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June 21, 2021

VIA ELECTRONIC FILING
Adam Teitzman, Commission Clerk
Division of the Commission Clerk and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

RE: Docket No. 20210015-EI
Petition by FPL for Base Rate Increase and Rate Unification

Dear Mr. Teitzman:

Attached for filing on behalf of Floridians Against Increased Rates, Inc. ("FAIR") in the above-referenced docket are the Direct Testimony of FAIR witness Breandan Mac Mathuna.

Please let me know if you should have any questions regarding this submission.

Cordially yours,

Robert Scheffel Wright

Robert Scheffel Wright

RSW:mae
Encl.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by Florida Power & Light Company for Rate Unification and for a Base Rate Increase	)))	DOCKET NO. 20210015-EI FILED: JUNE 21, 2021

DIRECT TESTIMONY

OF BREANDAN T. MAC MATHUNA

On Behalf of

Floridians Against Increased Rates, Inc.

IN RE: PETITION BY FLORIDA POWER & LIGHT COMPANY FOR RATE UNIFICATION AND FOR BASE RATE INCREASE, DOCKET NO. 20210015-EI

DIRECT TESTIMONY OF BREANDAN T. MAC MATHUNA ON BEHALF OF FLORIDIANS AGAINST INCREASED RATES, INC.

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IN RE: PETITION BY FLORIDA POWER & LIGHT COMPANY FOR RATE UNIFICATION AND FOR BASE RATE INCREASE, DOCKET NO. 20210015-EI

DIRECT TESTIMONY OF BREANDAN T. MAC MATHUNA ON BEHALF OF FLORIDIANS AGAINST INCREASED RATES, INC.

I. INTRODUCTION AND QUALIFICATIONS

Q. Please state your name, business address, and occupation.

A. My name is Breandan T. Mac Mathuna, and my business address is GDS Associates, Inc. ("GDS"), 1850 Parkway Place, Suite 800, Marietta, Georgia 30067. I am employed as a Principal with GDS. In my role as one of the company's Principals, I regularly provide, for and on behalf of GDS's clients, analyses and expert testimony regarding the cost of capital and capital structure for regulated electric companies.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of Floridians Against Increased Rates, Inc. ("FAIR"), a Florida not-for-profit corporation, and its members who are retail customers of Florida Power & Light Company ("FPL").

Q. Please summarize your educational background and professional work experience.

A. I received a Bachelor of Commerce degree with a major in Finance from University College Dublin, Ireland, in 2007, and a Master of Business Studies in Strategic Management and Planning, also from University College

Dublin, in 2008. I worked for EirGrid, the transmission and market operator in Ireland and Northern Ireland, from 2008 until 2013. My work for EirGrid included detailed analyses of regulatory compliance with the company's transmission system operator license, developing EirGrid's company dividend payment framework, revenue control planning, and preparing EirGrid's revenue requirements submissions to the industry regulator.

In 2014, I joined GDS Associates, Inc., where I have advised electric cooperative and municipal utilities on many aspects of power supply planning and procurement, including wholesale power cost forecasting, budgeting, and related financial matters. I have testified as an expert witness in regulatory proceedings before the Federal Energy Regulatory Commission on capital costs, including ROE, and capital structure issues. A summary of my education and professional experience is appended as Exhibit BTM-1.

Q. Have you previously testified in proceedings before utility regulatory authorities? If so, please briefly describe and summarize your prior testimony before regulatory authorities.

A. Yes. I have testified before the FERC in numerous proceedings on ROE and related issues. A listing of my testimonies before FERC is included in my Exhibit BTM-1.

Q. Are you testifying as an expert in this proceeding? If so, please state the area or areas of your expertise relevant to your testimony.

A. Yes, I am testifying as an expert regarding the cost of capital for regulated electric utility companies in the United States, including the components and structure of utility capital costs that are consistent with accepted regulatory principles applicable to determining allowable utility revenue requirements and setting rates based on such revenue requirements. My expertise includes the proper cost of common equity capital, usually referred to as the rate of return on equity, or "ROE," and the proper capital structure, i.e., the composition of a utility's capital including both equity and debt.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. What is the purpose of your testimony in this proceeding?

A. I am testifying on behalf of Floridians Against Increased Rates, Inc. ("FAIR") and its members who are retail customers of FPL. FAIR has engaged me to provide my professional opinions and analyses regarding the appropriate costs of equity capital and the appropriate capital structure, for FPL consistent with accepted principles of utility rate regulation.

Q. Please summarize your opinions and the results of your analyses.

A. Using a standard analytical technique, and referring to current capital market data, I conclude that FPL can provide safe and reliable service, recover all of its reasonable and prudent costs and expenses, and earn a fair and reasonable rate of return while maintaining satisfactory financial integrity if the Florida Public Service Commission ("Commission" or "PSC") sets FPL's rates using a mid-point rate of return on common equity of 8.56% and a financial equity

ratio, defined as the percentage of investor-supplied capital funds provided via common equity, at 55.4 percent for ratemaking purposes.

Q. Are you sponsoring any exhibits with your testimony?

A. Yes. I am sponsoring the following exhibits:

Exhibit BTM-1	Professional Qualifications of Breandan T. Mac Mathuna;
Exhibit BTM-2	Two-Step Constant Growth DCF Model Analysis;
Exhibit BTM-3	Sensitivity Analysis - Two-Step Constant Growth DCF Model;
Exhibit BTM-4	Market-To-Book Ratios;
Exhibit BTM-5	Modifications to Exhibit JMC-5.2 CAPM;
Exhibit BTM-6	Common Equity Ratio Analysis;
Exhibit BTM-7.1	Credit Metrics_ROE 8.56%;
Exhibit BTM-7.2	Credit Metrics_ROE 8.56%_Eq. Ratio 55.4%;
Exhibit BTM-7.3	Credit Metrics_ROE 11.5%_Eq. Ratio 55.4%;
Exhibit BTM-7.4	Credit Metrics_ROE 8.56%_Eq. Ratio 55.4%_COD+0.28%;
Exhibit BTM-8.1	Data Verification Workpapers; and
Exhibit BTM-8.2	Other Workpapers.

Q. Please provide a narrative summary of the remainder of your testimony.

A. Before proceeding further, please note that immediately following the title page of my pre-filed direct testimony, I have, consistent with the format and practice of other witnesses, included a Table of Contents to my testimony,

which I incorporate by reference to my testimony. In Part II above, I stated the basic purpose of my testimony and my ultimate conclusions regarding the appropriate cost of equity and capital structure for FPL. In Part III, I explain relevant regulatory principles that are applicable to regulatory authorities' decisions regarding a utility's overall cost of capital – ROE, cost of debt, and capital structure – to be applied in setting the utility's retail rates. In Part IV, I provide background information regarding FPL and the present proceeding. Next, in Part V, I describe and explain in detail the analysis that I conducted in evaluating the appropriate ROE for the PSC to use in setting FPL's revenue requirements and rates and set out my recommended ROE. In Part VI, I review FPL's witness Mr. Coyne's analysis and arguments in his direct testimony[1] and describe the flaws I identified with his analysis. Then, in Part VII, I present my evaluation of FPL's requested financial equity ratio and the basis for my determination that it is atypical. Additionally, I set forth my recommended financial equity ratio for use in setting FPL's revenue requirements and rates. In Part VIII, I describe the financial integrity assessment I performed in relation to my recommendations. Lastly, in Part IX, I summarize the conclusions I believe are supported by the analysis described in the preceding sections of my testimony.

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[1] Florida Power & Light Company, Docket No. 20210015-EI, Direct Testimony of James M. Coyne, March 12, 2021 ("Mr. Coyne Testimony").

III. REGULATORY CONTEXT AND ESTABLISHED PRINCIPLES

Q. Please summarize the basic context in which the regulation of FPL's retail rates is undertaken.

A. While several reasons for regulating the rates of electric utilities are provided in the literature, e.g., to address the problem of natural monopoly, to ensure rates that are as close as possible or feasible to the results that a competitive market would produce, to ensure fair, just, and reasonable rates for services that are deemed necessary, or to promote overall economic efficiency, among others, the ultimate context is often, and appropriately, summarized in the concept of the "regulatory compact."

Q. Please summarize the regulatory compact.

A. The "regulatory compact" is effectively an unwritten agreement between a regulated utility, its ratepayers, its investors and the regulatory authorities. The Regulatory Research Associates ("RRA") explains that the "regulatory compact" calls for:

> the utility to provide safe, reliable and reasonably priced service, the commission to provide the utility with a reasonable opportunity to recover its costs and earn a return similar to that of other investments with similar risk characteristics, the customer to pay the approved rates and the

> investor to supply the capital necessary to maintain or expand the utility system.[2]

It is intended to be a mutually beneficial and symmetrical compact between these stakeholders, providing opportunity and offering protections to each.

Q. In this context, what is the regulatory authority's task?

A. Ultimately, the question facing any regulatory authority in a rate case is what rates a utility should be allowed to charge in order to recover its legitimate, reasonable and prudent operating and maintenance costs and to recover, over and above those O&M costs, sufficient amounts to enable it to attract the equity and debt capital necessary to make the reasonable, prudent, and used and useful investments necessary for the utility to provide safe and reliable service to its customers. Following longstanding principles of public utility regulation, this means that utility rates should be sufficient to cover all legitimate costs (including O&M costs and return of amounts invested through allowed depreciation of prudent investments) and yield an ROE and debt cost recovery at competitive rates of return that will support the investments necessary to provide safe and reliable service.

Q. What are the general legal and regulatory standards for determining the appropriate ROE and equity ratio for by public utility commissions in

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[2] S&P Global Market Intelligence, Regulatory Research Associates, RRA Regulatory Focus, *The rate case process: a conduit to enlightenment*, June 15, 2020. *See* Exhibit BTM-8.2, page 95.

setting revenue requirements and rates for regulated electric companies?

A. The core principles and standards used to measure an appropriate rate of return are set forth in *Bluefield*[3] and *Hope*.[4] In these landmark decisions, the Supreme Court established standards for regulatory determinations of allowable rates of return on common equity capital. These standards recognize that ratemaking involves a balancing of investor and consumer interests and that the equity investor's interest is served if the return to the equity owner is comparable to the returns on investments in other enterprises having similar risks. In addition, the Supreme Court's standards support a rate of return that is sufficient to ensure confidence in the financial integrity of the enterprise so as to maintain its credit and to attract capital. The consumer interest is described as including protection from "exploitation at the hands of" the utility.[5]

IV. BACKGROUND

Q. Please describe Florida Power & Light Company.

A. FPL, a wholly-owned subsidiary of NextEra Energy, Inc. ("NEE"), is a regulated public utility primarily engaged in the generation, transmission,

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[3] *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923) ("*Bluefield*").

[4] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*").

[5] *See, e.g., Hope,* 320 U.S. at 603, 610.

distribution and sale of electricity in Florida. The sole shareholder of FPL's common equity stock shares is NextEra Energy, Inc.[6] According to the NEE 2020 Form 10-K, after its recent merger with Gulf Power, FPL serves approximately 11 million people (residential, commercial and industrial customers) and its operations are subject to the regulatory oversight of the Florida Public Service Commission, the Federal Energy Regulatory Commission ("FERC"), U.S. Nuclear Regulatory Commission, North American Electric Reliability Corporation and Environmental Protection Agency. FPL has a long-term issuer and/or senior unsecured credit rating from S&P Global Ratings ("S&P") and Moody's Investors Service, Inc., ("Moody's") of A and A1, respectively.

Q. Please summarize your understanding of FPL's requests relative to cost of capital in this case.

A. FPL and Gulf Power Company are both requesting, based on a unified rate structure, a midpoint ROE of 11.5 percent and a financial equity ratio of 59.6 percent based on investor-supplied funds.[7] For convenience, in my testimony, I refer to all of the affected retail customers of both FPL and Gulf Power as "FPL's customers," and I refer to the combined companies, i.e., both FPL and Gulf Power, simply as "FPL."

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[6] 2020 FERC Form 1, page 102.

[7] Florida Power & Light Company, Docket No. 20210015-EI, Direct Testimony of Robert E. Barrett, March 12, 2021 at page 45 and page 66 ("Mr. Barrett Testimony").

V. EVALUATION OF FPL'S RETURN ON COMMON EQUITY

Q. Why is cost of capital, and the cost of equity capital or ROE, such an important issue in utility rate cases?

A. The reason that the ROE, and the companion issue of the utility's capital structure or equity ratio, are so important is that the values determined by the regulatory authority are applied to the utility's entire rate base and accordingly, have a dramatic effect on the utility's allowed revenue requirements and thus on customers' rates. Generally speaking, it is not unusual for cost of capital witnesses in rate cases such as this FPL case to recommend ROEs that vary by 200 basis points or more and to recommend equity ratios that vary from 45 percent to as much as 60 percent. As way of example to demonstrate the magnitude of these differences, for a utility that has a rate base of $10 billion, the difference between an ROE of 9.0% vs. 11.0%, assuming a 50 percent equity ratio (the percentage of investor-supplied capital from equity as opposed to debt) and assuming current tax rates, can be well over $100 million per year. Holding ROE constant at 9%, the revenue requirement difference using a 50 percent equity ratio vs. a 60 percent equity ratio can also be well over $100 million per year. In short, these two decisions can literally be the difference between the PSC granting a rate increase or ordering a rate decrease.

Q. Please describe and explain your approach to developing your opinion as to the appropriate ROE for FPL.

A. There are several market-based methods or models that are often used to develop or calculate appropriate ROEs for regulated electric utilities in the U.S. The three primary methods include the Discounted Cash Flow ("DCF") method, the Capital Asset Pricing Model ("CAPM") and the Risk Premium model.[8] Of these, as explained below, I believe that the DCF method is the preferable method for determining ROEs for regulated electric utilities. I develop my analysis using this method by identifying an appropriate financial study period, collecting appropriate financial data for that relevant study period, identifying an appropriate group of utilities whose returns can be used as "proxy" values to indicate the returns required in a competitive equity capital market to attract equity financing, considering any particular or specific risk factors appliable to the subject utility – FPL in this case – and finally calculating my estimate of the appropriate ROE. Again, following appropriate and recognized regulatory principles, the appropriate ROE is that ROE that will enable FPL to attract sufficient equity capital, in a competitive equity capital market, to enable it to support the reasonable and prudent

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[8] *See* Jonathan A. Lesser, Ph.D., Leonardo R. Giacchino, Ph.D., *Fundamentals of Energy Regulation* 147 (Public Utilities Reports, Inc., 2nd Ed. 2013) ("A number of methodologies have been developed for estimating the return on equity. The three most common are the Discounted Cash Flow Model (DCF), the Capital Asset Pricing Model (CAPM), and the Risk Premium Model (RPM)." *See also*, Eugene F. Brigham and Michael C. Ehrhardt, *Financial Management: Theory and Practice* 425 (10th Ed. 2002) ("[t]hree methods typically are used: (1) the Capital Asset Pricing Model (CAPM), (2) the discounted cash 6 flow (DCF) method, and (3) the bond-yield-plus-risk-premium approach.")

investments that are necessary to enable FPL to provide safe and reliable service.

Q. How have you structured the description of your evaluation?

A. In the following subsections, I describe the following aspects of my analysis:

A. The financial study period data;

B. Electric utility proxy group development;

C. Two-step DCF model; and

D. ROE Recommendation.

A. Financial Study Period Data

Q. Please identify the financial study period data that you rely upon in your analysis.

A. I use financial data from the six-month period November 2020 through April 2020, which was the most recent six-month period for which data were available at the time my analysis was prepared.

