

BEFORE THE
GEORGIA PUBLIC SERVICE COMMISSION

In the Matter of:
Georgia Power Company's)
Third Semi-Annual Vogtle Units 3 & 4) **Docket No. 29849**
Construction Monitoring Report)
August 2010

PUBLIC DISCLOSURE

DIRECT TESTIMONY
OF
TOM J. NEWSOME, PE, CFA

ON BEHALF OF THE
GEORGIA PUBLIC SERVICE COMMISSION
PUBLIC INTEREST ADVOCACY STAFF

December 10, 2010

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**Attachment:
Appendix TJN-1, Qualifications and Experience**

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Before the
Georgia Public Service Commission
Docket No. 29849

DIRECT TESTIMONY OF
TOM J. NEWSOME, PE, CFA

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Tom J. Newsome. I am the Director of Utility Finance with the Georgia Public Service Commission ("Commission"). My business address is 244 Washington St., Atlanta, Georgia 30334.

Q. HAVE YOU PREPARED AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix TJN-1, which summarizes my experience and qualifications.

Q. MR. NEWSOME, HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE GEORGIA PUBLIC SERVICE COMMISSION?

A. Yes. I have testified in five Georgia Power Company ("Company" or "Georgia Power") proceedings before the Commission. In Docket 22403, I addressed Georgia Power Company's natural gas hedging program and in Docket 24506 I testified on the application of AFUDC accounting for calculating financing cost of capital projects. In Docket 27800, Certification of Plant Vogtle Expansion, I addressed the sources, impact and mitigation of financial risk from the construction and operation of new nuclear units

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1 at Plant Vogtle. I testified in Docket 29849 concerning Georgia Power's first semi annual
2 construction monitoring report on Plant Vogtle expansion. I evaluated the economic
3 analysis performed by Georgia Power and developed Staff's own independent economic
4 and risk analysis of the Project. In the second Vogtle semi annual hearing, I testified on
5 the Company's proposal to change how escalation on certain project cost was calculated
6 (Amendment 3). In Docket 28945 Fuel Cost Recovery – 21, I testified on seasonal rates. I
7 also presented cost of equity testimony in Atmos Energy's Rate Case in Docket 30442.

8
9 **Q. ON WHOSE BEHALF ARE YOU APPEARING?**

10 A. I am appearing on behalf of the Georgia Public Service Commission Public Interest
11 Advocacy Staff ("Staff").
12

13 **Q. WHAT ISSUE WILL YOU BE ADDRESSING IN YOUR TESTIMONY?**

14 A. My testimony presents a revised risk sharing mechanism that was first addressed in the
15 Vogtle 3 & 4 (the "Units") certification proceeding in Docket No. 27800. The purpose of
16 Staff's risk sharing mechanism is to align ratepayer and shareholder interests equitably.
17 The risk sharing mechanism accomplishes this by allocating the rewards and risk of
18 Vogtle 3 & 4 between ratepayers and shareholders in a fair and equitable manner.
19

20 **Q. PLEASE EXPLAIN HOW A RISK SHARING MECHANISM IS CONSISTENT**
21 **WITH TRADITIONAL UTILITY REGULATION.**

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1 A. Regulation acts as surrogate for the competition a utility would face in a competitive
2 market. Regulation should provide *an opportunity not a guarantee* for the utility to earn a
3 profit or return. The level of profit or return available to the utility should be
4 commensurate with the risk borne by the utility. If a utility is subject to a small amount of
5 risk then it should be allowed the *opportunity* to earn a relatively smaller profit or return.
6 The converse holds that if the utility is subject to a large amount of risk then it should be
7 allowed the *opportunity* to earn a relatively larger profit or return.

8
9 **Q. WHAT IS THE BASIS FOR STAFF'S RISK SHARING MECHANISM?**

10 A. Regulation is a surrogate for competition. Therefore, the profit and returns the Company
11 earns on Vogtle 3 & 4 should be similar to what it would earn in a competitive market. In
12 a competitive market if a project is completed under budget, then the owner(s) would
13 earn higher profits and returns. The converse holds that if a project is completed over
14 budget the owner(s) would earn lower profits and returns. Staff's risk sharing mechanism
15 is designed such that the Company would be allowed to earn profits and returns
16 commensurate with the final total project cost. The risk sharing mechanism would result
17 in closer alignment of ratepayer and shareholder interests.

18
19 **Q. PLEASE EXPLAIN HOW A COMPETITIVE MARKET NATURALLY ALIGNS**
20 **CUSTOMER (RATEPAYER) AND SHAREHOLDER INTEREST.**

21 A. In a competitive market a company's sales and profit are directly tied to the benefit that
22 customers receive from the product or service provided by a company. The greater the

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benefit of the product or service the larger the company's revenues and profits. Of course, the converse holds if customers receive little benefit, the company's revenues and profit would be smaller. In a competitive market customer benefit and company profit are correctly aligned.

CURRENT ALIGNMENT OF RATEPAYER AND SHAREHOLDER INTERESTS

Q. PLEASE DEFINE RATEPAYER INTEREST AND SHAREHOLDER INTEREST.

A. Ratepayer interest is the economic benefit of the Units. Shareholder interest is the profit earned on the Units.

Q. ARE RATEPAYER INTEREST AND SHAREHOLDER INTEREST ON VOGTLE 3 & 4 PROPERLY ALIGNED?

A. No. Ratepayer benefit is directly tied to the cost and output (kWh) of the Units. There is a complete misalignment of ratepayer and shareholder interests regarding capital cost and financing costs. For operating cost and output there is no alignment of ratepayer and shareholder interests.¹

Q. PLEASE EXPLAIN HOW RATEPAYER AND SHAREHOLDER INTERESTS ARE COMPLETELY MISALIGNED ON CAPITAL COST AND FINANCING COST OF VOGTLE 3 & 4.

¹ Complete misalignment identifies the opposing interest of ratepayer and shareholder. That is when one party benefits the other party suffers a loss. Complete misalignment is more severe than no alignment of ratepayer and shareholder interests.

