FILED AUG 30, 2016
DOCUMENT NO. 07118-16
FPSC - COMMISSION CLERK

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 160021-EI

PETITION FOR RATE INCREASE BY FLORIDA POWER & LIGHT COMPANY.
______________________________/

DOCKET NO. 160061-EI

PETITION FOR APPROVAL OF 2016-2018 STORM HARDENING PLAN BY FLORIDA POWER & LIGHT COMPANY.
____________________________/

DOCKET NO. 160062-EI

2016 DEPRECIATION AND DISMANTLEMENT STUDY BY, FLORIDA POWER & LIGHT COMPANY.
____________________________/

DOCKET NO. 160088-EI

PETITION FOR LIMITED PROCEEDING TO MODIFY AND CONTINUE INCENTIVE MECHANISM, BY FLORIDA POWER & LIGHT COMPANY.
____________________________/

VOLUME 25

(Pages 3029 through 3175)

PROCEEDINGS:	HEARING
COMMISSIONERS PARTICIPATING:	CHAIRMAN JULIE I. BROWN COMMISSIONER LISA POLAK EDGAR COMMISSIONER ART GRAHAM COMMISSIONER RONALD A. BRISÉ COMMISSIONER JIMMY PATRONIS
DATE:	Monday, August 29, 2016
TIME:	Commenced at 1:30 p.m. Concluded at 2:55 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

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

APPEARANCES: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
252 through 264			3172
707	Deposition of Richard Baudino	3149	
708	Baudino Late-Filed Deposition Exhibit No. 1	3155	
709	S&P's Ratings Dated 6/12/2015	3160	

P R O C E E D I N G S

CHAIRMAN BROWN: All right, everybody, and good afternoon. Today is August 29th and we are readjourning and calling this hearing to order.

We do have a few preliminary matters to address. All right. So let's start with Office of Public Counsel. OPC filed its motion to dismiss FPL's amended request for creation of a reserve amount amortization mechanism or alternatively -- it's a very long motion -- a motion for a directed final decision that FPL has failed to produce any evidence in support of its request.

As I stated or as staff stated on Friday afternoon, FPL has three working days to prepare or file its response, and so we will anticipate that. Our staff will thereafter address OPC's motion as well as FPL's response in its post-hearing recommendation to be filed on the revenue requirements issue that we are currently scheduled to consider in October, and then we will dispose of the motion at the revenue requirements special agenda.

So that's the first preliminary matter, and I want to get into a few issues related to that. Obviously right now we're in a posture that is really unprecedented, to say the least, in a rate case proceeding. And in the spirit of due process, I want to make sure that we hear from all the parties today on a few issues.

First, based on the withdrawal of OPC's witness -- Mr. Rehwinkel, do you pronounce it Pous?

MR. REHWINKEL: Pous.

CHAIRMAN BROWN: Pous. Okay. Pous. Any changes to testimony or exhibits that should be made should be OPC's changes to witnesses that incorporate Pous' testimony into its testimony as well as FPL's testimony that rebuts Pous. So I think it might have been better form, Public Counsel, to have asked the Commission to withdraw Pous and allow you to amend the testimony, although it's my understanding that OPC has filed a few revisions, and I'm going to go over that to make sure that you confirm that those are accurate.

My understanding is that OPC's notice -- has noticed that it will not introduce the testimony of Jacob Pous into evidence. OPC has served a notice of service of errata to the testimony and exhibits of Helmuth Schultz. OPC has served a notice of service of errata to the testimony and exhibit of Daniel Lawton, and OPC has served a notice of service of revised exhibits of Ralph Smith, which I believe was previously -- his testimony was previously stipulated.

MR. REHWINKEL: Yes. Madam Chairman, I can update that for you. We -- beginning Friday night, we worked with our witnesses to revise testimony. We -- the most important thing was Mr. Smith's exhibits, so we got his agreement on corrections and we submitted those to the parties by email over the weekend and we worked through the process. And just before we convened the hearing today, the final piece of all those adjustments was provided to the parties, and that was the errata for Mr. Smith's testimony and exhibits. So we previously had emailed that to the staff and to FPL when they were complete before the official filing just so they could see them as soon as we did.

CHAIRMAN BROWN: Mr. Rehwinkel, is that all that OPC plans to change with those modifications or --

MR. REHWINKEL: Yes, that is correct. The only -- and we're working with the company on this and we'll work with the staff. Mr. Schultz was in the midst of preparing an errata that addressed an issue unrelated to Mr. Pous. So those two were -- Mr. Pous' impacts were pulled out and this other issue was included in the same errata. But with those three witness testimonies, changes to their testimony and exhibits, we have withdrawn the effect of Mr. Pous' testimony on our other witnesses.

CHAIRMAN BROWN: Thank you for that clarification too.

FPL, do you plan to file any revisions to testimony or exhibits to your rebuttal?

MR. BUTLER: We do. The principal one is we will be filing revised rebuttal testimony for Mr. Allis, and that testimony was substantially directed at rebutting Mr. Pous. It's a big revision. We have cut it from 166 pages to 58, to give you an idea of the amount of it that related to Mr. Pous. We also have, that we know of at this point, a couple of minor places where Smith changes related to Pous changes affect numbers that were cited in Mr. Barrett's testimony, and we will be, I think, just making -- our plan is just to just make orally at the beginning of Mr. Barrett's testimony the small number of changes there, although if you have a preference, we can certainly file the revised.

CHAIRMAN BROWN: Yes. I got a little confused.

MR. BUTLER: Okay.

CHAIRMAN BROWN: So can you restate that of what the changes are?

MR. BUTLER: Yeah. As Mr. Rehwinkel indicated, you know, the withdrawal of Mr. Pous' testimony flows through various other testimonies, including Mr. Smith's testimony. Mr. Barrett, our witness, cited some figures from Mr. Smith's testimony that were revised in response to the Pous withdrawal, and so we'll be needing to have him correct that so that the numbers he's citing are the ones that are now reflected in Mr. Smith's testimony.

CHAIRMAN BROWN: Okay. So you'll be modifying Barrett.

MR. BUTLER: Yes.

CHAIRMAN BROWN: Okay. And Witness Allis.

MR. BUTLER: And Witness Allis. Those are the two that we are aware of. And I wanted to mention one other thing, though, that relates to what Mr. Rehwinkel said about Mr. Schultz's testimony. OPC has, you know, filed revisions, as he said, that don't relate to withdrawal of Pous' testimony. They actually relate to a correction, as I understand it, made in response to the cross-examination of Ms. Slattery, our witness last week, but then that led to Mr. Schultz apparently finding something that he wanted to correct and putting that into his testimony. We need to look at that, see what it is. And if it's something that -- well, we'll decide how to react to it, whether it's something we would object to as not really within the scope of what you are permitting as changes or if we'll need to have another witness testimony address that.

CHAIRMAN BROWN: Thank you. And I do want to remind the parties that it is proper form to ask this Commission to amend its prefiled testimony and exhibits. I cannot stress that enough. Okay? Is everybody aware of that? I just want to make sure you all are clear.

MR. MOYLE: I'm not, and I don't know if you want to get into it, but my understanding of the prehearing orders has been your witnesses file their testimony way in advance, everybody looks at that, they are on notice as to what the issues are, they take depositions on that, and then we go to hearing on that.

CHAIRMAN BROWN: That's right.

MR. MOYLE: And other than kind of errata like this should have been a four, not an eight type changes, that's it. So I don't know what's being contemplated by --

CHAIRMAN BROWN: No, you're right.

MS. PAGE: -- a 158-page change to a 58-page change, if -- when that's going to be forthcoming.

CHAIRMAN BROWN: Mr. Moyle, you're right.

MR. MOYLE: Okay.

CHAIRMAN BROWN: You're absolutely right. And that is my emphasis to the parties: You have to ask permission of the Commission to file an amended prefiled statement -- or prefiled testimony, pardon me, of your witnesses. Although I will accept it, Mr. Rehwinkel and Mr. Butler, I just want to remind the parties that is the proper practice at the Commission.

MR. BUTLER: Understood. My apologies. I thought we had an understanding from the bench on Friday that we were actually kind of directed to go do that and that's what we've been pursuing.

CHAIRMAN BROWN: Okay. All right.

MR. MOYLE: Can I follow up on that?

CHAIRMAN BROWN: Sure.

MR. MOYLE: Because I thought you had said parties that may have concerns can ask. So I had, on Friday, ventured a due process concern out there. A lot happened late on Friday, I understand, but we've had the weekend to think it over. FIPUG filed a notice of joinder of OPC's motion this morning. But we worked a lot of hours last week and this is the second week of the proceeding, we have a lot of witnesses, so to the extent that someone is going to drop either 158 or 58 pages of new testimony on us now --

MR. BUTLER: No, that's not correct.

CHAIRMAN BROWN: Hold on.

MR. MOYLE: I just didn't know. That was what was being referenced. That would present serious issues that would cause concern.

CHAIRMAN BROWN: Absolutely. We've had our lawyers involved in this all over the weekend. I'm sure all of the parties have been involved, Mr. Butler and Mr. Rehwinkel.

MR. MOYLE: I haven't.

CHAIRMAN BROWN: Hold on one second. I'll give everybody an opportunity to speak on that because we absolutely want to address any potential due process concerns you have, Mr. Moyle.

Mr. Butler.

MR. BUTLER: There is not a single point addressed in the revised Allis testimony that wasn't addressed in the original Allis testimony. All that's happened is a process of subtraction, taking out the portions that related to Mr. Pous' testimony, and very modest word changes to make it flow where it used to refer to both Pous and somebody else and now it's just referring to that one witness. That is the extent of the modifications to Mr. Allis' testimony.

CHAIRMAN BROWN: Thank you.

Mr. Rehwinkel.

MR. REHWINKEL: Thank you, Madam Chairman. And we take your concerns to heart, and I hope that this is a one-off situation, that we won't have to revisit this again.

CHAIRMAN BROWN: Thank you.

MR. REHWINKEL: We -- and I can say we worked through the weekend, and I think we worked transparently with Mr. Butler to give him our work as it was being done. And I understand -- I know exactly where the changes he's talking about are and I think they're reasonable. I know where they are in Mr. Barrett's testimony, and I know where they are in Mr. Allis' because I'm very familiar with that. So I think -- I understand what he's talking about. And without looking at it, I can probably accept that they've done it right, but we certainly will take a look at what they've done, so.

CHAIRMAN BROWN: Okay. Mr. Butler, I just want to clarify, when do you plan to file those revisions?

MR. BUTLER: We can file them this afternoon, if that's the Commission's desire.

CHAIRMAN BROWN: By what time? Close of business?

MR. BUTLER: Certainly by close of business. Yeah, definitely.

CHAIRMAN BROWN: Okay. Now, Mr. Moyle, any follow-up?

MR. MOYLE: No. I was not in any of these conversations, so seeing is believing. So when it's filed, I guess we'll look at it. But we have experts, Mr. Pollock, who I'd like to talk with, you know, about it. So, anyway, but thank you for giving me the chance to address it.

CHAIRMAN BROWN: Absolutely. And I know that you adopted OPC's position on this issue. So I'm going to turn to staff just to make sure the record is clear and that we can hear from them. Legal, actually -- pardon me, legal advisor.

MS. HELTON: I think what has been stated today is staff's understanding, that OPC stated on Friday that it planned to file -- or to withdraw the testimony of Mr. Pous, Pous.

CHAIRMAN BROWN: Pous.

MS. HELTON: I'm sorry. I'm having a hard time saying his name correctly. And that would also necessitate OPC changing up testimony of several witnesses where they had reflected the testimony of Witness Pous, and that then Power & Light had stated that it wanted to adjust its testimony because now Pous' testimony would no longer be in the record. It was also my understanding that Mr. Moyle was joining in with OPC, so I'm a little bit confused by Mr. Moyle's due process concerns in that -- but that's, I guess, for another day.

CHAIRMAN BROWN: All right. And, Ms. Helton, you are comfortable, if the parties are comfortable, which we'll get to in a second, in moving forward today with our list of witnesses, which I will be taking a little bit out of order, you're comfortable with moving forward?

MS. HELTON: If the parties are comfortable with moving forward, and I think you do need -- should hear from the parties, then, yes, ma'am.

CHAIRMAN BROWN: Thank you. Okay. I'm going to turn to Mr. Rehwinkel. Okay. I just want to make sure that it's your intention to start this afternoon with the cross-examination of the intervenor witnesses. Yes, no?

MR. REHWINKEL: Yes, ma'am.

CHAIRMAN BROWN: Okay. FPL.

MR. BUTLER: We are prepared to do that as well.

CHAIRMAN BROWN: Okay. Are there any objections to moving forward? Seeing none -- Mr. Moyle.

MR. MOYLE: I just, to go back on this other point, can I just get a little clarification about all of the testimony that's changing? So I think when OPC says, "We're pulling a witness," then the trial kind of moves on and the witness gets pulled and you keep going with the case. I'm a little unclear about all the testimony that's being changed. Is direct testimony being changed as a result of this?

CHAIRMAN BROWN: No. No, Mr. Moyle.

MR. MOYLE: It's all rebuttal?

CHAIRMAN BROWN: I'm going to have staff kind of address those concerns real quickly. Ms. Brownless.

MS. BROWNLESS: My understanding, from what I've seen and -- is that the OPC has withdrawn Pous or Pous or however you say it.

CHAIRMAN BROWN: Pous.

MS. BROWNLESS: Pous. And that there are subsequent changes that were made to the exhibits of Mr. Smith, to some schedules of Mr. Schultz, and to the testimony of Mr. Lawton as a result of the withdrawal of the --

CHAIRMAN BROWN: Pous.

MS. BROWNLESS: -- Pous testimony being withdrawn.

I also believe Mr. Baudino, if I'm correct, has made some changes to his testimony. And that may be incorrect, but I saw something that changed. And I don't know if that was an errata sheet that was associated with him or whatever. So that's what I understand has transpired so far.

CHAIRMAN BROWN: Okay. For the record and for clarity, are there any other witnesses whose testimony or exhibits will be altered as a result of OPC's motion and withdrawal of Pous? I'm just looking around and I see none.

MR. LITCHFIELD: May I ask a clarification? Then it's correct that Mr. Baudino has not filed any errata related to the withdrawal of Mr. Pous' testimony?

CHAIRMAN BROWN: Is that correct?

MR. SUNDBACK: Madam Chair, if we may.

CHAIRMAN BROWN: Yes.

MR. SUNDBACK: We have filed -- this is the Hospitals. We have filed today errata to Mr. Kollen's testimony as it relates to some computations. To my understanding, that has nothing to do with Mr. Pous or the changes to his testimony. It has to do with the revenue requirements calculations offered by Mr. Kollen. Mr. Baudino has not offered any errata to his testimony. So I apologize for the confusion, but Mr. Baudino is not changing his testimony.

CHAIRMAN BROWN: No. I appreciate the clarification. Thank you. So there are no other changes as a result of the withdrawal of Pous.

Are there any objections to moving forward?

MR. SUNDBACK: Madam Chair, if we could just clarify. Procedurally, as we understand it, and this may not be correct, and I'm sure I'll be corrected where I make a misstatement, it's FPL's intention now to file its revised testimonies this afternoon of Allis and perhaps not Barrett -- perhaps Barrett will do his changes verbally -- but at least Allis. If that's the case, what's the opportunity of -- what's the period in which other participants have an opportunity to review the filing? And we'd add that we are not privy to any changes that FPL has considered or made in response to the Pous developments to date.

CHAIRMAN BROWN: Uh-huh. Mr. Butler.

MR. BUTLER: We are preparing and either have right now or will very soon a redline version that's a, you know, comparison version of Mr. Allis' original testimony to the current one showing where all the deletions are, and we can distribute those to the parties. Our intent is to file with the Clerk's Office and serve a clean copy, but we've made courtesy redline versions so people can see where the changes are.

CHAIRMAN BROWN: Okay.

MR. SUNDBACK: And so, Madam Chair, my question is, presuming that all happens today, and we appreciate all the participants' efforts to work expeditiously through this situation, what are our opportunities as intervenors, who have seen nothing of this so far, to offer comment to the extent we believe that the changes to the FPL testimony are other than subtraction and elimination but are substantive in nature?

CHAIRMAN BROWN: Well, I'm going to turn to FPL and then I'm going to turn to our legal advisor on this. FPL, would you like to offer?

MR. LITCHFIELD: Yes, I can probably address Mr. Sundback's question.

So we will distribute marked copies of Mr. Allis' revised rebuttal this afternoon, and counsel can walk through it. And we're happy to -- maybe not with the counsel who is presently at table but with colleagues -- walk them through it in the corridor or do whatever we need to do to get them comfortable, probably in the presence of Mr. Rehwinkel. And we will make the clean filing, as Mr. Butler suggested, later this afternoon.

My suggestion is -- and I have every confidence that folks are going to get comfortable, and that could be presented tomorrow morning first thing on the record or, otherwise, that there is some discomfort.

MR. REHWINKEL: Madam Chairman, I would also like to state that given the posture of the case and the Public Counsel's position on the depreciation issues and our subsequent withdrawal of Mr. Pous' testimony, and assuming that the amendment of Mr. Allis' testimony removes rebuttal to Mr. Pous, we will be in a position to state to you that we will not have cross-examination for Mr. Allis under these circumstances. So we will commit to you we will not engage in needless cross-examination, so I think we could -- that'll help save some time.

CHAIRMAN BROWN: Thank you.

All right, Mr. Moyle.

MR. MOYLE: I think you had posed a question as to whether there was any objection with respect to proceeding at this point in time, and I was not clear as to exactly whether that was with a capital "P" or a small "p." Because I'll tell you FIPUG's position is we're good on having intervenor testimony go. We're not good on this FPL new testimony until we have a chance to review it.

CHAIRMAN BROWN: And let me tell you my intentions. Okay? And, by the way, I forgot to mention Commissioner Patronis had a family emergency -- my apologies for stating this in the middle of this -- but he had a family emergency. He is on his way, but please think of him in your minds and hearts. And he's on his way to this proceeding.

