BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 120015-EI

In the Matter of:

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

TELEPHONIC DEPOSITION OF:	RICHARD A. BAUDINO
TAKEN AT THE INSTANCE OF:	The Staff of the Florida Public Service Commission
PLACE:	Room 382-D Gerald L. Gunter Building 2540 Shumard Oak Boulevard Tallahassee, Florida
TIME:	Commenced at 1:00 p.m. Concluded at 3:42 p.m.
DATE:	Thursday, July 26, 2012
REPORTED BY:	JANE FAUROT, RPR Official FPSC Reporter (850) 413-6732

APPEARANCES:

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P R O C E E D I N G S

MR. HARRIS: Why don't we go ahead and see who we have on the line and see if we have everyone we need to get started.

This is Larry Harris. I'm here at the Commission, and I'll be appearing on behalf of the staff of the Public Service Commission. And with me is Mark Cicchetti and Michael Springer and Dale Buys, who are staff assigned to the docket. And I believe there's an FPL representative here.

MR. GUYTON: This is Charlie Guyton; I'm going to be appearing on behalf of Florida Power and Light Company.

MR. HARRIS: And who do we have on the line? Do we have the deponent, Mr. Baudino?

MR. SUNDBACK: Yes, Mr. Baudino is present.

MR. HARRIS: Okay. And representing him is --

MR. SUNDBACK: You have Mark Sundback of Andrews Kurth on behalf of SFHHA, as well as William Rappolt of the same firm for the client.

MR. HARRIS: And I know I heard -- I think I heard Jon for FIPUG, is that correct?

MR. MOYLE: That's right. Jon Moyle of the Moyle Law Firm on behalf of the Florida Industrial Power Users Group.

MR. HARRIS: Okay. And, who else. I think I heard Patty from OPC, but I'm not sure.

MS. CHRISTENSEN: Yes. Patty Christensen with the Office of Public Counsel.

MR. HARRIS: Do we have anyone else on the line?

MR. HENDRICKS: Yes, John Hendricks.

MR. HARRIS: All right. And, Mr. Baudino, do you have a Notary present who can swear you in?

THE WITNESS: Yes.

MR. HARRIS: Okay. If we could go ahead and take care of that now, I'd appreciate it.

(Witness sworn by Notary Public.)

MR. HARRIS: Okay, great. And if you could fax that to -- I think there is an affidavit of the oath that the notary will have to complete, and I think y'all have our fax number, so if you could fax that to us that would be great.

MR. SUNDBACK: Larry, can we do that at the conclusion of the deposition?

MR. HARRIS: Absolutely. You know, whenever you get to it. It's not a hurry.

And I understand that the convention we have been using is that the parties are preserving all of their objections except for as to form of the question, and that the deponents have not been waiving reading and signing of the depositions, is that correct?

MR. SUNDBACK: That's at least correct with regard to Mr. Baudino's deposition.

MR. HARRIS: Okay. And are there any other preliminary matters that I've missed?

Okay. With that, I guess we can go ahead and get started. And, Mr. Baudino, as you heard me say, my name is Larry Harris. I'm a staff attorney here at the Public Service Commission, and I do appreciate your time this afternoon and making yourself available. Have you ever had your deposition taken before?

THE WITNESS: Yes.

MR. HARRIS: Okay, great. This will probably be what you have had before. You know, if I am ever speaking too fast, or I ask a question that you don't understand, or you'd like clarification, just interrupt me and ask. This is really more of a conversation. And so, do you have any questions for me?

THE WITNESS: I do not.

MR. HARRIS: Okay, great. Then, if we can get started.

RICHARD A. BAUDINO

was called as a witness and, after being duly sworn by the court reporter, testified as follows:

DIRECT EXAMINATION

BY MR. HARRIS:

Q. Could you state your name for the record, please.

A. Sure. It's Richard A. Baudino.

Q. And what's your occupation and your business address?

A. Okay. I'm a consultant engaged with Kennedy and Associates, and the business address for Kennedy is 570 Colonial Park Drive, Suite 305, Roswell, Georgia.

Q. Okay. And on whose behalf are you testifying?

A. On behalf of the South Florida Hospital and Healthcare Association, which we abbreviate as SFHHA.

Q. Okay. And have you prefiled testimony and exhibits in this docket?

A. I have.

Q. And at this time are you aware of any changes or corrections or additions to your testimony?

A. I am not.

Q. Okay, thanks. Good. Great.

Now, for the first substantive area, if you could please turn to Page 21 of your prefiled testimony.

A. Okay, I have that.

Q. Okay. And I would ask you to read Lines 19 through 22 for me, please.

A. Sure. "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, these future cash flows generally take the form of dividends and appreciation in stock price."

Q. Thank you. And you used the word generally there in that sentence. What do you mean by that?

A. What I'm setting forth here is just the basic assumptions underlying the discounted cash flow model. So what I'm speaking of is just more or less the general form of the equation that I go on and specify later on. But from an investor's point of view, this is what I was speaking of generally.

Q. Okay. Could you easily identify for me any other things that would comprise future cash flows other than dividends and appreciation in stock price?

A. Well, with the DCF theory, that's really what you're looking at is the investors, of course, purchase price of that stock, the appreciation in the market value of that stock, if any, and then the discounted value of the cash flows. In this case, and this is why it's important for utilities, that cash flow would be in the form of dividends and growth in dividends.

Q. Okay. And then you did refer to that model, which is the discounted cash flow, or DCF, and you give a formula for that on Page 22, is that correct, between Lines 17 and 18?

A. Yes.

Q. And in that formula, I think you identified G as the expected growth rate, is that correct?

A. Yes.

Q. And is this expected growth rate that you are referring to the growth rate of dividends for the company?

A. Yes.

Q. Okay. And correct me if I'm wrong, but my understanding would be that the way you use this formula to predict an investor's required return on equity, this model is using the future growth rate of dividends as the model input, is that correct?

A. That's right.

Q. Okay. And then I think you go on in your testimony, if I understand it correctly, to sort of approximate or infer what that growth rate of dividends is by calculating earnings growth rates, is that correct?

A. Three out of the four sources I used are earnings growth rates, yes, and one of them is, of course, the Value Line dividend growth rate forecast.

Q. Okay; great. And so if the formula is looking for the dividend growth rate as an input, I'd like to sort of ask you why you used these earnings growth rates. You said three out the four. Could you explain to me why you use an earnings growth rate?

A. Sure. Typically, that earnings growth forecasts are widely available and the ones that are usually used by analysts such as myself in these cases. Dividend growth forecasts are not that common. The one I'm familiar with is with Value Line, and so what analysts like myself and what I have done here is use earnings growth rates as a proxy for dividend growth, assuming that over time in the long-run dividend growth and earnings growth will be approximately the same.

Q. Okay. I guess my follow-up question is if you can get these dividend growth rates from Value Line, why is it necessary to go ahead and do these earnings growth rate steps to get a number that approximates it?

A. Sure. I think it's very good to have a wider range of sources for these forecasts. Of course, Value Line is a well known one and very well respected, but also there are other what you would call consensus analyst forecasts available, and it's a reasonable assumption that those consensus analyst forecasts would influence investors' expectations for total return.

So, again, we are using these earnings growth forecasts as proxies for future dividend growth, and assuming that over time that they will be approximately equal because it is earnings growth that fuels dividend growth.

Q. Okay, and thank you. I'd like to move forward a couple of pages now to Page 25, if that's okay?

A. Sure. Okay. I have that.

Q. And I'd like you to read the sentence on Line 18 to 19.

A. Sure. "The dividend growth rate is a function of earnings growth and payout ratio, neither of which is known precisely for the future."

Q. Okay. And are all of a utility's earnings paid out as dividends?

A. No. A portion of earnings are retained within the firm and referred to as retained earnings, but not all of the earnings that a company has each year are paid out in dividends, typically.

Q. And is it a constant amount that's retained by a company from year to year?

A. No, it varies.

Q. All right. Thank you. And then if we could move on to Page 29.

A. Okay, I have that.

Q. And if I could ask you to read the sentence beginning on Line 5 through Line 6.

A. Sure. "I estimated the dividend yield by multiplying the current dividend yield by one plus one-half of the expected growth rate."

Q. Okay. And if you could explain to me why you believe that multiplying the current dividend yield by one plus one-half of the expected growth rate is appropriate?

A. Sure. In the constant growth form of the DCF model, what you're actually looking at is the dividend in the next period divided by the stock price plus growth. So what we're trying to do is move the current dividend ahead to approximate what D1, or that expected dividend is in the next period. And what half the growth rate does is sort of take it to the midpoint of that period, like it's an average number.

Q. Okay.

A. We've got to -- we've got to find some reasonable way of estimating what that D1 is going to be, and I think this one plus one-half the growth rate really reasonably estimates what D1 could be over the next period. Again, that's sort of like a midpoint in the future period.

Q. Okay. And are you aware of any academic textbooks or articles that describe using this sort of one and one-half method as this approximate growth -- the appropriate approximation for growth?

A. Well, I'm aware that some analysts in rate cases use that. Right offhand as I sit here, I can't refer -- I can't think of any text that show one plus one-half the growth rate. Again, what we're trying to do for regulatory purposes and ratemaking purposes is find a reasonable estimate of that forward-looking dividend.

Some analysts also use, like, the full growth rate to estimate D1, but what that does is sort of move it to the end point of the year. What I've tried to use here is using one plus one-half the growth rate is to estimate sort of the midpoint.

Q. Okay. I'm wondering if it would be possible for you to provide me with a deposition exhibit that would sort of make that comparison whereby you would sort of do two formulas. One that uses that end-of-period growth rate, and the second using your one and one-half method, and so I could sort of compare the two and see the value of that. The value -- how close it approximates, but also how you derive, the derivation of that one and one-half time formula. Does that make sense?

MR. SUNDBACK: Counsel, we'll reserve on that one, if we could, to review what burden, if any, might be associated with it. We're not saying we won't do it, but we just want to make sure that it's something that is feasible for Mr. Baudino to do, given the time constraints.

MR. HARRIS: And that's fine. And I don't mean for this to be particularly complicated. Really, I would like to have something that sort of sets forth exactly, you know, like an example of numbers of how that works. You know, where you would have the full period formula versus the one and one-half formula so I could just sort of compare at the end how those numbers work out. So in my mind I'm not intending to ask for something too terribly complicated.

