BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 120015-EI

In the Matter of:

PETITION FOR INCREASE IN RATES
BY FLORIDA POWER & LIGHT COMPANY.
_____/

VOLUME 21

Pages 2920 through 3177

PROCEEDINGS:	HEARING
COMMISSIONERS PARTICIPATING:	CHAIRMAN RONALD A. BRISÉ COMMISSIONER LISA POLAK EDGAR COMMISSIONER ART GRAHAM COMMISSIONER EDUARDO E. BALBIS COMMISSIONER JULIE I. BROWN
DATE:	Tuesday, August 28, 2012
TIME:	Commenced at 9:32 a.m. Concluded at 12:13 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	DEBRA R. KRICK (850)894-0828
APPEARANCES:	(As heretofore noted.)

PREMIER REPORTING
114 WEST 5TH AVENUE
TALLAHASSEE, FLORIDA
(850) 894-0828

I N D E X

WITNESSES

EXHIBITS

NUMBER:	ID	ADMTD.
118	3065	3073
278-279		2983
294-306		3073
307-319		3175
581	2957	2984
582	2984	2984
583	3059	3073
584	3141	3175

P R O C E E D I N G S

(Transcript follows in sequence from Volume 20.)

CHAIRMAN BRISÉ: Good morning. We are going to reconvene this morning, and we are going to continue with -- before that, I think that there is an appearance that needs to be made.

MR. YOUNG: Yes.

MR. LITCHFIELD: Thank you, Mr. Chairman. On behalf of FPL, I would like to enter an appearance in the proceeding for David Wells of the Gunster firm.

CHAIRMAN BRISÉ: All right. Welcome, Mr. Wells.

MR. WELLS: Thank you.

CHAIRMAN BRISÉ: All right. At this time we are going to continue with our witnesses.

Mr. Wright?

MR. WRIGHT: Thank you, Mr. Chairman and good morning. The Florida Retail Federation calls Mr. Steve W. Chriss to the stand.

DIRECT EXAMINATION

BY MR. WRIGHT:

Q Good morning, Mr. Chriss.

A Good morning.

Q Please state your name and business address for the record.

A My name is Steve Chris. My business address is 2001 Southeast 10th Street, Bentonville, Arkansas.

Q By whom are you employed and in what capacity?

A I am employed by Wal-Mart Stores, Incorporated. And I am Senior Manager, Energy Regulatory Analysis.

Q Thank you. Are you the same Steve W. Chriss who prepared and caused to be filed in this case, prefiled direct testimony dated July 2nd, 2 -- 2012, consisting of 12 pages?

A Yes.

Q Do you have any changes or -- or corrections to make to that testimony?

A I do have one change. On page 1, line 8, instead of 9,000, it should be 8,000.

Q Thank you.

MR. WRIGHT: Oh, Mr. Chairman, I apologize. Would you please swear Mr. Chriss? I -- he was not here at the first day of the hearing.

CHAIRMAN BRISÉ: Okay. If there are any other witnesses that need to be sworn in this morning that weren't sworn in yesterday, please rise.

Whereupon,

STEVE W. CHRISS

was called as a witness, having been first duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

CHAIRMAN BRISÉ: All right. Thank you. You maybe seated.

MR. WRIGHT: Thank you, Mr. Chairman.

BY MR. WRIGHT:

Q And, Mr. Chriss, with the change you just articulated to the Commission, if I were to ask you the same questions today, would your answers be the same?

A Yes.

MR. WRIGHT: Mr. Chairman, I request that Mr. Chriss' testimony be entered into the record as though read.

CHAIRMAN BRISÉ: Okay. We will enter Ms. -- Mr. Chriss' record into the record as though read. Are there any objections?

Okay. Seeing none, it's entered into the record.

(Whereupon, testimony inserted.)

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND OCCUPATION.

A. My name is Steve W. Chriss. My business address is 2001 SE 10th St., Bentonville, AR 72716-0550. I am employed by Wal-Mart Stores, Inc. as Senior Manager, Energy Regulatory Analysis.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS DOCKET?

A. I am testifying on behalf of the Florida Retail Federation ("FRF"), a statewide trade association of more than 9,000 of Florida's retailers, many of whom are retail customers of Florida Power & Light Company ("FPL" or "the Company"). FRF has requested that I testify in order to provide a customer perspective on FPL's proposed rate increase and to explain FRF's concerns regarding the Company's proposed return on equity ("ROE") and ROE adder.

Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.

A. In 2001, I completed a Master of Science in Agricultural Economics at Louisiana State University. From 2001 to 2003, I was an Analyst and later a Senior Analyst at the Houston office of Econ One Research, Inc., a Los Angeles-based consulting firm. My duties included research and analysis on domestic and international energy and regulatory issues. From 2003 to 2007, I was an Economist and later a Senior Utility Analyst at the Public Utility Commission of Oregon in Salem, Oregon. My duties included appearing as a witness for PUC Staff in electric, natural gas, and

telecommunications dockets. I joined the energy department at Wal-Mart in July 2007 as Manager, State Rate Proceedings, and was promoted to my current position in June 2011. My Witness Qualifications Statement is included herein as Appendix A.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION ("THE COMMISSION")?

A. Yes. I submitted testimony in Florida PSC Docket 110138-EI, which was the recent general rate case for Gulf Power Company.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE OTHER STATE REGULATORY COMMISSIONS?

A. Yes. I have submitted testimony in over 60 proceedings before 30 other utility regulatory commissions and before the Missouri House Committee on Utilities and the Missouri Senate Veterans' Affairs, Emerging Issues, Pensions, and Urban Affairs Committee. My testimony has addressed topics including cost of service and rate design, ratemaking policy, qualifying facility rates, telecommunications deregulation, resource certification, energy efficiency/demand side management, fuel cost adjustment mechanisms, decoupling, and the collection of cash earnings on construction work in progress.

Q. ARE YOU SPONSORING ANY EXHIBITS WITH YOUR TESTIMONY?

A. Yes. I am sponsoring the following exhibits to my testimony:

Exhibit SWC-1: Calculation of Test Year Jurisdictional Revenues Collected through Base Rates

Exhibit SWC-2: Calculation of Revenue Requirement Impact of FPL's Proposed Return on Equity Adder

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION.

A. My recommendations to the Commission are as follows:

1) The Commission should consider the impacts to customers thoroughly and carefully in ensuring that any increase in FPL's rates is only the minimum amount necessary to provide adequate and reliable service at the lowest possible cost. Additionally, the Commission should consider the proposed permanent base rate increase on its own merits and not in conjunction with changes in other components of FPL's retail rates, specifically FPL's Fuel Charges.

2) The Commission should carefully consider the Company's proposed ROE adder to determine: (1) whether the proposed adder is cost-based and (2) whether a single utility's general rate case is the appropriate venue to create a one-off performance-based adder that would be applicable to all utilities.

3) If the Commission determines that performance-based ratemaking is appropriate for Florida utilities, it should consider opening a separate proceeding for the examination of this topic.

The fact that an issue is not addressed should not be considered an endorsement of any filed position.

Q. GENERALLY, WHY ARE UTILITY CUSTOMERS, INCLUDING RETAILERS AND OTHER COMMERCIAL CUSTOMERS, CONCERNED ABOUT FPL'S PROPOSED RATE INCREASE?

A. Electricity represents a significant portion of retailers' operating costs. When rates increase, that increase in cost to retailers puts pressure on consumer prices and on the other expenses required by a business to operate, which impacts retailers' customers and employees. Rate increases also directly impact retailers' customers, who are also FPL's residential and small business customers. FRF recognizes FPL's duty to provide reliable and adequate service to its customers and that there are costs required to do so, including a reasonable return on the Company's used and useful capital investments. However, given current economic conditions, a rate increase is a serious concern for retailers and their customers and the Commission should consider these impacts thoroughly and carefully in ensuring that any increase in FPL's rates is only the minimum amount necessary to provide adequate and reliable service at the lowest possible cost.

Q. WHAT REVENUE REQUIREMENT DOES THE COMPANY PROPOSE IN ITS FILING?

A. The Company has proposed a total base rate revenue requirement increase of $516.5 million. *See* MFR Schedule A-1. Additionally, the Company has proposed a step increase of $173.9 million for the Canaveral Modernization Project upon commencement of commercial operation. *See* Direct Testimony of Robert E. Barrett, Jr., page 7, line 19 to line 21.

Q. DOES FPL'S PETITION REFERENCE FUEL COST REDUCTIONS AS MITIGATING THE COMPANY'S PROPOSED BASE RATE INCREASE?

A. Yes. *See* Petition, page 18.

Q. IS THE FORECAST CHANGE IN FPL'S FUEL COSTS RELEVANT TO THE COMMISSION'S CONSIDERATION OF THE MERITS OF FPL'S PROPOSED BASE RATE INCREASE?

A. No. While it is undisputed that reductions in fuel cost benefit customers through lower Fuel Charges on customer bills, fuel cost is not an issue in this docket and not relevant to the Commission's consideration of the merits of FPL's proposed base rate increase. What is at issue in this docket is a proposed *permanent* base rate increase that will be in place regardless of the level of the Company's fuel cost and should be considered by the Commission on its own merits and not in conjunction

with unrelated contemporaneous changes in other components of FPL's retail rates.

Q. WHAT IS THE COMPANY'S PROPOSED ROE IN THIS DOCKET?

A. The Company is proposing an after-tax ROE of 11.5 percent, composed of a base ROE of 11.25 percent and a 25 basis point ROE adder. *See* Direct Testimony of Moray P. Dewhurst, page 6, line 1 to line 7. Applying the Company's proposed Net Operating Income Multiplier (1.63188, from MFR A-1) to this return indicates that FPL is requesting a before-tax ROE of approximately 18.7 percent.

Q. IS FRF CONCERNED THAT THE PROPOSED ROE IS EXCESSIVE?

A. Yes. FRF is concerned that the Company's proposed ROE is excessive, especially given the current economic conditions faced by the utility's customers as well as when viewed in light of the Company's percentage of jurisdictional revenues collected through base rates that are at risk due to regulatory lag versus the amount of revenues collected through cost recovery clause charges such as the fuel, conservation, capacity, storm, and environmental cost recovery clauses. The reduced risk provided by these numerous pass-through charges should be reflected in the Commission's approved ROE in this docket.

Q. FOR THE COMPANY'S PROPOSED 2013 TEST YEAR, WHAT PERCENT OF JURISDICTIONAL REVENUES ARE PROPOSED TO BE COLLECTED THROUGH BASE RATES?

A. Approximately 42 percent of jurisdictional revenues for the proposed 2013 test year would be collected through base rates and would be essentially at risk due to regulatory lag. This percentage mirrors the corresponding significantly larger percentage of total revenues – 58 percent – that FPL recovers through cost recovery clause charges and other line-item charges. *See* Exhibit SWC-1. This is significant because the greater the percentage of a utility's revenues that are collected through pass-through charges, the lower the utility's risk due to regulatory lag.

Q. ARE THERE ANY OTHER FACETS OF THE COMPANY'S PROPOSAL IN THIS DOCKET THAT COULD IMPACT FPL'S EXPOSURE TO REGULATORY LAG?

A. Yes. The use of a projected test year reduces the risk due to regulatory lag because, as the Commission has previously stated, "the main advantage of a projected test year is that it includes all information related to rate base, NOI, and capital structure for the time new rates will be in effect." *See* Order No. PSC-02-0787-FOF-EI, page 9. As such, the Commission should carefully consider the level of ROE justified by the Company's exposure to regulatory lag.

Q. WHAT IS YOUR UNDERSTANDING OF THE COMPANY'S PROPOSED ROE ADDER?

A. My understanding is that FPL is requesting an adder of 25 basis points to its ROE, subject to the Company's maintaining the "lowest typical bill customer bill in the state." FPL proposes that this adder be created as an incentive for "all utilities regulated by the FPSC." *See* Direct Testimony of Moray P. Dewhurst, page 47, line 10 to line 15.

Q. WHY DOES FPL PROPOSE THE ROE ADDER?

A. It is my understanding that FPL proposes the ROE adder as a reward for its performance as a utility. *Id.*, line 16 to line 23. FPL witness John J. Reed provides a detailed analysis of a number of performance metrics.

Q. DOES FRF HAVE OTHER CONCERNS WITH THE COMPANY'S ROE ADDER PROPOSAL?

A. Yes. The proposed ROE adder has no cost basis and FRF questions whether it is appropriately included in a cost of service-based consideration of just and reasonable rates. Additionally, the Company has not provided any derivation for the level of the proposed 25 basis point adder, which increases the Company's revenue requirement by approximately $39.5 million. *See* Exhibit SWC-2.

Q. DOES THE COMPANY INDICATE THAT THE COMMISSION IS AUTHORIZED BY FLORIDA STATUTE TO CONSIDER NON-COST FACTORS IN SETTING RATES?

A. Yes. *See* Direct Testimony of William E. Avera, page 82, line 13 to line 15. While I am not an attorney, upon examination of Florida Statute 366.041(1) it appears that the Commission is authorized, but not obligated, to consider non-cost factors in setting rates. However, this authorization does not address the implementation issues with the Company's proposal.

Q. WHAT ARE THE PROPOSAL'S IMPLEMENTATION ISSUES?

A. The first issue is that the Company has proposed a performance-based adder that rewards positive performance but does not address how the ROE adder would be removed from rates were FPL's future benchmark results to show that the Company should no longer receive the adder. The second issue is that the "lowest typical customer bill in the state" benchmark is not necessarily a transparent, cost-based metric appropriate for use in this context – any comparison should provide a level playing field among Florida's regulated utilities.

Q. PLEASE EXPLAIN.

A. A number of factors play into the calculation of a typical bill for a given utility. For instance, what rate class or classes are included in the typical bill calculation, where the rate of return for each included rate class is in relation to the utility's overall rate of return, the Commission-approved allocation of revenues to each included rate class, and the rate design for each included rate class. The differences in these factors would play a significant role in a comparison between two utilities, and a utility could ostensibly propose non-cost-based changes in a rate case – such as a revenue allocation that moves revenues away from the included rate class or classes to lower the rates for the included class or classes – in order to obtain a favorable result and thus be able to increase its rates via a ROE adder.

Q. DOES FRF PROPOSE AN ALTERNATIVE BENCHMARK IN THIS DOCKET?

A. No. However, any benchmark metric or combination of benchmark metrics used for a performance-based adder should have as their basis a transparent and uniform calculation methodology and be uniformly applied to all included utilities.

Q. DOES FRF HAVE A FINAL POLICY CONCERN?

A. Yes. FRF questions whether it is appropriate to create a new performance-based ratemaking structure on a one-off basis in a single utility general rate case. This process could allow the filing utility to focus on one area in which it has an *ex ante* known advantage when compared to other Florida utilities – such as FPL's proposed "lowest typical bill customer bill in the state," which is an advantage it knows it has at this time – and could result in multiple performance-based adders that "apply" to all utilities but really only benefit one utility. Additionally, my understanding is that at the time this testimony is to be filed, no other regulated electric utilities in Florida are participating in this docket, and FRF questions whether it is appropriate to create a mechanism that would impact their businesses without their inclusion in the process. Further, if the Commission were going to consider this concept it should seriously consider including Florida's numerous municipal and cooperative utilities in analyzing comparative performance.

Q. WHAT ARE YOUR RECOMMENDATIONS TO THE COMMISSION ON THIS ISSUE?

A. My recommendations to the Commission regarding the proposed ROE adder are:

1) The Commission should carefully consider the Company's proposed ROE adder to determine: (1) whether the proposed adder is cost-based and (2)

whether a single utility's general rate case is the appropriate venue to create a one-off performance-based adder that would be applicable to all utilities.

2) If the Commission determines that performance-based ratemaking is appropriate for Florida utilities, it should consider opening a separate proceeding for the examination of this topic.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BY MR. WRIGHT:

Q Mr. Chriss, are you also sponsoring two exhibits to your testimony?

A I am.

Q And those are identified in your testimony document as Exhibits SWC-1 and SWC-2; is that correct?

A That's correct.

MR. WRIGHT: Mr. Chairman, these exhibits have been marked for identification in the Staff's Comprehensive Exhibit List as Exhibits 278 and 279.

BY MR. WRIGHT:

Q Okay. Mr. Chriss, have you prepared a less than five-minute summary of your testimony for the Commissioners?

A I have.

Q Please deliver it.

A Good morning, Chairman Brisé and Commissioners. My name is Steve Chriss, and I am testifying on behalf of the Florida Retail Federation, a statewide trade association of more than 8,000 of Florida's retailors, many of whom are customers of FPL.

Electricity represents a significant portion of retailors' operating costs. When rates increase, that increase in cost to retailors puts pressure on consumer prices and on the other expenses required by a

business to operate. Rate increases also directly impact retailors' customers, who are FPL's residential and small business customers.

FRF recognizes FPL's duty to provide reliable and adequate service to its customers and that there are costs required to do, including a reasonable return on the company's used and useful investments. However, given current economic conditions, a rate increase is a serious concern for retailors and their customers, and the Commission should consider these impacts thoroughly and carefully in ensuring that any increase in FPL's rates is only the minimum amount necessary to provide adequate and reliable service at the lowest possible cost.

Additionally, the Commission should consider the proposed permanent rate increase on its own merits and not in conjunction with changes in other components of FPL's retail rates, specifically FPL's fuel charges.

In regards to the proposed return on equity adder, my recommendations to the Commission are that the Commission should carefully consider whether the adder is cost based and whether a single utilities' general rate case is the appropriated venue to create a one-off performance based adder that would be applicable to all utilities.

Additionally, if the Commission determines that a performance based rate-making is appropriate for Florida utilities, it should consider opening a separate proceeding for the examination of this topic.

Thank you.

Q And that concludes your summary, Mr. Chriss?

A Yes.

Q Thank you.

MR. WRIGHT: Mr. Chairman, Mr. Chriss is available for cross-examination.

CHAIRMAN BRISÉ: Okay. OPC?

MR. McGLOTHLIN: No questions.

CHAIRMAN BRISÉ: Mr. Saparito?

MR. SAPARITO: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: Mr. Hendricks?

MR. HENDRICKS: No questions.

CHAIRMAN BRISÉ: South Florida Hospital Association?

MR. SUNDBACK: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: FIPUG?

MR. MOYLE: Just a couple.

CROSS EXAMINATION

BY MR. MOYLE:

Q Good morning, Mr. Chriss.

A Good morning.

Q I want to refer you to page 10 of your testimony, lines 9 through 13.

A Okay.

Q And if I am understanding what you're saying here, let me just state it and you can agree or disagree, is that one of the reasons you're saying the adder should not be put in place is because it may result in allocations further down the road to the extent the residential lowest bill is the -- is that trigger, then it may result in allocations to other customer classes, commercial, industrial that may not be warranted; is that right?

A That's correct. One of my concerns with the proposed mechanism, in that it would apply to all utilities, is that it could give the utilities incentive to change how they do cost -- their cost of service study if they move from, you know, 4CP to an energy allocation for generation plant to the very extreme example. You know, change the underlying methodology such that the lowest residential bill is sort of the outcome, but it's not really a cost-based outcome. That's my concern.

Q Okay. Have you -- have you tried to keep up with this proceeding in terms of the testimony and the -- the record evidence that's been put in?

A I have -- I have done my best, but I am not sure if I have -- I've satisfied what you are looking for.

Q Okay. Well, I am going to suggest to you what -- what I think the record evidence shows with respect to one issue related to allocation and then ask you whether you think that mitigates against your concern. So if I were to tell you that the interruptible credit for the CILC and CDR rate cases is currently in the four-dollar range and testimony in this case -- expert testimony in this case that has not been refuted is in the 12-dollar range, wouldn't that mitigate the concern you express here based on the facts in this case?

A I don't know enough to answer that question. I am sorry.

Q Okay. If -- so if you assume that those facts were indeed in the case, you -- you can't answer whether -- whether it would serve to lessen your concern that you articulate here?

A I don't know the extent to which FRF's members take service on CILC, if they get the interruptible credit. I don't believe Wal-Mart takes service on CLI -- CILCs subject to check, so to the extent that that may not impact the retailors individually or more

broadly, I -- I can't say yes or no that, that -- that would mitigate it ---

Q Do you know if you take service on CDR, or you get a CDR credit?

A Not to my knowledge, but that's subject to check.

Q Okay. What -- what -- what rate are Wal-Mart stores -- stores primarily on?

A GSLDT, I believe.

MR. MOYLE: Okay. Thank you. That's all I have.

CHAIRMAN BRISÉ: Okay. FEA?

MR. MILLER: No questions. Thank you.

CHAIRMAN BRISÉ: FPL?

MR. WELLS: Thank you.

CROSS EXAMINATION

BY MR. WELLS:

Q Mr. Chriss, you're an employee of Wal-Mart full-time, correct?

A Yes.

Q But your business for Wal-Mart has nothing to do -- you don't operate any retail facility yourself; you haven't held a operational role?

A Could you repeat that? I am sorry. I can't quite hear you.

Q Maybe I need get closer to the mic. Is that better?

A That's better. Thank you.

Q All right. So with Wal-Mart, you have held no operational role; you have never operated a Wal-Mart retail facility?

A I have not operated a retail facility, no.

Q Your -- your job for Wal-Mart is to travel the country testifying in rate cases?

A That is part of my job.

Q In fact, you testified, I think, 65 different times on rate cases for Wal-Mart?

A It's -- it's more than that now, but yes.

Q So it's more than 65 now, correct?

A Correct.

Q All right. And in terms of your performance being evaluated by the Wal-Mart company, you're evaluated by how well you do in terms of keeping down utility rates?

A I am evaluated in part on that.

Q Okay. You're not evaluated on the long-term effects of those utility rates on an utility in being able to be a sustainable, viable producer of electricity?

A I am not, however -- none of the utilities on

whose cases I have worked yet have gone out of business, so.

Q Okay. But the answer to my question is, no, you are not evaluated based on such things as sustaining or increasing utility reliability?

A No.

Q You're not evaluated on sustaining or increasing the utility's deliver -- delivery of power safely?

A No.

Q Okay. Your view and Wal-Mart's view is a short-term view, how low can we keep rates?

A Well, that needs to be done within the parameters --

Q Can you answer that yes or no?

A Could you repeat the question?

Q Sure. Your view is a short-term view with respect to any particular rate proceeding as to how low you can keep those rates; it's not a long-term view of the impact on the regulated utility?

A With regards to the term, certainly when you're working on a case, the impact is, you know, what the utility has proposed immediately. However, we still need service to be reliable and adequate. We still need our stores to be able to operate and to have electric

service or gas service, so we -- we don't make recommendations that would drive the financials into the ground and not allow the utility to provide reliable and adequate service.

Q Has that been true historic with Wal-Mart in terms of its treatment of suppliers and providers; it really cares about whether they continue in business?

A I don't work on that side of the business, so I can't speak to that.

Q Okay. So you are not familiar with the -- the bodies of companies that -- that litter the marketplace as a result of having been Wal-Mart's suppliers?

MR. WRIGHT: I object, Mr. Chairman. This is beyond the scope and argumentative.

CHAIRMAN BRISÉ: I would agree.

BY MR. WELLS:

Q Who is paying you as far as being here today?

A Wal-Mart.

Q Okay. Did you prepare this testimony yourself?

A I did.

Q Exclusively?

A Yes.

Q Had no input from anyone else?

A There are internal checks and reviews.

Mr. Wright did read it. However, it is my product.

Q Okay. I just want to make sure that it's basically your statement and Wal-Mart's statement that we have in front of us here, the result of your work and your staff at Wal-Mart?

A Ultimately, the product is produced by me, and I work for Wal-Mart. However, it's on behalf of FRF.

Q And it was approved by Wal-Mart before it went out?

A Yes.

Q Okay. Let me ask you this question, can you -- have you studied how the FRF constituents, other than Wal-Mart, take service from FPL?

A I have not. My understanding is that FRF is comprised of retailors who represent a broad range of -- of facilities and rate schedules.

Q There are some 8,000 retailors of all different sizes, right?

A That's my understanding, yes.

Q Who are the largest retailors in this group -- after Wal-Mart?

A I am looking over to my attorney to see if I could be divulging anything confidential by saying.

MR. WRIGHT: I think you can answer, Mr. Chriss.

THE WITNESS: Okay. Best Buy, Publix. I believe Target is a member of the group, JC Penney, Macy's.

BY MR. WELLS:

Q So several extremely large companies that are a part of the retail federation?

A Yes, sir.

Q Now, is you state on page 1, line 11 of your testimony that FRF asked you to provide a customer perspective on FPL's proposed rate increase, correct?

A Yes, sir.

Q In doing that, you obviously bring with you knowledge of Wal-Mart's perspective and how it takes service, but you have not studied how the other members take service and how they would be impacted, correct?

A Not specifically other than knowing that there are a number of other retailors who are concerned about this rate increase and are supporting this effort.

Q What are the rate classifications that -- that are covered by the FRF as they take power?

A I don't know specifically.

Q Okay. Are you aware that members of FRF take service pursuant to a variety of rate schedules?

A That's my understanding.

Q And they take under GSDT-1, GSLDT-1; are you

familiar with that?

A I don't know specifically, but I would not be surprised to hear that there is quite a range.

Q And are you aware that members of SFHHA are in the same rate class as some of the members of FRF?

A I will take your word for it.

Q Okay. So you don't know, but you wouldn't disagree?

A I am -- I don't know. I am not familiar with their load.

Q And are you aware that certain members of FIPUG also are in the same rate class as some members of FRF?

A Again, I don't -- I don't know their load, but I will take your word for it.

Q Okay. Are you aware that certain of the FEA folks, their agencies, are in the same rate classes as -- as some members of FRF?

A Again, I am not specifically aware. I am not familiar with their load, and I will take your word for it.

Q Okay. Within FRF, Wal-Mart is really not the typical retailor; is it?

A Define typical.

Q Well, let's put it this way: In terms of size

and scale, Wal-Mart is most assuredly not typical of the Florida retailor?

A More broadly, probably not, but I don't know to what extent the other members have stores in South Florida.

Q Okay. Well, Wal-Mart is the largest retailor in the world; isn't it?

A Yes.

Q Its revenues last year were 446.9 billion which would, if you were looking at gross domestic product, make it the 29th largest country in the world. Are you aware of that?

A Generally, yes.

Q So we are certainly talking about a company whose size and scale is vastly different than most of the commercial ratepayers that would be at issue here?

A On a global level, yes. However, within FPL service inventory -- service territory, pardon me, I don't know.

Q Okay. Now, one of the positions that you take, or at least the question that you ask, is whether the requested ROE of FPL is excessive; is that correct? And you could look at page 6, I think it's line 11 of your testimony if you need to refresh your recollection on that.

A That's correct.

Q Okay. Now, in coming to those conclusions, you didn't perform a market analysis to determine an appropriate ROE for FPL; did you?

A I did not. However, other parties did.

Q Okay. My question is, you did not?

A I did not.

Q Okay. And didn't make any recommendation as to what an appropriate ROE for FPL should be in your testimony?

A No. The Commission within its discretion can determine the appropriate range and ROE.

Q Okay. And you have not done -- well, strike that.

You -- you've -- there is no cost of equity expert testifying for FRF in this proceeding, correct?

A That's correct.

Q Okay. Now, on page 6, line 12, you cite the current economic conditions as a reason for concern over FPL's requested ROE; is that right?

A That's correct.

Q Okay. You would agree, though, that there are other electrical utilities in the country that are currently authorized to earn higher ROE's than FPL is requesting; wouldn't you?

A That's correct.

Q You're aware that Dominion Power is authorized to earn an ROE of 11.4 percent?

A My understanding of Dominion's last by annual rate review is that they were allowed a base ROE of ten four, the 50 basis point adder for RPS performance to bring them to ten nine. My understanding is the eleven four comes from one of their generation plants. This is subject to check, but that's my recollection of their 2011 biannual review.

Q And Energy Mississippi is authorized to earn an ROE of 11.75 percent?

A I don't know Energy Mississippi specifically. However, the Mississippi Commission is -- has opened investigations into Energy Mississippi and Mississippi Power's return on equity.

Q And you're aware in terms of the current economic conditions, is that these other states are suffering just as much as the State of Florida?

A Absolutely. And the Commission has opened an investigation to see if the ROE is too high.

Q Okay. Let's talk about the actual impact of FPL's requested ROE. A utility's authorized ROE impacts the customer's bill as a component of its total weighted average cost of capital, correct?

A That's correct.

Q So it's the weighted average cost of capital that impacts the customer's bill, not the ROE in isolation?

A That is correct.

Q Okay. So tell me, in your opinion, would a customer rather pay $100 monthly bill that includes an ROE of 11.5 percent or a higher $120 monthly bill that includes a lower ROE of 10 percent?

A I mean, there are a number of moving parts, and the Commission has to make determinations on all of them. I think any customer would like the lower bill, but there are a number of things, obviously, that have to get there if the ROE remains at 11.25 percent.

Q The customer is concerned what his bill is, not what the ROE is at the end of the day, correct?

A I would say most -- yeah, most end use customers are -- are concerned about the bill level.

Q Now, in terms of the excessive ROE that -- that you have talked about here with FPL asking for an ROE of 11.25 and a 0.25 rider, are you aware that Wal-Mart's trailing 12 months ROE is nearly 25 percent?

A I don't know the number specifically. I understand Mr. Dewhurst referenced -- was it Mr. Dewhurst? One of FPL's witnesses referenced it in

rebuttal.

However, it's important to keep in mind that Wal-Mart operates in an a competitive market, and -- and that ROE is extraordinary that we don't have a fixed customer base. If we price too high or don't provide value to our customers, our customers will leave.

Q Okay. And the increase in the bill of Wal-Mart in the state of Florida if this rate increase is permitted, do you know what that would be?

A I don't remember the specific number, but it's north of $3 million a year.

Q Are you sure it's not 2.2 percent of your bill?

A You will have to be specific because my guess is you're -- you're floating in some other components. Are you talking about the base rate increase?

Q Yes, sir.

A My understanding is that it's -- it's around $3 million. I think it's above $3 million, and that is higher than 2.2 percent of our bill, just working from memory.

Q With respect to the adder, you were asked a question earlier about your concern, as I understand it, being able to make, or manipulate, the cost of service methodology. Did I hear you correctly?

A Could you say that -- I am sorry. Could you say that one more time?

Q Earlier you were asked a question about the concern over allocation if there is an adder, and there might be, if I understood you correctly, manipulation of the cost of service in order to be able to have lower rates in one area?

A That is certainly a concern.

Q Okay. Is it your experience that a utility can change its cost of service methodology without PSC approval?

A It cannot. However, I mean, these issues get litigated all the time.

Q So it's correct you have to get PSC permission before you change any cost of service methodology?

A That is correct. However, given the cost of service methodologies applied nation wide, there is always a chance that things can change.

Q Okay. You mentioned Wal-Mart having to compete in these tough economic times. Are small retailors considered competition to Wal-Mart?

A I don't know specifically what our operational folks consider competition. In the marketplace, any other retailor that sells had the same goods is certainly a competitor.

Q Well, as an economist, you are familiar with macroeconomic terms and philosophies, and certainly, you would agree if they are selling the same goods, they would be competitors, right?

A Sure.

Q Okay. Let's turn, if you would, to page 7 of your report. There, you discuss the concern -- or you discuss the risk of regulatory lag as a risk faced by FPL and talk about how it's not a significant risk in your mind, correct?

A That's correct.

Q Okay. It's not your testimony that regulatory lag is the only risk a utility faces to collecting its base rate revenues; is it?

A No, I don't testify to that.

Q Yeah. For example, storms that cause outages will prevent the company from recovering base rent revenues for that period of time, correct?

A That's certainly a risk.

Q And you do understand that FRF's position in other proceedings with FP&L has been that FPL should not be able to recover lost rate revenues as a result of storm outages?

A I -- I -- I don't know specifically that which you speak, so absent hearing a lawyer's objection, I

will take your word for it.

Q Well, I can -- I will show you an exhibit here that might help you.

CHAIRMAN BRISÉ: For identification purposes the next exhibit is 581.

(Whereupon, Exhibit No. 581 was marked for identification.)

MR. SAPARITO: Mr. Chairman, I might be mistaken here, but I thought last -- yesterday 580 was used, but then it was withdrawn. I thought that number was vacated, so we can use that again or no. Am I wrong?

MR. YOUNG: Yes.

CHAIRMAN BRISÉ: Did we vacate it? We didn't -- right. We didn't apply it to anything -- I mean, it's -- it's not -- we didn't vacate it, so it's -- we are moving on to 581. Right. We marked it. We didn't enter it, so we are on to 581, just for clarity of the record and keeping it clean.

MR. WELLS: Do you have Exhibit 581, Mr. Chriss?

CHAIRMAN BRISÉ: Are there any -- any objections?

Okay. You may proceed.

THE WITNESS: I have two exhibits in front of

me. Could you please tell me --

BY MR. WELLS:

Q The first one would be the Florida Retail Federation's prehearing statement in docket number 060038-EI. Do you have that?

A I do.

Q If you'd turn to page 6, Issue 17. Do you see what FRF's position is on whether or not amounts not recovered through base rates due to the disruption of service due to the 2005 storm season be recoverable?

A I see the answer, and they say that only the costs that are directly related to restoring facilities should be included in allowable storm restoration costs recover --

Q So FRF's position was lost revenue was not recoverable and should not be recoverable?

A I haven't read the whole document, and this doesn't make any direct reference to lost revenues -- or amounts not recovered -- oh, okay. Yeah.