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1 A. Capital cost includes the initial in-service capital cost and capital additions throughout the
2 service life of the Units. As the capital cost of the Units increases (decreases) the
3 ratepayer economic benefit decreases (increases) but Company profit increases
4 (decreases). Company profit is based on the amount of net assets (rate base) used to
5 provide service so increases in net assets increase the Company's profit. Ratepayer and
6 shareholder interests should be aligned so a decrease (increase) in capital cost which
7 increases (decreases) ratepayer benefit would result in an increase (decrease) in
8 shareholder profit.

9
10 Regarding financing cost, the longer the Company takes to complete the Units the greater
11 the financing cost of which profit is a significant component. An increase in financing
12 cost results in more profit for the Company but decreases ratepayer benefit from the
13 Units. This is another example of complete misalignment of ratepayer and shareholder
14 interests on Vogtle 3 & 4.

15
16 **Q. PLEASE EXPLAIN HOW THERE IS NO ALIGNMENT BETWEEN**
17 **RATEPAYER AND SHAREHOLDER INTERESTS ON VOGTLE 3 & 4 OUTPUT**
18 **AND OPERATING COST.**

19 A. Ratepayer benefit is closely tied to the output of the Units. After capital cost, output is the
20 most important variable that impacts ratepayer benefit. Ratepayer benefit increases with
21 higher output and decreases with lower output. The Company's profit is completely
22 isolated from the Units' production.

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Operating cost, including fuel cost, is treated as a pass-through and has no bearing on Company's profit. However, operating cost does impact ratepayer benefit. Therefore, there is no alignment of ratepayer and shareholder interest regarding operating cost.²

Ratepayer benefit is also tied to how efficiently the Units consume fuel. The more output per unit of fuel consumed the greater ratepayer benefit. Currently, there is no linkage between how efficiently the Units consume fuel and the profit earned by shareholders.

Q. HOW DOES THE EPC AGREEMENT BETWEEN THE COMPANY AND CONSORTIUM IMPACT THE ALIGNMENT OF RATEPAYER AND SHAREHOLDER INTERESTS?

A. Staff recognizes the benefits of the EPC Agreement which contains provisions that should mitigate but not eliminate cost overruns if they occurred. However, the purpose of the EPC Agreement is not to align ratepayer and shareholder interest but to assign responsibilities and consequences of the project between the Consortium and the Company. All risk and cost overruns borne by the Company under the EPC Agreement are transferred to ratepayers. There are other sources of cost overruns that are not addressed by the EPC Agreement. Therefore, the EPC Agreement while helpful does not directly and comprehensively align ratepayer and shareholder interest.

² While operating costs are a relatively small portion of the Units total revenue requirement in the early years of the Units' service lives these costs are projected to grow over time and become significant in the later years of the Units' service lives.

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1 **Q. GIVEN THAT RATEPAYER AND SHAREHOLDER INTERESTS ARE EITHER**
2 **COMPLETELY MISALIGNED OR NOT ALIGNED, WHAT IS THE IMPACT**
3 **ON THE DISTRIBUTION OF REWARD AND RISK BETWEEN RATEPAYER**
4 **AND SHAREHOLDER?**

5 A. The Company is exposed to very little uncertainty while earning significant profits. In
6 contrast, the ratepayer bears significant risk and benefit is uncertain. The significant risk
7 borne by the ratepayer is the result of the uncertainty of the Units' cost and output. A risk
8 sharing mechanism is necessary to allocate the risk and reward of Vogtle 3 & 4
9 appropriately between the ratepayer and shareholder.

10
11 **EXAMPLES OF RISK SHARING MECHANISMS**
12

13 **Q. IS THIS COMMISSION FAMILIAR WITH RISK SHARING MECHANISMS?**

14 A. Yes. Two years prior to the Vogtle 3 & 4 certification proceeding, in Docket 24505 (the
15 Company's 2007 Integrated Resource Plan), the Commission addressed a risk sharing
16 mechanism with Company witness Jeff Burleson. The excerpt from the transcript below:
17

18 COMMISSIONER EVERETT: Let me ask you one thing, are
19 you familiar with the plan that they just approved in
20 Minnesota on costs of generation plant there?

21 WITNESS BURLESON: No, I'm not.

22 COMMISSIONER EVERETT: It's a sliding scale, I think
23 there's about five ranges. The more you come close to

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1 the estimated cost of the generation, the better your
2 ROE is. If you are below cost estimated, your ROE is
3 higher. If you are above that cost, your ROE is -- is
4 lowered. And so it gives the incentive for the power
5 company to make sure whatever estimated cost that they
6 come up with that they stay within that budget.
7 Because if they go way up over it, the ROE return is
8 lowered considerably. But if they come down below the
9 estimated cost, the company makes more money. And
10 you're not familiar with that?

11 WITNESS BURLESON: No, I -- I was not --

12 COMMISSIONER EVERETT: Will you speak to the people at
13 Southern Company and Georgia Power and see if they are
14 and are they studying that possibility that we might
15 could work out something like that so any estimated
16 cost you give us on any plant, the nuclear plant, et
17 cetera, that your ROE will be based on your
18 performance on the construction?

19 WITNESS BURLESON: We will certainly have discussions
20 of that, yes.

21 COMMISSIONER EVERETT: Thank you.
22

23 (Docket 24505, Transcript pages 372 - 373)
24

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**Q. DOES GEORGIA POWER UTILIZE VARIOUS FORMS OF RISK SHARING
MECHANISMS IN CONDUCTING ITS BUSINESS?**

A. Yes. The Company uses different forms of risk sharing mechanisms throughout its business. For example, Purchase Power Agreements ("PPA") with third parties to supply power contain extensive provisions that allocate risk between the Company and the provider of power. The provisions in the PPAs are much more comprehensive than the risk sharing mechanism being proposed by Staff.

**Q. DID THE COMPANY UNILATERALLY PROPOSE A RISK SHARING
MECHANISM DURING THE CONSTRUCTION OF VOGTLE UNITS 1 & 2
THAT WAS ACCEPTED BY THIS COMMISSION?**

A. Yes. During the end of the construction of Vogtle Units 1 & 2 the Company came before the Commission and proposed to cap the cost of the units at \$8.5 billion. The final cost of the units was \$8.9 billion and Georgia Power did not attempt to recover the \$400 million difference from the ratepayer. The Commission subsequently disallowed \$900 million of the remaining \$8.5 billion cost.