MR. SUNDBACK: We appreciate that.

MR. HARRIS: Okay. And if you do end up filing that, I think that would be -- let's see. I'm looking at your testimony to see how many exhibits you have, and I think you were up to 13, RAB-13. So if you file this could we identified as RAB-14.

MR. SUNDBACK: Well, Counsel, I think we would provide it to you as a form of discovery response, and your treatment of it thereafter is in the first instance in your hands. So it will be identified as a deposition exhibit and marked accordingly.

MR. HARRIS: Okay. If I might just have a second.

(Off the record.)

MR. HARRIS: Thank you for that break. I was consulting with my technical staff, and he thought I should make it clear exactly what the exhibit would be. And that is on Page 22 of Mr. Baudino's testimony he has a formula that is in various piece-parts, and he would like -- you know, 1, 2, 3, 4 periods, and so on, and he would like to show how this one plus one-half over G is derived from that periodic formula that is on Page 22, at the top of Page 22. So showing the derivation of the formula he gives between Lines 17 and 18 as a result of the longer form that is on Lines 3 to 4. So showing how you get from Lines 3 to 4 to Lines 17 to 18, what that one and one-half times dividend growth rate. Changing the D1 to D sub 0(1 plus .5G).

And, of course, you can call me if you have any questions about that, but I think it should be fairly straightforward. And I know you're going to look it, so with that, unless Mr. Baudino has a question, we can move on.

THE WITNESS: I do have a clarifying question, if I could.

MR. HARRIS: Sure.

THE WITNESS: You wanted to see -- if I understand, your request was to see what the difference would be from adding basically a full growth rate versus what I did using the half growth rate for D1?

MR. HARRIS: Sort of, yeah. Working through it, you know, if you started with the formula on Lines 3 to 4, and show how you can derive the part on Line 17 to 18, the D1 that you use on Lines 17 to 18, which, as I understand it, what you're saying, you changed from D1 you change it to D sub 0(1 plus .5 of G), which is over the P sub 0 plus G. So I'm wondering if you could just sort of show me with numbers how you got from the one to the other so that I could sort of see how closely it approximates from the full formula. Does that help?

THE WITNESS: Well, what I did really was estimate D1 -- and maybe we can clear this up this way. I estimated D1 by adding half a growth rate to, you know, the current dividend yield to approximate D1. Now, that's one approach. Another approach would be to add the full growth rate.

MR. HARRIS: Right, and that's what I'm getting at. I'd like to see the difference between the approximated versus the full growth rate.

THE WITNESS: Okay. I understand your question now.

MR. HARRIS: And the court reporter has asked me to identify it as Late-filed 1, and to give it a short title. And I would just say for the short title, if this is acceptable, we would call it Derivation of the DCF formula, the Baudino DCF formula. And we can move on. And, like I said, if you do have any questions, I know you might need to think about this a little bit, we can always coming back to it. But if you're ready, we could move on to Page 36.

(Late-filed Exhibit 1 marked for identification.)

THE WITNESS: Okay, sure. All right. I have that.

BY MR. HARRIS:

Q. And specifically I'd like you to read Lines 20 through 22.

A. Sure. "I do not rely on the CAPM for my ROE recommendation, but these results suggest that my recommended ROE of 9 percent is reasonable, even generous based on current capital market conditions."

Q. And to be clear in the deposition, the CAPM is an acronym for the capital asset pricing model, is that correct?

A. Yes.

Q. Can you explain to me why you don't rely on the CAPM results?

A. The CAPM -- I think there is a number of concerns I have with the CAPM. Basically, that the beta, the published beta may or may not really be indicative of a good risk indicator for these companies, and also you have got -- really with the CAPM, ideally what you would like is the broadest based measure of market return you could get. And it would not only include stock market, I mean, it would include any investment that an investor could conceivably invest in.

In other words, you want to have as wide a market measure as you could. And that's very difficult to find for the CAPM. Where a lot of times when we estimate CAPM, and for regulatory proceedings we are using some kind of a measure of the stock market, but that is rather limited. And so I think the CAPM is far less accurate and reliable than using DCF -- using stock prices, known dividend, and estimated growth rates. I just think that the DCF is a more robust and accurate model.

Q. Okay. Given that you say you don't rely on the CAPM, but then you go on in that part that you read to say that the results suggest that your DCF is reasonable, is that correct?

A. Well, I think that certainly my DCF results are on the high side. You know, they are the high end of the range. The CAPM result -- now, I'm just going to refer to my testimony exhibits. I think with the low interest rate environment we've got, and based on a wide market, expected market return that I'm using, you have got -- a forward-looking CAPM results that I'm getting are 8 percent. Well, 8.06 to 8.65 percent. And then using historical returns, 5.8 to 7.18, which really aren't usable. I mean, those are far too low.

Q. I'm sorry, I didn't mean to interrupt you. Go on.

A. No, that's okay. So, anyway, I'm using the upper end of the range of results that I have gotten from both models, and that's what I meant there.

Q. Okay; great. Then if we could move forward to Page 39. No, I'm sorry, the last question I had before we move forward is I just wanted to sort of put a bow on that. If you're saying that you don't rely on the results of your CAPM, the question is how could it verify the reasonableness of your DCF result?

A. I didn't use it to verify the results of my DCF. I mean, I think the DCF results are verified on their own. What I did was present CAPM as an alternate way of estimating investor required returns. It's commonly filed in rate cases, commonly used in rate cases by analysts, and I'm presenting the results for information purposes.

Q. Okay. Thank you. And so if we could move on to Page 39, and specifically Lines 1 through 5.

A. Okay. I have that.

Q. And if you could read those to me, please?

A. Okay. "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."

Q. Thank you. And you identify the utilities in the comparison in Table 2 on Page 38, is that correct?

A. Yes.

Q. Have you compared FPL's capital structure to the capital structures of the electric utilities operating companies that are associated with the holding companies identified in Table 2?

A. I did not make that calculation. What you see here in Table 2 are either the holding company or the total company capital structures. I did not identify or quantify the individual operating companies' capital structures.

Q. Wouldn't it be a more appropriate apples-to-apples, if you like, comparison to compare FPL's capital structure to the capital structure of the utility operating companies associated with those holding companies in your comparison group?

A. I considered that, but I did not think that was necessary for purposes of this case. Really, the way I approached this was to develop a required ROE based on the results of this comparison group of companies.

Now, this ROE is for these group of companies, it's for their stock prices, and it's for the holding company stock prices. It's what investors are saying in the marketplace they require for this group of companies on average. And what I came up with was results that ranged from 8-1/2 to about 9 percent. So I would say that I made -- if anything, I have made a judgment on the high side or on the generous side for FPL. Because what the market says, the required returns are for this set of companies with the equity ratios that you see here on Table 2, that it's between 8-1/2 and 9 percent.

So setting my ROE on the high side of the range there of DCF results and leaving FPL's capital structure intact with the equity ratio they have requested is certainly generous. So, now, if I were recommending a reduction in that equity ratio, what I would look at would be, you know, some other adjustment maybe to ROE or something like that.

Q. Okay. Thank you. For the companies identified in your comparison group, do you know how many of those companies are building or are contemplating building one or more nuclear power plants?

A. As I sit here, I don't recall that. I would need to go back and look and see.

Q. Offhand do you have an idea of what the estimated cost is for the construction of a nuclear power plant?

A. As I sit here, I don't know. It's not something I looked at in preparation for this deposition.

Q. Okay. Do you know if historically the construction of nuclear power plants puts pressure on a utility's balance sheets?

A. Well, any significant construction for power plants, whether it be nuclear, combined cycle, coal, could put pressure on a utility's balance sheets, depending on both the size of that utility, depending on the size of the expenditures, and depending on how those expenditures are treated by the regulatory commission.

For example, if -- it used to be construction work in progress was allowed in rate base, that takes significant pressure off the utility during the construction phase. And one thing we know is that FPL certainly has enjoyed the benefits of the nuclear recovery clause during the uprating process for its nuclear plants right now.

Q. Mr. Baudino, you mentioned the Nuclear Cost-Recovery Clause. Do you know if it allows for the recovery of construction costs for nuclear power plants?

A. Just a moment. I'm going to refer to one of my exhibits here.

Q. Sure.

MR. MOYLE: And I guess ultimately that's a legal question in the statute. He can give his understanding, but I would object, to the extent it calls for a legal conclusion.

THE WITNESS: Sure.

MR. HARRIS: I'm just asking what the witness knows.

THE WITNESS: Uh-huh. In my Exhibit RAB-9, Page 24 of 35, there is one of FPL's presentations. It talks about this nuclear cost-recovery rule, and the way the company presented it was it's recovery of the costs associated with new nuclear projects. During preconstruction, FPL receives dollar-for-dollar recovery of all expenditures. A project earns a cash return on expenditures during construction. FPL receives a base rate increase once the project is placed in service. And in a rectangle here it says FPL's uprate project at Turkey Point and St. Lucie qualify for NCRR treatment. NCRR being an acronym for Nuclear Cost-Recovery Rule.

Q. So would it be fair to say that your knowledge of the clause is based on that presentation by FPL?

A. Well, it's based on my understanding of testimony of the witnesses, too. Also, FPL and NextEra made presentations in the 10k about the nuclear cost-recovery rule.

Q. And, again, I'm not asking for a legal opinion, but from your personal knowledge, do you know if there is a difference between preconstruction and actual construction in the operation of the clause?

MR. SUNDBACK: Counsel, could you rephrase that? I'm not sure -- could you take another stab at framing that question?

MR. HARRIS: Absolutely. I'm not asking the witness for a legal conclusion anyway. I just want to know from his personal knowledge does he know if there is a distinction between preconstruction costs and actual construction costs in the operation of Florida's Nuclear Cost-Recovery Clause.

THE WITNESS: I'm not sure about that distinction as I sit here, Counselor. I would need to go back and review that.

MR. HARRIS: Okay. That's fine. Thank you.

BY MR. HARRIS:

Q. So getting off the subject of the clause, do you believe that it would be prudent for an electric utility that is contemplating the construction of a very large capital project such as a nuclear power plant to have a relatively thick equity cushion?