It is my intention to take up Hospitals intervenor Baudino, Dismukes -- I'm going to kind of rearrange them according to their testimony, their prefiled testimony. Baudino, Dismukes, Woolridge, Lawton, Schultz, O'Donnell, and then Smith today. And if we have an opportunity to get to the FEA witnesses, then we'll do that as well. And then tomorrow we'll start with the Hospital -- Kollen -- intervenors and Baron. I think tomorrow we'll probably stop a little early before dinner. And then we'll get to -- unless the parties concede that we can move forward with the rebuttal.

MR. REHWINKEL: Madam Chairman.

CHAIRMAN BROWN: Just a second.

MR. MOYLE: Mr. Pollock is on deck for tomorrow as well, I believe.

CHAIRMAN BROWN: Yes, he is. He's on there.

MR. LITCHFIELD: And FPL would also note that to the extent we haven't resolved, you know, any concerns relative to what I'll call the depreciation portion of the case, including Mr. Allis, we've got some witnesses who will be available to slot ahead of Mr. Allis, for example. So we think we can keep moving in that regard.

CHAIRMAN BROWN: Okay. Yes.

MR. SUNDBACK: Madam Chair, in terms of the timeline contemplated for responses to the redline of FPL, we appreciate the provision of the redline. We don't think that we'll be prepared to respond first thing tomorrow morning to it. We'd like to have at least until the end of the day, recognizing we all have to be moving expeditiously on this, if we could, please.

MR. LITCHFIELD: And, Madam Chair, I think -- while I have every -- I'm very optimistic that they will get comfortable sooner than that, but assuming they take a full day tomorrow, again, because we can put some other witnesses up in front of the others --

CHAIRMAN BROWN: Right.

MR. LITCHFIELD: -- I don't think we're going to come to an impasse in the schedule in that respect.

CHAIRMAN BROWN: That'd be great. We've got a -- we have a tropical storm looming over our state. We definitely have to use our time wisely, but we also have to be cognizant of some issues that you've raised. So we'll try to work around all of that.

Mr. Moyle, I've kind of put off Mr. Rehwinkel, so hold on one second. Mr. Rehwinkel.

MR. REHWINKEL: Madam Chairman, we would beg your indulgence. We've talked to the company about this. Baudino is up first, but Dr. Woolridge has a class tomorrow morning at Penn State and he is trying not to cancel it.

CHAIRMAN BROWN: Penn State or Kent State?

MR. REHWINKEL: Penn State.

CHAIRMAN BROWN: Penn State, the Nittany Lions?

MR. REHWINKEL: Yes, yes. And he would like to not cancel it, so we've asked if he could go ahead of Mr. Dismukes.

CHAIRMAN BROWN: Okay.

MR. REHWINKEL: And we had asked that Mr. Lawton be our last witness, if no parties have a problem with that.

CHAIRMAN BROWN: I've got this list from staff, so I'll have to turn to staff. Are you okay with Lawton going --

MS. BROWNLESS: Sure.

CHAIRMAN BROWN: Okay. So we're going to move -- let me --

MR. REHWINKEL: And one last housekeeping measure. Mr. Smith had originally, before all of this started, he had been slotted for Wednesday and then he was stipulated and understandably unstipulated. He has been able to move his schedule mightily and is in transit, will be in Tallahassee at 5:45 today.

CHAIRMAN BROWN: Okay.

MR. REHWINKEL: And we would hope that we could just take him up in the next available slot after he arrives.

CHAIRMAN BROWN: Okay. Anybody have any objection to that? I'm going to go through the list again.

MR. LITCHFIELD: We have no objection. I'm glad you're going through the list again.

CHAIRMAN BROWN: Let me go through the list again because it's gotten changed. All right. Baudino, Woolridge, Dismukes, Schultz, O'Donnell, Smith, Lawton. Am I correct?

MR. LITCHFIELD: Or Lawton before Smith, if Smith is not here is my --

CHAIRMAN BROWN: Exactly. Okay.

MR. REHWINKEL: Lawton would -- I mean, Smith would float based on his flight. Yes, thank you.

CHAIRMAN BROWN: Is that okay?

MR. REHWINKEL: Yes.

CHAIRMAN BROWN: All right. And then tomorrow we're pretty flexible on the schedule.

MR. LITCHFIELD: And, Madam Chairman, then FEA witnesses following Smith or Lawton, as it turns out.

CHAIRMAN BROWN: Yes, yes. I would prefer to go a little bit later tonight and go early tomorrow, if that is the pleasure of the parties here, but we'll kind of feel it out at dinnertime. Is that --

MR. JERNIGAN: Ma'am, just so I can say, I had spoken with my witnesses, and they are willing to go today and that's fine. They did make arrangements to travel tomorrow night after dinner.

CHAIRMAN BROWN: Uh-huh.

MR. JERNIGAN: So as long as we get to them before then, that would be great.

CHAIRMAN BROWN: Absolutely.

MR. JERNIGAN: Otherwise, we can -- we'll need to change some travel.

CHAIRMAN BROWN: We'll accommodate that.

MR. JERNIGAN: Thank you.

CHAIRMAN BROWN: Okay. All right. Mr. Moyle.

MR. MOYLE: I was going to ask a question that might be able to help solve this depreciation change of testimony, and depreciation is not the easiest substance -- you know, topic, subject matter, at least for some.

And if FPL said, you know, "We have a witness who's changing the ROE testimony and rather asking for 11.5, we want our witness to ask for 10," I think I would get that pretty readily and say no objection because I understand how the economics work on that. I'm not sure -- I mean, if FPL can make a representation with respect to -- I get that his number is changing, but if it's numbers changing that are going to hurt ratepayers, that would be more -- you know, that would be meaningful to me as compared to numbers changing that will help ratepayers. So I don't know if that can be answered that succinctly or it's too complicated to answer that way. But to my ROE example, it would sure make it a little -- maybe not require so much time spent into the changes if I could get a representation.

CHAIRMAN BROWN: Mr. Butler.

MR. BUTLER: I can give that representation. Let me just very briefly say what we've done. Mr. Allis' testimony, to start with, I would characterize it as defensive. It was responding to criticisms of FPL's depreciation study and to alternative suggested depreciation parameters of Mr. Pous. We don't propose any changes at all to what we had filed in our depreciation study, so there's no new number, sort of the equivalent of the new ROE in your example, that we are putting forward. It's simply defending our positions.

CHAIRMAN BROWN: Got it?

MR. MOYLE: I think so. I just don't understand why, if the testimony is all in responding to Pous and Pous goes away, why we still need it.

MR. BUTLER: It's not all -- I'm sorry.

MR. LITCHFIELD: Yeah, I was going to say, I think -- give us a chance at the break, and I'm really confident we can satisfy Mr. Moyle.

CHAIRMAN BROWN: Would you like a break now or in a couple of hours?

MR. LITCHFIELD: A couple of hours is fine.

CHAIRMAN BROWN: Okay. Are we all ready to move forward with Witness Baudino? I'm seeing heads nod. Yes.

Okay. For all the witnesses who are in the room who have not been sworn in, can you please stand with me and raise your right hand.

(Witnesses collectively sworn.)

Thank you. Please be seated.

All right. Mr. Sundback.

MR. SUNDBACK: Good afternoon.

CHAIRMAN BROWN: Good afternoon.

MR. SUNDBACK: We call at this time our first witness, Richard Baudino, to the stand, please.

CHAIRMAN BROWN: All right. Mr. Baudino, please come on up. And we're going to get our testimony books.

MR. SUNDBACK: Thank you. We have one preliminary housekeeping matter, when it's appropriate, before Mr. Baudino gets started.

CHAIRMAN BROWN: Just a reminder to all of the parties, that there is no friendly cross, and we will be cognizant of that.

Mr. Sundback.

MR. SUNDBACK: Thank you, Madam Chair. As a preliminary matter, you'll recall last week there was some discussion about Exhibit No. 697 and 699, which consisted initially of excerpts of documents, and at FPL's request, we provided FPL full copies of the documents and have tendered those to the stenographer. And it's our understanding that with that, the full copies will be made exhibits in this proceeding. Is that a fair understanding?

CHAIRMAN BROWN: Thank you. Yes, that's right, Mr. Sundback. And I appreciate you bringing that to our attention. And I'm assuming the Clerk did receive it, and I see a nod.

MR. SUNDBACK: So I don't know if we need to again move their admission as full --

CHAIRMAN BROWN: No.

MR. SUNDBACK: Okay. Thank you.

CHAIRMAN BROWN: You are good to go.

MR. SUNDBACK: They're already in. Great. Thank you.

Whereupon,

RICHARD A. BAUDINO

was called as a witness on behalf of South Florida Hospital and Healthcare Association and, having first been duly sworn, testified as follows:

EXAMINATION

BY MR. SUNDBACK:

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

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

Q Are you the same Richard Baudino who's caused to be filed in this proceeding 78 pages of prepared testimony and 13 exhibits initially marked as RAB-1 through RAB-13, now marked as Exhibits 252 through 264, attached to your testimony?

A Yes.

Q Okay. Have you any changes or corrections to those materials?

A I do not.

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

A Yes.

Q To the best of your information, knowledge, and belief, are the contents of your exhibits true and accurate?

A Yes.

MR. SUNDBACK: Okay. Madam Chair, at this time I don't know if there are any staff exhibits that we need to go through. I don't believe there are, but --

MS. BROWNLESS: No, sir. No.

MR. SUNDBACK: Okay. At this time we'd ask to have entered into the record as though read Mr. Baudino's prepared testimony.

CHAIRMAN BROWN: We will enter Mr. Baudino's prepared testimony into the record as though read.

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

IN RE: PETITION FOR RATE INCREASE BY FLORIDA POWER AND LIGHT COMPANY AND SUBSIDIARIES	**)))**	**DOCKET NO. 160021-EI**

DIRECT TESTIMONY OF RICHARD A. BAUDINO

I. QUALIFICATIONS AND SUMMARY

Q. Please state your name and business address.

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

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

A. I am a consultant with Kennedy and Associates.

Q. Please describe your education and professional experience.

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

I began my professional career with the New Mexico Public Service Commission Staff in October 1982 and was employed there as a Utility Economist. During my employment with the Staff, my responsibilities included the analysis of a broad range of issues in the ratemaking field. Areas in which I testified included cost of service, rate of return, rate design, revenue requirements, analysis of sale/leasebacks of generating plants, utility finance issues, and generating plant phase-ins.

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

Exhibit No. ___ (RAB-1) summarizes my expert testimony experience.

Q. On whose behalf are you testifying?

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

Q. What is the purpose of your Direct Testimony?

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

Q. Please summarize your Direct Testimony regarding the cost of equity.

A. I recommend that the Florida Public Service Commission ("Commission") approve a rate of return on equity ("ROE") for FPL of 9.00%. This recommendation is based on the results from my Discounted Cash Flow ("DCF") analyses for a comparison group of electric companies that has similar bond ratings to FPL. I also employed the Capital Asset Pricing Model ("CAPM"). Those results are set forth below. In my opinion, a return on equity of 9.00% is a reasonable estimate of the required return on equity for a low-risk, financially robust electric company such as FPL. As I will demonstrate in the following sections of my testimony, the market evidence I examined supports my ROE recommendation.

The Commission should reject the return on equity recommendation of 11.0% of FPL witness Robert Hevert. I will demonstrate in detail in Section IV of my Direct Testimony that Mr. Hevert's ROE analyses significantly inflated the investor required return for FPL. Mr. Hevert's recommended return on equity of 11.0% is unsupported by an objective evaluation of current financial markets. Moreover, a 11.0% ROE would burden Florida ratepayers with excessive rate levels.

In addition to FPL's excessive ROE request of 11.0%, several FPL witnesses also supported the addition of 0.50% to Mr. Hevert's recommended ROE, raising the Company's requested ROE to 11.50%. I will explain later in my testimony that the addition of a ROE adder for allegedly "excellent performance" is unwarranted, unreasonable and should be rejected by the Commission.

Q. Please summarize your testimony regarding the cost of debt.

A. FPL included two forecasted rates of long-term issuances with assumed coupon rates that are excessive and failed to reflect the reality of current debt costs. FPL assumed a 6.16% cost rate for these forecasted debt issuances in its 2017 rate year and a 6.50% rate for an additional issuance in its 2018 rate year. In order to reflect current and far more realistic debt costs, I recommend that these three issuances be assigned coupon rates of 4.10%.

Q. Please summarize your conclusions and recommendations regarding capital structure.

A. FPL witness Dewhurst recommended a capital structure that consists of approximately 60% common equity. This proposed equity ratio is clearly excessive and completely unnecessary for FPL to maintain an A credit rating. Under either my recommended ROE or that of FPL, *the carrying cost of each dollar of equity is three times as expensive as a dollar of debt.* Yet during the past four years, FPL failed to conduct analyses relevant to ensuring that ratepayers are not burdened with an excessive, unjust, and unreasonable amount of common equity in its capital structure. FPL did not benchmark its target capitalization against other utilities. In fact, FPL's proposed cost of equity and capital structure in this case will cost ratepayers approximately $723 million at a 9% equity return for the 2017 test year, according to Mr. Kollen's calculations. *See* SFHHA Witness Kollen Direct Testimony at page 5. I shall show later in my testimony that a 60% common equity ratio is significantly greater than prevalent in *any* of the electric utility comparison groups used to estimate the return on equity for FPL. In this proceeding, I recommend that the Commission set FPL's equity ratio at 55%. A 55% equity ratio is still higher than the average of the electric utility comparison groups used by Mr. Hevert and myself and is consistent with and A/A credit rating.

In a period of record low or near record low interest rates, it is wholly inconsistent with protecting the interests of FPL's ratepayers' to simply presume the capital structure of FPL should be set at 60%, above the level used by any of the comparison group members advanced by FPL or in my testimony. As recently as 2014, FPL's equity component of capital structure, as shown in MFRs, was 55%. FPL suffered no diminution in its credit and bond ratings from this lower common equity percentage.

I recognize that the Commission declined to adopt my recommendation in Docket No. 080677-EI to lower FPL's common equity ratio. In that proceeding, FPL's requested common equity ratio from investor-supplied capital was 59.6%. In that case, the Company imputed off-balance sheet purchased power agreements ("PPAs") of $950 million, which lowered its "adjusted" common equity ratio to 55.8%. Since FPL's last rate case, its PPA liabilities have declined substantially. To the extent that the Commission felt in 2012 it was necessary for FPL to increase its common equity ratio to offset its purchased power contract obligations, the reduction in FPL's PPA liabilities substantially reduces that concern.

II. REVIEW OF ECONOMIC AND FINANCIAL CONDITIONS

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

A. Generally speaking, interest rates have declined over the last few years. Exhibit No. ___ (RAB-2) presents a graphic depiction of the trend in interest rates from January 2008 through May 2016. The interest rates shown in this exhibit are for the 20-year U.S. Treasury Bond and the average public utility bond from the Mergent Bond Record. In January 2008, the average public utility bond yield was 6.08% and the 20-year Treasury Bond yield was 4.35%. As of May 2016 the average public utility bond yield was 4.06%, representing a decline of 202 basis points, or 2.02 percentage points, from January 2008. Likewise, the 20-year Treasury bond declined to 2.22% in May 2016, a decline of 2.13 percentage points (213 basis points) from January 2008.

Q. Was there a significant change in Federal Reserve policy during the historical period shown in Exhibit No. ___(RAB-2)?

A. Yes. In response to the 2007 financial crisis and severe recession that followed in December 2007, the Federal Reserve ("Fed") undertook a series of steps to stabilize the economy, ease credit conditions, and lower unemployment and interest rates. These steps are commonly known as Quantitative Easing ("QE") and were implemented in three distinct stages: QE1, QE2, and QE3. The Fed's stated purpose of QE was "to support the liquidity of financial institutions and foster improved conditions in financial markets." Exhibit No. ___ (RAB-3) at pp. 1-2 (also available at: http://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm).

QE1 was implemented from November 2008 through approximately March 2010. During this time, the Fed cut its key Federal Funds Rate to nearly 0% and purchased $1.25 trillion of mortgage-backed securities and $175 billion of agency debt purchases.

QE2 was implemented in November 2010 with the Fed announcing that it would purchase an additional $600 billion of Treasury securities by the second quarter of 2011. Exhibit No. ___ (RAB-3) at pp. 3-4 (also available at: http://www.federalreserve.gov/newsevents/press/monetary/20101103a.htm).

Beginning in September 2011, the Fed initiated a "maturity extension program" in which it sold or redeemed $667 billion of shorter-term Treasury securities and used the proceeds to buy longer-term Treasury securities. This program, also known as “Operation Twist,” was designed by the Fed to lower long-term interest rates and support the economic recovery.

QE3 began in September 2012 with the Fed announcing an additional bond purchasing program of $40 billion per month of agency mortgage backed securities. On June 19, 2013, the Federal Open Market Committee (“FOMC”) issued a press release indicating that it intended to extend "Operation Twist." In its press release, the Federal Reserve stated:

> To support a stronger economic recovery and to help ensure

> that inflation, over time, is at the rate most consistent with its dual mandate, the Committee decided to continue purchasing additional agency mortgage-backed securities at a pace of $40 billion per month and longer-term Treasury securities at a pace of $45 billion per month. The Committee is maintaining its existing policy of reinvesting principal payments from its holdings of agency debt and agency mortgage-backed securities in agency mortgage-backed securities and of rolling over maturing Treasury securities at auction. Taken together, these actions should maintain downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative.
>
> [Exhibit No. ___ (RAB-3) at pp. 5-6 (also available at: https://www.federalreserve.gov/newsevents/press/monetary/20130619a.htm).]

More recently, the Fed began to pare back its purchases of securities. For example, on January 29, 2014 the Fed stated that beginning in February 2014 it would reduce its purchases of long-term Treasury securities to $35 billion per month. The Fed continued to reduce these purchases throughout the year and in a press release issued October 29, 2014 announced that it decided to close this asset purchase program in October. Exhibit No. ___ (RAB-3) at pp. 7-8 (also available at: http://www.federalreserve.gov/newsevents/press/monetary/20141029a.htm).

Q. Since the Fed's announcements of scaling back and finally ending its purchases of long-term Treasury securities, what has the trend been in long-term Treasury yields from 2014 through 2016?

A. The yield on the 20-year Treasury bond has actually declined since the beginning of 2014. The January 2014 yield on the 20-year Treasury bond was 3.52%. Exhibit No. ___ (RAB-2). The closing yield for May 2016 was 2.22%, a decline of 130 basis points since January 2014. Exhibit No. ___ (RAB-2).