B. Development of Electric Utility Proxy Group

Q. Please explain the role of the proxy group.

A. As noted above, the core tenets of the *Bluefield* and *Hope* decisions require that a utility's allowed return is comparable to the returns on investments in other enterprises having similar risks. To implement that principle, one must examine the equity costs of a proxy, or representative, group of utilities that exhibit risk comparable to those of the subject utility. Additional factors

requiring the need for a proxy group include: (a) the subject utility may not have common stock that is publicly traded; and (b) given that an investor's required returns are not directly observable, it is not appropriate to rely on a sample of one firm.[9] The United States Court of Appeals for the District of Columbia Circuit has summarized the role of a proxy group as follows:

> [P]roxy group arrangements must be risk-appropriate. The principle is well-established… [and] captures what proxy groups do, namely, provide market-determined stock and dividend figures from public companies comparable to a target company for which those figures are unavailable.[10]

Q. How did you select your electric utility proxy group?

A. I selected a national electric utility proxy group using the following criteria:

- the use of a national group of companies considered electric utilities by Value Line;
- the inclusion of companies with credit ratings no more than one notch above or below the utility or utilities whose ROE is at issue. Both

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[9] Dr. Roger A. Morin in his treatise *New Regulatory Finance*, explains "[t]here are several convincing reasons why the determination of cost of capital should not rest on a sample of one firm" and suggests that it is most appropriate to employ an analysis based on a comparable group to increase reliability and account for abnormal conditions, among other limitations, inherent in relying on a sample of one firm. See *New Regulatory Finance,* Public Utilities Reports, Inc., 2006 at page 404 ("*New Regulatory Finance*").

[10] *Petal Gas Storage, L.L.C. v. FERC*, 496 F.3d 695, 699 (D.C. Cir. 2007) (citing *Hope Natural Gas Co.*, 302 U.S. at 603.)

Standard and Poor's and Moody's long-term ratings are used when each are available;

- the inclusion of companies that pay dividends and have neither made nor announced a dividend cut during the six- month study period;
- the inclusion of companies with no merger activity during the six-month study period that is significant enough to distort the study inputs; and
- the inclusion of companies whose ROE results pass threshold tests of economic logic, including both a low-end outlier test and a high-end outlier test.[11]

Q. How did you apply the credit rating screen?

A. I applied the credit rating screen using FPL's credit rating. FPL's long-term issuer credit rating from S&P is currently A and its long-term issuer credit rating from Moody's is currently A1. Applying the credit rating screen would lead to the inclusion of companies, subject to meeting the other criteria, with an S&P credit rating between A- and A+, and a Moody's credit rating between A2 and Aa3. However, in developing the proxy group, I found that there are currently no Value Line electric utilities with a Moody's rating of A2 or greater; that is, there are no Value Line electric utilities with a Moody's rating within one notch of FPL's rating (Value Line's universe of companies

[11] Please note this particular screen is applied when evaluating the ROE results produced by a model and is not used to initially develop the composition of the proxy group. I later discuss in my testimony how the specific outlier tests are developed and applied.

only directly covers holding companies or parent companies that are publicly listed and traded). For that reason, I expanded the credit rating screen by the minimum modification necessary and lowered the Moody's screen by two additional notches to Baa1, which is three notches lower than FPL's Moody's rating. Therefore, I excluded any Value Line electric utility that did not satisfy the criterion of having an S&P long-term issuer rating of A- to A+ and a Moody's long-term issuer or senior unsecured credit rating of Baa1 to Aa3.

Q. Why did you elect to relax the lower bound of the Moody's rating screen rather than apply a screen based on only S&P ratings?

A. First, given that the S&P and Moody's ratings diverge for the majority of the Value Line electric utilities that are rated by both firms, using both S&P and Moody's ratings for proxy group selection purposes provides greater assurance that the group selected includes companies that are comparable in risk to FPL, as compared to a group developed from S&P ratings only. Second, expanding the lower bound of the Moody's rating screen is a "conservative" adjustment in that it brings into the proxy group companies that exhibit greater risk and that may be expected for that reason to have higher investor return requirements. Third, I note that another regulatory body, the FERC, which applies a similar credit rating screen previously expanded the number of notches applied in another proceeding due to the

limited number of companies with ratings as high as the subject utility in order produce a reasonably sized proxy group.[12]

Q. How many electric utilities satisfied the credit rating screen?

A. Five companies included in the Value Line electric utility universe satisfied the credit rating screen with the Moody's lower-end rating adjusted as noted above.

Q. Were any of these five Value Line electric utilities eliminated from the proxy group for failing to meet the dividend payment/no dividend cut screening criterion and/or the significant merger activity screening criterion?

A. No. None of the five Value Line electric utilities failed to meet these two criteria.

Q. Please list the members of your electric utility proxy group.

A. The table below summarizes the proxy group I rely upon for my analyses.

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[12] *NSTAR Electric Co.*, Federal Energy Regulatory Commission Docket Nos. ER09-14-000 and ER09-14-001, Order On Transmission Incentives, 125 FERC ¶ 61,313 at P 84 (2008) ("Given the limited number of companies with S&P bond ratings as high as NSTAR's, however, we find it appropriate to include all companies rated in the broader A-rated category (A+, A, and A- by S&P) in order to produce a proxy group of a reasonable size of four companies."). Please note that in more recent times the FERC applies a dual S&P and Moody's credit rating screen.

Table 1: Proxy Group

Line No.	Study Period (November 2020 – April 2021)
1	Eversource Energy
2	NextEra Energy
3	Pinnacle West
4	WEC Energy Group
5	Xcel Energy
6	**Total of 5 Members**

Q. Have other regulatory bodies accepted the use of proxy groups with approximately five members?

A. Yes. For example, the FERC has recently explained that in proceedings involving natural gas and oil pipelines it will maintain its practice of loosening its proxy group screening criteria to the extent necessary in order to obtain a proxy group of at least five members.[13] Moreover, the FERC has emphasized the importance of having a proxy group that contains companies that are risk-comparable over and above the need to simply expand the number of proxy group members.[14]

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[13] *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, Federal Energy Regulatory Commission Docket No. PL19-4-000, Policy Statement on Determining Return on Equity for Natural Gas and Oil Pipelines, 171 FERC ¶ 61,155 (May 2020) at PP 64-65.

[14] *See id.* at P 59 ("At the same time, the Commission has also explained that although 'adding more members to the proxy group results in greater statistical accuracy, this is true only if the additional members are appropriately included in the proxy group as representative firms.'" (quoting Opinion No. 486-B, 126 FERC ¶ 61,034 at P 104).

Q. Do you consider this to be a low risk proxy group?

A. Yes, given that five Value Line electric utilities satisfy the credit rating screen, which by necessity was modified to the minimum extent possible to develop a proxy group of acceptable size, indicates that such a group is comprised of the highest quality and lowest risk electric utilities (as measured by credit ratings) which have market-based stock price data available. Correspondingly, it indicates that FPL is also a low risk utility. Clearly, relaxing the credit rating screen further to add more companies would result in the inclusion of electric utilities that have risks that are more disparate than FPL's risks.

Q. Nevertheless, in addition to your primary proxy group, have you applied your preferred DCF model to a proxy group that was developed through a further relaxation of the credit rating screen?

A. Yes. For the specific purpose of my testimony in this proceeding, I also prepared an additional sensitivity analysis, in which I further relaxed the credit rating screen in order to provide the PSC with the information to better understand how the DCF results change when a proxy group with more disparate risks, as compared to FPL, is used in the DCF analysis. The sensitivity analysis also demonstrates the effects of using a larger proxy group chosen through continuing to modify my analysis's original credit rating screen by the minimum modification necessary to develop a proxy

group of greater size. The analysis and results are presented in Exhibit BTM-3. My primary analysis and recommendations remain premised on the five-member electric utility proxy group discussed herein, because I continue to believe strongly that my chosen proxy group most closely reflects the risks of FPL, which is the underlying purpose of the proxy group.

1. FPL's Risk Relative to the Electric Utility Proxy Group

Q. Does FPL have higher risk than the proxy group average risk?

A. No. My analyses assume that FPL has about the same risk as the proxy group's average. However, this is a conservative assumption as there are strong indications that FPL is - or, at least, that FPL is viewed by investors and rating agencies as being - less risky than the proxy group as a whole. In simple terms, the fact that FPL's long-term issuer rating by both Standard & Poor's and Moody's is higher than all of the other members of my proxy group shows that investors and rating agencies perceive FPL as having lower risk. Even so, to be conservative in my analysis of FPL, I have assumed for these purposes that FPL's risk is about the same as the utilities in my proxy group.

Q. Please explain.

A. Credit ratings reflect an agency's comprehensive review of all the risks a company faces including both business and financial risk, and are intended

to provide an objective and independent measure of a utility's risk. Moreover, that credit ratings are relied upon by investors is a widely accepted view.[15]

As discussed earlier, I applied this screen (with a necessary modification), together with the other screens outlined to develop my electric utility proxy group. FPL has an S&P credit rating of A and all the proxy group members have an S&P rating of A-, which is one notch below FPL's rating. Additionally, FPL's Moody's A1 rating is of considerably greater credit quality than the Moody's ratings of any of the proxy groups members. One member out of the five proxy group members has an A3 rating which is two notches below FPL's rating. The remaining members all have a Baa1 rating, which is three notches lower than FPL's rating. This is indicative of FPL having lower investment risk, as measured by credit ratings, than the

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[15] For instance, the Managing Director for Moody's Global Regulatory Affairs, Farisa Zarin, noted in comments to the Securities and Exchange Commission, "To meet market needs over time, credit ratings have developed important attributes including insightful, robust and independent analysis, symbols that succinctly communicate opinions, and broad coverage across markets, industries and asset classes. These attributes have enabled credit ratings to serve as a point of reference and common language of credit that is used by financial market professionals worldwide to compare credit risk across jurisdictions, industries and asset classes, thereby facilitating the efficient flow of capital worldwide." Farisa Zarin, Letter Re: Credit Rating Standardization Study – Release No. 34-63573; File No. 4-622 (Feb. 18, 2011), *quoted in* Answering Testimony of Adrien M. McKenzie, Exh. No. SER-0001 at 33:9-17, *Ark. Pub. Serv. Comm'n v. Sys. Energy Res., Inc.*, Federal Energy Regulatory Commission Docket Nos. EL17-41-001, EL18-142-000 (filed Mar. 20, 2019).

proxy group as a whole. The figure below illustrates how the electric utility proxy group's credit ratings compare to FPL's credit ratings.

Figure 1: Electric Utility Proxy Group Credit Ratings

S&P Rating	FPL	BTM Proxy Group ES	NEE	PNW	WEC	XEL
AAA						
AA+						
AA						
AA-						
A+						
A	A					
A-		A-	A-	A-	A-	A-
BBB+						
BBB						
BBB-						
BB+						
BB						
BB-						

Moody's Rating	FPL	BTM Proxy Group ES	NEE	PNW	WEC	XEL
Aaa						
Aa1						
Aa2						
Aa3						
A1	A1					
A2						
A3				A3		
Baa1		Baa1	Baa1		Baa1	Baa1
Baa2						
Baa3						
Ba1						
Ba2						
Ba3						

Applying the credit ratings screens and other criteria, as described above, I sought to develop a proxy group of electric utilities that reasonably reflects FPL's investment risk such that FPL's risk is similar to the average risk of each proxy group. For the reasons I have noted above, however, there are strong indications that FPL is (or, at least, is viewed by investors and rating agencies as) less risky than the proxy group as a whole. Therefore, while I believe that the proxy group of electric utilities I have developed reasonably reflects FPL's investment risk, the assumption that FPL's risk is on a par with the proxy group's average risk is a conservative one.

Q. Are there further factors that support your view that FPL is a low risk utility?

A. Yes. There are several additional low-risk features that warrant highlighting. They include:

- Florida's regulatory environment is well-regarded by the financial community;
- Risk mitigation of storm cost recovery; and
- The benefits of FPL's broad regulatory cost recovery framework (e.g. projected test year, recovery clauses etc.)

Before turning to each item in turn, it bears repeating that credit ratings reflect an agency's comprehensive review of all the risks a company faces including both business and financial risk and allow for a direct risk comparison between electric utilities.

a. ***Florida's Regulatory Environment***

Q. How do credit rating agencies view the regulatory environment in Florida?

A. Both S&P and Moody's, in their respective credit reports for FPL, highlight the constructive and credit supportive nature of the regulatory environment in Florida. Specifically, S&P explains that "[w]e view the regulatory

environment in Florida as constructive and supportive of credit quality."[16] Similarly Moody's states that the regulatory environment in Florida "remains highly credit supportive."[17]

Q. Are you aware of any institution that specifically evaluates the state regulatory environments and provides a comparative assessment of those regulatory environments?

A. Yes. The Regulatory Research Associates ("RRA"), a group within the S&P Global Market Intelligence company, evaluates state regulatory environments across the United States of America.

Q. Please describe the RRA state regulatory evaluation and ranking system.

A. For each state, the RRA evaluates factors such as the regulatory process and utility-related legislative and court activity. Based on its evaluations, the RRA assigns a comparative rank to each state. The RRA explains that "[t]he rankings are designed to reflect the interest of both equity and fixed-income

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[16] S&P Global Ratings, RatingsDirect, Florida Power & Light Co., January 15, 2021 at page 4. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

[17] Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 2. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

investors."[18] In other words, they are from the perspective of investors and not ratepayers. RRA's ranking scale involves three primary rating categories, Above Average, Average and Below Average. Within each category there are notches, which are simply labeled 1, 2 and 3. These notches indicate the relative position within each primary category. Overall, there are nine different points in the ranking scale. RRA notes that the rankings are comparative in nature and that they seek to maintain an approximate normal distribution with an approximate equal number of rankings above and below the average.[19]

Q. How does the RRA view regulation in the state of Florida?

A. The RRA views regulation in Florida "as quite constructive from an investors perspective"[20] and awards Florida an Above Average/2 score, indicating a stronger than average rating. Indeed, this score forms part of the second highest category possible. As can be seen in the figure below most other state regulatory environments in the country are ranked much lower, and in fact, only one is ranked more favorably from the perspective of investors.

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[18] Regulatory Research Associates, S&P Global Market Intelligence, RRA Regulatory Focus: Quarterly Regulatory Evaluations, page 8, May 25, 2021. *See* Exhibit BTM-8.2 at page 119.

[19] *See* Exhibit BTM-8.2., at page 113.

[20] S&P Global Market Intelligence, RRA Regulatory Focus, Florida Regulatory Review, April 29, 2021, page 1. *See* Exhibit BTM-8.2 at page 77.

Figure 2: RRA State Commission Evaluation Results[21]

RRA state regulatory evaluations — energy

Above average/1	Above average/2	Above average/3	Average/1	Average/2	Average/3	Below average/1	Below average/2	Below average/3
Alabama	Florida	Iowa	Arkansas	California	Connecticut	Alaska	New Mexico	Dist. of Columbia
	Georgia	Michigan	Colorado	Hawaii	Delaware	Arizona	West Virginia	
	Pennsylvania	Mississippi	Indiana	Idaho	Louisiana — NOCC	Kansas		
	Wisconsin	Tennessee	Kentucky	Illinois	Maine	Montana		
			Nebraska	Louisiana — PSC	Missouri	New Jersey		
			North Carolina	Massachusetts	New Hampshire			
			North Dakota	Minnesota	Ohio			
			Virginia	Nevada	Oklahoma			
				New York	South Carolina			
				Oklahoma	Vermont			
				Oregon	Texas PUC			
				Rhode Island	Washington			
				South Dakota				
				Texas—PUC				
				Utah				
				Wyoming				

As of May 20, 2021.
NOCC = New Orleans City Council; PUC = Public Utility Commission; RRC = Railroad Commission
*Within a given subcategory, states are listed in alphabetical order, not by relative ranking.
Source: Regulatory Research Associates, a group within S&P Global Market Intelligence

b. Storm cost recovery risk is mitigated by cost recovery clauses.

