more often as sea level rises, because storm surges will become higher as well. Rising sea level is likely to increase flood insurance rates, while more frequent storms could increase the deductible for wind damage in homeowner insurance policies. Many cities, roads, railways, ports, airports, oil and gas facilities, and water supplies in the Southeast are vulnerable to the impacts of storms and sea level rise. People may move from vulnerable coastal communities and stress the infrastructure of the communities that receive them.

Increased rainfall may further exacerbate flooding in some coastal areas. Since 1958, the amount of precipitation during heavy rainstorms has increased by 27 percent in the Southeast, and the trend toward increasingly heavy rainstorms is likely to continue.

## Agriculture

Changing the climate will have both harmful and beneficial effects on farming. During the next few decades, hotter summers are likely to reduce yields of corn. But higher concentrations of atmospheric carbon dioxide increase crop yields, and that fertilizing effect is likely to offset the harmful effects of heat on cotton, soybeans, wheat, and peanuts—if enough water is available. More severe droughts however, could cause crop failures. Higher temperatures are also likely to reduce livestock productivity, because heat stress disrupts the animals' metabolism.

## Energy

Seventy years from now, temperatures are likely to rise above 95°F approximately 20 to 40 days per year in most of the state, compared with about 10 days per year today. Greater use of air-conditioning will increase electricity consumption.

## Human Health

Hot days can be unhealthy—even dangerous. Certain people are especially vulnerable, including children, the elderly, the sick, and the poor. High air temperatures can cause heat stroke and dehydration and affect people's cardiovascular and nervous systems. Warmer air can also increase the formation of ground-level ozone, a key component of smog. Ozone has a variety of health effects, aggravates lung diseases such as asthma, and increases the risk of premature death from heart or lung disease, so EPA and the North Carolina Division of Air Quality have been working to reduce ozone concentrations. As the climate changes, continued progress toward clean air will become more difficult.

The sources of information about climate and the impacts of climate change in this publication are: the national climate assessments by the U.S. Global Change Research Program, synthesis and assessment products by the U.S. Climate Change Science Program, assessment reports by the Intergovernmental Panel on Climate Change, and EPA's *Climate Change Indicators in the United States*. Mention of a particular season, location, species, or any other aspect of an impact does not imply anything about the likelihood or importance of aspects that are not mentioned. For more information about climate change science, impacts, responses, and what you can do, visit EPA's Climate Change website at [www.epa.gov/climatechange](http://www.epa.gov/climatechange).





Abramson Exhibit 3  
Docket Nos. E-2, Sub 1262 and  
E-7, Sub 1243

## Hurricane season ends historic as predicted by experts back in April.

By Allison Chinchar and Haley Brink, CNN meteorologists

Updated 1:32 PM ET, Mon November 30, 2020

**(CNN)**Monday officially marks the final day of Atlantic hurricane season, and it has been one for the record books.

2020 has been undoubtedly a crazy year -- with the [Covid-19 pandemic](#), [murder hornets](#) and some of the [largest wildfires](#) in recorded history. It seems understandable that hurricane season would also be memorable.

This season was forecast to be a busy season. Two of the most well-known and respected entities that forecast their predictions for the upcoming hurricane season are Colorado State University (CSU) and the National Oceanic and Atmospheric Administration (NOAA).

CSU's Tropical Meteorology Project team predicted an above-average Atlantic hurricane season on April 2. The team forecast 16 named storms, including eight hurricanes.

"We were forecasting a well above-average season in April, June and July, and increased that forecast to an extremely active season in August," said Phil Klotzbach, [a research scientist](#) at the university's Department of Atmospheric Science.



Forecast Parameter Average (in parentheses)	Issue Date April 2	Issue Date June 4	Issue Date July 7	Issue Date August 5	YTD
Named Storms (12)	16	19	20	24	30
Hurricanes (6)	8	9	9	12	13
Major Hurricanes (3)	4	4	4	5	6



"Active seasons can play out very differently," Klotzbach said. "For example, both 2004 and 2005 had comparable levels of ACE (227 ACE in 2004 and 245 ACE in 2005), but 2005 had 28 named storms while 2004 had only 15 named storms."