**Q. DID THE COMPANY USE A RISK SHARING MECHANISM IN ITS
CONTRACT WITH THE GENERAL CONTRACTOR IN THE CONSTRUCTION
OF THE FIRST TWO NEW COMBINED CYCLE UNITS AT PLANT
MCDONOUGH?**

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1 A. Yes. Cost overruns and under runs were split between the general contractor and the
2 Company. However, once the overruns or under runs exceeded set thresholds the general
3 contractor became responsible for the entire amount beyond the threshold.³ Project cost
4 exceeded upper threshold and general contractor took responsibility for the amount above
5 the upper threshold.⁴
6

7 **Q. HAS AN OPERATING COMPANY WITHIN SOUTHERN COMPANY**
8 **ACCEPTED A RISK SHARING MECHANISM ON A LARGE, COMPLEX**
9 **FIRST-OF-A-KIND PROJECT?**

10 A. Yes. Mississippi Power Company accepted a hard cap of \$2.9 billion on the capital in-
11 service cost and limits on operating cost of the Integrated Gasification Combined Cycle
12 unit being constructed in Mississippi.⁵
13

14 **Q. HAVE RISK SHARING MECHANISMS BEEN USED ON OTHER NUCLEAR**
15 **PROJECTS?**

16 A. Yes. The Olkiluoto nuclear unit currently being constructed in Finland had provisions in
17 the contract such that the builder, Areva, was responsible for cost overruns and not the
18 utility and its ratepayers.
19

³ Docket 24506. Page 3416 Lines 8 – 17, Pages 3529 Line 12 – Page 3530 Line 7, Page 3531 Line 8 – 22.

⁴ www.investor.fluor.com

⁵ Mississippi Public Service Commission. Docket 2009-UA-14. Order May 26, 2010. Final Certification Order June 3, 2010

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1 *"Further straining Areva's finances, the construction of a plant in Finland has suffered*
2 *delays and cost overruns that doubled the initial 3.0 billion Euro project price – and the*
3 *contract forbids Areva to pass those expenses on to the customer."*⁶

4
5 The retrofit of two mothballed nuclear reactors in Ontario, Canada has gone significantly
6 over budget by \$2.0 billion over the initial estimate of \$2.8 billion. The Ontario Minister
7 of Energy has stated that taxpayers and electricity customers will not be on the hook for
8 overruns and that "Bruce (reactor owner) will have to ultimately eat whatever losses may
9 occur as result of these overruns."⁷

10
11 **Q. GIVEN THE MANY EXAMPLES OF RISK SHARING MECHANISMS**
12 **IDENTIFIED ABOVE WHAT IS YOUR CONCLUSION ABOUT THE**
13 **APPLICABILITY OF A RISK SHARING MECHANISM TO VOGTLE 3 & 4?**

14 **A. Risk sharing mechanisms are a necessary and ubiquitous component of business**
15 **agreements. Risk sharing mechanisms have been used extensively by Georgia Power and**
16 **Southern Company operating companies. Risk sharing mechanisms are used by other**
17 **entities throughout the world on nuclear projects. A risk sharing mechanism is**
18 **appropriate and necessary to protect ratepayer interest in Vogtle 3 & 4 and align**
19 **ratepayer and Company shareholder interests.**

20
21 **SYNOPSIS OF STAFF'S RISK SHARING MECHANISM**

⁶ Wall Street Journal. "France Aims to Move Back Atop the Nuclear Pile". November 29, 2010. Page R9.

⁷ Nuclear Power International. "Market Focus: Canada and Latin America". December 2010. Page 11 – 12.

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Q. PLEASE PROVIDE AN OVERVIEW OF STAFF'S RISK SHARING MECHANISM.

A. Under the Staff's proposed risk sharing mechanism, the common equity return the Company would be allowed the opportunity to earn on the Vogtle 3 & 4 rate base would be directly tied to the total project cost. This would be accomplished by adjusting the most recently awarded return on common equity ("ROE") by the Commission and applying this adjusted ROE to the Vogtle 3 & 4 rate base. If the Units are completed within \$300 million of the Company's estimate of \$6.1 billion at certification then there would be no adjustment to the ROE applied to the Units. A dead band of \$5.8 billion to \$6.4 billion would be established so if total project cost fell within this range there would be no adjustment to the ROE. If total project cost is below \$5.8 billion then the ROE applied to Vogtle 3 & 4 rate base would be increased. The converse holds that if total project cost is above \$6.4 billion then the ROE applied to Vogtle 3 & 4 rate base is decreased.

The risk sharing mechanism would to a limited extent subject the Company's profit and return on Vogtle 3 & 4 to what would be available in a competitive market environment and help align ratepayer and shareholder interest.

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**Q. HAS STAFF PREPARED A SCHEDULE THAT IDENTIFIES THE
ADJUSTMENT TO THE ROE APPLIED TO VOGTLE 3 & 4 RATE BASE FOR
CORRESPONDING FINAL TOTAL PROJECT COST?**

A. Yes. Table 1 below identifies the adjustments to the current awarded ROE to be applied to Vogtle 3 & 4 rate base *after the Units are placed in service*. The Company would earn the current ROE assigned by the Commission on the project's balance (Construction Work In Progress) during the entire construction period.

TABLE 1

Total Project Cost (\$ millions)	Risk Sharing Mechanism ROE Adjustment (Basis Points)
5,500	155
5,800	0
6,100	0
6,400	0
6,700	-128
7,000	-185
8,000	-350
9,000	-483

**Q. PLEASE PROVIDE SOME EXAMPLES OF HOW THE ADJUSTED ROE
APPLIED TO VOGTLE 3 & 4 RATE BASE WOULD BE CALCULATED.**

A. All of the examples *assume* the most recent ROE awarded by the Commission is 11.15 percent. In the case where the total project cost is \$5,500 million then the ROE applied to

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Vogtle 3 & 4 rate base would be 12.70 percent (11.15% + 1.55%). If the project were completed within the dead band of \$5,800 million to \$6,400 million there would be no adjustment and the ROE applied to Vogtle 3 & 4 rate base would be 11.15 percent. In the case where the total project cost is \$7,000 million then the ROE applied to Vogtle 3 & 4 rate base would be 9.30 percent (11.15% - 1.85%). For total project cost values not shown on Table 1 the corresponding adjustment to Vogtle 3 & 4 ROE would be interpolated. For example, if total project cost was \$8,500 million then the ROE adjustment would be negative 416 basis points and the ROE applied to Vogtle 3 & 4 rate base would be 6.99 percent (11.15% - 4.16%).