Q. Does FPL propose a storm cost recovery mechanism as part of this rate case?

A. Yes. Mr. Barrett explains that FPL proposes to continue to recover prudently incurred storm costs under the framework reflected in the 2010 rate

[21] Regulatory Research Associates, S&P Global Market Intelligence, RRA Regulatory Focus: State Regulatory Evaluations, May 25, 2021, page 7. *See* Exhibit BTM-8.2 at page 118.

settlement agreement approved by the PSC and continued in both the 2012 and 2016 rate settlement agreements approved by the PSC.[22]

Q. How has the investment community viewed the storm cost recovery mechanisms referenced by Mr. Barrett?

A. Very favorably. For instance, credit agencies have stressed the role of the storm cost recovery mechanisms have played in mitigating risks faced by FPL and in maintaining its strong credit metrics. In its January 2021 rating report, S&P states:

> Further supporting our assessment of the company's business risk profile is the company's ability to consistently recover storm-related costs, protecting it from hurricanes that are common in its service territory and significantly reducing a key risk for the company.[23]

Additionally, Moody's, in its August 2020 report, explains:

> The 2016 rate settlement retained the cost recovery mechanisms that have allowed FPL to produce consistently strong credit metrics. An example includes storm cost recovery provisions, which are important in Florida where hurricanes are prevalent.[24]

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22 Mr. Barrett Testimony at page 56: 16-119.

23 S&P Global Ratings, RatingsDirect, Florida Power & Light Co., January 15, 2021 at page 4. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

24 Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 4. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

Furthermore, following along a similar theme, the RRA has noted that "[a]mong storm prone states, perhaps none has been as proactive in establishing mechanisms to allow utilities timely recovery of costs associated with responding to and repairing storm damage than the Sunshine State."[25] Therefore, if the PSC continues to allow for strong storm cost recovery mechanisms, it is quite reasonable to infer that the investment community will continue to consider FPL to be well insulated from storm related risks.

*c. **Broad regulatory cost recovery framework***

Q. In addition to storm cost recovery mechanisms, are there other features of FPL's regulatory environment that help to mitigate cost recovery risk?

A. Yes. FPL's benefits from a projected test year period convention to determine base rates, fuel and purchased power adjustment clauses that project and true-up rates annually, recovery of certain generation plant investment outside of rate cases, pass-through of franchise fees and gross receipts taxes, energy conservation costs, environmental costs, and a reserve surplus amortization mechanism among other features.[26] In 2020, the clauses recovered approximately 35% of FPL's jurisdictional operating expenses and

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[25] Regulatory Research Associates, S&P Global Market Intelligence, RRA Regulatory Focus: A look at storm recovery by energy utilities in Florida, September 4, 2019. See Exhibit BTM- 8.2 at page 136.

[26] S&P Global Market Intelligence, RRA Regulatory Focus, Florida Regulatory Review, April 29, 2021. *See* Exhibit BTM-8.2 at pages 77-94.

the pass-through franchise fees and gross receipts taxes amounted to approximately 9% of the jurisdictional operating expenses.[27]

Q. What has been FPL earned ROE for the last several years.

A. FPL's Earnings Surveillance Reports filed with the Florida PSC show that, calculated on an FPSC-adjusted basis, FPL has earned an ROE of 11.6%, the top of the allowed range, since 2018.[28]

Q. Have these regulatory mechanisms contributed to FPL earning at the top end of the earned ROE band?

A. Yes. Moody's has commented on how the various clauses provide for adequate and timely cost recovery resulting in very little regulatory lag.[29] Moreover, Moody's notably has remarked on the important contribution the reserve surplus amortization mechanism has had in supporting FPL's ability to earn the top end of the allowed range:

> "In addition, the company has the ability to earn roughly 100 bps above its authorized ROE, **which it has been able to achieve through the use of the reserve amortization mechanism** and continued improvements in operating efficiency."

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[27] *See* FPL's 2020 Earnings Surveillance Report at Schedule 1. *See* Exhibit BTM-8.2 at page 60.

[28] See FPL's Earnings Surveillance Reports filed with the Florida PSC for the years 2018, 2019 and 2020. *See* Exhibit BTM-8.2 at page 8, page 34, and page 60.

[29] Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 4. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

Moreover, a Scotiabank analyst, Andrew Wiesel, expressed an [CONFIDENTIAL] [redacted] [redacted] [CONFIDENTIAL]

Therefore, it is clear that the cost recovery clause mechanisms, and in particular the reserve surplus amortization mechanism, greatly minimize FPL's cost recovery risk and actively contribute to FPL's earning at the top of the ROE range.

2. *Economic Outlier Tests*

Q. Please explain the economic outlier tests that you apply as part of your ROE analysis.

A. Applying tests of economic logic in relation to the outlying results from an array of results produced by an ROE model is appropriate to help ensure the economic logic of the results. I apply a low-end test that I consider reasonably meets the objective of identifying ROE results that are so low as to be considered to yield essentially the same return as debt. I also apply a high-

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[30] Scotiabank, Equity Research, Daily Edge, January 26, 2021. Provided in response to request from the Office of Public Counsel, First of Set of Production of Documents, Number 13.

end test that I consider reasonably identifies results that may be considered atypical in relation to the risk profile of the proxy group. Specifically, the tests are as follows:

- Low-end test: the low-end threshold is calculated by adding a 100 basis points to the six-month average Moody's Public Utility Bond Index yield of the same rating category as the utility whose low-end ROE is being tested, subject to a natural break analysis.
- High-end test: the high-end outliers are identified if the ROE results are more than two standard deviations from the median of each model's ROE array prior to testing for low- and high-end outliers, subject to a natural break analysis.

C. Two-Step Constant Growth DCF Model Analysis

Q. Please describe the two-step constant growth DCF model that you employ?

A. The DCF methodology examines the relationship between stock prices, dividends, growth rate of dividends and the investors' required rate of return to invest in the common stock of a company. The constant growth DCF model assumes that the current stock price is a function of the sum of future dividend payments, that grow at the assumed growth rate in perpetuity, discounted by investors' required rate of return. Thus, one can rearrange this

formula to solve for the investors' required rate of return.[31] The two-step constant growth DCF methodology can be mathematically expressed as:

$$k = (D/P)\ (1 + 0.5g) + g$$

The "k" term is the investors' required rate of return. The "D/P" term is the dividend yield. In my analysis, I use a six-month average dividend yield for each proxy company. The "g" term is the expected long-term annual dividend growth rate. The long-term growth rate is the weighted average of two different growth rates for each proxy company, a shorter-term growth rate and a long-term growth rate (i.e., a two-step growth rate). The shorter-term growth rate is typically based on analysts' consensus forecasted "five year" earnings per share growth rates and the long-term growth rate is based on a forecast of the long-term growth of the economy as a whole. In my analysis, I weight the shorter-term growth rate at two-thirds and the longer-term growth rate at one-third, , which conservatively places a greater emphasize on analysts' short-term growth rate projections The dividend yield is multiplied by (1 + 0.5g) to reflect the fact that dividend payments are made across the year.

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[31] It is important to clarify that stock prices may change not only as a result of expected changes in dividends or dividend growth but also due to changes in investors' required rate of return for investing in a company's common stock.

Q. Please explain why you prefer to utilize the DCF method to estimate the cost of equity for electric utilities as opposed to other market-based methods, such as the CAPM and Risk Premium method.

A. The DCF method can be used to directly estimate firms' cost of equity. An example of the direct DCF method application is to calculate cost of equity for the individual utilities in a proxy group of comparably-risked electric utilities and inferring the fair and reasonable ROE from the analysis. The DCF method's direct application to estimate the cost of equity for electric utilities is particularly apt given the utility sector's reputation as relatively low-risk, defensive investments that offer steady dividends. In discussing the Dividend Discount Model ("DDM"), which is a DCF model very similar to the two-step DCF method, Stephan A. Ross, *et al.* explain it "is only applicable to firms that pay steady dividends; it is completely useless if companies do not."[32] Moreover, given the unique characteristics of the electric utility sector, it can be reasonably inferred that investors use the DCF method to assess the estimated cost of equity for electric utilities.

While the CAPM and Risk Premium methods have some capital market input, only the DCF method has direct, current utility stock investor input through use of recent, competitive, market-determined stock prices. In

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[32] *See* Stephen A. Ross, Randolph W. Westerfield and Jeffrey Jaffe, *Corporate Finance* 412 (McGraw-Hill Irwin, 10th Ed. 2013).

contrast, the CAPM method only captures the relative stock pricing information of each respective proxy group electric utility through the backward looking beta value which measures the volatility of a company's stock return relative to the market return. Regarding the Risk Premium method, along with other shortcomings that I discuss later in my testimony, it importantly fails to incorporate the current market value of electric utilities in any manner. Thus, I consider the DCF method the most robust and instructive method to use for determining electric utilities' ROEs, and I believe that it should be exclusively relied on for this purpose.

Q. Have you prepared a two-step DCF analysis that reflects your approach outlined above?

A. Yes. In applying the two-step DCF model to my electric utility proxy group, I used dividend yields for the six months ending April 2021. For the short-term growth rate, I used the average of the analysts' consensus "five-year" earnings per share ("EPS") growth rate projections for each proxy group company as reported by Yahoo! Finance from the I/B/E/S International, Inc. ("IBES") database on April 30, 2021. For the long-term growth rate, I relied upon a GDP projection of 4.20% estimated using three data sources, namely, the Energy Information Administration, Social Security Administration and IHS Markit . To estimate the composite growth rate, the "g" term, for each proxy group member, I placed two-thirds weight on the short-term growth rate and one-third on the long-term growth rate. I used the composite growth

rate in the calculation of the adjusted dividend yield. The results of these calculations are shown on Exhibit No. BTM-2. Before applying tests of economic logic and eliminating outliers, the DCF results for the proxy group produce an ROE range of 7.99% to 8.97%.

Q. Please state the low-end test and high-end test threshold levels when applying your outlier tests.

A. The low-end test and high-end test threshold levels, are stated in the table below, and the supporting calculations are shown on Exhibit No. BTM-2.

Table 2: Low-End and High-End Test Threshold Levels

	Threshold Level
Low-End Test	
Moody's Public Bond Index "A" Yield	**4.06%**
Moody's Public Bond Index "Baa" Yield	**4.34%**
High-End Test	**9.28%**

Q. Have you eliminated any high or low-end results in your two-step DCF analysis?

A. No. I did not find it necessary or appropriate to eliminate any low-end or high-end two-step DCF ROE results following a review of the threshold levels using my recommended low- and high-end outlier tests together with a natural break assessment.

Q. Please confirm the results of your application of the two-step DCF model to the proxy electric utilities after the application of the economic outlier tests.

A. The DCF results remained unaltered as I did not eliminate any low-end or high-end ROE results. The investor-required ROE results for the proxy group range from 7.99% to 8.97%, with a median of 8.56%. See Exhibit No. BTM-2 at page 1, lines 9-11. The table below summarizes these results:

Table 3: Two-Step DCF Model Results

	Median Result	Low-End of Range	High-End of Range
Two-Step DCF	**8.56%**	7.99%	8.97%

Q. What is the implied risk premium inherent in your median ROE result of 8.56%?

A. The table below summarizes the implied risk premium between the median ROE and various bond yields measured over the six-month study period through April 2021.

Table 4: Two-Step DCF Model Results

Bond Type	Six-Months Average Through April 2021	Implied Risk Premium
30-Year Treasury bond yield	1.97%	6.59%
Moody's Public Utility Bond Index "A" Yield	3.06%	5.50%
Moody's Public Utility Bond Index "Baa" Yield	3.34%	5.22%

Q. Based on your DCF analysis above, in your professional opinion, what is an appropriate ROE for FPL?

A. The range of results produced by the DCF model brackets investors' required rate of return for investing in companies with risk characteristics similar to FPL. However, it is not the extreme ROEs from the proxy group that are representative of the return required by investors for the average amount of risk represented by the proxy group, but rather the ROE around which the results cluster. The value that best represents this clustering of the ROEs is the median. Therefore, I recommend using the median result of 8.56% for FPL. As discussed earlier, there remain strong indications that FPL is of lower risk as compared to the proxy group average, which would lead analytically to a lower ROE than my recommendation. This conservatism is further reflected in my capital structure recommendation, which is discussed at the end of my testimony.

1. DCF Sensitivity Analysis – Alternative Proxy Group

Q. Please briefly describe your DCF Sensitivity Analysis.

A. As noted above, for the specific purpose of my testimony, I also prepared an additional sensitivity analysis, in which I developed an alternative proxy group where I expanded the credit rating screen criteria. In particular, I expanded the S&P long-term issuer rating screen to be two notches, rather than one notch, below FPL's S&P rating of A. I maintain the Moody's credit

rating screen used in my primary analysis. Overall, this leads to a less risk-comparable proxy group to FPL as compared to the proxy group I utilized in my primary analysis. Therefore, in the sensitivity analysis, I excluded any Value Line electric utility that did not satisfy the criterion of having an S&P long-term issuer rating of BBB+ to A+ and a Moody's long-term issuer or senior unsecured credit rating of Baa1 to Aa3. Applying this modified credit rating screen resulted in the identification of eleven Value Line electric utility candidates. One company was removed following the application of the M&A and dividend payment screens.

Q. Please identify the Value Line electric utility company that you removed for failing to meet the significant merger activity screening criterion and explain the basis for its exclusion.

A. I removed Avangrid, as it is involved in a major pending M&A.[33] On October 21, 2020 it was announced that Avangrid reached an agreement to acquire PNM Resources, Inc. The reported transaction value was $8.3 billion, and it is expected that the deal will be completed in the fourth quarter of 2021.[34]

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[33] I note that Mr. Coyne similarly classified Avangrid as being involved in a merger transaction which indicates it failed his merger proxy group screen. See FPL discovery response (public) to OPC's Third Request for Production of Documents, No. 70, file "OPC POD 3-70, Attachment 1_Full Proxy Group Screen."

[34] Exhibit BTM-8.1 at page 1.

Q. Please list the members of your electric utility proxy group used for the DCF sensitivity analysis.

A. The table below summarizes the alternative proxy group I rely upon for my sensitivity analysis.

Table 5: DCF Sensitivity Analysis – Alternative Proxy Group

Line No.	Study Period (November 2020 – April 2021)
1	Ameren Corp.
2	CMS Energy
3	Eversource Energy
4	NextEra Energy
5	OGE Energy Corp.
6	Pinnacle West
7	Portland General
8	Public Service Enterprise
9	WEC Energy Group
10	Xcel Energy
11	**Total of 10 Members**

Q. Have you prepared a two-step DCF sensitivity analysis that uses the alternative electric utility proxy group described above?

A. Yes. The sensitivity analysis uses the same two-step constant growth DCF method and data sources discussed earlier in my testimony in respect of the alternative electric utility proxy group. Before applying tests of economic logic and eliminating outliers, the DCF results for the proxy group produce a range of 6.48% to 13.97%.

Q. Please state the low-end test and high-end test threshold levels when applying your outlier tests.

A. The low-end test and high-end test threshold levels are stated in the table below, and the supporting calculations are shown on Exhibit No. BTM-3 at page 1.

Table 6: Low-End and High-End Test Threshold Levels

	Threshold Level
Low-End Test	
Moody's Public Bond Index "A" Yield	**4.06%**
Moody's Public Bond Index "Baa" Yield	**4.34%**
High-End Test	**12.52%**

Q. Have you eliminated any high or low-end results in your two-step DCF analysis?

A. Yes. I found it necessary to eliminate both a low-end and high-end result. Regarding the low-end assessment, while the lowest ROE result of 6.49% for Public Service Enterprise is greater than the low-end threshold of 4.34%, it becomes apparent following a natural break assessment that there is a clear "break" between the lowest value and the next lowest ROE result. The next lowest ROE result of 7.99% for Pinnacle West, is 150 basis points, or approximately 23%, greater than the low-end result of 6.49%. This establishes the Public Service Enterprise result as a low-end outlier.