MR. SUNDBACK: I will object to the extent it calls for a legal conclusion using the term prudent.

MR. MOYLE: I would also object that it requires the witness to assume facts in evidence that are not related to FPL's intention to move forward or not move forward with a nuclear project.

MR. HARRIS: Okay.

MR. MOYLE: He can answer, so long as the objection is noted.

BY MR. HARRIS:

Q. Mr. Baudino?

A. Okay. Thank you. I find that question difficult to answer because it's rather vague, and I don't know what you mean by thick equity ratio. As far whether it's prudent for a utility to have a so-called thick equity ratio really depends on a lot of different factors, and it depends on how construction costs of that plant are treated, preconstruction, I think it depends on a lot of things. I really can't answer that.

Q. Okay. Do you believe that a utility's equity ratio is something that rating agencies would be interested in if a utility were pursuing licenses from the Nuclear Regulatory Commission for the construction of a new nuclear power plant?

A. Well, I mean, I can't say that. Really, I think the rating agencies can answer that for themselves better than I can. I can tell you from my own review of rating agency reports over the years, you know, capital structure is one of the things rating agencies consider in evaluating financial risk and credit ratings and bond ratings.

Q. Okay. Thank you. I would like to stay on Page 39, but move down a little bit to Line 7 of your testimony.

A. Yes, I have that.

Q. And I believe you refer to Standard and Poor's having three key financial ratios.

A. Right.

Q. Have you calculated what Standard and Poor's key financial ratios for FPL would be for this test year if from your recommend ROE was adopted by the Commission?

A. I have not calculated that.

Q. Would it be possible for you to provide me with a deposition exhibit that performs that calculation?

MR. SUNDBACK: Counselor, we'll reserve on that one to determine what burden might be imposed on it. I don't know for a fact that it would be unduly burdensome; we'll investigate that.

MR. HARRIS: Okay. And for purposes of the deposition if we could identify that as, I guess, Deposition Exhibit 2, Late-Filed Deposition Exhibit 2. And, I guess, a short title would be Calculation of Key Financial Ratios with Baudino Recommended ROE.

(Late-filed Exhibit 2 marked for identification.)

BY MR. HARRIS:

Q. And then if we could move on a little bit further, Page 59 of your testimony?

A. Okay. I have that.

Q. And if you could read the sentence that begins on Line 11 and runs through Line 13?

A. Sure. "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."

Q. Okay. And what are flotation costs?

A. Generally, it refers to expenses associated with issuing common stock.

Q. Okay. And can you explain to me why you believe that flotation costs would already be accounted for in the current stock price?

A. Stock prices are not like bond prices, and really there's no other method to account for flotation costs in the stock price, because the stock price is what it is. So to the extent investors understand that a company may incur flotation costs to issue stock, those costs are likely already accounted for in the stock price. In other words, if you make an additional adjustment to a company's stock price for flotation costs, it's basically saying the current market price is not correct. So --

Q. And are you aware -- sorry.

(Inaudible; simultaneous conversation.)

A. Go ahead.

Q. I was just going to say are you aware of any, you know, textbooks or financial articles that contain that understanding?

A. As I sit here, no, I can't think of any. I would have to go back and look and see, you know, if I could find any, but this has been a consistent position of mine through the years. One way I've modified it is if a company can prove that it has got flotation costs in a particular year from issuing stock, it could come before the Commission and ask to have those expenses recouped.

But, you know, FPL has not done that in this case. And so, really, what we have got here is an adjustment for flotation costs that we don't even know have been incurred or not.

Q. So are you suggesting that FPL has not incurred flotations costs in the issuance of stock?

A. Well, I'm saying that it's up to FPL to come before the Commission and show what its flotation costs are, if any.

Q. Okay. I sort of want to go through this idea with you a little bit and have you make sure I understand how this works. In my understanding, if FPL intends to sell stock and they sell through an underwriter, they place that stock and the underwriter sells it. Does the underwriter pass on the entire sale price of that stock back to FPL?

A. No. I think it's the -- if I understand your question, it would be the proceeds net of whatever expenses there would be.

Q. Right. And those expenses are the flotation costs, correct?

A. Yes.

Q. Okay. And so, essentially, if FPL sells, you know, $100 worth of stock, FPL isn't going to realize that full $100. It would be the $100 -- it would be whatever was net of those flotation costs, is that correct?

MR. SUNDBACK: Counsel, could you indicate whether you are talking about face value or the actual amount of money received on the stock in your hypothetical?

MR. HARRIS: The actual amount of money that FPL would receive.

A. Well, in your hypothetical here, my understanding of it would be that the actual amount of money they would receive would be whatever the issuance would be less the issuance costs or flotation costs.

Q. Okay. So if the amount that the utility receives then from this new stock issuance is reduced by those expenses, or those flotation costs, how would the utility ever earn their required return if you don't allow for the recovery of those flotation costs?

A. Well, you know, the fact really is that the utility, you know, may have expenses in any given year that is not reflected in, say, a test period. And if those particular expenses, you know, are outside of a test period, they would not get reflected. There may be additional revenues that the company gets, as well, that aren't necessarily reflected in the test period which would benefit the company.

Ultimately, it's going to be the money, the cash dollars that the company gets back from its stock issuances and from its debt issuances that fund rate base, and that rate base is afforded a return, a market -- you know, an investor required return plus taxes. And so there is always going to be differences between the book value and the actual rate base value upon which the company earns a return. So really like the book value of the stock, the book value of the bonds, you know, that all supports -- the balance sheet amounts support the company's rate base and other investments and so forth, but that rate base is what's going to be earning the return.

Q. Okay. I think I understand you. I want to ask sort of a hypothetical situation. Assuming that FPL wants to issue stock through an underwriter, and instead of letting the underwriter pass on the net proceeds, you know, that is the underwriter would retain flotation costs, the underwriter passes on to FPL 100 percent of the proceeds from that stock issuance; and instead, FPL writes a check out of a separate account to the underwriter, you know, pays them a fee. Would you recommend that that fee be disallowed as an expense?

MR. SUNDBACK: Would you, Counsel, clarify the question. Is it a fixed fee or is there some kind of contingency or success payment contained in the compensation to the investment banker?

MR. HARRIS: It doesn't matter either way. We could assume it's a fixed fee that just so happens to equal what the underwriter would have charged in flotation costs. So that would be my hypothetical.

MR. MOYLE: And I assume your question also assumes that the fee is reasonable?

MR. HARRIS: For purposes of my hypothetical, the assumption would be that FPL negotiates a deal that in lieu of, quote, flotation costs, they write a separate check that to the underwriter is transparent; that is, the underwriter receives the full amount they would have under a traditional underwriting with flotation costs arrangement. Rather, this way the underwriting gets a separate check.

MR. SUNDBACK: Now, just so we're on the same page with the hypothetical, Counsel, you're presuming that FPL when it issues stock that is going to be acquired by NextEnergy is paying an investment banker for the issuance of that stock even though the parent is acquiring it directly, or is your hypothetical applicable to the issuance of stock at the NextEnergy entity level to the public?

MR. HARRIS: It doesn't matter to me either way. Where I'm trying to get at is I understand the witness is -- my understanding of Mr. Baudino's testimony is essentially he believes that flotation costs should not be considered. What I'm trying to get at is if FPL needs to issue stock, or NextEra needs to issue stock, and instead of going through what I understood to be the traditional route, which is underwriting that includes flotation costs, if NextEra, or FPL, or whoever in this hypothetical we want to say it is just paid that out of a separate fee, they said we are going to sell $100 worth of stock, you give us the $100, and we will pay you some fee for your services in issuing that -- in underwriting that stock for us.

MR. SUNDBACK: Counselor, your question is ambiguous, because it contemplates in one instance the issuance of a security to the public in which, unless there is a direct investor program where the investor can buy with dividends the stock from the company, you really have to use an investment banker.

The other hypothetical potential interpretation of your question is its a sale by FPL of its stock to its complete corporate parent, which may or may not involve an investment banker fee. And we're trying to understand from your hypothetical which fact pattern that is, because it may influence the applicability of the answer.

BY MR. HARRIS:

Q. The NextEra sale to the public, how about that?

A. Okay. I think I understand your hypothetical. That's a difficult one to answer, because NextEra Energy and NextEra could be issuing stock for general corporate purposes, some of which could go to FPL, some of which could go to its unregulated subsidiary. And, you know, you really have to look at where that money is going.

So, you know, your hypothetical is positing a situation I'm not really familiar with, and so in any event, I couldn't say whether or not those expenses would be, you know, reasonable for including in rates or not.

Q. So in your mind, Mr. Baudino, what is the difference between the cost associated with issuing stock and any other expense that would be allowed for ratemaking purposes?

A. Well, what I'm really -- we're referring here to Page 59 of my testimony, and what I'm saying -- what I'm suggesting to the Commission, what I'm recommending is not to allow some kind of generic 15-basis-point adjustment that's really not based on any prudently incurred costs that we know of, because the company hasn't made that case.

Q. So your testimony is more specifically an objection to a generic 15-basis-point adjustor versus a demonstration of actual expenses, is that correct?

A. That anything was actually incurred by NextEra on behalf of FPL, you know, for the book equity that it has got. We have not seen -- I mean, it's really up to FPL to provide that information, not me.

Q. Okay. Wouldn't it be true that once a utility incurs flotation costs and that those costs are recovered through an adjustment to that utility's cost of equity, then that adjustment would continue indefinitely?

A. Yes. Typically that is how it's done, it's a permanent adjustment.

MR. HARRIS: If I might just have a moment.

I think that's all the questions I have. I do really appreciate your time and your cooperation with this. And I don't know, I don't have in front of me who else issued cross-notices of deposition, so I will let the intervenors speak up first, I think.

THE WITNESS: You're welcome, Counselor.

MR. HARRIS: Thank you, sir.

MR. MOYLE: This is Jon Moyle. I think we did file a cross-notice. I have clarifying questions, if I could.

MR. GUYTON: Jon, would you mind terribly if we took a short break before you started?

MR. MOYLE: No, that's fine. Five minutes?

MR. SUNDBACK: Just for reference purposes, does any other intervenor have questions aside from FIPUG?

MR. HENDRICKS: This is John Hendricks. I might have one or two to follow FIPUG.