Q. PLEASE EXPLAIN HOW THE RISK SHARING MECHANISM BETTER ALIGNS RATEPAYER AND SHAREHOLDER INTEREST.

A. If the Units are completed at a cost below the certified amount, the ratepayers would receive more benefit. In this case, under the Staff's proposed risk sharing mechanism the Company would be allowed to earn a higher profit and return as it would in a competitive market. As the ratepayer receives more benefit, the Company receives a higher return and profit which results in closer alignment of ratepayer and shareholder interests. The converse holds under the Staff's proposed risk sharing mechanism that if the Units are completed at a cost above the certified amount, the ratepayer would receive less benefit and the Company would be allowed to earn a lower return and profit.

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**Q. WHAT IMPACT WOULD THE RISK SHARING MECHANISM HAVE ON
RATEPAYER BENEFIT FROM VOGTLE 3 & 4?**

A. Under Staff's risk sharing mechanism, if the project were to exceed the original \$6.1 billion estimate at certification, the ratepayer benefit is less than it would be if the Units were complete on budget due to increase in revenue requirement. The risk sharing mechanism would only mitigate the impact of cost overruns and the complete misalignment between ratepayer and shareholder interest. Under the risk sharing mechanism ratepayer benefit would still be reduced if the project suffered cost overruns.

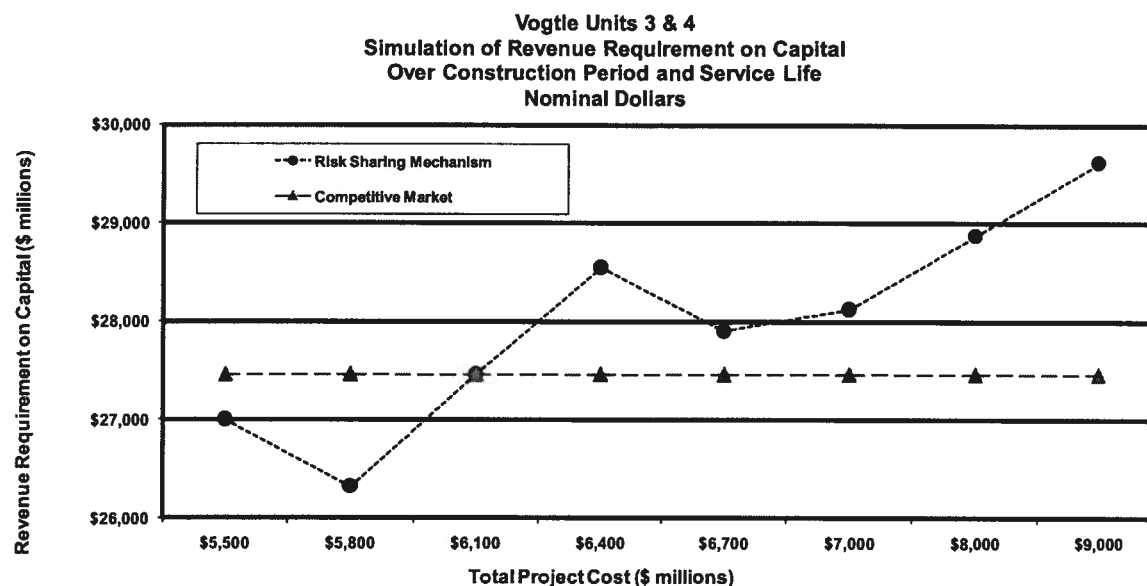
Graph 1 below is a simulation of the cumulative revenue requirement on capital over the service life of the Units under two cases: Staff's risk sharing mechanism and simulated competitive market.⁸ Revenue requirement on capital consist of depreciation, interest expense, income taxes and net income (profit). Capital revenue requirement does not represent the total revenue requirement which includes operating costs.

⁸ The capital revenue requirement values were derived based on publicly available information and certain simplifying assumptions. The simulation values do not represent the actual capital revenue requirement of Vogtle 3 & 4 which would be used for ratemaking but are rough estimate given the assumptions of the simulation.

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Graph 1



Q. PLEASE PROVIDE AN OVERVIEW OF THE VALUES IN GRAPH 1.

A. Under the competitive market simulation capital revenue requirement is fixed at all levels of total project cost and is represented by the straight line. The capital revenue requirement under Staff's risk sharing mechanism represents the values in Table 1. Between total project cost of \$5.8 billion and \$6.4 billion no ROE adjustment is applied and capital revenue requirement is directly tied to total project cost. Below \$5.8 billion and above \$6.4 billion total project cost the ROE is adjusted and revenue requirement is modified relative to current ratemaking.

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1 **Q. PLEASE EXPLAIN HOW GRAPH 1 DEMONSTRATES THAT THE RISK**
2 **SHARING MECHANISM ONLY MITIGATES THE MISALIGNMENT**
3 **BETWEEN RATEPAYER AND SHAREHOLDER INTEREST.**

4 A. As total project cost increases above \$6.1 billion, ratepayer benefit decreases as capital
5 revenue requirement increases. The Company would continue to collect additional
6 revenue for coming in over budget. This is in direct contrast to the competitive market
7 simulation where revenue is fixed. Even under Staff's proposed risk sharing mechanism
8 there would continue to be a misalignment of ratepayer and shareholder interest on
9 capital cost.

10
11 **Q. PLEASE EXPLAIN HOW GRAPH 1 DEMONSTRATES THAT THE**
12 **RATEPAYER IS NOT HARMED IF THE COMPANY WERE TO COMPLETE**
13 **THE UNITS FOR LESS THAN THE \$5.8 BILLION LOWER THRESHOLD AND**
14 **EARN A HIGHER ROE.**

15 A. The capital revenue requirements at all total project values less than \$5.8 billion are less
16 than the capital revenue requirement at \$6.1 billion even when the ROE would be
17 increased. The ratepayer is not harmed by an increase in ROE.