Regarding the high-end assessment, the high-end result of 13.92% for Portland General is 140 basis points greater than the threshold level of 12.52%, which identifies it as a candidate for elimination. Additionally,

following a natural break analysis, it is clear that there is a significant gap in the array of high-end ROE results, as the next highest ROE is Ameren Corp.'s 9.23% ROE result. Thus, there is a gap of 469 basis points, or approximately 51%, between the highest ROE and the next highest value. Furthermore, the ROE result of 9.23% for Ameren Corp. is clustered much more closely with the next highest set of ROE results. Thus, I consider the 13.92% ROE result for Portland General to be a high-end outlier.

Q. Please confirm the results of your application of the DCF sensitivity analysis after the application of the economic outlier tests.

A. The table below summarizes the results. The results of this sensitivity analysis show that using a proxy group with more disparate and greater risks, as compared to FPL, produces a higher median ROE. The higher ROE is approximately 50 bps greater than the result produced when using my primary and more risk-comparable proxy group. Indeed, the lower median result of this sensitivity analysis, which can be used when the subject utility's risk is lower than the average of the proxy group, is within 10 basis points of the 8.56% median result produced by my primary analysis. In sum. these datapoints further support the reasonableness of my recommendation which utilized a proxy group that is more risk-comparable to FPL.

Table 7:Sensitivity Analysis - Two-Step DCF Model Results

	Lower Median Result	Median Result	Low-End of Range	High-End of Range
Sensitivity Analysis - Two-Step DCF	8.50%	8.93%	7.99%	9.23%

VI. REVIEW OF FPL WITNESS MR. COYNE'S ROE ANALYSIS

Q. Please summarize Mr. Coyne's ROE recommendation?

A. Mr. Coyne recommends an ROE midpoint of 11.0%. It bears noting that FPL is also requesting a 50 bps ROE adder over and above Mr. Coyne's recommended 11.0% ROE for a total midpoint ROE request of 11.5%. Mr. Coyne's recommendation is based on the results of his application of four different analytical methods, which produce an average ROE of 10.89%, together with an 11 basis points adder for flotation costs. Furthermore, while Mr. Coyne's argues that FPL is above average risk relative to the proxy group he relied on, he explains that that he did not make an explicit upward adjustment to his ROE recommendation.[35]

Q. Please describe the methodologies that Mr. Coyne relied upon in developing his ROE recommendation of 10.89% (or 11.0% inclusive of his floatation cost adjustment).

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[35] Mr. Coyne Testimony, pages 5-7.

A. Mr. Coyne relies on four analytical models: (1) DCF (2) CAPM (3) Risk Premium method and (4) the Expected Earnings method. His analysis includes three variations of the DCF method (using dividend yields measured over different lengths of time), two CAPM analyses (each using different data sources for the Beta estimate) and three Risk Premium analyses (one using recent interest rate yields and the other two using projected interest rates).[36]

Q. Do you consider the specific ROE models adopted by Mr. Coyne to be appropriate tools to rely upon when determining the cost of equity?

A. No, I do not. In my view, the specific ROE models Mr. Coyne chose to apply have significant shortcomings. These shortcomings are discussed in greater detail below but in summary, I find that (1) the use of DCF model that solely relies on short-term growth rates is flawed; (2) Mr. Coyne's CAPM analysis is flawed for several reasons including his reliance on inflated market risk premium estimates; (3) Mr. Coyne's Risk Premium model, among other factors, is inherently circular and relies on a dataset that provides an inadequate signal of underlying market-based ROE estimates; and (4) the Expected Earnings method should not be relied upon as it is devoid of market-based input.

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[36] *See* Exhibits JMC-4, JMC-5.2, JMC-6 and JMC-7.

Q. Do you have any opinions regarding the 50 basis point "ROE performance incentive" adder that Mr. Coyne and other FPL witnesses support?

A. While I generally do not study or analyze such proposals in depth, it is obvious on its face that FPL's proposal is not an incentive at all, because it would simply be "baked in" to FPL's rates, which would then not vary regardless of FPL's performance. My analyses address the proper regulatory questions, which are what ROE and what equity ratio or capital structure should be included in setting FPL's revenue requirements and rates in order to ensure that FPL will be able to raise the capital it needs to provide safe and reliable service. To be fair and reasonable to both FPL and its customers, consistent with the regulatory compact, that ROE must be the rate that an objective market would produce based on FPL's risks as compared to the risks of similar companies. My ROE analyses address this question; a proposed "ROE performance incentive" adder does not.

A. Proxy Group

Q. Please summarize how Mr. Coyne selected his proxy group 14 members.

A. Mr. Coyne started with the companies considered electric utilities by Value Line and then excluded companies that do not consistently pay quarterly cash dividends; that are not covered by more than one equity analyst; do not have positive earnings growth rates published by at least two of three sources

listed;[37] that do not own regulated electric generation assets, that have less than 60% of total revenue and net operating income derived from regulated operations over the three year period (2017-2019); that have less than 80% of total revenue and net operating income derived from regulated electric operations over the three year period (2017-2019); that are involved in a merger or other transformative transaction for an approximate six-month period prior to Mr. Coyne's analysis; and that do not have investment grade long-term issuer rating (BBB- to AAA) from S&P. Through applying this screening criteria, Mr. Coyne states it resulted in a 14-member proxy group.[38]

Q. Do you consider Mr. Coyne's exclusion of NextEra Energy, Inc. from the proxy group in order to "avoid the circular logic that would otherwise occur,"[39] to be reasonable?

A. No. The DCF model (in addition to the CAPM model used by Mr. Coyne) relies on a proxy group in its application and is a market-based method used to determine the investor's required return for investing in the common stock equity of the utility. It is highly appropriate to apply these methods to the subject company, or its parent, along with other comparable utilities, given

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37 Namely, Value Line, Thomson First Call (as reported by Yahoo! Finance), and Zack's Investment Research.

38 Mr. Coyne Testimony, pages 42-44.

39 Mr. Coyne Testimony, page 43:1-4.

that the reliance on market data alleviates concerns of circularity. Additionally, I observe that in a separate, recent regulatory proceeding before the FERC, FPL's ROE witness, Mr. Adrien McKenzie, testifying on behalf of FPL included NextEra Energy Inc. in his electric utility proxy group.[40]

The more acute forms of circularity arise with relying on the Risk Premium method (in which primary reliance is placed on past regulatory determinations) and the Expected Earnings method (which relies directly on currently allowed ROEs). However, I note that Mr. Coyne does not comment on these more severe forms of circularity despite relying on these methods.

Q. What observations do you have regarding the proxy group used by Mr. Coyne in his analyses?

A. From reviewing Mr. Coyne's proxy group it is apparent that it is far less risk comparable to FPL when measured using credit ratings as compared to the proxy group I rely upon in my analysis.[41] As previously noted, FPL has S&P and Moody's long-term ratings of A and A1, respectively. The proxy group I developed included electric utilities with S&P ratings within one notch of FPL's S&P rating of A (i.e. no lower than A-) and by necessity I included

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[40] Florida Power & Light Company, Federal Energy Regulatory Commission Docket No. ER19-2585-000, Direct Testimony and Exhibits of Adrien M. McKenzie, Exhibit FPL-403.

[41] This comparative credit rating analysis used ratings as of April 30, 2021.

electric utilities with Moody's ratings within three notches of FPL's Moody's rating of A1 (i.e., no lower than Baa1). In contrast, Mr. Coyne includes companies that have S&P ratings as low as BBB-, which is four notches below FPL's rating, and which have Moody's ratings as low as Baa3, which is five notches below FPL's rating.

Stated directly, Mr. Coyne's proxy group exhibits significantly greater risk, as perceived by rating agencies and by investors, than the proxy group that I rely upon in my analyses. The figures below illustrate how divergent the credit ratings of the utilities in Mr. Coyne's proxy group are both from FPL's ratings and from the ratings of the proxy group utilities that I utilized.

Figure 3: S&P Credit Rating - Proxy Group Comparison

S&P		BTM Proxy Group					JMC Proxy Group												
Rating	FPL	ES	NEE	PNW	WEC	XEL	ALE	LNT	AEE	AEP	DUK	EIX	ETR	EVRG	HE	IDA	OGE	PNW	POR	XEL
AAA																				
AA+																				
AA																				
AA-																				
A+																				
A	A																			
A-		A-	A-	A-	A-	A-		A-		A-				A-				A-		A-
BBB+									BBB+		BBB+		BBB+				BBB+		BBB+	
BBB							BBB					BBB				BBB				
BBB-															BBB-					
BB+																				
BB																				
BB-																				

Figure 4: Moody's Credit Rating - Proxy Group Comparison

Moody's Rating		BTM Proxy Group					JMC Proxy Group												
	FPL	ES	NEE	PNW	WEC	XEL	ALE	LNT	AEE	AEP	DUK	EIX	ETR	EVRG	HE	IDA	OGE	PNW	POR	XEL
Aaa																				
Aa1																				
Aa2																				
Aa3																				
A1	A1																			
A2																				
A3				A3														A3	A3	
Baa1		Baa1	Baa1		Baa1	Baa1	Baa1		Baa1							Baa1	Baa1			Baa1
Baa2								Baa2		Baa2	Baa2		Baa2	Baa2						
Baa3												Baa3								
Ba1																				
Ba2																				
Ba3																				

Q. Mr. Coyne asserts that several factors increase FPL's risk profile as compared to his proxy group. What are those factors?

A. Mr. Coyne mentions several factors including; FPL's capital expenditure program; FPL's nuclear generation fleet; severe weather risk; and risk related to FPL's proposed four-year plan. I note that Mr. Barrett also discusses a number of these factors in his testimony.

Q. Do you agree with Mr. Coyne's assertions that FPL faces above average risks?

A. No. Credit agencies' rating evaluations are specifically designed to differentiate between risks of individual companies and to consider a broad range of variables affecting both the business risk and financial risk of the companies. Such evaluations include the factors highlighted by Mr. Coyne including the regulatory environment, capital expenditure plans,

geographical risk and economic, social and governance considerations.[42] Therefore, credit ratings facilitate a direct risk comparison between electric utilities. As discussed above, many of the companies included in Mr. Coyne's proxy group have ratings that are significantly lower than FPL's ratings, indicating that FPL is less risky, not riskier, as compared to the average risk of Mr. Coyne's proxy group. Moreover, again as discussed earlier, FPL's regulatory environment is viewed as constructive and well-regarded in the financial community and it has been recognized that FPL suffers from little regulatory lag and the storm cost recovery mechanism is viewed favorably. Lastly, commentators have highlighted the role that the surplus reserve amortization mechanism has played in enabling FPL to consistently earn the top end of the ROE range permitted by the PSC in recent years. Overall, it is evident that FPL does not have above-average risk relative to Mr. Coyne's proxy group.

B. Expected Earnings Method

Q. Please briefly describe the Expected Earnings Method.

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[42] For example, see Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

A. The Expected Earnings method is a form of the Comparable Earnings method that examines a company's expected accounting return on the book value of its common equity.

Q. Is the Expected Earnings method an appropriate method for measuring investors' required rate of return?

A. No. The principal flaw with the Expected Earnings method is that it does not measure the rate of return investors require to invest in the common equity capital of a utility, which is the utility's cost of equity capital. Rather, the Expected Earnings method measures investment analysts' expectations of what the utility will earn on the book value of its common equity. The method standing alone is devoid of market or investor input, making it incapable of measuring investors' or the market-required rate of return. Since an investor cannot purchase a utility's common stock at book value, the utility's expected earned return on book value says nothing about what an investor could expect to earn on the utility's common stock or what level of return an investor requires to invest in the common stock, except in the unusual circumstance where the utility's common stock happens to be trading in the market at a price at or very near the utility's book value per share.

Q. Has this fatal flaw been acknowledged in regulatory and financial communities?

A. Yes. The method has long been thoroughly discredited and has been replaced with market-based methods such as the DCF method. For example, Eugene F. Brigham, Dilip K. Shome and Steve R. Vinson, in a 1985 paper, report that the variation of the Expected Earnings method, known as the Comparable Earnings method, "has now been thoroughly discredited...and it has been replaced by three market-oriented (as opposed to accounting-oriented) approaches."[43] Additionally, the authors of *Risk and Return for Regulated Utilities* briefly summarize the evolution seen in the methods used to determine the rate of return for regulated utilities as follows:

> Until the 1960s, there were few if any alternatives to comparable earnings. Then the DCF method came along, followed by the CAPM. In 1972, Stewart C. Myers showed that the appropriate rate of return on a regulated company's rate base was the cost of capital as defined by modern finance, that is, based on expected rates of return in capital markets, not in accounting statements. Over the years since, use of the comparable earnings method has dwindled. There are good reasons for this.[44]

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[43] *See* Eugene F. Brigham, Dilip K. Shome, and Steve R. Vinson, *The Risk Premium Approach to Measuring a Utility's Cost of Equity*, 14 Fin. Mgmt. 33 (1985) (citations omitted). Note while the authors specifically reference the Comparable Earnings method, which examines historical accounting rates of return using unregulated firms in the sample group, the points that the accounting rates of return, including projected accounting rates of return used by the Expected Earnings method, do not provide meaningful information on the cost of capital or economic rates of return, are equally valid when regulated firms are used.

[44] Dr. Villadsen, *et al.*, *Risk and Return for Regulated Industries* (Elsevier Inc., 2017), at 128 ("*Risk and Return for Regulated Industries*"), citing Stewart C. Myers, "Application of Finance Theory to Public Utility Rate Cases," The Bell Journal of Economics and Management Science 3 (Spring 1972): 58-97.

Q. Has the PSC recognized the importance of market-based analytical models?

A. Yes. The PSC previously explained that market-based approaches are consistent with the "market-based standards of a fair return enunciated in the *Hope* and *Bluefield* decisions."[45] Relying on the Expected Earnings method directly conflicts with the PSC's explanation of how the *Hope* and *Bluefield* standards should be met.

Q. Mr. Coyne suggests the range of accounting based ROEs that are produced by his Expected Earnings analysis is "useful in helping to determine the opportunity cost of investing in the subject company."[46]Do Expected Earnings analyses estimate the opportunity cost of investing in a particular utility?

A. No, they do not. Forecasted earnings on a utility's book value cannot be considered a measure of the opportunity cost of capital because an investor cannot purchase the utility's common equity at its book value. Rather, an investor must pay the prevailing market price for its common equity. Dr. Morin, in his treatise *New Regulatory Finance*, also makes this point:

> Accounting rates of return are not opportunity costs in the economic sense, but reflect the average returns earned on past investments, and hence reflect past regulatory actions. The

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45 Order No. PSC-10-0153-FOF-EI at page 121.

46 Mr. Coyne Testimony, page 64:3-4.

> denominator of accounting return, book equity, is a historical cost-based concept, which is insensitive to changes in investor return requirements. Only stock market price is sensitive to a change in investor requirements. Investors can only purchase new shares of common stock at current market prices and not at book value. More simply, the Comparable Earnings standard ignores capital markets.[47]

While Dr. Morin referenced historically-earned book returns, the key points are the same for projected book returns. Book returns are not opportunity costs. The denominator is book equity, which is insensitive to changes in investor return requirements. Only stock market price is sensitive to a change in investor requirements. Investors can only purchase new shares of common stock at current market prices and not at book value. And, simply stated, the Comparable Earnings standard ignores capital markets.

