

**Before the
Georgia Public Service Commission**

In Re:	§	
	§	
Georgia Power Company's	§	Docket No. 27800-U
Application for the	§	
Certification of Units 3 and 4 at	§	
Plant Vogtle and Updated	§	
Integrated Resource Plan	§	

PUBLIC DISCLOSURE

Direct Testimony and Exhibits of

Jeffry Pollock

On behalf of

**Georgia Industrial Group
Georgia Traditional Manufacturers Association**

Project 70101
December 19, 2008



J . P O L L O C K
I N C O R P O R A T E D

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Direct Testimony of Jeffry Pollock

1 **1. INTRODUCTION, QUALIFICATIONS AND SUMMARY**

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

3 **A Jeffry Pollock; 12655 Olive Blvd., Suite 335; St. Louis, Mo., 63141.**

4 **Q WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

5 **A I am an energy advisor and President of J.Pollock, Incorporated.**

6 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

7 **A I have a Bachelor of Science Degree in Electrical Engineering and a Masters in**
8 **Business Administration both from Washington University. Since graduation in 1975,**
9 **I have been engaged in a variety of consulting assignments including energy**
10 **procurement and regulatory matters in both the United States and several Canadian**
11 **provinces. I have participated in numerous regulatory matters before this**
12 **Commission since 1977. More details are provided in Appendix A to this testimony.**

**1. Introduction, Qualifications
And Summary**

1 **Q ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?**

2 A I am testifying on behalf of the Georgia Industrial Group (GIG) and the Georgia
3 Traditional Manufacturers Association (GTMA). GIG and GTMA members are
4 customers of Georgia Power Company (GPC or Company). They consume large
5 quantities of electricity primarily for manufacturing under a wide variety of GPC
6 tariffs.

7 **Q WHAT ISSUES ARE YOU ADDRESSING IN YOUR TESTIMONY?**

8 A I am addressing GPC's proposal to recover a cash return (*i.e.*, financing costs) on
9 construction work in progress (CWIP) associated with the Plant Vogtle Expansion
10 (Expansion). I am not addressing the need for the Expansion, the choice of the
11 nuclear option, the request to commence making environmental improvements at
12 plants Branch and Yates, or the updated integrated resource plan (IRP). The fact
13 that I am not addressing these issues should not be interpreted as an endorsement
14 of GPC's proposals. Throughout the testimony, I refer to the projected in-service
15 costs of the Expansion. The reference is for illustrative purposes.

16 **Q ARE YOU SPONSORING ANY EXHIBITS WITH YOUR TESTIMONY?**

17 A Yes. I am sponsoring **Exhibits JP-1** through **JP-3**. These exhibits were prepared by
18 me or under my direction and supervision.

1 **Summary**

2 **Q PLEASE SUMMARIZE YOUR FINDINGS AND CONCLUSIONS**

3 A Georgia Power has not yet demonstrated that it needs to recover cash earnings (*i.e.*,
4 financing costs) on the construction work in progress (CWIP) associated with the
5 Plant Vogtle Expansion. Based on an analysis of the evidence, GPC's proposal
6 would be more costly to ratepayers than following traditional rate-making practices
7 on a net present value (NPV) basis.

8 Absent a clear benefit and a defined need, traditional ratemaking is clearly
9 more appropriate because it: (1) properly matches cost recovery and cost causation;
10 (2) preserves intergenerational equity; and (3) provides incentives for the Company
11 to minimize costs by completing construction early and/or under budget. Upfront
12 cost recovery, on the other hand, would force ratepayers to pre-pay for an asset that
13 they may never use. Furthermore, should the Commission subsequently determine
14 that any portion of the costs were clearly imprudent, upfront recovery could violate
15 the principles that this Commission has used for decades, which allow only prudent,
16 used-and-useful costs to be recovered in rates.

17 GPC also has not demonstrated that upfront cash recovery of the Expansion
18 costs is necessary to maintain its present "A" bond rating. This is because GPC's
19 projected financial ratios are (in certain respects) consistent with an "A"-rated utility,
20 even during the peak construction years. In any event, a downgrade would not be
21 catastrophic. Most investor-owned electric utilities are BBB-rated, and under most
22 circumstances, they have reasonable access to capital, albeit at a higher cost.
23 Historically, the spread between "A"-rated and "BBB"-rated corporate bonds has

1 averaged 53 basis points. This could increase GPC's revenue requirements, but
2 only by about \$35 million per year.

3 However, bond ratings are not determined solely on financial ratios.
4 Constructive support of this Commission can provide confidence to the investment
5 community that will allow GPC access to capital on reasonable terms. Should the
6 Commission determine that some upfront recovery is necessary, it should be
7 prepared to grant appropriate relief.