18
19 **Q. WHAT ARE THE FACTORS WHICH IMPACT RATEPAYER BENEFIT BUT**
20 **ARE NOT ADDRESSED BY STAFF'S PROPOSED RISK SHARING**
21 **MECHANISM?**

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1 A. The primary factors are output and operating cost. Output is especially critical to
2 ratepayer benefit. If the Units do not produce planned output, ratepayer benefit is reduced
3 as the ratepayer would have a significant capital revenue requirement on the Units and
4 would be paying for replacement power. The ratepayers bear all the risk on these factors
5 and Company profit is not impacted by the performance of these factors.
6

7 **Q. COULD THE UNITS HAVE "NEGATIVE BENEFIT" FOR RATEPAYERS?**

8 A. Yes. As discussed in Mr. Hayet's testimony the Units could be completed for the
9 budgeted amount and result in negative benefit for ratepayers.
10

11 **Q. PLEASE EXPLAIN THE TERM "NEGATIVE BENEFIT".**

12 A. The original analysis performed during certification to determine whether the Units were
13 economically viable compared the cumulative total revenue requirement of Vogtle 3 & 4
14 against the cumulative total revenue requirement of natural gas fired combined cycle
15 units. If the cumulative total revenue requirement of Vogtle 3 & 4 is less than the
16 cumulative total revenue requirement of natural gas fired combined cycle units then the
17 Units provide benefit or are economically viable. If Vogtle 3 & 4 revenue requirement
18 exceeds combined cycle revenue requirement then the Units would result in negative
19 benefit for ratepayers.
20

21 **Q. PLEASE IDENTIFY THE DIFFERENCE BETWEEN THE COMPANY'S MOST**
22 **RECENT ECONOMIC ANALYSIS AND STAFF'S CONCLUSION ABOUT THE**

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POTENTIAL ECONOMIC VIABILITY OR RATEPAYER BENEFIT OF

VOGTLE 3 & 4.

A. The purpose of the Company's economic analysis submitted in this proceeding was to determine whether to continue with the project at this point in time. The Company's economic analysis is a cost to complete analysis which only considers the remaining cost to complete the Units when compared against combined cycle unit(s). The costs already incurred, or sunk costs, on Vogtle 3 & 4 are ignored in the Company's analysis. This is the correct analysis given the regulatory structure the Company operates under in Georgia.

However, this analysis is not applicable for comparing ratepayer benefit of Vogtle 3 & 4 against combined cycle unit(s). The conclusion above about the potential negative benefit of the Units for the ratepayer considers total project cost and not merely cost to complete. Total project cost is the correct cost to consider since the ratepayer will be subject to recovery of total project cost.

Q. THE COMPANY HAS TESTIFIED THAT ONE OF THE SIGNIFICANT BENEFITS OF VOGTLE 3 & 4 IS AN INCREASE IN FUEL DIVERSITY. PLEASE EXPLAIN HOW THE RISK SHARING MECHANISM HELPS THE RATEPAYER REALIZE THIS BENEFIT FROM INCREASED FUEL MIX DIVERSITY.

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1 A. The benefit of lower fuel cost of Vogtle 3 & 4 and less exposure to potential volatile and
2 high cost coal and natural gas could be eliminated if the Units are brought in over budget.
3 The risk sharing mechanism would partially mitigate additional revenue requirement
4 from cost overruns so the fuel diversity benefit is realized by ratepayers.
5

6 **RISK SHARING MECHANISM IMPACT**
7

8 **Q. HOW DOES THE RISK SHARING MECHANISM IMPACT THE RECOVERY**
9 **OF PRUDENT IN-SERVICE CAPITAL COSTS (DIRECT CONSTRUCTION**
10 **COST) OF THE UNITS?**

11 A. Under the Staff's proposed risk sharing mechanism, the Company would be allowed full
12 recovery of prudent in-service capital cost regardless of the final amount. Whether the
13 final in-service capital cost is \$4.4 billion as estimated by the Company at certification or
14 \$6.6 billion or \$8.8 billion the Company would be allowed full recovery of prudently
15 incurred costs. In-service capital cost does not include the financing cost of Vogtle 3 & 4
16 during construction which was estimated at \$1.7 billion at certification.
17

18 **Q. HOW DOES THE RISK SHARING MECHANISM IMPACT THE COMPANY'S**
19 **RECOVERY OF FINANCING COST AS REQUIRED BY GEORGIA LAW (SB**
20 **31)?**

21 A. Under the Staff's proposed risk sharing mechanism, the Company would fully recover all
22 financing cost and corresponding income taxes regardless of the final in-service cost or

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1 the time to complete the Units. The ROE applied to Vogtle 3 & 4 Construction Work In
2 Progress would be the ROE most recently awarded by the Commission.

3
4 **Q. HOW DOES THE RISK SHARING MECHANISM IMPACT THE RECOVERY**
5 **OF VOGTLE 3 & 4 PRUDENT OPERATING COSTS, INCLUDING**
6 **DEPRECIATION, FUEL AND OPERATING AND MAINTENANCE (O&M)**
7 **COSTS?**

8 A. Under the Staff's proposed risk sharing mechanism, the Company would be allowed full
9 recovery of prudent operating costs, including depreciation, fuel and O&M costs. Even if
10 operating costs are significantly higher than the Company projected, these costs would be
11 fully recovered under the Staff's proposed risk sharing mechanism.

12
13 **Q. HOW DOES THE RISK SHARING MECHANISM IMPACT THE COMPANY'S**
14 **BONDHOLDERS?**

15 A. Under the Staff's proposed risk sharing mechanism bondholders would fully recover all
16 capital invested (return of capital) and interest payments (return on capital). Bondholders
17 are made whole regardless of the final in-service cost or output or operating cost of the
18 Units.

19
20 **Q. HOW DOES THE RISK SHARING MECHANISM IMPACT THE COMPANY'S**
21 **PREFERENCE STOCK AND PREFERRED STOCK INVESTORS?**

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1 A. Under the Staff's proposed risk sharing mechanism preference stock and preferred stock
2 investors would fully recover all capital invested (return of capital) and dividend
3 payments (return on capital). Preference stock and preferred stock investors are made
4 whole regardless of the final in-service cost or output or operating cost of the Units.

5
6 **Q. HOW WOULD STAFF'S PROPOSED RISK SHARING MECHANISM IMPACT**
7 **THE COMPANY'S COMMON SHAREHOLDER?**

8 A. The common shareholder would be assured a return of capital under all circumstances
9 and only profit (return on capital) is subject to potential modification. The shareholder
10 would not suffer a loss and would earn a profit. The level of profit would be tied to the
11 final total project cost.