Moreover, when an investor must pay more than book value, that investor must be expecting to earn, and thus require, something less than the company's reported earned return on book value. Therefore, not only does the Expected Earnings method fail to measure the market cost of common equity capital, but more importantly it produces an erroneously inflated measure when the market-to-book ratios are above 1.0.

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[47] *New Regulatory Finance* at 393. Also, as previously noted, the Expected Earnings method is a form of the Comparable Earnings method that examines a company's expected accounting return on the book value of its common equity.

Q. Please explain how the Expected Earnings method results in an inflated measure when the market-to-book ratios are above 1.0.

A. When the investor must pay something more than book value to gain the right to the future expected earnings on book value, that investor must be expecting to earn (and thus requires) something less than the reported earned return on book value. This fundamental logic has been described by Dr. Morin as intuitive.[48] Dr. Morin adds that "[t]he condition that the M/B ratio will gravitate toward 1.0 if regulators set the allowed return equal to capital costs will be met only if the actual return expected to be earned by investors is at least equal to the cost of capital on a consistent long-term basis and absent inflation."[49] This view is also confirmed by Stewart C. Myers, who explains that "[a] firm's market value will equal book value if it consistently earns a book rate of return equal to the cost of capital."[50] Dr. Jonathan A. Lesser and Dr. Leonardo R. Giacchino likewise opine that "[u]nder ideal circumstances, with a rate of return set exactly equal to the firm's [weighted average cost of capital], the market-to-book ratio would equal one."[51]

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48 *New Regulatory Finance* at 359.

49 *See id.* at 376.

50 Stewart C. Myers, *The Application of Finance Theory to Public Utility Rate Cases*, *The Bell Journal of Economics and Management Science*, Vol. 3, No. 1 (Spring 1972) at 73.

51 Jonathan A. Lesser, Ph.D., Leonardo R. Giacchino, Ph.D., *Fundamentals of Energy Regulation* 240 (Public Utilities Reports, Inc., 2nd Ed. 2013).

Q. Please provide an example of how an ROE produced by the expected earnings method misrepresents an investor's required level of return.

A. The Expected Earnings method's fatal flaw of mispresenting an investor's required level of return can be seen when reviewing the Expected Earning analysis used by Mr. Coyne.[52] A review of market price-to-book value ratios for the companies included in Mr. Coyne's Expected Earnings analysis shows that all are well above 1.0, with a range of 1.36 to 2.35, and a median and midpoint of 1.81 and 1.86, respectively.[53] Therefore, the Expected Earnings analysis demonstrates only that his 10.55% median and 10.22% mean expected earned returns are substantially higher than investors' required ROE.

Q. What conclusion do you have regarding Mr. Coyne's reliance on the Expected Earnings analysis?

A. Mr. Coyne's reliance on the Expected Earnings method is misplaced and the PSC should reject it. The Expected Earnings method should not be relied on in any manner as it is devoid of market-based input. As discussed in my testimony and in the academic and financial literature cited above, it has been thoroughly discredited as a flawed methodology for the purposes of

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52 Exhibit JMC-7.

53 *See* Exhibit BTM-4.

estimating investors' required rate of return for investing in a company's common equity.

C. One-Step Constant Growth DCF Analysis

Q. Please briefly describe Mr. Coyne's application of the DCF model.

A. Both Mr. Coyne and I employ a constant growth variation of the DCF model. However, the manner in which Mr. Coyne applies this model differs from my application. Mr. Coyne's analysis utilizes stock prices across three different study periods, namely, a 30-day, a 90-day and 180-day period through February 26, 2021. These different study periods are used to produce three separate DCF models. The average stock prices over each respective period are then combined with the annualized dividend per share as of February 26, 2021 in the calculation of the dividend yield.[54] Regarding the growth rate used in the DCF model, Mr. Coyne relies on the analysts' consensus "five-year" earnings per share ("EPS") growth rate projections for each proxy group company as reported by Yahoo! Finance from the I/B/E/S International, Inc. ("IBES") database and those reported by Zacks. Additionally, he uses EPS growth rates published by Value Line.[55]

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[54] Mr. Coyne Testimony, page 47:12-17.

[55] Mr. Coyne Testimony, page 48:15-18.

Q. Please state the overall DCF result that Mr. Coyne uses to support his ROE recommendation.

A. The DCF result used is 9.29%.[56]

Q. Have you identified any flaws with Mr. Coyne's application of the DCF model?

A. The principal flaw that I have identified is that Mr. Coyne's application of the DCF model only incorporates a short-term growth rate in its computation i.e., it is a "one-step" constant growth DCF model. The omission of a long-term growth rate in the DCF model fails to recognize that all company earnings growth rates are constrained in the long run by the rate of growth in the economy as a whole.[57] It is for this very reason that many experts have expressed the need to include a long-term growth rate when applying the DCF method. For example, Dr. Morin explains that "[analysts' earnings growth] forecasts are typically for the next five years. From this standpoint of the DCF model that extends into perpetuity, this forecasting horizon may be too short. For example, it is quite possible that a company's dividends can

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[56] Mr. Coyne Testimony, page 65, Figure 15.

[57] See Dr. Villadsen, Dr. Vilbert, Mr. Harris and Dr. Kolbe, *Risk and Return for Regulated Industries* (Academic Press, 2017) at 100, footnote 12 ("...no company can grow at a rate above that of the general economy forever.").

grow faster than the general economy for five years, but it is quite implausible for such growth to continue into perpetuity."[58]

Q. Has Mr. Coyne, in his testimony to other state utility regulatory authorities, adopted and recommended a DCF model that incorporates a long-term growth rate?

A. Yes. I observe that Mr. Coyne has utilized the multi-stage DCF method in his analysis in testimony filed in other regulatory jurisdictions.[59] Both the multi-stage DCF method and the two-step constant growth DCF model that I rely on share the same goal of managing the DCF method's perpetual assessment time horizon and the fact that analysts' earnings-per-share growth rate estimates, which typically do not exceed a five-year horizon, are unrealistic for use as the sole growth rate in a perpetuity model.[60] The multi-stage DCF method attempts to explicitly estimate different stages of growth, whereas, the two-step DCF method blends the growth rates into a single

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58 *See New Regulatory Finance* at 309.

59 For example, see, Tariff filing of Green Mountain Power, State of Vermont Public Utility Commission, Docket No. 18-0974, Prefile Testimony of James M. Coyne (April 13, 2018). Also see, Application of Northern States Power Company, Public Service Commission of Wisconsin, Docket No. 4220-UR-123, Direct Testimony of James. M. Coyne (May 4, 2017).

60 *New Regulatory Finance* at page 308.

composite rate.[61] It is not clear why Mr. Coyne chose not to adopt the multi-stage DCF model in his analysis for this proceeding.

Q. Have you identified any other inappropriate assumptions and specifications used by Mr. Coyne in his DCF analysis in this case?

A. Yes. I find Mr. Coyne's reliance on Value Line growth rates to estimate the short-term growth rate to be inappropriate. I have two primary issues with relying on Value Line growth rates. First, the usefulness of Value Line's growth rates is limited by Value Line's publication schedule, which dictates that the earnings projection for a company it covers is only updated on a rolling quarterly basis. Typically, one obtains the short-term growth rates on a date that is reasonably close to the end of the study period. Therefore, Value Line growth rates may not necessarily provide a contemporaneous representation of investors' short-term earnings growth expectation for the subject company. In this instance, Mr. Coyne appears to have used Value Line growth rates that were taken from the December 11, 2020, January 22, 2021 and February 12, 2021 editions of Value Line investor reports.[62]

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61 Generally speaking, a multi-stage DCF method involves three stages of growth. Stage 1 typically covers the first five years and is based on analysts' short-term earnings-per-share growth rates. In Stage 2, the method assumes a transition period whereby an industry-wide growth rate or some other growth rate may be applied. Stage 3 involves the assumption that the company will continue to grow at the rate of the wider economy, which can be measured by a GDP growth projection.

62 *See* FPL discovery response (public) to OPC's 1st set of POD, No. 36, file "Exhibit JMC-4 Value Line Reports Feb 2021."

Second, Value Line's growth rate projections do not represent the consensus of a number of different analysts; rather, they represent the view of only one analyst—the Value Line analyst.[63] As noted by Dr. Morin consensus growth forecasts "are more reliable estimates of investors' consensus expectations likely to be impounded in stock prices."[64]

Q. Do you have an opinion regarding Mr. Coyne's reliance on analyses that implement a "one-step" constant growth DCF model?

A. Yes. It is my opinion that Mr. Coyne's reliance on a constant growth DCF model that relies solely on short-term growth rates is flawed and should not be relied upon by the Florida PSC in its determination of an allowed ROE to be used in determining FPL's revenue requirements and setting the rates to be charged to FPL's customers.

D. Capital Asset Pricing Model Analysis

Q. Please briefly describe Mr. Coyne's application of the CAPM model.

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[63] Typically, an investment research firm will publish its earnings projection under the name of the lead analyst covering each company. Each firm may have several analysts contributing to the development of the projection and the firm may have in place a peer review group to act as a quality control check. However, the involvement of multiple people in the development of a given analyst's projection should not be construed as equivalent to a "consensus" estimate, which is based on the projections from more than one analyst/firm.

[64] Dr. Roger Morin, *New Regulatory Finance* (Public Utilities Reports, Inc., 2006) at 302.

A. Before turning to specific input estimates employed by Mr. Coyne as part of his CAPM analysis, it is helpful to describe how the CAPM methodology is mathematically expressed in order to identify the various components that require estimation. The mathematical formula is:

$$ER_i = R_f + \beta_i\,(ER_m - R_f)$$

where:

ER_i = expected return on investment

R_f = risk-free rate

β_i = beta, or systematic risk, of the investment

ER_m = expected return of market

$(ER_m - R_f)$ = market risk premium

For the risk-free rate, Mr. Coyne relied on a projection of the yield on 30-year Treasury bonds for the years 2022 through 2026 published in a December 2020 Blue Chip Financial Forecast report.[65] Regarding the beta estimate, Mr. Coyne in one CAPM application, used betas sourced through the Bloomberg platform, and, in another CAPM application, he used betas sourced from Value Line.[66] To estimate the market risk premium, Mr. Coyne relied on the average of three different market return estimates and subtracted the risk-free rate mentioned above. One market return estimate was directly sourced from a report published by S&P Dow Jones Indices. The other two market return estimates were calculated by Mr. Coyne using a one-step

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65 Mr. Coyne Testimony, page 57:7-10.

66 Mr. Coyne Testimony, page 58:12-18.

constant growth DCF model using data sourced from the Bloomberg platform and Value Line, respectively.

Q. Please state the overall CAPM result that Mr. Coyne uses to support his ROE recommendation.

A. The CAPM that Mr. Coyne uses is 14.17%.[67]

Q. Do you find Mr. Coyne's application of the CAPM method appropriate?

A. No. Mr. Coyne's application is flawed for two primary reasons: the use of projected bond yields for the risk-free rate and the use of an inappropriate approach to estimate the ex-ante forward looking market return. Simply put, the market return estimates, and resulting market risk premiums, used by Mr. Coyne are inconsistent with other respected measures of such estimates. I discuss each element below.

1. Use of Projected Bond Yields for the Risk-Free Rate

Q. Why do you consider it inappropriate to rely on projected bond yields?

A. Relying on projected bond yields, which estimate what a bond yield will be at a certain point in the future, conflicts with the task at hand, which is to estimate the *current* market cost of common equity. Investors' expectations about the future certainly affect the level of return they require to invest in a

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[67] Mr. Coyne Testimony, page 65, Figure 15.

utility's stock, but the objective remains to establish the *current* cost of equity based on investors' *current* forward-looking return requirements, as measured during the financial study period. This objective is best fulfilled through the use of verifiable financial data, such as actual current bond yields, which already reflect investors' expectations about the future direction of interest rates. For example, if investors expect interest rates to rise in the future, they will bid down the price they are willing to presently pay for a fixed-rate bond, thereby increasing that bond's current yield.

Moreover, it bears noting, that the other components of Mr. Coyne's CAPM analysis are measured at the time of his study period. For instance, Mr. Coyne's forward-looking market return estimates are as of the end of February 2021 and not at the corresponding time period that the projected bond yield is forecast to occur. This creates an internal inconsistency given the necessary feedback loop that occurs between investors market return expectations and the Treasury bond yields.

Q. Do you have any other concerns with placing any reliance on projected bond yields as part of an analysis to determine the cost of equity?

A. Yes. Forecasted bond yields are speculative and prone to forecasting error. Indeed, the United State Treasury offers a cautionary note regarding projected bond yields and explains that "future economic and monetary policies that impact the yield curve cannot be accurately forecast, and thus

attempts to forecast future [Constant Maturity Treasury] rates must be considered risky, at best."[68] In a separate proceeding , I previously measured how projected bond yields for the period 2018-2022, which were estimated during the 2017 year, compared to actual yields.[69] The projections were provided by Value Line Investment Survey, IHS Global Insight and Wolters Kluwer (Blue Chip Forecast). The figure below compares the projections and actuals for the years for which such information is available. This comparison clearly shows how projected yields can significantly differ from the actual outcome and render them unreliable for use as part of the CAPM model used to determine an authorized ROE.

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68 U.S. Department of the Treasury, Treasury Yield Curve Methodology, https://home.treasury.gov/policy-issues/financing-the-government/interest-rate-statistics/treasury-yield-curve-methodology (last accessed June 17, 2021).

69 *See Pacific Gas & Electric Company*, Docket No. ER16-2320-002, Answering Testimony of Breandan T. Mac Mathuna, Exhibit CIT-0114 at pages 31 and 32 (February 12, 2021). I sourced the underlying projected bonds yields used by PG&E ROE witness Mr. McKenzie from the native Excel version of Exhibit No. PGE-0047. The spreadsheet supporting the assessment of the projected bond yields was provided as Exhibit No. CIT-0117.

Figure 5: Projected 30-year Treasury Bond Yield Analysis[70]

2018	Value Line Investment Survey	IHS Global Insight	Wolters Kluwer (Blue Chip Forecast)
Projected	3.60%	3.75%	3.60%
Actual	3.11%	3.11%	3.11%
Basis Point Delta	***0.49%***	***0.64%***	***0.49%***
2019	**Value Line Investment Survey**	**IHS Global Insight**	**Wolters Kluwer (Blue Chip Forecast)**
Projected	3.80%	4.36%	4.20%
Actual	2.58%	2.58%	2.58%
Basis Point Delta	***1.22%***	***1.78%***	***1.62%***
2020	**Value Line Investment Survey**	**IHS Global Insight**	**Wolters Kluwer (Blue Chip Forecast)**
Projected	4.00%	4.57%	4.30%
Actual	1.56%	1.56%	1.56%
Basis Point Delta	***2.44%***	***3.01%***	***2.74%***

In this proceeding, I note that Mr. Coyne is using a projected 30-year Treasury bond yield of 2.80% in his CAPM analysis. This rate is approximately 83 basis points greater than the six-month average 30-year Treasury bond yield through April 2021 which was approximately 1.97%.[71]

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[70] *See Pacific Gas & Electric Company*, Docket No. ER16-2320-002, Answering Testimony of Breandan T. Mac Mathuna, Exhibit CIT-0114 at page 33.

[71] Using monthly constant maturity 30-year Treasury bond yield data for the six-month period through April 2021, produced by the Federal Reserve Board and made available at https://www.federalreserve.gov/datadownload/Choose.aspx?rel=H15

2. *Market Return Estimate*

Q. Please summarize the three market return estimate values relied on by Mr. Coyne.

A. Mr. Coyne used the following market return values.

- S&P Earnings & Estimates Report = 17.70%
- Bloomberg = 15.46%
- Value Line = 14.07%

The average of the three values is 15.75%. This value is used in the two CAPM analyses Mr. Coyne develops.[72]

Q. What issues have you identified with Mr. Coyne's one-step DCF analyses used to derive the above mentioned Bloomberg and Value Line based estimates.