Q Do you understand it now?

A Yeah. Sorry.

Q Okay.

A Reading on my feet.

Q And in 2005, four major hurricanes struck Florida with massive energy outages and massive losses

of revenue; isn't that right, sir?

A I will take your word for it. I -- I was not working and doing any Florida work in 2005 or 2006.

Q And even living in Bentonville, Arkansas, you weren't familiar with the fact that four major hurricanes struck Florida in 2005?

A In 2005, I lived in Salem, Oregon, so I was out of the southeastern realm. But I will take your word for it.

Q Okay. And -- now, you are familiar with the fact that there is a Tropical Storm, probably soon to be hurricane, Isaac out there right now?

A I am.

Q Okay. And are you aware of the power outages that FPL has already suffered as a result of that storm, which has not even directly hit South Florida?

A I understand there have been power outages, yes.

Q And for every one of those power outages, there are revenue losses?

A That's correct.

Q And that's certainly a risk that the company faces that has nothing to do with regulatory lag?

A Sure.

Q Okay. And if you look at Exhibit 582, which

should be the order of the Commission, and you can turn to page 40 -- no, I am sorry, page 212. It's question 40. Forgive me.

A Oh, all right.

Q You can see there that the Commission determined not to permit FPL to recover these lost revenues as a result of the 2005 storms, correct?

A I am sorry. I am -- I am having -- I am still reading it.

Q Okay. Okay.

A It appears as such.

Q Okay. Thank you.

Now, you spoke earlier about Wal-Mart and its competing in -- in the marketplace. A Florida Power & Light has to compete in the marketplace as well for investors, for lenders, for a bond rating, correct?

A That's my understanding.

Q Okay. Certainly, Florida Power & Light, in competing for investors, folks look to its ROE, right?

A I would -- I would imagine so, yes.

Q Well, just like investors would look at Wal-Mart to see what its ROE is in determine whether or not to invest their precious dollars there, they would do the same thing with respect to FPL?

A Sure.

Q Okay. Lenders do the same thing; they look to your financial results, including your ROE, in determining whether or not to loan precious capital funds, right?

A Sure.

Q Rating agencies also look to the ROE to determine how to rate that company and the company's debt, correct?

A Yes.

Q And Wal-Mart makes certain that it does the very best it can with respect to its ROE for its investors and in order to maintain its high bond rating; doesn't it?

A Yes.

Q In fact, as of the second quarter of 2013, your executive ex-president and chief financial officer declared that for the year 2011 -- or the fiscal year 2012, excuse me, Wal-Mart returned $3.1 billion to shareholders during the quarter; isn't that correct?

MR. WRIGHT: Mr. Chairman, I -- I object only to the extent that I think counsel misstated the date. I heard him say that the statement was asserted to have occurred in 2013.

BY MR. WELLS:

Q If I did, I misspoke. It occurred

August 16th, 2012, as part of the second quarter 2013 earnings release.

A We are in 2013 fiscal year.

Q Right. And are you familiar with the fact that Wal-Mart has recently returned $3.1 billion to its shareholders?

A I have not seen that specific release, but I do know that we did well for this previous quarter.

Q Okay. And if, in fact, Wal-Mart was required to pay the modest rate increase in its rates that FPL has here, that wouldn't even put a dent in the return to Wal-Mart's shareholders; would it?

A Well, that return is based on our global business. I don't know specifically the results in FPL's territory, and any rate increase, like I said in the testimony, increases the bottom line, in that it drives our costs up. And it also impacts our top line because our customers have less money to spend in our stores.

Q And the same thing is true for Florida Power & Light, any decrease in the amount of revenues that it needs to do its business would simply -- similarly impact it? It's not just -- the cost side is the revenue side as well; isn't it, sir?

A I am sorry. Could you say that one more time?

Q Okay. You have talked a lot about the concern over Wal-Mart over costs. Revenues are equally important; aren't they?

A Yes, revenues are important.

Q And revenues are equally important to Florida Power & Light in -- in order to provide sustainable energy; isn't it?

A Yes, and the Commission will use its discretion to determine the just and reasonable amount.

Q Thank you. Yes, they will.

MR. WELLS: No further questions.

CHAIRMAN BRISÉ: Staff?

MR. YOUNG: No questions.

CHAIRMAN BRISÉ: Commissioners. Commissioner Balbis?

COMMISSIONER BALBIS: Thank you. I have, I think, one -- one or two questions for Mr. Chriss.

You state in your testimony that you're here on the behalf of the Retail Federation?

THE WITNESS: I do.

COMMISSIONER BALBIS: So you are not representing Wal-Mart; you're representing the Retail Federation, correct?

THE WITNESS: That's correct.

COMMISSIONER BALBIS: Okay. And -- and what

range of businesses are represented by the Retail Federation in size?

THE WITNESS: My understanding is that the range of businesses spans from Wal-Mart and the other big box stores at the larger end down to the mom and pops. That's my understanding, so I don't have the list of -- of the retailors that are part of the Federation.

COMMISSIONER BALBIS: No, that's fine. That's what I wanted to get to.

THE WITNESS: Sure.

COMMISSIONER BALBIS: So ranging from the large box stores down to the mom and pop stores, would you say that that is a -- that they employ a significant workforce in FPL's territory.

THE WITNESS: Yes, I would imagine so.

COMMISSIONER BALBIS: Do you have any idea about the scale? Is it 50 percent? Is it 10 percent? Is it --

THE WITNESS: That, I don't know. I will look to my lawyer to see if we need to do a late-filed exhibit to get you those numbers.

MR. WRIGHT: Mr. Chairman, if Commissioner Balbis wants a late-filed exhibit, we will do our best to provide it. We -- subject -- subject to

your preference.

COMMISSIONER BALBIS: I -- I think it's important at least for me. There has been a lot of discussion with other witnesses on number of jobs -- jobs lost or created in different sectors, and I think that the retail sector, it's important to see how many jobs are created by representatives of the Retail Federation, since this witness did indicate that they are a significant employer in FPL's territory.

And with that, I don't have any other -- any other questions.

MR. SWITALSKI: Mr. Chairman, I just had a lot to go on. If I could please ask that Commissioner Balbis restate exactly what he wants so I can get it right. I would appreciate it.

COMMISSIONER BALBIS: Yeah. What -- what I would like is a good estimate on number of employees within the businesses represented by the Retail Federation in FPL's service territory.

MR. YOUNG: Mr. Chairman, just a clarifying question on the numbering of the exhibit. I heard Mr. Wells -- Mr. Wise -- Wells indicated that he did 582.

CHAIRMAN BRISÉ: 582.

MR. YOUNG: Then, this will be 583, the late-filed exhibit.

CHAIRMAN BRISÉ: If we get a late-filed exhibit for this witness, it will be 583.

MR. YOUNG: Yes.

CHAIRMAN BRISÉ: But we will deal with exhibits in a little bit.

Mr. Moyle?

MR. MOYLE: Just at some point, I have a couple of comments on the late-filed. That's been something that I have had a recurring issue with, so I don't want to --

CHAIRMAN BRISÉ: Okay.

MR. MOYLE: -- raise it. Do you want me to talk about it now?

CHAIRMAN BRISÉ: No, when -- when we get to exhibits --

MR. MOYLE: Okay.

CHAIRMAN BRISÉ: -- we will deal with that.

MR. MOYLE: Thank you.

COMMISSIONER BALBIS: And I have one more --

CHAIRMAN BRISÉ: Sure.

COMMISSIONER BALBIS: -- unless we have -- have we closed out that late-filed?

CHAIRMAN BRISÉ: Go ahead.

COMMISSIONER BALBIS: FIPUG entered in an Exhibit 472 that I only have one copy of, but it's a copy of July 2012 excerpt from the Bureau of Labor Statistics report. I don't know if this witness has that or if staff could give him a copy of that. It's Exhibit 472.

MR. WRIGHT: Mr. Chairman, my colleague is trying to fish out a copy of it out of the box.

CHAIRMAN BRISÉ: Sure, you may --

MR. WRIGHT: Thank you, Mr. Chairman.

THE WITNESS: Thank you.

COMMISSIONER BALBIS: And if you could turn to the second to the last page of that exhibit, which I believe is Table 6.

THE WITNESS: Okay.

COMMISSIONER BALBIS: And Mr. Moyle had highlighted Florida and two numbers manufacturing, which I believe is in thousands of jobs. Would the jobs that are associated with the companies represented by the Retail Federation be included in manufacturing or in trade transportation and utilities -- or information? Would it be included in trade?

THE WITNESS: If I had to make a wild guess, I would say trade. I don't -- I am not totally sure

how they derive these numbers, but with just three broad industries represented there, I -- I assume they would be represented in trade.

COMMISSIONER BALBIS: Okay. And then, so if I'm reading this correctly, there appears to be five times the number of jobs in trade, transportation utilities than there are in manufacturing. Is that correct according to this table?

THE WITNESS: Yes, sir.

COMMISSIONER BALBIS: Okay. Thank you. That's all I had.

CHAIRMAN BRISÉ: Mr. Litchfield?

MR. LITCHFIELD: Thank you, Mr. Chairman.

With regard to the late-filed exhibit requested by Commissioner Balbis, my sense is this may represent somewhat of a challenge for Retail Federation, but we are certainly not opposed to it coming in.

But perhaps, it would be helpful for us and for the Commission in -- in reviewing it and giving it its -- its -- the requisite weight, to the extent that it can be sourced to -- to published information, you know, from state agencies or chambers something that -- that we can really

source well.

CHAIRMAN BRISÉ: Okay. When -- when we get to exhibits, we will go ahead and deal with all those issues.

MR. LITCHFIELD: Thank you.

CHAIRMAN BRISÉ: Commissioner Edgar.

COMMISSIONER EDGAR: Thank you, Mr. Chairman. Hi.

THE WITNESS: Good morning.

COMMISSIONER EDGAR: In your testimony regarding the request from FPL for the 25 basis points additional ROE for what they have termed superior performance, you say that if the Commission were to consider that favorably -- that's not the exact words, but I think that's the intent -- if -- if the Commission were to consider that, that we should spin it out into a separate case or a separate docket.

So my question on that is, what information do we not have in this evidentiary proceeding that we would need, in your opinion, in order to consider that and therefore need a separate docket?

THE WITNESS: Well, I think ultimately because FPL proposes that the adder -- or the -- this bonus, basically, be applied to all utilities, you

would need to have a comparable set of information for all of the utilities to be able to set up a benchmark that covers all of them.

As I say in the testimony, one of the things that is really concerned to FRF is setting up this sort of, I can do this, and I know I can do this, so I win sort of adder that would be applied to all utilities. So if I know I am the best at something, I can come in and say, well, give me 25 basis points because I am the best at it and rope all of the other utilities into that.

Any -- any adder that's set up or any performance benchmark really needs to be transparently calculated. It needs to be something that can be applied to all of the utilities fairly.

For instance, I know that in rebuttal testimony, FPL talks about Virginia. Well, Virginia has a myriad of ROE incentive statutes, and while they have them, they are applied to all utilities evenly. There is no -- there is nothing that focuses on one and says, you are really good at that, you get it there and -- and there -- then says to another, you're really good at that, and you will get it here. It says these are the parameters, and here is what the reward is --

So any performance-based rate-making that is put in, especially if it is applied to all the utilities, really needs to have all the information from all the utilities.

COMMISSIONER EDGAR: So are you suggesting that this Commission should consider a -- an ROE adder for providers -- for more than one provider?

THE WITNESS: What I am saying is that in this docket, the Commission really -- if the -- if the Commission wants to provide an ROE over and above the cost-based level, which my understanding is the midpoint of the range, it certainly has within its discretion to do so. And that's one thing.

The -- the other thing is sort of what FPL has proposed where they want a specific mechanism with specific inputs and outputs that would apply to all utilities, but we are only dealing with it now for FPL. So think of it sort of -- because the Commission has within its discretion to apply, really, whatever it wants. I mean, the statute says it. I reference it in my testimony.

So if, you know, Commissioner Balbis yesterday mentioned doing a range -- a midpoint of 10 and a range of 9 to 11.25. I mean, the Commission can certainly do that, and that's well within the

confines of this case in my opinion. However, settings up a mechanism in this case that would impact all utilities, I don't believe is appropriate because the other utilities .

COMMISSIONER EDGAR: I think we may be talking past each other, and I really am trying to understand --

THE WITNESS: Sure.

COMMISSIONER EDGAR: -- how -- how does -- and purely for discussion purposes, how does a request for 25 basis points due to having currently the lowest rates within a specific geographic area, how does that impact other utilities?

THE WITNESS: Well, if the mechanism is set up in such a way where other utilities can then work to have the lowest residential rate and achieve the adder their --

COMMISSIONER EDGAR: Can't only one have the lowest?

THE WITNESS: Yes, only -- on one can have it, but it's -- the -- the incentives it could provide, you know, we talked earlier about the underpinnings of the Class Cost of Service Study, and especially with something like generation plant, which is a highly litigated part of the Cost of Service Study

nationwide, you know, if -- if utilities come in with changes made there or -- or revenue allocation changes, it --

Ultimately, the -- I believe the Commission broadly should be focused on setting rates in cost of service and having them be just and reasonable. And to the extent that the performance mechanisms or rewards are set up, they really need to work within that cost of service framework.

And my concern and FRF's concern is that the performance adder that FPL has proposed doesn't work within that cost of service framework because it provides an incentive to move away from that.

COMMISSIONER EDGAR: Can you talk to me about how ROE is or is not cost-based?

THE WITNESS: There is a lot of discussion in every case and in case of -- of the cost -- I mean, essentially ROE is a cost. It's a cost of money.

So there is a lot of talk about investor expectations, whether or not they think the ROE should be high or if it should be low. And I believe the range in this case is from 9 to 11.25. And so -- and it's not directly measurable, so the Commission determines what it feels is the appropriate cost-based return on equity. And

that's what it applies.

COMMISSIONER EDGAR: Okay. So -- so how is determining the appropriate ROE cost-based?

THE WITNESS: Well, if -- if the Commission feels that -- from the determination of evidence, that what the expectations are would result in an ROE of 10, to then award an ROE of 11 wouldn't be cost-based because there would be a 100 basis point difference.

So -- so maybe my understanding, as we talked about before, is that the -- the Commission sets the range and that the midpoint is the cost based level of ROE. So to the extent that it veers from the midpoint up or down, the Commission would -- would, in a sense, be looking at non-cost issues.

COMMISSIONER EDGAR: Okay. All right. Thank you. Thank you.

CHAIRMAN BRISÉ: I have a couple of questions, and this sort of goes back to the basic premise of the decision-making process as to how FRF determines what positions they are going to take within a particular case, and you're here representing FRF?

THE WITNESS: Correct.

CHAIRMAN BRISÉ: Right? Not -- not

specifically Wal-Mart?

THE WITNESS: Correct.

CHAIRMAN BRISÉ: So considering the wide range of size of companies that you have that are represented by FRF, and you may have a wide range of impact of -- of -- in a proposed rate case, what is that process that goes through -- what -- I mean, how do you get to deciding what issues and how much interest is put in certain issues considering the wide range of -- of groups that you have that -- or wide range of size companies that you have within your association?

THE WITNESS: Sure. In terms of determining the issues, the broader issues are typically the ones that are determined that it's worth looking at. So the concerns about the -- the ROE, the concerns about the ROE adder, those are issues that impact customers, if not equally, pretty close to equally.

Typically, FRF doesn't advocate on cost of service or revenue allocation or rate design because those are things that either, you know, can potentially shift dollars between rate classes or can shift dollars within rate classes. So FRF doesn't address those, so it's typically the big --

the bigger picture issues.

CHAIRMAN BRISÉ: Okay. So it's fair to say that FRF is primarily concerned about what they would consider to be the bottom line impact on the individual stores, which are represented, and the person walking into the store.

THE WITNESS: Yes, sir.

CHAIRMAN BRISÉ: Okay. So their concern is not more global than that in terms of looking at the impact of the rate case or outcome of the rate case on what the -- the Commission's responsibilities is in terms of reliability, sustainability and those type of things?

THE WITNESS: Well, I mean, FRF believes, and I state it in my testimony that -- and I will point you to page -- where did it go? Page 4. We recognize that this needs to be done within FPL's duty to provide reliable and adequate service, and we would like to see that done at the lowest possible cost.

CHAIRMAN BRISÉ: Okay. That -- that clarifies for me your perspective.

THE WITNESS: Thank you.

CHAIRMAN BRISÉ: Thank you.

Redirect?

MR. WRIGHT: Thank you, Mr. Chairman. I do have a few questions on redirect.

REDIRECT EXAMINATION

BY MR. WRIGHT:

Q I just want to clarify one thing in response to a question asked to you by Commissioner Edgar. I -- I thought that she asked you whether it was your testimony that the Commission should apply the -- any performance adder type adjustment to more than one provider. If that's not correct, we can continue to dialogue.

But the question I did want to ask the witness is this, is it your understanding that FPL's proposal is to apply its performance adder for low rates to more than one provider?

A That's my understanding, yes.

Q Mr. Wells asked you a few questions about long -- whether Wal-Mart is concerned about long-term effects on utilities and -- and whether Wal-Mart was -- had a short-term view of rate cases. Does Wal-Mart -- and this is a followup redirect question to that.

Does Wal-Mart -- Wal-Mart care about the utilities that -- from which it obtains service being able to provide adequate and reliable service at low cost in the long run?

A Yes. The utilities are essentially our partners in business. We have to keep our stores open and keep providing service to our customers, and in order to do that, we certainly need our -- our utilities to be providing reliable and adequate service in the long run.

Q And does Wal-Mart expect to pay rates that cover the provision of adequate and reliable service at the lowest possible or the lowest reasonable cost in the long run?

A Yes.

Q Mr. Wells asked you a few questions as to whether Wal-Mart was or was not typical. I want to just ask you a couple of questions. Are -- as a predicate question, if I were to mention to you the rate classification General Service Large Demand Time of Use, would you know what that meant?

A Yes.

Q And if I were to mention up to the rate classification, General Service Demand or General Service Demand Time of Use, would you know what that meant?

A Yes.

Q In terms of being a -- a typical customer, would a Wal-Mart store that had a size characteristic of

FPL's GSLDT-1 or 2 rate class be similarly situated as any other customers served under the same rate class?

A In -- in terms of size, yes. Obviously, there are factors like load factor that differ.

Q But for -- following that, if -- if the customer had same -- a similar load factor, they would be similarly situated?

A Yes.

Q And so from a utility perspective, is a GSLDT-1 customer with a 57 percent load -- load factor, whether it's Wal-Mart or Publix or Target, typical of that type of customer?

A Well, of those three customers, it would be.

Q Thank you.

Mr. Wells asked you a few questions about whether you -- you were aware of other states having awarded electric utilities higher ROE's than FPL's currently authorized 10 percent. Do you recall those questions?

A Yes.

Q Are you aware of states that have awarded -- state public utility commissions that is, that have awarded ROE's -- rates of return on Common Equity less than 10 percent?

A Yes.

Q Can you name one?

A Well, I believe that the Public Utility Commission of Texas just award Energy Texas 9.8. Xcel Public Service Company of Colorado received 10 earlier this year. Arizona Public Service received 10 earlier this year, so those are some of the bigger ones.

Q Thank you.

Mr. Wells asked you a few questions about whether you can look at the impact of ROE as a component of -- of weighted average cost of capital. My question for you is this --

Do you recall that line of questioning?

A I do.

Q Thanks.

My question is this, can you separate the impact of a specified rate of return on equity in terms of its rate impact on customer? For example, can -- can you tell the Commission how much a one-percent division differential in the allowed return on equity means to -- to the allowed revenue requirements?

A Yes.

Q And do you know what that number is?

A My understanding is it's approximately -- 100 basis points is approximately $160 million. I have a calculation in Exhibit SWC-2 that deals with the 25

basis point adder, and that result is about 40 million so multiplying that by four.

Q Thank you.

You were asked some questions about cost of service methodologies. In -- in response to that question, my notes indicate that you agreed that a utility cannot change its cost of service methodology without Public Service Commission approval? Is that correct?

A That's correct.

Q Okay. A utility propose to change its cost of service methodology in any rate case?

A Yes.

Q Mr. Wells, in a line of questioning, suggested to you that -- predicate question, I believe you testified in response to Mr. Wells' questioning that the impact of the rate increase on Wal-Mart would be approximately $3 million?

A Yes.

Q Or north of $3 million, I think you said, correct?

A Yes.

Q My -- he then asked you some questions about, isn't it true that, that wouldn't make a dent in Wal-Mart's profits?

My question for you is, is $3 million or something north of $3 million a dent to Wal-Mart?

A Absolutely.

Q You used a term that -- that I am not sure everyone is familiar with. In responding to Mr. Wells' question, you said there is also a top line impact. Could you explain that to the Commissioners, please?

A Those are just the revenues that come in from sales at our stores.

Q Thanks.

And so when you used that term, what were you referring to?

A Essentially, our customers will feel the rate increase as well, and they will have less money. I mean, everybody has a fixed pot of money every month or every time period, and so to the extent that more has to go to one place, less goes every place else.

And so -- and this isn't just Wal-Mart. This is all retailors, so to the extent that families have less money and less purchasing power due to an increase in utility costs, that affects sales at retailors' stores.

Q I have one more followup question to Mr. Wells' questioning of you regarding other states and ROEs. Are you aware of the general trend in requested

ROEs by investor-owned utilities in other states?

A Yes. The general trend has been declining, and we have had several cases this last year where the asks have been under 11. And I believe the -- even the most recent Hawaiian Electric Light Company, which is the utility that serves the big island, they filed their 2013 rate case last week and asked for 10.25.

MR. WRIGHT: Thank you very much. That's all the redirect I have, Mr. Chairman.

CHAIRMAN BRISÉ: All right. At this time, we will deal with exhibits.

MR. WRIGHT: I would move Exhibits 278 and 279 into the record, Mr. Chairman.

CHAIRMAN BRISÉ: Okay. Without any objections, we will move 278 and 279 into the record.

(Whereupon, Exhibit Nos. 278 and 279 were received into evidence.)

CHAIRMAN BRISÉ: Moving on to 581 and 582.

MR. WELLS: Yes, we would move them both into the record.

CHAIRMAN BRISÉ: Okay. So we move --

MR. WRIGHT: No objection.

Excuse me, Mr. Chairman. I thought that -- that this 582 is a -- is a PSC order, and I thought

we weren't going to move them in, just merely identify them and reference them in our briefs.

MR. WELLS: That's correct.

CHAIRMAN BRISÉ: Okay. So the -- the preference is to take official recognition of 582, which is Commission Order 060038-EI.

Okay. So 581 is the prehearing statement on that same order.

582, now, would be the late-filed exhibit, Mr. Wright? 582 would --

(Whereupon, Exhibit No. 582 was marked for identification.)

(Whereupon, Exhibit Nos. 581 and 582 were received into evidence.)

MR. WRIGHT: That -- that's the numeration I would have, Mr. Chairman. Yes, sir.

CHAIRMAN BRISÉ: Okay.

MR. WRIGHT: And -- and we will -- we will endeavor to do our best to provide the information requested by Commissioner Balbis and with as authoritative sourcing as can we can muster in whatever time you wind up giving us.

CHAIRMAN BRISÉ: Okay. So what we will do with that is, if you can have it by this afternoon.

MR. WRIGHT: Mr. Chairman, frankly, I doubt

that that's going to be possible. We will do our best. I --

CHAIRMAN BRISÉ: Okay.

MR. WRIGHT: We will do our best. I think we -- we should be able to have it by the end of the hearing with FPL and all the other parties review it so that they can lodge -- lodge any objections they might have at the time.

CHAIRMAN BRISÉ: Okay. So we will grant you the time to -- to probably Thursday because by my time clock, we will probably be concluding on Thursday. So if we could have that by Thursday, and then we will deal with whatever objections with respect to the actual exhibit at that time.

MR. WRIGHT: Yes, sir.

CHAIRMAN BRISÉ: Okay.

MR. MOYLE: Mr. -- Mr. Chairman, can I just ask a clarification?

CHAIRMAN BRISÉ: Sure.

MR. MOYLE: I -- to -- to make sure I understand what is being requested, is it businesses in the FPL service territory? Is it businesses that are members of the Florida Retail Federation and the number of employees? I -- I --

Because I think, you know, if you just say how

many -- how many employees does the Florida Retail Federation represent? They have the whole state of Florida, and so they have members in other service territories. I am not sure -- I mean, I -- and again, I have a history with late-filed exhibits, so the notion that we get to look at them before they come in is very much appreciated. But I just was not 100 percent clear as to the information being sought, and -- and that would be helpful to me.

CHAIRMAN BRISÉ: I will -- I will ask Commissioner Balbis to restate what his interest is.

COMMISSIONER BALBIS: Well, as long as the Retail Federation is clear, but what I requested was the number of employees for Retail Federation businesses in FPL service territory.

MR. MOYLE: Thank you.

CHAIRMAN BRISÉ: Okay. All right. So that deals with the exhibits for this witness.

Mr. Wright, would like to have this witness excused?

MR. WRIGHT: Yes, sir. I would. May Mr. Chriss be excused please, sir?

CHAIRMAN BRISÉ: All right. Mr. Chriss, you

are excused.

THE WITNESS: Thank you.

CHAIRMAN BRISÉ: Safe travels.

MR. WRIGHT: Thank you, Mr. Chairman.

(Witness excused.)

CHAIRMAN BRISÉ: Okay. South Florida Hospital Association.

MR. SUNDBACK: Good morning, Mr. Chairman.

CHAIRMAN BRISÉ: Good morning.

MR. SUNDBACK: At this time, the South Florida Hospital Healthcare and Association would like to call to the stand Richard A. Baudino.

While the witness is getting settled in, we would like to double check that his exhibits have been premarked as numbers 294 through 306 for record purposes.

CHAIRMAN BRISÉ: According to my records, that's correct.

MR. SUNDBACK: Thank you, Mr. Chairman.

Whereupon,

RICHARD BAUDINO

was called as a witness, having been previously duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. SUNDBACK:

Q Sir, would you state your name and business address for the record, please?

A Yes, my name is Richard Baudino. My business address is J. Kennedy & Associates, Inc., 570 Colonial Park Drive, Suite 305, Roswell, Georgia.

Q You're the same Richard A. Baudino who has caused to be filed in this proceeding 64 pages of prepared evidence?

A Yes.

Q And have you also cause to be filed in this proceeding materials that have been initially designated as exhibits RAB-1 through 13?

A Yes.

Q Do you have any changes or corrections to the foregoing materials?

A I do not.

Q If you were asked the questions contained in your prepared testimony today, would your answers be the same?

A Yes.

Q To the best of your information, knowledge and belief, is the information contained in your exhibits correct?

A Yes, it is.

MR. SUNDBACK: Mr. Chairman, at this time, we would ask to have moved into the record as though now read, Mr. Baudino's evidence.

CHAIRMAN BRISÉ: Okay. We will enter into the record Mr. Baudino's testimony as though read seeing no objections.

(Whereupon, testimony inserted.)

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

IN RE:

PETITION FOR RATE INCREASE BY FLORIDA POWER AND LIGHT COMPANY	)))	**DOCKET NO. 120015-EI**

DIRECT TESTIMONY OF RICHARD A. BAUDINO

I. QUALIFICATIONS AND SUMMARY

Q. Please state your name and business address.

A. My name is Richard A. Baudino. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. What is your occupation and by whom are you employed?

A. I am a consultant with Kennedy and Associates.

Q. Please describe your education and professional experience.

A. I received my Master of Arts degree with a major in Economics and a minor in Statistics from New Mexico State University in 1982. I also received my Bachelor of Arts Degree with majors in Economics and English from New Mexico State in 1979.

I began my professional career with the New Mexico Public Service Commission Staff in October 1982 and was employed there as a Utility Economist. During my employment with the Staff, my responsibilities included the analysis of a broad range

of issues in the ratemaking field. Areas in which I testified included cost of service, rate of return, rate design, revenue requirements, analysis of sale/leasebacks of generating plants, utility finance issues, and generating plant phase-ins.

In October 1989, I joined the utility consulting firm of Kennedy and Associates as a Senior Consultant where my duties and responsibilities covered substantially the same areas as those during my tenure with the New Mexico Public Service Commission Staff. I became Manager in July 1992 and was named Director of Consulting in January 1995. Currently, I am a consultant with Kennedy and Associates.

Exhibit ____(RAB-1) summarizes my expert testimony experience.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the South Florida Hospital and Healthcare Association ("SFHHA").

Q. What is the purpose of your Direct Testimony?

A. The purpose of my direct testimony is to address the allowed return on equity and capital structure for ratemaking purposes for Florida Power and Light Company ("FPL" or "Company").

Q. Please summarize your Direct Testimony.

A. I recommend that the Florida Public Service Commission ("Commission") approve a rate of return on equity ("ROE") for FPL of 9.00%. This recommendation is based

on the results from my Discounted Cash Flow ("DCF") analyses for a comparison group of electric companies that has similar bond ratings to FPL. I also employed the Capital Asset Pricing Model ("CAPM"), but did not directly incorporate the results into my recommendation. In my opinion, a return on equity of 9.00% is a reasonable, even generous estimate of the required return on equity for a low-risk, financially robust electric company such as FPL. As I will demonstrate in the following sections of my testimony, the market evidence I examined supports my ROE recommendation.

Turning to the Company's testimony, the Commission should reject the return on equity recommendation of 11.25% of Dr. William Avera, witness for FPL. As I will explain in detail in Section IV of my Direct Testimony, the results from Dr. Avera's quantitative analyses do not support his recommendation. In particular, FPL's requested equity return simply exceeds the range of results calculated by FPL itself for its utility proxy group. Dr. Avera's recommended ROE only is supported by the ROE range from a group of non-utility companies. This non-utility group utterly fails to reflect the lower risk, regulated utility operations of FPL. Dr. Avera's recommended return on equity of 11.25% would burden Florida ratepayers with excessive rate levels. Moreover, an objective evaluation of current evidence from the financial markets fails to support anything close to Dr. Avera's 11.25% ROE recommendation.

Several FPL witnesses also supported the addition of 0.25% to Dr. Avera's recommended ROE, raising the Company's requested ROE to 11.50%. I will explain later in my testimony that the addition of a ROE adder for "excellent performance" is unreasonable and should be rejected by the Commission.

Q. What exhibits are you sponsoring as a part of your Direct Testimony?

A. I am sponsoring the following exhibits as a part of my Direct Testimony:

Exhibit ___(RAB-1) - Resume of Richard A. Baudino

Exhibit ___(RAB-2) - Historical Bond Yields

Exhibit ___(RAB-3) - DCF Dividend Yield Calculations

Exhibit ___(RAB-4) - DCF Growth Rates and ROE Calculation

Exhibit ___(RAB-5) - CAPM Analysis - Comparison Group

Exhibit ___(RAB-6) - CAPM Analysis - Historic Market Premium

Exhibit ___(RAB-7) - Avera Utility Proxy Group Growth Rates

Exhibit ___(RAB-8) - Five Year VIX Chart

Exhibit ___(RAB-9) - NextEra Investor Presentations

Exhibit ___(RAB-10) - Avera Prior Testimony

Exhibit ___(RAB-11) - FPL Data Responses

Exhibit ___(RAB-12) - Credit Rating Agency Report

Exhibit ___(RAB-13) - Florida Corporate State Income Tax and Wage Data

II. REVIEW OF ECONOMIC AND FINANCIAL CONDITIONS

Q. Mr. Baudino, what has the trend been in long-term capital costs over the last few years?

A. Exhibit ___(RAB-2) presents a graphic depiction of the trend in interest rates from January 2000 through December 2011. The interest rates shown are for the 20-year U.S. Treasury Bond and the average public utility bond from the Mergent Bond Record. Exhibit ____(RAB-2) shows that the yields on long-term Treasury and utility bonds have declined since early 2000, although not in an unbroken trend-line. Yields trended downward from 2002 through 2006, with the 20-year Treasury bond yield declining from 5.69% to 4.78% at the end of December 2006. The yield on the average public utility bond also decreased significantly over that time, falling from 7.83% in March 2002 to 5.83% in December 2006, a decline of 200 basis points. Public utility bond yields fell far more than long-term Treasury yields over that four year period.

2007 saw a rise in bond yields, fueled in part by investors' concerns over turmoil and defaults associated with the sub-prime lending market. This accelerated in 2008, a year in which world financial markets experienced tumultuous changes and volatility not seen since the Great Depression. As noted in the SBBI 2009 Yearbook, both large and small company stocks declined around 37% for the year.[1] Investors, in a flight to quality and safety, also pulled their funds out of those corporate bonds that

[1] *2009 Ibbotson SBBI Classic Yearbook*, Morningstar, page 11.

were perceived to be higher risk and invested in the safety of Treasury securities. The 2009 SBBI Yearbook reported that long-term Treasury Bonds returned 25.87% during 2008, while long-term corporate bonds returned 8.78%. Thus, bonds significantly outperformed stocks in 2008.

The stocks of electric utilities did not fare well during the financial market upheaval of 2008. The Dow Jones Utility Average was down from its opening level in January 2008 of 532.50 to 370.76 at the end of December, a decline of 30.4%. This decline was smaller than the decline in the overall stock market. Utility bond yields also increased significantly during the year, rising from 6.08% in January to a high of 7.80% in November. As investors flocked to the safety of Treasury securities, the yield spread between long-term Treasury securities and the index of public utility bonds widened from 1.73% in January to 3.69% in December, the highest spread during the entire period shown in Exhibit ___(RAB-2).