Q. Has the Fed recently indicated any important changes to its monetary policy?

A. Yes. Recently the Fed raised its target range for the federal funds rate to 1/4% to 1/2% from 0% to 1/4%. The Federal Reserve also issued a press release on March 16, 2016 stating that it would continue to maintain this target range at present. Exhibit No. ___ (RAB-3) at pp. 9-10 (also available at: http://www.federalreserve.gov/newsevents/press/monetary/20160316a.htm). This press release also stated:

> The Committee currently expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labor market indicators will continue to strengthen. However, global economic and financial developments continue to pose risks. Inflation is expected to remain low in the near term, in part because of earlier declines in energy prices, but to rise to 2 percent over the medium term as the transitory effects of declines in energy and import prices dissipate and the labor market strengthens further. The Committee continues to monitor inflation developments closely.
>
> Against this backdrop, the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent. The stance of monetary policy remains accommodative, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation.

Q. Why is it important to understand the Fed's actions with respect to monetary policy since 2007?

A. The Fed's monetary policy actions since 2007 were deliberately undertaken to lower interest rates and support economic recovery. The Fed's actions have been quite successful in lowering interest rates given that the 20-year Treasury Bond yield in June 2007 was 5.29% and the public utility bond yield was 6.34%. The U.S. economy is currently in a low interest rate environment that, in my opinion, will likely continue at least through this year. As I will demonstrate later in my testimony, low interest rates have also significantly lowered investors' required return on equity for the stocks of regulated utilities.

Q. Have recent developments reinforced the prevailing low interest rate environment?

A. Yes. Several central banks have implemented *negative* interest rates. Exhibit No. __ (RAB-3) at pp. 11-12 (noting that the Swiss National Bank set its benchmark interest rate at minus 0.75% and that nearly the entirety of Switzerland's yield curve was negative; yield curves for Japan and Germany are also provided showing negative interest rates for bonds with a duration of up to 10 years). Indeed, Federal Reserve Chairman Yellen has discussed the possibility of negative interest rates (available at: http://www.bloomberg.com/news/articles/2016-05-12/yellen-doesn-t-rule-out-negative-rates-in-letter-to-congressman (last visited July 2, 2016) (in written responses Thursday to questions from Representative Brad Sherman, Yellen said that "while I would not completely rule out the use of negative interest rates in some future very adverse scenario, policy makers would need to consider a wide range of issues before employing this tool in the United States, including the potential for unintended consequences.").

Q. Is NextEra Energy obtaining significant financing from outside of the U.S.?

A. Yes. *See* Exhibit No. ___ (RAB-4) at p. 5.

Q. Are current interest rates indicative of investor expectations regarding future policy actions by the Federal Reserve?

A. Yes. Securities markets are efficient and most likely reflect investors' expectations about future interest rates. As Dr. Roger Morin pointed out in *New Regulatory Finance:*

> A considerable body of empirical evidence indicates that U.S. capital markets are efficient with respect to a broad set of information, including historical and publicly available information.

I acknowledge that the U.S. economy is operating in a low interest rate environment. It is likely at some point in the near future that the Fed will raise short-term interest rates further. However, the timing and the level of any such move are not known at this time. It is important to realize that investor expectations of higher interest rates, if any, are already embodied in current securities prices, which include debt securities and stock prices.

The current low interest rate environment favors lower risk regulated utilities. As I shall demonstrate in Section III, market evidence indicates that investors require lower rates of return on equity on regulated utility stocks than many other types of enterprises. It would not be advisable for utility regulators to raise ROEs in anticipation of higher interest rates that may or may not occur.

Q. Please compare current financial market conditions with the conditions that were present during FPL's last rate case, Docket No. 1200015-EI.

A. When I submitted my Direct Testimony in July 2012, Treasury bond yields were 2.22%, virtually unchanged from their present levels. I noted in my testimony that the June 13, 2012 Moody's average public utility bond yield was 4.28%. As of June

13, 2016, Moody's average public utility bond yield was 3.90%, 38 basis points lower than 2012. Moreover, public utility bond yields have declined this year from the 4.62% yield in January.

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

A. The Value Line Investment Survey noted the following in its May 20, 2016 report on the Electric Utility (East) Industry:

> So far, 2016 has been an excellent year for electric utility stocks. Every issue we cover is up, year to date, and most have risen at a low double-digit pace. With interest rates as low as they are, some investors are reaching for yield. This is reflected in the high valuation of many electric company equities. Most are trading at a market premium, and have recent quotations within our 2019-2021 Target Price Range. The average dividend yield of this group is just 3.4%, which is low by historical standards. The average 3- to 5-year total return potential is just 3%, which is low by any standard.

Value Line also noted the following in its June 17, 2016 report on the Electric Utility (Central) Industry:

> Merger and acquisition activity (or speculation of deals) is just one factor in the strong performance of electric utility equities so far in 2016. The price of every issue under our coverage is up, year to date, and in most cases, the rise has been significant: between 10% and 20%. Another factor is the ongoing low-interest rate environment, and the belief that the Federal Reserve will be slow to raise rates. With minuscule returns available on savings accounts, CDs, and money-market funds, many income-oriented investors have reached for yield by putting money into utility stocks.
>
> As long as the interest-rate environment remains benign, this would be good for electric utility stocks. If interest rates are higher over the 3- to 5-year period, as we expect, that would probably be unfavorable for the equities in the group.

Q. Briefly describe FPL.

A. FPL is a wholly owned subsidiary of NextEra Energy, Inc. ("NextEra Energy"). NextEra Energy's other principal subsidiary is NextEra Energy Resources, which engages in the competitive energy business and produces its energy primarily from clean and renewable fuels. FPL's 2015 SEC Form 10-K noted that NextEra Energy is one of the largest electric power companies in North America, servicing over 5.3 million customers and having over 46,000 megawatts ("mW") of generating capacity in 27 states and 4 provinces in Canada. Exhibit No.__ (RAB-4) at p. 13. As of December 31, 2015, FPL's resources for serving load consisted of 26,073 mWs.

Q. How has FPL described its generation fleet?

A. On page 8 of its 2015 10-K report, FPL noted: "FPL relies upon a mix of fuel sources for its generation facilities, along with purchased power, in order to maintain the flexibility to achieve a more economical fuel mix by responding to market and industry developments." Exhibit No. ___ (RAB-4) at p. 14.

Q. How does FPL's generation fleet position it with regard to possible implementation of the Clean Power Plan or similar environmental regulation?

A. FPL derived approximately 69% of its 2015 Mwh produced from natural gas fired generating plants. Exhibit No. ___ (RAB-4) at p. 14. Compared to electric utilities that rely on coal-fired capacity, FPL's risk from carbon-based environmental rules and legislation is lower.

Q. How does FPL recover its fuel costs?

A. FPL collects fuel costs through a recovery mechanism approved by the Commission that enables the company to true-up differences between actual and projected costs.

Q. Is that the only tracker FPL enjoys?

A. No. In addition, FPL receives substantial benefits from a number of other cost recovery clauses that have been approved by the Commission over the years. The Company stated the following on page 12 of its 2015 10-K report:

> Cost recovery clauses, which are designed to permit full recovery of certain costs and provide a return on certain assets allowed to be recovered through the various clauses, *include substantially all fuel, purchased power and interchange expense, certain construction-related costs and conservation and certain environmental-related costs*. Cost recovery clause costs are recovered through levelized monthly charges per kWh or kW, depending on the customer's rate class. These cost recovery clause charges are calculated at least annually based on estimated costs and estimated customer usage for the following year, plus or minus true-up adjustments to reflect the estimated over or under recovery of costs for the current and prior periods. An adjustment to the levelized charges may be approved during the course of a year to reflect revised estimates. [Exhibit No. ___ (RAB-4) at p. 16 (emphasis added)].

Regarding the cost of compliance with environmental laws and regulations, FPL noted on page 13 of its 2015 10-K that the Company "expects to seek recovery through the environmental clause for compliance costs associated with any new environmental laws and regulations." *Id.* at p. 17.

With respect to capitalization, FPL's regulated utility operations are far less leveraged, and far less risky, than NextEra Energy's unregulated operations. As of December 31, 2015, FPL's utility operations were capitalized with 60.4% common equity compared to NextEra Energy's unregulated operations, which were supported by only 27.8% common equity. This information came from FPL's Schedule D-2.

Q. What else have ratings agencies stated about FPL's regulatory approach?

A. Following its discussion of the Commission's order on FPL's 2012 rate case, Fitch noted that "[w]hile the order spans a four-year term (till December 2016), *FPL could potentially delay filing a rate case for a longer period by proactively managing its costs*." Exhibit No. ____(RAB-5) at p. 2 (SFHHA 007530) (emphasis added).

Q. What has happened with respect to the credit rating of FPL since FPL's last base rate case?

A. In January 2014, Moody's upgraded the ratings of FPL, including its long term issue rating, to A1 from A2 with an outlook of stable. According to a Moody's Senior Vice President, "FPL is one of the strongest regulated electric utilities in the U.S. . . ." *See* FPL Response to OPC POD No. 12 (OPC 009813). "Because a high percentage of FPL's revenues are recovered through cost recovery clauses and its leverage is low, FPL's credit metrics are among the strongest in the utility sector . . . ." *Id.*

Q. What else has happened since FPL's last base rate case that signals increased confidence in FPL's ability to maintain or grow its earnings?

A. In August 2015, NextEra Energy announced its intention to increase its proportion of dividend payouts, from 55% in 2014 to 65% in 2018. Exhibit No. ____(RAB-5) at p. 27 (OPC 009881).

Q. Does FPL's messaging to investors about its service territory support an increased payout ratio?

A. According to an investor presentation provided in June 2016, NextEra states that FPL "is one of the best utility franchises in the U.S." Exhibit No. ___ (RAB-4) at p. 9.

Q. Do the rating agencies have a comparable outlook regarding FPL's service territory?

A. Fitch's November 2015 credit report states:

> Florida's economy is recovering well after the recent prolonged recession, with most key indicators such as housing starts, employment statistics and consumer sentiment on an upward trend. Adjusted for weather, FPL's retail kilowatt hour sales grew 1.3% in 2014, driven by 1.2% customer growth and 0.1% usage increase. Fitch's financial forecasts for FPL are based on a 1% cumulative annual growth rate in retail sales over 2015-2018; any upside in sales growth would be positive for FPL's credit metrics.

See Exhibit No. ___ (RAB-5) at p. 4 (OPC 009887).

Q. How is FPL's capital structure described by the credit rating agencies?

A. According to Moody's, FPL's "debt-to-capitalization of 30.4% at 31 December 2015 is among the lowest in its peer group . . . ." FPL Response to OPC POD No. 12 at OPC 009810.

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

A. FPL's senior secured ratings are A by Standard & Poor's ("S&P") and Aa2 by Moody's. These are basically the same bond ratings that the Company had during its last base rate case before this Commission, although Moody's rating actually improved from Aa3 in 2012.

Q. What commentary accompanies these ratings of extremely high credit quality?

A. In its March 31, 2016 report on FPL, Moody's noted that FPL is "one of the strongest regulated utilities in the US" with "good cost recovery mechanisms that produce consistently above-average financial performance." FPL Response to OPC POD No. 12 at OPC 009807.

According to Moody’s, “FPL has some of the strongest cash flow metrics in the US utilities sector, because a high degree of its revenues is recovered through cost recovery clauses and it is well capitalized . . . These metrics are strongly positioned for the company’s current rating category.” FPL Response to OPC POD No. 12 at OPC 009809.

S&P found FPL's business risk is "excellent" in its June 15, 2015 report on the Company. This is the category for enterprises with the lowest level of business risk according to S&P. Standard and Poor's noted that it attributed "significantly higher business risk" to NextEra Energy 's non-utility operations compared to its regulated utility operations (Exhibit No. ___ (RAB-5) at p. 10 (OPC 009834)), meaning that NextEra Energy has higher business risk overall than FPL.

Q. How does FPL's capital structure compare to that of its owner, NextEra Energy?

A. With respect to capitalization, FPL's regulated utility operations are far less leveraged, and thus involve much less financial risk, than NextEra Energy's unregulated operations. As of December 31, 2015, FPL's utility operations were capitalized with 60.4% common equity compared to NextEra Energy's unregulated operations, supported by only 27.8% common equity. These numbers are based on FPL's Schedule D-2. Yet, FPL's utility operations also have far less business risk than NextEra Energy's other operations as well.

Q. What does S&P's outlook say?

A. S&P states that:

> Our rating outlook on NextEra and its subsidiaries is stable and reflects a business risk profile that is equally affected by higher-risk merchant energy activities and a utility that still presents a better credit profile than its peers. [Exhibit No. ___ (RAB-5) at p. 41 [SFHHA 007583]; *id.* at p. 49 [SFHHA 007592]].

Q. Are those the only statements highlighting the difference in risks between FPL and other NextEra Energy investments?

A. No. S&P notes that while the "[r]egulated utility operations have low business risk and support the overall credit profile," "[n]on-utility operations are primarily engaged in unregulated power generation and materially increase business risk." Exhibit No. ___ (RAB-5) at p. 8 (OPC 009832).

Q. Is there additional credit rating agency analysis of the difference between the risk of FPL and its NextEra Energy affiliates?

A. Yes.

> NextEra's regulated utility operations have low business risk and provide about 60% of consolidated operating income, lending support to the company's overall business risk profile within the “strong” category. The regulated business is conducted through Florida Power & Light (FPL) and benefits from operations under a constructive regulatory framework that provides for timely investment and fuel cost recovery. FPL has historically managed its regulatory risk effectively and this has resulted in earned returns that are consistently close to or at the authorized levels. The customer base is large with no meaningful industrial exposure and demonstrates above-average growth. The company has material exposure to natural-gas-fired generation, which, in combination with low natural gas prices and the company’s efficient operations, contributes to overall competitive customer rates.
>
> The company’s non-utility operations are conducted under NextEra Energy Capital Holdings Inc. (NEECH). We ascribe significantly higher business risk to these non-utility operations compared to the regulated utility operations because they focus largely on unregulated generation, both merchant and contracted, with an emphasis on renewable energy projects and to a lesser extent on fossil-fired and nuclear generation. Integral to our view of NextEra’s business risk profile as “strong” is that all merchant generation projects that are financed in a nonrecourse manner provide NextEra with only residual cash flows, an arrangement that we view as inherently weaker compared to NextEra having full access to all project cash flows. NextEra’s non-utility operations also engage in proprietary trading and marketing as well as retail supply and wholesale full requirements contracts, businesses which can have significant liquidity needs and are generally characterized by small margins on a per unit basis, relying on large volumes to generate a meaningful contribution. Moreover, these operations require excellent risk management and disciplined hedging practices to limit a company’s exposure to the fluctuation in commodity prices. [Exhibit No. ___ (RAB-5) at p. 10 (OPC 009834)].

Q. Does Fitch’s link FPL’s credit ratings to that of NextEra Energy?

A. Yes. Fitch's observed that with regard to potential "Positive Rating Action," "Given strong rating linkage with its parent company, NextEra Energy Inc. . . . future positive rating actions appear unlikely." Exhibit No. ___ (RAB-5) at p. 5 (OPC 009888).

Fitch's also noted that NextEra Energy's "continued shift away from merchant businesses toward regulated investments and contracted non-regulated renewable assets is also supportive of its credit profile." Exhibit No. ___ (RAB-5) at p. 2 (SFHHA 007530).

Finally, Fitch's states that if "parent [NextEra Energy] increases its debt leverage or changes its corporate strategy such that its risk profile materially worsens, it could adversely affect *FPL's ratings* . . . ." Exhibit No. ___ (RAB-5) at p. 3 (SFHHA 007531) (emphasis added).

Q. What does S&P say about the impact of FPL's affiliates upon their affiliates' ratings.

A. S&P states that:

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

> quality, in our view.
>
> We characterize FP&L's business risk profile as “excellent,” NextEra’s business risk profile as “strong,” and the consolidated financial risk profile as “intermediate” under our criteria.
>
> * * * *
>
> NER, the main subsidiary under unregulated NextEra Energy Capital Holdings Inc., engages in electric generation, marketing, and trading throughout the U.S. NER’s focus is on geographic and fuel diversity and on developing environmentally advantageous facilities that benefit from public policy trends. The merchant generator's capacity of almost 16,600 MW consists of more than half wind turbines, one-quarter natural-gas-fired stations, and the rest mainly nuclear facilities. More than three-quarters of the wind projects and almost 60% of the total portfolio operate under largely fixed-price, long-term contracts. The rest of the portfolio, including one nuclear plant, is merchant capacity that can be exposed to market prices for its output. While a policy of actively hedging the commodity price risk of plant inputs and outputs helps to reduce the risks associated with merchant energy activities, NER faces an inherent level of commodity price risk. In addition, NER’s extensive project financing (approximately 46% of installed capacity) of its assets diminishes its cash flow quality, but this is offset by lower financial risk. NER’s risks permanently hinder NextEra’s credit quality, especially in light of the influence that marketing and high-risk proprietary trading results have on NER’s earnings and cash flows. [Exhibit No. ___ (RAB-5) at pp. 33-34 (SFHHA 007574-75) (emphasis added)].

Q. Does NextEra Energy’s group credit profile affect FPL?

A. Yes. S&P states:

> FPL is subject to our group rating methodology criteria. We assess FPL as a “core” subsidiary of NextEra because it . . . . is closely linked to the parent’s reputation. As a result, the issuer credit rating on FPL is ‘A-‘, in line with the ‘a-’ group credit profile of NextEra. [Exhibit No. ___ (RAB-5) at p. 58 (OPC 008063)].

Q. Is there another reason why FPL's credit rating and NextEra Energy's credit rating are linked?

A. Yes. S&P explains that:

> We assess the status of NextEra's subsidiaries, Florida Power & Light Co. and NextEra Energy Capital Holdings, Inc., as core subsidiaries . . . . Because there are no structural or regulatory insulation provisions in place that could restrict NextEra's access to the assets and cash flow of its subsidiaries, the issuer credit rating on each subsidiary is 'A-', based on the group credit profile of NextEra. [Exhibit No. ___ (RAB-5) at pp. 64-65 (OPC 008151-52)].