A. I have identified several inappropriate aspects. These are:

- Use of an inappropriate dataset;
- Reliance on Value Line short-term growth rates;
- Lack of testing of the economic soundness of the results; and
- Failure to include a long-term growth rate as part of the DCF analysis.

Q. Please explain in what way Mr. Coyne's dataset is inappropriate.

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[72] Mr. Coyne Testimony at Exhibit JMC 5.2.

A. Mr. Coyne's derived a market return estimate using a dataset that includes both dividend-paying and non-dividend paying S&P 500 companies.[73] In particular, the market capitalization weighted growth rate includes the growth rates of companies that do not pay dividends. This is inappropriate. The proper and customary approach is to include only companies that pay dividends in the DCF model. The use of the DCF model to estimate the market return is no different. For example, Dr. Morin explains that the typical application of the constant growth DCF model to estimate market return involves the measurement of "the expected rate of return (cost of equity) of each dividend-paying stock in the S&P 500."[74]

Q. Earlier in your testimony, you discuss limitations in relying on Value Line short-term growth rates. Are these same limitations applicable in the context of developing a market return estimate?

A. Yes. Please refer back to the discussion in my testimony at section VI.C under the heading "One-Step Constant Growth DCF Analysis" for a more thorough description and discussion of the limited usefulness of the Value Line short-term growth rates.

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[73] For example, in Exhibit JMC-5.1, the S&P 500 market capitalization weighted estimate of the S&P 500 growth of 13.87%, uses in part the market weighted growth rate for the Walt Disney Company, a company that does not currently pay a dividend. There are many such examples.

[74] *New Regulatory Finance* at 160.

Q. Did Mr. Coyne apply tests of economic logic in his application of the one-step DCF analyses used to estimate the market return?

A. No.

Q. Do you consider it necessary and appropriate to apply threshold tests of economic logic to DCF model results where such results are intended to be used to assess the market return used in a CAPM analysis?

A. Yes. Just as the results of the electric utility two-step DCF model should be subject to an appropriate test or tests of economic logic, it is critical that the DCF model used to estimate market return produces results that pass threshold tests of economic logic. Indeed, it bears noting that the FERC has expressly recognized the importance of applying a test of economic logic in both settings.[75]

Q. Earlier in your testimony, you criticized Mr. Coyne's electric utility one-step constant growth DCF model for failing to include a long-term growth rate component. Is that criticism equally valid in the context of using a DCF model to estimate a market return?

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[75] For example, *see* Federal Energy Regulatory Commission, *Ass'n of Bus. Advocating Tariff Equity, et al. v. Midcontinent Indep. Sys. Operator, Inc., et al.*, Docket Nos.EL14-12-000 and EL15-45-000, Opinion No. 569-A, 171 FERC ¶ 61,154 at P 77 ("We are not persuaded by [Midcontinent Independent System Operator Transmission Owners'] arguments that the CAPM methodology should consider growth rates that are negative or above 20% and continue to find that such a screen is consistent with the elimination of outliers elsewhere in the ROE methodology.").

A. Yes, it is. Mr. Coyne's DCF modelling approach unduly inflates the estimated market return, and, in turn the estimated market risk premium, through its sole reliance on short-term expected growth rates and the absence of a long-term growth rate in its computation. Moreover, it has been widely recognized by economists that a market representative index or portfolio of companies – and the S&P 500 in particular - cannot circumvent the fact that companies cannot grow in perpetuity at a faster rate than the broader economy. For instance, John Mauldin, in an article from his regularly-issued "Thoughts from the Frontline" series, explained that:

> Earnings growth is primarily driven by economic growth. Although profit margins vary across the business cycle and by industry and company, earnings for the stock market as a whole over the long term tend to track sales growth. Measures of the economy, including gross domestic product (GDP), tend to measure the aggregate sales of all companies in the economy. As a result, earnings growth has historically been similar to GDP growth. In reality, earnings growth for large-company indexes like the S&P 500 has been slightly lower than overall economic growth. The economy includes faster-growth small companies and start-ups that tend to outpace the more stable giants.[76]

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[76] John Mauldin, *It's Not Over Till the Fat Lady Goes on a P/E Diet*, Mauldin Economics (July 10, 2013), https://www.mauldineconomics.com/frontlinethoughts/its-not-over-till-the-fat-lady-goes-on-a-p-e-diet. (Emphasis added) (last accessed June 18, 2021). S*ee also* Robert D. Arnott, *Equity Risk Premium Myths*, The Research foundation of CFA Institute (2011) at 93, *and* David Sharp *et al.*, J.P. Morgan Asset

Additionally, Mr. Robert D. Arnott, Chair and Founder of Research Affiliates, LLC, has commented on the intrinsic relationship between the S&P 500 consensus growth rate and the GDP long-term growth rate:

> [t]he current consensus growth rate for earnings on the S&P 500, according to the Zacks Investment Research survey, is 10 percent, which, if we assume a consensus inflation expectation of 2–3 percent, corresponds to 7–8 percent real growth. Real earnings growth of 8 percent is six times the real earnings growth of the past century, however, and three times the consensus long-term GDP growth rate. This growth is not possible.[77]

Q. Is there evidence that financial experts use a long-term growth rate when estimating a market risk premium?

A. Yes. Authoritative financial sources use long-term growth rates when computing the market risk premium for major market indexes like the S&P 500. For example, the co-authors of the treatise *Risk and Return for Regulated Industries* explain the manner in which Bloomberg incorporates GDP projections as part of its calculation to estimate a projection of the market risk premium as follows:

Mgmt., *Long-Term Capital Market Assumptions 2015 Estimates and the Thinking Behind the Numbers* at 25 (2014).

[77] Robert D. Arnott, *Equity Risk Premium Myths*, The Research Foundation of CFA Institute (2011) at 97.

> commercial data providers such as **Bloomberg also produce [market risk premium] forecasts, which are based on the major market index in the country of interest (e.g., the S&P 500 in the US**, the S&P/TSX in Canada, the FTSE in the UK, and the DAX in Germany). The Bloomberg forecasted [market risk premium] uses a normalized cash flow (rather than dividends) and a payout ratio for the initial yield **and analyst forecasts that converge to the GDP growth rate over a period of 8-15 years, with mature companies being in the lower range and start-ups being in the longer range.** Thus, the convergence to GDP growth is faster for established companies and slower for growth companies…The Bloomberg [market risk premium] forecast is based on the local market index (e.g., the S&P 500) and is over the 10-year risk-free rate.[78] (emphasis added)

Q. How do Mr. Coyne's ex-ante market return estimates and market risk premiums compare to the estimates of independent third parties?

A. Mr. Coyne's market return estimates of 17.70%, 15.46% and 14.07%, and corresponding market risk premiums of 14.90%, 12.66% and 11.27% are considerably greater than those produced by other reputable institutions and

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[78] Dr. Villadsen, Dr. Vilbert, Mr. Harris and Dr. Kolbe, *Risk and Return for Regulated Industries* (Academic Press, 2017) at 71 (footnotes omitted). Please note the logic of incorporating a long-term growth is not impacted by Bloomberg's use of cash flow as opposed to dividends as part of the model.

professionals.[79] Below I have outlined forward-looking market return and market risk premium examples:

- Duff & Phelps estimate the ex-ante market risk premium at 5.5%, effective as of December 30, 2021 and thereafter until changed. This estimate is combined with a normalized risk-free rate of 2.5%.[80]
- Dr. Damodaran, Professor of Finance at the Stern Schooled of Business at New York University, provides two ex-ante market risk premium estimates. As of April 30, 2021 his standard calculation of the market risk premium estimate is 4.22% and his COVID-19 adjusted market risk premium estimate is 4.26%. Dr. Damodaran couples the market risk premium with an estimate of the risk-free rate that is based on 10-year Treasury bond yields, which was estimated at 1.75%, as of April 30, 2021.[81]

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[79] The market risk premium values were calculated by subtracting the risk-free rate of 2.80% (which is based on a projection of 30-year Treasury bond yields) from each respective market return value. *See* Mr. Coyne Testimony, page 59, lines 8:16.

[80] Duff & Phelps U.S. Equity Risk Premium Recommendation, effective December 31, 2021. Available at https://www.duffandphelps.com/insights/publications/valuation-insights/valuation-insights-first-quarter-2021/duff-and-phelps-recommended-us-equity-risk.

[81] Damodaran Online, estimate as of April 30, 2020, available at http://pages.stern.nyu.edu/~adamodar/.

- KPMG estimate the ex-ante market risk premium at 5.75%, as of March 31, 2021.[82]
- Bank of America, Global Research, in its March 2021 report estimated an implied and required S&P 500 return of 10.4% and 10.7%, respectively.[83]

Thus, it is evident that the market return, and subsequent market risk premium values, relied on by Mr. Coyne are excessive as compared to these other independent estimates.

Q. Have you calculated how Mr. Coyne's CAPM results would be altered if a recent six-month period of 30-year Treasury bond yields were used and if a more modest estimate of the market risk premium was adopted?

A. Yes. By way of example, to demonstrate the excessiveness of Mr. Coyne's results, I utilized a six-month average period for 30-year Treasury bond yields through April 2021 to estimate the risk-free rate and simply adopted the highest market return estimate from the independently sourced examples outlined above (10.7%). For the purposes of this calculation I utilized Mr.

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[82] KPMG Equity Market Risk Premium, Research Summary, March 31, 2021. Available at https://home.kpmg/nl/nl/home/insights/2020/04/equity-market-risk-premium-2020.html.

[83] Bank of America, Global Research, Quantitative Profiles, Stick with Value until everyone says stick with Value, March 22, 2021, Exhibit 35: BofA Universe Sector/Industry Factor Evaluation. The report made available in State of New York Public Service Commission, *Orange and Rockland Utilities, Inc.* Cases 21-G-0073 & 21-E-0074, Prepared Exhibits of Staff Finance Panel, Exhibit FP-20 (May 2021).

Coyne's proxy group, which is a conservative assumption in favor of FPL given that Mr. Coyne's proxy group exhibits far greater risks than my more risk-comparable proxy group, when measured using credit ratings.[84] The resulting median CAPM result is 9.39%, which is 478 bps lower than Mr. Coyne's primary ROE result of 14.17%.[85]

Q. What conclusions do you draw about the CAPM analysis that Mr. Coyne employed?

A. Mr. Coyne's CAPM analysis includes assumptions that bias the ROE results upward and are problematic for several reasons, as detailed above, rendering the analysis unreliable. Indeed, it can be seen that a more reasonably developed analysis would result in a CAPM result that is 478 bps lower than Mr. Coyne's result.

E. Risk Premium Method

Q. Please briefly describe Mr. Coyne's application of the Risk Premium method.

A. The Risk Premium method is based on "the simple idea that since investors in stocks take greater risk than investors in bonds, the former expect to earn a return on a stock investment that reflects a 'premium' over and above the

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[84] Please refer back to the discussion in my testimony at section VI.A under the heading "Proxy Group" for a more thorough discussion of how Mr. Coyne's proxy group is less risk-comparable.

[85] *See* Exhibit BTM-5.

return they expect to earn on a bond investment."[86] The specific method adopted by Mr. Coyne measures the implied risk premium by calculating the difference between allowed state ROEs awarded to vertically integrated utilities since January 1992 and actual 30-year Treasury bond yields and examines how the implied risk premium changes when the bond yield changes through a linear regression analysis. Mr. Coyne then applies this regression relationship to recent and projected bond yields to arrive at overall cost of equity estimates. In particular, Mr. Coyne used a 30-day average Treasury yield of 1.97%, a projection for the Q2 2021 – Q2 2022 period and a projection for the years 2022 through 2026. Mr. Coyne's analysis produced three ROE estimates, of 9.53%, 9.66% and 9.88%.[87]

Q. Please state the Risk Premium result that Mr. Coyne uses to support his ROE recommendation.

A. The Risk Premium result used by Mr. Coyne is 9.88%.[88]

Q. Is the Risk Premium method an appropriate method for measuring investors' required rate of return?

A. No. I consider the Risk Premium method, as applied by Mr. Coyne, to be problematic for several reasons, including:

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86 *New Regulatory Finance* at 108.

87 Mr. Coyne Testimony, page 63, Figure 14.

88 Mr. Coyne Testimony, page 65, Figure 15.

(1) While the method seeks to update the implied risk premium to the contemporary interest rate environment, this does not change the fact of the method's core reliance on past state commissions' ROE decisions, and this reliance renders the analysis inherently circular.

(2) The available dataset of state proceedings involving ROE determinations consists of many proceedings resolved through settlement agreements that were approved by a regulator. However, an ROE reached through settlement may reflect trade-offs with other aspects of the agreement and, therefore, it provides a poor signal of the underlying market-based ROE estimate.

(3) Mr. Coyne's Risk Premium method's sole use of some form of Treasury bond yield to estimate the cost of equity fails to address the specific risk profile of the subject utility whose ROE is at issue (*i.e.*, FPL). It is commonly understood that the utility with a higher credit rating will have a lower risk premium and vice versa.[89]

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[89] For example, Dr. Morin, in his treatise, *New Regulatory Finance*, recognizes this when discussing a study completed by Brigham, Shome and Vinson that "examined the relationship between risk premium and bond rating and found, unsurprisingly, that the risk premiums are higher for lower rated firms than for higher rated firms." *See New Regulatory Finance* at 129. I also note that Dr. Morin presents a figure based on data from that study that shows that "A" rated electric utilities had an approximately 100 basis points lower risk premium than those rated "A/BBB."

Q. Do your concerns about the use of projected bond yields in the CAPM analysis, as discussed above, equally apply to Mr. Coyne's Risk Premium analysis here?

A. Yes, they do. In fact, the use of projected bond yields in the Risk Premium method is particularly problematic. The allowed ROEs and bond yields used to calculate the risk premiums are based on actual results for each proceeding's relevant study period. Adding back in a forecasted yield in the final step, which is what Mr. Coyne does, is inconsistent with the methodology used to derive the historically based risk premium. Furthermore, subtracting forecasted utility bond yields from the allowed ROEs almost certainly would have reduced the calculated premium, because forecasters tend to project higher yields in the future.

Q. What conclusion do you draw regarding Mr. Coyne's use and application of the Risk Premium method in this case?

A. For the reasons set forth and explained above, I recommend that the Florida PSC not rely on this method, and in particular Mr. Coyne's application of the method, when determining an allowed ROE for FPL.

F. Flotation Cost ROE Adjustment

Q. Do you agree with Mr. Coyne's inclusion of 11 bps in his ROE recommendation to account for purported equity flotation costs?

A. No. There is no indication provided by Mr. Coyne, that FPL's parent company, NEE, has firm plans to issue common equity during the test year periods. Therefore, it is unreasonable to include a flotation cost adjustment absent such evidence. I note that other regulators require firm evidence of such plans when permitting the inclusion of flotation costs.[90]

G. Conclusion: Evaluation of FPL's Proposed ROE

Q. What are your ultimate conclusions regarding FPL's requested midpoint ROE of 11.50%?

A. For the reasons explained above, I find Mr. Coyne's analysis underpinning the request to be broadly inappropratie and unreliable. The flawed models and assumptions that he has employed do not reasonably measure investors' required rate of return, and therefore Mr. Coyne's analyses fail to provide adequate or reliable support for FPL's requested ROE. The Commission should reject Mr.Coyne's analyses and conclusions and set FPL's ROE based on my thoroughly documented, methodologically sound analyses.