In 2009 and continuing through 2011, utility bond yields fell significantly from November 2008 levels, as did the spread between public utility bond yields and long-term Treasuries. The average utility bond yield in December 2011 was 4.47%, a decline of 333 basis points from the November 2008 level of 7.80%. At the end of December the yield spread between utility bonds and the long-term Treasury bond declined substantially to 1.80%. This is much closer to the historical spread.

So far in 2012, bond yields have changed little from their December 2011 levels. As of June 13, the Moody's average public utility bond yield stood at 4.28%.

On June 20, 2012, the Federal Reserve issued a Federal Open Market Committee press release indicating that it intended to extend what has been termed "Operation Twist". This refers to the Federal Reserve maturity extension program whereby the Federal Reserve redeems or sells shorter-term treasury securities and uses the proceeds to buy longer-term securities. By reducing the supply of longer-term Treasury securities, the prices of these securities will rise, putting downward pressure on long-term interest rates. The Fed hopes this accommodative monetary program will provide additional stimulus to the economy. Thus, it is reasonable to assume that long-term interest rates will remain low in the near future.

Q. Please compare current financial market conditions with the conditions that were present in FPL's last rate case, Docket No. 080677-EI.

A. When I submitted my testimony in July 2009 in Docket No. 080677-EI, the financial markets were recovering slowly from the tumultuous volatility and substantial losses sustained in 2008 and the country had fallen into a deep recession. I reported in that testimony that as of June 30, 2009 the average public utility bond was yielding 6.22%, almost 200 basis points higher than the yield as of June 13 this year. Since 2009, financial markets have recovered from the tumult of 2008 and interest rates are near historic lows. The Dow Jones Utility Average, which closed at 357.81 in June 2009, closed at 484.02 as of June 18, 2012, a rise of approximately 35%.

In addition the Chicago Board of Options Exchange ("CBOE") VIX index, a well-known measure of stock market volatility that Dr. Avera cited in his Direct Testimony in FPL's last rate case, has declined significantly. A chart of the VIX over the past five years is provided as Exhibit ____(RAB-8). At the end of February 2009, the VIX stood at 46.35. At the end of January 2012, the VIX has fallen to 19.44, indicating far less stock market volatility in this proceeding vis-à-vis FPL's last rate case. In FPL's last rate case, Dr. Avera stated that VIX "is a key measure of expectations of near-term volatility and market sentiment . . ."[2]

Also, FPL and NextEra Energy, Inc. ("NextEra"), FPL's parent company, have stated in investor presentations that economic conditions in FPL's service territory have been improving. Please refer to pages 1 through 7 of Exhibit ___(RAB-9). Because Florida's hourly wage rates and state corporate income tax rate are comparatively low, FPL's service territory will likely experience continued economic development and growth in its employment. Exhibit ___(RAB-13) at pp. 1-2 (Florida's corporate tax rate as compared to other states) pp. 3-4, row "All Occupations", columns "Median hourly wage", "Mean hourly wage", and "Annual mean wage" (Florida's wage rates as compared to the average rate in the United States).

Q. What does this suggest for the return on equity in this proceeding?

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[2] Avera Direct Testimony, Docket No. 080677-EI at p. 13 lines 6-7.

A. It suggests that the ROE in this case should be lower than in FPL's last rate. My ROE analysis in the next section of my testimony supports exactly this conclusion.

Q. How does the investment community regard the electric utility industry as a whole?

A. The March 23, 2012 Value Line report on the Electric Utility (Central) group of companies noted the following regarding the effect of the current low interest rate environment on electric utilities:

> Interest rates are at their lowest level in many years. Most of the effects of low interest rates on utilities are good, but there are drawbacks, too. As one would expect, many utilities have taken advantage of the low interest rate environment to refinance debt that was much more costly. The ensuing reduction in interest expense will eventually be passed onto customers, if the debt is held at the utility level, but the companies will retain the savings if the debt is held at the parent company or a nonregulated subsidiary. Low interest rates mean a lower cost of capital, which is beneficial for utilities financing large construction projects or acquiring assets—or entire companies.
>
> On the other hand, when interest rates are low, the allowed returns on equity that are awarded in rate cases trend downward. For instance, the two gas utilities in Illinois that are owned by Integrys Energy were granted an allowed ROE of just 9.45% for rate hikes that took effect at the start of 2012. Also, when a company such as CenterPoint Energy is holding onto cash in anticipation of acquiring assets, it is earning a negligible return on

these funds. Finally, pension expense for most utilities will increase this year because the interest rate used to discount future obligations has declined. Although a few companies have regulatory mechanisms that track pension costs, most will have to wait for their next rate case before recovering these increased expenses.

Low interest rates also help utility stocks. Many investors have turned to dividend stocks such as utilities because the returns on CDs or money market funds are minuscule. Nevertheless, when interest rates finally begin to rise, we believe that won't be disastrous for these equities because rates will be advancing from such a low level and will still be relatively low.

Value Line's May 4, 2012 review of the Electric Utility (West) group of companies also noted:

> The broader market averages have fared well so far in 2012, but electric utility stocks (as a group) have declined. This is a reversal from 2011, which was a very good year for utility equities. Perhaps the market is concerned about the possibility of a tax increase on dividend income, but we believe that the underperformance can be explained by a simple reversion to the mean. Electric utility equities now offer an average yield of 4.3%, which is nearly twice that of all dividend-paying issues under our coverage.

Q. Briefly describe Florida Power and Light Company.

A. FPL is a wholly owned subsidiary of NextEra. NextEra's other principle subsidiary is NextEra Energy Resources, which engages in the competitive energy business and produces its energy primarily from clean and renewable fuels. FPL's 2011 10-K noted that NextEra is one of the largest electric power companies in North America, serving over 4 million customers and having over 41,000 megawatts ("mW") of generating capacity in 24 states and 3 provinces in Canada. As of December 31, 2011, FPL's resources for serving load consisted of 26,538 mWs, 24,460 of which are owned by FPL. On page 3 of the Company's 2011 10-K report, it is stated "[w]ith 85% of its power generation coming from natural gas, nuclear and solar, FPL is also one of the cleanest electric utilities in the nation." FPL also noted that it provided residential and commercial bills that were among the lowest in Florida and below the national average based on rates per kWh in July 2011.

On page 6 of its 2011 10-K report, FPL noted: "FPL relies upon a diverse mix of fuel sources for its generation facilities, along with purchased power, in order to maintain the flexibility to achieve a more economical fuel mix by responding to market and industry developments." FPL collects fuel costs through a recovery mechanism approved by the FPSC that enables the company to true-up differences between actual and projected costs.

FPL derived approximately 62% of its 2011 generation from natural gas fired generating plants. Compared to electric utilities that rely on coal-fired capacity, FPL's risk is lower since it will not be as vulnerable to carbon-based environmental

rules and legislation. In a recent presentation to investors, NextEra stated: "Our strategic focus on clean generation assets has resulted in one of the lowest emissions profiles among the nation's top 50 power producers ... which provides attractive upside given the continuing direction of U.S. environmental policy." Exhibit ____(RAB-9) at pp. 12-13, 8-9, 11. Also, Dr, Avera previously stated in other proceedings (an example of which is provided in Exhibit ___(RAB-10) at p. 2 lines 5 through 10) that utilities, unlike FPL, that rely on coal-fired generation faced higher risks because of existing and potential environmental regulations.

In fact, FPL receives substantial benefits from a number of cost recovery clauses that have been approved by the FPSC. As the Company stated on page 11 of its 2011 10-K report:

> Cost recovery clauses, which are designed to permit full recovery of certain costs and provide a return on certain assets allowed to be recovered through the various clauses, include substantially all fuel, purchased power and interchange expenses, conservation and certain environmental-related expenses, certain revenue taxes and franchise fees. Beginning in 2009, pre-construction costs and carrying charges on construction costs for FPL's planned two additional nuclear units at Turkey Point and carrying charges on construction costs for FPL's approximately 450 mw to 490 mw of additional capacity at St. Lucie and Turkey Point are also recoverable through a cost recovery clause. Also beginning in 2009, costs incurred for FPL's three solar generating facilities are recoverable through a cost recovery clause. Cost

recovery clause costs are recovered through levelized monthly charges per kwh or kw, depending on the customer's rate class.

FPL's 2011 10-K noted that the Company would incur significant planned capital expenditures through 2016 that are expected to total $10.725 billion.

With respect to capitalization, FPL's regulated utility operations are far less leveraged than NextEra's unregulated operations. As of 2011, FPL's utility operations were capitalized with 58% common equity compared to NextEra's unregulated operations, which were supported by only 21.1% common equity. In fact, NextEra's unregulated operations have increased their debt leverage from 73.8% in 2009 to 80.9% in 2011. This data came from FPL's Schedule D-2.

Q. What are the current senior secured bond ratings for FPL?

A. FPL's first mortgage bonds are rated A by Standard & Poor's ("S&P") and Aa3 by Moody's. These are basically the same bond ratings that the Company had during its last base rate case before this Commission, Docket No. 080677-EI.

FPL's rating changed for various reasons after the Commission's decision in the last rate case. According to Moody's Global Credit Research report published on April 9, 2010 NextEra and FPL's ratings reflected "higher risk throughout the consolidated organization resulting from increased leverage at the company's unregulated businesses, higher earnings and cash volatility, a growing energy trading and marketing business, and a deterioration in the political, regulatory, and economic

environment at its core Florida regulated utility."[3] Despite that deterioration, Moody's described FPL's regulatory framework as "characteristic of an *average regulatory environment*", not a high risk regulatory environment.[4] In particular, Moody's assessment of FPL's credit risk did not find the ROE granted FPL by the Commission in FPL's last rate case to be a negative factor in its assessment. Moody's stated, "[t]he downgrade of [FPL] is attributed to . . . [h]istorically strong financial metrics that may decline somewhat following the recent rate case decision, although Moody's expects any decline to be modest as a high percentage of [FPL's] revenues are recovered through riders or other cost recovery provisions that remain strong. In addition, [FPL's] recently awarded *10% ROE is consistent with those granted to some utilities in other parts of the country and its 59.1% equity ratio remains one of the highest in the U.S., mitigating the negative effect of the relatively low base rate increase.*"[5] FPL's more recent credit rate agency reports also demonstrate FPL's risk environment.

Moody's April 10, 2012 report on FPL noted that the ratings drivers for the Company are:

- Stabilized political and regulatory environment with new base rate case

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[3] Moody's Investors Service, "Rating Action: Moody's Downgrades FPL Group to Baa1 and FP&L to A2", *Global Credit Research* at p. 1 (Apr. 9, 2010).

[4] *Id.* at p. 2 (emphasis added).

[5] *Id.* at p.2 (emphasis added).

pending

- Strong credit metrics and low leverage
- Substantial capital expenditures program
- Strong liquidity

More specifically, the Moody's report noted the following:

> FPL continues to exhibit some of the stronger financial performance measures and cash flow coverage ratios in the industry, with ratios that are generally well above the parameters required for its rating under our Regulated Electric and Gas Utilities rating methodology. These include CFO pre-working capital interest coverage in the 6.0x to 8.0x range and CFO pre-working capital to debt in the 30% to 35% range in recent years. Its debt to capitalization of 33.8% at December 31, 2011 is among the lowest in the industry and the company maintains a fully funded pension plan, contributing to this low leverage profile (as Moody's adds pension underfunding to debt).
>
> * * *
>
> **Liquidity Profile** . . . FPL's cash flow has been strong (totaling $2.2 billion in 2011) and relatively stable in recent years due to the lack of regulatory deferrals that had affected the company's financials in some previous years as a result of storms and high fuel costs. With fuel costs remaining relatively low and exhibiting less volatility more recently,

regulatory deferrals have not been as significant.[6]

Moody's currently maintains a stable rating outlook for FPL.

S&P's April 24, 2012 Summary Report on FPL stated the following:

> Standard & Poor's Ratings Services' bases its ratings on [FPL] on the consolidated credit profile of its parent, diversified energy holding company [NextEra]. The credit fundamentals on its regulated utility side have been among the strongest in the U.S., due primarily to low regulatory risk and an attractive service territory with healthy economic growth and a sound business environment. Both of those pillars have been shaken in recent years as Florida, and [FPL] service territory in particular, suffered during the recession, and regulators have responded in ways that reflect greater political influence over regulatory decisions. Although the utility has found maintaining financial strength despite mild regulatory upheaval and a moribund economy in Florida to be challenging, its actions to rebuild its regulatory risk profile have been effective. *More importantly, the proportion of NextEra's unregulated businesses--the riskier merchant generation, marketing, and trading activities--could increase, which could further erode its consolidated business risk profile.* [italics added]

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[6] Moody's Investors Services, "Credit Opinion: Florida Power & Light Company", *Global Credit Research*, at pp. 1-2 (Apr. 10, 2012).

* * *

> Standard & Poor's Ratings Services' ratings on all NextEra entities reflect the strength of the regulated cash flows from integrated electric utility [FPL], and the diverse and substantial cash-generation capabilities of its unregulated operations at subsidiary NextEra Energy Resources (NER). [FPL] represents about half of the consolidated credit profile and has better business fundamentals than most of its integrated electric peers, with a better-than-average service territory, sound operations, and a credit-supportive regulatory environment in which the company has been able to manage its regulatory risk very well. A willingness to expand through acquisitions, fluctuating cash flows from NER's rapidly expanding portfolio of merchant generation assets and growing marketing and trading activities, and significant exposure at the utility to natural gas detract from credit quality, in our view.

Exhibit ____(RAB-12) at pp. 1-2.

S&P's rating outlook for NextEra and FPL is stable.

Q. Mr. Baudino, what is your conclusion regarding the financial health and overall risk of FPL?

A. Since its last rate proceeding before the Commission, the Company has had nearly unfettered and low cost access to capital markets for its construction program and for other corporate purposes. In fact, in a recent presentation to its investors, NextEra noted that in June 2011, FPL issued $250 million of 30-year bonds at 5.125% and in December issued $600 million of 30-year bonds at 4.125%. NextEra noted that both

issues were "oversubscribed representing investor confidence and demand for our debt." Exhibit ___(RAB-9) at p. 19. And the December issuance of $600 million is at a rate less than the current average utility bond yield I cited earlier of 4.28%. In addition, FPL's short term debt costs have declined from 5.301% in January 2007 to 0.220% in March 2012. Exhibit ___(RAB-11) at pp. 1-2.

FPL also benefits from several Commission-approved cost recovery clauses that significantly reduce its business and financial risk profiles and help stabilize its earnings. Its excellent bond ratings currently enjoy a stable credit outlook from Moody's and S&P. Overall FPL remains a low risk electric utility with rock solid financial health and overall better credit metrics than its electric utility peers.

Further, as I mentioned earlier, current interest rates are at or near historic lows. This suggests a much lower return on equity, other things equal, for FPL than in Docket No. 080677-EI. I expect the Federal Reserve to support the current low interest rate environment based on recent statements that indicate that the Federal Funds rate will remain exceptionally low through at least late 2014.[7] In the next section of my testimony, I will discuss what rate of return I recommend the Commission should adopt for FPL in this proceeding.

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[7] http://www.federalreserve.gov/faqs/money_12849.htm

III. DETERMINATION OF FAIR RATE OF RETURN

Q. Please describe the methods you employed in estimating a fair rate of return for FPL.

A. I employed a Discounted Cash Flow ("DCF") analysis for a group of comparison electric companies to estimate the cost of equity for the Company's regulated electric operations. I also employed several Capital Asset Pricing Model ("CAPM") analyses using both historical and forward-looking data.

Q. What are the main guidelines to which you adhere in estimating the cost of equity for a firm?

A. Generally speaking, the estimated cost of equity should be comparable to the returns of other firms with similar risk and should be sufficient for the firm to attract capital. These are the basic standards set out by the United States Supreme Court in *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield W.W. & Improv. Co. v. Public Service Comm'n*, 262 U.S. 679 (1923).

From an economist's perspective, the notion of "opportunity cost" plays a vital role in estimating the return on equity. One measures the opportunity cost of an investment equal to what one would have obtained in the next best alternative. For example, let us suppose that an investor decides to purchase the stock of a publicly traded electric utility. That investor made the decision based on the expectation of dividend payments and perhaps some appreciation in the stock's value over time; however, that investor's opportunity cost is measured by what she or he could have invested in as the next best alternative. That alternative could have been another

utility stock, a utility bond, a mutual fund, a money market fund, or any other number of comparable investment vehicles.

The key determinant in deciding whether to invest, however, is based on comparative levels of risk. Our hypothetical investor would not invest in a particular electric company stock if it offered a return lower than other investments of similar risk. The opportunity cost simply would not justify such an investment. Thus, the task for the rate of return analyst is to estimate a return that is equal to the return being offered by other risk-comparable firms.

Q. What are the major types of risk faced by utility companies?

A. In general, risk associated with the holding of common stock can be separated into three major categories: business risk, financial risk, and liquidity risk. Business risk refers to risks inherent in the operation of the business. Volatility of the firm's sales, long-term demand for its product(s), the amount of operating leverage, and quality of management are all factors that affect business risk. The quality of regulation at the state and federal levels also plays an important role in business risk for regulated utility companies.

Financial risk refers to the impact on a firm's future cash flows from the use of debt in the capital structure. Interest payments to bondholders represent a prior call on the firm's cash flows and must be met before income is available to the common shareholders. Additional debt means additional variability in the firm's earnings, leading to additional risk.

Liquidity risk refers to the ability of an investor to quickly sell an investment without a substantial price concession. The easier it is for an investor to sell an investment for cash, the lower the liquidity risk will be. Stock markets, such as the New York and American Stock Exchanges, help ease liquidity risk substantially. Investors who own stocks that are traded in these markets know on a daily basis what the market prices of their investments are and that they can sell these investments fairly quickly. Many electric utility stocks are traded on the New York Stock Exchange and are considered liquid investments.

Q. Are there any sources available to investors that quantify the total risk of a company?

A. Assessments by credit rating agencies are tools that investors use to assess the risk comparability of firms. Rating agencies such as Moody's and Standard and Poor's perform detailed analyses of factors that contribute to the risk of a particular investment or enterprise. The end result of their analyses is a rating that reflects these risks.

Discounted Cash Flow ("DCF") Model

Q. Please describe the basic DCF approach.

A. The basic DCF approach is rooted in valuation theory. It is based on the premise that the value of a financial asset is determined by its ability to generate future net cash flows. In the case of a common stock, those future cash flows generally take the form of dividends and appreciation in stock price. The value of the stock to

investors is the discounted present value of future cash flows. The general equation then is:

$$V = \frac{R}{(1+r)} + \frac{R}{(1+r)^2} + \frac{R}{(1+r)^3} + \cdots \frac{R}{(1+r)^n}$$

Where: V = *asset value*
R = *yearly cash flows*
r = *discount rate*

This is no different from determining the value of any asset from an economic point of view; however, the commonly employed DCF model makes certain simplifying assumptions. One is that the stream of income from the equity share is assumed to be perpetual; that is, there is no salvage or residual value at the end of some maturity date (as is the case with a bond). Another assumption is that financial markets are reasonably efficient; that is, they correctly evaluate the cash flows over time relative to the appropriate discount rate. Finally, the model I employ also assumes a constant growth rate in dividends. The fundamental relationship employed in the DCF method is described by the formula:

$$k = D_1/P_0 + g$$

Where: D_1 = *the next period dividend*
P_0 = *current stock price*
g = *expected growth rate*
k = *investor-required return*

Under the formula, it is apparent that "k" must reflect the investors' expected return. Use of the DCF method to determine an investor-required return is complicated by the need to express investors' expectations relative to dividends, earnings, and book value over an infinite time horizon. Financial theory suggests that stockholders purchase common stock on the assumption that there will be some change in the rate of dividend payments over time. We assume that the rate of growth in dividends is constant over the assumed time horizon, but the model could easily handle varying growth rates if we knew what they were. Finally, the relevant time frame is prospective rather than retrospective.

Q. What was your first step in conducting your DCF analysis for FPL?

A. My first step was to construct a comparison group of companies with a risk profile that is reasonably similar to FPL.

Q. Please describe your approach for selecting a comparison group of electric companies.

A. I used several criteria to select a comparison group. First, using the June 2012 issue of AUS Utility Reports, I selected electric companies that were rated at least A by Moody's and Standard and Poor's. FPL currently carries senior secured bond ratings of A from S&P and Aa3 from Moody's, so using the either/or criterion for an A rating assures that the companies in the comparison group carry bond ratings that are similar to FPL.

From that group, I selected companies that had at least 50% of their revenues from electric operations and that had long-term earnings growth forecasts from Value Line

and either Zacks Investment Research ("Zacks") or Thomson Financial. I will describe Zacks and Thomson Financial later in my testimony. From this group, I then eliminated companies that had recently cut or eliminated dividends, were recently or currently involved in merger activities, or had recent experience with significant earnings fluctuations.

The resulting comparison group of 12 electric companies that I used in my analysis is shown in the table below.

FLORIDA POWER AND LIGHT COMPANY
ELECTRIC UTILITY COMPARISON GROUP

		S&P	Moody's
1	Alliant Energy Corporation	A-/BBB+	A2/A3
2	Consolidated Edison, Inc.	A-	A3/Baa1
3	DTE Energy Company	A	A2
4	IDACORP, Inc.	A-	A2
5	MGE Energy, Inc.	AA-	A1
6	Nextera Energy	A	Aa3
7	Pepco Holdings, Inc.	A	A3
8	Portland General Electric	A-	A3
9	SCANA Corporation	A-	A3
10	Southern Company	A	A2/A3
11	Wisconsin Energy Corporation	A-	A1
12	Xcel Energy Inc.	A	A3

Q. What was your first step in determining the DCF return on equity for the comparison group?

A. I first determined the current dividend yield, D_1/P_0, from the basic equation. My general practice is to use six months as the most reasonable period over which to estimate the dividend yield. The six-month period I used covered the months from

December 2011 through May 2012. I obtained historical prices and dividends from Yahoo! Finance. The annualized dividend divided by the average monthly price represents the average dividend yield for each month in the period.

The resulting average dividend yield for the group is 4.04%. These calculations are shown in Exhibit ____(RAB-3).

Q. Mr. Baudino, did the dividend yield for your comparison group exhibit volatility over the six-month period you used in your analysis?

A. No, not really. Page 2 of Exhibit ____(RAB-3) shows the monthly average yields for the comparison group, which ranged from 3.96% to 4.10%. The 6-month average dividend yield for the comparison group, 4.04%, is quite close to the April and May dividend yields. Monthly dividend yields for the comparison group have been relatively stable over this 6-month period.

Q. Having established the average dividend yield, how did you determine the investors' expected growth rate for the electric comparison group?

A. The investors' expected growth rate, in theory, correctly forecasts the constant rate of growth in dividends. The dividend growth rate is a function of earnings growth and the payout ratio, neither of which is known precisely for the future. We refer to a perpetual growth rate since the DCF model has no arbitrary cut-off point. We must estimate the investors' expected growth rate because there is no way to know with absolute certainty what investors expect the growth rate to be in the short term, much less in perpetuity.

In this analysis, I relied on three major sources of analysts' forecasts for growth. These sources are Value Line, Zacks, and Thomson Financial.

Q. Please briefly describe Value Line, Zacks, and Thomson Financial.

A. The Value Line Investment Survey is a widely used and respected source of investor information that covers approximately 1,700 companies. It is updated quarterly and probably represents the most comprehensive of all investment information services. It provides both historical and forecasted information on a number of important data elements. Value Line neither participates in financial markets as a broker nor works for the utility industry in any capacity of which I am aware.

According to Zacks' website, Zacks "was formed in 1978 to compile, analyze, and distribute investment research to both institutional and individual investors." Zacks gathers opinions from a variety of analysts on earnings growth forecasts for numerous firms including regulated electric utilities. The estimates of the analysts responding are combined to produce consensus average estimates of earnings growth.

Like Zacks, Thomson Financial also provides detailed investment research on numerous companies. Thomson Financial also compiles and reports consensus analysts' forecasts of earnings growth. I obtained these forecasts from Yahoo! Finance.

Q. Why did you rely on analysts' forecasts in your analysis?

A. Return on equity analysis is a forward-looking process. Five-year or ten-year historical growth rates may not accurately represent investor expectations for dividend growth. Analysts' forecasts for earnings and dividend growth provide better proxies for the expected growth component in the DCF model than historical growth rates. Analysts' forecasts are also widely available to investors and one can reasonably assume that they influence investor expectations.

Q. How did you utilize your data sources to estimate growth rates for the comparison group?

A. Exhibit____(RAB-4) presents the Value Line, Zacks, and Thomson Financial forecasted growth estimates. These earnings and dividend growth estimates for the comparison group are summarized on Columns (1) through (5) of Exhibit ____(RAB-4).

I also utilized the sustainable growth formula in estimating the expected growth rate. The sustainable growth method, also known as the retention ratio method, recognizes that the firm retains a portion of its earnings to fuel growth in dividends. These retained earnings, which are plowed back into the firm's asset base, are expected to earn a rate of return. This, in turn, generates growth in the firm's book value, market value, and dividends.

The sustainable growth method is calculated using the following formula:

$$G = B * R$$

Where: *G = expected retention growth rate*
B = the firm's expected retention ratio
R = the expected return

In its proper form, this calculation is forward-looking. That is, the investors' expected retention ratio and return must be used in order to measure what investors anticipate will happen in the future. Data on expected retention ratios and returns may be obtained from Value Line.

The expected sustainable growth estimates for the comparison group are presented in Column (3) on page 1 of Exhibit ____(RAB-4). The data came from the Value Line forecasts for the comparison group.

Q. How did you approach the calculation of earnings growth forecasts in this case?

A. For purposes of this case, I looked at two different methods for calculating the expected growth rates for my comparison group. For Method 1, I calculated the average of all the growth rates for the companies in my comparison group using Value Line, Zacks, and Thomson. For Method 2, I calculated the median growth rates for my comparison group. The median value represents the middle value in a data range and is not influenced by excessively high or low numbers in the data set. The median growth rate for each forecast provides additional valuable information regarding expected growth rates for the group.

The expected growth rates produced from these two methods fall in a range from 3.75% to 5.04%.

Q. How did you proceed to determine the DCF return of equity for the electric comparison group?

A. To estimate the expected dividend yield (D_1) for the group, the current dividend yield must be moved forward in time to account for dividend increases over the next twelve months. I estimated the expected dividend yield by multiplying the current dividend yield by one plus one-half the expected growth rate.

I then added the expected growth rates to the expected dividend yield. The calculations of the resulting DCF returns on equity for both methods are presented on page 2 of Exhibit ____(RAB-4).

Q. Please explain how you calculated your DCF cost of equity estimates.

A. Page 2 of Exhibit ____(RAB-4) presents the DCF results utilizing the two different methods I described earlier. Method 1 utilizes the average growth rates for the comparison group. I used the Value Line earnings and dividend growth forecasts and the consensus analysts' forecasts. The average for the comparison group is 8.96% and the midpoint is 9.00%.

Method 2 employs the median growth rates from Value Line, Zacks, and Thomson. The average DCF return on equity is 8.72% and the midpoint of the results is 8.50%.

Capital Asset Pricing Model

Q. Briefly summarize the Capital Asset Pricing Model ("CAPM") approach.

A. The theory underlying the CAPM approach is that investors, through diversified portfolios, may combine assets to minimize the total risk of the portfolio.

Diversification allows investors to diversify away all risks specific to a particular company and be left only with market risk that affects all companies. Thus, the CAPM theory identifies two types of risks for a security: company-specific risk and market risk. Company-specific risk includes such events as strikes, management errors, marketing failures, lawsuits, and other events that are unique to a particular firm. Market risk includes inflation, business cycles, war, variations in interest rates, and changes in consumer confidence. Market risk tends to affect all stocks and cannot be diversified away. The idea behind the CAPM is that diversified investors are rewarded with returns based on market risk.

Within the CAPM framework, the expected return on a security is equal to the risk-free rate of return plus a risk premium that is proportional to the security's market, or non-diversifiable, risk. Beta is the factor that reflects the inherent market risk of a security and measures the volatility of a particular security relative to the overall market for securities. For example, a stock with a beta of 1.0 indicates that if the market rises by 15%, that stock will also rise by 15%. This stock moves in tandem with movements in the overall market. Stocks with a beta of 0.5 will only rise or fall 50% as much as the overall market. So with an increase in the market of 15%, this stock will only rise 7.5%. Stocks with betas greater than 1.0 will rise and fall more than the overall market. Thus, beta is the measure of the relative risk of individual securities vis-à-vis the market.

Based on the foregoing discussion, the equation for determining the return for a security in the CAPM framework is:

$$K = Rf + \beta(MRP)$$

Where: K = *Required Return on equity*
Rf = *Risk-free rate*
MRP = *Market risk premium*
β = *Beta*

This equation tells us about the risk/return relationship posited by the CAPM. Investors are risk averse and will only accept what they anticipate as higher risk if they expect to receive higher returns. These returns can be determined in relation to a stock's beta and the market risk premium. The general level of risk aversion in the economy determines the market risk premium. If the risk-free rate of return is 3.0% and the required return on the total market is 12%, then the risk premium is 9%. Any stock's required return can be determined by multiplying its beta by the market risk premium. Stocks with betas greater than 1.0 are considered riskier than the overall market and will have higher required returns. Conversely, stocks with betas less than 1.0 will have required returns lower than the market as a whole.

Q. In general, are there concerns regarding the use of the CAPM in estimating the return on equity?

A. Yes. As briefly discussed earlier, there is some controversy surrounding the use of the CAPM.[8] There is evidence that beta is not the primary factor in determining the risk of a security. For example, Value Line's "Safety Rank" is a measure of total risk, not its calculated beta coefficient. Beta coefficients usually describe only a small amount of total investment risk. Finally, a considerable amount of judgment must be employed in determining the risk-free rate and market return portions of the CAPM equation. The analyst's application of judgment can significantly influence the results obtained from the CAPM. My past experience with the CAPM indicates that it is prudent to use a wide variety of data in estimating returns. Of course, the range of results may also be wide, indicating the difficulty in obtaining a reliable estimate from the CAPM.

Q. How did you estimate the market return portion of the CAPM?

A. The first source I used was the Value Line Investment Analyzer, Plus Edition, for June 6, 2012. This edition covers nearly 7,000 stocks. The Value Line Investment Analyzer provides a summary statistical report detailing, among other things, forecasted growth in earnings and book value for the companies Value Line follows. I have presented these two growth rates and the average on page 2, lines 8 and 9 of Exhibit ____(RAB-5). The average growth rate is 10.74%. Combining this growth rate with the average expected dividend yield of the Value Line companies of 0.65%

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[8] For a more complete discussion of some of the controversy surrounding the use of the CAPM, refer to *A Random Walk Down Wall Street* by Burton Malkiel, pp. 229 – 239, 1999 edition.

> the past. Indeed, evidence presented in the following sections indicates that relative expected returns should, and do, vary significantly over time. Empirically, the measured historic premium is sensitive both to the choice of estimation horizon and to the end points. These choices are essentially arbitrary, yet can result in significant differences in the final outcome.[9]

In summary, the use of historic earned returns should be viewed with a great deal of caution. There is no real support for the proposition that an unchanging, mechanically applied historical risk premium is representative of current investor expectations and return requirements.

Q. How did you determine the risk free rate?

A. I used the average yields on the 20-year Treasury bond and five-year Treasury note over the six-month period from December 2011 through May 2012. Exhibit ___(RAB-5) at p. 2, lines 1 through 7. The 20-year Treasury bond is often used by rate of return analysts as the risk-free rate, but it contains a significant amount of interest rate risk. The five-year Treasury note carries less interest rate risk than the 20-year bond and is more stable than three-month Treasury bills. Therefore, I have employed both of these securities as proxies for the risk-free rate of return. This approach provides a reasonable range over which the CAPM may be estimated.

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[9] Brigham, E.F., Shome, D.K. and Vinson, S.R., "The Risk Premium Approach to Measuring a Utility's Cost of Equity," *Financial Management*, Spring 1985, pp. 33-45.

Q. What is your estimate of the market risk premium?

A. Exhibit ____(RAB-5), lines 9 and 22 of page 1, presents my estimates of the market risk premium based on a DCF analysis applied to current market data. The market risk premium is 8.65% using the 20-year Treasury bond and 10.52% using the five-year Treasury bond.

Utilizing the historical Ibbotson data on market returns, the market risk premium ranges from 4.50% to 6.50%. This is shown on Exhibit ____(RAB-6), line 3.

Q. How did you determine the value for beta?

A. I obtained the betas for the companies in the electric company comparison group from most recent Value Line reports. The average of the Value Line betas for the electric group is .68. Exhibit ___(RAB-5) at p. 2, line 20.

Q. Please summarize the CAPM results.

A. The CAPM results using the 20-year and five-year Treasury bond yields and Value Line market return data range from 8.06% to 8.65%. Exhibit ___(RAB-5) at p. 1, lines 14 and 27.

The CAPM results using the historical Ibbotson data range from 5.81% to 7.18%. These results are shown on Exhibit ____(RAB-6), line 7.