8 Currently, the only options on the table are (1) 100% CWIP and (2) no CWIP.
9 Because these are the only options being considered and because the vast majority
10 of the construction costs will not be incurred until after a combined construction and
11 operating license (COL) is issued (in late 2011—after new base rates are approved),
12 this issue is more properly decided in the 2010 rate case. This will allow the
13 Company an opportunity to provide updated projections, and the Commission and
14 parties can conduct a more thorough analysis to ensure that there are benefits of
15 upfront cash recovery and that these benefits would more than offset the additional
16 costs to the Company and the ratepayers.

17 Should the Commission grant the Company's request, either in whole or in
18 part, two conditions should be imposed. First, GPC should refund all monies
19 collected under the NCCR rider after Units 3 and 4 begin commercial operation. This
20 would provide a "quid pro quo" for early recovery by restoring intergenerational
21 equity (to some degree) and temporarily offsetting the significant rate increase from
22 adding a major investment to rate base. During the refund period, the Company
23 would be allowed to accrue AFUDC on the investment so that, in the end, the

1 Expansion will have an in-service cost as if it had never received a cash return on
2 CWIP. Second, the Company should be required to periodically demonstrate that
3 the Expansion is clearly more cost effective than alternative base load options. This
4 will ensure that the Expansion continues to be the best alternative for ratepayers,
5 even under changing circumstances.

1 **2. CASH RETURN ON NUCLEAR CONSTRUCTION COSTS**

2 **Q IS GEORGIA POWER SEEKING COMMISSION APPROVAL TO RECOVER**
3 **COSTS ASSOCIATED WITH THE EXPANSION?**

4 A Yes. GPC is seeking approval to recover a cash return on construction work in progress
5 (CWIP) associated with the Plant Vogtle Expansion (Expansion). This treatment would
6 commence on January 1, 2011 and would continue until both Units 3 and 4 commence
7 service. GPC is projecting the in-service dates to be April 2016 and April 2017,
8 respectively.

9 **Q THROUGH WHAT MECHANISM WOULD RECOVERY OF A CASH RETURN ON**
10 **VOGTLE-RELATED CWIP BE ACCOMPLISHED?**

11 A GPC is proposing a Nuclear Construction Cost Recovery (NCCR) tariff, effectively, a
12 rider. The proposed rider was described conceptually in the testimony filed by Ms.
13 Dais and Mr. Morris. It would recover cash earnings on the projected average CWIP
14 balance for the applicable calendar year. Thus, the NCCR rider in effect during 2011
15 would reflect the projected average 2011 CWIP balance. There would be a true up
16 in each subsequent year to account for differences between projected and actual
17 CWIP balances during the prior year.

18 **Q WOULD THE NCCR RIDER CAUSE RATES TO INCREASE?**

19 A Yes. The Company is planning to incur significant costs to build out the Expansion.
20 The NCCR rider would reflect these projected expenditures. This would result in a
21 series of annual rate increases until the Expansion is completed.

**2. Cash Recovery of Nuclear
Construction Costs**

1 **Q HAVE YOU ESTIMATED THE REVENUES THAT WOULD BE COLLECTED IN**
2 **THE NCCR RIDER?**

3 A Yes. **Exhibit JP-1** shows the annual revenue requirement for the period January
4 2011 through December 2016. As can be seen, the NCCR rider would initially
5 collect \$220 million, and these collections would gradually increase to \$620 million
6 per year.

7 **Q HOW DO THE PROJECTED ANNUAL REVENUES COLLECTED IN THE NCCR**
8 **RIDER COMPARE TO GPC'S MOST RECENT BASE REVENUE INCREASE?**

9 A GPC was awarded a \$322 million base revenue increase in the 2007 Rate Case
10 (Docket No. 25060). Thus, at its peak, the proposed NCCR rider would recover
11 nearly double the base revenue increase in GPC's last rate case.

12 **Q ARE THESE THE ONLY RATE INCREASES THAT WOULD OCCUR WHILE THE**
13 **VOGTLE EXPANSION IS UNDER CONSTRUCTION?**

14 A No. These rate increases would be in addition to base rate, Environmental
15 Compliance Cost Recovery (ECCR) and Fuel Cost Recovery (FCR) rate increases
16 that the Company may implement in the future. The next FCR rate case is
17 scheduled to be filed next March, with implementation of FCR-21 expected by June
18 2009. The Company is also obligated to file a base rate case in July 2010 with rates
19 effective on January 1, 2011. This would coincide with the initial rate increase under
20 the NCCR rider. Subsequent fuel and base rate cases may occur prior to Units 3

**2. Cash Recovery of Nuclear
Construction Costs**

1 and 4 achieving commercial operation. As discussed later, these rate increases
2 would allow GPC to recover higher costs, related primarily to additional generation
3 capacity, environmental improvements and transmission and distribution plant
4 additions.