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[90] *See* Federal Energy Regulatory Commission, *Bangor Hydro-Electric Company et al.* Docket Nos. ER04-157-004 and ER04-714-001, Opinion No. 489, 117 FERC ¶ 61, 129 at P 87 (2006) ("In the past, the Commission has approved flotation cost adjustments only when the utility demonstrates that a new stock issuance is imminent."). Also, *see* State of New York Public Service Commission, *Orange and Rockland Utilities, Inc.* Cases 21-G-0073 & 21-E-0074, Prepared Testimony of Staff Finance Panel, page 132 (May 2021) ("The Commission has provided for recovery of anticipated issuance expenses when a public common stock issuance is reasonably expected to occur during the Rate Year.").

VII. EVALUATION OF FPL'S CAPITAL STRUCTURE – FINANCIAL EQUITY RATIO REQUEST

Q. What is meant by the term "equity ratio" in the context of setting the revenue requirements and rates of rate-regulated electric utilities?

A: The utility's "financial equity ratio," generally referred to simply as the "equity ratio," is the percent of investor-supplied funds provided by common equity and investor-supplied debt. (Unless stated otherwise, where I use the term "equity ratio" in my testimony, I am referring to the financial equity ratio as defined here.) A financial capital structure, depending on the specific regulatory jurisdiction, can either include or exclude a short-term debt component. The inclusion or exclusion of a short-term debt component in the utility's capital structure can alter the specific value of the equity ratio.

Q. In Florida, are other components aggregated with the financial capital structure in determining allowed revenue requirement?

A. Yes, a regulatory capital structure is created by combining other components with the financial capital structure, including customer deposits, deferred income taxes, investment tax credits. Note each component has its own cost assigned to it. The weighting and cost rates are combined to arrive at an overall weighted average cost of capital, which is applied to the utility's allowed or approved rate base and then "grossed up" (using the "revenue

expansion factor") to provide for the federal and state income taxes that would or could be applicable to the utility's net operating income.

Q. Please state the financial equity ratio requested by FPL.

A. FPL is requesting an equity ratio of 59.6% based on investor-supplied funds.[91] Additionally, it is explained FPL explains that it seeks to maintain its financial capital structure at approximately 59.6% on a month to month basis.[92] For additional clarity, FPL's requested financial capital structure is based on common equity, long-term debt and short-term debt.

Q. On what basis does FPL seek to support its requested financial equity ratio of 59.6%?

A. Mr. Barrett argues that it is appropriate to set the financial equity ratio, ultimately used to determine the allowed revenue requirement, at the level that has been reflected on its books for some time.[93] Additionally, Mr. Coyne

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91 Mr. Coyne Testimony, page 84.

92 At Schedule D-8, Financial Plans – Stocks and Bond Issues, Projected Test Year Ended: 12/31/2022, FPL states "WHILE FPL'S CAPITAL STRUCTURE MAY FLUCTUATE MONTH-TO-MONTH DUE TO SHORT-TERM OR SEASONAL CASH REQUIREMENTS, ON AVERAGE FPL IS MAINTAINING ITS CAPITAL STRUCTURE BASED ON INVESTOR SOURCES AT THE FOLLOWING APPROXIMATE PERCENTAGES: DEBT 40.4% EQUITY 59.6%. ASIDE FROM THESE APPROXIMATE PERCENTAGES, FPL DOES NOT MAINTAIN SPECIFIC OBJECTIVES WITH RESPECT TO THE PERCENTAGE OF SHORT TERM AND LONG TERM DEBT."

93 Mr. Barrett Testimony, page 46:8-10.

compares the requested financial equity ratio to the ratios of the operating companies of his proxy group members.

Q. In your view, must a regulatory authority simply adopt a financial capital structure chosen by the subject utility's management?

A. No. It is appropriate for a regulatory authority to assess the reasonableness of the requested financial equity ratio together with all other components of a utility's rate case (e.g. ROE, operations and maintenance expenses etc.). An assessment of the equity ratio forms part of the regulatory authority's objective of determining fair and reasonable rates.

Q. Please briefly describe the comparative financial equity ratio that Mr. Coyne performed and his conclusions.

A. Mr. Coyne examined how FPL's requested financial equity ratio of 59.6% compared to the equity ratios of operating companies of his proxy group members by calculating the weighted average equity ratio for each of the proxy group operating company measured on a quarterly basis over the period Q4 2018 through Q3 2020. Mr. Coyne's analysis produced an equity ratio range of 46.91% to 58.95%. Mr. Coyne concludes FPL's request is reasonable as the request is "the upper end of the range."[94]

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[94] Mr. Coyne Testimony, page 85:13-17.

Q. Is FPL's requested financial equity ratio within the range produced by Mr. Coyne's analysis?

A. No. In fact, it is 0.65 percentage points greater than the top end of the range produced by Mr. Coyne.

Q. Does Mr. Coyne's analysis support the appropriateness of FPL's requested financial equity ratio?

A. No. First, it is problematic to judge the reasonableness of a financial equity ratio by examining other operating companies rather than the ratios of the parent companies included in the proxy group that reflect market pressures. In particular, other regulatory authorities have "acknowledged that its ratemaking policies can create an incentive for the corporate parent of a regulated utility to maintain an equity-rich capital structure in the subsidiary."[95] Moreover, such a comparison with the financial equity ratios of the proxy group members ensures greater internal consistency between the ROE analysis and the assessment of the requested financial equity ratio.

Second, the reasonableness of the requested financial equity ratio should not only be assessed in terms of whether it falls within a given range. Rather, much like in the ROE analysis, arguably of more importance is a

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[95] *See, e.g.*, *Transcontinental Gas Pipe Line Corp.*, Federal Energy Regulatory Commission, Opinion No. 414-A, 84 FERC ¶ 61,084, at 61,412 (1998).

comparison with a central measurement of equity ratio values for a given proxy group. In this instance, it can be observed that FPL's requested financial equity ratio is 7.15 percentage points greater than the mean result of 52.45% produced by Mr. Coyne's analysis. Additionally, only two equity ratio results are within 1.00 percentage points of FPL's request (both are lower than FPL's request) and the remaining ten companies are more than 5.46 percentage points lower. Therefore, even when assessed using Mr. Coyne's analysis, it is clear that FPL's requested financial equity ratio is overstated relative to the equity ratios of the operating companies of the parent companies included in Mr. Coyne's proxy group.

Q. Have you independently assessed the reasonableness of FPL's requested financial equity ratio of 59.6%?

A. Yes. I assessed how FPL's requested financial equity ratio compares to the ratio of the proxy group I rely on in my ROE analysis. For the purposes of my analysis, I utilized financial capital structure data sourced from Value Line Investor Services. However, Value Line's capital structure data that is included in each utility's individual report is only focused on long-term investor sourced funding and excludes the short-term debt component. Therefore, for comparative purposes, I converted FPL's requested financial equity ratio to an equivalent ratio that excludes the short-term debt component. On that basis, I calculated an equivalent FPL requested financial

equity ratio of 62.4%,[96] in order to make my FPL value comparable to the Value Line data. Note, I account for the short-term debt component in my ultimate financial equity ratio recommendation.

Q. What range of financial equity ratios were seen in your proxy group and how does FPL's request compare to the equity ratios of the utilities in your proxy group?

A. The financial equity ratio range for the utilities in my proxy group, based on the average of the 2019 and 2020 year-end data, ranged from 42.9% to 50.1%, with a median of 47.3%. Thus, FPL's equivalent financial equity ratio of 62.4%, is far above both the median and high-end results result *(i.e.*, approximately 15.2 percentage points greater than the median and approximately 12.4 percentage points greater than the highest value for any utility in my proxy group, respectively).[97]

Q. Did you compare FPL's requested equity ratio to financial equity ratios directly associated with Mr. Coyne's proxy group members (*i.e.*, the corporate parents)?

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[96] *See* Exhibit BTM-6 page 2. Note Value Line reports year end data and for comparative purpose I compared the average 2019 and 2020 Value Line reported financial equity ratios to FPL's projected average 2021 and 2022 year end financial equity ratio (excluding short-term debt).

[97] Values may not equal due to rounding.

A. Yes. While I find Mr. Coyne's proxy group to be less risk-comparable to FPL than the proxy group I rely on, I nevertheless examined how the financial equity ratios for that group compared to FPL's request. The financial equity ratio range, based on the average of the 2019 and 2020 year-end data, ranged from 35.4% to 60.2%, with a median of 47.3%. Therefore, FPL's request is 15.1 percentage points greater than the median result and 2.2 percentage points greater than the top end of the range of the parent corporations for Mr. Coyne's proxy group utilities.

Q. Is FPL's requested financial ratio similar to its corporate parent, NEE?

A. No. NEE's financial equity ratio in the two most recent years of 2019 and 2020 of 49.6% and 46.5%, respectively, are considerably lower than FPL's request.

Q. What conclusions do you draw from your comparative financial equity ratio analysis?

A. Based on this analysis, I find that FPL's requested financial equity ratio to be atypical when compared to the risk-comparable electric utility proxy group I utilized in my ROE analysis. Indeed, it is considerably greater than the vast majority of financial equity ratios associated with Mr. Coyne's proxy group (*i.e.*, based on the corporate parent capital structures). Therefore, because it is so much greater than the equity ratios of comparable electric utilities in my proxy group, and so much greater than the vast majority of the

less comparable electric utilities in Mr. Coyne's proxy group,[98] I believe that FPL's requested equity ratio is unreasonably high and that the PSC should reject it for determining FPL's revenue requirements and rates in this case.

Q. How do you recommend that the Florida PSC address FPL's request to employ an atypically high financial equity ratio?

A. I recommend that the Commission impute a financial equity ratio for ratemaking purposes that brings it closer to the average of the proxy group used in the ROE analysis. I suggest that it employ a financial equity ratio of 56.3%, based on common equity and long-term debt. This can be converted to a value of 55.4%, when short-term debt is incorporated, using 13-month 2022 Test Year data.[99] The recommendation is set above the halfway point between the proxy group's median equity ratio and FPL's requested financial equity ratio. Indeed, it is 9 percentage points greater than the median equity ratio result for the proxy group. While it could be appropriate to set the financial equity ratio at the average of the proxy group, which is an approach other regulators have taken in certain circumstances when they have found the subject utility's equity ratio to be anomalous,[100] for the specific purpose

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98 The proxy groups used by both Mr. Coyne and I for the purpose of our respective ROE analyses, are comprised of certain parent companies that are publicly listed and traded and which Value Line classifies as electric utilities.

99 *See* Exhibit BTM-6 page 3.

100 See Federal Energy Regulatory Commission, BP Pipelines (Alaska) Inc., et al., Docket Nos. IS05-82-002 et al., Opinion No. 502, 123 FERC ¶ 61,287 at P 174 (2008).

of this testimony I suggest a more modest and conservative approach. It is also important to note that this financial equity ratio recommendation is coupled with a conservative ROE recommendation, *i.e.*, my ROE recommendation is conservatively high, in FPL's favor, because there are strong indications that FPL is of lower risk as compared to the proxy group average. As will be discussed in the section below, it can reasonably be expected that FPL will maintain its financial integrity with a financial equity ratio set at this level for rulemaking purposes.

Q. Would there be any validity to an argument that FPL needs an equity ratio of 59.6 percent in order to attract the capital needed to support its reasonable and prudent investments and provide safe and reliable service to its customers?

A. No. The readily observable fact that the majority of the utilities in my proxy group and in Mr. Coyne's proxy group operate with substantially lower equity ratios than that proposed by FPL clearly demonstrates that FPL does not need to employ a capital structure with its proposed equity ratio.

VIII. FINANCIAL INTEGRITY ASSESSMENT

Q. How does the concept of financial integrity enter into the regulatory decisions that the Florida PSC must make in this case?

A. As discussed earlier, the U.S. Supreme Court has set out core principles and standards to assess the rate of return for a regulated utility. As part of the requirement to balance investor and consumer interests, the rate of return needs to be sufficient to assure confidence in the financial integrity of the utility and to maintain the company's credit and allow it to attract capital. Therefore, the concept of financial integrity is an integral part of the Commission's deliberations in this proceeding.

Q. What does a utility's long-term debt rating by established rating agencies such as Standard & Poor's, or Moody's tell a regulatory authority, or the financial markets in general, about a utility's financial integrity?

A. Credit ratings reflect an agency's comprehensive review of all the risks a company faces including both business and financial risk, and are intended to provide an objective and independent measure of a utility's risk. Therefore, a utility's rating provides a robust assessment of the financial integrity of the company.

Q. Can a utility with a bond rating that indicates satisfactory financial integrity borrow money at interest rates that are competitive relative to those paid by borrowers with similar bond or debt ratings?

A. Yes.

Q. Is there a range of bond ratings within which it can be said that the rated utility has financial integrity as used in this context?

A. Yes. Each rating agency has its own rating scale and divide their ratings in two broad categories of (a) investment grade ratings and (b) non-investment grade ratings. Companies that have non-investment grade ratings are viewed by the rating agencies as speculative and subject to significant credit risk. Therefore, it is reasonable to infer that regulated utilities' financial integrity is compromised if they have a non-investment grade rating. Correspondingly, regulated utilities with investment grade ratings can be viewed as having financial integrity.

Q. Will reduced earnings, as compared to those that would result from FPL's requested rate increases in this case, negatively impact financial credit metrics?

A. Yes. Clearly, the awarding of a lower revenue requirement than that requested by FPL will result in lower financial credit ***metrics***, but not necessarily in any credit downgrade or increase in FPL's costs of capital. However, the mere fact that numeric credit metrics would change, alone, should not forbid the Commission from determining that a lower ROE and financial equity ratio than that proposed by FPL appropriately balances the interests of customers and investors. As has been noted elsewhere, fundamental principles of cost-based ratemaking dictate that the ROE should

be based on the market cost of capital.[101] Moreover, regarding the broader question of whether a regulated utility's bond rating will be downgraded due to the lower revenue requirement, the authors Bruce Louiselle and Jean Heilman characterizes the situation well:

> It is often alleged that the use of a capital structure containing more debt than actually exists could cause a derating in the company's bonds and result in its credit not being maintained. In response, it must be noted that it is generally recognized that there are various grades of bonds, all of which are considered investment grade. For example, Moody's rates bonds in four categories ranging from "AAA" to "Baa," all of which are characterized as investment grade. Very few utilities enjoy the luxury of a "AAA" bond rating. The bonds of most utilities are rated "Baa" or "A." One of two conclusions follows: Either there is a constitutionally guaranteed right to possess a bond rating above "A" or the rates of most utilities' bonds are set in violation of the mandates of *Hope*. Utilities obviously do not have a constitutionally guaranteed right to a "AA" or "AAA" bond rating. Consequently, whether a capital structure could cause a decline in a company's bond rating is not determinative so long as the bonds remain of investment grade.[102]

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[101] See Federal Energy Regulatory Commission, *Ass'n of Bus. Advocating Tariff Equity, et al. v. Midcontinent Indep. Sys. Operator, Inc., et al.*, Docket Nos.EL14-12-000 and EL15-45-000, Opinion No. 569-A, 171 FERC ¶ 61,154 at P 44.

[102] Louiselle, Bruce M. and Heilman, Jean E. (1982) "The Case for the Use of an Appropriate Capital Structure in Utility Ratemaking: The General Rule Versus Minnesota," William Mitchell Law Review: Vol. 8: Iss. 2, Article 8.

In other words, a deterioration of a regulated utility's credit rating should not, in of itself, be seen as a violation of the landmark standards set out in *Hope* and *Bluefield*.

Q. Is there any reason that a regulatory authority should refuse to make a decision that would result in a utility's debt rating being reduced?

A. Under certain circumstances not applicable to FPL in this case, it might be in the best interests of customers for the regulatory authority not to make a decision that could result in a lower bond rating. The worst-case scenario where a regulatory authority should avoid a decision that could result in a lower bond rating would be where the utility was already at the lowest end of investment grade ratings, clearly not a relevant concern regarding FPL. As always, the relevant consideration is whether the regulator's decisions provide fair treatment for the utility in recovering its reasonable and prudent costs, including a fair and reasonable – i.e., market-based – return on its capital investments, while enabling the utility to make needed investments and provide safe and reliable service.