MR. SUNDBACK: And, Mr. Hendricks, did you send us a notice, a cross-notice of deposition?

MR. HENDRICKS: I did not. I understood that if time was available I would be able to ask a question. If not, it just wouldn't happen.

MR. SUNDBACK: Well, I guess we'll cross that bridge when we get there.

MR. HENDRICKS: Thank you.

MR. SUNDBACK: Any other intervenors?

Thank you. We'll break for five, I guess.

MR. HARRIS: A little more than five. Let's say we come back right at 2:00 o'clock, if that will work. All right. Thank you.

(Recess.)

MR. HARRIS: If we're back, I guess, Jon, you can get going.

MR. GUYTON: Jon, before you get started, at trial we would object to friendly cross. I'm not going to interrupt you here today, but note that I'm reserving the right to raise objections about friendly cross, should the deposition be used at trial.

MR. MOYLE: Charlie, I always thought you liked my cross. (Laughter.) The objection is noted.

MR. SUNDBACK: And just for the record, who was speaking?

MR. GUYTON: That's Charlie Guyton on behalf of Florida Power and Light Company.

MR. SUNDBACK: Thank you.

MR. GUYTON: Thank you.

MR. MOYLE: And also for the record, FIPUG has not filed ROE testimony with a witness. Mr. Jeff Pollock is your witness we filed testimony with, and I do not believe he has taken a position on ROE, so I guess we could have a debate about friendly. But, anyway, let me move on.

CROSS EXAMINATION

BY MR. MOYLE:

Q. And I have some questions following up on some questions staff asked you, and then some about your testimony. And I'm probably just going to work in reverse order from the topics you spoke with staff about, and I was not clear on the line of questioning related to the cost of issuance of stock and your view of the cost of issuance of stock.

So let me just ask a nonleading question. Could you clarify your view on the cost of issuance of stock?

A. Sure. What I'm really addressing here is this sort of generic basis point adjustment to recognize alleged flotation costs. That's what I'm really looking at here and what my testimony is. This is on Page 59.

Now, really as I sit here, it's likely that to the extent the market -- you know, investors are rational, we can assume, and that they know what's going on with these companies. And to the extent that there were flotations costs incurred by companies who were issuing stock, it's likely it's already included in current stock prices. So multiplying this dividend yield, as I said here on Line 14, multiplying the dividend yield by some 4 percent flotation cost adjustment sort of assumes that the price is wrong.

So, you know, and beyond that, really, any kind of -- I would object to any kind of generic inclusion of flotation costs that's not based on a utility's actual cost, and the utility hasn't presented any actual flotation costs. I hope that clarifies it a bit.

Q. Okay. And let me ask you this. I have a question, but I'll start it with a comment. Sometimes lawyers work on contingency fees, and sometimes a contingency fee is smaller when you get into higher dollar numbers. So, you know, anything from a dollar to 10,000 may be 35 percent, and anything over, say, a dollar to 100,000 may be 35 percent and 100,000 to a million may be 30, and everything over a million could be 20, with the idea being that there's an adjustment in the percentage based on the dollar value.

Do you know has FPL in their testimony suggested a similar type of adjustment based on the amount of stock issued?

A. Not that I know of. Again, this was just a -- this is pretty much a generic 15-basis-point adjustment.

Q. Right. And I just did some rough math, but if you assumed a $100 million stock issuance, then the fee would be $150,000, according to my math; do you agree?

A. I would accept that, subject to check. I don't have a calculator with me, but I will accept it subject to check.

Q. And then if you said 500 million in stock, you know, I assume a lot of it is the same, but it's a different dollar figure. If you applied the straight 15 basis points without any adjustment, it would give you a $600,000 fee. So I guess your point is you don't think FPL has provided enough proof to warrant a 15 percent basis point adjustment?

A. Yes, that's right. But, you know, my testimony here is just -- and this is on Page 59, Lines 10 through 19. It's likely it is already reflected in current stock prices.

Q. Okay. All right. Let me take you to Page 43 of your testimony, and you have a section about a capital structure adjustment, and the way I understood what you were suggesting is that to the extent the Commission awards more than 9 percent in ROE, that there be an adjustment in the debt-to-equity ratio of approximately 2 percentage points, that you ought to have a 2 percentage point decrease in the equity portion of the capital structure for every 50 basis points above 9 percent, is that right?

A. Yes. That's the example I have posited here, correct.

Q. Okay. So would I be correct that if you assume -- if you assume that the Commission came in and awarded an 11 percent ROE, and you're at 9, that would be 200 basis points over, correct, your recommendation?

A. Correct.

Q. And would you then -- would it follow that your recommendation would be that there be an 8 percent reduction in the current equity portion of FPL's capital structure?

A. Sure. That's certainly one outcome. I haven't really taken it up that far, I'll admit. This is just one approach the Commission could consider. You know, 11 percent -- I mean, I can't -- I didn't follow it up that far, because I just think 11 percent is really out of the range of reasonableness. And I would definitely strongly recommend the Commission not go to 11 percent, and certainly not to 11-1/2 percent.

This is one method the Commission could consider. I think really it's more important as a principle that if the Commission awards FPL a higher return on equity, or a significantly higher return on equity, there should be some adjustment for ratemaking purposes to that equity ratio. It's very rich; very, very rich. And this really is in alignment with, I think, the Commission's order in the Gulf Power case in which they awarded a 10 percent ROE to Gulf Power, and Gulf Power had a much lower equity ratio. So that's all I'm trying to reflect here.

Q. Right. And on Page 44, I guess, you -- I guess you say it's a 10.25 return on equity in Gulf, is that right?

A. Yes.

Q. And the chart that you're showing on common equity, Gulf has a 46 percent common equity as compared to Light's common equity of 59 percent?

A. Yes. You know, one thing you have got to add in there really is that FPL doesn't have preferred, and really Gulf Power has a significant amount of preferred stock. So I guess I would look at the total equity ratio there as about 52 percent, roughly. Preferred stock is kind of a hybrid instrument, of course.

You would be looking at a debt ratio -- excuse me, I looked at -- let me revise that. On Page 45 it said the common equity approved by the Commission was 46.26 percent with a total equity being 51-1/2 percent. So, you know, that's kind of the number I would look at.

Q. I just want to make sure I understand. If you have 10.25 in Gulf with a 51.5 percent equity ratio, if you have Power and Light that has thicker/richer, more heavy equity ratio of over 59 percent, according to your training and studying, what would that do to the return on equity? Would that mean that FPL's return on equity should be the same as Gulf's, lower than Gulf's, higher than Gulf's?

A. Well, it should be in the same neighborhood. You have got -- I think FPL's is slightly list risky. You could certainly on that basis argue for a lower ROE, just other things being equal, because FPL is slightly less risky. For example, like the Moody's bond rating for Gulf Power is A3. The Moody's bond rating for FPL is AA3; their S&P bond writing is about the same.

So certainly I just -- this was important to put in the testimony to inform the Commission that, you know, here we have got FPL with a very rich equity ratio, and the recent order in Gulf Power was ten and a quarter on equity, based on a much lower equity ratio. So all things considered, you know, there needs to be -- I really strongly recommend some movement there. You would not with a 59 percent equity ratio want to give FPL a ten and a quarter percent ROE, given what was awarded in Gulf Power.

Q. And your ROE recommendation is 9 percent, is that right?

A. Correct.

Q. And some of that, I assume, was premised on FPL having a rich capital structure?

A. You know, I felt that 9 percent was really kind of generous, on the upper end. Nine percent is really the top of my range, and I went ahead in this case and accepted the company's equity ratio. What I'm suggesting to the Commission is that if it decides to give FPL a higher ROE, then I'm recommending some adjustment should be made to the equity ratio. That's really the principle here.

Q. So if 9 percent is the upper end of your range, what would be the lower end of your range?

A. Eight and a half. Eight and a half to 9 percent is the range that I recommend.

Q. And I saw in your testimony you had identified a couple of commissions that looked like they had issued orders that had return on equities in the single digits, and by single digits I mean under 10. That's correct, isn't it?

A. Could you refer me to the point in my testimony where I said that?

Q. Yes. Page 9, Lines 20 through 23.

A. Yes, that's correct. And that's from the Value Line report that I cite.

Q. And do you know are there other instances -- I assume you track ROEs throughout the country as part of your professional responsibilities, is that right?

A. Yes.

Q. Are there other instances that you are aware of where recent utilities have come in in single digits or at least below the 11 percent that FPL is requesting?

A. There may be. I would need to go back and look at that. I could provide that later, if you wish.

Q. Yes, that might be helpful. If you are providing late-filed exhibits, that may be a helpful one to have.

A. Okay.

Q. Thank you for considering that. And let me move on. I don't want to take up a lot of your time, but --

MR. HARRIS: Jon, this is Larry Harris. I guess that would be Late-Filed Exhibit 3. Do you have a title for it?

MR. MOYLE: Recent Decisions Regarding Return on Equity.

MR. HARRIS: Thank you.

(Late-Filed Exhibit 3 marked for

identification.)

BY MR. MOYLE:

Q. One of the arguments -- I guess that you're aware FPL makes an argument that they need a high return on equity to access capital, is that right?

A. I'm not sure I'd characterize it that way. You know, it's my understanding and my interpretation of it that they are seeking an 11-1/2 percent ROE, which in Doctor Avera's opinion is a fair and reasonable return for a utility company in the situation that FPL is in, and that they are also requesting a quarter percent adder for excellent management, so kind of two pieces there.

Q. Well, for the purposes of -- well, let me just ask you this. With respect to access to capital, you in your testimony on Page 17 went back and looked at the history of FPL having access to debt capital, is that right?

A. Yes. Recent history; this was in 2011.

Q. Yes.

A. And they certainly had no problem with debt issuances last year at all.

Q. Okay. So you're not aware of anything that would suggest that FPL has a problem currently with a 10 percent return on equity accessing capital?

A. They certainly haven't had any trouble accessing debt markets since the last rate case, let's put it that way.

Q. Okay. And do you know -- did you track their stock from the last rate case to the current day? Do you know if it's up or down?

A. Let me see if there's something in the company's presentation material about that.

Q. It's probably not fair to you. I can ask Mr. Dewhurst that when he takes the stand, if you're having difficulties putting your hands on it.