Conclusions and Recommendations

Q. Please summarize the cost of equity you recommend the Commission adopt for FPL.

A. I recommend that the Commission adopt the DCF model I developed and the cost of equity estimates for the comparison group of electric utility companies that I compiled. The results for the electric company comparison group using the constant-growth DCF model and the expected growth rate forecasts ranged from 8.50% to 9.00%. Exhibit ___(RAB-4) at p. 2, lines "Midpoint of Results". Based on this range of results, I recommend that the Commission adopt a 9.00% return on equity for FPL in this proceeding. Notwithstanding the lower level of risk FPL experiences relative to my comparison group, for purposes of the ROE ranges I am recommending, I am placing FPL at the top of my range (a positioning that would not be justified using FPL's inflated ranges). I offer this recommendation to the FPSC as a just and reasonable estimate of investor return on equity requirements for a lower risk electric utility such as FPL.

Finally, it should be noted that the CAPM results are significantly lower than the DCF results in this proceeding. Exhibit ___(RAB-5) at p. 1, lines 14 and 27 and Exhibit ___(RAB-6) at p. 1, line 7. This is the case with both the forward-looking and the historical versions of the CAPM. I do not rely on the CAPM for my ROE recommendation, but these results suggest that my recommended ROE of 9.00% is reasonable, even generous, based on current capital market conditions.

Capital Structure and Weighted Cost of Capital

Q. Did you review FPL's requested capital structure?

A. Yes. The Company's requested capital structure and weighted cost of capital is presented in Schedule D-1A and is supported by the Direct Testimony of FPL witnesses Avera, Ousdahl, Barrett, and Dewhurst. These witnesses supported an "adjusted" equity ratio of 56.3%, which includes the imputation of $949 million of off-balance sheet purchased power agreements ("PPAs"). It is important to note that this is not the capital structure the Company is using for ratemaking purposes, but is instead one that is designed to reflect how FPL off-balance sheet PPAs are treated for purposes of bond rating agency reporting. Dr. Avera presented the calculation of this so-called adjusted equity ratio in his Exhibit WEA-14.

FPL witness Dewhurst and Dr. Avera both testified that based on investor supplied capital, the Company's equity ratio is 59.6%.

Q. Mr. Baudino, is FPL's proposed level of equity comparable to the companies in your comparison group?

A. No. FPL's proposed level of equity is significantly higher than that used by the companies in my comparison group. Table 2 below presents the common equity ratios for the comparison group. I obtained the data from the Value Line Investment Survey and from AUS Utility Reports, June 2012.

TABLE 2
COMPARISON GROUP CAPITAL STRUCTURES

		2011 Value Line Common Equity	AUS Common Equity
1	Alliant Energy Corporation	50.9%	51.2%
2	Consolidated Edison, Inc.	52.5%	51.0%
3	DTE Energy Company	49.4%	47.1%
4	IDACORP, Inc.	54.4%	51.8%
5	MGE Energy, Inc.	60.4%	60.6%
6	Nextera Energy	41.8%	38.8%
7	Pepco Holdings, Inc.	53.3%	45.3%
8	Portland General Electric	50.4%	49.3%
9	SCANA Corporation	45.7%	42.1%
10	Southern Company	47.1%	46.5%
11	Wisconsin Energy Corporation	46.0%	43.9%
12	Xcel Energy Inc.	48.9%	45.5%
	Average	50.1%	47.8%

Source: Value Line Reports 2012; AUS Utility Reports, June 2012

It is abundantly clear that FPL's equity ratio greatly exceeds the comparison group equity ratio. Only MGE Energy has a common equity ratio anywhere close to FPL's.

Q. Please summarize FPL's presentation of its capital structure and common equity ratio.

A. Both Dr. Avera and Mr. Dewhurst support an adjusted equity ratio of 56.3%. Dr. Avera supported this presentation as being reasonable based, in part, on the premise that the rating agencies take PPAs into account when evaluating financial strength and bond ratings.

Q. Does FPL need to maintain an unadjusted equity ratio of 60% to maintain its bond and credit ratings?

A. In my opinion, it does not. The utilities in my comparison have similar bond ratings to FPL and have much lower common equity ratios, even when FPL's PPAs are factored into the capital structure equation. In my view, this suggests that FPL could reduce its equity ratio by several percentage points and likely be able to maintain its bond ratings.

S&P described how it assigns three key financial ratios in developing and assigning bond ratings using a business risk and financial risk matrix.[10] These ratios are as follows:

- Funds from Operations ("FFO") Interest Coverage
- Funds from Operations / Total Debt
- Total Debt / Total Capital

S&P explained how these key ratios are used by it to develop a "Business Risk Profile" and "Financial Risk Profile" for the companies that it is rating. The Financial Risk Profile is assessed based on the three key ratios cited above. The Business Risk Profile encompasses S&P's qualitative assessment of factors such as the quality of regulation, the markets in which the company operates, operations, competitiveness, and management. Business Risk Profiles are characterized by S&P as Excellent, Strong, Satisfactory, Fair, Weak, or Vulnerable. Financial Risk Profiles are characterized as Minimal, Modest, Intermediate, Significant, Aggressive, or Highly Leveraged.

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[10] Please refer to "Business Risk/Financial Risk Matrix Expanded", originally published by S&P on May 26, 2009 and updated on November 30, 2011.

The April 24, 2012 S&P report I cited earlier in my testimony assigned an "excellent" business risk profile to FPL and an "intermediate" financial risk profile to NextEra. According to S&P, the adjusted debt/total capital ratios to support these ratings would fall into a range of 35% - 45%. The corollary is an adjusted equity ratio range of 55% - 65%.

S&P noted that its ratio analysis matrix serves as a guide and that it does not arrive at ratings by rote. Other factors may lead its rating committee to a different conclusion than what would otherwise be indicated by the matrix.

Another important factor to consider is that FPL's PPA obligations are going to decline significantly in 2015. Dr. Avera and FPL's 2012 10-K report noted that FPL's take-or-pay purchased power contracts with the Jacksonville Electric Authority and subsidiaries of the Southern Company provide 1,330 mWs of power through 2015 and then decline to 375 mWs thereafter through 2021. This means that the 949 mW of imputed debt from the PPAs will decline significantly within the next 2 - 3 years.

Q. Does FPL have a capacity cost recovery clause that mitigates the risk of its PPA obligations?

A. Yes. Page 11 of the Company's 2012 10-K stated that "[c]apacity payments to other utilities and generating companies for purchased power are recovered from customers through the capacity clause." The capacity clause assures FPL of

complete recovery of its purchased power obligations and is much less risky than including these costs in base rates.

Q. Do you have any other concern regarding FPL's equity rich capital structure?

A. Yes. An excessive FPL common equity ratio could result in ratepayers subsidizing NextEra's unregulated affiliate activities. It is unlikely that NextEra would be able to support and maintain a single 'A' credit rating on a corporate-wide basis without the support of an excessive FPL common equity ratio because NextEra Energy Resources is extremely highly leveraged. And, as I noted in Section II of my Direct Testimony, NextEra's unregulated operations have actually increased leverage over the last few years to over 80% debt.

Second, it is an economically inefficient outcome for ratepayers to support a higher than necessary equity ratio for FPL. There is a transfer of income in the form of economic rents being paid by FPL's customers to FPL, a monopoly provider of electric service. Regulation should prevent this kind of income transfer, which benefits shareholders to the detriment of ratepayers.

Q. What is your recommendation in this proceeding for FPL's capital structure and weighted cost of capital?

A. I recommend that the FPSC adopt the Company's requested test year capital structure, but only if it adopts my recommended return on equity of 9.00%. It would certainly be reasonable to reduce the Company's excessive common equity ratio in this case; however, the Commission declined to accept my recommendation to reduce the Company's common equity ratio in the last base rate case Order in 2009.

So for purposes of this case only, I am proposing use of FPL's proposed common equity ratio, and the result of my DCF computations. If a higher ROE is adopted, the capital structure issue would warrant much greater skepticism, because it means that ratepayers are not getting one of the prime benefits of a thick equity cushion, namely the benefit of the lower resulting risk. Please refer to Table 3 below for the calculation of my recommended weighted cost of capital for FPL, which is 5.85%.

TABLE 3
SFHHA ADJUSTED WEIGHTED COST OF CAPITAL

		Amount	Pct	Cost	Weighted Cost
Long-Term Debt	$	6,199,550	29.46%	5.26%	1.55%
Preferred Stock	$	-	0.00%	0.00%	0.00%
Customer Deposits	$	426,531	2.03%	5.99%	0.12%
Common Equity	$	9,684,101	46.03%	9.00%	4.14%
Short-term Debt	$	360,542	1.71%	2.11%	0.04%
Deferred Income Tax	$	4,369,074	20.76%	0.00%	0.00%
ITC	$	923	0.00%	9.06%	0.00%
Totals	$	21,040,721	100.00%		5.85%

Q. If the Commission chooses to adopt a higher ROE than your recommendation of 9.00%, then what is your recommendation with respect to FPL's common equity ratio for ratemaking purposes?

A. I recommend that the Commission reduce FPL's common equity ratio if it adopts a return on equity higher than 9.00%. One reasonable way to make this adjustment

would be for the Commission to reduce FPL's equity ratio by two percentage points for every 0.50% increase in the ROE over 9.00%. So for example, if the Commission adopted a ROE of 9.50%, the Company's equity ratio could be reduced by 2% to 57.6% of investor supplied capital. See Table 4 below for the calculation.

TABLE 4
SFHHA ALTERNATIVE WEIGHTED COST OF CAPITAL

			Pct	Cost	Weighted Cost
Long-Term Debt	$	6,526,996	31.02%	5.26%	1.63%
Preferred Stock	$	-	0.00%	0.00%	0.00%
Customer Deposits	$	426,531	2.03%	5.99%	0.12%
Common Equity	$	9,356,655	44.47%	9.50%	4.22%
Short-term Debt	$	360,542	1.71%	2.11%	0.04%
Deferred Income Tax	$	4,369,074	20.76%	0.00%	0.00%
ITC	$	923	0.00%	9.06%	0.00%
Totals	$	21,040,721	100.00%		6.01%

In this example, I moved common equity into long-term debt in order to reduce the common equity ratio to 57.60%. This reduced the amount of common equity for ratemaking purposes to $9,356,655,000, a decrease from the Company's requested amount of equity of $327,446,000. The Commission could also accomplish this by allocating a pro-rata share of the $327.446 million between long-term debt and short-term debt. This would slightly lower the overall weighted cost of capital. This

equity ratio is still within the S&P guidelines for a company with an intermediate financial risk profile.

This is one alternative I recommend to the Commission. The importance of this exercise is that if the Commission decides to raise FPL's ROE above my recommendation, it is reasonable to reduce the equity ratio so as not to increase the overall weighted cost of capital that must be supported by ratepayers. My market evidence suggests that a 9.0% ROE would be reasonable even with a lower equity ratio than FPL's 59.6% based on the equity ratios from my comparison group of companies. However, a higher ROE award in this case should only coincide with a lower equity ratio for FPL. This appropriately balances the interests of shareholders and ratepayers.

Q. Mr. Baudino are you aware of the Commission Order in Docket No. 110138-EI, which is the most recent Gulf Power rate proceeding?

A. Yes. I reviewed the portion of Commission Order No. PSC-12-0179-FOF-EI that discussed return on equity and the weighted cost of capital for Gulf Power Company. The Commission's Order adopted a 10.25% return on equity. In addition, the Commission's adjusted capital structure included the following percentages of investor-supplied capital.

TABLE 5
GULF POWER INVESTOR SUPPLIED CAPITAL

	Amount	Pct.
Long-Term Debt	$ 657,374,442	47.21%
Preferred Stock	$ 72,956,634	5.24%
Common Equity	$ 644,159,245	46.26%
Short-term Debt	$ 17,925,426	1.29%
Total	$ 1,392,415,747	100.00%

It is important to note that Gulf Power's current S&P bond rating is A and Moody's rating is A3. The common equity ratio approved by the Commission was 46.26%, with the total equity ratio being 51.5%. This is a substantially lower equity ratio than FPL is requesting in this case. Indeed, it would be reasonable for the Commission in this proceeding to approve a significantly lower ROE than it did in the Gulf Power case, given that FPL's common equity ratio is so much greater than Gulf Power's equity ratio.

IV. RESPONSE TO FPL TESTIMONY

Q. Have you reviewed the Direct Testimony of Dr. William Avera?

A. Yes.

Q. Please summarize your conclusions with respect to Dr. Avera's testimony and return on equity recommendation.

A. Dr. Avera's approach to estimating the cost of equity for FPL has some parallels with the approach he used in FPL's last base rate case, Docket No. 080677-EI, which was largely rejected by the FPSC in that case.

First, Dr. Avera's recommended 11.25% return on equity is grossly overstated, relies in essence entirely on the results of an inapposite non-utility proxy group and, just like the last base rate case, fails to reasonably track the majority of the results from his Utility Proxy Group analyses (not subject to unjustified adjustments), which range from 9.6% to 10.8%. As I shall demonstrate later in my testimony, even this range overstates the investor required return for FPL. Furthermore, equity return computations that exceed the upper end of this range are fatally flawed and should be rejected for reasons that I will explain later in my testimony.

Second, Dr. Avera made largely subjective changes to the results of his DCF analysis by excluding individual company DCF results that he considered to be either too high or too low. His results are skewed toward including DCF results that are still excessive, resulting in an overstatement of the average adjusted results from his Utility Proxy Group.

Third, Dr. Avera failed to include forecasted dividend growth in his DCF analyses. Failing to include this important information overstated his DCF results.

Fourth, Dr. Avera overstated the Market Risk Premium in his CAPM analysis because of a faulty approach to estimating the market return portion of the CAPM. My CAPM results incorporate a more sound method of estimation. Regardless, any defensible analysis on this issue would produce a lower ROE than that proposed by FPL.

Fifth, Dr. Avera included a size adjustment to his CAPM formulations that is incorrect and inappropriate. This size adjustment resulted in a significant overstatement of his CAPM results.

Sixth, Dr. Avera's expected earnings approach is inappropriate and should be rejected by the Commission.

Seventh, Dr. Avera's adjustment for flotation costs is inappropriate and should be rejected.

Dr. Avera's ROE Range and Recommendation

Q. Please summarize the results of Dr. Avera's ROE analyses.

A. Dr. Avera used four methods to estimate the cost of equity for FPL: a DCF model, a CAPM, a risk premium model, and an expected earning approach. He applied a DCF

model to two groups of companies, one composed of regulated electric utilities ("Utility Proxy Group") and another using unregulated companies ("Non-Utility Proxy Group"), which completely excluded utility operations. The results from his various methods are as follows:

Utility Proxy Group:

DCF – 9.6% to 10.3%
CAPM - 10.4% - 10.8%
CAPM Size Adjusted – 11.2% - 11.6%
Utility Risk Premium – 9.6% - 10.4%
Expected earnings – 10.5% - 12.0%

Non-Utility Proxy Group:

DCF – 11.5% - 12.3%

Notably, the group containing non-utility enterprises not surprisingly produced significantly higher upper range returns than the utility group.

Dr. Avera also recommended a 15 basis point adjustment for flotation costs. Finally, Dr. Avera supported an additional 0.25% adder for excellent management performance.

Based on these results, Dr. Avera recommended a range for FPL cost of equity of 10.25% - 12.25%. His recommended ROE was 11.25% "before any adder for low rates and excellent management". Adding 0.25% for these factors resulted in his final ROE recommendation of 11.5%.

Q. In your opinion, do the results of Dr. Avera's various analyses support his recommended 11.5% ROE for FPL?

A. No. Most of Dr. Avera's results from his Utility Proxy Group suggest a much lower ROE. The size-adjusted CAPM results, while higher than the DCF results suffer from several serious infirmities and should be disregarded by the Commission. I will discuss this later in my testimony. The Non-Utility Proxy Group DCF results support an ROE above 11.0%, but these results should be rejected as well.

Q. Is it appropriate to use a group of unregulated companies to estimate a fair return on equity for a low-risk regulated electric company such as FPL?

A. Absolutely not. Dr. Avera's use of non-utility companies to estimate a fair rate of return for FPL is completely inappropriate.

Utilities have protected markets, e.g. service territories, exclusive franchises granted by Florida municipalities, and may increase the prices they charge in the face of falling demand or loss of customers. This is contrary to competitive, unregulated companies who often lower their prices when demand for their products decline. Generally, the non-utility companies simply do not have these characteristics and must compete with other firms selling the same product for sales and for customers. Obviously, the non-utility companies have higher overall risk structures than a lower risk electric company like FPL and will have higher required returns from their shareholders. It is not at all surprising that Dr. Avera's ROE results for his Non-Utility Proxy Group were substantially higher than the results for his Utility Proxy Group. Given the higher business risk for the non-utility group of companies, this is exactly the result that would have been expected. However, these results do not

form any kind of reasonable basis to estimate the investor required ROE for FPL. Quite the contrary, the returns from the non-utility proxy group are a good measure of returns that are, by definition, substantially in excess of those to be expected in the utility segment.

Q. Are the DCF returns for the Non-Utility Proxy Group comparable to the DCF returns for Dr. Avera's Utility Proxy Group?

A. No. The DCF results for the Non-Utility Proxy Group are presented in Dr. Avera's Exhibit WEA-7. It is instructive to note that DCF returns are uniformly higher for this group of companies than one would expect for regulated electric utilities. For example, the DCF results for Kellogg range from 11.6% to 17.5% and the results for McCormick & Co. range from 10.6% to 22.8%. Dr. Avera attempted to eliminate what he considered to be excessively high DCF results from the DCF averages for the Non-Utility Proxy Group, but he still included returns ranging from 12.0% to 16.8%, returns that are clearly excessive when applied to electric utilities such as FPL because the Company experiences lower risk than non-utility enterprises.

In my opinion, Exhibit WEA-7 clearly shows that DCF results for the Non-Utility Proxy Group have no bearing whatsoever on investor expected returns for regulated electric companies.

Q. Do you have any concluding remarks for this section of your response to Dr. Avera?

A. Yes. In my subsequent response to Dr. Avera's DCF analyses, I will confine my remarks to the results from his Utility Proxy Group. I will not further address the

Non-Utility Proxy Group because I have already explained why the Commission should reject the use of this group in estimating the cost of equity for FPL.

DCF Analyses

Q. Please summarize Dr. Avera's approach to the DCF model and its results.

A. Dr. Avera utilized the constant growth form of the DCF model to estimate the fair return on equity for a group of what he considered to be comparable risk utility companies, which he referred to as the Utility Proxy Group. The criteria he used to select companies to include in this group are discussed and enumerated on pages 33 and 34 of his Direct Testimony. He employed analysts' earnings growth forecasts from Value Line, IBES, and Zacks to estimate the growth component of the DCF model.

Dr. Avera adjusted the results of his DCF analyses by eliminating what he considered to be high and low outliers from the group average DCF results. Dr. Avera discussed the criteria he used for making these adjustments on pages 49 through 53 of his Direct Testimony. He presented the results of his Utility Proxy Group DCF estimates in Exhibit WEA-4, page 3 of 3. The results ranged from 9.6% to 10.3%.

Q. Did Dr. Avera include unreasonably high DCF results in his adjusted DCF calculations for the Utility Proxy Group?

A. Yes. Exhibit WEA-4 shows that Dr. Avera included DCF results that ranged from 14.3% to 16.0%. These results are clearly outside the range of investor required returns for electric utility companies. For example, according to Dr. Avera's Exhibit WEA-11, page 3 of 4, the average allowed ROEs for utilities since 2002 ranged from

11.16% (2002) to 10.22% (2011), and the trend is downward. There is no sound reason for including ROEs above 14% in Dr. Avera's DCF analyses and, therefore, their inclusion merely serves to inflate the ROE results presented in Exhibit WEA-4.

Excluding the extreme DCF results I mentioned earlier lowers Dr. Avera's Utility Proxy Group results as shown in Table 6.

TABLE 6
AVERA ADJUSTED UTILITY PROXY GROUP DCF RESULTS

	Company	Value Line	IBES	Zacks	br+sv Growth
1	Alliant Energy	11.4%	9.3%	10.4%	10.0%
2	Consolidated Edison	7.1%	7.8%	7.4%	8.0%
3	Dominion Resources	8.6%	7.3%	9.1%	9.3%
4	Integrys Energy Group	14.3%	14.7%	9.8%	8.4%
5	ITC Holdings Corp.	16.0%	20.7%	18.5%	15.8%
6	NextEra Energy, Inc.	8.6%	9.9%	10.5%	10.5%
7	OGE Energy Corp.	9.6%	11.3%	9.9%	10.1%
8	PG&E Corp.	10.5%	5.9%	8.5%	10.4%
9	SCANA Corp.	7.7%	9.3%	8.9%	9.7%
10	Sempra Energy	7.3%	11.2%	10.8%	9.9%
11	Southern Company	10.5%	10.4%	9.6%	10.1%
12	Vectren Corp.	10.4%	10.9%	9.6%	8.8%
13	Wisconsin Energy	12.2%	11.5%	11.2%	8.4%
14	Xcel Energy, Inc.	9.1%	9.4%	9.2%	8.4%
	Average (b)	9.4%	9.8%	9.6%	9.4%

Please note that the DCF values that were excluded are shown in rectangular boxes in Table 5. Excluding the remaining implausible DCF calculations from Dr. Avera's analysis results in a range of 9.4% - 9.8%, which is close to my recommended 9.0% ROE for FPL.

Q. Did Dr. Avera consider dividend growth forecasts in his DCF analysis?

A. No. Dr. Avera failed to include dividend growth forecasts in his analysis.

On page 44 of his Direct Testimony, Dr. Avera opined that dividend growth rates "are not likely to provide a meaningful guide to investors' current growth expectations."

Q. Should Dr. Avera have included dividend growth forecasts in his DCF analyses?

A. Yes. Dr. Avera erred in failing to include dividend growth forecasts from Value Line in his DCF analyses. With respect to regulated utility companies, dividend growth provides the primary source of cash flow to the investor. It is certainly the case that earnings growth fuels dividend growth and should be considered in estimating the ROE using the DCF model. However, Value Line's dividend growth forecasts are widely available to investors and can reasonably be assumed to influence their expectations with respect to growth. Because I used three earnings growth estimates and one dividend growth estimate in my average growth rate calculation, I weighted earnings growth 75% and dividend growth 25%. Exhibit ___(RAB-4) at p. 2, cols. 1 through 5, line "DCF Return on Equity". Therefore, I agree to some extent with Dr. Avera that earnings growth is the primary factor considered by investors. But it should not be considered the only factor.

Q. What are the average and median dividend growth rates for Dr. Avera's Utility Proxy Group?

A. The average and median dividend growth rate forecasts are shown below in Table 7.

TABLE 7
AVERA UTILITY PROXY GROUP
VALUE LINE DIVIDEND GROWTH FORECASTS

Company	Value Line Div. Growth
Alliant Energy	5.50%
Consolidated Edison	1.00%
Dominion Resources	6.00%
Integrys Energy Group	0.50%
ITC Holdings Corp.	8.00%
NextEra Energy, Inc.	8.00%
OGE Energy Corp.	4.50%
PG&E Corp.	2.00%
SCANA Corp.	2.00%
Sempra Energy	9.00%
Southern Company	4.00%
Vectren Corp.	2.50%
Wisconsin Energy	13.50%
Xcel Energy, Inc.	5.00%
Average	5.11%
Median	4.75%

Source: 2012 Value Line Reports

Please refer to Exhibit ___(RAB-7), which shows the average and median earnings growth rates for the Utility Proxy Group used by Dr. Avera. The average earnings growth forecasts for this group range from 5.8% to 6.6% and the median growth rates range from 5.1% to 5.9%. Since the average growth rates are unduly influenced by unusually high growth rates for certain companies in this group, the median growth rates are more indicative of investor expected earnings growth for this group of companies. In any case, Dr. Avera's exclusion of forecasted dividend growth serves to overstate the DCF ROE for the companies. Adding Dr. Avera's

4.1% dividend yield for the Utility Proxy Group to Value Line's forecasted dividend growth results in the following DCF ROE estimates:

4.1% * (1 + (0.5 * 4.75%) + 4.75% = 8.95%

4.1% * (1 + (0.5 * 5.11%) + 5.11% = 9.31%

Capital Asset Pricing Model

Q. Please present your conclusions regarding the results of Dr. Avera's CAPM analysis.

A. I disagree with Dr. Avera's formulation of the CAPM and in particular with his estimate of the expected market return. Dr. Avera estimated the market return portion of the CAPM by estimating the current market return for dividend paying stocks in the S&P 500. This limited his "market" return to only 373 companies.

The market return portion of the CAPM should represent the most comprehensive estimate of the total return for all investment alternatives, not just a small subset of publicly traded stocks. In practice, of course, finding such an estimate is difficult and is one of the more thorny problems in estimating an accurate ROE when using the CAPM. If one limits the market return to stocks, then there are more comprehensive measures of the stock market available, such as the Value Line Investment Survey that I used in my CAPM analysis. Value Line's projected earnings growth used a sample of 2,455 stocks and its book value growth estimate used 1570 stocks. These are much broader samples than Dr. Avera's limited sample

of dividend paying stocks from the S&P 500.

The forward-looking CAPM results I present in Exhibit ___(RAB-5) using a broader market index suggest much lower required rates of return than Dr. Avera recommends in his testimony.

Q. On page 57 of his Direct Testimony, Dr. Avera explained that he incorporated a size adjustment of 81 basis points to his CAPM results, which increased the CAPM cost of equity to 11.2%. Is this size adjustment appropriate?

A. No. The data that Dr. Avera relied upon to make this adjustment came from the *Ibbotson SBBA 2011 Valuation Yearbook* published by Morningstar. Dr. Avera supplied the source document from this publication with his work papers in response to Staff's Request for Production of Documents. The group of companies from which Dr. Avera took the 81 basis point adjustment contains many unregulated companies and the group has an average beta of 1.03. This beta is greatly in excess of my utility comparison group beta of 0.68 and Dr. Avera's Utility Proxy Group beta of 0.70. There is no evidence to suggest that the size premium used by Dr. Avera applies to regulated utility companies, which on average are quite different from the group of companies included in the Morningstar research on size premiums. I recommend that the Commission reject Dr. Avera's size premium in the CAPM ROE.

Q. Dr. Avera also recommended using forecasted interest rates in the formulation of the CAPM. Do you agree with using forecasted interest rates?

A. No. I recommend that the Commission reject the use of forecasted Treasury bond yields. Current interest rates embody all of the relevant market data and expectations of

investors, including expectations of changing future interest rates. The forecasted interest rates used by Dr. Avera are speculative and may or may not come to pass. Current interest rates present tangible market evidence of investor return requirements today, and these are the interest rates that should be used in the CAPM.

Risk Premium

Q. Please summarize Dr. Avera's risk premium approach.

A. Dr. Avera developed an historical risk premium using Commission-allowed returns for regulated utility companies and average public utility bond yields from 1974 through 2011. He also used regression analysis to estimate the value of the inverse relationship between interest rates and risk premiums during that period. On page 66 of his Direct Testimony, Dr. Avera calculated the risk premium return on equity to be 9.60% using a public utility bond yield as of December 2011. Dr. Avera also used a forecasted bond yield of 6.00% and, as he explained on page 67, calculated a risk premium ROE of 10.6%.

Q. Please respond to Dr. Avera's risk premium analysis.

A. The bond yield plus risk premium approach is imprecise and can at best provide very general guidance on the current authorized ROE for a regulated electric utility. Risk premiums can change substantially over time and with varying risk perceptions of investors. As such, this approach is a "blunt instrument", if you will, for estimating the ROE in regulated proceedings. In my view, a properly formulated DCF model using current stock prices and growth forecasts is far more reliable and accurate than

the bond yield plus risk premium approach, which relies on an historical risk premium analysis over a certain period of time. In addition, Dr. Avera's study assumes that this Commission should rely on the decisions of other regulatory commissions for its ROE award in this case. I do not agree with this implied assumption and I recommend that the Commission rely upon valid current market evidence presented in this proceeding to support its ROE decision.

Second, for the reasons I stated in the CAPM subsection of my testimony, it is inappropriate and incorrect to use forecasted interest rates in the risk premium approach. Current interest rates are the valid ones to use and are far more reliable than forecasted interest rates, which will likely be incorrect and subject to change depending on future economic events. Thus, I recommend that the FPSC reject the 10.6% risk premium ROE presented by Dr. Avera.

Expected Earning Approach

Q. Please comment on Dr. Avera's expected earning approach.

A. Dr. Avera's expected earnings approach should be rejected by the Commission.

All Dr. Avera did in this analysis was report Value Line's forecasted returns on book value over the 3-year period of 2014 - 2016. He did not use any market-based model such as the DCF or CAPM. Forecasted earned returns on book equity may have nothing whatsoever to do with investors' required returns in the marketplace. For example, if earned returns on book equity exceed the market-based DCF return on

equity, then investors may expect a company to earn more on book equity than the market-based required rate of return. Instead, I recommend that the Commission utilize a range of returns generated by the DCF model in setting FPL's cost of equity in this case.

Flotation Costs

Q. On page 72 of his Direct Testimony, Dr. Avera recommended a 15 basis point adjustment to recognize flotation costs. Should the Commission add a flotation cost adjustment to the cost of equity for FPL?

A. No. I recommend that the Commission reject Dr. Avera's proposed flotation cost adjustment. In my opinion, it is likely that flotation costs are already accounted for in current stock prices and that adding an adjustment for flotation costs amounts to double counting. A DCF model using current stock prices should already account for investor expectations regarding the collection of flotation costs. Multiplying the dividend yield by a 4% flotation cost adjustment, for example, essentially assumes that the current stock price is wrong and that it must be adjusted downward to increase the dividend yield and the resulting cost of equity. I do not believe that this is an appropriate assumption. Current stock prices most likely already account for flotation costs, to the extent that such costs are even accounted for by investors.

ROE Adder for Excellent Management

Q. Several FPL witnesses, including Dr. Avera, recommended that the Commission recognize and encourage exemplary management in setting the return on equity for FPL by adding 0.25% to the return on equity in this proceeding. Do you agree?

A. Definitely not. The Commission should base its allowed return on equity on market-based data and analysis that I have provided in my testimony. Using appropriate cost of equity models to estimate the investor required return for FPL will, if applied properly, fairly compensate investors for their equity investment. Arbitrarily increasing the investor required return to recognize factors such as alleged "excellent management" would overcompensate investors and result in excessive rates to ratepayers. The regulatory balance would be tipped in favor of shareholders and against customers.

Moreover, providing an inflated return on equity to recognize claimed "exemplary management" performance undercuts the benefits of such performance, which should be greater efficiency, lower costs, and lower rates to customers. Ratepayers should *expect* exemplary management from the Company without having to support inflated returns to shareholders. It is important to realize that FPL's ratepayers have paid FPL dollar for dollar for the O&M expenses and capital investments the Company has made over time that have resulted in the rates currently being paid by customers. And FPL's management and employees have accomplished this without any special ROE adder that would flow to shareholders.

Also, with respect to FPL's relatively low rates, there are other factors that have benefitted the Company beyond what could be considered "excellent management". One major factor is that gas prices are currently quite low. Since FPL derives approximately 62% of its generation from gas-fired units, low gas prices are a major

contributing factor to lower rates. FPL's management is not the cause of low gas prices and its need to build new generation capacity over the past 3 decades to meet population growth has afforded it an opportunity to add gas-fired units when other utilities, not benefitting from such population growth, have not had the same opportunity.

Another major factor contributing to FPL's low rates is the fact that the Company is a very large utility with a contiguous Florida service territory that has taken advantage of economies of scale. This means that fixed costs per customer will be lower for FPL than other, smaller utilities that have higher fixed costs per customer.

FPL's current nuclear fleet has also been significantly depreciated. Turkey Point has been operating since 1973 and St. Lucie has been in operation since 1983. These depreciated nuclear units, combined with very low running costs, are significant contributors to FPL's low rates. Once again, this was not due to exemplary management and does not merit any bonus on the Company's ROE.

Capital Structure

Q. On page 89 of his Direct Testimony, Dr. Avera concluded that FPL's requested 59.6% equity ratio "is well within the range of individual results" for the Utility Proxy Group. Do you agree with this assessment?

A. No. FPL's 59.6% book equity ratio is significantly higher than the average book equity ratio of each of Dr. Avera's Utility Proxy Groups, which ranges from 45.9% to 48.1% according to Exhibit WEA-16. This demonstrates that FPL's equity ratio

is, in fact, well outside the range of results for the Utility Proxy Group on average. With respect to individual company results, the highest book equity ratio is 54.5% on a projected basis for Integrys Energy Corp.

With respect to operating company results shown on Exhibit WEA-15, the group average book equity ratio is 53.8%, again substantially lower than FPL's equity ratio.

Q. On Exhibit WEA-17, Dr. Avera calculated market value equity ratios for the companies in his Utility Proxy Group. Is this analysis of any value in gauging the reasonableness of FPL's equity ratio in this proceeding?

A. No, it is not. Comparing the market value of the Utility Proxy Group's equity to the book value of FPL's common equity is comparing apples and oranges and does not provide a valid test of the reasonableness of the book value of FPL's common equity ratio. Although the market value of common equity is relevant to investors with respect to their investment decisions, it is the book value of common equity that is relevant to ratemaking and to the rates paid by ratepayers. Comparisons of the book equity ratios from my utility comparison group and Dr. Avera's Utility Proxy Group indicate that, without a doubt, FPL's common equity ratio is substantially higher than that of firms with similar credit and bond ratings.