5 **Q IS GPC PROPOSING TO RECOVER A CASH RETURN ON NON-NUCLEAR**
6 **CONSTRUCTION COSTS?**

7 A No. GPC would not begin recovering a cash return on new non-nuclear investments
8 until they are placed in service. As such, GPC's proposed NCCR rider for the
9 Expansion would be a dramatic departure from the traditional ratemaking practices of
10 this Commission (as applied in the past and as would be applied to GPC's non-
11 nuclear investments).

12 **Traditional Ratemaking**

13 **Q WHAT DO YOU MEAN BY TRADITIONAL RATEMAKING?**

14 A Under traditional ratemaking, a utility is allowed to begin recovering costs associated
15 with electrical facilities when they are placed in service. This is when the facilities
16 are "used and useful" in providing electricity service. During construction, the utility
17 is allowed to capitalize the financing costs. These financing costs, referred to as
18 "allowance for funds used during construction" (AFUDC), are subsequently included
19 in the costs of the plant when it is placed in service. AFUDC is reported as non-cash
20 earnings on the utility's income statement.

1 **Q WHY ARE UTILITIES ALLOWED TO BEGIN RECOVERY OF COSTS**
2 **ASSOCIATED WITH NEW INVESTMENTS ONLY AFTER THEY ARE USED AND**
3 **USEFUL?**

4 A This long-standing rate-making policy is founded on the matching principle. Under
5 this principle, costs associated with electric facilities are recovered over the same
6 period as the facilities are utilized to provide electricity service. For example, the
7 Company estimates that the Plant Vogtle Expansion will have at least a 60-year
8 useful life. This means it will provide electric power and energy for 60 years.
9 Recovering the plant-related costs over the same 60 years, thus, would match the
10 period over which customers will benefit from the power and energy provided by the
11 Expansion. The result of the matching principle is that the ratepayers who receive
12 the capacity and energy provided from the Expansion will be the same ones who pay
13 the costs of the plant. In other words, traditional ratemaking preserves
14 intergenerational equity.

15 **Q WOULD INTERGENERATIONAL EQUITY BE MAINTAINED UNDER THE**
16 **PROPOSED NCCR RIDER?**

17 A No. The proposed NCCR rider would force ratepayers to begin paying for a plant
18 that is not currently providing electricity and that will not be doing so for more than
19 five years after the NCCR rider goes into effect. This means that current ratepayers
20 will pay a disproportionate share of the costs of the capacity that will be used by and
21 benefit future ratepayers. Customers that, for whatever reason, are not still receiving

1 service from GPC after 2016 would pay a significant portion of the costs without
2 receiving any of the benefits.

3 **Q WHAT ARE THE OTHER ADVANTAGES OF TRADITIONAL RATEMAKING?**

4 A Besides matching cost recovery and utilization and preserving intergenerational
5 equity, traditional rate-making provides an incentive for the utility to minimize costs.
6 Tying the ability to begin cost recovery with placing a new investment in service
7 provides a strong incentive to complete construction early and/or under budget.

8 Traditional ratemaking also ensures that only prudently incurred costs are
9 recovered. An investment may not be placed in rate base and recovered from
10 customers until the plant has been substantially completed and the Commission has
11 ruled that the utility was not clearly imprudent in its oversight and management
12 during construction. Allowing recovery of a cash return now could result in
13 ratepayers paying for costs that are subsequently determined to be clearly
14 imprudent. This would violate the principles under which this Commission has
15 regulated utilities for decades.

16 Furthermore, traditional ratemaking provides a more equitable sharing of
17 risks. The proposed NCCR rider would effectively shift construction risks entirely to
18 ratepayers. This is because the ratepayers would begin to immediately pay the
19 financing costs related to construction before the Expansion is placed in service and
20 prior to a Commission determination that the costs were prudently incurred. Under
21 traditional ratemaking, construction risk is borne by the utility because it cannot
22 recover the costs of a new facility until it has been placed in service and the costs

2. Cash Recovery of Nuclear
Construction Costs

1 have been determined by the Commission to be prudent. In return for bearing this
2 risk, the utility is allowed to earn a return on equity (ROE) that reflects a premium
3 over and above the cost of debt. If recovery were guaranteed up front, there would
4 be no reason to include as large of a risk premium in setting the allowed ROE. For
5 this reason, approval of the proposed NCCR rider should support a lower ROE in
6 GPC's next rate case than otherwise would be the case.