A. I'm having difficulty putting my finger on that at the moment. For purposes of preparing for this deposition, I didn't compare NextEra's or track NextEra's, or FPL Group's stock prices over the last couple of years.

Q. Okay. So another point that you make in your testimony, I think you talk about certain recovery clauses, and is the purpose of that testimony to suggest that Florida as a state and a regulatory environment has less risk than maybe other states have?

A. I think generally the regulatory environment is considered average, although these clauses certainly have been of great assistance to FPL and has lowered their risk other things being equal.

Q. Okay. So if I were to ask you, and I will try to do it all in one question, but you would agree that things like having a Nuclear Cost-Recovery Clause, a capacity clause, an environmental cost-recovery clause, a fuel cost-recovery clause, and a conservation cost-recovery clause, all those type of clauses reduce the risk of regulatory lag, correct?

A. Significantly, yes.

Q. And are you aware of any other state that has as many clauses as compared to Florida that act to reduce risk?

A. Well, I can't say that I have made an exhaustive study like a state-by-state comparison. Typically, it's not unusual to see fuel cost-recovery clauses, you know, or what we would call fuel adjustment clauses. I'm familiar with environmental, some environmental cost-recovery clauses. Certainly Florida has given, you know, FPL the benefit of several clauses, in addition to the two I mentioned.

Q. Yes. And I guess I was just curious as to whether you are aware of any other state that has more clauses than Florida?

A. At this point I just don't know the answer to that question. I haven't really studied that.

Q. One final line of questioning. Are you aware of some states that use a historical test year as compared to a projected test year?

A. Yes. Some states use historical test years, that's correct.

Q. Okay. And Florida uses a projected test year, correct?

A. Right.

Q. And is that also another mechanism that reduces the risk of regulatory lag and makes Florida less risky as a regulatory environment?

A. Well, it certainly is designed to eliminate regulatory lag, or in a another way to put it, try to set rates in accordance with what the Commission can ascertain costs will be in a rate affected period, and that certainly has benefits over an historical test period.

Q. And then you were asked some questions by Staff about the operating company of FPL vis-a-vis other companies. I think you had a chart that were, maybe, holding companies that had an operating company contained within them, and were asked why didn't you compare the capital structure of FPL, the operating company, to operating companies within larger holding companies. Do you recall that?

A. Yes, I recall that.

Q. Okay. And isn't it true that FPL is sort of similarly situated to the companies that you looked at, in that it is held within a holding company, NextEra?

A. Well, it's held within the holding company of NextEra. You know, the thing on this table that you referred to, this is on Page 38, this really provides sort of an apples-to-apples comparison with respect to the capital structures or the equity ratios for the group that produced the rate of return on equity that I'm recommending. That rate of return is really for this group of companies, and their equity ratios on average are, you know, depending on how it's measured, between 48 and 50 percent equity ratio, common equity ratio.

So really what this does is provide an apples-to-apples comparison for these companies to the ROE that I would be recommending for FPL. And so that's the purpose of this here. I would not -- I'm not sure that having the operating companies' capital structures would be useful, because really I didn't estimate the cost of equity for the operating companies. I estimated it for these companies.

Q. And are you comfortable that what you did with respect to FPL to make your recommendation is apples-to-apples with the Table 2 found on Page 38?

A. Could you repeat the question? I'm not quite sure I understood it.

Q. Yes. So you made a recommendation with respect to FPL and its capital structure, right?

A. Yes.

Q. And you're using Table 2, I'm just trying to understand whether your recommendation for FPL's capital structure, whether the Table 2 and the companies in Table 2 are comparable to FPL?

A. Well, they have similar bond ratings in that respect, and they are engaged mostly in the -- mostly, if not all, in the business of regulated electric sales to customers. So, you know, that was really the basis that I looked at -- two of the bases I looked at for developing this group of companies.

Q. Okay.

A. Does that answer your question?

Q. And NextEra Energy, I guess, is number six on your group, is that right?

A. Yes.

Q. Okay. And then you're aware that Southern Company -- that Gulf Power Company is part of Southern Company?

A. Yes.

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

THE WITNESS: You're welcome.

MR. HARRIS: Anybody else?

MR. HENDRICKS: Yes. This is John Hendricks, if the other are finished.

MR. GUYTON: Florida Power and Light is not, but --

MR. HARRIS: This is Larry. Mr. Hendricks, you said you might have a couple of questions?

MR. HENDRICKS: Yes. I would like to ask them. I'm not trying to jump in line in front of someone, though.

MR. GUYTON: No, that's fine.

MR. HARRIS: Is that okay with the Hospital Association?

MR. SUNDBACK: We'll listen to the questions. We're not making commitment, given the fact there was no notice as to whether the witness is going to answer them or not. Let's hear the questions.

MR. HENDRICKS: That's fine.

CROSS EXAMINATION

BY MR. HENDRICKS:

Q. I guess I would like to take you back just a second to that infamous table on Page 38 that we were just discussing, or you were just discussing. You're using that to basically derive the 9 percent ROE recommendation, if I understand it correctly.

A. No, that's not correct.

Q. Okay.

A. I used financial models to make that recommendation.

Q. All right. I'm sorry. Are these consistent with the recommendation that you did make, then? I'm sorry, I should have put it the other way. Do you find these confirming to that recommendation, or what's the purpose of this table?

A. The purpose of this table is to really compare the equity ratios for the group of companies I used to estimate the ROE to the requested equity ratio that FPL is asking for in this case. And what I would say is that it really sort of confirms my recommendation as generous or sort of on the high side of a range of results.

Q. Okay. All right. That's fine. Let me just move on to -- let's see, Page 41, please.

A. Okay. I have that.

Q. In Lines 19 through 23 you lay out your recommendation. And could you just read that for us, please?

A. Nineteen through 23?

Q. Yes.

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 percent. 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."

Q. Is that intended to convey that you really think the equity ratio should be lower, but you don't believe it's realistic to ask for it?

A. Well, I did ask for it. Later in my testimony I described how the Commission would make an adjustment if it so desired. I wanted to just acknowledge, though, what I said. You know, the purpose of this statement is so acknowledge what happened in the last case, and I recognize the Commission did not choose to go with my recommendation then.

Q. All right. For just a moment, stepping up on that same page, the earlier question on that page. I'm not going to ask you to read the whole thing, but the one regarding FPL's equity rich capital structure where you make comments about an excessive common equity ratio could result in taxpayers subsidizing NextEra's unregulated affiliate activities.

A. Ratepayers. It would be ratepayers.

Q. Yes. Are you suggesting that this is an excessive equity ratio, or it could be an excessive equity ratio?

A. It's certainly quite high. It's very rich. And the concern I'm expressing here is sort of like what you might also call it a double-leverage situation whereby you have an inflated equity ratio at the utility operating company level, which is very much lower risk than the unregulated NextEra Energy Resources, which has leverage of over 80 percent. And that on a total company basis, a holding company basis, there is a concern that too high an equity ratio at the operating company, regulated utility operating company level could result in subsidization of an unregulated affiliate which is far riskier.

Q. Right. And part of the difficulty in sort of zeroing in on that question in a very precise way is the holding company structure and the fact that the capital is always raised at the holding company level?

A. It's just a comparison of what's going on within the holding company, between the regulated operating company and the unregulated company.

Q. With this question of subsidization raised, do you have any concerns about the tax, the effect of relative taxes between the two, the regulated and unregulated subsidiaries?

A. Taxes?

Q. Yes, income taxes.

A. No, I haven't really addressed that.

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

CROSS EXAMINATION

BY MR. GUYTON:

Q. Mr. Baudino, my name is Charlie Guyton. I'm with the Gunster law firm, and I represent Florida Power and Light in this deposition. I'm going to ask you -- I have been accused of speaking slowly, and I have also been accused of sometimes mumbling, and sometimes people even accuse me of not understanding what I'm asking.

So if any of that evidences itself today, and you don't understand what I have asked you, would you stop me and ask me to restate the question or say you don't understand?

A. Yes, I appreciate that. And, yes, I would certainly ask you to restate the question or let you know if I didn't understand it.

Q. Okay. Thank you.

MR. SUNDBACK: Counsel, could you tell us whether you sent us a cross-notice of deposition?

MR. GUYTON: Yes, Florida Power and Light Company sent a cross -- notice of deposition.

MR. SUNDBACK: Thank you.

BY MR. GUYTON:

Q. Whose cost of equity have you estimated in this testimony, Mr. Baudino?

A. The investor required return for FPL.

Q. And it's FPL's cost of equity, not NextEra's?

A. Correct.

Q. Whose stock price did you use, FPL's or NextEra's?

A. I'm not sure I know what you mean. What stock price?

Q. Well, in your DCF model, what stock price did you use; FPL's or NextEra's?

A. I had to use NextEra's, because NextEra is the publicly traded company.

Q. And in your DCF model, next period dividend did you use, FPL's or NextEra's?

A. Well, I estimated the next period dividend for the group by applying one plus one-half the growth rate. So that was an average.

Q. And that would have included NextEra's as one of the members of the proxy group, right?

A. Yes.

Q. And it wouldn't have included FPL because it wasn't part of the proxy group?

MR. SUNDBACK: Objection; mischaracterizes the witness' past testimony. The witness hasn't testified that it doesn't include FPL. He said it includes NextEra.

MR. GUYTON: Fine. I'll restate.

BY MR. GUYTON:

Q. Does your proxy group include FPL?

A. Well, it's certainly included indirectly as part of NextEra.

Q. When you calculate the next dividend for the proxy group, are you using FPL's next dividend as part of the proxy group or NextEra's dividend as the proxy group?

A. Well, I'm using -- I estimated D1 based on the average growth rates for the group.

Q. And the group included NextEra, but it didn't explicitly include FPL?

A. It included NextEra, and, of course, FPL is part of NextEra.

Q. Right. So the input for NextEra on the next period dividend, was that FPL's input or was that NextEra's input?

A. Well, all of the estimated growth rates that I have in my testimony and in my DCF model are for the companies in the group, and so that growth rate would have been the forecasted or estimated growth rate for NextEra because it's not available for FPL.