Other ROE Considerations

Q. Please summarize some of the main considerations Dr. Avera mentioned in arriving at his recommended 11.25% ROE, before the adder for excellent management.

A. On page 80, Dr. Avera summarized several factors he considered in arriving at his 11.25% ROE. These included "potential exposures faced by FPL and the economic requirements necessary to maintain access to capital even under adverse circumstances." Dr. Avera specifically cited the following:

- Recent challenges in the capital markets.
- Ongoing economic uncertainties.
- FPL's ability to "absorb potential shocks associated with devastating hurricanes, volatile fuel pricing, and disruptions in energy supply."

Q. Do these considerations, in connection with Dr. Avera's quantitative analyses, support a ROE of 11.25%?

A. No. First, it is important to note that, with appropriate adjustments, I have demonstrated that the majority of Dr. Avera's DCF results indicate a ROE around 9.0% - 9.50%. Even his risk premium analysis indicates a cost of equity of 9.6%. My own cost of capital analyses do not support anything above a ROE of 9.0% for FPL. In short, the current market data in this low interest rate environment indicate that investor required returns for electric utilities with characteristics similar to FPL are about 9.0%. An 11.25% ROE simply cannot be justified on the basis of current financial market evidence.

Second, the risks and concerns enumerated by Dr. Avera have all been taken into account by S&P and Moody's, which currently rate FPL's senior debt as A and Aa3, respectively. These are very strong ratings with solid financial support, Dr. Avera's concerns notwithstanding.

Third, Dr. Avera's recommendation fails to consider the balance of interests between ratepayers and shareholders. Without a doubt, investors would be extremely happy with a ROE of 11.25% on an investment like FPL. However, the flip side of that coin is that Florida ratepayers would have to shoulder a burdensome increase in rates to support this ROE, compared to the 9.0% I recommend. I suggest to the Commission that my recommended 9.0% ROE balances the interests of ratepayers and shareholders. My analysis is based on current financial data for regulated electric utilities that fully support my recommendation. Contrast this with Dr. Avera's recommendation, which can only be supported by the use of a Non-Utility Proxy Group. Dr. Avera essentially abandoned the results from the Utility Proxy Group in making his recommendation.

Q. Does this complete your prepared direct testimony?

A. Yes.

BY MR. SUNDBACK:

Q Mr. Baudino, do you have a -- a prepared summary for the Commissioners?

A Yes, I do.

Q Could you provide that, please?

A Good morning, Commissioners. My name is Richard Baudino. I represent the South Florida Hospital Healthcare and Association. And in this proceeding, my testimony addresses the investor required rate of return on equity and weighted cost of capital that I recommend the Commission adopt in this proceeding.

Now, I recommend that the Commission adopt a 9 percent return on equity for FPL, and I also represent the Commission adopted the company's requested capital structure with the adopt -- with the adjustment that Mr. Collin described in his direct testimony.

And, Commissioners, my recommendation of 9 percent represents the top of the range of estimates from my discounted cash flow analyzes on a comparison group of regulated electric companies that have similar bond ratings to FPL.

I think it would be helpful at this point to provide the Commission with bit of perspective and quickly describe what has happened since FPL's last rate case in 2009. At that time, the financial markets were

recovering from the volatility and substantial economic losses suffered in 2008 when the country was in recession. I reported in my testimony in that rate case that the average public utility bond was yielding 6.22 percent. And now, in my testimony in this case, I reported that as of June 13th this year, the average public utility bond yield stood at 4.2 -- 4.28 percent, representing a decline in interest rates of nearly 200 basis points, or 2 percent.

I recently looked at that same average utility bond yield on Monday, August 20th, and according to Moody's, the yield was 4.32 percent. So there had not been much change in bond yields since I filed my testimony, and Commissioners, interest rates are much lower than they were in FPL's last rate case.

Financial markets have recovered and are less volatile. NextEra, as I reported in my testimony, has had no problem whatsoever in -- in accessing capital markets since FPL's last rate case. The low interest rate environment we find ourselves in suggests a lower ROE now for FPL than investors were requiring back in 2009. My recommendation to the Commission reflects this economic reality.

Turning now to FPL's requested return on equity, an 11.5 percent ROE is simply unreasonable and

unsupportable by evidence in the capital markets today. First, some perspective would be useful for the Commission. The intervenor witnesses are recommending ROEs in the range of 8.5 to 9.5 percent. FPL's requested ROE is 200 basis points higher than the top of this range. Just on its face, Commissioners, the company's requested ROE is an extreme outlier.

In my view, FPL's witness Dr. Avera could really only support this recommendation based on his returns for a group of unregulated companies that are not in the regulated utility business. Dr. Avera's analysis clearly shows that investors require higher equity returns for unregulated businesses than they do for regulated utility companies.

Using return on equity based on a group of unregulated companies would only inflate FPL's return on equity and burden Florida's ratepayers with higher rates. I strongly recommend the Commission reject the use of unregulated companies to determine the rate of return on equity for a low risk electric company like FPL.

Finally, I recommend the Commission reject the performance adder of 0.25 percent that FPL is seeking in this case. This performance adder is based only on low rates and not on any actual standards of performance by

management. FPL has not showed that these low rates were due to superior management.

And, in fact, the company and ratepayers should expect excellent management from their monopoly provider of electric service. In my opinion, it is not appropriate to inflate FPL's allowed return on ROE for alleged excellent management.

Thank you.

MR. SUNDBACK: Mr. Chairman, Mr. Baudino is available for cross-examination.

CHAIRMAN BRISÉ: Okay. FIPUG?

MR. MOYLE: No -- no questions.

CHAIRMAN BRISÉ: FEA?

MR. MILLER: No questions. Thank you.

CHAIRMAN BRISÉ: Florida Power & Light?

MR. GUYTON: Just a few questions. Thank you, Mr. Chair.

CROSS EXAMINATION

BY MR. GUYTON:

Q Mr. Baudino, we met over the telephone. My name is Charlie Guyton. I represent Florida Power & Light. Good morning.

A Good morning, Mr. Guyton.

Q Let's see if we can begin where we agree. A return on equity analysis is a forward looking analysis,

correct?

A Yes, sir.

Q And the estimated cost of equity should be comparable to the returns of other firms with similar risk, correct?

A Yes.

Q And you make that statement at page 19, lines 10 and 11, correct?

A Let -- let me get that, please.

Q Certainly.

A Yes, what I say there is, generally speaking, the estimated cost of equity should be comparable to the returns of other firms with similar risk that should be sufficient for a firm to attract capital.

Q And the returns that you're referring to there are allowed returns, correct?

A I -- yes, I would say within the context of utility rate cases, it would be returns allowed by the Commission, but it's also really investor required returns.

Q Okay. Now, you consider AUS utility reports to be an -- an authoritative source for data; do you not?

A Yes.

Q And, indeed, you relied on the June report in

preparing your testimony; didn't you?

A Yes.

Q And your recommendation to the Commission in this case is that the Commission allow FPL a return on equity of 9 percent, correct?

A Yes, that's correct.

Q And that recommendation is based on a discounted cash flow analysis that you performed for a group of companies that you characterize as your electric utility comparison group, correct?

A Yes.

Q And that group has a risk profile which you believe to be reasonably similar to FPL?

A Yes, that's correct.

Q And that group is shown on page 24 of your testimony, correct?

A Yes.

MR. GUYTON: Mr. Chairman, we are having handed out an exhibit for Mr. Baudino's review. I would ask that it be identified as the next exhibit in order.

CHAIRMAN BRISÉ: Sure. That will be 584.

MR. GUYTON: 584. Thank you, Mr. Chairman.

MR. YOUNG: Three, I am sorry. 583.

CHAIRMAN BRISÉ: No, it is 583 because 582 is

the late-filed.)

(Whereupon, Exhibit No. 583 was marked for identification.)

BY MR. GUYTON:

Q Mr. Baudino, do you have what has been identified as Exhibit 583 before you?

A I do.

Q Would you confirm that the names of the electric utilities on 583 are the same utilities that comprise your electric utility comparison group?

A Yes, if you give me a moment, I will.

Yes, those are the same.

Q And would you confirm that the S&P and Moody's bond rating that are shown on 583 are the same bond rate that you show on page 24 of your testimony?

A Yes.

Q Now, I have added another column to the table that you have at page 24. It's entitled, Allowed ROE. Do you see that?

A Yes, I do.

Q Now, I have taken that from AUS Utility Reports, the source that you have stated is authoritative. Would you accept, subject to check, that I have captured the correct values off the AU -- AUS Utility Reports?

MR. SUNDBACK: Mr. -- Mr. Chairman, I am not sure that we object at this point, but we would like a realistic opportunity to check such that to the extent the witness needs some time to do that, electronically or for whatever -- through whatever source would be available, he has that realistic opportunity. These data, as you know, sometimes can be slippery things.

CHAIRMAN BRISÉ: Fair.

MR. SUNDBACK: Thank you, Mr. Chairman.

MR. GUYTON: I have Exhibit 571, which is the July report. May I approach the witness and provide him with a copy?

CHAIRMAN BRISÉ: Sure.

THE WITNESS: Thank you. I am sorry. May I ask a question? Did you want me to -- to go ahead and review this and verify the numbers, counselor?

MR. GUYTON: I thought your counsel did. I would be perfectly willing for you to accept, subject to check, that I -- I reflected them accurately, but I think your counsel wants you to look.

THE WITNESS: Thank you.

Okay. Thanks for your time. I have verified that those are all correctly from the July issue of

AUS Reports.

BY MR. GUYTON:

Q Thank you.

Now, looking at what has been identified as Exhibit 583, am I correct that your recommended ROE is at least 95 basis points lower than any of the allowed ROEs for any of the electric utilities in your electric comparison group?

A Well, that's correct, and there is some stale data in here. I mean, IDACORP is a ten eighteen, as we see, and that was based on an order dated May 2009. Portland General Electric is 10 percent; that was based on twelve ten. MGE Energy of 10.3, that was based on January 2011.

Certainly, interest rates have -- have trended down since that time significantly. So unfortunately, the -- the dates for some of these -- for the rest of them that I did not mention are not listed in here. Certainly, eleven four six Southern, that seems -- that seems quite out-of-date, as the rest of them may be as well.

Q Would you accept -- well, that's all right. We will go -- we will --

Is it your understanding that the public utilities commissions that have set those costs of

equity, which you have described as stale, are in a position just like this Commission is to go back and reassess cost of equity on its own initiative?

A I am not sure I know what you mean. Do you mean that they could -- the Commissions could initiate an investigation into the rates on -- on their own motion?

Q Yes, and set a lower return on equity.

A I don't -- I don't really know the extent to which every state commission has the ability to do that. I suppose that is within the purview of a Commission to do that.

Q Okay.

A Normally, what happens is the commissions wait to reset that rate of return when the utility files a rate case.

Q Okay. Now, am I also correct that your recommended ROE of 9.0 is 140 basis points lower than the average allowed return on equity? I am sorry, 139 basis points lower than the average allowed return on equity for your comparable risk comparison group?

A That's what the arithmetic shows, yes.

MR. GUYTON: Okay. Thank you. That's all we have.

CHAIRMAN BRISÉ: All right. Mr. McGlothlin?

MR. McGLOTHLIN: No questions.

CHAIRMAN BRISÉ: Mr. LaVia?

MR. LaVIA: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: Mr. Saparito?

MR. SAPARITO: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: Mr. Hendricks?

MR. HENDRICKS: Yeah. I just -- one or two.

CHAIRMAN BRISÉ: Sure.

CROSS EXAMINATION

BY MR. HENDRICKS:

Q Mr. Baudino, to return back to this exhibit that was just handed out by FPL for a moment.

A Sure.

Q Do you know what the equity ratios were for these -- for the companies in this group?

A I have got that reported in my testimony, Mr. Hendricks. If you would look on page 38, there is Table 2, and it shows the capital structure from two different sources, Value Line and AUS. Those AUS ratios are from the June report, which is what I had available to me when I prepared this testimony.

Q Okay. I can't get to that page right now on my electric device, it's --

A Oh, okay.

Q -- in a little bit.

Did you -- do you think that some of the differences between the allowed ROEs here and -- and the recommendation that you're making are -- FPL might have something to do with the different equity ratios that are reflected in this group?

A It might. I have not reviewed all of those orders, so it would be -- I would be guessing really to -- to answer that.

Generally speaking, you would expect a somewhat higher return on equity, other things being equal, for a lower equity ratio in the capital structure to compensate for that additional financial risk, generally speaking. I -- I can't say that that's true for this group. I haven't examined the orders there.

Q Very good. Thank you.

A You're welcome.

CHAIRMAN BRISÉ: Staff.

MR. YOUNG: Thank you, sir.

In lieu of staff's questions, staff will be -- staff has an agreement amongst the parties that they can move in the deposition of -- of Mr. Baudino included -- amended to include the errata sheet an the Late-Filed Exhibits 1, 2 and 3. Those were handed out during the course of the -- earlier this morning, and all the parties have

received that along -- along with all the Commissioners.

MR. GUYTON: FPL has no objection.

CHAIRMAN BRISÉ: All right. So what number would that be, what, 584, or do we have a previous number?

MR. YOUNG: That was previously identified as number 118.

CHAIRMAN BRISÉ: Okay. Thank you.

(Whereupon, Exhibit No. 118 was marked for identification.)

CHAIRMAN BRISÉ: Commissioners. Commissioner Brown?

COMMISSIONER BROWN: Thank you, Mr. Chairman.

There has been a lot of discussion about the various rating agencies, and in your testimony, you cite certain portions from the Moody's 2010 report and then the 2012 report. I just kind of want to get an understanding about what the purpose is for you comparing these two reports for our consideration. Is it to support your proposition for a lower ROE?

THE WITNESS: I am sorry, Commissioner. I am not sure -- did you mean the -- the rating, the bond rating agency reports that, in the first part

of my testimony?

COMMISSIONER BROWN: That's correct. On page 14.

THE WITNESS: Yes, ma'am. It was to provide the Commission with a bit of perspective and -- and what the rating agencies were saying, you know, around the time of the Commission order in 2 -- in 2010, how the rating agencies reacted to that. That was a bit of history, you know, for that time.

And then, the more current reports I cited were to say this is what the situation is now, and it stabilized quite a bit and -- since that time -- since 2010.

COMMISSIONER BROWN: So the significance of the 2012 report as compared to the 2010 report would be?

THE WITNESS: That as far as the S&P and Moody's reports go, FPL contributes substantial financial strength to the holding company NextEra. It has credit metrics that fully support its credit ratings and its bonds ratings.

And in my opinion, I could see no really disastrous impact from the Commission's last rate order when it ordered a 10 percent ROE. There were other factors that the rating agencies cited there.

I have cited those in my testimony.

Now, they are saying that the situation has stabilized a bit as far as regulatory area goes, and again, the company's final metrics were good -- are -- are very solid. The business position the company is in is excellent. It's a -- it's viewed very favorably by the rating agencies at this point.

COMMISSIONER BROWN: Okay. Thank you.

THE WITNESS: You're welcome.

CHAIRMAN BRISÉ: Commissioner Balbis?

COMMISSIONER BALBIS: Thank you. I just have a question or -- or a clarification. You included on page 16 of your testimony, starting with line 5, an excerpt from S&P's April 24, 2012 Summary Report.

THE WITNESS: Yes, sir.

COMMISSIONER BALBIS: And I am going -- I am going to read line 11 where you state -- well, where it's quoted from the report, both of those pillars have been shaken in recent years as Florida and FPL's service territory, in particular, suffered during recession, and regulators have responded in ways that reflect greater political influence over regulatory decisions. So I assume

that is stating that the previous decisions made reflected greater political influence; is that correct?

THE WITNESS: That's my understanding, it was the decision in the past, is that was S&P's opinion of it.

COMMISSIONER BALBIS: Okay. Thank you.

THE WITNESS: The one thing I would like to add, if I may, Florida is still considered to have an average regulatory environment, which, I mean, to me, that -- in my opinion, that -- that's a good rating for the Commission.

COMMISSIONER BALBIS: Okay. Thank you. That's all I have.

CHAIRMAN BRISÉ: All right. Redirect?

MR. SUNDBACK: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. SUNDBACK:

Q Mr. Baudino, do you still have in front of you what's been marked as Exhibit 571?

A Yes.

Q Okay. Could you turn to page 6 of those materials, please?

A I have that.

Q And in the second to the last column on the

right, we see the allowed returns. Do you see that?

A Yes, I do.

Q Okay. In the fifth column from the right, we see the Common Equity ratios. Do you see that?

A Yes, I do.

Q Can you describe how the Common Equity Ratio for next energy -- I am sorry, NextEra Energy relates, to your understanding of the common ratio -- Common Equity Ratio of FPL in this case?

A Well, yes. For NextEra Energy, the Common Equity --

MR. GUYTON: I'm going to object to this. It's beyond the line of cross-examination. I only used this for purposes of the allowed ROE. I asked him nothing about the equity ratio of FPL or NextEra Energy, which is the subject of this question. It is supplemental direct. It is not redirect.

MR. SUNDBACK: Mr. Chairman, there were both questions about the risk -- I am sorry -- the ROE calculated for the members of the proxy group, which include NextEra Energy in some of the proposals for the case.

And in addition, it directs -- it relates directly to questions about the change in ROE that

have -- has occurred since 2010. So we think it's appropriate and proper to have a discussion of that.

These numbers cannot be taken in a vacuum. What FPL wants to do is say, just look at the ROEs, and the circumstances that contribute to those ROEs, you shouldn't pay any attention to. This exhibit shows the related impact -- the factors that impact the level of ROE that was ultimately authorized by those commissions.

The commissions is didn't act in a vacuum. Like this Commission, they took information about the relative risks of those enterprises, and certainly one of those risks is financial risk.

MR. GUYTON: Commissioner, may I be heard briefly?

CHAIRMAN BRISÉ: Sure.

MR. GUYTON: Mr. Chair, very eloquent testimony. This witness, however, testified that he had not looked at those orders and he couldn't testify as to how the equity ratios had an impact on the ROE. This is not proper redirect.

CHAIRMAN BRISÉ: I -- I am going to allow you to pursue the question.

MR. SUNDBACK: Thank you, Mr. Chairman.

THE WITNESS: Could you please restate the question?

BY MR. SUNDBACK:

Q How -- how does the Common Equity Ratio shown on page 6 for NextEra Energy relate to the Common Equity Ratio you understand to be the topic of the company's request in this proceeding?

A The -- the Common Equity Ratio shown here on page 6 for NextEra is 38.8 percent, and of course, FPL's requested Common Equity Ratio in this proceeding is 59 percent -- 59.4 percent, almost 60 percent. So you have a substantially higher rate -- equity ratio for the regulated utility company that -- for which ratepayers are supporting rates and a drastically lower equity ratio for the unregulated subsidiary of NextEra.

Q Do you have any understanding of the equity rat-- well, strike that.

If you would look at the last line for -- I am sorry, the second to the last line for the companies in that list, you will see the Southern Company. Do you find that?

A Yes, I do.

Q Okay. And the eleven four six ROE, could you describe the relationship of that to the Common Equity structure you see there?

A Yes. The 46.5 percent Common Equity Ratio shown is for -- for Southern Company, and obviously, FPL's requested equity ratio is substantially higher; that's 59.4 percent.

Q You had some questions about whether PUC -- public service commissions or public utility commissions are able to go back and reassess ROEs. Do you recall that?

A Yes, I do.

Q Are there commissions, to your knowledge, that do not have the type of earning surveillance -- earning surveillance report detail that this Commission receives from its regulated electric utilities?

A Uh-huh. There may well be that they don't have -- there may be commissions out there who do not have that kind of earnings surveillance, yes.

Q Okay.

MR. SUNDBACK: No further questions. Thank you, Mr. Chairman.

CHAIRMAN BRISÉ: Okay. Thank you.

Exhibits?

MR. SUNDBACK: Mr. Chairman, at this time, we would move the admission into evidence of what have been premarked as Exhibit 294 through 306, if our recordkeeping is correct.

CHAIRMAN BRISÉ: Are there any objections to Exhibits 294 through 306?

Seeing none, we will enter those into the records.

(Whereupon, Exhibit Nos. 294 through 306 were received into evidence.)

MR. GUYTON: Florida Power & Light moves Exhibit 583.

CHAIRMAN BRISÉ: Okay. Are there any objections?

Okay. Seeing none, we will move 583 into the record.

(Whereupon, Exhibit No. 583 was received into evidence.)

MR. SUNDBACK: Mr. Chairman, if this is an appropriate time, could we ask that the witness --

CHAIRMAN BRISÉ: We -- we have one more.

MR. SUNDBACK: I'm sorry.

MR. YOUNG: Mr. Chairman, at this time, we move the amended -- what is now amended 118.

CHAIRMAN BRISÉ: Okay. Seeing no objections, we will move into the record 118.

(Whereupon, Exhibit No. 118 was received into evidence.)

MR. SUNDBACK: Mr. Chairman, just for clarity

purposes to make sure we are on the same page, we would like to establish through the bench that 118 includes not only the deposition and the errata but the three late-filed exhibits.

MR. YOUNG: Yes.

MR. SUNDBACK: Thank you for that clarification.

CHAIRMAN BRISÉ: All right. Thank you. So 118 is entered into the record.

MR. SUNDBACK: Thank you, Mr. Chairman. Would now be a good time to excuse Mr. Baudino?

THE COURT: Sure. Mr. Baudino, you are excused from the hearing.

THE WITNESS: Thank you very much.

CHAIRMAN BRISÉ: Safe travels.

(Witness excused.)

MR. SAPARITO: Mr. Chairman, with respect to Staff's Exhibit 118. Is -- is the record clear on all those late-filed exhibits as to their identity -- identity in there? Have we explained those, what they are?

MR. YOUNG: I can if -- if the Chair wishes to do it, or the court -- the court reporter has the 118.

CHAIRMAN BRISÉ: Has the information, so

it's -- it's one packet.

Mr. Wiseman?

MR. WISEMAN: Thank you, Mr. Chairman. SFHHA would call its next witness, Mr. Stephen Baron.

Whereupon,

STEPHEN BARON

was called as a witness, having been previously duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows.

DIRECT EXAMINATION

BY MR. WISEMAN:

Q Could you please state your name and business address for the record?

A Yes. My name is Stephen Baron, and my business address is J. Kennedy & Associates, Inc., 570 Colonial Park Drive, Suite 305, Roswell, Georgia, 30075.

Q And are you the same Stephen Baron who caused 55 pages of testimony to be prepared in -- for this proceeding?

A Yes.

Q And are you also the same Stephen Baron who caused a number of exhibits that have been premarked for identification as Exhibits 307 through 319 to be prepared.

A Yes.

Q Mr. Baron, do you have any changes to your testimony?

A Just one to my -- none to my testimony to my knowledge. I -- I do have a change to my Exhibit 5 -- SJB-5. It's just a clarification. On page 1 of Exhibit SJB-5, about midway down, there is a line that says, cost of 35-foot an smaller poles. It should be cost of 35/40/45-foot and smaller poles.

Q Thank you, Mr. Baron.

And if I were to ask you -- do you have any other changes to your testimony or exhibits?

A I am sorry?

Q Do you have any other changes --

A No.

Q Okay. If I were to ask you the same questions that appear in your prepared testimony, would your answers be the same?

A Yes.

MR. WISEMAN: Mr. Chair, at this time, I would ask that Mr. Baron's prepared testimony be submitted into the record as -- as if read.

CHAIRMAN BRISÉ: All right. At this time, we will enter Mr. Baron's prefiled testimony as though read. Seeing no objections.

(Whereupon, testimony inserted.)

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

IN RE:

PETITION FOR RATE INCREASE BY	)	
FLORIDA POWER AND LIGHT	)	**DOCKET NO. 120015-EI**
COMPANY	)	

DIRECT TESTIMONY OF STEPHEN J. BARON

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Stephen J. Baron. My business address is J. Kennedy and Associates, Inc. ("Kennedy and Associates"), 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. What is your occupation and by whom are you employed?

A. I am the President and a Principal of Kennedy and Associates, a firm of utility rate, planning, and economic consultants in Atlanta, Georgia.

Q. Please describe briefly the nature of the consulting services provided by Kennedy and Associates.

A. Kennedy and Associates provides consulting services in the electric and gas utility industries. Our clients include state agencies, large consumers of electricity and other market participants. The firm provides expertise in system planning, load forecasting, financial analysis, cost-of-service, and rate design. Current clients include the Georgia and Louisiana Public Service Commissions, and consumer groups throughout the United States.

Q. Please state your educational background.

A. I graduated from the University of Florida in 1972 with a B.A. degree with high honors in Political Science and significant coursework in Mathematics and Computer Science. In 1974, I received a Master of Arts Degree in Economics, also from the University of Florida. My areas of specialization were econometrics, statistics, and public utility economics. My thesis concerned the development of an econometric model to forecast electricity sales in the State of Florida, for which I received a grant from the Public Utility Research Center of the University of Florida. In addition, I have advanced study and coursework in time series analysis and dynamic model building.

Q. Please describe your professional experience.

A. I have more than thirty years of experience in the electric utility industry in the areas of cost and rate analysis, forecasting, planning, and economic analysis.

Following the completion of my graduate work in economics, I joined the staff of the Florida Public Service Commission in August of 1974 as a Rate Economist. My responsibilities included the analysis of rate cases for electric, telephone, and gas utilities, as well as the preparation of cross-examination material and the preparation of staff recommendations.

In December 1975, I joined the Utility Rate Consulting Division of Ebasco Services, Inc. as an Associate Consultant. In the seven years I worked for Ebasco, I received successive promotions, ultimately to the position of Vice President of Energy Management Services of Ebasco Business Consulting Company. My responsibilities included the management of a staff of consultants engaged in providing services in the areas of econometric modeling, load and energy forecasting, production cost modeling, planning, cost-of-service analysis, cogeneration, and load management.

I joined the public accounting firm of Coopers & Lybrand in 1982 as a Manager of the Atlanta Office of the Utility Regulatory and Advisory Services Group. In this capacity I was responsible for the operation and management of the Atlanta office. My duties included the technical and administrative supervision of the staff, budgeting, recruiting, and marketing as well as project management on client engagements. At Coopers & Lybrand, I specialized in utility cost analysis, forecasting, load analysis, economic analysis, and planning.

In January 1984, I joined the consulting firm of Kennedy and Associates as a Vice

President and Principal. I became President of the firm in January 1991.

During the course of my career, I have provided consulting services to numerous industrial, commercial, Public Service Commission and utility clients, including international utility clients.

I have presented numerous papers and published an article entitled "How to Rate Load Management Programs" in the March 1979 edition of "Electrical World." My article on "Standby Electric Rates" was published in the November 8, 1984 issue of "Public Utilities Fortnightly." In February of 1984, I completed a detailed analysis entitled "Load Data Transfer Techniques" on behalf of the Electric Power Research Institute, which published the study.

I have presented testimony as an expert witness in Arizona, Arkansas, Colorado, Connecticut, Florida, Georgia, Indiana, Kentucky, Louisiana, Maine, Michigan, Minnesota, Maryland, Missouri, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Texas, Utah, Virginia, West Virginia, Wisconsin, Wyoming, before the Federal Energy Regulatory Commission ("FERC"), and in United States Bankruptcy Court. A list of my specific regulatory appearances can be found in Baron Exhibit ____ (SJB-1).

Q. Do you have previous experience in FPL regulatory proceedings?

A. Yes. I have been involved in a number of FPL rate proceedings during my career. This

includes participation as a Florida Public Service Commission Staff member in a 1975 FPL rate case, a generic DSM proceeding in 1993 and FPL rate cases in 2002, 2005 and 2009. I have also testified before the Commission in other proceedings on a number of occasions.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of the South Florida Hospital and Healthcare Association, Inc. ("SFHHA" or the "hospitals"). SFHHA members take service on FPL General Service, High load factor-Time of Use and CILC rate classes throughout the Company's service area.

Q. What is the purpose of your testimony?

A. I will address issues associated with FPL's class cost of service study and its proposed revenue allocation to rate classes of its requested Step 1 (January 2013) base rate revenue increase of $516.5 million and its requested Step 2 (June 2013) increase of $173.9 million. FPL's class cost of service study is based on a 12 CP and $1/13^{th}$ average demand methodology that does not classify any distribution plant and expense as customer related, other than services and meters. Initially, I will discuss the Company's study and identify what appear to be anomalies in the development of rate class demand allocation factors, all of which bias the Company's study, overstating the cost of service attributed to large customers. I will correct FPL's class cost of service study so that it incorporates more accurate allocation factors.

I will also discuss the methodology used by the Company to classify distribution costs. As in prior cases, FPL classifies all distribution plant in FERC accounts 364 (poles), 365 (overhead conductors), 366 (underground conduit), 367 (underground conductors) and 368 (line transformers) as 100% demand related. FPL's methodology, which is inconsistent with the distribution cost allocation methodologies discussed in the NARUC Electric Utility Cost Allocation Manual (the "NARUC Manual"), ignores any cost consequences associated with simply connecting a customer to the Company's distribution system, regardless of the level of demand the customer imposes on the system or whether the customer premises are even occupied. I will present an alternative class cost of service study that illustrates the impact of utilizing a more reasonable minimum distribution system ("MDS") methodology. As I will discuss, in the recent Gulf Power Company ("GPC") rate case, GPC filed an MDS class cost of service study, which was adopted as part of a Commission approved stipulation of issues.

I have also developed an alternative class cost of service analysis using a summer coincident peak (1 CP) demand methodology. FPL's summer peak is the primary driver of capacity resource needs and it is therefore an appropriate basis to assign cost responsibility to rate classes for generation and transmission fixed costs. I will present the results of this analysis as an alternative to the Company's 12 CP and $1/13^{th}$ demand methodology.

I will also discuss the Company's proposed methodology to allocate revenue increases

to each rate class. FPL has proposed a two-part revenue allocation methodology for its requested $516 million January 2013 increase. FPL adjusts rate class revenue to remove what FPL calculates under its methodology as rate of return parity differences at present rates. Then, the Company allocates the $516 million revenue increase based on total revenue from each rate class (before the parity adjustment), including all clause revenues. The sum of these two parts becomes the target increase for each class, which FPL then adjusted in an effort to meet the Commission's practice of limiting the increase to any rate class to 1.5 times the retail average and insuring that no rate class receives a decrease. FPL also makes additional adjustments that are unexplained and disregard its own data, which distort the relationship between certain general service rate classes. I will address FPL's methodology and explain why it is inappropriate. While I agree with the use of a two-part framework generally, the $516.5 million increase that is uniformly spread to each rate class should be spread on the basis of base revenues. Also, I will recommend an alternative mitigation approach that applies the "1.5 times" increase limit to individual rate class base revenue increases, rather than total revenues including clause revenues.

Finally, I will address two rate design issues affecting large general service rate classes. The first issue concerns FPL's proposed rate design for the CILC-1D rate schedule. FPL is proposing a 320% increase in the on-peak energy charge for this rate, which is not reasonable. I will propose and recommend an alternative rate design that more reasonably reflects cost of service and produces more stable increases to all customers taking service on this rate schedule. The second rate design issue concerns FPL's

proposed Step 2 increases on large, demand metered, general service rate classes. FPL is proposing to recover 100% of the Canaveral revenue increase for Rates GSLDT-1, 2 and 3 and for CILC through the on-peak and off-peak energy charges, despite the fact that over 80% of the Canaveral revenue requirements are demand related. FPL's rate proposal is disconnected from the nature of the underlying costs. I will recommend an alternative recovery approach for these large general service rate classes that more accurately reflects the characteristics of the Canaveral cost of service increase.

Q. Would you summarize your conclusions and recommendations?

A. Yes.

- **FPL has used cost of service methodologies in this case that unreasonably attribute cost responsibility to large general service rate classes due to incorrect demand allocation factors, including the failure to use a Minimum Distribution System cost classification methodology to assign cost responsibility for FPL's primary and secondary distribution system. In addition, FPL's cost of service study should utilize a 1 CP methodology to allocate production and transmission demand related costs to rate classes.**

- **FPL has based its proposed rate class increases on the results of its 12 CP and 1/13th average demand cost of service study and a goal to bring each rate class to within parity of the system average rate of return as determined using FPL's cost of service methodology. However, FPL has ignored its own load research data for the month of January 2013, thus biasing its cost of**

service results. In addition, FPL's demand allocation factor "adjustment methodology" is unreasonable and distorts demands attributed to different classes of customers. These problems should be corrected. In addition, the Commission should adopt a Minimum Distribution System approach to the classification of distribution facilities. FPL's failure to reasonably allocate costs in this case has resulted in an over-allocation of cost of service to large customers, which FPL then relies on to support significantly above average increases to these rate classes.

- **FPL has proposed increases to some rate classes that are substantially in excess of 1.5 times the average retail base rate increase requested by the Company. Some rate classes, such as CILC-D, GSLD-1, GSLDT-1, GSLDT-2, HLFT-2 and HLFT-3 will receive increases of 22% to 35% under the Company's proposals in this case, compared to the retail average base revenue increase of 12%. Putting aside for the moment the issue of whether FPL's cost responsibility calculations are correct, in consideration of the impact and the potential for "rate shock" with such large increases, no rate class should receive an increase greater than 150% of the system average base rate increase.**

- **FPL's proposed rate CILC-1D rate design should be modified to provide a more reasonable balance between the proposed increase in the on-peak**

energy charge (320% proposed by FPL) and the various demand charges of the rate.