7 **Q WHAT ARE THE RISKS ASSOCIATED WITH BUILDING A NEW NUCLEAR**
8 **PLANT?**

9 A The risks are substantial. This is because:

- 10 • No new nuclear plants have been built in the U.S. in over ten years;
- 11 • No advanced designed nuclear plants, such as the AP 1000, have ever
12 been built;
- 13 • The Nuclear Regulatory Commission (NRC) has not licensed a new
14 nuclear plant in over twelve years;
- 15 • GPC will be one of the first utilities in the nation to receive a combined
16 construction and operating license (COL) and to subsequently build a
17 new advanced designed nuclear plant;
- 18 • We will not know for over two years whether the NRC will issue a COL
19 for the Vogtle Expansion; and
- 20 • Delays in receiving the COL will almost certainly mean delays in
21 completing the plants, which will result in higher costs.

22 Despite GPC's good intentions, it cannot guarantee, prior to implementing the NCCR
23 rider, that:

- 24 • It will receive a COL from the NRC;
- 25 • Construction will be well underway; and

**2. Cash Recovery of Nuclear
Construction Costs**

- 1 • Every dollar spent will be prudent.
- 2 For all of the above reasons, the risks associated the Expansion are substantial.
- 3 The NCCR rider would shift all of these risks to GPC’s customers.

4 **Q IS THE VOGTLE EXPANSION THE ONLY FACTOR THAT WILL DRIVE FUTURE**
5 **ELECTRICITY RATES?**

6 A No. GPC has accumulated \$781 million in deferred fuel costs, which will need to be
7 addressed in the upcoming fuel rate case. GPC is in the midst of a large
8 construction program. The major components of this program include:

PROJECT	ESTIMATED COST
Plant McDonough conversion/expansion	[REDACTED]
Additional environmental controls on Plants Bowen, Hammond, Scherer and Wansley	\$1.6 Billion over the next three years
Selected catalytic refiners (SCR) and scrubbers on Plant Branch Units 1, 2, 3 and 4, and Plant Yates Units 6 and 7	\$2.2 Billion
Transmission and distribution infrastructure build-outs	\$1.8 Billion over the next three years (based on past experience)
Demand side management (DSM) and renewable resource acquisitions	\$1.5 Billion over the next 10 years
Fuel Cost Under-Collection as of October 2008	\$0.78 Billion
Higher municipal franchise fees (MFF) and state sales taxes	Up to 9.9% of the above cost increases

2. Cash Recovery of Nuclear Construction Costs

1 **Q HAVE GPC'S RATES CHANGED OVER THE PAST SEVERAL YEARS?**

2 A Yes. Since May 2005, GPC has had four FCR rate cases and the 2007 base rate
3 case. The FCR rate increases were 38.5%, 32%, 8.8% and 8.0%. The 2007 rate
4 case resulted in a 4.7% increase after fuel. Taking these five rate increases into
5 effect, GPC's average rates have increased by between 30% and 42% in just the
6 past 3½ years. These increases do not include the more than doubling of real time
7 prices (RTP) over the same period, which have resulted in overall cost increases of
8 up to 68%. Many GIG and GTMA members and many other commercial and
9 industrial customers purchase a substantial portion of their electricity under the RTP
10 tariffs. The result of these substantial and repeated increases in rates have caused
11 industrial customers' electricity rates to become non-competitive in the region and
12 has contributed to an exodus of manufacturing jobs from Georgia.

13 **Cash Return on CWIP**

14 **Q HOW IS THE RECOVERY OF A CASH RETURN ON CWIP DIFFERENT FROM**
15 **TRADITIONAL RATEMAKING?**

16 A Under traditional ratemaking, the utility is allowed to recover a non-cash return on
17 CWIP (*i.e.*, AFUDC). However, the AFUDC earnings do not provide cash until the
18 investment is placed in rate base, when the facility becomes used and useful.
19 Recovering a cash return on CWIP is different because the utility is allowed to begin
20 collecting the costs associated with new plant prior to the plant going into service.

2. Cash Recovery of Nuclear
Construction Costs

1 **Q IS ALLOWING A CASH RETURN ON CONSTRUCTION WORK IN PROGRESS A**
2 **NORMAL REGULATORY PRACTICE?**

3 A No. For example, the Public Utility Commission of Texas (PUCT) regards CWIP as
4 an “exceptional form of rate relief.” Under the PUCT’s rules:

5 Under ordinary circumstances the rate base shall consist only
6 of those items which are used and useful in providing service
7 to the public. Under exceptional circumstances, the
8 Commission will include construction work in progress in rate
9 base to the extent that:

- 10 i. The electric utility has proven that:
- 11 I. the inclusion is necessary to the financial
12 integrity of the electric utility; and
13 II. major projects under construction have been
14 efficiently and prudently planned and managed.
15 However, construction work in progress shall
16 not be allowed for any portion of a major project
17 which the electric utility has failed to prove was
18 efficiently and prudently planned and managed;
19 or
- 20 ii. for a project ordered by the Commission under §25.199
21 of this title (relating to Transmission Planning,
22 Licensing and Costs-recovery for Utilities within the
23 Electric Reliability Council of Texas), if the commission
24 determines that conditions warrant the inclusion of
25 CWIP in rate base, the project is being efficiently and
26 prudently planned and managed, and there will be a
27 significant delay between initial investment and the
28 initial cost recovery for a transmission project.¹