Q. You testify at Page 27, Line 2, that the return on equity analysis is a forward-looking process. Do you recall that?

A. Yes, I have that page and I see that.

Q. And several times in your testimony you observed that interest rates are at or near historic lows, do you not?

A. Yes.

Q. If cost of equity analysis is a forward-looking exercise, why spend time discussing historic interest rates?

A. The reason is because it frames the current situation and it forms a basis for trends, which I've discussed earlier in my testimony; interest rate trends, cost of capital trends. I show interest rate and yield comparisons on Exhibit RAB-2, and so it really helps frame the overall environment for a discussion of capital markets, financial markets, and how I estimated the return on equity for FPL going forward.

So it's useful because it shows what is

happening -- I mean, I did show historical interest rates, that's true. I also discussed current interest rates as well as outlook for interest rates in the future. I discussed all of those things.

Q. Well, let's look a little more closely at your observation about current interest rates and where they are. Would you agree with me that there are three options for interest rates prospectively; they could decline further, they could stay at or near historic lows, or they could increase?

A. I would agree with that.

Q. And given that interest rates are currently at or near historic lows, which of those three prospective options is the most probable?

A. I would say the more probable would be through this year and next year, if not into 2014, interest rates remaining about the same or perhaps increasing a little bit. Certainly, the Federal Reserve has made statements that it's going to try to perhaps push more aggressively to get the economy going again. I don't expect to see interest rates going up with the slow, sluggish growth we have had.

And certainly I mentioned Operation Twist where the Federal Reserve is going to be actively involved in trying to keep longer rates low and keep them low for longer to use as one tool to help jump start, or at least get the economy moving again. So I don't see, you know, for the short-term interest rates going up significantly. That's my guess. I mean, that's the best I can see from looking at it at this point.

Q. I'm going to you about some of your testimony between Pages 11 through 18 where you describe FPL.

A. Yes, I have that.

Q. Do you consider the information that you recount in your testimony describing FPL at Pages 11 through 18 to be accurate?

MR. SUNDBACK: Objection; that is a substantial amount of testimony. Do you have a more specific cite to ask the witness about?

MR. GUYTON: I do, but I would really like for him to answer the broad question.

THE WITNESS: Let's start on Page 11. This is data and statements that I have taken from statements made by the company and figures provided by the company. I'm assuming those numbers are accurate. You know, I cite here from the company's 10k, so I'm relying on the accuracy of the company's numbers. Let's put it that way.

BY MR. GUYTON:

Q. And you wouldn't -- I'm sorry, I didn't mean to interrupt.

A. That's okay.

Q. You wouldn't have used those numbers in your testimony if you didn't consider them accurate and if you weren't relying on them, would you?

A. Well, that's true. I mean, I'm looking at -- I presented these as, you know, data that describe the company. And, of course, I wanted to cite the company's own statements about its operations, because obviously 10k, this is the report to the FCC in which investors would avail themselves of to look at and to get information, hopefully accurate information about the company. So, you know, I did rely on that as a way to describe what's going on with the company right now.

Q. At Page 11, Lines 9 through 11, you state, "On Page 3 of the Company's 2011 10k report it is stated, '(w)ith 85 percent of its power generation coming from natural gas, nuclear, and solar, FPL is one of the cleanest electric utilities in the nation.'"

Did I read that correctly?

A. Yes.

Q. Is that a good thing, that FPL is one of the cleanest utilities in the nation?

A. I would consider that a good thing, yes.

Q. And why is that good for customers?

A. Well, I think to the extent any utility attempts to control its air pollution coming from its generating plants that is better for customers and noncustomers, as well.

Q. Does it have the effect of reducing air compliance costs for customers?

MR. SUNDBACK: We will object to that. That presents a question that's incomplete at a minimum. It presumes some facts not in evidence. If you want to lay in front of the witness some alleged savings and ask him whether he agrees with that, that's your prerogative, but there's nothing in his testimony that you pointed to that goes directly to that point, and it presumes some savings that haven't been demonstrated.

MR. GUYTON: You can go ahead an answer the question, unless counsel is instructing you not to.

A. No, he has not instructed me not to answer.

I don't know the answer to your question if it saves customers money or not. Certainly, there are significant concerns from the EPA's recent rulings and environmental regulations, both proposed and now implemented, regarding coal plants. FPL is not subject to that. However, certainly with nuclear there's decommissioning costs, there's disposal of waste from nuclear plants. You know, again, I have not seen any projected cost savings, either. So, again, it's difficult to answer that question.

Q. How did FPL end up as one of the cleanest utilities in the nation?

A. Well, this is a statement from FPL's 10k, and according to FPL, they believe it came from their natural gas, nuclear, and solar generating facilities.

Q. And would you agree that FPL's management had a significant role in FPL implementing natural gas and solar?

A. Well, I believe it was FPL and its management that decided to go that route with respect to the generation mix that it has.

Q. Now, you state at Page 11, Lines 11 through 13, that FPL notes in its 10k that it has provided residential and commercial bills that were among the lowest in Florida. Is that a good thing for FPL's customers?

A. FPL's customers have benefited from lower rates, that's certainly true. A couple of contributors to that, one of the main contributors, of course, is low gas prices, and that's something that really FPL's management had no control over or influence on. We know that gas prices have varied quite a bit. Right now we are in a low gas price environment, which has been good for customers. There is also depreciated nuclear plants that are relatively low cost.

Q. Was it FPL's management that made the generation choices that allowed FPL to take advantage of the current low natural gas prices?

A. Well, it was FPL's management who made the decisions to invest in these plants.

Q. And, indeed, since 2001 FPL has repowered or built or is in the process of developing some 14 gas-fired natural gas plants, correct?

MR. SUNDBACK: Presumes a fact not in evidence. If you can point the witness to a particular factual statement that he can review and see whether he agrees with it or not, that's fine, but you're presuming some facts that aren't in the record.

MR. GUYTON: I am. I'm just asking him if he is aware of it or not.

A. Well, I'm not aware of those numbers. Well, I should say I don't recall those numbers. I would have to go back and look at that.

Q. If FPL's management hadn't made the decisions that it made to build natural gas plants, it wouldn't have been able to take advantage of those low gas prices, would it?

A. Well, it follows that if you have a significant percentage of your generation fleet burning natural gas and gas prices are low, you will be able to benefit from low gas prices and lower generation costs. If that turns around and gas prices become higher, those rates will go up, those costs will go up. And perhaps if the gas prices go high enough, management could be questioned about the prudence of that.

Q. That's not something you're questioning the management about at this time, is it?

A. I'm not sure I understand your question.

Q. Well, you just postulated a situation where gas prices could go up and FPL's management might be questioned about its prior management decisions, and I'm just simply asking if that is a question that you are raising for the Commission in your testimony?

A. I'm saying that with respect to gas prices, management, FPL's management did not influence gas market prices to be low right now. Certainly, we have seen them much higher. All you need to do is look back a few years after Hurricane Katrina, gas prices were much higher with supply disruptions and so forth. So that situation can change. It's a market situation that has to do with what goes on in the gas market, and that was my point there.

Q. You also mentioned part of the reason that FPL enjoys low rates is because it has nuclear plants that have been depreciated. Did I understand that correctly?

A. Yes, that's one reason.

Q. Who was it that made the decision to build nuclear plants for Florida Power and Light Company?

A. You know, I wasn't there when the company undertook its construction of its nuclear plants. I'm --

Q. Do you have any reason to believe that -- I'm sorry.

A. I'm going to assume that management made that decision to go forward with those nuclear plants. It was FPL's decision to do that.

Q. Who has made the decision at FPL that resulted in these plants having what you describe as, quote, very low running costs, end quote?

A. Well, I mean, FPL and its management and employees are responsible for the operation of those plants, so it's FPL.

Q. You also state that FPL states in its 10k that FPL's rates are, quote, below the national average based on rates per kilowatt hour in July of 2011, end quote.

Is that a good thing for FPL's customers?

A. What page are you referring to again?

Q. Well, I think that would be back at Page 11, Lines 11 through 13.

A. Well, certainly customers benefit from lower rates, so --

Q. And would you agree that it is FPL's management that was responsible for the decisions that allowed it to have rates below national averages?

A. I think management -- I think certainly management had a part to play in that, and I'm going to reiterate the other factors I mentioned, too, which are low gas prices, the depreciated nuclear fleet, economies of scale, lower wages in Florida. I mean, those all are contributing factors.

Q. Uh-huh. At Page 13, Lines 14 and 15, you report that FPL's first mortgage bonds are rated A by S&P and AA3 by Moody's. Are those good bond ratings?

A. They certainly indicate a financially robust company and, yes, those are investment grade bond ratings.

Q. Do those investment grade bond ratings benefit customers?

A. They benefit customers with relatively lower cost of debt than, say, BBB, for example. If the company were rated BBB, it would have slightly higher debt costs when it issued new debt, so there is a benefit there.

Q. At Page 17, Line 9, S&P says in a quote that you set forth there that FPL has, quote, sound operations, correct? It's at Line 9.

A. Yes. It really says a bit more. It says FPL represents about half the consolidated credit profile referring to NextEra Energy Resources -- I'm sorry, NextEra -- 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.

It goes on to talk about the 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.

Q. Do the sound operations that are referred to in that quote benefit FPL's customers?

A. You would expect prudent utility management to engage in sound operations. So if the company did not have sound operations, certainly that would be an indication of imprudent operation on management's part.

Q. That's not what I asked you. I asked if customers benefited from FPL's sound operations?

A. I would say both ratepayers and shareholders benefit from that.

Q. In that same quote it talks about FPL having better business fundamentals than most of its integrated electric peers. Does that benefit customers?

A. The way I read this is better business fundamentals than most of its electric -- integrated electric peers with better than average service territory, meaning the territory in which the company operates, sound operations, which we discussed, credit-supportive regulatory environment, which refers to the Florida Public Service Commission, so certainly I think better business fundamentals would be more beneficial to customers than worse business fundamentals.

Q. And would you agree that FPL's management decisions contributed to that in some measure?

A. Could you repeat that, please?

Q. Yes. Would you agree that FPL's management decisions have contributed to its better business fundamentals?

A. I think, yes, to some extent it certainly did, and these other items I mentioned also contributed to that. I would also add to that this service territory could be harmed by the higher rates FPL is seeking. I mean, FPL is seeking quite a large rate increase in this case, and we've, you know, OPC and SFHHA have recommended a much lower revenue requirement than FPL is seeking, so that management decision would not benefit ratepayers.