ACE stands for "accumulated cyclone energy." It is the metric used by meteorologists to account for both a storm's strength and how long the storm lasts. Typically, the more ACE there is in a single hurricane season, the more active the season is.

Seven weeks after CSU put out its initial forecast, NOAA forecast a 60% chance for an above-normal season, predicting a 70% chance of having 13 to 19 named storms, of which six to 10 could develop into hurricanes, including three to six major hurricanes.

"Obviously, given our forecast named storm numbers, we were quite surprised to see 30 named storms, but as you can see from other indices that we forecast, most of them were close to in line with our predictions," Klotzbach said.

Researchers at CSU use forecast models mainly based on ACE to make their hurricane season predictions.

### Most groups predict an above-average hurricane season

The Atlantic hurricane season begins on 1 June, and over one dozen groups have already issued seasonal hurricane forecasts for the 2020 season. To date, most groups have predicted an above-average season, with several forecasting an extremely active season.

### ***The records***

The season began early when Tropical Storm Arthur formed on May 14, more than two weeks before Atlantic hurricane season officially began. The season runs from June 1 through November 30.

"The 2020 Atlantic hurricane season ramped up quickly and broke records across the board," said Neil Jacobs, acting NOAA administrator, [in a media release](#).

Every named storm so far this season except three (Arthur, Bertha, and Dolly) set a record for the earliest named storm ever recorded.

For example, Cristobal was the earliest third named storm on record when it formed on June 2, beating the previous record -- Colin in 2016 -- by three

days. By the time Wilfred formed, the earliest 21st named storm, these systems were beating the previous records by nearly three weeks.

When Hurricane Delta was churning in the Atlantic, it [broke numerous records](#), only to see many of them broken a few weeks later when Hurricane Iota moved through the western Caribbean.

During the peak of the season, there were five tropical cyclones in the Atlantic at the same time -- Paulette, Rene, Sally, Teddy and Vicky -- for [only the second time in history](#).

The only other time there were five active tropical cyclones -- hurricane, tropical storm and/or tropical depression -- in the Atlantic was in 1971.

This year, six storms reached major hurricane status -- Laura, Teddy, Delta, Epsilon, Eta and Iota. This ties for the second highest number of major hurricanes in a single season. A major hurricane is a Category 3 or larger storm with winds of at least 111 mph (178 kph).

There were four major hurricanes that formed in October and November only. Before this year, [no year ever had more than two](#) major hurricane formations in those two months.

The season's strongest storm was Hurricane Iota, which peaked at 160 mph. It was the second major hurricane to form in the month of November, which has never happened in recorded history -- Eta was the first.

Iota made landfall in Nicaragua as a Category 4 hurricane with sustained winds of 155 mph, just 2 mph shy of the Category 5 threshold. It was the strongest November hurricane on record to hit Nicaragua, breaking the record set by Eta two weeks before.

### ***US landfalls***

A record 12 named storms made landfall across seven states this year: Bertha, Cristobal, Fay, Hanna, Isaias, Laura, Marco, Sally, Beta, Delta, Eta and Zeta.

People along [nearly every mile of coastline from Texas to Maine](#) were affected by at least one named storm this season.

"Every mile of the US Gulf and Atlantic coast has been under a tropical storm or hurricane watch or warning, except for one single county with coastline: Wakulla County, Florida," said Jake Carstens, a meteorology graduate research assistant at Florida State University.





Almost the entire Gulf and Atlantic coastlines, save for a small area in Florida, have been under at least a tropical storm watch or stronger alert this year.

In 2020, every month of hurricane season saw a storm make landfall in the US. May, considered pre-hurricane season, also experienced a storm landfall, meaning there were seven straight months of direct landfalls.