29 **Q UNDER WHAT CIRCUMSTANCES ARE UTILITIES ALLOWED TO BEGIN**
30 **RECOVERING A CASH RETURN ON CONSTRUCTION COSTS?**

31 A Because of its extraordinary nature, the recovery of a cash return on CWIP from
32 retail customers is generally limited to extraordinary circumstances. Such

¹ Public Utility Commission of Texas, Substantive Rule §25.231(c)(2)(D)

1 circumstances would occur when a utility is engaged in a very large construction
2 program relative to its existing rate base and where the utility requires substantial
3 external financing. Under these circumstances, a utility may experience lower
4 earnings quality; that is, its cash earnings may not provide ample interest coverage,
5 and its reported earnings would include a substantial amount of non-cash AFUDC
6 earnings. These earnings cannot be used to pay the interest and repay the principle
7 on outstanding long-term debt.

8 The lower earnings quality could trigger a reassessment of the utility's
9 outstanding debt by the major bond rating agencies. Absent prospects for
10 improvement, the bond rating agency could decide to downgrade the utility's bonds.
11 All other things being equal, a lower bond rating would increase the cost of the debt
12 issued to finance the utility's construction program. This would increase the utility's
13 cost of capital. A higher cost of capital would result in higher rates.

14 **Q WHAT RATINGS ARE ASSIGNED TO GEORGIA POWER'S BONDS?**

15 A GPC currently has an "A" bond rating from Standard & Poor's and Fitch Ratings and
16 an "A2" rating from Moody's. An "A" or "A2" rating means that GPC's credit is strong,
17 high credit quality, and upper medium credit quality, respectively.

18 **Q DOES A UTILITY'S BOND RATING AFFECT THE COST OF DEBT?**

19 A Yes. **Exhibit JP-2** is a history of the 12-month rolling average spreads between "A"
20 and "BBB" rated corporate bonds of varying maturities. As can be seen, the spreads

1 have ranged from 31 to 96 basis points (0.31% to 0.96%), with an average of about
2 53 basis points.

3 **Q WERE GEORGIA POWER DOWNGRADED FROM “A” TO “A-“, WOULD IT**
4 **EXPERIENCE AN INCREASE IN ITS DEBT COSTS?**

5 A A one “notch” downgrade could increase GPC’s cost of debt. However, the data is
6 not granular enough to measure the precise impact.

7 **Q IS THERE ANYTHING WRONG WITH AN A- BOND RATING?**

8 A No. According to Standard & Poor’s:

9 An obligation rated ‘A’ is somewhat more susceptible to the adverse
10 effects of changes in circumstances and economic conditions than
11 obligations in higher rated categories. However, the obligor’s capacity
12 to meet its financial commitment on the obligation is still strong.

13 **Q WHAT WOULD HAPPEN IF GPC WERE TO BE DOWNGRADED TO BBB?**

14 A Most of the investor-owned electric utilities in the nation are BBB-rated. This is still
15 considered investment grade. As described by Standard & Poor’s:

16 An obligation rated ‘BBB’ exhibits adequate protection parameters.
17 However, adverse economic conditions or changing circumstances
18 are more likely to lead to a weakened capacity of the obligor to meet
19 its financial commitment on the obligation.

20 Under most circumstances, even BBB-rated utilities can still attract capital on
21 reasonable terms.

1 **Q BY HOW MUCH WOULD GEORGIA POWER'S REVENUE REQUIREMENTS**
2 **INCREASE IF IT WERE A BBB-RATED UTILITY?**

3 A Assuming a 53 basis point increase in the cost of new debt financing, GPC's cost of
4 capital would increase by about 15 basis points. This would raise GPC's base
5 revenue requirements by approximately \$35 million per year.

6 **Q WOULD ALLOWING A CASH RETURN ON CWIP BE ADVANTAGEOUS UNDER**
7 **CERTAIN CIRCUMSTANCES?**

8 A Yes. CWIP recovery would be more advantageous than traditional ratemaking if it
9 would prevent a utility from suffering a material adverse change in its financial
10 integrity. This is because it will increase cash earnings, which would also increase
11 both coverage and cash flow ratios. Thus, CWIP recovery could help the utility
12 mitigate a potentially adverse change in its bond rating, thereby preventing higher
13 long term borrowing costs.