Q. Is it your position that the Commission should not encourage superior performance in terms of customer service, reliability, and low bills?

A. I think good regulation really sort of expects good to superior performance from its regulated electric companies, and I think customers should expect that, too, based on the rates they are paying for monopoly service.

Q. So is it your position that the Commission should encourage superior performance in terms of customer service, reliability, and low bills?

MR. SUNDBACK: I think that has been asked and consequenced. You asked that question a different way in your last question.

MR. GUYTON: And I still don't have an answer to it either time.

MR. SUNDBACK: No, I think the witness did answer your question.

MR. GUYTON: No. It called for a yes or no and I never got an answer.

BY MR. GUYTON:

Q. Is it your position that the Commission should not encourage superior performance in terms of customer service, reliability, and low bills; yes or no?

A. What are the factors again?

Q. Is it your position that the Commission should not encourage superior performance in terms of customer service, reliability, and low bills; yes or no?

A. Well, I can't agree with the premise of that question. I think, you know, in my almost 30 years of regulatory experience, and I worked for the staff of the New Mexico Public Service Commission before I went to work for Kennedy, the regulatory authority expects the utility to provide reliable service at just and reasonable rates, and so I think service quality is something commissions are always very focused on and very concerned about.

And a utility is expected to do that as part of the regulatory compact. A utility is expected to provide -- I mean, it is the monopoly service provider to ratepayers. It's the only game in town. My view is the Commission should encourage, you know, the best service that it can as an expectation of the utilities fulfilling its end of the regulatory bargain or the regulatory compact. That includes customer service, reliability, making sure the lights stay on, and just and reasonable rates, meaning the lowest possible bills given the utility's cost structure and prudently incurred costs.

Q. In your answer you introduced a new term. What is the regulatory compact that you're speaking of?

A. This is -- it has to do with -- it has to do with the sort of agreement between, and this is my characterization of it, the agreement between the regulators, the regulated monopoly, and customers. That the utility is provided a protected franchise service territory under which they will not have any competition, they are the monopoly service provider, and in return for that they must provide reasonable and reliable service at just and reasonable rates. And they are allowed all of their prudently incurred costs for that and a reasonable return on their investment.

Q. And all prudently incurred costs would be all costs that were prudent that were used to provide service?

A. Yes, prudently incurred costs using the provision of service to ratepayers.

Q. Okay. Now you have stated in your testimony that you don't think it is appropriate to increase investor returns for excellent management or superior performance, correct?

MR. SUNDBACK: Do you have a cite, counsel?

MR. GUYTON: I do. But, Mr. Baudino, is that not a fair characterization of your testimony?

MR. SUNDBACK: Counsel, I think it is appropriate and fair to ask the witness about a specific portion of his testimony. Your characterization or paraphrase may or may not be correct, and it will certainly expedite the cross-examination if you focus the witness on a particular part of the testimony that you are actually cross-examining him on.

MR. GUYTON: Well, I'm not sure that it will expedite, because I'll have to find it again, but I'll be glad to.

MR. SUNDBACK: Thank you.

BY MR. GUYTON:

Q. At Page 59 of your testimony you have a section that reads ROE adder for excellent management. Are you familiar with that?

A. Yes, I have that.

Q. Is it a fair characterization of that testimony that you don't think it's appropriate to increase investor returns for excellent management or superior performance?

A. That's correct, and certainly not as FPL has proposed it in this case.

Q. Do you also believe that it would be inappropriate to lower investor returns for poor management performance?

A. As I'm sitting here, I can't necessarily think of an example of where I would advocate that unless the utility had been found, you know, so imprudent in what it was doing that the Commission decided there should be some kind of ROE penalty. So what I'm really addressing here on 59 and on Page 60 is really just sort of inflating an investor required return for FPL by really an arbitrary amount, 25 basis points, that's not tied to anything but low rates and really no measure of management performance.

Q. I understand. I was just wondering how -- I was wondering if your general approach to this was even-handed, that the return on equity ought to be market-based and shouldn't reflect either superior performance or poor performance. Is that your position?

A. Well, I'm certainly not advocating a penalty for FPL in any way. In fact, as I have said prior in this deposition, I have really gone on the high end of my results for FPL in terms of ROE and agreeing with the company's capital structure. So, I mean, if anything there is sort of a -- that's a generous position with respect to cost of capital. Though I'm not recommending an ROE adder for excellent performance, I'm not recommending a penalty either.

Q. In preparing your testimony, did you review prior Commission practice as to whether or not it has given ROE adders or penalties for superior or poor performance?

A. I haven't reviewed those specific Commission orders. I'm familiar with Doctor Avera's testimony in which I believe he cited to -- if memory serves me correctly, he cited to an order in which there was a company that was given an additional bonus for management performance. I would need to go back and look at that and really refresh my recollection, though.

Q. Is it your position that any adjustment outside -- no, let me rephrase that. Let me just drop that.

At Page 21 and 22 of your testimony -- at Line 22 of Page 21, continuing on to Page 22, you state, "The value of a stock to investors is the discounted present value of future cash flows," correct?

A. Yes.

Q. And then back on Page 21 in the sentence prior you said, "Those future cash flows take the form of dividends and appreciation in stock price," correct?

A. Correct.

Q. I want to read to you a statement out of Mr. Woolridge's testimony, or Doctor Woolridge's testimony; it's at Page 26, Lines 19 through 21. I just want to see if you agree or disagree with it. He says, "According to the DCF model, the current stock price is equal to the discounted value of all future dividends that investors expect to receive from investment in the firm."

Do you agree with that statement?

A. You know, I don't have Doctor Woolridge's testimony in front of me, and I don't know the context in which he said that. I have reviewed his testimony, but before I say I agree with that one little statement, I would want to look at the context that was offered in.

Q. Fair enough. Now, in your DCF analysis you relied on analyst forecasts of growth, did you not?

A. Yes, I did.

Q. So we can appropriately conclude that you think it's appropriate to use analyst forecasts of growth in the DCF analysis?

A. Yes. I used four sources of growth; two from Value Line and then two from consensus analyst forecasts.

Q. And all of those were analyst forecasts, correct?

A. Yes.

Q. Turn to Page 19 of your testimony, please.

A. Okay. I have that.

Q. At Lines 10 and 11 you make the statement, "The estimated cost of equity should be comparable to the returns of other firms with similar risk." Do you see that?

A. Yes.

Q. When you use the term return in that sentence, do you mean earned return, allowed return, or some other type of return?

A. I'm talking about the cost of equity, so that would be the required return of investors.

Q. So it's neither earned return nor allowed return unless they get it just right?

A. What I'm referring to here is the estimated cost of equity within the ratemaking process. So what we all try to do is, you know, what I have done, what Doctor Avera has done, what Doctor Woolridge has done is to do our best to estimate what that cost of equity should be. And so this would be the allowed return, meaning the Commission allowed return. And, of course, this is the Hope and Bluefield cite here. So what we are talking about is -- you know, this forms the basis for constructing comparison groups to estimate cost of equity for the subject utility. You want to get firms that are relatively similar in risk.

Q. And did I understand correctly that you said that that refers to the allowed return?

A. Yes. The allowed return, estimated cost of equity, this is -- what we're trying to offer to the Commission here is our suggestions for return on equity.

Q. At Page 20, Lines 4 and 5, you state that 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 investments of similar risk.

In that statement where you speak of comparable risk, are you referring to total risk or what some people might call investment risk?

MR. SUNDBACK: Could you -- counsel, there is some ambiguity to the question. Could you define the last term as you understand it or intend to mean it?

MR. GUYTON: Well, rather than try to confuse the matter, let me just limit it to total risk.

BY MR. GUYTON:

Q. In making that statement where you speak of comparable risk, are you referring to total risk?

A. Yes. I think total risk in the mind of investors, that's correct.

Q. So when you speak of comparable risk in your testimony, you're speaking of comparable total risk to investors?

A. Right. And certainly within the context of setting an allowed rate of return for a utility company you would want to look at comparable firms, meaning firms that do business in the retail electric industry that have similar risk characteristics which can be estimated by using either bond ratings or credit rating and developing a comparison group, as I have done it, with the criteria that I have used.

So this is kind of what -- it's forming a foundation here for sort of estimating opportunity costs, if you want to call it that as I have called it here in the testimony, and also the allowed rate of return required by -- or investor required return that the Commission should allow in this case.

In this case, I have done this with a comparison group. That's looking at opportunity costs, it's looking at firms of comparable risk. I have done that, Doctor Avera has done that, Doctor Woolridge has done that.

Q. Let's stay on Page 20, and there you describe the various elements of total risk, do you not? They are comprised of business risk, financial risk, and liquidity risk?

A. Yes.

Q. Okay. And then you go on at the bottom of that page and the next page to describe each one of those particular types of risk that comprise total risk?

A. Yes.

Q. Now, after that discussion, you then discuss the sources available to investors to quantify total risk, correct?

A. Yes.

Q. And there you speak of credit rating agencies and their end results or rating, correct?

A. Yes.

Q. So is it your testimony that a ratings agency's rating is an assessment of total risk?

A. Well, what I would say is that what I was referring to here is that this is one source to quantify total risk of the company, and, yes, Moody's and Standard & Poor's perform detailed analyses of a number of factors that contribute to total risk of a particular investment or enterprise. So these are sources commonly used by myself and other rate-of-return analysts to look at whether firms are of similar risk or not.

Q. And when you speak of similar risk there, you are speaking of total risk, correct?

A. I'm referring to total risk here, yes.

Q. And you start the development of your comparison group or what other people call proxies by using a rating that reflects total risk, correct?

A. As best as I can comprehend it, yes, and I use bond ratings for that, bond ratings from S&P and Moody's.

Q. And then once you have that group, then you use some other criteria to narrow your comparison group?

A. Yes.

Q. But when, after all of the narrowing is done and that group is finalized, was it your intent to have a comparison group that had a total risk comparable to FPL?

A. I don't think you can ever say that total risk is completely comparable, because there are so many differences between firms. So there is nothing -- you know, no two firms are totally comparable in terms of everything that comprise their business operations, their customer base, and so forth, their generating mix.