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

A. FPL remains a low cost and low risk electric utility with strong A/A ratings.

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

Further, as I mentioned earlier, current interest rates are at or near historic lows. Although the Fed may increase interest rates later this year, I expect the Fed to support the current low interest rate environment in order to foster economic growth. This interest rate environment supports lower expected returns from investors and my ROE analysis in the next section of my testimony will demonstrate that this is the case.

III. DETERMINATION OF FAIR RATE OF RETURN

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

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

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

A. Generally speaking, the estimated cost of equity should be comparable to the returns of other firms with similar risk and should be sufficient for the firm to attract capital. These are the basic standards set out by the United States Supreme Court in *Federal Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591 (1944) and *Bluefield W.W. & Improv. Co. v. Public Service Comm'n,* 262 U.S. 679 (1922).

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

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

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

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

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

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

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

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

<u>Discounted Cash Flow ("DCF") Model</u>

Q. Please describe the basic DCF approach.

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

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

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

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

$$k = {}^{D_1}/_{P_0} + g$$

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

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

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

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

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

A. I used several criteria to select a comparison group. First, using the June 2016 issue of AUS Utility Reports, I selected electric companies whose bonds were rated at least A by Moody's and/or Standard and Poor's. FPL currently carries senior secured bond ratings of A from S&P and Aa2 from Moody's, so using the either/or criterion for an A rating assures that the companies in the comparison group carry bond ratings that are similar to FPL.

From that group, I selected companies that had at least 50% of their revenues from electric operations and that had long-term earnings growth forecasts from Value Line and either Zacks Investment Research ("Zacks") or Thomson Financial. I will describe Zacks and Thomson Financial later in my testimony. From this group, I then eliminated companies that had recently cut or eliminated dividends, or were recently or currently involved in significant merger activities.

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

TABLE 1
COMPARISON GROUP

	Company	S&P Bond Rating	Moody's Bond Rating
1	ALLETE, Inc. (NYSE-ALE)	A-	A3
2	Alliant Energy Corporation (NYSE-LNT)	A-	A2/A3
3	Avista Corporation (NYSE-AVA)	A-	Baa1
4	Consolidated Edison, Inc. (NYSE-ED)	A-/BBB+	A3
5	Edison International (NYSE-EIX)	BBB+	A2/A3
6	Eversource Energy (NYSE-ES)	A-	A3/Baa1
7	IDACORP, Inc. (NYSE-IDA)	A-	A3
8	NorthWestern Corporation (NYSE-NWE)	NR	A3
9	OGE Energy Corp. (NYSE-OGE)	BBB+	A3
10	Portland General Electric Company (NYSE-POR)	A-	A3
11	Wisconsin Energy Corporation (NYSE-WEC)	A-/BBB+	A1/A2
12	Xcel Energy Inc. (NYSE-XEL)	A-	A3

Source: AUS Monthly Utility Report, June 2016

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

A. I first determined the current dividend yield, D_1/P_0, from the basic equation. My general practice is to use six months as the most reasonable period over which to estimate the dividend yield. The six-month period I used covered the months from December 2015 through May 2016. I obtained historical prices and dividends from Yahoo! Finance. The annualized dividend divided by the average monthly price represents the average dividend yield for each month in the period.

The resulting average dividend yield for the group is 3.44%. These calculations are shown in Exhibit No. ___ (RAB-6).

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

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

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

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

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

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

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

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

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

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

A. Exhibit No. ___ (RAB-7) presents the Value Line, Zacks, and Thomson Financial forecasted growth estimates. These earnings and dividend growth estimates for the comparison group are summarized on Columns (1) through (5) of Exhibit No. ___ (RAB-7).

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

The sustainable growth method is calculated using the following formula:

$$G = B * R$$

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

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

The expected sustainable growth estimates for the comparison group are presented in Column (3) on page 1 of Exhibit No. ___ (RAB-7). The data came from the Value Line forecasts for the comparison group.

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

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

The expected growth rates produced from these two methods fall in a range from 3.75% to 6.00%.

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

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

I then added the expected growth rates to the expected dividend yield. The calculations of the resulting DCF returns on equity for both methods are presented on Exhibit No. ____ (RAB-7), page 2.

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

A. Exhibit No. ___ (RAB-7) presents the DCF results utilizing the two different methods I described earlier. I used the Value Line earnings and dividend growth forecasts and the consensus analysts' forecasts. Using the average group growth rate in Method 1, the DCF results range from 8.15% to 9.50%, with an average ROE for the group of 8.64%. For Method 2, which employs median growth rates, the DCF results range from 8.52% to 9.54%, with an average ROE of 8.87%.

<u>Capital Asset Pricing Model</u>

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

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

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

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

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

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

This equation tells us about the risk/return relationship posited by the CAPM. Investors are risk averse and will only accept higher risk if they expect to receive higher returns. These returns can be determined in relation to a stock's beta and the market risk premium. The general level of risk aversion in the economy determines the market risk premium. If the risk-free rate of return is 3.0% and the required return on the total market is 15%, then the risk premium is 12%. Conceptually, any stock's required return can be determined by multiplying its beta by the market risk premium. Stocks with betas greater than 1.0 are considered riskier than the overall market and will have higher required returns. Conversely, stocks with betas less than 1.0 will have required returns lower than the market as a whole.

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

A. Yes. There is some controversy surrounding the use of the CAPM.[1] There is evidence that beta is not the primary factor for determining the risk of a security. For example, Value Line's "Safety Rank" is a measure of total risk, not its calculated

1 For a more complete discussion of some of the controversy surrounding the use of the CAPM, refer to *A Random Walk Down Wall Street* by Burton Malkiel, pp. 206 - 211, 2007 edition.

beta coefficient. Beta coefficients usually describe only a small amount of total investment risk.

There is also substantial judgment involved in estimating the required market return. In theory, the CAPM requires an estimate of the return on the total market for investments, including stocks, bonds, real estate, etc. It is nearly impossible for the analyst to estimate such a broad-based return. Often in utility cases, a market return is estimated using the S&P 500 or the return on Value Line's stock market composite. However, these are limited sources of information with respect to estimating the investor's required return for all investments. In practice, the total market return estimate faces significant limitations to its estimation and, ultimately, its usefulness in quantifying the investor required ROE.

In the final analysis, a considerable amount of judgment must be employed in determining the risk-free rate and market return portions of the CAPM equation. The analyst's application of judgment can significantly influence the results obtained from the CAPM. My past experience with the CAPM indicates that it is prudent to use a wide variety of data in estimating investor-required returns. Of course, the range of results may also be wide, indicating the difficulty in obtaining a reliable estimate from the CAPM.

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

A. The first source I used was the Value Line Investment Analyzer, Plus Edition, for June 12, 2016. This edition covers several thousand stocks. The Value Line Investment Analyzer provides a summary statistical report detailing, among other things, forecasted growth rates for earnings and book value for the companies Value Line follows as well as the projected total annual return over the next 3 to 5 years. I present these growth rates and Value Line's projected annual return on page 2 of Exhibit No. ___ (RAB-8). I included median earnings and book value growth rates. The estimated market returns using Value Line's market data range from 9.88% to 11.0%. The average of these two market returns is 10.44%.

Q. Why did you use median growth rate estimates rather than the average growth rate estimates for the Value Line companies?

A. Using median growth rates is likely a more accurate method of estimating the central tendency of Value Line's large data set compared to the average growth rates. Average earnings and book value growth rates may be unduly influenced by very high or very low 3 - 5 year growth rates that are unsustainable in the long run. For example, Value Line's Statistical Summary shows both the highest and lowest value for earnings and book value growth forecasts. For earnings growth, Value Line showed the highest earnings growth forecast to be 98% and the lowest growth rate to be -30.7%. The highest book value growth rate was 73.5% and the lowest was -40.0%. None of these levels of growth is compatible with long-run growth prospects for the market as a whole. The median growth rate is not influenced by such extremes because it represents the middle value of a very wide range of earnings growth rates.

Q. Please continue with your market return analysis.

A. I also considered a supplemental check to the Value Line projected market return estimates. Morningstar publishes a study of historical returns on the stock market in its *Ibbotson SBBI 2015 Classic Yearbook*. Some analysts employ historical data to estimate the market risk premium of stocks over the risk-free rate. The assumption is that a risk premium calculated over a long period of time is reflective of investor expectations going forward. Exhibit No. ___ (RAB-9) presents the calculation of the market returns using the historical data.

Q. Please explain how this historical risk premium is calculated.

A. Exhibit No. ____ (RAB-9) shows both the geometric and arithmetic average of yearly historical stock market returns over the historical period from 1926 - 2014. The average annual income return for 20-year Treasury bond is subtracted from these historical stocks returns to obtain the historical market risk premium of stock returns over long-term Treasury bond income returns. The historical market risk premium range is 5.03% - 7.03%.

Q. Did you add an additional measure of the historical risk premium in this case?

A. Yes. Morningstar reported the results of a study by Dr. Roger Ibbotson and Dr. Peng Chen indicating that the historical risk premium of stock returns over long-term government bond returns has been significantly influenced upward by substantial growth in the price/earnings ("P/E") ratio for stocks from 1980 through 2001.[2] Morningstar recommended adjusting this growth in the P/E ratio for stocks out of the

2 *2015 Ibbotson SBBI Classic Yearbook,* Morningstar, pp. 156 - 158.

historical risk premium because "it is not believed that P/E will continue to increase in the future." Morningstar's adjusted historical arithmetic market risk premium is 6.19%, which I have also included in Exhibit No. ___ (RAB-9).

Q. Mr. Baudino, you testified that you used the SBBI 2015 Yearbook. Does Morningstar still publish the SBBI Yearbook?

A. No. Morningstar discontinued publication of the SBBI Yearbook this year. However, I present the analyses in Exhibit No. ___ (RAB-9) as additional information and perspective with respect to historical risk premiums of common stocks over long-term Treasury bonds.

Q. How did you determine the risk free rate?

A. I used the average yields on the 20-year Treasury bond and five-year Treasury note over the six-month period from December 2015 through May 2016. The 20-year Treasury bond may be used as a proxy for the risk-free rate, but it contains a significant amount of interest rate risk. The five-year Treasury note carries less interest rate risk than the 20-year bond and is more stable than three-month Treasury bills. Therefore, I have employed both of these securities as proxies for the risk-free rate of return. This approach provides a reasonable range over which the CAPM return on equity may be estimated.

Q. How did you determine the value for beta?

A. I obtained the betas for the companies in the electric distribution group from the most recent Value Line reports. The average of the Value Line betas for the comparison group is 0.73.

Q. Please summarize the CAPM results.

A. For my forward-looking CAPM return on equity estimates, the CAPM results are 8.03% - 8.28%. Using historical risk premiums, the CAPM results are 6.02% - 7.49%.

<u>Conclusions and Recommendations Regarding Authorized ROE</u>

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

A. I recommend that the Commission adopt the DCF model I developed and the cost of equity estimates for the comparison group of electric utility companies that I compiled. Table 2 below summarizes the results of my ROE analyses.

TABLE 2
SUMMARY OF ROE ESTIMATES

Baudino DCF Methodology:	
Average Growth Rates	
- High	9.50%
- Low	8.15%
- Average	8.64%
Median Growth Rates:	
- High	9.54%
- Low	8.52%
- Average	8.87%
CAPM:	
- 5-Year Treasury Bond	8.03%
- 20-Year Treasury Bond	8.28%
- Historical Returns	6.02% - 7.49%

The results for the electric company comparison group averages using the constant-growth DCF model and the expected growth rate forecasts ranged from 8.64% to 8.87%. Based on this range of results, I recommend that the Commission adopt a 9.00% return on equity for FPL in this proceeding. Based on a comparison of current bond ratings, FPL is a lower risk utility company relative to my comparison group. Nonetheless, for purposes of the ROE ranges I recommend, I am placing FPL at the top of the range and rounding upward to 9.0%. I offer this recommendation to the Commission as a just and reasonable estimate of investor return on equity requirements for a lower risk electric utility such as FPL.

Finally, it should be noted that the CAPM results are significantly lower than the DCF results in this proceeding. This is the case with both the forward-looking and the historical versions of the CAPM. I do not rely on the CAPM for my ROE recommendation, but these results suggest that my recommended ROE of 9.00% is reasonable, even generous, based on current capital market conditions.

Capital Structure

Q. Please explain what a capital structure is and how it affects a utility's rates.

A. A utility's capital structure consists of the percentages of debt, equity or other financial components that are used to finance a utility's investments. Equity and debt are two primary components for a capital structure and affect a utility's costs and rates in different ways.

Utilities are permitted an allowed return on common equity by regulatory commissions. Those returns are not tax deductible and an income tax gross-up is added to the calculated equity return. Therefore, equity financing is more expensive than debt financing when income taxes are considered. In this proceeding, for example, FPL's debt cost rate is 4.62% and its requested cost of equity, including the proposed performance adder, is 11.50%. Using the Company's gross-up factor of 1.63, the gross-up cost of equity is 18.75%. FPL's grossed-up requested cost of equity, then, is 400% greater than its cost of debt.

In addition, from the investors' perspective, equity investment is more risky than debt investment. Thus, equity investors require a higher return than debt investors to compensate them for the additional risks that they incur.

Selecting a utility's capital structure for ratemaking purposes involves balancing different considerations. Two extreme examples may help illustrate those considerations. If a utility were completely financed by equity, the utility would not have any leverage and would therefore be less risky. However, its overall rate of return, and therefore costs to consumers, would be higher because its capital structure would consist completely of higher cost equity. In this example, the manner in which the utility financed its rate base results in unreasonable and burdensome costs for ratepayers.

On the other hand, if a utility was completely financed by debt, the utility would experience a high amount of financial risk and the utility's cost of debt would substantially increase. In both of these examples, ratepayers would not be well served by the utility's management of its capital structure.

Setting a utility's target capital structure involves balancing the risk of using lower cost debt against the cost of equity financing, including both the actual cost of equity and the tax implications. A utility and its regulator must consider the risks and costs of various capitalization ratios to ensure that ratepayers are provided with a prudent capitalization ratio at the least overall cost.

Q. Do the incentives of regulated and unregulated enterprises differ when it comes to capital structures?

A. FPL has acknowledged that there is a distinction between rate regulated entities and unregulated entities. Exhibit No. ___ (RAB-10) at p. 8 (Tr. at 459). FPL has acknowledged that if an unregulated enterprise substitutes more debt in lieu of a thicker equity component, earnings per share would increase because of spreading such earnings over a smaller equity base. Exhibit No. ___ (RAB-10) at p. 5 (Tr. at 456:14-21).

However, if within FPL's capital structure existing equity was replaced with debt, earnings per share of FPL would not automatically increase, in contrast to unregulated entities. Exhibit No. ___ (RAB-10) at p. 8 (Tr. at 459:6-10).

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

A. Yes. The Company's requested capital structure and weighted cost of capital is presented in Schedule D-1A and is supported by the Direct Testimony of FPL witnesses Hevert and Dewhurst. On page 23 of his Direct Testimony, Mr. Dewhurst recommended an equity ratio of 59.6% based on investor sources of capital. Mr. Dewhurst states that FPL has maintained its equity ratio at around 59% - 60% for "well over a decade". On lines 14 through 16, Mr. Dewhurst testified that "the current equity ratio will continue to support FPL's strong financial position and the benefits its provides to customers."

Q. When asked during discovery in this case to produce written documentation from NextEra Energy or FPL over the last 4 years discussing capital structures, how many documents were produced?

A. None. Exhibit No. ___ (RAB-5) at p. 68 (Response to OPC POD No. 35).

003103

Q. What is FPL's position concerning capitalization structure?

A. FPL claims that FPL's current financial policies, including its capitalization, resulted in customers enjoying "a low total cost of capital" (Dewhurst Direct at 9:1). Yet FPL has no documents regarding how "increasing, decreasing or maintaining FPL's equity ratio would affect its 'total cost of capital.' " Exhibit No. ___ (RAB-5) at p. 69 (Response to SFHHA POD No. 62).

FPL Witness Dewhurst also claims that FPL's financial policies, including its capitalization, "resulted in an excellent credit rating." Dewhurst Direct at 16:7-9. Yet, when asked in discovery to provide "all documents prepared by or for FPL in the past four years but prior to March 15, 2016 that discuss or analyze how FPL's equity ratio affected its credit ratings," FPL could not provide any responsive documents. Exhibit No. ___ (RAB-5) at p. 70 (Response to SFHHA POD No. 65).

Q. As you described earlier, there is a tradeoff between cost and risk that must be considered when selecting a utility's capital structure. How has FPL documented its analysis of that trade off?

A. In discovery, FPL admitted that it had no "documents prepared by or for FPL in the past four years but prior to March 15, 2016 that discuss the costs and benefits of FPL maintaining its current credit rating" or "improving FPL's financial strength." Exhibit No. ___ (RAB-5) at pp. 72-73 (Responses to SFHHA POD Nos. 66 and 67).

Q. Did FPL provide any documents, created prior to filing this rate case, that described FPL's target capital structure?

A. No. Exhibit No. ___ (RAB-5) at p. 74 (Response to SFHHA POD No. 60).

Q. Did FPL provide any analysis, performed prior to filing the instant rate case, of the costs and benefits of maintaining FPL's credit ratings?

A. No. Exhibit No. ___ (RAB-5) at p. 73 (Response to SFHHA POD No. 67).

Q. Did FPL provide any analysis, performed prior to filing this rate case, concerning whether changing or retaining FPL's equity ratio would affect its total cost of capital?

A. No. Exhibit No. ___ (RAB-5) at p. 75 (Response to SFHHA POD No. 62).

Q. Did FPL provide any documents, prepared before filing this case, that analyzed how FPL's equity ratio affected its "financial strength" or access to capital?

A. No. Exhibit No. ___ (RAB-5) at p. 76 (Response to SFHHA POD No. 64).

Q. Did FPL document any analysis of how FPL's equity ratio affected its credit ratings?

A. No. Exhibit No. ___ (RAB-5) at p. 70 (Response to SFHHA POD No. 65).

Q. How many other vertically-integrated utilities did FPL identify as having an approved equity ratio equivalent to that of FPL based on investor-sourced funds?