14 **100% Cash Return on CWIP versus Traditional Ratemaking**

15 **Q DOES IT NECESSARILY FOLLOW THAT RATEPAYERS WOULD BE BETTER**
16 **SERVED IF GPC IS ALLOWED 100% CASH RETURN ON CWIP?**

17 A The \$1.9 billion lower in-service cost must be balanced with the higher rates that
18 GPC would implement under the NCCR rider prior to completion of the Expansion.
19 These higher rates were previously quantified in **Exhibit JP-1**. When examined from
20 this perspective, it is unlikely that ratepayers would be better off with 100% CWIP
21 than under traditional ratemaking, unless some CWIP recovery would be necessary
22 to avoid higher borrowing costs.

**2. Cash Recovery of Nuclear
Construction Costs**

1 **Q WOULD ALLOWING A CASH RETURN ON 100% OF THE EXPANSION CWIP**
2 **HAVE A LOWER IMPACT ON RATEPAYERS THAN TRADITIONAL**
3 **RATEMAKING?**

4 A No. To measure the impact, I have calculated the net present value (NPV) revenue
5 requirements of the Plant Vogtle Expansion under (1) traditional ratemaking and (2)
6 GPC's 100% cash return on CWIP for the period January 2011 through December
7 2077. This period encompasses the proposed time frame that the Expansion costs
8 would be recovered in rates under GPC's cost recovery proposal. The results are
9 shown in **Exhibit JP-3**. As can be seen, regardless of the discount rate used to
10 calculate NPV, the NCCR rider would be more expensive for ratepayers.

11 **Q WHAT IS THE SIGNIFICANCE OF USING TWO DISCOUNT RATES IN EXHIBIT**
12 **JP-3?**

13 A The discount rate used in a NPV analysis reflects the opportunity cost of capital or
14 the cost to finance an alternative investment. From GPC's perspective, the
15 opportunity cost of capital would be the Company's after tax cost of capital or 8.01%.
16 Using GPC's opportunity cost of capital, the NPV revenue requirement would be \$5.0
17 billion under traditional ratemaking, and \$5.2 billion under the NCCR rider.

1 **Q DO RATEPAYERS HAVE THE SAME OPPORTUNITY COST OF CAPITAL AS**
2 **GEORGIA POWER?**

3 A No. Most consumers have a higher opportunity cost of capital than GPC. For
4 example, a residential customer may have the choice of either paying higher
5 electricity rates to GPC or paying down a credit card balance that carries an 18%
6 interest rate or higher. Similarly, businesses will also have higher opportunity cost of
7 capital, because, in most instances, they are not as highly leveraged as GPC.

8 **Q WOULD ALLOWING CASH EARNINGS ON 100% CWIP BE PREFERABLE FROM**
9 **THE RATEPAYERS' PERSPECTIVE?**

10 A No. I have calculated the NPV revenue requirement assuming a 14% discount rate,
11 which conservatively reflects a consumer's opportunity cost of capital. As can be
12 seen, the NPV revenue requirement under traditional ratemaking would be about
13 \$740 million below the corresponding NPV revenue requirement under the NCCR
14 rider. Thus, ratepayers would be worse off with CWIP than under traditional
15 ratemaking, all other things being equal.

1

3. ANALYSIS AND RECOMMENDATION

2 **Q WHY ALLOW ANY CASH EARNINGS ON CWIP IF IT WOULD RESULT IN**
3 **HIGHER RATES TO CONSUMERS?**

4 A A prolonged deterioration of GPC's financial ratios without a reasonable prospect of
5 improvement could trigger a downgrading of the utility's bonds. This would result in
6 higher interest costs, which would in turn result in higher rates. Therefore, as a
7 matter of policy, the Commission should allow recovery of enough CWIP to prevent
8 GPC's bonds from being downgraded because that would result in higher costs for
9 all consumers.

10 **Q HAVE YOU REVIEWED GPC'S PROJECTED FINANCIAL RATIOS?**

11 A Yes. I have reviewed the financial ratios presented in Exhibit APD RBM-1 for the
12 period 2010 through 2017.

13 **Q DO THESE PROJECTIONS PROVIDE CONVINCING AND COMPELLING**
14 **EVIDENCE THAT GPC'S BONDS WILL BE DOWNGRADED?**

15 A No. Moody's bond ratings parameters and GPC's projections are as follows:

Criteria/Bond Rating Low Business Risk ²	A	GPC Traditional Ratemaking 2011-2016	Baa
FFO Interest Coverage	3.0-5.7	[REDACTED]	2.0-4.0
FFO/Debt (%)	12-22	[REDACTED]	5-13
Debt/Capital (%)	50-75	[REDACTED]	60-75

1 Even under traditional ratemaking, GPC's projected would still be consistent with an
 2 "A" bond rating, assuming low business risk; that is, a company with wholly regulated
 3 activities in a supportive framework.³ However, although the ratios are projected to
 4 decline during the peak construction years, there would be marked improvement as
 5 the Expansion costs are put into the rate base.