- **FPL's proposed Step 2 (Canaveral) rate design for large general service rate classes (CILC-1D, GSLDT 1, 2 and 3) should be modified so that both the demand and on-peak energy charges of these rates are increased, consistent with the classification of other production revenue requirements, which FPL uses to allocate the Step 2 increase to rate classes. FPL has proposed to apply 100% of the increase to the on-peak energy charges of these rates.**

II. COST ALLOCATION ISSUES

Q. Have you reviewed the class cost of service study filed by FPL in this case?

A. Yes. Consistent with the instructions for the MFR, FPL has prepared a 12 CP and 1/13th average demand based cost of service study in this case. Another important methodological feature of the Company's cost study (beyond the allocation method for production and transmission demand costs) is the Company's classification of all distribution costs (except meters and services) as demand related. As I will discuss, the Company's methodology ignores any "customer related" cost responsibility for hundreds of millions of dollars of distribution plant and expenses, contrary to the approaches used by many other utilities throughout the country (including Florida's Gulf Power Company) and the NARUC cost allocation manual, which recognizes a "customer component" of distribution cost based on a minimum system concept.

Given the significance placed on the rate of return parities produced by the Company's class cost of service study, the reasonableness of the Company's study is a significant issue. In particular, because FPL's revenue allocation methodology is an attempt to first eliminate any rate of return disparities (at present rates) and then allocate the overall revenue increase to rate classes, the issue of the reasonableness of the class cost of service study is of critical importance.

Q. Do you support the class cost of service study filed by FPL in this case?

A. No. I do not support the Company's study for a number of reasons, including FPL's use

of a 12 CP and 1/13th average demand allocation methodology to allocate production/transmission demand related costs, discussed later in this section of my testimony.

I have specific concerns regarding FPL's cost of service analysis. First, I have identified a problem with the Company's calculation of the 12 CP and Group NCP ("GNCP") demand allocation factors developed for use in its cost of service study. Second, I do not agree with the methodology used to classify distribution plant and expenses. FPL has not considered any minimum distribution system costs in its cost classification analysis, which unreasonably overstates the cost responsibility for large general service rate classes. I address both of these issues below.

Q. Would you please discuss FPL's demand allocation factor development?

A. FPL calculates projected test year 2013 12 CP, Group NCP demand ("GNCP") and NCP demands by applying a 3-year historic load factor to projected 2013 mWh sales for each rate class. The historic 3-year period of data used in this case consists of sample load research data or, in the case of very large customers, actual metered data, for the years 2008, 2009 and 2010. FPL uses the LodeStar system to develop its monthly analyses. FPL witness Joseph Ender discusses this process beginning on page 11 of his testimony. He explains on page 12, beginning on line 19, how FPL actually performed its calculations in this case:

> Projected 2013 Test Year monthly CP, GNCP and NCP ratios for each rate class were then developed based on the average of their

respective historical ratios. The projected CP, GNCP and NCP ratios were then applied to the sales forecast by rate class to derive the projected CP, GNCP and NCP demands for each class.

This analysis forms the basis for the demand allocation factors used in the Company's filed class cost of service study.

Q. Does FPL actually use the monthly rate class demands, as calculated using the historic 3-year average load research results?

A. No. FPL does not use all 12 months of the data, as calculated. This point is not addressed in Mr. Ender's testimony.

Q. Please summarize how FPL departs from using actual historical data.

A. The first change that FPL made to the rate class demands was to make a substitution for the actual 3-year January CP and GNCP residential class load factors. This "adjustment" increased the January residential class CP and GNCP load factors, which has the effect of reducing the January 2013 CP and GNCP residential class demands. This "adjustment" reduces the residential class 12 CP and 1/13th average allocation factor (FPL 101) used to allocate production and transmission demand related costs and the GNCP allocation factor (FPL 104) used to allocate distribution plant and expenses to rate classes, and has the effect of increasing cost responsibility of other rate classes. Table 1 below compares the actual January CP load factors based on the results of FPL's load research to the January CP load factors that are instead imputed by FPL to

develop its demand allocation factors. A similar adjustment was made to the residential class January GNCP load factor.

Table 1

Month of January 3-Year Average CP Load Factor

3-Year Average as Determined by LodeStar

	Per FPL LodeStar Data Base	Per FPL Filing (adjusted)	Difference
RETAIL:			
CILC-1D	1.3134	1.3134	-
CILC-1G	1.2988	1.2988	-
CILC-1T	1.2052	1.2052	-
GS(T)-1	0.9542	0.9542	-
GSCU-1	1.0253	1.0253	-
GSD(T)-1	0.9361	0.9361	-
GSLD(T)-1	0.9552	0.9552	-
GSLD(T)-2	1.0723	1.0723	-
GSLD(T)-3	0.9320	0.9320	-
METRO	0.6550	0.6550	-
OL-1	7.1486	7.1486	-
OS-2	1.9418	1.9418	-
RS(T)-1	0.4364	0.4839	(0.0475)
SL-1	7.0992	7.0992	-
SL-2	1.0000	1.0000	-
SST-D	9.2232	9.2232	-
SST-1T	0.4684	0.4684	-

Q. Is the residential class load factor substitution significant, in your opinion?

A. Yes. Moving the January CP demand load factor from 43.64% to 48.39% (a 9.8% difference) *increases* the share of costs borne by all other rate classes.

Q. What is the basis for FPL's substitution of load research data for the residential class?

A. There is no explanation or acknowledgement of this adjustment in the Company's testimony.

Q. Do you have additional concerns with the Company's demand allocation factor development?

A. Yes. Putting aside FPL's changes to the January CP and GNCP load factors described above, I have identified another methodological problem with FPL's calculation of its test year demand allocation factors. After the development of the 2013 rate class CP, GNCP and NCP demands, the Company performed a test to check whether the monthly GNCP demand is less than or equal to the monthly NCP demand. The NCP demand represents the sum of each customer's maximum hour of demand throughout a particular calendar month over all hours (e.g., customer 1's highest demand may occur in hour 300, while customer 2's highest demand may occur in hour 305 – these highest demands are summed for the month to calculate the NCP demand). The GNCP demand represents the highest aggregate demand in any single hour of the entire rate class during the month. If each individual customer had its highest hourly demand in the identical hour during the month, the GNCP would equal the NCP for the class. However, the GNCP could never exceed the NCP. Similarly, the rate class CP demand, which is the GNCP coincident with the monthly system peak hour, can never exceed the monthly GNCP (which is the maximum hourly GNCP during the month). Because the CP, GNCP and NCP demands are based on sample load research data, sampling errors can produce anomalies.

The problem that I identified with FPL's methodology is that it begins with the NCP and tests the GNCP and CP demands sequentially. If the GNCP exceeds the NCP in a month, the GNCP is set equal to the NCP and the excess is spread to all other rate classes. Similarly, if the CP exceeds the adjusted GNCP, the CP is set equal to the GNCP and the excess is spread to all other rate classes. Finally, after these adjustments, the "adjusted CP" demands are then summed across rate classes and compared to the FPL monthly system peak forecast. Any differences are spread only to the rate classes that were not adjusted in the NCP/GNCP/CP reconciliation process.

Q. Would you provide an example of the adjustments that the Company made in this case to the demand allocation factors?

A. Yes. Table 2 shows the Company's adjustment calculations for the residential class and for GSLDT-2, for the month of January 2013.[1] These adjustments do not include the effect of the Company's residential class CP load factor adjustment, which I discussed earlier; they only reflect the Company's reconciliation adjustments.

[1] This information was provided by FPL in response to OPC POD Number 2-12.

Table 2
Example of Residential and GSLDT-2 Class Load Data Adjustments
January 2013

I. Adjustment - "Pass 1"

	Residential	GSLDT-2
KW Demands (January 2013)	@ Meter	@ Meter
CP	12,021,250	258,850
GNCP	12,495,859	371,089
NCP	32,753,098	450,328

[Residential class passes test, no adjustment in "Pass 1"]
[CP forecasted peak reconciliation - 1,384,606, spread to all classes except SL-2]

II. Adjustment - "Pass 2"

KW Demands (January 2013) - w/share of CP forecast adjustment		
CP	12,883,684	277,420
GNCP	12,495,859	371,089
NCP	32,753,098	450,328

[Residential class fails "Pass 2" test, CP demand set equal to GNCP
[CP forecasted peak reconciliation - 421,360 spread to all classes except GSCU-1, residential and SL-2]

III. Final Adjusted Demands

CP	12,495,859	294,921
GNCP	12,495,859	371,089
NCP	32,753,098	450,328

IV. Final Adjusted Demands - Percent Change From Load Data

CP	3.95%	13.94%
GNCP	0.00%	0.00%
NCP	0.00%	0.00%

Part I of the table shows the kW demands at the meter (before adjustments) for both the residential and GSLDT-2 classes. In each case, the GNCP demands are less than the NCP demands and the CP demands are less than the GNCP demands. Both of these classes "pass" the first rounding of testing. After the first "pass," a reconciliation test is

performed to compare the calculated January 2013 CP demands (summed over all classes) to the Company's independent 2013 peak forecast. The reconciliation shows that there is a shortfall of 1,384,606 kW (at generation voltage) that is then spread to all classes (other than SL-2, which is capped because its CP demand equals its GNCP demand already).

After this "peak forecast" reconciliation adjustment, the residential class January CP demand is now 12,883,684 and the GSLDT-2 CP demand is 277,420. At this point ("Pass 2"), the residential adjusted CP demand now exceeds the residential GNCP demand and therefore the residential class fails the CP/GNCP/NCP reconciliation test. As a result, the residential class January CP demand is now capped at 12,495,859, which is the GNCP demand for January 2013. With the residential capped demand (and the cap for GSCU-1, which also failed the "Pass 2" test and the cap for SL-2), the new "peak forecast" shortfall is 421,360 kW, which is spread to all classes except residential, GSCU-1 and SL-2. The final adjusted residential CP demand is 12,495,859 (equal to the residential GNCP demand due to the cap) and the GSLDT-2 CP demand is 294,921. For the residential class, this represents a 3.95% adjustment from the original load research based demand calculation. For the GSLDT-2 class, the adjusted CP demand is 13.94% higher than the original demand calculation. This obviously has resulted in a significant up-ward adjustment to the GSLDT-2 rate class demand allocation factor, and its cost responsibility as determined by the Company's cost of service study. This result is particularly problematic since the GSLDT-2 and other large general service classes have 100% actual hourly load data available, while the residential class and other

smaller rate classes use sample load research data. In other words, the meter data for large general service classes needs no adjustment because they are already recorded and billed at a level of detail that does not require further statistical extrapolation, unlike some other rate schedules. Thus, FPL's adjustment for the large general service classes distorts actual recorded data and class cost responsibility.

Q. Is FPL's NCP/GNCP/CP reconciliation methodology reasonable?

A. No. The only reconciliation information available, beyond the load research sample data, is the independently developed FPL system peak forecast. It would be much more appropriate and valid to rely on the sample load research data (the 3-year load factors) to develop the rate class CP demands, which can then be uniformly adjusted to tie to FPL's system peak demand forecast. The resulting CP demands would then not be further adjusted in any reconciliation process; rather, the GNCP and NCP demands should be adjusted to insure that they are internally consistent.

FPL's methodology effectively reduces the quality of the statistically based random sample forming the load research data. As I showed in Table 2, the upward adjustment to large general service rate classes is substantial. There is simply no basis to perform the adjustments made by the Company. Particularly given that those adjustments distort actual metered data for certain rate classes. The rate class CP demands should be reconciled to the system peak forecast by FPL before the NCP/GNCP/CP reconciliation test is performed. It makes no sense to perform the adjustment process used by FPL; it once again has the effect in this case of improperly raising the large general service rate

classes' cost responsibility.

Q. Have you revised FPL's demand allocation factors to correct the two problems that you have identified?

A. Yes. First, I used the correct residential class January CP and GNCP load factors, rather than FPL's substituted values. Second, I applied the reconciliation test by assuming that the rate class CP demands, which already have been reconciled with FPL's 2013 peak demand forecast, are reasonable. I made adjustments, if necessary, to the monthly GNCP demands if the GNCP was less than the CP demand by setting the GNCP equal to the CP for the month. Similarly, if the adjusted GNCP demand for the month (for each rate class) is greater than the NCP demand, I set the NCP demand equal to the GNCP demand.[2] Table 3 below shows a comparison of my corrected demand allocation factors for CP, GNCP and NCP to FPL's originally filed allocation factors.

[2] Because there is no need to tie the sum of the rate class GNCP and NCP demands to another forecast (as is the case with the requirement to tie the CP demands to the Company's peak forecast), there is no requirement to "spread" the adjustment of GNCP and NCP demands to other rate classes.

TABLE 3
Comparison of Demand Allocation Factors: SFHHA Corrected vs. FPL's
(mW)

	SFHHA Corrected Allocators			FPL Allocators		
	FPL101 12CP	FPL104 GNCP	FPL109 NCP	FPL101 12CP	FPL104 GNCP	FPL109 NCP
CILC-1D	364	451	347	367	451	347
CILC-1G	23	30	36	24	30	36
CILC-1T	159	-	-	161	-	-
GS(T)-1	1,064	1,369	2,487	1,070	1,351	2,487
GSCU-1	5	5	5	5	5	5
GSD(T)-1	4,034	4,915	6,955	4,074	4,915	6,955
GSLD(T)-1	1,793	2,221	2,405	1,817	2,221	2,405
GSLD(T)-2	332	396	333	336	396	333
GSLD(T)-3	26	-	-	26	-	-
MET	16	21	-	17	21	-
OL-1	2	29	29	2	29	29
OS-2	2	13	12	2	13	12
RS(T)-1	10,927	14,988	35,395	10,848	13,504	35,395
SL-1	10	154	154	10	154	154
SL-2	4	4	4	4	4	4
SST-DST	1	30	-	1	6	-
SST-TST	13	-	-	13	-	-

Q. Why is your methodology more reasonable than FPL's methodology?

A. FPL's methodology distorts each of the demand allocation factors calculated in this case because of the sequence of the Company's reconciliation adjustments. Of the three demand allocation factors (CP, GNCP and NCP), only the CP demands can be reconciled with a separate forecasted peak. To the extent that the sum of the class CP demand for each month developed using FPL's three-year load factor analysis does not match the 2013 monthly FPL system peak forecast, it is appropriate to perform a reconciliation on a uniform basis so that the adjustments to each rate class are consistent – this is the methodology that I have used in this case. FPL's methodology distorts

these rate class CP demands, which is particularly problematic for rate classes, such as larger general service classes, that have actual historic hourly data rather than estimated data from a load research sample. Also, the Company's method distorts rate class GNCP demands, as I have shown.

Q. Have you revised FPL's class cost of service study to incorporate your corrected demand allocation factors?

A. Yes. Baron Exhibit__(SJB-2) presents a summary of this corrected cost of service study. The only changes that I made to the Company's filed cost of service study are the demand allocation factors (FPL 101, 104, 105 and 109) to reflect the corrections that I have just discussed. Table 4 compares the rate parity results from my corrected cost of service study to FPL's originally filed study. As can be seen, the correction to the demand allocation factors shows that FPL's flawed methodology understates the rate parity results for numerous rate schedules.[3]

[3] It should be noted that rate Class SST-DST has a negative rate of return when corrected allocation factors are used. This occurs because FPL made a significant adjustment to the SST-DST December GNCP and NCP load factors in its analysis, which had the effect of reducing test year GNCP and NCP demand for this rate class. This FPL adjustment had little effect on other rate classes (unlike the residential class adjustment) because of the small size of rate class SST-DST (only 0.02% of retail mWh). This adjustment is not made in the SFHHA corrected analysis.

Table 4
Comparison of ROR Parities
SFHHA w/Corrected Demand Allocation Factors
vs. FPL COS Study

	SFHHA Corrected	FPL As-Filed
CILC-1D	0.95	0.91
CILC-1G	1.19	1.14
CILC-1T	0.81	0.78
GS(T)-1	1.38	1.35
GSCU-1	1.22	1.21
GSD(T)-1	1.09	1.05
GSLD(T)-1	0.75	0.70
GSLD(T)-2	0.71	0.67
GSLD(T)-3	0.99	0.96
MET	0.86	0.81
OL-1	0.98	0.98
OS-2	0.78	0.73
RS(T)-1	0.98	1.00
SL-1	0.97	0.97
SL-2	2.08	2.08
SST-DST	(0.18)	1.15
SST-TST	3.02	2.99

Q. Would you please discuss the methodology used by FPL to allocate distribution plant investment and expenses to retail rate classes?

A. Yes. As discussed in FPL witness Joseph Ender's testimony, the Company has classified all distribution plant as demand related except account 369 Services and account 370 meters, which are classified as customer related.[4] The Company's approach does not give any recognition to a customer component of any primary or

[4] Primary pull-offs are also specifically assigned to rate classes.

secondary line, pole or transformer. All of these costs are assigned on the basis of kW demand.

Q. Do you agree with the Company's classification of these distribution costs?

A. No. FPL places significant weight on the "parity" results from its cost of service study when assigning increases to rate classes. In particular, the proposed increases to its general service rate classes are substantially higher than the system average increase due to the parity results. These parity results are driven to a large extent by the methodology used by FPL to classify and allocate costs to rate classes. This is not purely an argument of academic interest. To the extent that the cost of service study is used to allocate the approved increase in this case, the underlying methodology used in the study will materially increase rates to a number of rate classes. Therefore, given the significant reliance that the Company has placed on the results of its cost of service study in assigning its requested revenue increase to rate classes in this case, it is reasonable for the Commission to consider evidence on alternative methods of classifying distribution costs in this case.

Q. What is the central argument underlying a classification of some portion of distribution costs (other than services, meters and "primary pull-offs") as customer related?

A. As described in the NARUC Electric Utility Cost Allocation Manual, the underlying argument in support of a customer component is that there is a minimal level of distribution investment necessary to connect a customer to the distribution system (lines,

poles, transformers) that is independent of the level of demand of the customer.[5] The amount of distribution cost that is a function of the requirement to interconnect the customer, regardless of the customer's size, is appropriately assigned to rate classes on the basis of the number of customers, rather than on the kW demand of the class. As stated on page 90 of the NARUC cost allocation manual:

> When the utility installs distribution plant to provide service to a customer and to meet the individual customer's peak demand requirements, the utility must classify distribution plant data separately into demand- and customer-related costs.

Q. Has FPL offered evidence disputing that conclusion?

A. No.

Q. Would you briefly explain the conceptual basis for a minimum distribution cost methodology?

A. As discussed in the NARUC cost allocation manual, there are two approaches that are typically used to develop a customer component of distribution plant and expenses. Each of the two approaches ("zero-intercept" and "minimum size") is designed to measure a "zero load cost" associated with serving customers. Each methodology attempts to measure the customer component of various distribution plant accounts

[5] An excerpt from the NARUC manual that discusses the classification of distribution costs is contained in Baron Exhibit__(SJB-3).

(e.g., poles, primary lines, secondary lines, line transformers, etc.). Each of the two methods (the zero-intercept method, for example) is designed to estimate the component of distribution plant cost that is incurred by a utility to effectively interconnect a customer to the system, as opposed to providing a specific level of power (kW demand) to the customer. Though arithmetically the zero-intercept method does produce the cost of say "line transformers" associated with "0" kW demand, the more appropriate interpretation of the zero-intercept is that it represents the portion of cost that does not vary with a change in size or kW demand and thus should not be allocated on NCP demand (as FPL has done). Essentially, the "zero-intercept" represents the cost that would be incurred, irrespective of differences in the kW demand of a distribution customer. It is this cost, which is not related to customer usage levels, that is used in the zero-intercept method to identify the portion of distribution costs that should be allocated to rate classes based on the number of primary and secondary distribution customers taking service in the class.

Conceptually, this analysis is designed to estimate the behavior of costs statistically, as the Company meets growth in both the number of distribution customers and the loads of these customers. For example, new distribution investment in poles, or underground conductors, for a new subdivision may be associated with unsold, or unoccupied homes that have "0" kW demand – yet the cost for these facilities is still incurred. Similarly, distribution facilities must be installed to meet the needs of part time residents that may have little or no demand during a portion of the year – yet the cost of such distribution facilities still must be incurred and does not vary as a result

of the fact that such facilities serve part-time residents. The MDS methodology gives recognition to this circumstance by assigning a portion of the cost of these facilities based on the existence of a "customer," and not just the level of the customer's kW demand. This is in contrast to FPL's analysis that assumes that all distribution costs (except services and meters) vary directly with kW demand, without any fixed component that should be allocated on the basis of the number of customers in each class.

Q. Do you have a specific example that illustrates this point?

A. Yes. In FPL's prior base rate case (Docket No. 080677-EI), I presented an analysis of account No. 364 secondary poles allocated by the Company using its "100% demand" methodology. This analysis clearly demonstrated that the Company's refusal to acknowledge any customer component of distribution cost (other than for services and meters) is not justified.

Q. Have you performed a similar analysis of account No. 364 data in this case?

A. Yes. FPL has classified all costs in account No. 364, poles, towers and fixtures, as demand related and allocated these costs to rate classes on the basis of rate class NCP demand. This account mainly consists of primary and secondary poles. Based on the Company's workpapers in this case, there were approximately 185,000 secondary poles in the account that have been allocated to rate classes using rate class NCP demand. Table 5 summarizes FPL's implicit allocation of these secondary poles to major general service rate classes and the residential rate class on the basis of

demand. As can be seen in the table, FPL's cost of service study assumes that on average more than 35 residential customers are served from a single pole, while it takes about 14 poles to serve a single GSLDT-2 customer. This obviously is not realistic; yet, this is the cost allocation underlying FPL's proposed rate class increases in this case.

Table 5
FPL's Assignment of Secondary Poles Per Customer

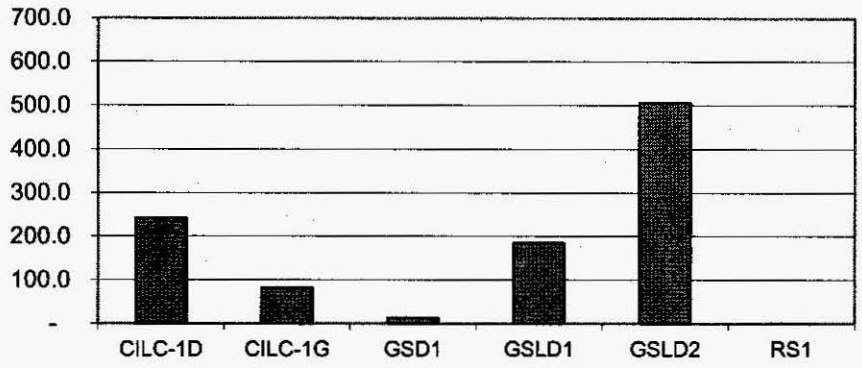
Total Secondary Poles: **182,304**

Rate Class	Allocation Factor*	Poles Allocated to Rate	Poles Per Customer	Poles Per Every 35 Customers
CILC-1D	1.254%	2,287	6.91	241.8
CILC-1G	0.132%	241	2.32	81.2
GSD1	21.605%	39,387	0.37	13.1
GSLD1	9.441%	17,211	5.26	184.1
GSLD2	1.198%	2,183	14.45	505.8
RS1	59.525%	108,517	0.03	0.9

* FPL105

Figure 1 below illustrates this in graphic form. This result suggests that the Company's study, which ignores any measure of a customer component for distribution facilities (other than meters and services), overstates cost responsibility for large general service rate classes.

Figure 1
FPL Cost of Service Study
Secondary Poles Per Every 35 Customers



Q. Are there other reasons why a customer classification of some portion of distribution plant is appropriate for FPL's system?

A. Yes. As discussed by FPL witness Rosemary Morley on page 20 of her testimony, at the end of 2011, the ratio of inactive meters to total customers on the FPL system was 6.1%. According to Dr. Morley, this ratio is "a proxy for empty homes" on the FPL system (testimony at page 20, line 7). The Company's test year cost of service study would tend to systematically understate the actual cost responsibility of such customers for distribution plant and expenses. "Empty homes" nonetheless have distribution facilities (*e.g.*, poles, overhead and underground lines, transformers) installed to allow connection to such customers, despite the fact that they are empty. These distribution facilities are installed to serve these homes, even if there is no or de minimus usage because the homes are empty. These vacant homes required investments by FPL in primary and secondary lines, poles, conduit and transformers. Yet, because kW demand, which FPL uses to allocate the cost of these distribution

facilities to rate schedules, approaches zero for unoccupied homes, the costs of these distribution facilities are essentially allocated to other rate classes, not the cost-causers. While a minimum distribution system methodology may still not fully remedy this problem, it would provide a more reasonable allocation of cost.

Q. Do other major electric utility operations in Florida incorporate minimum distribution system classifications in class cost of service studies?

A. Yes. In a recent Gulf Power Company ("GPC") rate case (Docket No. 110138-EI), GPC presented and strongly supported the use of an MDS methodology to develop its class cost of service study. GPC's cost of service witness in that case, Michael O'Sheasy, testified in support of an MDS methodology as follows:

> Q. Please explain why the Minimum Distribution System methodology is important to Gulf and its customers?
>
> A. As I discuss in more detail later, some costs of the distribution system beyond the customer meter and service drop do not vary with customers' use of electricity. The Minimum Distribution System (MDS) methodology is necessary to accurately determine and allocate these customer-related distribution costs. The misclassification of costs that results from not using the MDS methodology sends misleading price signals to customers. This misclassification also results in different customer rate

classes bearing more or less costs than their cost-causative share of distribution costs. It is therefore important to examine these customer-related costs and classify them appropriately, which the MDS methodology enable us to do. [O'Sheasy Direct Testimony at pages 16 -17, Gulf Power Company Docket No. 110138-EI].

Q. Do you agree with Mr. O'Sheasy's quoted testimony on the MDS issue?

A. Yes. There is no question that some portion of each of FPL's distribution accounts 364 to 368 is customer related. FPL of course assumes that each of these accounts is 100% demand related – that is, if a customer were to decrease its usage to 0 kW, all of the poles, overhead conductors, underground conductors and transformers would somehow disappear or be used to supply customers in other parts of FPL's system. This is obviously not the case. With the FPL system having over **285,000** inactive accounts, this problem is exacerbated.[6] It is simply not credible to argue, as FPL does, that 100% of its primary and secondary distribution system (other than services and meters) is cost-causally related to kW demand and none to the number of customers served on the distribution system.

Q. What were the results of GPC's MDS classification analysis?

A. Baron Exhibit__(SJB-4) contains a copy of Mr. O'Sheasy's MDS results for each

[6] Number of inactive accounts on the FPL system in July 2011(Source: response to SFHHA POD No. 77).

FERC distribution account.

Q. Did the Commission adopt GPC's MDS methodology in Docket No. 110138-EI?

A. It is my understanding, based on a review of the Commission's Order in that case, that the Commission approved a Stipulation adopting the methodology "solely for use in designing rates in this case." At least for that GPC case, the conceptual framework that some portion of distribution accounts 364 through 368 is customer related has been accepted, even if it is only for "use in designing rates" in that case.

Q. Do you believe that a minimum distribution system is appropriate for FPL?

A. Yes. Given the importance of the cost of service results (parities) in this case, it is appropriate for the Commission to adopt an alternative methodology, particularly given clear evidence that FPL's methodology produces results that over-estimate cost responsibility of some classes. The conceptual basis for the MDS method is that it reflects a classification of the distribution facilities that would be required to simply interconnect a customer to the system, irrespective of the kW load of the customer. From a cost causation standpoint, the argument supporting this approach is that all of these minimal facilities are needed to interconnect a customer to the FPL system, including meeting minimum safety standards set forth in the National Electric Safety Code ("NESC"), which the FPSC requires be adhered to for all Florida electric utilities.

Q. Have you performed any analysis to evaluate the reasonableness of using the

GPC MDS results as a measure of minimum distribution costs on the FPL system?

A. Yes. As described by GPC witness O'Sheasy in Docket No. 110138-EI on page 25 at line 24 of his Direct Testimony, GPC used a minimum size methodology for Account 364 data based on the "the average of the smallest, most frequently used poles since the unit cost of different sized poles did not lend itself to regression analysis."[7] In the GPC analysis, the Company used the cost of wooden poles that were 35 feet and smaller. Using FPL Account No. 364 data provided by the Company in response to OPC POD 2-12 (used to support FPL's primary-secondary distribution plant split in its cost of service study), I performed a similar analysis of the cost of smaller wooden poles on the FPL system. Baron Exhibit__(SJB-5), pages 1 and 2 presents the analysis that I performed.

Page 1 of the exhibit includes an extract from FPL's file "2010 Primary Secondary Split-Final.xlsx," Tab "2009 Surviving Balance Report," which was provided in response to OPC POD 2-12. This file extract shows the installed cost of various pole categories in the FPL Account No. 364 inventory. Based on the Company's own data, there were 1,011,357 wooden poles on the FPL system in the two smallest categories used by FPL ("23/30 FT" and "35/40/45 FT"). As shown on the exhibit, the average cost of these smaller wooden poles is $616.57 per pole. The entire inventory of FPL poles (1,297,659) is then re-priced in my analysis at this minimum

[7] For all other distribution plan accounts, GPC used a zero intercept, regression methodology.

unit cost. Based on this analysis, using the GPC methodology, 82% of FPL's Account No. 364 costs are customer related. This compares to GPC's Account No. 364 classification (page 2 of the exhibit) that assigns 65% of these cost as customer related. The higher FPL customer classification appears to be consistent with the fact that FPL's 35 foot category also included large 40 foot and 45 foot poles. Nonetheless, my conclusion from this analysis is that the GPC classification results are a reasonable proxy for the FPL system.

Q. Have you developed an alternative class cost of service study reflecting a minimum distribution system methodology?

A. Yes. In order to provide indicative rate of return parity impacts from the use of an MDS methodology, I have rerun the corrected FPL class cost of service study that I presented in Baron Exhibit__(SJB-2) using the customer/demand classifications for FERC Account Nos. 364 through 368 developed by Gulf Power Company in its recent rate case before the Commission [see Baron Exhibit__(SJB-4)]. These results illustrate the bias in the Company's study as a result of the classification of 100% of distribution plant accounts 364 through 368 as demand related and 0% as customer related. Baron Exhibit__(SJB-6) presents the results of this study of FPL's cost of service. This analysis also includes the correction to the residential class 12 CP, GNCP and NCP demands that I previously discussed.

Q. How do the rate of return parities in your MDS cost of service study compare to the Company's filed MFR cost study?

A. Table 6 shows the comparison. I have highlighted the large general service rate classes in Table 6 to show the impact of these changes to the Company's cost of service study. As can be seen from the table, there are significant differences in the rate of return parities for most large general service rate classes using an MDS methodology.

Table 6
Comparison of ROR Parities
SFHHA Minimum Distribution System COS Study
w/Corrected Demand Allocation Factors
vs. FPL COS Study

	SFHHA Corrected	FPL As-Filed
CILC-1D	1.01	0.91
CILC-1G	1.27	1.14
CILC-1T	0.81	0.78
GS(T)-1	1.32	1.35
GSCU-1	1.00	1.21
GSD(T)-1	1.16	1.05
GSLD(T)-1	0.81	0.70
GSLD(T)-2	0.77	0.67
GSLD(T)-3	0.99	0.96
MET	0.91	0.81
OL-1	1.01	0.98
OS-2	0.89	0.73
RS(T)-1	0.95	1.00
SL-1	0.99	0.97
SL-2	2.18	2.08
SST-DST	(0.12)	1.15
SST-TST	3.02	2.99

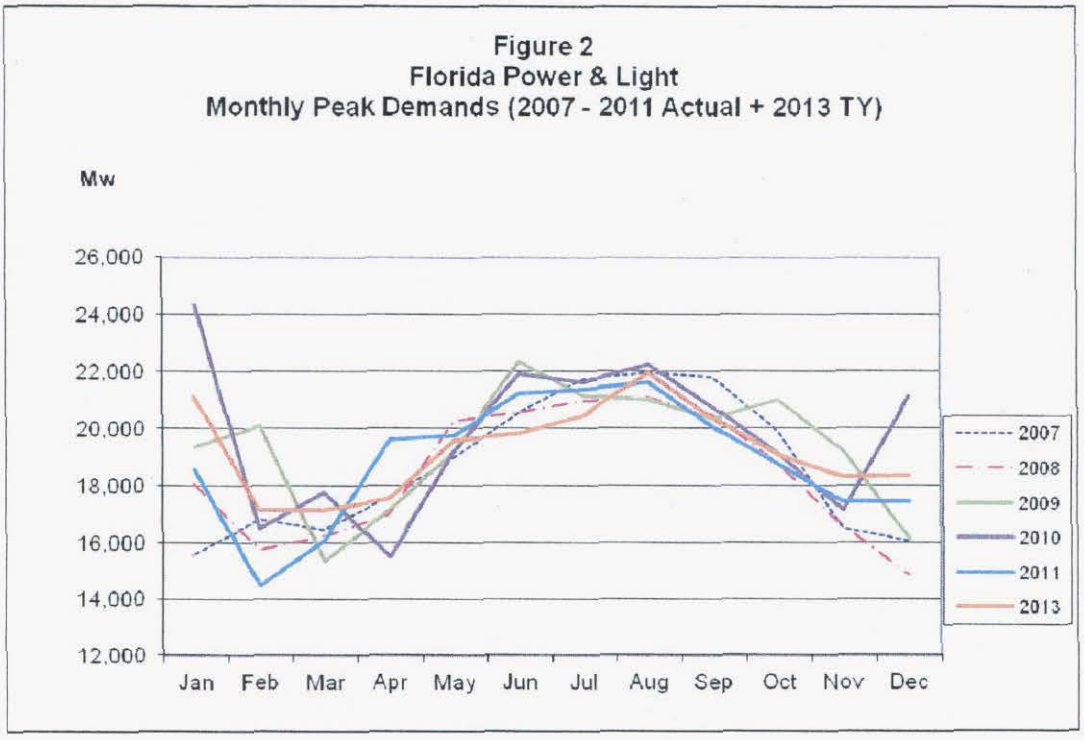
Q. What is the implication of these results from your MDS cost of service study?