A. None. Exhibit No. ___ (RAB-5) at pp. 77-78 (Responses to FIPUG Int. No. 3 and FIPUG POD No. 2).

Q. Did FPL adequately consider how other utilities finance their operations?

A. No. FPL Witness Dewhurst claimed that FPL "employed a balanced capital structure consistent with other financially strong utilities." However, when asked in discovery to "provide FPL's study of the capital structures employed by 'other financially strong utilities' ", FPL could not provide any analyses. Exhibit No. ___ (RAB-5) at p. 79 (Response to SFHHA POD No. 61).

FPL also failed to conduct any studies "that compare the financial strength of FPL to that of other U.S. electric utilities." Exhibit No. ___ (RAB-5) at p. 80 (Response to SFHHA POD No. 63).

Q. Mr. Baudino, is FPL's proposed proportion of investor-sourced capitalization composed of equity comparable to that of the companies in your comparison group?

A. No. The Company's proposed proportionate share composed of equity is significantly higher than that used by the companies in my comparison group. Table 3 below presents the common equity ratios for my comparison group. I obtained the data from the most recent Value Line Investment Survey reports and from AUS Utility Reports, June 2016.

TABLE 3
Comparison Group Capital Structure

	Value Line 2015 Common Equity	AUS Common Equity
ALLETE, Inc.	53.7%	54.1%
Alliant Energy Corp.	51.4%	48.3%
Avista Corporation	50.0%	50.3%
Consolidated Edison, Inc.	52.1%	48.2%
Edison International	46.7%	44.8%
Eversource Energy	53.6%	50.4%
IDACORP, Inc.	54.4%	52.4%
NorthWestern Corp.	46.9%	45.2%
OGE Energy	55.7%	53.9%
Portland General Electric	52.2%	51.0%
WEC Energy	48.6%	46.9%
Xcel Energy Inc.	45.9%	43.3%
Averages	50.9%	49.1%

Sources: Value Line Investment Survey, AUS Utility Monthly Reports

It is abundantly clear from Table 3 that FPL's equity ratio greatly exceeds the comparison group equity ratio. In fact, none of the companies has an equity ratio near 60%, the highest being OGE Energy at 55.7%.

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

A. In my opinion, it does not. The utilities in my comparison have similar bond ratings to FPL and have much lower common equity ratios. In my view, this suggests that FPL could materially reduce its equity ratio and very likely be able to maintain an A/A bond rating.

Furthermore, FPL Witness Dewhurst's comparison group of regulated utilities in Southeast States have authorized equity ratios that range from approximately 43% to just 54%. Exhibit No. ___ (RAB-5) at pp. 81-82 (Response to Staff ROG No. 146, Attachment No. 1).

Likewise, the average capital structure for Mr. Hevert's proxy group of utilities is 53%, slightly higher than my comparison group but very far below FPL's requested common equity ratio of nearly 60%.

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

A. Yes. One concern is that the excessive FPL common equity ratio means that ratepayers are subsidizing NextEra Energy's unregulated affiliate activities. It is unlikely that NextEra Energy would be able to support and maintain a single 'A' credit rating on a corporate-wide basis without the support of an excessive FPL common equity ratio because NextEra Energy Resources is extremely highly leveraged. And, as I noted in Section II of my Direct Testimony, NextEra Energy 's unregulated operations are financed with only 27% common equity. The materials quoted in Section II above indicate that FPL's credit rating is linked to that of NextEra Energy. NextEra Energy's credit rating is a function of the higher-risk, higher-leverage non-retail electric service operations, and of FPL's lower risk, modestly leveraged, retail electric service operations.

Second, debt financing for investment-grade enterprises with FPL's characteristics are at, or near, historic lows. FPL should have more fully analyzed the potential for capital cost savings to ratepayers. As shown above FPL has not done that in any form that regulators or customers can review and conclude that the Company made a series of sound choices to provide service at the lowest reasonable cost.

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

A fourth reason relates to the efficient use of society's scarce capital resources. A 60% common equity ratio imposes higher than necessary capital costs, when the same productivity and output could be achieved with a less costly set of inputs. This approach is economically inefficient from the perspective of producing the same output at a lower total overall cost to society.

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

A. In this proceeding, I recommend that the Commission adopt a common equity ratio for FPL of 55%. The highest single common equity ratio in my comparison group is 55%. FPL had a 55% equity component in 2014 as described above. The Hevert comparison group has an overall average capital structure of 53% equity, and my comparison group has an average equity component of approximately 50% of average capital structure. My recommended common equity ratio of 55% is quite liberal and certainly reasonable compared to FPL's 60% common equity ratio.

Q. Didn't you accept FPL's common equity ratio in Docket No. 1200015-EI?

A. Yes, I did. However, I also testified in that docket that it would have been reasonable to reduce the Company's excessive common equity ratio in that case and that the Commission declined to accept my recommendation to reduce the Company's common equity ratio in the last base rate case Order in 2009.

In this docket, I recommend that the Commission focus on reducing FPL's common equity ratio. Equity financing is by far the most expensive form of financing for the Company. At a 9.0% return on equity, the pretax return equates to a pretax cost of 14.7% using a tax gross-up factor of 1.63. This is the return ratepayers must pay to finance the Company's rate base. The Company's current cost of long-term debt is 1,000 basis points lower, at 4.62%, obviously a far lower cost of financing than 14.7%. This disparity in cost between equity and debt is even greater -- approximately 1400 basis points -- if FPL’s recommended ROE were to be implemented. Thus equity under either ROE is at least 3 to 4 times as expensive as debt. Of course, FPL cannot finance its entire rate base with debt and must use common equity in order to reduce its financial risk and generate cash coverages to maintain its A/A bond rating. However, it is clear that FPL does not need a 60% common equity ratio to generate an A bond rating. Setting the Company's equity ratio at **55%** represents a fair balance between FPL's ratepayers and its financial integrity.

Q. In FPL's last rate case, did Company witnesses cite PPAs as support for having a higher common equity ratio?

A. Yes. Mr. Dewhurst noted on page 28, line 20 through page 29, line 17 of his Rebuttal Testimony in Docket No. 120015-EI that rating agencies make adjustments to a utility's capital structure in evaluating financial risk. Mr. Dewhurst testified that S&P imputed $922 million of the Company's PPAs as debt when evaluating FPL's financial strength.

Q. Did either Mr. Dewhurst or Mr. Hevert cite FPL's PPAs as a reason for maintaining the Company's common equity ratio at nearly 60% in this proceeding?

A. No.

Q. Has there been a reduction in FPL's PPA obligation since the last rate case?

A. Yes. FPL's 2012 Form 10-K noted on page 113 that the Company was obligated under take-or-pay purchased power contracts with the Jacksonville Electric Authority ("JEA") and with subsidiaries of the Southern Company to pay for approximately 1,330 mWs annually through 2015 and 375 mWs thereafter through 2021. For the year ending December 31, 2011, FPL stated that annual capacity charges its PPA contracts were $511 million.

For the year ending December 31, 2015, NextEra Energy 's 2015 10-K report noted on page 118 that its PPA obligations were for only 375 mWs through 2021, or about

28% of the level in 2011. This reflects the expiration of a substantial portion of FPL's PPAs since 2012. FPL reported that capacity charges under the PPAs were $434 million in 2015. However, the Company forecasted a substantial reduction in these charges, with $185 million in 2016 declining to $110 million in 2020.

Q. Given the substantial decline in FPL's PPA obligations, should the Commission continue to allow FPL a 60% common equity ratio?

A. No, given the change in circumstances since 2012.

Q. If the Commission decides to authorize a ROE greater than your recommended 9.0%, should your 55% equity ratio be adjusted?

A. Yes. If the Commission authorizes a ROE greater than 9.0%, I recommend that FPL's equity ratio be lowered. The Commission could lower the Company's equity ratio to 53%, which is the average common equity ratio of Mr. Hevert's proxy group of companies. This is certainly a reasonable, even generous, equity percentage considering that the average equity ratio for my comparison group of companies is 50%.

Cost of Debt

Q. Did you examine FPL's requested cost of long-term debt?

A. Yes, I did. On page 24 of his Direct Testimony, lines 10 through 13, Mr. Dewhurst testified that the Company projected its long-term debt cost by relying on the Blue Chip Financial Forecast. Cost projections were presented in MFR D-8. For the 2017 test year, the Company included two new issues of First Mortgage Bonds with assumed coupon rates of 6.16%. For the year 2018 the Company included two additional new issues of First Mortgage Bonds with assumed coupon rates of 6.50%.

Q. Are these assumed coupon rates for 2017 and 2018 reasonable?

A. No, they are not. Given current long-term debt rates for A-rated utilities, coupon rates from 6.16% to 6.50% are grossly inflated and should be rejected by the Commission.

Q. What have the recent yields been for A-rated utility bonds in 2016?

A. According to the Mergent Bond Record, A-rated utility bond yields ranged from 3.93% in May to 4.27% in January. Moody's reported that as of June 10, 2016 A-rated utility bond yields were 3.75%.

Although the Blue Chip Financial Forecasts may be forecasting higher future interest rates in 2017 and 2018, there is absolutely no reason to adopt forecasts that are excessively higher than today's current utility bond yields. Forecasts of future interest rates may never come to pass and in that eventuality, ratepayers would be forced to support inflated debt costs.

Q. What is your recommended cost of long-term debt for FPL's forecasted debt issues in 2017 and 2018?

A. I recommend that the Commission authorize a cost of debt of 4.1% for FPL's forecasted debt issues.

My recommendation is based on the highest yield for A-rated debt this year. As I stated previously, the yield on A-rated utility debt in June is 3.75%. Thus, my recommended yield of 4.10% allows for a 35 basis point increase in the current A-rated bond yield.

Q. How would financing debt in 2017 at FPL's projected interest rates compare to financing debt at current rates?

A. Presuming the need for $950 million in debt in 2018, it is obvious that financing it now rather than running the risk of incurring interest rates of 6.16% - 6.50% would benefit ratepayers.

Assume, for example, that FPL obtains an interest rate of 6.40% on future debt issuances. Borrowing $950 million at 6.40% per year on a non-amortizing basis would involve annual interest payments of **$60.8** million (*e.g.*, $950 million times 6.40%). Assume instead that the debt was financed in 2016 at 4.10% (the midpoint of the January-May yields identified above, and well above the 3.75% yield for the most current A-rated yield). The resulting annual interest cost would be **$39** million. The annual savings in that situation would be about $22 million, or about **$440** million over the life of a 20-year bond. The savings would be greater for bonds of longer duration.

While this simplified scenario can be modified for different maturities and types of debt (*e.g.*, amortizing versus non-amortizing), the point is the same. FPL can save ratepayers substantial money by financing its expected long-term debt at lower current interest rates.

Q. Did you review FPL's requested cost of short-term debt?

A. Yes. The Company's cost of short-term debt is included in its Schedule D-3.

Q. Is FPL's requested cost of short-term debt reasonable?

A. No. I recommend that FPL's cost of short-term debt be adjusted.

Q. Please explain how you adjusted the Company's cost of short-term debt.

A. According to Schedule D-3, FPL included commitment fees of $4.569 million in its requested cost of short-term debt. These fixed fees should not be included in the cost of short-term debt. Including these largely fixed fees in short-term debt costs requires the Commission to recalculate the percentage cost of short-term debt whenever it changes the rate base or modifies the amount of short-term debt.

Instead, I recommend that these fees be collected in O&M expenses. In this manner, the Commission ensures that the Company fully recovers these fixed expenses. At the same time, only the short-term debt interest rate itself is reflected in the weighted cost of capital regardless of the adjustments to rate base or the modifications to the capital structure.

Q. What is your recommended cost of short-term debt in this proceeding?

A. I recommend that the Commission adopt a cost of short-term debt of 0.56%. This is the percentage cost shown in Schedule D-3 for the prior year ended December 31, 2016. In my opinion, FPL inflated its cost of short-term debt based on forecasts that may or may not come to pass, just as it did for its forecasted long-term debt issuances. My recommended 0.56% cost of short-term debt allows for a reasonable increase over FPL's December 31, 2015 cost of short-term debt of 0.28%, which is also shown in Schedule D-3. The Commission should not allow FPL to pass through inflated costs of short-term debt to its Florida ratepayers.

Q. In your view, is it likely that interest rates will rise this year?

A. Yes, I believe it is likely that interest rates will rise. The Federal Reserve considered raising interest rates this year, only to defer any such increases due to economic concerns relating to job creation, domestic economic growth, and the effect on exchange rates that would increase the value of the dollar abroad and potentially harm U. S. exports. Many financial observers forecasted that the Federal Reserve would increase rates in June 2016; of course, that ultimately did not occur. In any case, how much interest rates will increase this year, if at all, in anyone's guess.

Q. Did FPL provide interest rate forecasts in its filing in Docket No. 120015-EI?

A. Yes. Dr. William Avera presented forecasts of interest rates in his Exhibit WEA-2, page 1 of 1. I have attached this exhibit as my Exhibit No. ___ (RAB-11). This exhibit shows that in 2012, Dr. Avera presented forecasted interest rates for 2016 for the 30-year Treasury Bond and the AA Utility bond. Those forecasts showed a 2016 30-Year Treasury yield of 5.3% - 5.5% and a AA Utility yield of 6.8% - 6.9%. Current experience shows that these forecasts were obviously very far off the mark. According to the Mergent Bond Record, the Aa Utility bond yield for May 2016 was 3.65%, 315 basis points lower than the forecasts presented by Dr. Avera. Likewise the 30-Year Treasury bond yield in May 2016 was 2.63%, 209 basis points less than the upper end of the forecasted yields presented by Dr. Avera.

This exhibit shows the dangers of relying on forecasted bond yields to set rates for Florida customers.

Q. What is the effect of your recommended common equity ratio, cost of equity and forecasted cost of debt on FPL weighted cost of capital?

A. Mr. Kollen quantified the effect of my recommendations in his Direct Testimony.

IV. RESPONSE TO FPL TESTIMONY

Q. Have you reviewed the Direct Testimony of Mr. Robert Hevert?

A. Yes.

Q. Please summarize Mr. Hevert's testimony and approach to return on equity.

A. Mr. Hevert employed four methods to estimate the investor required rate of return for FPL: (1) the CAPM, (2) the bond yield plus risk premium model, (3) the constant growth DCF model, and (4) a multi-stage DCF model.

With respect to the CAPM, Mr. Hevert's results ranged from 9.08% to 13.21%, including a proposed adjustment for imputed flotation costs. Hevert Direct at 22:19-20.

Mr. Hevert's formulation of the bond yield plus risk premium approach resulted in a ROE estimate range of 10.04% - 10.53%. Hevert Direct at 26, Table 3.

With respect to the DCF model, Mr. Hevert used 30-day, 90-day, and 180-day average stock prices ending January 15, 2016 to estimate the dividend yield for the companies in his proxy group.

For his constant growth DCF approach, he used Value Line, First Call, and Zacks for the investor expected growth rate. Mr. Hevert's mean growth rate ROE results for his proxy group of companies ranged from 9.31% to 9.42%, which include an adjustment for imputed flotation costs. Hevert Direct at 31, Table 4.

Regarding his multi-stage DCF analysis, Mr. Hevert used the same proxy group. This model consisted of three distinct stages with assumptions regarding growth rates and payout ratio changes. Mr. Hevert used a forecast of growth in nominal Gross Domestic Product ("GDP") for his long-term growth rate. The results for this method using the mean growth rate for his proxy group ranged from 9.84% to 9.96% including imputed flotation costs. Hevert Direct at 36, Table 7.

Based on the results of his analyses and judgment, Mr. Hevert recommended a ROE range for FPL of 10.50% to 11.50%, concluding that the cost of equity is 11.00%. Hevert Direct at 69:1-4.

Q. Before you proceed to the particulars of your review with respect to Mr. Hevert's testimony, what is your overall conclusion with respect to Mr. Hevert's recommended ROE range?

A. In my opinion, the results of Mr. Hevert's ROE analyses do not support his recommended ROE range of 10.5% to 11.5%. His mean DCF results for both the constant growth and multi-stage models are far below this recommended range. I would also note that his results for the constant growth DCF are consistent with the results I quantified. Mr. Hevert's bond yield plus risk premium approach yielded a midpoint ROE of 10.29%. Only his CAPM results showed an ROE greater than 10.5%, which is the lower bound of his recommended range. Indeed, Mr. Hevert appears to have omitted the entirety of his average, or mean, DCF results, all of which are significantly below the lower end of his recommended range. The Commission should reject Mr. Hevert's recommended ROE range as unsupported by his own analyses.

Q. You and Mr. Hevert used different proxy groups to estimate FPL's ROE in this proceeding. Do you have any comments with respect to Mr. Hevert's proxy group of companies?

A. Yes. Mr. Hevert's group includes Dominion Resources, Great Plains Energy, and Westar Energy. These three companies are involved in significant merger activity and should not be included in a proxy group for purposes of estimating the return on equity for FPL.

<u>CAPM</u>

Q. Briefly summarize the main elements of Mr. Hevert's CAPM approach.

A. On page 20 of his Direct Testimony, Mr. Hevert testified that he used several different measures of the risk-free interest rate: the current 30-day average yield on the 30-year Treasury bond (2.96%) and near term and long term projected yields on 30-year Treasury bond yields (4.00% - 4.80%). Mr. Hevert did not consider any shorter maturity bonds, such as the 5-year Treasury note.

Mr. Hevert then calculated ex-ante measures of total market returns using data from Bloomberg and Value Line. Total market returns from these two sources were a 13.63% market return using Bloomberg data (Exhibit No. ___ (RBH-6) at p. 1) and a 12.82% return using Value Line data (Exhibit No. ___ (RBH-6) at p. 7).

Mr. Hevert used two different estimates for beta from Bloomberg and Value Line.

Q. Is it appropriate to use forecasted or projected bond yields in the CAPM?

A. Definitely not. Current interest rates and bond yields embody all of the relevant market data and expectations of investors, including expectations of changing future interest rates. The forecasted bond yield used by Mr. Hevert is speculative at best and may never come to pass. Current interest rates provide tangible and verifiable market evidence of investor return requirements today, and these are the interest rates and bond yields that should be used in both the CAPM and in the bond yield plus risk premium analyses. To the extent that investors give forecasted interest rates any weight at all, they are already incorporated in current securities prices.