6 Thus, it is far from certain that GPC would suffer a ratings decline even if no
 7 cash earnings on CWIP is allowed.

8 **Q ARE THERE OTHER VARIABLES BESIDES INTEREST COVERAGE AND CASH**
 9 **FLOW RATIOS THAT DETERMINE A UTILITY'S BOND RATING?**

10 **A** Yes. For example, Standard & Poor's states:

11 The rating matrix is not meant to be precise. There can always be
 12 small positives and negatives that would lead to a notch higher or
 13 lower than the typical outcome.
 14

² Moody's Investor Service, *Rating Methodology: Global Regulated Electric Utilities*, March 2005 at 8.

³ *Id.* at 7

1 Moreover, there will always be exceptions—cases that do not fit
2 neatly into this analytical framework.⁴

3 Similarly, Moody's states that:

4 Moody's uses financial ratio analysis as part of our quantitative
5 analysis of all corporates, including electric utilities. Ratio analysis is
6 a helpful way of comparing one company's performance to that of
7 another and the performance in one year to that in another.

8 However, the importance of ratio analysis can be overstated. No two
9 companies look exactly alike from a qualitative assessment standpoint
10 and each company we rate is constantly changing. It is impossible to
11 assign an accurate credit rating on the basis of financial ratio analysis
12 alone, even less so on the basis of any one ratio. Therefore, Moody's
13 does not have any specific "hurdle rate" to explain which ratio will
14 make the difference between any two rating categories.⁵

15 As Mr. Fetter explains, regulatory policies have a major impact on a utility's credit
16 rating.⁶ In other words, if this Commission is supportive of providing the Company
17 adequate rate relief to provide the necessary interest coverage and stable cash
18 flows, this could be more than sufficient to prevent GPC from being downgraded.

19 **Q HOW IS THE GEORGIA PUBLIC SERVICE COMMISSION VIEWED BY**
20 **FINANCIAL AND REGULATORY ANALYSTS?**

21 **A**Moody's assesses the supportiveness of regulatory commissions based on a
22 comparative assessment of the predictability and stability of regulated cash flows for
23 a company operating under a particular regulatory framework—or the

⁴ Standard & Poor's, *Corporate Ratings Criteria 2008* at 21.

⁵ Moody's Investor Service, *Ratings Methodology Global Regulated Electric Utilities*, March 2005 at 7.

⁶ *Direct Testimony of Steven M. Fetter* at 7.

1 Supportiveness of Regulatory Environment (SRE). The Georgia PSC is ranked in
2 the SRE-2 category, meaning that the “Regulatory framework is fully developed, is
3 predictable and stable and there is a high expectation of timely recovery of costs and
4 investments.”⁷ Standard & Poor’s regards the GPSC as providing a “generally
5 constructive regulatory environment.”⁸

6 **Q DOES THE COMMISSION HAVE TO DECIDE NOW WHETHER TO GIVE THE**
7 **COMPANY 100% CWIP RECOVERY?**

8 A No. As previously stated GPC will not receive a COL or commence construction for
9 two to three years. The Company will not begin incurring the bulk of the costs to
10 build the Expansion until after 2011. Further, GPC will be filing its next rate case in
11 July 2010. Thus, there is more than ample time for the Commission to reassess the
12 Company’s projections to determine if the need for some cash return on CWIP is
13 both reasonable and necessary.

14 **Q WHY WAIT UNTIL THE 2010 RATE CASE TO DECIDE THE CWIP ISSUE?**

15 A A rate case is the proper forum to “scrub” the Company’s projections. The 2010 rate
16 case would provide a better opportunity to assess the Company’s financial integrity
17 in the years 2012-2015, when GPC is projecting the most decline in its projected
18 ratios. The projections will have been updated to reflect the best available
19 information and assumptions. Further, the analysis can be refined to consider
20 varying levels of CWIP cash returns, ranging from 0% to 100% as compared to

⁷ Moody’s, *Ratings Methodology*, March 2005 at 4-5.

⁸ GPC’s Reply to STF-TN-4-1, Attachment STF-TN-4-1 Supplemental.

1 GPC's "all-or-nothing" approach. Based on this more updated and thorough
2 assessment, the Commission can then, if appropriate, allow the Company to
3 implement a rider to recover the appropriate cash return as necessary to forestall or
4 to mitigate the expected higher interest costs from a likely ratings downgrade.

5 **Q WHAT IF THE COMPANY'S BOND RATINGS WERE TO COME UNDER**
6 **SCRUTINY SUBSEQUENT TO THE 2010 RATE CASE?**

7 A Once a rider is in place, a ratings review could trigger a filing by the Company to
8 reassess the projections and determine whether an additional amount of cash return
9 on CWIP is warranted under the circumstances. In no event should the amount of
10 CWIP subject to a cash return be more than is necessary to prevent the Company
11 from incurring higher borrowing costs.