Despite most of the storms hitting the Gulf Coast, the Northeast was affected by three named storms -- Fay, Isaias and Zeta. Tropical Storm Fay was the only storm to make landfall in the Northeast, hitting New Jersey on July 10. Hurricane Isaias, which made landfall in North Carolina in August, triggered a huge swath of power outages along the East Coast.

Remarkably, Florida made it almost to the very end of hurricane season before a storm made landfall. Eta became the first November landfall for Florida since Mitch in 1998. And since Eta made two landfalls in Florida, it added to the many miles of coastline under tropical alerts this season.

But of all the areas affected by tropical cyclones this year, Louisiana was the most frequent target. It had a record-breaking five storms make landfall: Cristobal, Laura, Marco, Delta and Zeta.

Hurricane Laura made landfall as a strong Category 4 storm near Cameron, Louisiana, on August 27. Six weeks later, Hurricane Delta struck the same area, battering homes and businesses that were still being repaired from Laura.



Zeta was the fastest of these storms, making landfall at 24 mph. The slowest was Hurricane Sally, which was moving at 3 mph at landfall. Even though the storms were Category 2, the varying landfall speeds changed how the storms affected the local communities.

An average human walks at 3 to 4 mph, which means a person could have walked faster than Sally. But Sally's super slow movement allowed the storm to dump a tremendous amount of rain over a prolonged period of time in the same locations. An average September sees 4-5 inches of rainfall along the Florida-Alabama-Mississippi panhandle, but Sally dropped that in just a couple of hours. By the time the storm left the region, at least three months of rain had accumulated in some spots.

Zeta's fast speed allowed the tropical storm-force winds to travel very far inland, not just along the coast, and those winds felled trees and power lines from Louisiana to Virginia. More than [2 million people lost power](#) from Zeta. But that speed also meant that rainfall totals were not as high as they were with Sally. Widespread totals were within the 2-4 inch range, with one small area of 6 inches near the Mississippi-Alabama border.

Isaias, the name people struggled to pronounce, affected almost everyone along the Eastern Seaboard. More than 100 million people were under either a hurricane watch or warning or tropical storm watch or warning stretching from Florida to Maine.

Damaging winds triggered power outages for [more than 3 million customers](#). Tornadoes were also a big factor with Isaias -- at one point more than 30 million people were under tornado watches. The storm produced [more than 50 tornado reports](#) in two days, a high number given

that tropical systems in the Gulf are [more likely to produce tornadoes](#) than their Atlantic counterparts.

Texas had two landfalls, Hanna in July and Beta in September. Alabama was hit by Hurricane Sally in September. South Carolina was hit by the preseason storm Bertha in May.

### ***The Greek alphabet***

For the second time in recorded history, the National Hurricane Center used every name on the pre-determined list of names for tropical systems in the Atlantic basin, [prompting the use of the Greek alphabet](#) to name storms for the remainder of the season.

And there were a record number of Greek alphabet letters used for storm names -- nine: Alpha, Beta, Gamma, Delta, Epsilon, Zeta, Eta, Theta and Iota. Four of the 12 US named storms were from the Greek alphabet. Two of the top five worst storms to ever hit Nicaragua in recorded history were from the Greek alphabet.

The latter portion of the season was remarkably the more intense portion of the season.

Of the first 21 named storms, on the regular hurricane season list, only two were major hurricanes -- Laura and Teddy. However, of the nine names used in the Greek alphabet, four were major hurricanes -- Delta, Epsilon, Eta and Iota.