As described *supra*, the interest rates FPL projected in 2012 to occur in 2016 never came to pass and were substantially higher than today's interest rates. This clearly demonstrates the risk of reliance on forecasted interest rates in setting the cost of equity and cost of debt for FPL. Once again, I strongly recommend that the Commission reject this approach.

Q. Should Mr. Hevert have considered shorter-term Treasury yields in his CAPM analyses?

A. Yes. In theory, the risk-free rate should have no interest rate risk. 30-year Treasury Bonds do face this risk, which is the risk that interest rates could rise in the future and lead to a capital loss for the bondholder. Typically, the longer the duration of the bond, the greater the interest rate risk. The 5-year Treasury note has much less interest rate risk than 20-year or 30-year Treasury Bonds and may be considered one reasonable proxy for a risk-free security. My CAPM analysis shows that the ROE using a 5-year Treasury note would be only 8.00% using the expected market return. This is much lower than any of the CAPM estimates provided by Mr. Hevert.

Q. Please comment on Mr. Hevert's use of Bloomberg and Value Line earnings growth estimates for the S&P 500.

A. Mr. Hevert used earnings growth estimates from these two sources to estimate the expected market return for his CAPM. Using the data contained in Exhibit No. ___ (RBH-6), I calculated that the average Value Line growth rate is 10.18% and the average Bloomberg growth rate is 10.06% (average the growth rates contained in column 7).

These are by no means long-run sustainable growth rates. They are about double the long-term GDP growth forecast of 5.35% presented by Mr. Hevert. If forecasted GDP growth is used, then both Mr. Hevert's and my own market return estimates would fall significantly. Obviously, using 5.35% as a proxy for long-term growth for the S&P 500 companies would reduce Mr. Hevert's market return of 12.82% and 13.63% quite substantially. This would also apply to my forward-looking CAPM analyses as well.

Q. Is the S&P 500 a good proxy for the market when estimating a CAPM return on equity?

A. No. That is because the S&P 500 is limited to the stocks of the 500 largest companies in the United States. The market return portion of the CAPM should represent the most comprehensive estimate of the total return for all investment alternatives, not just a small subset of publicly traded stocks. In practice, of course, finding such an estimate is difficult and is one of the more thorny problems in estimating an accurate ROE when using the CAPM. If one limits the market return to stocks, then there are more comprehensive measures of the stock market available, such as the Value Line Investment Survey that I used in my CAPM analysis. Value Line's projected earnings growth used a sample of 2,209 stocks and its book value growth estimate used 1,527 stocks. Value Line's projected annual percentage return included 1,680 stocks. These are much broader samples than Mr. Hevert's limited sample of the S&P 500.

Q. Do the market returns you used in your CAPM suggest that Mr. Hevert's estimated market returns are excessive?

A. Yes. The market returns I estimated from Value Line ranged from 9.88% to 11.00%, far lower than Mr. Hevert's estimated returns on the S&P 500.

Bond Yield Plus Risk Premium Analysis

Q. Please summarize Mr. Hevert's risk premium approach.

A. Mr. Hevert developed a historical risk premium using Commission-allowed returns for regulated electric and gas utility companies and 30-year Treasury bond yields from January 1980 through January 15, 2016. He used regression analysis to estimate the value of the inverse relationship between interest rates and risk premiums during that period. Applying the regression coefficients to the average risk premium and using both current and projected 30-year Treasury yields I discussed earlier, Mr. Hevert's risk premium ROE estimate ranges from 10.04% to 10.53%. Hevert Direct at 26, Table 3.

Q. Please respond to Mr. Hevert's risk premium analysis.

A. First, the bond yield plus risk premium approach is imprecise and can only provide very general guidance on the current authorized ROE for a regulated electric utility. Risk premiums can change substantially over time. As such, this approach is a "blunt instrument" for estimating the ROE in regulated proceedings. In my view, a properly formulated DCF model using current stock prices and growth forecasts is far more reliable and accurate than the bond yield plus risk premium approach, which relies on a historical risk premium analysis over a certain period of time.

Second, I recommend that the Commission reject the use of the forecasted Treasury bond yields for the same reasons I described in my response to Mr. Hevert's CAPM approach. The Blue Chip Consensus 30-Year Treasury yield forecasts resulted in ROEs of 10.24% - 10.53%, the highest of the three results obtained from Mr. Hevert's analysis. Changing Mr. Hevert's analysis only to use the current 30-Year Treasury yield, without addressing other potential shortcomings of that analysis, would result in a ROE of 10.04%. *See* Exhibit No. ___ (RBH-3) at p. 1, col. 5.

Constant Growth DCF Analyses

Q. What are Mr. Hevert's DCF results without the inclusion of flotation costs?

A. Table 4 below summarizes Mr. Hevert's constant growth DCF results excluding flotation costs and using average growth rates.

TABLE 4

Hevert Constant Growth DCF Results
Without Flotation Costs

	Group Mean DCF	Group Median DCF
30-Day Average Stock Price	9.19%	9.00%
90-Day Average Stock Price	9.23%	8.99%
180-Day Average Stock Price	9.30%	9.12%

Once flotation costs are excluded, it becomes clear that Mr. Hevert's DCF results are quite similar to mine. Averaging Witness Hevert's median growth rates produces a DCF result of 9.04%.

Q. Are the stock prices Mr. Hevert used in his DCF analyses out of date?

A. Yes, they are quite dated. Mr. Hevert used stock prices ending January 15, 2016, making them nearly six months out of date. The Commission should not rely on ROE analyses that use such stale data.

Q. Beginning on page 47 of his Direct Testimony, Mr. Hevert urges the imputation of flotation costs in the allowed ROE. Should the Commission add a flotation cost adjustment to the cost of equity for FPL?

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

<u>**Multi-stage DCF Model**</u>

Q. Please summarize the components of Mr. Hevert's multi-stage DCF model.

A. Mr. Hevert described the structure and the inputs for his multi-stage DCF model on pages 31 through 36 of his Direct Testimony. The main elements of Mr. Hevert's multi-stage DCF analyses are as follows:

- 30, 90, and 180 average stock prices.
- First stage of growth based on the average earnings growth rates from Value Line, Zacks, and First Call.
- A transition period from near-term to long-term growth.
- Long-term growth estimated using GDP growth based on historical real GDP growth from 1929 through 2014 and a forecasted inflation rate (5.35%).
- Expected dividend in the final year divided by solved cost of equity less long-term growth rate.
- Payout ratio assumptions based on Value Line for the first stage, a transition period, and a long-term expected payout ratio.

Q. As a practical matter, is it likely that investors would use the multi-stage model presented by Mr. Hevert?

A. No. In my opinion, it is highly unlikely that investors would employ the complicated structure and set of assumptions used by Mr. Hevert. Mr. Hevert presented no evidence whatsoever that investors use such a model in forming their required return for an electric utility such as FPL. He presented no evidence that investors use GDP growth in their evaluation of expected growth in dividends and earnings for electric utility companies. Nor did he show that investors utilize his assumptions regarding the transition period or payout ratio forecasts.

Q. In your opinion, did Mr. Hevert overstate expected GDP growth?

A. Yes. There are two publicly available forecasts of GDP growth that are relied upon by the Federal Energy Regulatory Commission ("FERC") in the determination of the second stage of the two-stage growth rate in its DCF return on equity formula. These forecasts come from the Energy Information Administration ("EIA"), and the Social Security Administration ("SSA") Trustees Report.[3] The latest EIA GDP forecast shows expected growth in nominal GDP of 4.19%. The SSA Report forecasts nominal growth in GDP of 4.41%. The average of these two long-term GDP forecasts is 4.30%. I include the calculations of these two GDP growth rates on Exhibit No. ___ (RAB-12). My calculations are based on my understanding of how the FERC Staff uses the data contained in the EIA and SSA documents to calculate long-term GDP growth for the second stage of its two-stage DCF model.

3 Please see the Energy Information Administration, *Annual Energy Outlook 2015* (April 2015) and Social Security Administration, 2016 OASDI Trustees Report, Table VI.G6 - Selected Economic Variables, Calendar Years 2015-90.

These independent sources are forecasting nominal GDP growth to be substantially lower than the forecast used by Mr. Hevert (4.30% vs. Mr. Hevert's forecast of 5.35%). In my opinion, Mr. Hevert's GDP forecast contributes to a significant overstatement of his multi-stage DCF results.

Q. Did you recalculate Mr. Hevert's multi-stage DCF using the 4.30% forecasted GDP from the two sources you just cited?

A. Yes. Please refer to my Exhibit No. ___ (RAB-13), which provide a recalculation of Mr. Hevert's multi-stage DCF using a 4.30% forecasted GDP growth and a 180-day average stock price from Exhibit No. ___ (RBH-5). I did not change any other assumption used by Mr. Hevert in this analysis.

The resulting mean DCF ROE result is 9.03%. This provides an idea of how much Mr. Hevert overstated his multi-stage DCF results using his own 5.35% GDP forecast.

<u>Business Risks and Other Considerations</u>

Q. Please summarize the business risk discussion contained in Section VI of Mr. Hevert's Direct Testimony.

A. Beginning on page 37 of his Direct Testimony, Mr. Hevert presented the risks and other considerations that he believes should be taken into account in setting the allowed cost of equity for FPL. These considerations include:

- Geographic risk

- Capital access
- Nuclear generation regulatory requirements
- Four-year rate proposal

Q. Did Mr. Hevert perform a study comparing these risk considerations involving FPL to those of the companies he includes in his proxy group?

A. No. Mr. Hevert did not conduct any such studies regarding geographic risks (Exhibit No. ___ (RAB-5) at pp. 83-86 (FPL's Response to SFHHA ROG No. 85 and Staff ROG No. 239(b)), capital access (Exhibit No. ___ (RAB-5) at p. 87 (FPL's Response to SFHHA POD No. 76)), and nuclear generation regulatory requirements (Exhibit No. ___ (RAB-5) at p. 88 (FPL's Response to SFHHA POD No. 77)).

In response to discovery Mr. Hevert explained that he "did not believe it was necessary to perform any additional comparative risk analysis" other than his "selection criteria used to identify a proxy group of comparable publically traded electric utility companies." Exhibit No. ___ (RAB-5) at pp. 89-90 (FPL's Responses to SFHHA POD No. 79 and Staff ROG No. 236)).

Q. Mr. Baudino, what is your response to Mr. Hevert's discussion of these risk factors and their effect on the Commission's determination of a fair rate of return for FPL in this case?

A. It is important to consider that bond rating agencies consider the risks that Mr. Hevert mentioned, as well as other factors, in determining their bond and credit ratings for regulated electric companies. As I testified previously, these bond and credit ratings provide a summary assessment of the overall risk of a utility company such as FPL. Thus, comparing FPL's bond and credit ratings to the companies in our respective proxy groups will provide the Commission an objective assessment of how FPL's overall risk compares to our groups.

Referring to Table 1 of my Direct Testimony, six of the twelve companies in my comparison group have A/A ratings. They do not have a split bond rating in which one agency gave the subject company a BBB/Baa rating while the other agency gave the company an A/A rating. The remaining six companies in the comparison group have a split bond rating. FPL's senior securities carry an A/Aa2 bond rating. Comparing FPL's bond ratings to the bond ratings of my comparison group shows that FPL is a lower risk company than the group on the basis of bond ratings.

Q. Did Mr. Hevert conduct a comparison of FPL's bond and credit ratings to the companies in his electric proxy group?

A. No, he did not. However, I shall present such a comparison of FPL's bond ratings to the bond ratings contained in the June 2016 issue of AUS Utility Reports. Please refer to my Table 5 below for this information.

TABLE 5
Hevert Proxy Group Bond Ratings

Company	S&P	Moody's
ALLETE, Inc.	A-	A3
Alliant Energy Corporation	A-	A2/A3
Ameren Corporation	BBB+/BBB	Baa1
American Electric Power Company, Inc.	BBB/BBB-	Baa1
Avista Corporation	A-	Baa1
CMS Energy Corporation	BBB+/BBB	A3/Baa1
Dominion Resources, Inc.	A-	A3/Baa1
DTE Energy Company	A-/BBB+	A2/A3
Great Plains Energy Inc.	BBB	Baa2
IDACORP, Inc.	A-	A3
NorthWestern Corporation	NR	A3
OGE Energy Corp.	BBB+	A3
Otter Tail Corporation	BBB-	Baa2
Pinnacle West Capital Corporation	BBB	A3/Baa1
PNM Resources, Inc.	BBB	Baa2
Portland General Electric Company	A-	A3
SCANA Corporation	BBB+	Baa1/Baa2
Westar Energy, Inc.	A-	A3/Baa1
Xcel Energy Inc.	A-	A3

Table 7 shows the following:

- Six of the eighteen proxy companies have BBB/Baa bond ratings.
- Seven of the eighteen proxy companies have split ratings (A/BBB/Baa).
- Five of the eighteen proxy companies have A/A bond ratings.

The information in Table 7 clearly shows that the Mr. Hevert's proxy group is more risky than FPL when bond ratings are considered. *Thus, if the Commission is to make any adjustment to FPL's ROE based on the results of Mr. Hevert's ROE analyses, it should be to lower FPL's ROE compared to his proxy group*.

Q. Did Mr. Hevert omit any important considerations with respect to total company risk?

A. Yes. Mr. Hevert overlooked the fact that FPL's financial risk is lower than his proxy group due to FPL's inflated common equity ratio. Mr. Hevert's Exhibit No. ___ (RBH-10) shows that the average common equity ratio for his proxy group is 52.7%. The average common equity percentage for the operating companies is 53.2%. Adjusting the Company's requested 60% common equity to 55% would still leave FPL with a higher common equity ratio that his proxy group average, and correspondingly lower financial risk.

Q. Beginning on page 50 of his Direct Testimony, Mr. Hevert discussed additional risks from FPL's proposed Four Year Rate Proposal. Do you agree with Mr. Hevert's discussion on this point?

A. No. It would make no sense from FPL's perspective to propose a multi-year rate plan if such a plan did not have substantial benefits for its shareholders. The Company's Four Year Rate Proposal would lend revenue stability and certainty of cost recovery over the next four years if approved. Regarding the risk of higher interest rates over that time, FPL included substantially higher assumed interest rates for its projected new debt issues in 2017 and 2018. This would completely mitigate interest rate risk for the Company and, by the same token, expose Florida customers to paying a higher cost of debt if those assumed interest rates fail to materialize. In fact, if FPL expects interest rates to be higher in 2017 and 2018, it would be prudent for the Company to lock in lower interest rates now and issue its forecasted debt this year.

Finally, Mr. Hevert's proposed ROE of 11.0% is so far above recently approved ROEs that interest rates could rise substantially and FPL could still earn an above market ROE. Mr. Hevert's data on Exhibit No. ___ (RBH-3) shows Commission-allowed returns from January 1980 through January 2016. According to my calculations, the average Commission-allowed return from January 2015 through January 2016 was 9.59%, which is 141 basis points lower than Mr. Hevert's recommended 11.0% ROE. If the 50 basis point performance adder is included the 11.5% ROE becomes even further removed from recent Commission-allowed returns.

In conclusion, FPL's excessive ROE and interest rate projections have eliminated any cost of capital risk from its proposed four-year rate plan.

Q. Should the Commission raise FPL's ROE based on Mr. Hevert's discussion of the four risk factors you summarized earlier?

A. No. These risks are already embedded in FPL's bond and credit ratings. FPL carries a strong A/A credit rating from Moody's and Standard and Poor's. With respect to overall business risk, the S&P credit report I cited earlier in my testimony assigned FPL an "excellent" business risk rating, which is the very top of S&P's business risk scale.

<u>Capital Market Environment</u>

Q. Beginning on page 52 of his Direct Testimony, Mr. Hevert discussed current capital market conditions. Could you please respond to Mr. Hevert's discussion of these conditions?

A. Yes. As I described in Section II of my testimony, the United States continues to be a low interest rate environment that suggests lower ROEs for regulated utilities. Even though the Federal Reserve has considered raising interest rates this year, it has delayed any such move for the time being. In a press release dated June 15, 2016 the Federal Open Market Committee stated the following:

> Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee currently expects that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace and labor market indicators will strengthen. Inflation is expected to remain low in the near term, in part because of earlier declines in energy prices, but to rise to 2 percent over the medium term as the transitory effects of past declines in energy and import prices dissipate and the labor market strengthens further. The Committee continues to closely monitor inflation indicators and global economic and financial developments.
>
> Against this backdrop, the Committee decided to maintain the target range for the federal funds rate at 1/4 to 1/2 percent. The stance of monetary policy remains accommodative, thereby supporting further improvement in labor market conditions and a return to 2 percent inflation. [Exhibit No. ___ (RAB-3) at p.13].

Note that the stance of the Federal Reserve is one of accommodation and that it decided to maintain short-term interest rates at their present levels. This continues to favor lower expected returns on the part of investors for lower risk and higher yielding regulated utility stocks.

Q. Beginning on page 56, Mr. Hevert discusses equity market volatility. Please respond to his discussion on this point.

A. On page 61 of his Direct Testimony, Mr. Hevert testified: "in light of the fact that volatility now is considerably above its prior levels, it is difficult to conclude that fundamental risk aversion and investor return requirements have fallen."

I would agree with Mr. Hevert that the indices of overall market volatility he presented suggest that market volatility has increased so far in 2016. I would further suggest that market volatility will most likely increase further with Great Britain voting to leave the European Union on June 23, 2016. However, I would note that with respect to the stocks of regulated utilities, investors appear to be seeking safe havens for their money by purchasing utility stocks. For example, the Dow Jones Utilities Average ("DJU") began the year, January 4, 2016 at 574.51. The DJU closed on Friday, June 24 at 685.71, an increase of 19.4%. On June 24, 2016, the day after the "Brexit" vote, the DJU closed up from the prior day by 1.0%. Contrast this with the overall market. The S&P 500 lost 3.6% and the Dow Jones Industrial average lost 3.4%.

Investors appear to continue to view regulated utilities as safe, stable investments compared with the market as a whole. Recent stock market movements underscore my recommendation of 9.0% as reasonable, indeed generous, for a financially strong and low risk utility investment like FPL.

<u>ROE Adder for Excellent Management</u>

Q. Several FPL witnesses, including Mr. Hevert, recommended that the Commission recognize and encourage exemplary management in setting the

return on equity for FPL by adding 0.50% to the return on equity in this proceeding. Do you agree?