12
13 **Q. WHAT WOULD BE THE IMPACT OF STAFF'S PROPOSED RISK SHARING**
14 **MECHANISM ON GEORGIA POWER'S PROFIT?**

15 A. The impact would generally be minor. For example, assuming the Units suffered an
16 overrun of \$900 million, or 15 percent over the \$6.1 billion estimate at certification, the
17 reduction to the Company's net income relative to current ratemaking would be three
18 percent during the first five years of the Units' operating life. The reduction to the
19 Company's net income would decrease to two percent over the next ten years and would
20 be one percent or less for the remaining operating life of the Units. In this example, the

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decrease to the Company's net income during the last 35 years of the Units' operating life would be less than one percent.⁹

Q. PLEASE EXPLAIN WHY AN UNCERTAIN RETURN ON COMMON EQUITY IS REASONABLE FROM A COMPETITIVE MARKET PERSPECTIVE?

A. A common equity investment is inherently uncertain. There are no contractual financial guarantees associated with common equity. The prospective cash flows to common equity are not known or guaranteed. Common equity may rise or fall in value or become worthless depending on company management performance and/or market conditions. The company that issues common equity is under no obligation to exchange cash for the stock or make dividend payments. More simply put, an investor in common equity takes his or her chances. The volatile returns in the stock market over the past decade are a prime example of the inherent uncertainty of an investment in common equity.

Q. PLEASE EXPLAIN HOW THE RISK SHARING MECHANISM REPRESENTS FAIR AND EQUITABLE TREATMENT OF THE COMPANY'S COMMON SHAREHOLDER.

A. Under Staff's proposed risk sharing mechanism the Company shareholder (Southern Company) will earn substantial profits from Vogtle 3 & 4 regardless of the final total project cost or Unit output or ratepayer benefit. Regardless of how long it takes to build the Units or the amount of any cost overruns or the level of operating cost or the Units'

⁹ Assumed the Company's net income grows 4.0 percent annually. Growth rate developed from data in the Company's 10-K filings.

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output, the Company's shareholder will not suffer a loss. Georgia Power's shareholder is treated fairly and equitably under Staff's risk sharing mechanism.

Q. IN PRIOR PROCEEDINGS, COMPANY WITNESSES HAVE TESTIFIED THAT IF MANAGEMENT MAKES PRUDENT DECISIONS, THEN SHAREHOLDERS SHOULD EARN THEIR EXPECTED RETURN ON AN INVESTMENT. DO YOU AGREE WITH THIS STATEMENT?

A. No. In competitive markets, the management of companies strive every day to make prudent decisions. However, businesses may earn lower returns or even suffer losses due to market forces beyond management control in spite of management making prudent decisions. *In competitive markets the consequences of adverse outcomes are borne by shareholders and not customers or ratepayers even if management actions were prudent.*

Q. IN PRIOR PROCEEDINGS, COMPANY WITNESSES HAVE TESTIFIED THAT THE COMPANY'S SHAREHOLDER SHOULD NOT BEAR THE CONSEQUENCES RESULTING FROM FACTORS BEYOND MANAGEMENT'S CONTROL. DO YOU AGREE WITH THIS POSITION?

A. No. The Company's position is based on a false premise and its conclusion is not consistent with free market capitalism and competitive markets. In any business there are numerous factors which management has various degrees of control over. Many factors are naturally beyond management's control. These factors may play out in a beneficial or detrimental manner for the business. The critical point is who bears the consequences of

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1 these various factors. In competitive markets it is shareholders who bear the
2 consequences and not customers or ratepayers.

3
4 **Q. WHAT FACTORS DID COMPANY MANAGEMENT HAVE CONTROL OVER?**

5 A. The Company management had complete control over the decision to request
6 certification of Vogtle 3 & 4 and the \$6.1 billion cost estimate presented at certification
7 and adopted by the Commission. It was Company management's responsibility to ensure
8 that the cost estimate was realistic and sufficient given the many uncertainties of this
9 large, complex, first-of-a-kind project. It is Company management's responsibility to
10 ensure sufficient contingency is built into the \$6.1 billion estimate to account for the
11 numerous permitting, engineering, procurement and construction uncertainties of the
12 project. The Company's position that it is unfair to hold the Company accountable for
13 certain cost it does not control is not supportable as the Company brought Vogtle 3 & 4
14 before this Commission and the Commission adopted the Company's estimate as the
15 certified total project cost.

16
17 **DERIVATION OF ROE ADJUSTMENT VALUES**

18
19 **Q. HOW WERE THE ROE ADJUSTMENT VALUES IN THE RISK SHARING**
20 **MECHANISM CALCULATED?**

21 A. The ROE adjustment values were derived based on the profit and return the Company
22 would earn on Vogtle 3 & 4 under current ratemaking and a competitive market. The

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ROE adjustment values in Table 1 represent a blend of profit and return available under current ratemaking and a competitive market. Under a competitive market the ROE adjustments would have been larger as described below.

Q. HAS STAFF PREPARED A SIMULATION OF THE COMPANY'S PROFIT AND RETURN ON VOGTLE 3 & 4 IN A COMPETITIVE MARKET?

A. Yes. Graph 2 below shows the profit the Company would earn in a competitive market and under current ratemaking.¹⁰ The profit values under the competitive market simulation were derived by assuming the Company revenues were fixed regardless of total project cost. The competitive market revenue was set equivalent to the revenue requirement on capital if the project was completed for \$6.1 billion.

As shown in the Graph 2 below, under the competitive market simulation the Company's profit would increase if Vogtle 3 & 4 were completed under \$6.1 billion estimate at certification and would decrease if completed above \$6.1 billion.