### **2020 Atlantic hurricane season named storms**

All of the named storms used during the record-breaking 2020 Atlantic hurricane season

Arthur	Isaias	Rene	Delta
Bertha	Josephine	Sally	Epsilon
Cristobal	Kyle	Teddy	Zeta
Dolly	Laura	Vicky	Eta
Edouard	Marco	Wilfred	Theta
Fay	Nana	Alpha	Iota
Gonzalo	Omar	Beta	
Hanna	Paulette	Gamma	

CNN WEATHER



Source: National Hurricane Center / World Meteorological Organization Tropical Cyclone Programme



Abramson Exhibit 4  
Docket Nos. E-2, Sub 1262 and  
E-7, Sub 1243

### **The Missing Link in the Climate Change Risk Puzzle.**

**Companies and investors often overlook the costly knock-on effects of climate change. The solution? Accounting for climate change vulnerability, according to a new report from the Morgan Stanley Institute for Sustainable Investing.**

Consider this: Two industry competitors have key manufacturing facilities in the same coastal community. After weathering a damaging hurricane season, one company suspends operations for six months, while the other is up and running in six weeks. Why the disparity? The latter moved key internal infrastructure to the roof after a recent flood disrupted manufacturing. The former restored its facility exactly as it was beforehand. Their respective climate vulnerabilities—the underlying weaknesses that can exacerbate the consequences of exposure to climate-related events—differ significantly, leading to different levels of risk and financial impacts. In this case, and others, companies and investors are unprepared, having overlooked the adverse knock-on effects of climate-related events on both direct and indirect operations, according to a new report from the [Morgan Stanley Institute for Sustainable Investing](#).

However, by considering these climate vulnerabilities, the report says, markets, investors and consumers can be better prepared.

[Climate change](#) has become an investment consideration impossible to ignore, as related disasters and economic losses grow<sup>1</sup> and regulators increasingly recognize it as a systemic financial risk. Moreover, among institutional and individual investors, demand to integrate climate change as a factor in portfolios is high: Of institutions, 44% are actively considering or seeking to address climate change as a sustainability issue and 78% of individuals are interested in it as an investment theme, according to the report.

Despite this, investors find themselves charting new territory when it comes to assessing climate-related risk. Efforts by organizations including the Task Force on Climate-Related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB) have helped spur more transparent corporate environmental disclosures, but access to certain data continues to be a challenge. While related information may reveal direct operational exposure to potential climate-related events, it rarely accounts for indirect repercussions that would help investors better assess risk and compare peers.

The onus, then, falls on investors to ask the right questions and perform thorough analyses, which they can do only if they're equipped with a comprehensive way to assess climate change risk. The Morgan Stanley Institute for Sustainable Investing's three-pronged framework is designed to do just that.

### Related articles

- INSTITUTE FOR SUSTAINABLE INVESTING  
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- RESEARCH  
***Decarbonization: The Race to Zero Emissions***

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### *Climate Change Risk: A Three-Dimensional Assessment Framework*

The Morgan Stanley Institute for Sustainable Investing defines climate-related risk in three ways:

- **Events:** Natural or human-induced incidents that may have adverse effects on people, companies or investors. Examples include the implementation of policies to price greenhouse gas (GHG) emissions like carbon taxes, or physical hazards, such as hurricanes or drought.
- **Exposure:** Factors such as business activities or locations that influence whether climate change-related events will affect companies directly. Examples include operations at risk from new carbon regulations or manufacturing sites that may be at risk from extreme weather.
- **Vulnerability:** The underlying weaknesses that can exacerbate the consequences of exposure to climate-related events. In a hurricane, for example, vulnerability could include the failure to raise a facility's key infrastructure to avoid flood damage and prevent business disruptions.

Given the interrelated nature of companies, their supply chains, the communities they operate in and the infrastructure they rely on, developing a thorough understanding of climate risk can help investors make more informed investment decisions. By integrating climate vulnerability into the risk assessment process, investors can improve their evaluation of potential financial impacts on portfolio companies and develop more climate-resilient investment approaches. Factoring in vulnerability can also help investors

more accurately weigh risks and returns, differentiate securities, build portfolios and inform shareholder engagement strategies.

To learn more, get the full report: *[“Climate Impact: Understanding Vulnerability as the Missing Piece in the Climate Risk Puzzle.”](#)* Plus, discover *[Morgan Stanley’s Institute for Sustainable Investing](#)*.

### **ASSESSING VULNERABILITY WITHIN CLIMATE RISK**

[download full report](#)