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

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

Also, with respect to the level of FPL's rates, there are other factors that have benefitted the Company beyond what could be considered "excellent management". One major factor is that gas prices are currently quite low. Since FPL derives approximately 69% of its generation from gas-fired units, low gas prices are a major contributing factor to lower rates. FPL’s management is not the cause of low gas prices and its need to build new generation capacity over the past 3 decades to meet population growth has afforded it an opportunity to add gas-fired units when other utilities, not benefitting from such population growth, have not had the same opportunity.

Another major factor contributing to FPL's low rates is the fact that the Company is a very large utility with a contiguous Florida service territory that has economies of scale. This means that fixed costs per customer will be lower for FPL than other, smaller utilities that have higher fixed costs per customer. Again, economies of scale have no bearing on FPL's claimed "excellent management".

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

Q. Does this complete your prepared Direct Testimony?

A. Yes.

MR. SUNDBACK: Thank you, Madam Chair. Mr. Baudino is available for cross-examination.

CHAIRMAN BROWN: Is he going to provide a brief summary?

MR. SUNDBACK: Oh, thank you.

BY MR. SUNDBACK:

Q Mr. Baudino, do you have a summary you'd like to provide to the Commission?

A Yes, I have a brief summary I'd like to provide.

Good afternoon, Commissioners. Thank you. I recommend that the Florida Public Service Commission approve a rate of return on equity, or ROE, for Florida Power & Light Company of 9 percent. My recommendation is based on results from a Discounted Cash Flow Model analysis for a comparison group of electric companies that had similar bond ratings to FPL. And I also employed the Capital Asset Pricing Model and, in my opinion, a rate of return on equity of 9 percent is a reasonable estimate for a low-risk, financially robust electric utility such as FP&L.

I further recommend the Commission reject the return on equity recommendation of 11 percent provided by FPL witness Robert Hevert, and Mr. Hevert's ROE analysis would significantly inflate investor-required returns for FPL and would burden Florida ratepayers with excessive rate levels. In addition to FPL's excessive ROE request of 11 percent, certain FPL witnesses also support the addition of a half a percent, or 50 basis points, to Mr. Hevert's recommended ROE, which would raise the company's requested ROE to 11.5 percent. And for reasons I state in my testimony, the addition of this ROE adder for alleged excellent performance is unwarranted, unreasonable, and should be rejected by the Commission.

FPL also included two forecasted long-term debt issuances with assumed coupon rates that are excessive and failed to reflect the reality of current debt costs. FPL assumed a 6.16 percent cost rate for these forecasted debt issues in 2017 and a 6.5 percent rate for additional debt issues in 2018 rate year. And in order to reflect current and far more realistic debt costs for FPL, I recommend that these three issues be assigned coupon rates of 4.1 percent.

FPL has requested an equity ratio, common equity ratio of approximately 60 percent. This proposed equity ratio is clearly excessive and, in my opinion, completely unnecessary for FPL to maintain its A bond rating -- credit rating. Excuse me. Under either my recommended ROE or that of FPL, the carrying cost of each dollar of equity is at least three times as expensive as a dollar of debt, and yet during the past four years, FPL failed to document any analysis relevant to ensuring that ratepayers are not burdened with an excessive amount of common equity in this capital structure and the costs that go along with that. FPL did not benchmark its target capitalization against other utilities, and, in fact, FPL's proposed cost of equity and capital structure in this case will cost Florida ratepayers approximately $723 million at a 9 percent equity for the 2017 test year, according to Mr. Kollen's calculations, and, of course, much more at FPL's higher ROE levels. A 60 percent common equity ratio is significantly greater than any of the electric utility proxy groups used to estimate the return on equity for FPL in this case.

In this proceeding, I recommend the Commission reduce FPL's equity ratio to a very reasonable 55 percent, and a 55 percent equity ratio is higher than the average of the electric utility comparison groups used by Mr. Hevert and myself and is consistent with an A credit rating.

I recognize that the Commission declined to adopt my recommendation in Docket No. 080677-EI to lower FPL's common equity ratio. And in that proceeding, FPL's requested common equity ratio for investor-supplied capital was 59.6 percent. And in that case as well, the company imputed off-balance sheet purchased power agreements, or PPAs, of 950 million, which lowered the adjusted common equity ratio to 55.8 percent.

Since FPL's last rate case, its PPA liabilities, that's the purchased power agreements' liabilities, have declined substantially. And to the extent that the Commission felt it was necessary in the past for FPL to increase its common equity ratio to offset these purchased power obligations, this reduction in FPL's PPA liability substantially reduces that concern. Thank you.

CHAIRMAN BROWN: Thank you.

MR. SUNDBACK: Madam Chair, now the witness is available for cross-examination.

CHAIRMAN BROWN: Thank you.

And good afternoon. Are you still living in New Mexico?

THE WITNESS: No, but I'm going back there for my honeymoon.

CHAIRMAN BROWN: Nice.

THE WITNESS: Which is going to be October -- starting October 10th.

CHAIRMAN BROWN: Congratulations.

THE WITNESS: Thank you.

CHAIRMAN BROWN: Thank you.

THE WITNESS: Thank you very much.

CHAIRMAN BROWN: Well, welcome to the Public Service Commission here in Florida.

THE WITNESS: Thank you.

CHAIRMAN BROWN: Office of Public Counsel.

MR. SAYLER: No questions for this witness.

CHAIRMAN BROWN: Thank you.

Mr. Moyle.

MR. MOYLE: I do have a few questions for him. And also I just want to, for your information, to note FIPUG took the position that on the ROE, it shouldn't be over 10. He just said his number is 9, so I'm going to ask him a couple of questions about that, given that each 100 basis points is worth 240 million.

CHAIRMAN BROWN: Not friendly cross.

MR. MOYLE: No. I'm going to explore the difference between 9 and 10, if I could.

CHAIRMAN BROWN: Sure.

EXAMINATION

BY MR. MOYLE:

Q Sir, have you looked at the average ROEs awarded by Commissions around this country in 2015 and

2016?

A I did look at that, yes.

Q All right. And that number is just under 10 percent; correct?

MR. GUYTON: Objection. That's friendly cross.

MR. MOYLE: Well, I think it's, of course, my witness's position that --

CHAIRMAN BROWN: Mr. Moyle.

BY MR. MOYLE:

Q You're aware that Mr. Pollock is -- that FIPUG has taken a position that it should be 10 -- not more than 10 percent with respect to the ROE?

A I'll accept that, subject to check. I don't recall Mr. Pollock's position.

Q And what's your position? 9 percent?

A Yes.

Q All right. And so isn't it true that the Commissions that have looked at and awarded ROE since 2015 and 2016 have been at 9 percent, but the 9 percent number has been closer to 10 percent than just flat 9 percent?

MR. GUYTON: Objection. That goes beyond what's in the record already and is in the nature of friendly cross.

CHAIRMAN BROWN: Mr. Moyle.

MR. MOYLE: I think it is in the record already, that chart that we spent that time with where I drew the line across, that exhibit that showed the awards of ROEs from '15 and '16. That's in the record, so I should be able to ask him about, I think, that exhibit that's in the record.

MR. GUYTON: I objected to it because it wasn't a correct characterization of that prior testimony. But regardless of that, it's friendly cross.

CHAIRMAN BROWN: Mr. Moyle, can you rephrase it?

MR. MOYLE: Sure.

BY MR. MOYLE:

Q You're an expert, so I can ask you a hypothetical question; right?

A All right.

Q All right. Assume there's an exhibit in the record in this case that has a bunch of numbers on it that are averaged. If that exhibit, and the math was done correctly on it, assume it was, and that the grand total showed that for 2015 and 2016 Commissions around the country awarded an ROE average that was under 10 percent but closer to 10 percent than 9 percent, wouldn't you agree that that result would be more supportive of FIPUG's position than the Hospitals' position, all other things being equal?

A Well, yes. If I -- I mean, I'm accepting, subject to check, Mr. Pollock's position is that it should be less than 10. And if that exhibit showed that, then, yes, that would be closer than FPL's position, which is 11 percent -- 11.5 percent actually.

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

CHAIRMAN BROWN: Thank you, Mr. Moyle.

Retail Federation.

MR. LaVIA: No questions.

CHAIRMAN BROWN: Thank you.

Mr. Jernigan.

MR. JERNIGAN: No questions. Thank you.

CHAIRMAN BROWN: Thank you.

Ms. Csank.

MS. CSANK: No questions.

CHAIRMAN BROWN: Thank you.

Wal-Mart is not here. They were supposed to be here today. Does anybody know Wal-Mart's whereabouts?

MR. MOYLE: On a corner near you. No, I'm sorry.

(Laughter.)

CHAIRMAN BROWN: That was good.

AARP.

MR. COFFMAN: No questions.

CHAIRMAN BROWN: Okay. Thank you.

Larsons are not here. Oh, that's right. They're excused.

FPL.

MR. GUYTON: FPL has no questions.

CHAIRMAN BROWN: Thank you. Staff.

MS. BROWNLESS: Yes, ma'am.

EXAMINATION

BY MS. BROWNLESS:

Q Good afternoon, Mr. Baudino.

A Good afternoon.

Q In preparing your testimony in this proceeding, did you review the testimony of FP&L's direct witnesses?

A Yes.

Q And who did you review?

A I reviewed Mr. Dewhurst and Mr. Hevert primarily, and I may have sort of made a quick look at another witness or two. But those are the two primary witnesses whose testimony I reviewed.

Q Okay. Staff filed 42 set of interrogatories and 21 sets of PODs in this case during the five-month course of this proceeding. Were you provided the responses to staff's interrogatory and POD requests associated with your subject area as they became available?

A I believe that I was, yes.

Q Okay.

A That's a lot of material to sort of keep track of, but I certainly was provided with a substantial amount of staff -- responses to staff interrogatories and PODs.

Q Thank you. And were you also provided the responses associated with your subject areas of FIPUG's, FEA's, AARP's, and OPC's discovery?

A I don't know if I was provided all of those. I know I reviewed a substantial amount of that material also.

Q Okay.

A I just don't recall the exact number.

Q And during the course of your engagement in this proceeding, did you prepare discovery questions for FP&L?

A Yes.

Q Okay. And were you given an opportunity to review the responses to the discovery questions that you prepared on behalf of the South Florida Hospital and

Healthcare Association?

A Yes.

MS. BROWNLESS: That's great. Thank you so much. And I'll turn it over to my co-counsel.

EXAMINATION

BY MS. MAPP:

Q Good afternoon, Mr. Baudino. My name is Kyesha Mapp with Commission staff. Do you happen to have a copy of your direct testimony in front of you?

A Yes, I do.

Q Could you please turn to page 5 and lines 18 through 21 -- excuse me -- 17 through 20 where you state, "To the extent the Commission felt in 2012 it was necessary for FPL to increase its common equity ratio to offset its purchased power contract obligations, the reduction in FPL's PPA liabilities substantially reduces that concern." Just to clarify, FPL's 2012 rate proceeding in Docket No. 120015-EI ended in a settlement agreement to which SFHHA was a party; correct?

A Yes.

Q So you would agree that the Commission did not specifically approve FPL's equity ratio to offset FPL's purchased power obligations?

A That's right.

Q And you would agree that the equity ratio settled upon within the 2012 rate proceeding was the same that was filed within FPL's MFRs?

MR. SUNDBACK: I'm sorry. Could I have that question back, please?

BY MS. MAPP:

Q Would you agree that the equity ratio that was settled upon within the settlement agreement within the 2012 rate proceeding was the same equity ratio that was filed in FPL's MFRs in that case?

MR. SUNDBACK: I'd object to that question as presuming a fact that's not yet been established in the record of the proceeding; that is, that there was a specified equity ratio applicable to all circumstances in the 2012 settlement.

CHAIRMAN BROWN: Objection overruled.

Continue, staff. Repeat your question.

BY MS. MAPP:

Q Okay. Would you agree that the equity ratio settled upon within the 2012 rate proceeding was the same that was filed in FPL's MFRs?

A No.

Q Mr. Baudino, you were handed several exhibits. Do you have those in front of you?

A Yes, I do.

Q Okay. Can you please turn to the third exhibit.

CHAIRMAN BROWN: Let's mark that, if you will.

MS. MAPP: Yes. This is deposition of Richard Baudino.

CHAIRMAN BROWN: Okay. We're going to mark that as 707, and we'll name it as such.

(Exhibit 707 marked for identification.)

Mr. Baudino, do you have a copy of that?

THE WITNESS: It's -- okay. My exhibit numbers are not -- are blank.

CHAIRMAN BROWN: Yes. You just write 707 on the one that's entitled Deposition of Richard -- of you.

THE WITNESS: Okay. 707?

CHAIRMAN BROWN: Uh-huh.

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

BY MS. MAPP:

Q Okay. Can you please turn to page 35 of that exhibit.

A Yes, I have it.

Q Could you read beginning on lines 9 through 17 under the column labeled Correction/Amendment into the record, please.

A Okay. It says, "FPL's as-filed equity ratio in the 2012 rate proceeding was 58.4 percent, including short-term debt for rates that FPL proposed to go into effect on January 1st, 2013. However, the Commission did not approve that equity ratio."

Q And when you state that "FPL's as-filed equity ratio," you mean as filed within their MFRs?

A Well, I think that's -- I believe that was filed in the MFRs, yes.

Q Thank you. Now could you please turn to page 42 of your direct testimony, lines 1 through 2.

A I'm sorry. Which page?

Q Page 42, lines 1 through 2.

A Okay. I have that.

Q Okay. Why do you not rely on the results of the CAPM for your ROE recommendation?

A I explained that earlier in my testimony, but it's just not -- it's -- the CAPM is not as reliable a model as the direct market evidence obtained using a DCF model.

Q And on page 41, I'm looking to your Table 2.

A Yes.

Q Am I correct that the results of your CAPM analysis range from 6.02 percent to 8.03 percent?

A That's right.

Q Now if you could turn to page 35. At the top of the page, you list the CAPM equation you used in your

CAPM analysis. Is this the same equation Mr. Hevert used in his CAPM analysis?

A I need to refresh my recollection there. Just a moment.

(Pause.)

Subject to check, I believe the general equation is the same, yes.

Q And you calculate the market risk premium by subtracting the risk-free rate from the market return; is that correct?

A Yes.

Q And looking at your equation, "RF" would refer to the risk-free rate or the risk-free investment?

A I'm just -- I'm going to turn back to that. I was looking further on in my testimony. Okay. Yes.

Q When you calculated the market risk premium, did you use a different risk-free rate than the value for the risk-free rate used in this equation?

A Let's see.

(Pause.)

No.

Q In your opinion, is that an appropriate application of the CAPM?

A Is it an appropriate what?

Q Is it an appropriate application of the CAPM to use a different risk -- I'm sorry -- to use the same risk-free rate as the value in your equation?

A Yes, the way I specified it, it is.

Q Why do you believe that to be an appropriate application?

A Because that's the way -- that's the way it's done. You obtain the market risk premium by subtracting the return on the market less the risk premium, and then multiply the risk premium by the beta, then add back the risk-free rate. And that's the -- how you get the answer.

Q Can you please turn to page 48 of your testimony, lines 10 through 11. You testify that "FPL could materially reduce its equity ratio and very likely be able to maintain its A/A bond rating." When you say an "A/A bond rating," from what rating agency are you referring?

A Standard & Poor's and Moody's.

Q And when you say FPL is "likely" to maintain an A/A bond rating, how exactly are you using the term "likely"?

A It's based on my judgment using the values in Table 3, which show that the average group -- the average equity ratio for my group is around 50 to 51 percent. 55 percent is equivalent to really the high, the high end of the range of estimates there, which is OGE Energy at 55.7. So I think just on its face it shows that a 55 percent equity ratio would be certainly adequate and more than enough to support an A/A bond rating. Staff also asked me to, in my deposition to provide a couple of financial metric calculations, which I provided to the staff, that support that as well.

Q Would you agree that the term "likely" infers some level of uncertainty?

A Well, there's always uncertainty. There's always risk. But I think going from certainly a modest reduction from 59 and almost 60 percent, what the company is proposing, to 55 and a 9 percent ROE on top of that certainly, based on my evaluation, would support an A/A credit rating.

Q But you cannot say with certainty that FPL will maintain its current credit rating from S&P if your recommendation -- if your -- an A minus from S&P if your recommended ROE and the equity ratio were approved by this Commission?

A Well --

MR. SUNDBACK: Objection. That was asked and answered, Madam Chair. We already went through that, so we're just replowing the same ground.

MS. MAPP: I do not believe I asked the witness this question. I'm just trying to understand if he can say yes or no, if he can say with certainty that FPL will be able to maintain its A minus rating.

MR. SUNDBACK: Madam Chair, we had just a paraphrase of this question two questions ago.

MR. MOYLE: Plus it calls for speculation. She's asking him what rating agencies may or may not do or whether FPL can maintain its rating.

CHAIRMAN BROWN: Can you rephrase the question?

MS. MAPP: Yes.

(Pause.)

I'll move on.

CHAIRMAN BROWN: Okay.

BY MS. MAPP:

Q You were deposed in this proceeding, and you have a copy of the deposition in front of you marked Exhibit 707; correct?

A Yes.

Q In your deposition, do you recall our discussion regarding the core equity ratios that S&P uses in rating FPL?

A Did you say, "the core equity ratios"?

Q Yes.

A I don't think they're called that.

Q Sorry. The core ratios. Excuse me.

A Now which -- what page of my deposition are you referring?

Q This relates to the late-filed deposition exhibit you provided. This would be also handed out to you. It's labeled Baudino Late-Filed Deposition Exhibit Number 1.

CHAIRMAN BROWN: It has not been marked yet, so we're going to mark that as you described, Ms. Mapp, as 708.

(Exhibit 708 marked for identification.)

Mr. Baudino, do you have a copy of it in front of you?

THE WITNESS: The late-filed deposition exhibit?

CHAIRMAN BROWN: That's right.

THE WITNESS: Yes. 708?

CHAIRMAN BROWN: Yes.

THE WITNESS: Okay. I have that.

MS. MAPP: Thank you.

BY MS. MAPP:

Q Please review the calculations provided within this exhibit. I believe it's three pages. And please let me know once you familiarize -- or refamiliarize yourself with this information.