12 **Q SHOULD THE COMMISSION IMPOSE ANY OTHER CONDITIONS IN RETURN**
13 **FOR ALLOWING THE RECOVERY OF CASH EARNINGS ON CWIP?**

14 A Yes. I believe that two conditions should be imposed on GPC in exchange for
15 allowing cash earnings for CWIP.

16 The first condition should be to require GPC to reverse the impact of allowing
17 cash earnings on CWIP after Units 3 and 4 begin commercial operation. That is, the
18 Company should re-pay ratepayers for providing up-front cost recovery by returning
19 the revenues collected under the NCCR rider over a relatively short time period.

20 For example, if the NCCR rider recovers \$1.2 billion, the same \$1.2 billion
21 should be returned to customers immediately after Unit 4 commences service.
22 During the refund period, the Company would be allowed to accrue additional

3. Analysis and Recommendation

1 AFUDC such that at the end of the refund period, Plant Vogtle would have a total
2 cost including AFUDC of \$6.446 billion, the same as under traditional rate making.

3 **Q WHY SHOULD GPC BE REQUIRED TO REPAY RATEPAYERS?**

4 A First, repaying ratepayers for providing “front-end” financing would partially restore
5 intergenerational equity; that is, the cost of the plant would be recovered from the
6 same ratepayers that receive the electricity that it provides. Second, it would
7 temporarily offset the significant rate increase that would normally result from adding
8 a major investment to rate base. Although perfect matching can never be achieved,
9 promptly returning the revenues recovered under the rider would likely provide
10 refunds to the same customers who paid the higher charges.

11 **Q WHAT IS THE SECOND CONDITION THAT SHOULD BE IMPOSED IF GPC IS**
12 **ALLOWED A CASH RETURN ON CWIP?**

13 A The Company should be required to periodically demonstrate that the Expansion is
14 clearly more cost effective than alternative base load options. This will ensure that
15 the Expansion continues to be the best, lowest reasonable cost alternative for
16 ratepayers, even under changing circumstances.

17 **Q DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

18 A Yes.

Appendix A
Qualifications of Jeffry Pollock

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

2 A Jeffry Pollock. My address is 12655 Olive Blvd, Suite 335; St. Louis, Missouri; 63141.

3 **Q WHAT IS YOUR OCCUPATION AND BY WHOM ARE YOU EMPLOYED?**

4 A I am an energy advisor and President of J.Pollock Incorporated.

5 **Q PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

6 A I have a Bachelor of Science Degree in Electrical Engineering and a Masters in
7 Business Administration both from Washington University. At various times prior to
8 graduation, I worked for the McDonnell Douglas Corporation in the Corporate
9 Planning Department; Sachs Electric Company; and L. K. Comstock & Company.
10 While at McDonnell Douglas, I analyzed the direct operating cost of commercial
11 aircraft.

12 Upon graduation, in June 1975, I joined Drazen-Brubaker & Associates, Inc.
13 (DBA). DBA was incorporated in 1972 assuming the utility rate and economic
14 consulting activities of Drazen Associates, Inc., active since 1937. From April 1995 to
15 November 2004, I was a managing principal at Brubaker & Associates (BAI).

16 During my tenure at both DBA and BAI, I have been engaged in a wide range
17 of consulting assignments including energy and regulatory matters in both the United
18 States and several Canadian provinces. This includes preparing financial and
19 economic studies of investor-owned, cooperative and municipal utilities on revenue

1 requirements, cost of service and rate design, and conducting site evaluation.
2 Recent engagements have included advising clients on electric restructuring issues,
3 assisting clients to procure and manage electricity in both competitive and regulated
4 markets, developing and issuing request for proposals (RFPs), evaluating RFP
5 responses and contract negotiation. I was also responsible for developing and
6 presenting seminars on electricity issues.

7 I have worked on various projects in over 20 states and in several Canadian
8 provinces, and have testified before the regulatory commissions of Alabama, Arizona,
9 Colorado, Delaware, Florida, Georgia, Illinois, Iowa, Louisiana, Minnesota,
10 Mississippi, Missouri, Montana, New Jersey, New Mexico, Ohio, Pennsylvania,
11 Texas, Virginia and Washington. I have also appeared before the City of Austin
12 Electric Utility Commission, the Board of Public Utilities of Kansas City, Kansas, the
13 Bonneville Power Administration, Travis County (Texas) District Court, and the U.S.
14 Federal District Court.

15 **Q PLEASE DESCRIBE J.POLLOCK INCORPORATED**

16 **A** J.Pollock assists clients to procure and manage energy in both regulated and
17 competitive markets. The J.Pollock team also advises clients on energy and
18 regulatory issues. Our clients include commercial, industrial, and institutional energy
19 consumers. Currently, J.Pollock has offices in St. Louis, Missouri, Houston and
20 Austin, Texas.