A. Using an alternative methodology that recognizes a minimum level of distribution

cost associated with connecting customers to the system produces a more accurate measure of rate class revenue increases. I believe that the Commission should require FPL to file an MDS cost of service study in a compliance filing in this case and use these results to allocate any Commission approved revenue increases. Further, I recommend that the Commission require FPL to perform and file an MDS cost of service study with the appropriate supporting data in its next base rate case.

Q. You indicated previously that you believe that a summer coincident peak demand ("1 CP") methodology to allocate production and transmission demand costs is more appropriate than FPL's proposal to use a 12 CP and 1/13th average demand method. What is the basis for your opinion on this issue?

A. As in prior FPL rate cases, I continue to support the use of a 1 CP methodology based on the significance of customer demands during the summer months as a driver of new generation capacity on the system. Figure 2 below shows FPL's actual monthly system peaks for the last five years (2007 to 2011) and the Company's forecasted 2013 test year monthly peaks.



As is clear from this chart, FPL summer peak demands predominate on the FPL system. While winter peaks on rare occasions have exceeded the summer peak under certain weather conditions, the summer peak drives the need for capacity on the system. Clearly, customer usage during lower load months such as March, April, May, October and November does not drive the need for additional generation resources on the system. This is confirmed in the Company's 10 Year Site Plans repeatedly over time. For example, in the 2011 Site Plan, FPL states that the Company uses a dual planning criterion of maintaining a 20% reserve margin based on the summer and winter peaks, as well as a loss of load probability criterion.[8] Since FPL forecasts that the summer peak will exceed the winter peak, the Company's

[8] FPL's "Ten Year Power Plant Site Plan 2012-2021" (April 2012) at page 55.

generating capacity needs are clearly being driven by summer peak load.

Q. Is the 12 CP and 1/13th average demand methodology consistent with this planning criterion?

A. No. The 12 CP and 1/13th average demand methodology assumes that the peak day usage in any one month contributes equally to the need for FPL to add new capacity as the peak day usage in every other month. I do not believe that it is consistent or reasonably reflects the significance of customer demands during the summer peak months in driving the need for capacity additions on the FPL system. As a result, the price signals from the Company's rates, which are based on the 12 CP and 1/13th average cost of service analysis, do not reasonably reflect cost causation.

Q. Have you developed a 1 CP class cost of service analysis in this case?

A. Yes. Baron Exhibit__(SJB-7) presents the results of a revised FPL cost of service study using a 1 CP methodology, as well as the corrections to the Company's demand allocation factors and the MDS classification of distribution costs. I believe that this cost of service study would be the most appropriate basis to assign cost responsibility in this case and to use in developing the allocation of the Commission approved increase to rate classes. Table 7 summarizes the rate parities for each rate class based on a 1 CP/MDS cost of service study, compared to the rate parities in FPL's filed cost of service study.

Table 7
Comparison of ROR Parities
SFHHA MDS - 1 CP COS Study
w/Corrected Demand Allocation Factors
vs. FPL COS Study

	SFHHA MDS - 1 CP	FPL As-Filed
CILC-1D	1.03	0.91
CILC-1G	1.30	1.14
CILC-1T	0.83	0.78
GS(T)-1	1.23	1.35
GSCU-1	1.06	1.21
GSD(T)-1	1.14	1.05
GSLD(T)-1	0.82	0.70
GSLD(T)-2	0.78	0.67
GSLD(T)-3	1.05	0.96
MET	0.94	0.81
OL-1	1.05	0.98
OS-2	1.00	0.73
RS(T)-1	0.96	1.00
SL-1	1.03	0.97
SL-2	2.33	2.08
SST-DST	(0.13)	1.15
SST-TST	2.09	2.99

III. ALLOCATION OF THE AUTHORIZED REVENUE INCREASE

Q. What does this issue involve?

A. FPL is seeking to increase *base rates* by $516.5 million in Step 1 and $173.9 million in Step 2. This portion of my testimony concerns how increases in base rates should be spread across customer classes.

Q. What is the single most important goal in this exercise in your opinion?

A. I believe it is critically important to use revenue related to base rates -- not other revenues (*e.g.*, fuel or other costs subject to trackers that are triggered in ways independent of base rate cost responsibility) to allocate these step increases.

Q. Would you please briefly describe the methodology that FPL is proposing to use to allocate its requested base rate Step 1 increase of $516.5 million and its base rate Step 2 increase of $173.9 million to rate classes?

A. Based on the testimony of FPL witness Renae Deaton and an analysis of FPL's workpapers in this case, the Company uses two factors to develop the initial "target revenue increases" for base rates in each rate class. The first component of the target revenue increase for base rates is an adjustment to each rate class to remove any rate of return parity differences as calculated by FPL. This adjustment is intended to remove any dollar subsidies paid or received by each rate class based on the results of FPL's class cost of service study at present rates. Effectively, rate classes receive revenue increases or decreases necessary to move towards an equal rate of return.

The second component of the target revenue increase is a uniform percentage increase to each rate class on a *total revenue* basis (including all clause revenues and unbilled revenues) sufficient to recover the Step 1, $516 million revenue increase. Based on FPL's filing, this uniform percentage factor is 5.86%. The sum of these two parts becomes the target increase for each class.

Q. You indicated that the uniform percentage increase portion of the "target revenue" increase is based on total rate class revenues. What is included in FPL's "total revenue" for each rate class that is used in the revenue allocation calculations?

A. Total revenue includes the following categories in addition to base revenues:

a. miscellaneous revenues

b. other allocated operating revenue credits

c. unbilled revenues

d. an add-back of any CILC or CDR incentives included in base revenues

e. All Clause Revenues

Table 8 below shows the composition of "total revenues" used by FPL for rate GSLDT-1. The only revenues actually at issue in this case are base revenues and miscellaneous revenues. These constitute 41% of the "total revenues" used in FPL's calculations; the remaining 59% revenues used by FPL to allocate its requested increase *are not at issue in this case.*

Table 8
Example of Total Revenues - GSLDT-1

Rate Class		GSLD(T)-1
2013 Base Rate Revenue	$	306,793,721
Misc. Sevice Revenue	$	805,007
Other Operating Revenue	$	6,612,648
CILC Incentive offset.	$	5,959,107
Unbilled	$	(917,546)
Clause Revenue	$	433,061,467
2013 Operating Revenue	$	752,314,404

In other words, the base rate increase is being allocated primarily, in the instance of GSLDT-1, *not* on the basis of base rate revenues, but instead on other revenue.

Q. Does the Company make any adjustments to this "target revenue" increase?

A. Yes. There are three sets of adjustments made to the initial target increases. First, any revenue decreases are eliminated, following the Commission's prior decisions that no rate class should receive a rate decrease. The excess revenue produced in this step is credited (a reduction) to all rate classes receiving an increase on the basis of the dollars of target revenue increases. The next adjustment is the application of the Commission's "1.5 times average increase" rule that limits the increase to any rate class to a maximum of 1.5 times the retail average increase. FPL has applied this "1.5 times" limitation to the "total revenue" increase of each rate class (based on all revenues, from whatever the source), rather than the base revenues at issue in this case. These "total revenues" for each rate class are the same amounts used in developing the uniform increase portion of the "target revenue" increase that I discussed above.

Q. What is the final set of adjustments that FPL makes to its "target revenue"

increases?

A. The Company made a number of adjustments to the revenue increases for large general service rate classes that have the effect of preserving relationships ("cross-over points") between similar rates across rate classes.

Q. Do you agree with FPL's revenue allocation methodology for its Step 1, $516 million revenue increase?

A. No. I have two separate objections to the Company's methodology. First, I believe that the development of the rate class "target increases" is inappropriate because it uses "total revenues" to allocate the Step 1 $516 million increase instead of the base revenues and miscellaneous revenues that are at issue in this case. There is no justification to assign the "target" increase for each rate class based on total rate class revenues that include such extraneous items as the rate class share of pole attachment revenues (a component of "other revenues" that are allocated by FPL to each rate class and included in the calculation of total revenues). The second objection that I have concerns the use of "total revenues" in the application of the Commission's "1.5 times" maximum increase rule. While it is true that the Commission required FPL to include all clause revenues in the application of the "1.5 times" adjustment in the 2009 FPL rate case, I will recommend that this mitigation adjustment apply only to the base revenue and miscellaneous revenues at issue in this case.

Q. Has the Commission previously found that the "target revenue" increase for each rate class should be based on "total revenues" rather than base revenues?

A. No, I am not aware that the Commission has ever adopted such a policy. As I indicated, the Commission did require that the "1.5 times" maximum increase be based on base revenues plus clause revenues, but this did not address the computation of "target revenue" increases. These two issues, the computation of the "target revenue" increase and the application of the "1.5 times" maximum increase rule, are separate issues, though as I indicated I am recommending that both calculations use base plus miscellaneous revenues, rather than total revenues, as FPL has done in this case.

Q. Is FPL's use of "total revenues" in the development of target rate class increases reasonable?

A. No. The only revenue categories at issue in this case are base revenues and miscellaneous revenues. While the Commission has included "clause revenues" in the calculation of the "1.5 times" maximum increase in prior cases, there is no basis to include any of these other categories of "revenue" in the computation of rate class target increases. In particular, including "other operating revenues," which has nothing to do with rate class "rates" (it represents an allocated credit of "other" FPL revenues for such items as late payment charges, initial connection and reconnection charges, pole attachment rent revenues, transmission revenues, other rents) or clause revenues, in the development of the target rate class increase makes no sense. Effectively, higher load factor rate classes that have a higher proportion of fuel charges (which they already have paid for in their fuel clause charges) receive a larger share of the "target increase" in base rates, all else being equal. Based on FPL's methodology, as fuel costs increase, high load factor general service customers will receive a larger share of the non-fuel

base revenue increase, even though they may not be causing more costs reflected in the derivation of base rates. FPL in fact suggests that fuel costs (recovered in the fuel charge) will decline as a result of the Canaveral capital costs (included in base rates).[9] Thus, it is fundamentally illogical to use one to allocate the other. Also, FPL adds-back CILC and CDR incentives to base revenues before applying the uniform percentage increase. This means that CILC and other large general service rate classes are allocated target revenue increases on the basis of "hypothetical revenues." In fact, in FPL's 2009 rate case, the Company did not add-back incentive revenues before computing target rate class revenue increases.

Q. Is FPL's use of "total revenues" in the application of the "1.5 times" maximum rate class increase rule reasonable?

A. No. For the same reasons that I discussed above, it is not reasonable to use total rate class revenues in the application of the "1.5 times" maximum increase rule. The "1.5 times" maximum increase rule should only apply to base and miscellaneous revenues because of the significant increases being proposed by the Company for some large general service rate classes. Table 9 shows the base rate increases proposed by the Company for major rate classes and the relative increase for that rate class compared to the retail average. The Company is proposing increases for some general service rate classes of 21% to 35%, which is 1.8 to 2.9 times the retail average increase.

[9] Kennedy Direct Testimony at 9:11-13 (noting that fuel cost savings will increase as new and modernized generating units are placed into service); 11:1-5 (noting that the Canaveral Modernization Project will, *inter alia*, reduce fuel costs); and 14:18-21 (stating that "FPL is a leader in converting older power plants to modern combined cycle technology . . . providing significant fuel cost savings to customers . . . .").

Table 9
FPL Proposed Rate Class Increases
Step 1 - January 2013

	Increase ($000)	% Base Revenue*
CILC-1D	$ 13,032,796	23.0%
CILC-1G	$ 336,645	7.5%
CILC-1T	$ 5,678,789	35.2%
GS(T)-1	$ 3,469,333	1.1%
GSCU-1	$ 38,612	2.3%
GSD(T)-1	$ 97,175,710	11.2%
GSLD(T)-1	$ 66,062,257	21.5%
GSLD(T)-2	$ 13,077,926	23.1%
GSLD(T)-3	$ 593,583	14.6%
MET	$ 553,338	19.1%
OL-1	$ 1,303,193	11.3%
OS-2	$ 123,450	14.5%
RS(T)-1	$ 306,503,369	11.8%
SL-1	$ 7,990,149	11.3%
SL-2	$ (225,732)	-17.1%
SST-DST	$ 58,320	15.8%
SST-TST	$ 749,557	17.5%
TOTAL RETAIL	$ 516,521,295	12.0%

* Base revenue plus miscellaneous revenue

Q. Do the increases proposed by the Company give reasonable weight to the regulatory concept of "gradualism?"

A. No. Based on the proposed increases shown in Table 9, FPL has not reasonably applied gradualism or mitigation in assigning increases to rate classes.

Q. Do you agree with the Company's methodology to allocate the proposed $516 million Step 1 increase to rate classes?

A. No. First, as discussed by SFHHA witnesses Lane Kollen and Richard Baudino,

SFHHA does not agree with the overall level of proposed revenue requirements reflected in the Company's filing. Also, for the reasons that I discussed above, I disagree with the Company's proposed allocation of the revenue increase in this case to rate classes. I am recommending a modification to FPL's revenue allocation methodology to use "base plus miscellaneous" revenues instead of total revenues for both the development of the target revenue increases for each rate class and for use in applying the Commission's "1.5 times" maximum increase rule.

Q. Have you developed rate class revenue allocations using your modified FPL methodology?

A. Yes. I have developed four revenue allocation analyses using my recommended methodology that utilizes base plus miscellaneous revenues, rather that FPL's calculation of "total revenues" for both the initial target increase and the application of the "1.5 times" maximum increase rule. The three alternative revenue allocations are as follows:

1. FPL's As-Filed cost of service study.

2. FPL's cost of service study with SFHHA's recommended correction to the demand allocation factors.

3. FPL's cost of service study with both SFHHA's demand allocation factor correction and the incorporation of a minimum distribution system methodology.

4. FPL's cost of service study with SFHHA's demand allocation factor correction, the incorporation of a minimum distribution system methodology and the use of a 1 CP production/transmission demand allocation methodology.

Baron Exhibit__(SJB-8), Schedules A through D present the results of this analysis. Table 10 summarizes these revenue allocation results for each rate class.

Table 10
Alternative Rate Class Increases Using SFHHA Revenue Allocation Methodology
Step 1 - January 2013*

	FPL COS Study		FPL COS - Corrected Demand		FPL COS - MDS-Corrected Dem		FPL COS - MDS-Corr Dem-1 CP	
	Increase ($000)	% Increase Base Rev**	Increase ($000)	% Increase Base Rev**	Increase ($000)	% Increase Base Rev**	Increase ($000)	% Increase Base Rev**
CILC-1D	$ 10,371,750	18.3%	$ 8,890,529	15.7%	$ 6,655,892	11.7%	$ 5,951,649	10.5%
CILC-1G	$ 246,127	5.5%	$ 143,634	3.2%	$ 15,876	0.4%	$ 12,958	0.3%
CILC-1T	$ 2,904,845	18.0%	$ 2,904,845	18.0%	$ 2,904,845	18.0%	$ 2,904,845	18.0%
GS(T)-1	$ 2,646,185	0.9%	$ 1,996,915	0.6%	$ 2,509,755	0.8%	$ 10,758,309	3.5%
GSCU-1	$ 101,711	6.1%	$ 90,964	5.4%	$ 204,307	12.2%	$ 169,940	10.2%
GSD(T)-1	$ 91,860,043	10.6%	$ 74,329,106	8.6%	$ 48,245,710	5.6%	$ 55,145,807	6.4%
GSLD(T)-1	$ 55,336,918	18.0%	$ 55,336,918	18.0%	$ 55,336,918	18.0%	$ 55,336,918	18.0%
GSLD(T)-2	$ 10,188,255	18.0%	$ 10,188,255	18.0%	$ 10,188,255	18.0%	$ 10,188,255	18.0%
GSLD(T)-3	$ 585,412	14.4%	$ 534,568	13.2%	$ 525,116	12.9%	$ 419,656	10.3%
MET	$ 520,275	18.0%	$ 520,275	18.0%	$ 484,358	16.7%	$ 429,827	14.9%
OL-1	$ 1,668,942	14.4%	$ 1,567,464	13.6%	$ 1,391,830	12.0%	$ 1,185,428	10.2%
OS-2	$ 153,638	18.0%	$ 153,638	18.0%	$ 152,070	17.8%	$ 105,933	12.4%
RS(T)-1	$ 329,323,337	12.7%	$ 349,787,725	13.5%	$ 378,796,816	14.6%	$ 365,887,605	14.1%
SL-1	$ 10,555,452	14.9%	$ 9,984,111	14.1%	$ 9,028,876	12.7%	$ 7,944,529	11.2%
SL-2	$ 9,242	0.7%	$ 7,016	0.5%	$ 3,777	0.3%	$ 3,030	0.2%
SST-DST	$ 24,228	6.6%	$ 66,451	18.0%	$ 66,451	18.0%	$ 66,451	18.0%
SST-TST	$ 24,796	0.6%	$ 18,741	0.4%	$ 10,302	0.2%	$ 10,014	0.2%
TOTAL	$ 516,521,155	12.0%	$ 516,521,155	12.0%	$ 516,521,155	12.0%	$ 516,521,155	12.0%

* This table is based on FPL's requested revenue increase. It does not reflect SFHHA's recommended reduction to FPL's proposed increase.

** Base revenue plus miscellaneous revenue

Q. What is your recommendation in this case regarding revenue allocation?

A. I recommend that the Commission adopt my proposed modified revenue allocation methodology based on base revenues and miscellaneous revenues. Consistent with my recommendation on class cost of service, I also recommend that the Commission utilize the results of my revenue allocation methodology reflecting a minimum distribution system methodology, a 1 CP production/transmission demand methodology and incorporate my correction to FPL's demand allocation factors.

Q. Have you reviewed FPL's proposed allocation of its requested Step 2, Canaveral increase of $173.9 million?

A. Yes. FPL is proposing to allocate the Canaveral increase on the basis of "other production revenue requirements" developed at proposed, equal rates of return. I recommend that the application of the "1.5 times" maximum increase rule be based on the same base revenues plus miscellaneous revenues that I recommend for the Step 1, $516 million increase. Table 11 below summarizes my recommended allocation of the Total Step 1 plus Step 2 (Canaveral) increases to each rate class using FPL's cost of service study and the two alternative studies that I have discussed.[10] As I previously indicated, I am recommending the revenue allocation based on the minimum distribution system study.

[10] Baron Exhibit__(SJB-8), Schedule A through D contains the support for Table 11.

Table 11
Alternative Rate Class Increases Using SFHHA Revenue Allocation Methodology
Total Proposed FPL Step 1 + Step 2 Increases*

	FPL COS Study		FPL COS - Corrected Demand		FPL COS - MDS-Corrected Dem		FPL COS - MDS-Corr Dem-1 CP	
	Increase ($000)	% Base Rev**	Increase ($000)	% Base Rev**	Increase ($000)	% Base Rev**	Increase ($000)	% Base Rev**
CILC-1D	13,629,362	24.0%	12,523,861	22.1%	10,287,196	18.1%	9,582,314	16.9%
CILC-1G	479,829	10.8%	376,974	8.5%	249,101	5.6%	246,179	5.5%
CILC-1T	3,882,554	24.0%	3,882,554	24.0%	3,882,554	24.0%	3,882,554	24.0%
GS(T)-1	12,668,704	4.1%	12,011,746	3.9%	12,525,051	4.0%	20,781,089	6.7%
GSCU-1	148,929	8.9%	138,089	8.3%	251,535	15.1%	217,137	13.0%
GSD(T)-1	130,555,261	15.1%	112,935,257	13.1%	86,828,196	10.0%	93,734,553	10.8%
GSLD(T)-1	72,451,059	23.6%	72,410,458	23.5%	72,410,458	23.5%	72,410,458	23.5%
GSLD(T)-2	13,451,962	23.8%	13,444,424	23.7%	13,444,424	23.7%	13,444,424	23.7%
GSLD(T)-3	841,645	20.7%	790,283	19.5%	780,822	19.2%	675,267	16.6%
MET	673,261	23.3%	672,884	23.3%	636,934	22.0%	582,354	20.1%
OL-1	1,715,457	14.8%	1,612,926	13.9%	1,437,132	12.4%	1,230,543	10.6%
OS-2	169,887	19.9%	169,791	19.9%	168,223	19.7%	122,043	14.3%
RS(T)-1	428,654,328	16.5%	448,897,070	17.3%	477,932,480	18.4%	465,011,557	17.9%
SL-1	10,804,293	15.2%	10,226,380	14.4%	9,270,278	13.1%	8,184,947	11.5%
SL-2	50,316	3.8%	48,059	3.6%	44,818	3.4%	44,070	3.3%
SST-DST	32,275	8.7%	74,518	20.2%	74,518	20.2%	74,518	20.2%
SST-TST	162,033	3.8%	155,881	3.6%	147,435	3.4%	147,146	3.4%
TOTAL	$ 690,371,155	16.0%	$ 690,371,155	16.0%	$ 690,371,155	16.0%	690,371,155	16.0%

* This table is based on FPL's requested revenue increase. It does not reflect SFHHA's recommended revenue increase.

** Base revenue plus miscellaneous revenue

IV. RATE DESIGN ISSUES

Q. Have you reviewed FPL's proposed CILC-1D rate design in this case?

A. Yes. The Company is proposing an increase to the on-peak energy charge of CILC-1D in excess of 320% in this case. This outcome occurs because of the protocols that FPL has adopted for CILC-1D rate design. Specifically, the Firm On-peak demand charge, the Load Control On-peak demand charge, the Max Demand charge and off-peak non-fuel energy charge are all set at unit cost based on proposed revenue levels at equal rate of return. All additional revenue is recovered from the On-peak energy charge. In this case, this protocol results in a 320% increase to this charge.

Q. Is there a valid rate design rationale to justify imposing the residual revenue requirement for CILC-1D only on the on-peak non-fuel energy charge?

A. No. In fact, to the extent that customers are more likely to be price responsive to energy charges than demand charges, it would be more appropriate to impose the "residual revenue requirement" on the demand charges of the rate. All else being equal, this would impose the largest deviations from unit cost on the least price sensitive portion of the rate, thus preserving cost of service to the extent possible in the CILC-1D rate design. Moreover, imposing an extreme (320%) increase to one of the rate elements of the rate will produce unreasonable increases to some customers, relative to the CILC-1D increase overall.

Q. Do you have an alternative CILC-1D rate design proposal that is revenue neutral

to this rate class?

A. Yes. Baron Exhibit__(SJB-9) presents a revenue neutral alternative CILC-1D rate design that produces the same revenue level (and therefore revenue increase) as FPL's proposed rate. The protocol that I am recommending is to set the non-fuel energy charges of CILC-1D at unit cost, which is $0.00700/kWh and then uniformly increase all three of the CILC-1D demand charges by an equal percentage to meet the revenue target. Based on FPL's proposed overall 22.2% increase for CILC-1D, this would result in a 29.5% increase in the Max Demand, Load Control On-Peak and Firm On-Peak demand charges.

Q. Does your proposed alternative CILC-1D rate design have any impact on other rate classes in this case?

A. No. Because it produces the identical CILC-1D revenues at proposed rates as FPL's rate design, there is no impact on other rate classes or schedules.

Q. Would you please address FPL's proposal to recover the Canaveral Step 2 rate increase from large general service rate classes?

A. FPL is proposing to recover 100% of the Canaveral revenue increase for Rates GSLDT-1, 2 and 3 and for CILC through the on-peak and off-peak energy charges, despite the fact that over 80% of the Canaveral revenue requirements are demand related. As I will discuss, FPL has allocated the $173.9 million Canaveral revenue increase to rate classes following the allocation of "Other Production Revenue Requirements," as developed in its class cost of service study [see FPL's response to FIPUG's Third Set of

Interrogatories, Interrogatory No. 14 attached as Baron Exhibit__(SJB-10)]. The rate design, to the extent feasible, should follow the same cost allocation basis.

Q. How are "Other Production Revenue Requirements," which is used to allocate the Canaveral revenue increase, classified in FPL's class cost of service study?

A. Baron Exhibit__(SJB-11) contains an excerpt from MFR No. E-6b, Attachment No. 2 of 2. This is the workpaper supporting the cost classification and allocation of Other Production Revenue Requirements, which is the basis for the Canaveral revenue allocation. Line 5 of this schedule shows that the demand portion of "Production – Other Production" revenue requirements is $886,456 (Total Retail, column 2). On page 2, the energy portion of "Production – Other Production" revenue requirements (Line 17) is shown to be $187,728 (Total Retail, column 2). These two amounts total to $1,074,184, of which 82.5% is demand related, 17.5% is energy related.

Q. Has FPL provided any reasonable basis for its proposal to assign 100% of the Canaveral revenue increase to large general service energy charges?

A. No. Baron Exhibit__(SJB-12) contains FPL's response to SFHHA's First Set of Interrogatories, Interrogatory No. 56 requesting an explanation for FPL's proposed rate design. FPL states that the Canaveral increase should not be recovered through the customer charge (which I agree with) and then goes on to state that it is administratively efficient, follows fuel savings and benefits low load factor customers. The Company does not state that its proposal is consistent with cost of service, which it is not as I have demonstrated. None of the reasons cited by FPL support its proposal. FPL has

allocated the Canaveral increase to rate classes on the basis of other production revenue requirements and the allocation of this same Canaveral revenue increase within each large general service rate class should follow the same protocol, which means that 82.5% of the increase should be recovered from demand charges and 17.5% from non-fuel energy charges.

Q. What is your recommendation on this issue?

A. I recommend that 82.5% of the Canaveral revenue increase for Rates GSLDT-1, 2 and 3 and for CILC be assigned to the on-peak demand charge and 17.5 of the Canaveral increase be assigned to the on and off-peak energy charges. For non-time of day general service rate classes, the Canaveral increase should be assigned 82.5% to the demand charge and 17.5% to the non-fuel energy charge of each such rate.

Q. Does your Canaveral rate design proposal affect any other rate classes besides the large, demand metered general service rates?

A. No.

Q. Have you identified any additional issues associated with the Company's rate design analyses?

A. Yes. As discussed by FPL witness Morley in her Direct Testimony at page 11, FPL's test year 2013 forecast "relies on a twenty year history in order to determine normal weather patterns." This normal weather forecast assumption thus forms the basis for FPL's projected billing determinants and rate class revenues in this case. I have

performed an analysis that compares the Company's normal weather assumption to actual weather history in the FPL service territory for the past 10 years. The comparison that I made uses cooling degree hours ("CDH") as the weather metric, which is the principal weather variable used by FPL in its net energy for load (mWh) forecast in this case.

Baron Exhibit__(SJB-13) presents the results of this analysis. As shown on page 1 of the exhibit, I calculated the actual 10 year average annual CDH value for the FPL service area using the data supplied by the Company in response to SFHHA POD 1-5, which requested the forecast model inputs. The 10 year average annual FPL CDH is 1,990.5. This is compared to the Company's assumed normal CDH, based on a 20 year history of 1,958.3. The comparison shows that the actual 10 year CDH is 1.64% greater than the 20 year normal value assumed by the Company for its test year projections in this case.

Q. What is the impact on mWh energy from a 1.64% increase in CDH, based on the NEL forecast model relied on by FPL in this case?

A. Using the sensitivity factor calculated by the Company and presented in MFR Schedule F-6 in the Company's filing, a 1.64% increase in CDH results in a 0.38% increase in NEL mWh. This calculation is shown on page 2 of the exhibit.

Q. What do you conclude from your analysis?

A. During the past 10 years, weather conditions in the FPL service area have been 1.64%

hotter than during the 20 year period assumed by FPL for normal weather. Using a 10 year "normal" in this rate case would have produced a higher level of mWh sales and revenues than assumed by the Company in its rate filing. These additional revenues would, all else being equal, have offset some of the Company's revenue deficiency in this case.

Q. Does that complete your prepared testimony?

A. Yes.

BY MR. WISEMAN:

Q Mr. Baron, have you prepared a -- a summary for the Commission?

A Yes.

Q If you could go ahead and provide that, please?

A Yes. Good morning, Mr. Chairman and Commissioners.

My testimony addresses issues associated with FPL's Class Cost of Service Study and its proposed revenue allocation to rate classes of the January 2013 increase of 517 million and the June increase of 174 million associated with the Canaveral project.

A basic tentative rate-making is that cost responsibility follows cost causation. FPL's Class Cost of Service Study is based on the 12CP and 1/13th average demand method. That method attributes cost responsibility based on the contribution of each rate class to each of the monthly peaks on FP&L's system.

While the 12CP and 1/13th method has been used in Florida for many, many years, I believe that it is appropriate to recognize that the 12CP and 1/13th methodology is not consistent with cost causation on FPL's system. The methodology disregards and is inconsistent with FPL's acknowledgment that it is

constructing new generating capacity to meet its summer peak load.

My testimony shows that a summer CP methodology properly assigns production plant by allocating costs to rate class -- classes based on each class' contribution to the summer peak, which is the factor causing the need for additional generating capacity.

My testimony also shows anomalous in FPL's rate class demand allocation factors, all of which bias FPL's study overstating the cost of service to large customers. And I have presented a corrected version of the company's Cost of Service Study.

I also discuss the meth -- the methodology used by FPL to classify distribution costs. As in prior cases, FPL classifies all distribution plant for poles, overhead conductors, underground conduit, underground conductors and line transformers as 100 percent demand related. The company's method ignores any cost consequences associated with simply connecting a customer to the distribution system other than the service drop in the meter.

The methodology I recommend, the Minimum Distribution Method, or MDS, is discussed in the NARUC Electric Utility Cost Allocation Manual for allocating

distribution costs. My alternative cost study illustrates the impact of using an MDS method.

In the recent Gulf Power rate case, the Commission accepted the MDS method in the context of a settlement for rate design purposes. My testimony in this case provides strong evidence to the Commission for the adoption of an MDS methodology and -- in this litigated proceeding.

I also recommend an alternative method to allocate the overall revenue increase to rate classes. FPL has proposed a two-part revenue allocation method, which is based on total class revenues to come up with the target rate of return, and it uses that same total class revenues, including all clause revenues, for mitigation purposes. This includes large costs associated with fuel, which I disagree with. I believe that the appropriate basis should be base revenues.

I also address two rate design issues that are extremely important. One of them concerns the CILC-1D rate design, where the company is proposing a 320 percent increase in the on-peak energy charge for the rate. I proposed a -- a revised methodology which is revenue neutral to the rate class. It does not affect any other rate classes that is more reasonable and, in my opinion, is based more consistently on the

Cost of Service Study results.

The second rate design issue that I address concerns the design of the large customer rates with respect to the Second Step Canaveral increase. The company has proposed to put that increase all in on-peak and off-peak energy charges. The cost of service information indicates that 80 percent of the costs would be demand related, and so those costs should be spread to the demand charges of the rate, not the energy charges.

Finally, I address weather -- the weather normalization issue and recommended a 10-year normal weather basis, and that completes my summary.

MR. WISEMAN: Mr. Baron is available for cross-examination.

CHAIRMAN BRISÉ: Thank you. Mr. --

MR. MOYLE: Moyle.

CHAIRMAN BRISÉ: Moyle?

MR. MOYLE: Yes, FIPUG has no -- no questions.

CHAIRMAN BRISÉ: All right. Captain Miller?

MR. MILLER: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: Ms. Clark?

MS. CLARK: Thank you, Mr. Chairman. We just have a couple question.

CROSS EXAMINATION

BY MS. CLARK:

Q One of the things you mention towards the end of your summary was, I will term it, gradualism with respect to the limitation on the amount of revenue increases. And you -- as I heard you summarize just now, you said you disagree with FPL's proposal with regard to that limitation?

A Yes. I actually disagreed with two aspects of how the company came up with its revenue apportionment, but I did disagree with the application of the 1.5 maximum increase methodology. And I recommended that it be applied to base revenues, which are the revenues that are at issue in this case, but there was another aspect that I disagreed with as well.

Q Okay. Well, let's just focus on the first aspect. And I believe in your testimony, you refer to this as an alternative mitigation approach; is that correct?

A Yes. It's an alternative to that which the company proposed.

Q You also testified in the last FPL rate case; did you not?

A Yes, I did.

Q And wasn't that also your position in the last

case? By that, I mean, what you are advocating today is the same that you advocated in that last rate case?

A With respect to the application of the 1.5 times maximum increase, yes. I did recommend that it be applied to base revenues, which, again, are the revenues that are associated with the costs that are at issue in this case.

Q And what did the Commission decide in that case --

A The --

Q -- with respect to this issue?

A The Commission order indicated that the 1.5 times limitation would -- should be -- should include -- should be applied to revenues including clause revenues, but of course, I recall that case the -- the increases were relatively small --

Q Well --

A -- compared to the large increases that are at issue in this case.

Q It would be fair to say, then, the Commission disagreed with your proposal?