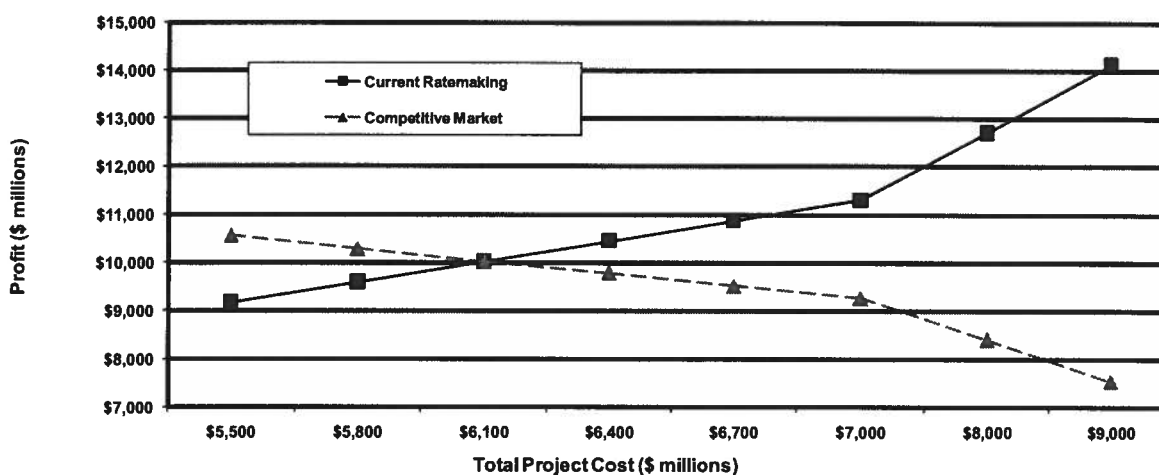
¹⁰ The profit values were derived based on publicly available information and certain simplifying assumptions. The profit values do not represent the actual profits the Company would earn on Vogtle 3 & 4 but are rough estimate given the assumptions of the simulation.

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Graph 2

Vogtle Units 3 & 4
Simulation of Cumulative Profit
Over Construction Period and Service Life
Nominal Dollars



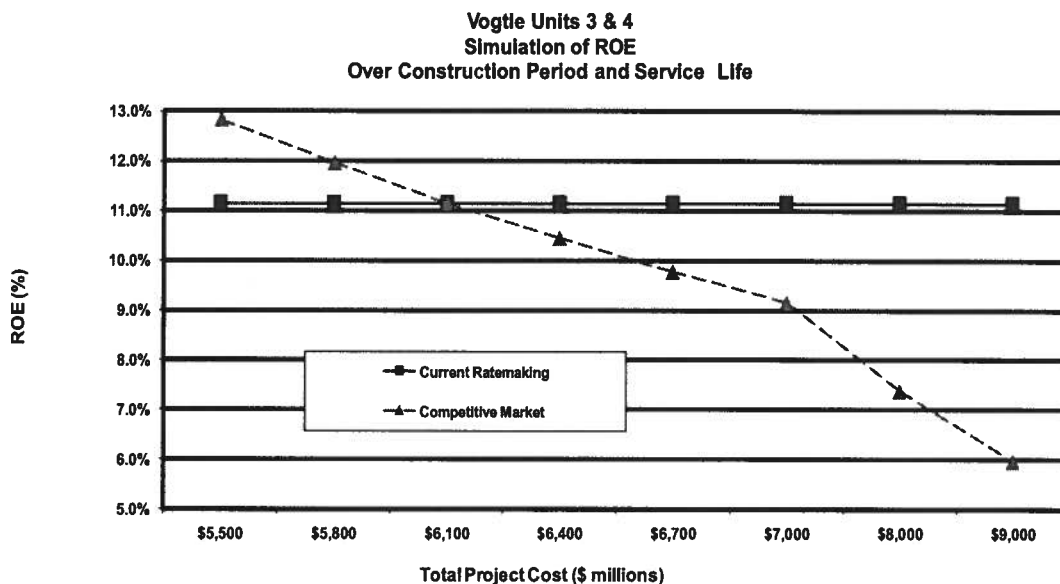
Under current ratemaking, the Company's profit would increase with increasing total project cost. This illustrates the complete misalignment between ratepayer and shareholder interest as profits increase and ratepayer benefit decrease with increased total project cost.

The next graph, Graph 3, shows the corresponding ROE the Company would earn in a competitive market and under current ratemaking. In a competitive market, relatively small deviations in total project cost result in significant changes in ROE. In a competitive market large cost overruns result in large decreases in ROE. For example, a \$900 million or 15 percent overrun would result in a 2 percent reduction in ROE. A \$3 billion or 50 percent overrun would result in a 5 percent reduction in ROE.

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Graph 3



Graph 3 illustrates the complete misalignment between ratepayer and shareholder interest as the Company ROE remains fixed under current ratemaking when total project cost increases (decreases) and ratepayer benefit decreases (increases).

Q. PLEASE SUMMARIZE HOW THE ROE ADJUSTMENT VALUES IN TABLE 1 WERE DERIVED FROM THE INFORMATION ILLUSTRATED IN GRAPHS 2 AND 3.

A. The Company profit was set at each level of total project cost such that it was a blend that would be earned under current ratemaking and competitive market. Once the profit level was set then ROE was calculated. The ROE adjustment values represent the difference between ROE under current rate making and risk sharing mechanism.

RISK SHARING MECHANISM PROVISIONS

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Q. UNDER THE STAFF'S PROPOSED RISK SHARING MECHANISM, HOW LONG WOULD AN ADJUSTED ROE BE APPLIED TO THE VOGTLE 3 & 4 RATE BASE?

A. The adjusted ROE would be applied over the entire service life of the Units since the Company earns profit on Units throughout their service life. Since a risk sharing mechanism may result in the modification of Vogtle 3 & 4 profits, the necessary ROE adjustment, if required, should be applied over the entire period profits are generated. The time period an adjusted ROE is applied could be decreased but this would require a larger adjustment to make the necessary modification to profit earned on the Units.

Q. WHAT IS STAFF'S POSITION ON EXEMPTING CERTAIN COSTS FROM TOTAL PROJECT COST FOR PURPOSES OF DETERMINING THE APPLICATION OF THE RISK SHARING MECHANISM?

A. Staff fundamentally disagrees with any exemptions to total project cost for purposes of determining risk sharing mechanism impact as the Company should have had sufficient contingency built into the \$6.1 billion estimate at certification. In addition, Staff has proposed a \$300 million buffer above the \$6.1 billion certification estimate to absorb unexpected costs. However, in the spirit of compromise Staff would exempt the following costs under corresponding circumstances identified below.