A Yeah, I'm familiar with this information. And this morning I discovered a correction that actually needs to be made here. It does not change the conclusion I made, but there is a correction that needs to be made.

Q And what is that correction?

A Okay. If you refer to page 1 of 3.

Q Yes.

A And you see the "Funds from operations" on line 1, "Funds from operations, FFO/Debt."

Q Yes.

A If you go down to line 6, it says, "SFHHA Income Tax Calculation," and it says, "724,035." That number is incorrect. When you calculate funds from operations, you don't add income taxes back. What you do add is ADITs and ITCs. So that number was incorrectly input there. So what you would need to do is strike "724,035" and strike the "SFHHA Income Tax Calculation," replace those words with "ADIT and ITC" and replace the number with "598,846." And that is from the company's Schedule C-22.

CHAIRMAN BROWN: Can you please repeat all of that?

THE WITNESS: Sure.

CHAIRMAN BROWN: Strike?

THE WITNESS: Strike -- okay. If we go to line 6, strike "SFHHA Income Tax Calculation."

CHAIRMAN BROWN: Uh-huh. Go ahead.

THE WITNESS: Okay. Replace that with "ADIT and ITC." ADIT stands for accumulated deferred income tax, and ITC expenses.

CHAIRMAN BROWN: And the figure?

THE WITNESS: 598,846.

CHAIRMAN BROWN: Thank you.

THE WITNESS: And then you would strike page 3, line 25, and replace that with "Schedule C-22."

MR. SUNDBACK: I'm sorry, Madam Chair. Just so the record is accurate and not confused when we review it, may I ask one clarifying question at this point, because there was a reference to page 3, line 25 and I want to --

CHAIRMAN BROWN: Sure. Sure. Sure.

MR. SUNDBACK: Isn't it true that the change you reference to page 3, line 25, is a reference to a source on page 1 of what's been marked as Exhibit 708? No, I'm sorry. It's -- yeah, 708.

THE WITNESS: Yes.

MR. SUNDBACK: Okay. Thank you.

CHAIRMAN BROWN: Ms. Mapp.

MS. MAPP: I'm sorry. Could you repeat your question?

MR. SUNDBACK: I just didn't -- Madam Chair, if I could address this directly. I didn't want the record to -- if read cold, to suggest that Mr. Baudino is saying with regard to what's been marked as Exhibit 708, that we go to page 3 of that exhibit.

CHAIRMAN BROWN: Okay. You could have done that later, but that's fine.

MR. SUNDBACK: Okay. I'm sorry.

CHAIRMAN BROWN: Okay. Ms. Mapp, please proceed.

BY MS. MAPP:

Q Okay --

A If I -- may I continue with the last couple of corrections?

Q Yes.

A Okay. The funds from operations total would need to change, and that number is "3,214,846." Total debt would stay the same. And then on line 12, the number, the percentage number would -- strike "30.2%" and insert "29.0%." And that's the correction that needs -- those are the corrections that need to be made to that.

Q Thank you. So I would like you to look to page 1 of 3, line 12, where you just made the amendment so it now reads, "29.0%." On line 19, you present the ratio of debt to EBITDA; correct?

A Right. Correct.

Q And that ratio is still correct at 2.93?

A Yes, it is.

Q Now looking at page 2 and 3 of the exhibit, it appears that these ratios were calculated using all the adjustments to FPL's rate case as recommended by SFHHA; is that correct?

A Right.

Q Do those recommended adjustments include an ROE of 9 percent and an equity ratio of 55 percent?

A Yes.

Q Based on the values of these two ratios, do you believe that FPL would maintain an S&P credit rating of A minus?

A Yes.

Q Now if I could refer you to the third exhibit that was handed out.

CHAIRMAN BROWN: Which will be marked as 709, if you like.

MS. MAPP: Yes.

CHAIRMAN BROWN: Please give a title.

MS. MAPP: Thank you. Yes. The title is

Standard & Poor's Ratings Dated June 12th, 2015.

CHAIRMAN BROWN: Okay. So noted.

(Exhibit 709 marked for identification.)

BY MS. MAPP:

Q Now this was asked in staff's 11th set of interrogatories, No. 239. If you could please turn to Attachment No. 2, which -- page 3 (sic) of 8.

A Yes.

Q Please read the paragraph under the heading "Financial Risk: Intermediate."

MR. SUNDBACK: I'm sorry, Madam Chair. Could we have the page number of Exhibit 709 again, please?

CHAIRMAN BROWN: Ms. Mapp, can you repeat?

MS. MAPP: Okay. Yes. I'm sorry. It's page 4 of 8.

MR. SUNDBACK: Okay. Yes, I have it.

BY MS. MAPP:

Q And could you please review the paragraph under the heading "Financial Risk: Intermediate"?

A I have it.

Q Would you agree that debt-to-EBITDA ratio of 2.93 calculated using SFHHA's recommended adjustments is significantly higher than S&P's expected debt-to-EBITDA ratio -- I'm sorry, debt-to-EBITDA for FPL ratio 2.5?

A Yes, it's greater.

Q Would you agree that a lower debt-to-EBITDA ratio is preferable?

A It is, but, you know, that ratio that I calculated, 2.93, is still within the intermediate risk, intermediate financial risk range. So, again, based on the range from FPL -- the range from S&P, excuse me, I believe that my recommendation is consistent with an intermediate financial risk rating, and, again, it's consistent with that. Whatever the -- I mean, the rating agencies will do whatever they do. I can't predict that. But I can predict and I did estimate what these -- the core financial ratios would be for my recommendation, really the ratemaking recommendations.

Q Would you agree that FFO-to-debt ratio of 2.90 calculated using SFHHA's recommended adjustments is lower than the S&P's expected FFO-to-debt ratio of 33 percent?

A Well, yes, it is lower, and it's still within the range of an intermediate risk company, intermediate financial risk company. So that did not change.

Q And would you agree that a higher FFO-to-debt ratio is preferable?

MR. SUNDBACK: Madam Chair, we'd like a clarification on that question or we'll object to it without the clarification. Preferable from what perspective?

CHAIRMAN BROWN: Ms. Mapp.

MS. MAPP: I'm asking from S&P's ranking perspective.

CHAIRMAN BROWN: Okay.

MR. MOYLE: Calls for speculation.

CHAIRMAN BROWN: I'll allow it.

THE WITNESS: I don't know if it's preferable from S&P's perspective. Again, they're dealing in ranges. So the ratios I've calculated are still within the intermediate financial risk range as far as I can tell, so I don't think there would be any diminution of credit quality based on what I've evaluated here. But, again, S&P and Moody's will make the final call on that.

BY MS. MAPP:

Q And could you turn back to page 3 of 8 of Exhibit 709 and refer to the paragraph under the heading labeled "Downside scenario."

A Page 3 of 8?

Q Yes.

A Yes, I see it. Okay. I see it.

Q If the Commission set FPL's authorized ROE at 9.0 percent, could that be considered by Standard & Poor's as an unfavorable regulatory outcome?

MR. MOYLE: Objection, speculation.

CHAIRMAN BROWN: Overruled.

THE WITNESS: I don't know. That's up to S&P.

BY MS. MAPP:

Q Thank you. Please turn to page 66 of your direct testimony. And on lines 13 through 15 you state, in part, that in your opinion it is likely that the flotation costs are already accounted for in current stock prices and that adding an adjustment for flotation costs amounts to double counting. Are you aware of any authoritative text that agrees with or supports your opinion regarding flotation costs?

A I'm not aware of it. And, you know, furthermore, it's not necessary for me to make that statement. The flotation costs I really consider more of an academic adjustment. In the real world, investors don't make that adjustment. In the real word, the investors pay what they pay. They pay the market price for that stock and they don't then put another like, say, 4 percent discount on it for flotation costs. Whatever assumptions investors make about flotation costs is embodied in that stock price and it must be. There's no other way to -- there's no good way really to adjust the stock price that occurs in the market for a flotation cost. It is what it is, and investors know that.

Q When an underwriter sells a share of stock to an investor, does the utility receive the full sale price of the stock collected by the underwriter, or does the underwriter receive a percentage of the sale price as a commission for executing the stock sale?

A Well, assuming that there are flotation costs or issuance costs associated with that equity, the utility would receive less than -- it would receive whatever the proceeds were less the issuance costs. But we don't really know -- you know, it can vary, depending on the issuance, how much issuance costs you have, so -- and what the nets proceeds would be from that.

Q I'd like you to consider this hypothetical. Presume a utility is issuing new stock in the marketplace. From an equity issuer's perspective, if the amount the utility receives from a new stock issuance is reduced by flotation costs, how will the utility earn the required return for its stock if a flotation cost allowance is not recognized?

A It will earn the required return based on the Commission allowing the investor-required return on rate base, on the portion of rate base that's financed by common equity. That's how the investor would earn it.

Q Now please turn to page 56 of your testimony. On line 6 through 16 you discuss FPL's inclusion of commitment fees of 4.569 million in its cost of short-term debt. You recommend that the commitment fees be collected in O&M expenses. Is the cost to ratepayers the same regardless of the method used to recover the commitment fees?

A Ideally it should be, but the way that I've recommended is much cleaner and it really results in a greater chance of dollar-for-dollar collection of those commitment fees because it separates out the actual cost of debt, the -- whatever that percentage cost of debt, short-term debt is. That's reflected then in the capital structure. So when FPL changes its amount of short-term debt, okay, you then don't have to recalculate what the resulting rate would be with those commitment fees plus the short-term debt cost.

What you do is you get the debt cost. We know what the short-term debt cost is. The commitment fees are $4,569,000. Put that in O&M expenses, so make sure the utility collects that. And then you can put in what the actual pure cost, the percentage cost rate of short-term debt is. And even if you change the amount of short-term debt, you know, the percentage cost is what it is. So you really have a more accurate way of reflecting the cost of short-term debt by including these commitment fees in the O&M expenses as I've proposed.

Q If the commitment fees are collected in O&M, do you know what the difference is and what the impact to the revenue requirement would be?

A Well, you'd have an additional 4.569 million of commitment fees in O&M expenses. It would be higher than the company's proposal since those commitment fees aren't in O&M in the company's proposal. And then -- but you'd also have a lower percentage cost of short-term debt -- a lower percentage of short-term -- let's see. Yes, the -- in the capital structure, the percentage cost of short-term debt, the actual percentage cost less the commitment fees would be reflected in short-term debt cost. So that would be lower, but the O&M would be higher.

Q But there would be no difference to the ratepayers, would there?

A If it's all calculated correctly, that's right.

MS. MAPP: Thank you. I have no further questions for the witness.

CHAIRMAN BROWN: Thank you, Ms. Mapp. Commissioners, any questions of this witness? Redirect.

MR. SUNDBACK: Thank you, Madam Chair.

EXAMINATION

BY MR. SUNDBACK:

Q Mr. Baudino, let's start with a question you were you asked by staff. You recall that you discussed placement in the intermediate range with regard to credit rating agency assessments. Do you recall that?

A Yes, intermediate financial risk. That's correct.

Q Can you describe for the Commission what that range represents generally?

A Sure. The -- these core ratios that S&P looks at really represent sort of a range of outcomes. So you have intermediate financial risk, which is less risky than significant financial risk, which would -- so intermediate financial risk would tend to suggest, you know, higher equity, lower debt. Significant financial risk would -- category is a more risky rating.

CHAIRMAN BROWN: Could you just move closer to the mike, please.

THE WITNESS: Okay. Is a more risky rating and would tend to suggest a higher debt and higher debt cost and less coverage. But within those broad categories there are ranges of core ratios that can -- that the actual number that's produced could fall between. So for FFO to debt and -- excuse me, funds from operations to debt and debt to EBITDA, that's earnings before income taxes depreciation and amortization, S&P sets ranges within which those values can fall and still remain in the intermediate financial risk category or the significant financial risk category.

In other words, you can have changes, you can have increases or decreases within the range. And as long as they stay within the range, you're still going to be an intermediate or, you know, an intermediate risk company.

BY MR. SUNDBACK:

Q Okay. If you recall, you had a discussion this afternoon about flotation costs with staff.

A Yes.

Q In this proceeding, is FPL proposing a flotation cost based on its own issuance costs or on a general measure of flotation costs incurred by companies other than FPL?

A The latter. It's a general flotation cost adjustment based on other companies.

Q You had a discussion this afternoon about some changes to what's been marked as Exhibit 708, the first page of calculations. Do you recall that?

A Yes.

Q Does that impact your analysis and the answer that you gave during your deposition?

A With respect --

MR. GUYTON: Object. I'm not sure that I have an objection here. I'm just not sure to what question we're referring in the deposition, or answer.

CHAIRMAN BROWN: Mr. Sundback.

MR. SUNDBACK: In the deposition, which, as I understand it, is going to be proposed to be laid in the record in its entirety, Mr. Baudino was asked whether he had calculated these types of metrics and whether that would influence his analysis. And so my question is do the changes that have been provided today with regard to page 1 affect his analysis or his conclusions?

MS. MAPP: If I may, Chairman.

CHAIRMAN BROWN: Sure.

MS. MAPP: Staff has no intention of entering the deposition into the record.

CHAIRMAN BROWN: Okay.

MR. SUNDBACK: Okay. In that case, may I reformulate, Madam Chair?

CHAIRMAN BROWN: Sure.

BY MR. SUNDBACK:

Q Mr. Baudino, with regard to the discussion you had about changes to what's been marked as Exhibit 708, can you tell us how those changes impact your analysis and conclusions with regard to FPL, if at all?

A They do not impact my analysis and conclusions with respect to the ROE and credit quality of FPL and tend to -- it still supports my conclusion.

Q If you look at line 7 -- you changed the number on line 7; is that correct?

A Yes.

Q Okay. Does that have any impact on the description of the method of derivation of numbers further down in that schedule and, if so, what impact does it have?

A It does not.

MR. GUYTON: Objection. It's leading. It's suggesting the answer of the witness.

CHAIRMAN BROWN: Rephrase, please.

BY MR. SUNDBACK:

Q Mr. Baudino, to the extent that you've changed the number on line 7, are there subsequent changes in the schedule that you believe should be made to reflect that change?

MR. GUYTON: Objection. Still leading.

CHAIRMAN BROWN: Is it?

MR. SUNDBACK: Madam Chair, if that was the standard, half of FPL's redirect would have been attacked.

CHAIRMAN BROWN: Can you state the question again, Mr. Sundback?

BY MR. SUNDBACK:

Q Mr. Baudino, to the extent you've made a change to the number on line 7, are there any other changes with regard to the derivation of numbers on page 1 that you feel should be made. That's not --

CHAIRMAN BROWN: I'll allow it.

A Only to line 12, as I had explained to staff counsel before. That number would change to 29 percent and be slightly lower.

Q Okay. And that's -- so that's the mathematical calculation you would change in the schedule?

A Yes.

Q Okay. Are there changes with regard to the source that flow from the changes you have made to the number?

A No. Of the rest of the numbers, no. The new number that I put in in line 6, 598,846, does come from Schedule C-22, the company's Schedule C-22. That's where that came from, and that's since the source changed. But none of the other numbers changed or the sources for those numbers.

MR. SUNDBACK: Thank you, Madam Chair. Those are all our questions.

CHAIRMAN BROWN: Thank you, Mr. Sundback. Thank you.

THE WITNESS: Thank you.

CHAIRMAN BROWN: Staff -- oh, no staff.

Exhibits.

MR. SUNDBACK: Yes. Thank you, Madam Chair. At this time, we'd move for the admission of what's been marked as Exhibits 252 through 264, if our recordkeeping is correct.

CHAIRMAN BROWN: You are correct. Are there any objections to 252 -- entering into the record 252 through 264? Seeing none, we'll go ahead and do that. We will enter those in.

(Exhibits 252 through 264 admitted into the record.)

And, staff, you have 707 through 709?

MS. MAPP: Staff does not need to enter these exhibits into the record.

CHAIRMAN BROWN: Okay. All right. Would you like your witness excused?

MR. SUNDBACK: Yes, please, Madam Chair.

CHAIRMAN BROWN: Safe travels back to wherever you are going, Mr. Baudino.

THE WITNESS: Sorry?

CHAIRMAN BROWN: Bye-bye. You are excused.

THE WITNESS: Oh, thank you. Thank you very much.

CHAIRMAN BROWN: Thank you. All right. Office of Public Counsel, your witness is up next in the rotation, and we've got Woolridge.

MR. SAYLER: Yes, ma'am. The Office of Public Counsel would like to call Dr. Randall J. Woolridge to the stand and -- or J. Randall Woolridge to the stand.

CHAIRMAN BROWN: Okay.

MR. SAYLER: As a housekeeping matter, I do have some cleanup from my Hevert questionings last week. I have the disk with the full copies for all the parties and also for the court reporter to just pass out at whatever time now, if that's good.

CHAIRMAN BROWN: Why don't you pass that after Mr. Woolridge is done.

MR. SAYLER: Yes, ma'am.

CHAIRMAN BROWN: Is that good?

Okay. Mr. Woolridge, you've been sworn in?

THE WITNESS: I have been.

MR. DONALDSON: Excuse me one second, Madam Chair. Right here. Kevin Donaldson. I'm sorry.

Before we actually begin with OPC's witnesses, FPL, for the sense of expediency, wanted to enter into the record some admissions that OPC has filed in this particular case. And as I'm sure that all the parties are aware, admissions are -- can be admitted into the record as a party opponent evidence. And so we have -- your staff is going to be passing out a copy of that, so if we can just wait a second. And it'll help the cross for some of these additional OPC witnesses go a little bit smoother.

CHAIRMAN BROWN: Mr. Donaldson, would you like us to label that for identification purposes?

MR. DONALDSON: Yes.

CHAIRMAN BROWN: Okay. We're going to label that as Exhibit 710.

MR. DONALDSON: And you can disregard where it says, "Lawton." It should be really for all of OPC's witnesses.

CHAIRMAN BROWN: It says, "Dismukes." It says, "Dismukes." Is that the right one?

MR. DONALDSON: They may be handing out the wrong one.

(Transcript continues in sequence in Volume 26.)

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

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

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

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

DATED THIS 30th day of August, 2016.

Linda Boles

LINDA BOLES, CRR, RPR
FPSC Official Hearings Reporter
(850) 413-6734