A In that case, yes. And I am -- as I showed in my table here on -- Table 9 on page 45 of my testimony, for the -- for base revenues that are at issue in this case, the company is proposing an average increase of

12 percent. Whereas the large general service classes are being proposed for increases in excess of 20 percent, GSLDT-2, 23 percent, CILC, 23.

Q Mr. Baron, isn't it also true that that application of the limitation has been pretty consistent with this Commission? They have they have calculated it with respect to total revenues, including clauses; isn't that correct?

A I have not done a thorough review of the history. I -- I -- I have a recollection that I have seen that in other cases, but I -- I haven't done a review of every case in the last 10 years. But nonetheless, the -- the increases in -- in base rates being proposed by the company, in my view, warrant an alternative mitigation measure.

CHAIRMAN BRISÉ: I am going to remind the -- the witness that we prefer a yes or no answer, and if you need to clarify that -- that you clarify, but specifically to the question that is posed.

THE WITNESS: Yes, Mr. Chairman.

BY MS. CLARK:

Q Let me move to a different subject. I believe in your testimony you're critical of FPL adjusting data used to forecast the January 2013th coincident peak and group non-coincident peak demands; is that correct?

A For the -- yes, for the residential class.

Q Is it correct that your -- the basis of your disagreement is the fact that FPL didn't use actual data from January 2010; is that correct?

A Yes. For one class, the residential class, that -- that is correct, yes. My criticism was that the company disregarded its own methodology for that class.

Q Do you know what basis those demands are actually forecasted? In other words, what data is used to forecast the test year demands in this case?

A Well, it's a -- it's a -- yes, I do know. The -- the methodology that the company uses is based on a three-year average load factor of historic data. For some classes, like the residential class, it's based on a load research sample. For other classes, there would be actual data.

And those load factors -- that average load factor is then applied to the test year level of kilowatt hour sales to arrive at the demands, and then of course, there is a reconcil-- a methodology to actually adjust those demands, which I -- I discuss elsewhere in my testimony.

Q You would agree that in developing a forecast, the aim would be to estimate as closely as possible the likely actual demand?

A Yes. The -- I -- I would agree that the purpose after forecast is to produce the best estimate of the future. In this case, the test year level of demands. I would agree with that.

Q And wouldn't you agree that in -- in attempting to do that, you would likely, or you should disregard significant abnormalities in the data?

A If there -- the answer to that is, no, if the -- if the disregarding is simply removing for one rate class data that appears to the analyst to be high and effectively disregards the systematic methodology that the analyst, or in this case FP&L, believes is appropriate. The concept of using a three-year average is to --

MS. CLARK: Mr. Chairman.

THE WITNESS: -- remove that. I --

CHAIRMAN BRISÉ: Thank you, Mr. Baron.

MS. CLARK: Mr. Chairman, I have an exhibit I would like to pass out. Thank you. What's the number?

CHAIRMAN BRISÉ: We are now on 584.

(Whereupon, Exhibit No. 584 was marked for identification.)

CHAIRMAN BRISÉ: Any objections to this document?

MR. WISEMAN: Well, I -- I have a question. And I -- I can see what this document is, but that it appears -- well, what it appears to be. If counsel could explain where this document was obtained and whether it's current data, you know, what it is.

MS. CLARK: Mr. Chairman, this is a report from, as you can see from the NOAA National Weather Service from Miami, Florida. It is information we have obtained with regard to the weather data for the date in question.

MR. WISEMAN: So if -- this was obtained from the NOAA website?

MS. CLARK: I believe so.

MR. WISEMAN: Okay. No objection at this time.

CHAIRMAN BRISÉ: All right. Ms. Clark, you may proceed.

BY MS. CLARK:

Q I just have a couple of questions. Looking at this, Mr. Baron, wouldn't you agree that in January 2010 there was a historic cold snap both in duration and magnitude in that month?

A That's what it says.

Q And wouldn't you agree that would likely

result in abnorm-- abnormal data, at least for one rate class?

A Well, for -- did you say --

Q Is that a yes or no?

A Well, I -- I --

MR. WISEMAN: Could counsel repeat the question because I am not sure I -- I understood it or heard it?

MS. CLARK: Okay.

CHAIRMAN BRISÉ: I am not sure if the -- if the witness heard it as well, so if you could repeat it.

MS. CLARK: All right.

CHAIRMAN BRISÉ: Thank you.

BY MS. CLARK:

Q I guess my question to you is, would you agree that in January 2010 there was a historic cold snap in both duration and magnitude in that month?

A That -- again, my answer was, yes. According to this document, that what's it says.

Q And it -- this document says it was the coldest 12-day period since that at least 1940.

A That's what it says in the headline.

Q So would you agree with me that that would be likely to produce abnormal data, at least with respect

to one rate class?

A Well, the -- the answer is, no. The answer is no because you added a clause, at least for one rate class. I am not sure what you mean by that, so I -- I would have to answer no.

Q All right. I will ask it this way: Wouldn't you agree that it would result in abnormal data at least for the residential rate class?

A I -- I would agree -- the answer is, no, it wouldn't just be for the residential class. And when you say -- and -- on the other hand, I would answer yes if you mean by abnormal data different from some measure of normal, whether it's a 10-year average or a 20-year average history. I would agree with that. What I -- but I don't know that there is any evidence that it would apply only to the residential class.

Q Well, let me ask you this, are you aware when peak usage occurred in the month of January?

A The time of day?

Q Yes.

A I don't -- I probably have -- I may have that somewhere. I don't recall. I would expect probably in the morning, but I don't know.

Q Yes. And -- and would you accept, subject to check, it was in the morning before businesses were

open?

A Yes. I would accept that it would be in the morning.

Q So isn't it more likely to affect the resident -- residential class than any other class?

A It -- more likely -- not necessarily, but I -- I would agree -- yes, I guess I would agree that it would have -- certainly in FPL's case, there are more residential customers, but it would not only affect the residential class. And it's simply not credible to say that cold weather doesn't affect any entity, any customer that has electric heating facilities. That's just not credible.

Q Have you done any analysis to determine how the temperatures in January of 2010 affected the other classes?

A I have not, but -- and -- and the reason I didn't is because I rejected FPL's adjust -- unilateral adjustment to disregard its method for just the residential class, and -- and it wasn't based on weather. It was simply throwing out the data. It wasn't an adjustment to reflect weather. It was simply throwing out the data.

Q Mr. Baron, have you read Mr. Ender's rebuttal testimony?

A I believe -- yes, I have.

Q Okay. Let's change to a different subject. In your testimony in this case, you are recommending two different costs of service methodologies; is that correct? And I will be more specific. You are recommending the summer peak method for general -- for production plant, and then for distribution plant, you are recommending the minimum distribution system methodology?

A Yes.

Q Okay. Let's focus just for a minute on the summer peak method.

Isn't it true that in the 2009 case, you also proposed the FPSC require the use of the summer peak methodology?

A I believe so, yes. I certainly have in -- in prior FP&L cases.

Q And did this Commission accept that methodology?

A I am sorry. I couldn't hear that last question.

Q Did this Commission accept that methodology?

A No.

Q And I think you said this in your summary, it's at least over 30 years that Florida has used the

12CP and 1/13th methodology, correct?

MR. WISEMAN: Objection. States a fact not in evidence.

MS. CLARK: I am sorry. I thought I heard him say it in his summary.

MR. WISEMAN: He -- he said a long time. He didn't say anything about 30 years.

BY MS. CLARK:

Q Well, let me ask a different question. Isn't it true that the Commission's rules require the use of the 12CP and 1/13th?

A It -- it's my understanding that the MFR requirements require utilities to file that method.

Q Do you agree that demand influences the need for more capacity while energy influences the choice of the plant to meet that capacity?

A Could you -- could you repeat it? I couldn't -- I am sorry. I am just having trouble hearing.

Q Do you agree that demand influences the need for more capacity while energy influences the choice of the plant to meet that capacity?

A Yes, it -- it certainly can. It depends on relative prices of the capital equipment. It depends on relative fuel prices, but the ultimate need for capacity

is determined by the summer peak demand, in the case of FP&L, based on its demand documents.

Q Let me ask you simple question, then, you would agree that energy would influence the type of plant you choose?

A The type -- now, when you say type of plant, I assume you're referring to combustion turban or combined cycle generator or a -- some other form or a coal plant, for example, and it's my experience in, in generation planning analyzes that once a decision is made to add capacity, utilities would typically engage in economic evaluations.

So that would include all of the costs, both the -- the total cost of the generator. So in that sense, energy can factor into that economic evaluation, but not the need -- but it wouldn't in the first instance factor into the need.

Q Thank you. One last area.

The Minimum Distribution System Methodology, MDS, you also advocated the use of that methodology in the last case, correct?

A Yes.

Q And did the Commission accept that?

A Not to my recollection, no.

Q And you have not performed an independent

analysis of FPL's distribution plan accounts to develop the customer and demand portion of each account, have you?

A Not specifically. I did ask for information, and based on the data response in -- I was not able to conduct that analysis. I did perform an analysis of pole data, which I presented in my testimony, specific for FP&L just to provide some indicator.

Q Well, maybe I can get yes or nos to the next questions.

You are proposing using the results of the Gulf's MDS methodology as a proxy to classify FPL's distribution cost; is that correct?

A Yes. That's correct.

Q And what proxy did you use to classify distribution costs in the 2009 case?

A In that case, I used a -- some -- basically, a group of utilities for which I had data. I believe it was five utilities around the United States.

Q Okay. In comparing the results from those two proxies, there is an approximately 30 percent lower amount of distribution costs in this case -- being shifted to residential customers in this case than in 2010; would you agree with that?

A No, I wouldn't agree with that because you --

you're -- you're premising the question on shifting costs. If -- as -- as though it were some purposeful design that I had to move costs from one category to another.

Q I will ask it a different way then.

In terms of -- of the revenue requirements that would be required of the residential class, isn't your recommendation in this case result -- resulting in 30 percent lower revenue requirements than the methodology you used in 2010?

A I -- I don't know. I -- I haven't done that calculation. The -- I -- I certainly would agree that it would be different.

Q You don't know whether it's lower or higher?

A I think I saw in Ms. -- I think Mr. Ender had, in his rebuttal, this stated that. I -- I haven't --

CHAIRMAN BRISÉ: Mr. Baron, that was a pretty straightforward yes or no question.

THE WITNESS: Okay.

CHAIRMAN BRISÉ: If you could restate the question, Ms. Clark, and get that yes or no.

MS. CLARK: I closed up my notes.

CHAIRMAN BRISÉ: Okay. No problem.

MS. CLARK: I -- I think he agreed it --

BY MS. CLARK:

Q Mr. Baron, you agreed that your recommendation today results in lower revenue requirements from the residential class, is that correct, than what you were recommending in 2013 -- 2010, thank you? If you don't know, you don't know.

A Can I ask a clarification? Are you referring to -- with respect to this -- the MDS issue?

Q Yes, Mr. Baron.

A I -- I don't -- I have not done the calculation, so I don't know.

MS. CLARK: That's all I have. Thank you.

CHAIRMAN BRISÉ: Thank you, Ms. Clark.

Ms. Christensen.

MS. CHRISTENSEN: No questions.

CHAIRMAN BRISÉ: Mr. LaVia?

MR. LaVIA: No questions.

CHAIRMAN BRISÉ: Mr. Saparito?

MR. SAPARITO: One quick question, Mr. Chairman.

CHAIRMAN BRISÉ: Sure.

CROSS EXAMINATION

BY MR. SAPARITO:

Q Good afternoon. My name is Thomas Saparito. I am here pro se.

Just for clarification, FPL's counsel was asking you some questions with -- with respect to two methods that you analyzed the rates for -- your -- for a specific class of customers. Would any of your two methods that you testified here about today result in the residential customer of FPL's bill increasing?

A The -- all else being -- the answer is, yes. All else being equal, the MDS methodology, in recognition of -- of what I believe to be cost causation works assign more cost to the residential class. The -- what -- the summer CP methodology actually results in lower residential cost responsibility and therefore lower bills, all else being equal, than the 12 and 1/13th methodology.

MR. SAPARITO: Thank you. That's all I have, Mr. Chairman.

CHAIRMAN BRISÉ: Mr. Hendricks?

MR. HENDRICKS: No questions, Mr. Chairman.

CHAIRMAN BRISÉ: Staff?

MR. HARRIS: Yes. Thank you, Chairman.

CROSS EXAMINATION

BY MR. HARRIS:

Q Good morning, Mr. Baron.

A Good morning.

Q I wanted to discuss a little bit you with some

of your testimony, specifically about, you know, Gulf, the stipulation and what the Commission did in Gulf. And the first line of questions I have if you would turn to page 33 of your testimony, please.

A Yes, I have that.

Q In -- in lines 9 to 15 --

A Yes.

Q And I believe here you state that you reran the corrected FPL Class Cost of Service Study using the customer and demand classifications for accounts 364 through 368, those are FERC accounts, developed by Gulf Power Company in its recent rate case, which subject to check, was docket 110138; is that correct?

A Yes.

Q Okay. And now, if you would refer to your Exhibit SJB-4?

A Yes, I have that.

Q Okay. And am I correct that these are Gulf's percentages of customer and demand related costs for its distribution of FERC account that you have applied to FPL's Cost of Service Study?

A Yes.

Q Okay. And in developing its customer and demand classifications, do you know whether Gulf used the zero-intercept technique to estimate the customer

components of Gulf's transformers -- the transformers costs as a basis to for rates approved in Gulf's recent rate case?

A That -- yes, my understanding is that Gulf used the zero-intercept methodology.

Q Okay. And now with regard to distribution poles, do you know which technique Gulf used to determine the customer component of its distribution poles in that rate case?

A Yes. My -- I do know.

Q Okay. And what is that?

A My understanding is that Gulf used the minimum size method because the regression results in the zero-intercept methodology were not satisfactory.

Q Okay. And the same question with respect to its dist -- Gulf's distribution conductors, and that is, do you know which technique they used to determine the customer components of distribution conductors? And if you know, what was it?

A Yes. My understanding is that for conductors and -- and the other accounts, it was zero-intercept.

Q Okay. And now, if you would turn back to page 35 in your direct testimony. It's lines 2 through 6 -- or 2 through 4. I am sorry.

A Yes, I have that.

Q Okay. And I believe that you state that you believe the Commission should require FPL to file an MDS, or Minimum Distribution System, Cost of Service Study in a compliance filing in this case and use these results to allocate any Commission-approved revenue increases in both this rate case and in FPL's next rate case; is that correct?

A Yes, that's correct.

Q Okay. If FPL were required by the Commission to generate such a study, do you agree that the appropriate MDS technique by FERC account for FPL may not be the same technique by FERC account used by Gulf in its last rate case?

A Yes, I -- I can agree with that, that in a very -- in a specific analysis, it may be that data for FP&L might indicate that one methodology would be superior versus another. I -- I -- I can accept that.

Q Okay. Thank you.

I would like to move on to a slightly different area. And if we could turn back to page 32 of your direct testimony, lines 8 through 12.

A Excuse me. Did you give me a line reference?

Q Yes, lines 8 through 12, page 32.

A Okay. Yes, let me just look at this.

Yes, I have that.

Q And if I understand your testimony, I understand that you performed an analysis of the percentage of FPL's costs included in FERC Account 364s, which is poles, transformer and fixtures, which are considered to be customer related for purposes of cost allocation; am I correct?

A Yes. The only caveat to that would be that I was not able to adjust the entire plant account for current cost -- cost of new construction. In other words, vintage the plant account, so this is an indicative analysis.

Q Okay. Now, if I could get you to turn to your Exhibit SJB-5, please. And page 1 of 2 of SJB-5.

A Yes, I have that.

Q Okay. And if I -- if I look at this and I am looking at the column entitled, cost, down towards the bottom, am I correct that you calculated a customer component percentage of FPL's distribution poles, which is equal to 82 percent, and that's based on the minimum size tech -- MDS technique?

A Yes, that's what this analysis shows. Now, as we discussed in your prior questions, I did not use this in modifying my Cost of Service Study, but I did -- that is what this exhibit shows.

Q Okay. And am I correct that you used the cost

of 25, 30, 35, 40 and 45-foot poles to calculate the customer component percentage for distribution poles?

A Yes, I -- that's correct. I did that consistent with the GPC analysis, that it -- it used minimum size poles in that range. I was trying to do somewhat of a comparability calculation.

Q Okay. And based on this detail, would you accept, subject to check, that when I do the math, 78 percent of FPL's distribution poles are 25 to 45-foot wood poles and that you have defined that as minimum size?

A I had -- yes, I would accept that. That -- again for the purpose -- for this purpose, that's -- that's what the data show.

Q Okay. And now if I could ask you to turn back a couple of pages to Exhibit SJB-3.

A Okay. And was there a particular page reference?

Q Yes, sir. SJB-3, page 8 of 17.

A Okay. Yes, I have that.

Q I am going to ask you to refer to the -- the bottom of the page, the last paragraph, and particularly the second sentence which begins, I think, on the third line of that last paragraph at the bottom with, the minimum size. And if could I have you read that

sentence to me.

A The minimum size method involves determining the minimum size pole, conductor, cable, transformer and service that is currently installed by the utility.

Q And if I could ask you to explain to me, why did you use FPL's 25, 30, 35, 40 and 45-foot wood poles to calculate the customer component of account 364 despite what I read from this manual, that only the minimum size pole be used for that purpose?

A The -- the reason, as I indicated in my prior answer, was I was trying to develop some level of comparability to the data from Gulf Power, and my -- in -- in the Gulf Power analysis, those large -- those poles, the 35-foot was used. And so I was really trying to demonstrate that the -- the essential data from FP&L was, for in this case for poles, was really not that different from Gulf Power, and then I -- I computed the -- the value.

As I indicated, I didn't use this result specifically to come up with an estimate of the customer component of account 364, and -- and if you look at my -- you had referred me earlier to the -- my Exhibit 4, page 1, Gulf Power calculates a 65 percent customer component for account 364, and that's what I used, not the -- the other -- the 88 percent.

Q Okay. And if we could jump back to SJB-5 and again page 1 of 2?

A Yes.

Q Would you agree, subject to check, that restricting the customer component calculation using the minimum size method to just the 25 and 30-foot wooden poles would result in a customer component percentage of 13.8 percent rather than the 82 percent that is shown under column labeled, cost, and the customer component percentage?

A I -- I haven't done that calculation. If one were to use following the method, it would -- it would basically involve repricing all of the poles at the unit cost of $312 shown for the 25-foot pole instead of the 60 -- the $616 that I had used, and I could check the arithmetic. But that -- that is how you -- one would do it.

Now, the one thing that I -- I don't know the answer to is whether 25 and 30-foot poles are currently installed. You recall when you asked me about -- to read from the NARUC manual, it's -- one of the criteria is what the company is currently installing, and so I -- I don't know whether those are currently being installed. But I -- I -- subject to check, with respect to the arithmetic, I -- that's the methodology.

Q Thank you.

MR. HARRIS: Thank you, Mr. Baron. You have been very helpful, and I appreciate your time. We have no further questions.

CHAIRMAN BRISÉ: Thank you.

Commissioner Balbis?

COMMISSIONER BALBIS: Thank you, Mr. Chairman. I have a few questions for this witness. Welcome, Mr. Baron.

THE WITNESS: Yes.

COMMISSIONER BALBIS: I want to go to page 7 of your testimony, where you summarize your conclusions and recommendations. And I just want to go through each one of those quickly and -- and ask you a specific question of each one.

In the first recommendation, the last sentence, you recommend that FPL's Cost of Service Study should utilize a 1 CP methodology for production and transmission. My question is, can FPL use that methodology without going to an MDS methodology for distribution?

THE WITNESS: Yes.

COMMISSIONER BALBIS: Okay.

THE WITNESS: Those are independent.

COMMISSIONER BALBIS: Okay. For the next

recommendation, you discuss load research data for the months of 2013 and how it had an affect in biasing its cost of service results. Could they use that load research data for the months of 2013 with without adopting an MDS methodology for distribution?

THE WITNESS: Yes. That -- those -- that adjustment -- that issue is independent of the other issues.

COMMISSIONER BALBIS: Okay. And then the next point, you discuss the one-and-a-half times the average retail base rate and how some of the other rate classes differed from that. And I believe we had other testimony on that 150 percent, or 1.5 times the average retail rate base.

Can this Commission adjust the rate impacts to fall within that 150 percent without having FPL utilize the MDS methodology for distribution?

THE WITNESS: Yes, Commissioner. The -- the criteria for the revenue apportionment would be independent of any Cost of Service Study. In fact, I -- I did a calculation using FP&L's study as one of my exhibits.

COMMISSIONER BALBIS: Okay. And I think you can see where I am going with this, but the next

recommendation is about the CILC-1D rate design. And you recommend a modification that provides more reasonable balance. Can we make that modification without having FPL use an MDS methodology?

THE WITNESS: Yes, that issue -- to the extent -- the answer is yes. It is -- it's a rate design issue is that is only impacts that rate class, and so in that -- I -- I would answer it that way. The only caveat is that to the extent that the Commission required a different cost of service method or a different revenue level, it would affect the target revenues for the class, but the rate design is independent, yes.

COMMISSIONER BALBIS: Okay. And then the last one concerning your recommendation of FPL's proposed step two rate design for large general service rate classes, this Commission could modify that as well independent of an MDS methodology, correct?

THE WITNESS: That is correct. That is -- it's related to the production -- other production cost allocation.

COMMISSIONER BALBIS: Okay. So then, let's to go my favorite subject, which is MDS methodology, and you cited the Gulf -- recent Gulf rate case

that -- where this Commission approved a settlement agreement that included the use of an MDS methodology.

THE WITNESS: Yes.

COMMISSIONER BALBIS: Okay. Did you read the transcripts, or did you hear the discussion that this Commission had concerning that decision?

THE WITNESS: I did not. No, Commissioner. I read the stipulation, but I did -- and I read the Commission's order, but I did not read the transcript, no.

COMMISSIONER BALBIS: Okay. Well, I recall the discussion, and there was a lot of discussion by the Commission in -- in making that decision. And I believe it was Commissioner Graham that indicated that because Gulf being small and where they are located, that it would be a great place to get started to.

And I quote from the transcript, at least a good place to test this theory and see how it works, and then there was other discussion on it.

And then the Commission approved or made that decision on, I believe it was a three to two vote, but it was discussed that there was going to be no precedential value of the decision, and it was

associated with the settlement and that -- I just wanted to make sure you were aware of that.

THE WITNESS: I -- as I indicated, I did not read the transcript, but my understanding and assumption was that a stip -- the stipulation would not be binding in any manner, so. It was -- I cited it simply for the purposes of recognizing that it's -- it has credibility. It's not just a lunatic idea.

COMMISSIONER BALBIS: I will leave that one alone.

Last question, has there been a change in circumstances with FPL's service territory or anything else since their last rate case that would warrant a change in methodology?

THE WITNESS: I -- I am not aware of any.

COMMISSIONER BALBIS: Okay. Thank you. That's all I had.

CHAIRMAN BRISÉ: Redirect?

MR. WISEMAN: Thank you, Mr. Chairman.

REDIRECT EXAMINATION

BY MR. WISEMAN:

Q Mr. Baron, let's start with the discussion about the January 2010 abnormal weather. Do you recall you were asked a number of questions by FPL counsel,

Ms. Clark, about that?

A Yes.

Q And do you recall she asked you whether the fact that the weather peak occurred in the early morning was most likely to affect residential customers. Do you recall that?

A Yes.

Q Okay. Hospitals run 24 hours a day; don't they?

A Yes.

Q And do you think that the hospitals in South Florida kicked all their patients out at, I don't know, 12:000 midnight the night before the cold, the abnormal weather?

A No, I -- I would suspect that when it got cold, the heating equipment kicked in, the same as it would for a residential customer in -- in that sense.

Q Right. And they have to run -- they run their lights, they run heavy electric equipment; isn't that true?

A Yes.

Q And, in fact --

MS. CLARK: Mr. Chairman, I would ask that you ask counsel not to ask leading questions.

MR. WISEMAN: I -- I apologize. I can do this

without leading questions. That's fine.

BY MR. WISEMAN:

Q What rate schedules do hospitals take service under, to your knowledge?

A The hospitals take service under primarily GSLDT-1, GSLDT-2 and CILC-1 and then also the HLFT rates that are effectively subsets of the GSLDT rates.

Q All right. Now, the adjustment that FPL made --

A Excuse me. I should add that some of the hospitals have accounts on smaller rate schedules as well, probably, and I think including GS.

Q Fair enough.

And are -- are hospitals the only hospital -- I am sorry, the only entities in the -- that take service under those general service and CILC rate schedules that run their facilities 24 hours a day?

A Most of the facilities -- the hospitals, most of them would run it 24 hours a day.

Q But there -- are there other commercial type entities that run their facilities 24 hours a day?

A Yes, I believe there are, but probably more to the point on this issue of weather normalization, the heating equipment certainly would be responsive even in my commercial office building. No one is there, but if

it gets cold, the heating -- the heating comes on.

Q Now, do you recall Ms. Clark asked you whether the one problem you had with the adjustment that FPL made to the data for January 13th was related to a disagreement over the methodology that was used for the residential class; do you recall that?

A Yes.

Q Okay. Do you have another problem with the manner in which FPL adjusted the -- the data for January 2013?

MS. CLARK: Mr. Chairman, I object. I did not cross-examine him on that issue.

MR. WISEMAN: She asked him -- she asked him -- she asked him specifically, the question was, isn't your criticism that you have a disagreement with FPL's methodology for adjusting the January 2013 methodology? I think it's fair to ask him if he has another criticism.

CHAIRMAN BRISÉ: If I recall the -- the question, it was specific to -- to the one issue that she raised in -- in her line of questions. And so you are asking whether -- you're asking him to provide an explanation on the second, which was not part of the of the -- the cross-examination.

MR. WISEMAN: Well, the second was actually

discussed in the -- let me -- let me ask him this question him a different question. I think it will -- it will reach the same point.

BY MR. WISEMAN:

Q Mr. Baron, if you could turn to your page 13 of your testimony?

A Yes, I have that.

Q Okay. In that Table 1, if -- if we look and there is an adjustment there for the RST-1 or residential rate class, that's the subject that you were discussing with Ms. Clark, correct?

A Yes.

Q Okay. Why didn't FPL make adjust the to these other rate schedules consistent with the adjustment it made to the residential rate class?

MS. CLARK: Mr. Chairman, I -- I object to this. I think it calls for information he doesn't have.

MR. WISEMAN: If you know -- if he knows.

CHAIRMAN BRISÉ: I think it's a fair question.

THE WITNESS: The -- the answer is, as a matter of fact, I -- I make this statement at page 14 of my testimony, the company provides no explanation for -- actually in its testimony of any of its adjustments, including the residential.

It was only subsequently that the -- that the company identified that the residential adjustment was because of abnormal weather, and they did not provide any explanation as to why there was not an adjustment for any other rate class to reflect the same abnormal weather to the extent that, that class had some sensitivity to temperature. And obviously, probably every rate class has some sensitivity of varying degrees.

BY MR. WISEMAN:

Q All right. Now, Ms. Clark also asked you a series of questions about gradualism. Do you -- do you recall that?

A Yes.

Q Okay. And among the questions she asked you was whether the -- whether your proposal was adopted by the Commission con -- concerning the manner in which to calculate the 1.5 limitation on rate increases, whether that proposal was accepted by the Commission in the last rate case. Do you call -- recall that?

A Yes, I recall her question on that.

Q Okay. Now, what did the Commission rule in the last rate case with respect to the method for applying the 1.5 times limitation?

A I recall a sentence in the order that stated

the 1.5 times maximum increase would apply to revenues including clause revenues. That was my recollection. I don't have a copy of the order in front of me, but that was recollection.

Q And what's FPL's proposal in this case with respect to the 1 .5 limitation?

A The company's proposal in this case is to apply it to total revenues including all clause revenues, also including unbilled revenues, also including an add back of the CILC and CDR incentives to the rates, which was different from what the company did in the 2009 case.

Q Well, what consistency, if any, is there between FPL's proposal with respect to the 1.5 times limitation in this case and the Commission's decision in the last case?

A Based on what -- the answer I just gave you, I would say that it's not consistent because the company changed its methodology in this case because of the -- of the -- certainly the add back of the CILC and CDR incentives, which tended to -- for example, for CILC, it increased the starting point on which the -- the factor is applied. The revenues are higher, and therefore, the -- the potential increase could be higher.

Q Now, let's shift to a different topic.

Ms. Clark asked you a -- a question about distribution costs. And do you recall she asked you a question that implied that you were proposing that rates -- that costs be shifted from one rate class to another. Do you recall that question?

A I recall that being part of her question.

Q Right.

A And I believe I objected to it.

Q Yeah. Well, I am not sure you objected.

A Well, objected not in a legal sense, in a -- in a more general sense.

Q Can -- can you explain to -- to be clear what your objection to that question was? Why you had a problem with the word, shift?

A Well, the concept of shifting presumes that the starting point is correct, and that is the -- the base framework for evaluation. And therefore, any deviation, any change, any proposed change is therefore shifting cost. It sounds almost nefarious that I am somehow moving something in that shouldn't be there. But the proper way to look at this issue is, what is the right cost? And that -- it should be based, in my view, on a reasonable methodology and reflective of cost causation.

Q And -- all right. Let's shift gears again,

and let's talk about your -- some of the cross-examination on the summer CP methodology.

Ms. Clark asked you asked you questions about whether -- the extent which need influences a decision to add capacity and energy influence -- influences the choice of capacity. Do you recall those questions?

A Yes.

Q Okay. Would it -- in the absence of need, would it be economically rational for a utility to add new capacity in order to address the energy question or the type of -- the type of facility that would be added to a system?

A Generally, the answer would be no. No utility would add capacity unless it was for the purpose of effectively shutting down other capacity because it's uneconomic, but basically, the -- the need to meet peaks is the driver. If one looks at their 10-year site plan, that's what it says.

Q All right. Last area, when Commissioner Balbis was asking you some questions, he discussed the transcript or the discussion that took place in the Gulf Power proceeding concerning the MDS system. Do you recall that?

A Yes.

Q And I think what he -- he said, he was quoting

Commissioner Graham, talking about, what I think, if I had this correct, was that Gulf Power was a smaller utility. This was a -- a good place to kind of start and test the system, see how it works. Do you recall that?

A Yes, I do.

Q Okay. Does the size of a utility have anything to do with the application of the MDS system?

A No, not in -- not -- I don't believe so at all. The -- it's -- it's really the characteristics of the factors that -- that cause costs to be incurred, and the -- the size of the utility in and of itself wouldn't be a factor in that.

Q What are the main factors which influence or -- what are the main reasons why you believe that the MDS system is appropriate for classifying distribution costs?

A The -- the -- the primary basis for it is that there are certain distribution costs that are, in my view and consistent with the discussion in the NARUC manual and as adopted by many other commissions, there are certain -- there are some -- there are some components of the basic distribution's infrastructure costs that are invariant. In other words, they don't -- they are not a function of the overall level of demand.

Demand certainly causes some of the costs, but there is some component of the cost that would be incurred absent a change in -- in demand. And it's -- it's these types of costs that are considered the customer component.

You know, I can speak from personal experience on the FP&L system. When I was growing up, I was --

MS. CLARK: Mr. Chairman.

THE WITNESS: -- I lived in a household that was -- I lived in Satellite Beach, and I was an F -- my family was an FP&L customer. And I distinctly recall those poles in the backyard.

MS. CLARK: Mr. Chairman.

CHAIRMAN BRISÉ: Mr. Baron. Mr. Baron.

MR. WISEMAN: I thought it was interesting. I have no further questions, Mr. Chairman.

CHAIRMAN BRISÉ: Thank you, Mr. Wiseman.

THE WITNESS: Mr. Chairman, I -- my attorney never, I never talked to him about this, so he didn't know.

CHAIRMAN BRISÉ: Understood.

Mr. Wiseman, exhibits.

MR. WISEMAN: At this time, Your Honor, I would move the existence of Exhibits 307 through 319.

CHAIRMAN BRISÉ: All right. We will move into the record 307 to 319, seeing no objections.

(Whereupon, Exhibit Nos. 307 through 319 were received into evidence.)

CHAIRMAN BRISÉ: FPL, I think you have one.

MS. CLARK: Mr. Chairman, we would move the admission of 584.

CHAIRMAN BRISÉ: Okay. 584, are there any objections?

Seeing none, we will move 584 into the record.

(Whereupon, Exhibit No. 584 was received into evidence.)

CHAIRMAN BRISÉ: Okay. And I think that takes care of the exhibits for Mr. Baron. All right.

MR. WISEMAN: And if we could ask for Mr. Baron to be excused at this time.

CHAIRMAN BRISÉ: Sure. Mr. Baron, you are excused from the hearing.

THE WITNESS: Thank you, Mr. Chairman.

CHAIRMAN BRISÉ: Thank you very much.

(Witness excused.)

CHAIRMAN BRISÉ: It is now 12:13. We will move it up to 12:15, so we will be back here at 1:15. So we stand at recess.

(Lunch recess.)

(The transcript continues in sequence to Volume 22)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, DEBRA R. KRICK, Professional Court Reporter, certify that the foregoing proceedings were taken before me at the time and place therein designated; that my shorthand notes were thereafter translated under my supervision; and the foregoing pages, numbered 2923 through 3176, are a true and correct record of the aforesaid proceedings.

I further certify that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 30th day of August, 2012.

DEBRA R. KRICK
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(850) 894-0828