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Q. PLEASE IDENTIFY ACCEPTABLE SOURCES OF CHANGE TO TOTAL PROJECT COST WHICH WOULD BE EXEMPTED FROM TOTAL PROJECT COST FOR PURPOSES OF DETERMINING THE APPLICATION OF THE RISK SHARING MECHANISM.

A. The first source of change to total project cost that may be exempted would be design or engineering changes that result in a net benefit. Net benefit is defined as an incremental increase in total project cost that is more than offset by lower annual total revenue requirements. The second source of changes to total project cost that would be exempted is changes required by Nuclear Regulatory Commission ("NRC") rules and regulations and other governmental agencies with authority over the construction or operation of Vogtle 3 & 4.

Q. PLEASE IDENTIFY THE CRITERIA THAT SHOULD BE USED TO DETERMINE WHETHER ADDITIONAL TOTAL PROJECT COST BROUGHT ABOUT BY A DESIGN OR ENGINEERING CHANGE SHOULD BE EXEMPTED FOR PURPOSES OF STAFF'S PROPOSED RISK SHARING MECHANISM.

A. An example of such a design or engineering change would be a relatively minor item such as the placement of valves or ladders which allow for better access for operators or maintenance personnel. These design or engineering changes may only be considered if identified after applicable engineering drawings have been stamped Issued For Construction ("IFC"). It would be the Company's burden to prove the design or

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engineering change results in a net benefit and the change could not have been reasonably identified prior to issuance of the applicable IFC engineering drawings. This exemption should not be an avenue to exempt additional cost resulting from design or engineering changes that are the result of insufficient detailed engineering due to manpower or time constraints.

Q. PLEASE IDENTIFY THE CRITERIA THAT SHOULD BE USED TO DETERMINE WHETHER ADDITIONAL TOTAL PROJECT COST RESULTING FROM A CHANGE IN NRC OR OTHER GOVERNMENT AGENCIES SHOULD BE EXEMPTED FOR PURPOSES OF APPLICATION OF THE RISK SHARING MECHANISM.

A. If the regulatory change resulting in an increase in total project cost occurs after permits have been received by the NRC or other government agencies then the change may be exempted. For example the Combined Operating License ("COL") is the primary permit the Company must receive from the NRC prior to starting major construction at the site. If *after* issuance of the COL the NRC were to make a modification to the COL or promulgates other rules that increase total project cost then those costs could be considered exempted for purposes of the risk sharing mechanism. Any additional cost that is the result of NRC regulatory changes prior to issuance of the COL would not be eligible for exemption. The same criteria would apply to changes in total project cost due to changes in rules or regulations of other governmental agencies. Only costs that are the result of changes in governmental agencies regulation after the permits are issued are

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eligible for exemption. This exemption should not be an avenue for the Consortium or Owners to exempt additional cost resulting from changes in governmental agency regulation that should have been identified prior to issuance of permits.

Q. WHAT ADDITIONAL CRITERIA SHOULD BE APPLIED TO COST EXEMPTIONS FROM BOTH SOURCES?

A. If total project cost is below \$6.4 billion then any additional cost from acceptable design or engineering changes or government regulation changes described above would not be exempted for purpose of application of risk sharing mechanism. However, if total project cost exceeds \$6.4 billion, additional cost from acceptable design or engineering changes or government regulation changes may be exempted for purpose of application of risk sharing mechanism.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

Appendix TJN-1

Summary of Educational and Professional Experience of Tom J. Newsome

Mr. Newsome received a Bachelor of Chemical Engineering with certificates in Pulp & Paper and Polymers from the Georgia Institute of Technology in June 1986. In 1994, Mr. Newsome passed both required examinations and received a professional engineering license (PE) from the State of North Carolina. Mr. Newsome received a Master of Science in Business Economics and a Master of Science in Finance from Georgia State University in August 1996 and June 1997, respectively. Mr. Newsome is the recipient of the George J. Malanos Graduate Award for Academic Excellence for completing the finance program with a 4.0 grade-point average. In 2003, Mr. Newsome received Chartered Financial Analyst (CFA) designation from the CFA Institute after successfully completing three six-hour examinations on security analysis and portfolio management.

After graduation from Georgia Tech, Mr. Newsome worked as plant/process engineer for Shaw Industries, a carpet manufacturer. In April 1988, Mr. Newsome joined Weatherly, Inc., engineering and construction firm specializing in fertilizer plants, as a process engineer. Mr. Newsome's primary responsibilities were process design and plant start-ups, including start-ups in Korea and India. Mr. Newsome joined Midrex Direction Reduction Corp., an applied research, engineering and construction firm with proprietary iron ore processing plant technology in March 1993 as a process engineer. Mr. Newsome duties were similar to those at Weatherly, including assisting in the start-up of the world's largest Direct Reduction Iron plant in India.

Following graduation from graduate school at Georgia State, Mr. Newsome joined Georgia Gulf Corporation in 1997 as a corporate development analyst. While at Georgia Gulf, Mr. Newsome performed financial analysis and modeling for natural gas purchasing/hedging program, developed a "make-or-buy" model for methanol business, performed financial modeling for an acquisition, and calculated and summarized the financial performance of prior capital investments. In 1999, Mr. Newsome joined FMV Opinions, Inc. as a business valuation analyst and valued private companies for gift and estate tax, transactional and management planning purposes.

Mr. Newsome joined the Georgia Public Service Commission ("Commission") in January 2005 as a Financial Analyst/Economist. Mr. Newsome was promoted to Director of Utility Finance in 2008. Mr. Newsome has testified before the Commission in five Dockets. In Docket 22403, Mr. Newsome addressed Georgia Power Co.'s natural gas hedging program and in Docket 24506 testified on the application of AFUDC accounting for calculating financing cost of capital projects. Mr. Newsome's primary responsibility, prior to presenting testimony in this docket, has been performing analyses of the parties' cost of equity capital positions in Dockets 18638 (Atlanta Gas Light Company 2004/2005 Rate Case), 19758 (Savannah Electric and Power Company 2004 Rate Case), 20298 (Atmos Energy Corporation - Georgia Division 2005 Rate Case), 25060 (Georgia Power Co. 2007 Rate Case) and 27163 (Atmos Energy Corporation - Georgia Division 2008 Rate Case) and developing the Advisory PIA Staff's cost of equity recommendation to the Commission.