There is a lot of differences in this group, so what I have tried to do is look at some factors, major factors that these companies have in common with FPL. Mainly, that they have got A-rated bonds and have at least half or more of their business devoted to sales of regulated electric.

Q. Well, let me ask the question in a little bit different way, because I understand you're taking issue with comparability, and I really want to go back to the term that you used in your testimony.

When the group was finalized, was it your intent to have a comparison group that had a total risk similar to FPL?

MR. SUNDBACK: Well, Counsel, you say you want to use a term that is used in the witness' testimony. Can you point us to where he says total risk in testimony in connection with the proxy group?

MR. GUYTON: Well, at discussion on Page 21, Line 10, there is a question about total risk, and it speaks of the rating agencies -- or the answer speaks of the rating agencies' ratings and that was the basis for our earlier discussion here. Is that helpful?

MR. SUNDBACK: Would you repeat your question, please?

MR. GUYTON: Sure, I would be happy to.

BY MR. GUYTON:

Q. When your comparison group was finalized, was it your intent to have a comparison group that had a total risk similar to FPL's?

A. I think that's a fair characterization. I mean, again, it's similar, within a reasonable range, and, yes, that's what I tried to do.

Q. Bear with me a minute, and I'll see if I can't bring us in for a landing here.

In your mind total risk is comprised of three risks: Business, financial, and liquidity risk, correct?

A. Yes. Those are the three main areas.

Q. And FPL has a total risk rating that is similar to the ratings of your comparison group companies?

A. Well, as best I was able to estimate it using the criteria I did, what I've got here is a comparison group. And as I said before, they are not -- no two companies are ever totally comparable. What you try to get here is a range. And if you'll notice on Page 24, there is even a range of bond ratings from A- to AA3. So there's going to be differences there. I think what any analyst tries to do in the regulatory arena is get a reasonable proxy group of companies that forms the basis for a recommendation for return on equity, and that's what I have done here.

Q. Mr. Baudino, I have a couple of follow-up questions from earlier questions in the deposition.

A. Sure.

Q. You were asked for a late-filed deposition exhibit that compared the next period dividend based upon moving it from -- let me back up.

Do you recall being requested Late-filed Deposition Exhibit 1?

A. Yes, I remember that.

Q. And what is your understanding that staff counsel has asked you to do?

A. Well, my understanding of it is that staff would like to see the difference in the end result ROE estimate from going from one plus one-half times the growth rate to one plus the full growth rate, and estimating the -- to estimate the forward dividend, the D1.

Q. How long would it take to do that analysis?

A. I really don't know.

Q. It's simply a matter of replacing a dividend growth rate in your formula with another one, isn't it?

A. Really, that's what -- I mean, I'm thinking that's what I would do in -- I believe in RAB-4, Page 2 of 2, it would be replacing -- if I understand staff's request, it would be replacing the formula for expected dividend yields in the two methods.

Q. And you don't have an idea of how long that would take?

A. It wouldn't take very long.

Q. You were also asked about flotation costs?

A. Yes.

Q. Have you reviewed prior Florida Public Service Commission decisions on return on equity to see if the Commission has embraced flotation cost adjustments in those cases?

A. I have reviewed those in the past, yes.

Q. And the Commission has both done it and declined to do it, correct?

A. That's my understanding, yes.

Q. In instances where they decided to recognize flotation costs, were they wrong?

MR. SUNDBACK: Objection, calls for a legal conclusion.

MR. GUYTON: Oh, no, it calls for a factual opinion from the expert witness.

MR. SUNDBACK: No, to the extent that you're wrong, for instance, as a matter of law, that is a legal conclusion.

MR. GUYTON: I didn't ask him if it was wrong as a matter of law, I asked him if it was wrong as a matter of finance.

A. Well, I'll answer it this way. I don't want to call the Commission wrong or anything like that. I will say I disagree with that decision to include flotation costs, and I would recommend the Commission not include them in this case.

Q. In an answer to Mr. Moyle, you spoke of double leverage. Do you recall that?

A. Yes.

Q. Are you suggesting that FPL's capital structure is double leveraged?

A. I'm saying the concern arises when you have a regulated operating company with a very rich equity ratio and an unregulated subsidiary with a very high debt ratio. That issue, that concern certainly is a valid one with respect to cross-subsidization between subsidiaries, and is something -- you know, I'm not accusing the company of that, but I'm saying it's a concern that should be looked at.

Q. You don't have any proof of that, do you?

A. I haven't made a study of that, but certainly looking at it, there would be a concern given FPL's very high, almost 50 percent equity ratio, substantially higher than the companies in my group, higher than the companies in Doctor Avera's group, and having an unregulated subsidiary with only approximately 20 percent equity and 80 percent debt. It's something the Commission should be aware of and look at and address. Again, I have accepted the company's requested equity ratio in this case, but it's still a concern.

Q. And you were concerned enough that you didn't go out and do a study of that?

A. I did not do a study of that for purposes of my ROE.

MR. GUYTON: Mr. Baudino, thank you for your time and your patience with me.

THE WITNESS: You're welcome. And would it be all right if we took a small break?

MR. HARRIS: Yes. Unless Mr. Wiseman has any questions, I think we're done. I don't know that there is any other questions for you.

MR. SUNDBACK: We may have a few redirect, for instance, based on FPL's questions.

MR. HARRIS: Okay, sure. Five minutes?

MR. SUNDBACK: That's fine.

MR. HARRIS: All right. Let's come back at -- well, it's a little before 3:30, how about 3:35?

(Recess.)

MR. SUNDBACK: Thank you. So just to confirm, all the intervenors who had questions for Mr. Baudino are done with their questions?

MR. HENDRICKS: That is correct.

MR. SUNDBACK: Okay.

REDIRECT EXAMINATION

BY MR. SUNDBACK:

Q. Mr. Baudino, you will recall there were some questions about your expectations concerning interest rates.

A. Yes, I recall those.

Q. You will recall that you were asked about the reference to interest rates being at historic lows when you filed your testimony?

A. Yes, that's correct.

Q. Can you describe for us your understanding of the perception of interest rates in 2001?

A. Well, I think in 2001 interest rates were declining and were considered low. And, you know, really since -- if you look at Exhibit RAB-2 and the trend of what has happened with interest rates and yields over that period from 2001 forward, what we see with -- it's not an unbroken trend line, but the trend is definitely down over that period.

Q. And so have there been instances since 2001 where you would characterize -- how would you characterize interest rates, for instance, that you could observe in 2008 and '09?

A. Uh-huh. Well, with respect to interest rates in 2008, if you look at the 20-year Treasury Bonds, again, those were low. They were lower than in 2001 and 2002 and 2003 and so forth. They trended up a bit in 2008, and are now on their way back down.

Q. Do you recall you were asked some questions by FPL's counsel about double leveraging?

A. Yes.

Q. Okay. You were asked -- do you recall you were asked whether you had performed a study regarding double leveraging?

A. Yes, I recall that.

Q. Can you describe for us why you didn't need a study, given conclusions you have reached in your testimony?

A. Certainly. I didn't need to provide or to perform a study because it's obvious, if you look at what is going on in the cash generation inside NextEra, the main contributor to that, to dividends, to the financial profile, the positive financial profile of NextEra, that contributor is FPL by far. The bond rating agencies have pointed that out. They have pointed out the riskier operations of the unregulated affiliate, and I know there have been write-offs that resources have taken in the past. So really the financial profile of the holding company is supported in large measure by the very equity rich capital structure that FPL has, and, you know, it is not supported by the debt heavy capital structure of resources.

Q. You will recall you were asked some questions about your testimony at Page 11, and fuel mix, and mix of generation resources that FPL has. Do you recall that?

A. Yes.

Q. Okay. When we consider these circumstances, are their factors aside from the immediate fuel costs that we consider, and what would those factors be?

A. Certainly. You would need to really do -- you would need to consider all the costs. For example, you could -- in assessing this, you would need to look at possibly much higher start-up costs of a new gas plant as well as fuel costs relative to, say, a depreciated nuclear plant, which FPL does have. Or to, for example, coal plants. Coal plants could -- certain coal plants may not be as much at risk for these environmental regulations as others. They may not be as depreciated as others. I mean, there's a number of factors to consider here with respect to a generation fleet and the cost of that fleet.

MR. SUNDBACK: Thank you.

Those are all of our redirect.

MR. HARRIS: Wonderful.

Mr. Baudino, thank you so much for making yourself available. I appreciate this discussion, and look forward to hopefully those late-filed exhibits.

THE WITNESS: Thank you.

MR. HARRIS: Anybody have anything else?

Okay, great. Thank you guys so much for joining us. I think there is another deposition tomorrow with another one of the witnesses. I'm not handling that one, but I guess the same people will be in the same place tomorrow. So thank you so much, and have a good afternoon.

(The deposition concluded at 3:42 p.m.)

ERRATA SHEET

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IN RE: DOCKET NO. 120015-EI
NAME: Richard A. Baudino
DATE: July 26, 2012

PAGE	LINE	CHANGE

Under penalties of perjury, I declare that I have read my deposition and that it is true and correct subject to any changes in form or substance entered here.

DATE

Richard A. Baudino

CERTIFICATE OF OATH

~~STATE OF~~ District of Columbia

~~COUNTY OF~~ ____________

I, the undersigned authority, certify that Richard Baudino personally appeared before me at 1350 I Street, NW, # 1100 and was duly sworn by me to tell the truth.

WITNESS my hand and official seal in the ~~City of~~ District of Columbia ~~County of~~ ________, ~~State of~~ ____________, this 26th day of July, 2012.

Elizabeth S. Parris

Notary Public

~~State of~~ District of Columbia

District of Columbia
Notary Public
Elizabeth S. Parris
My Commission Expires 10/14/2015

Personally known ____________ OR produced identification ✓

Type of identification produced North Carolina Driver License

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

I, Jane Faurot, Official FPSC Commission Reporter, do hereby certify that I was authorized to and did stenographically report the foregoing deposition at the time and place herein stated.

I FURTHER CERTIFY that this transcript, consisting of 96 pages, constitutes a true record of the testimony given by the witness.

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 3rd day of August, 2012.

Jane Faurot

JANE FAUROT, RPR
FPSC Official Commission Reporter
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