Q. Please generally describe the assessment framework you employed to assess FPL's financial integrity.

A. In recent rating reports, S&P and Moody's note factors that could lead to a downgrade.[103] Of those factors, each agency highlights a specific numeric credit metric whereby if FPL were to fail to meet the stated threshold value of the metric on a sustained basis, it might lead to a downgrade. Namely, S&P mentions a Funds From Operations ("FFO") to debt metric threshold of 19% and Moody's refers to a Cash Flow from Operations ("CFO") pre-working capital to debt metric threshold of 25%. I observe that based on comparing 2018 and 2019 metrics reported in recent credit rating reports, that both metric results were relatively similar.[104] Therefore, I infer that the Moody's stated metric threshold is a stricter test to meet and I focus on how a reduced revenue requirement, as compared to that proposed by FPL, may impact FPL's performance regarding this metric. Additionally, I examine how the CFO pre-working capital plus interest to interest metric is impacted. Ultimately a credit rating assessment is multi-faceted, and one cannot know

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[103] See S&P Global Ratings, RatingsDirect, Florida Power & Light Co., January 15, 2021 and Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020. The reports are available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

[104] Moody's reports that the CFO pre-working capital to debt metric for 2018 was 38.8% and for 2019 it was 33.3%. S&P reports that the FFO to debt metric for 2018 was 38.8% and for 2019 it was 31.5%. See S&P Global Ratings, RatingsDirect, Florida Power & Light Co., January 15, 2021 and Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020. The reports are available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

with certainty what a rating agency's overall judgment may be. The objective of my analysis is to provide insight as to how these particular Moody's credit metrics may be impacted, as a relevant and useful indicator of potential impacts on FPL's debt ratings.

Q. Does either S&P or Moody's outline a specific number of notches that FPL could be downgraded by if the highlighted CFO pre-working capital to debt metric threshold level is not met on a sustained basis?

A. No. However, regarding the Moody's CFO pre-working capital to debt metric value of 25% that Moody's report highlights, I note it is close to the middle of the metric range of 22% – 30% that Moody's states supports a general "A" rating.[105] FPL currently has a long-term issuer rating of A1 from Moody's. Therefore, based on this particular metric and keeping all else constant, if FPL had a 25% CFO pre-working capital to debt metric, it can reasonably be expected that FPL would continue to maintain a rating within the general "A" category i.e., A1, A2 and A3.

Q. Please provide an overview of how you developed your analysis.

A. I estimated the CFO pre-working capital to debt and CFO pre-working capital plus interest to interest metrics using a CFO projection presented by

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[105] Moody's Investors Service, Rating Methodology, Regulated Electric and Gas Utilities, page 22 (June 2017). *See* Exhibit BTM-8.2 at page 161.

FPL as a proxy for the "CFO pre-working capital" component, together with the financial capital structure and interest expense information related to the 2022 test year provided as part of the rate case filing.[106] In a March 2021 presentation to Moody's, FPL provided a CFO projection through 2023 that appeared to be based on the requested rate case.[107] To determine how my recommended ROE and financial equity ratios to be used for rulemaking purposes would impact the metric, I estimate how my recommendations would reduce FPL's requested revenue requirement[108] and assumed that the reduced revenue requirement would result in the CFO projection being reduced by that same amount. The estimated credit rating financial strength metric analysis is presented in Exhibits BTM-7.1 through 7.4.

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[106] Please note that the use of the CFO as a proxy for the CFO pre-working capital value can reasonably be considered a conservative proxy. It can be observed from a recent Moody's report that the CFO pre-working capital values were greater than the CFO values for the years 2016 through 2019 and the last twelve months through June 2020. *See* Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 10. The report is available at http://www.investor.nexteraenergy.com/fixed-income-investors/download-library (last accessed June 17, 2021).

[107] Presentation to Moody's Investors Service, 2021 Annual Update, slides marked 70-72, March 19, 2021. The presentation was provided in response to the Office of Public Counsel, First Request For Production of Documents, Number 12, file name "2021 Annual Update_Moodys_Redacted."

[108] In a response to LULCA-ECOSWF-FL Rising's, First Set of Production of Documents, Number 1, FPL provided the attachment entitled "LULAC-ECOSWF-FL Rising 1st POD No. 1," which is a working model of how changes to the weighted average cost of capital impacted the revenue requirement request. Using the calculations contained in that file, I examined how the overall weighted average cost of capital would change based on my recommendations and estimated an associated revenue requirement change.

Q. Based on the approach outlined above, what are your estimated financial strength credit rating metric outputs when using FPL's requested parameters and how does it compare to historical data points?

A. The estimated 2022 CFO pre-working capital to debt metric result is 33.1%.[109] Moody's reports that the 2018 metric was 38.8% and the 2019 metric was 33.3%.[110] Additionally, the estimated 2022 CFO pre-working capital plus interest to interest metric score is 10.8x.[111] Moody's reports that the 2018 metric was 10.5x and the 2019 metric was 9.8x.[112]

Q. Would setting FPL's allowed revenue requirement and rates using an ROE of 8.56% and FPL's proposed financial capital structure impair FPL's financial integrity?

A. No. Based on my analysis, the requested 2022 test year revenue requirement increase of approximately $1,108 million would be reduced by approximately $1,077 million to a revenue increase of approximately $32 million.[113] The estimated CFO pre-working capital to debt metric would be

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[109] *See* Exhibit BTM-7.1, page 1.

[110] Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 10.

[111] *See* Exhibit BTM-7.1, page 1.

[112] *Moody's Investor Service, Credit Opinion, Florida Power & Light Company, Update to Credit Analysis, August 25, 2020 at page 10.*

[113] *See* Exhibit BTM-7.1, page 2.

28.2%,[114] which is 3.2 percentage points greater than the potential downgrade threshold level stated by Moody's. Also, the estimated 2022 CFO pre-working capital plus interest to interest metric result is 9.3x.[115] This metric result falls within the metric range of ≥8.0x that Moody's states supports a general "Aaa" rating.[116]

Q. Would setting FPL's allowed revenue requirement and rates using your recommended financial equity ratio of 56.3% excluding short-term debt, or 55.4% including short-term debt, together with FPL's requested ROE of 11.5%, impair FPL's financial integrity?

A. No. Based on my analysis, the requested 2022 test year revenue requirement increase of approximately $1,108 million would be reduced by approximately $244 million to approximately $865 million.[117] The estimated CFO pre-working capital to debt metric is 32.0%,[118] which is 7.0 percentage points above the potential downgrade threshold level stated by Moody's. Also, the estimated 2022 CFO pre-working capital plus interest to interest

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[114] *See id.*, page 1.

[115] *Id.*

[116] Moody's Investors Service, Rating Methodology, Regulated Electric and Gas Utilities, page 22 (June 2017).

[117] *See* Exhibit BTM-7.3, page 2. Numbers may not precisely equal due to rounding.

[118] *See id.*, page 1.

metric result is 10.4x[119] which as noted above falls within the general "Aaa" rating metric range.

Q. Do you believe that, if the Florida PSC were to adopt both your recommended ROE and your recommended equity ratio for purposes of setting FPL's allowed revenue requirements and rates in this case, FPL's financial integrity would be impaired?

A. No. Based on my analysis, the requested 2022 test year revenue requirement increase of approximately $1,108 million would be reduced by approximately $1,230 million, that is, FPL's revenue requirements would be reduced by approximately $121 million.[120] Even with this reduction, FPL's estimated CFO pre-working capital to debt metric is 27.6%,[121] which remains 2.6 percentage points above the potential downgrade threshold level of 25.0% stated by Moody's. Additionally, as a reminder, the 25.0% score is close to the middle of the metric range of 22% – 30% that Moody's states supports a general "A" rating. The estimated CFO pre-working capital plus interest to interest metric result is 9.1x[122] and continues to remain within the general "Aaa" rating metric range.

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[119] *Id.*

[120] *See* Exhibit BTM-7.2, page 2. Numbers may not precisely equal due to rounding.

[121] *See id.*

[122] *Id.*

Q. Have you further stress-tested your analysis?

A. Yes. In general, I understand that regulatory authorities do not dictate the actual capital structure a utility chooses to utilize. However, I examined how the CFO pre-working capital to debt metric would be impacted if FPL were to adopt the recommended ratemaking financial equity ratio. On that basis, and maintaining the use of the recommended ROE and financial equity ratio, the resulting CFO pre-working capital to debt metric is 25.1%.[123] This score is within the broader metric range of 22 – 30% that Moody's assigns to the general "A" rating and does not cross the Moody's threshold for a downgrade event.

Q. In the extreme, albeit unlikely here, situation whereby FPL's Moody's rating was downgraded to a Baa rating, how could that impact the revenue requirement?

A. The cost of debt may increase. It can be observed for the six-month period through April 2021, that Moody's Public Utility Index "Baa" yields have been on average 0.28% greater than the yield for Moody's Public Utility Index "A" yields.[124] To conservatively measure the impact of a higher cost of debt, I added 0.28% to FPL's projected 2022 test year overall embedded

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[123] *See* Exhibit BTM-7.2, page 1.

[124] *See* Exhibit BTM-2, page 1:18-19.

cost of debt of 3.61% for a total cost of 3.89%.[125] Of course, in reality, only the incremental debt obtained by FPL would be impacted by the increased cost of debt. This increased debt cost would change the reduction in the revenue requirement requested by FPL from approximately $1,230 million, based on my recommendations, to approximately $1,154 million, a difference of around $76 million.[126] This increased debt cost pales in significance compared to the reduced revenue requirement seen with a lower ROE and financial equity ratio.

I would reiterate here my belief and opinion that, if the PSC were to set FPL's revenue requirements using my recommended ROE and equity ratio, it would not be likely to cause a downgrade event, because Moody's downgrade event threshold would not be crossed, and the remaining CFO pre-working capital to debt ratio would remain solidly in the metric range of 22-30% that Moody's assigns to a general "A" bond rating.

Q. Are there any meaningful data and information that the Commission can observe in the real world of utility rate decisions by other U.S. state regulatory authorities that should inform the Commissioners' decisions in this case?

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[125] *See* Exhibit BTM-7.4, page 4.

[126] *See* Exhibit BTM-7.4, page 2.

A. Yes. From regularly published, widely recognized data sources, it is apparent that since January 2019, many other state regulatory authorities have deemed that ROEs which are significantly closer to my recommended value than to FPL's inflated request satisfy the *Hope* and *Bluefield* fair rate of return and financial integrity standards.[127] From the same data sources, it is also apparent that many other regulatory authorities have deemed it appropriate to allow equity ratios in the general range of 46 percent to 53 percent, as compared to FPL's inflated request that its rates be set based on a 59.6 percent equity ratio.[128] Moreover, with the exception of two utilities, the remaining vertically integrated utilities that were involved in a state decision made during the January 2019 – March 2021 period, and which have a credit rating from S&P and Moody's, maintained an investment grade rating over this period. These two exceptions were Pacific Gas & Electric Company, which has been exposed to extraordinary wildfire liabilities

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[127] Based on data reported by the RRA, the median state authorized ROE for Vertically Integrated Utilities over the period January 2019 through March 2021 was 9.65% and the average was 9.63%. The delta between my recommended ROE of 8.56% to the median ROE is 1.09 percentage points and the delta between FPL's requested ROE of 11.5% is greater at 1.85 percentage points. When compared to the average state ROE, the deltas are 1.07 percentage points and 1.87 percentage points, respectively.

[128] Based on data reported by the RRA, there were 52 state proceedings for Vertically Integrated Utilities over the period January 2019 through March 2021that reported an equity ratio. The median equity ratio reported was approximately 51% and the average was approximately 49%. Out of these 52 proceedings, 32 had an equity ratio within the approximate of 46% - 53% range, with 11 proceedings having a lower equity ratio and 9 proceedings having a higher equity ratio. The highest equity ratio reported was approximately 57%.

litigation and filed for bankruptcy protection, and Entergy New Orleans, which Moody's has long rated below investment grade.[129] The range of bond ratings as of the end of Q1 2021 are listed in the table below.

Figure 6: Credit Ratings: Vertically Integrated Utilities with a state decision issued over the period January 2019 - March 2021

S&P Rating	No. of Utilities
AAA	-
AA+	-
AA	-
AA-	1
A+	-
A	4
A-	18
BBB+	7
BBB	10
BBB-	-
Below Investment Grade	1
Total	**41**

Moody's Rating	No. of Utilities
Aaa	-
Aa1	-
Aa2	-
Aa3	-
A1	1
A2	8
A3	8
Baa1	11
Baa2	6
Baa3	1
Below Investment Grade	1
Total	**36**

It is also noteworthy that the Florida PSC recently approved a settlement between Duke Energy Florida ("DEF"), the second largest investor-owned electric utility in Florida, and several consumer parties, pursuant to which Duke's rates are to be set on the basis of an ROE of 9.85% and a financial

[129] Note that as of March 31, 2021, that S&P's issuer credit rating for Entergy New Orleans was at the investment grade rating of BBB.

equity ratio of 53 percent.[130] These parameters are much lower than that requested by FPL, especially when considered in light of DEF's lower credit ratings. DEF currently has a long-term rating from S&P of BBB+, two notches below FPL, and a rating from Moody's of A3, again two notches below FPL.

Q. Earlier in your testimony, you discussed the views of Standard & Poor's, Moody's, and Regulatory Research Associates regarding the Florida PSC having a credit-supportive environment or reputation. Would the PSC's setting FPL's ROE and equity ratio as you have recommended change their views?

A. Of course, I cannot speak for these companies, but I will say that there is nothing inconsistent with a utility commission's decisions to set equity return and capital structure as I recommend, which are in line with market-based data, and that commission having a constructive and credit-supportive regulatory philosophy and policy. For instance, I note that Moody's previously explained that it places greater emphasize on cash flow measures over and above the authorized ROEs when determining ratings, which suggests that it is the overall package of regulatory mechanisms that is

[130] Order No. PSC-2021-0202-AS-EI. I note that there is a mechanism to alter the ROE based on a change in 30-year Treasury bond yields.

paramount to an agency's rating evaluation.[131] In other words, mechanisms, such as storm cost recovery provisions, that allow for timely cost recovery and minimize regulatory lag are very important components of a credit-supportive regulatory framework. As discussed earlier in my testimony the Florida PSC has the general reputation of providing entirely adequate opportunities and mechanisms for utilities, including FPL, in this regard. These risk-mitigating provisions will continue unimpeded by my recommendations. Moreover, based on the analysis I presented in this testimony, my recommendations will leave FPL satisfying the "A" bond rating requirement in relation to the metrics studied.

IX. CONCLUSIONS

Q. Please summarize the major conclusions of your testimony.

A. My conclusions are as follows:

First, in this testimony I present an independent analysis assessing the fair and reasonable ROE for FPL. My recommendation of an 8.56% ROE was informed and developed through applying the two-step DCF model to a

[131] Moody's Investors Service, Sector In-Depth, US Regulated Utilities, Lower Authorized Equity Returns Will Not Hurt Near-Term Credit Profiles, March 10, 2015. ("We view cash flow measures as a more important rating driver than authorized ROEs, and we note that regulators can lower authorized ROEs without hurting cash flow, for instance by targeting depreciation, or through special rate structures.")

risk-comparable electric utility proxy group using recent financial data. I note that it is somewhat of a conservative recommendation given that my recommended ROE of 8.56% is the median of my proxy group and that there are strong indications that FPL has lower risk than the proxy group average.

Second, I reviewed the analysis put forward by FPL witness Mr. Coyne that seeks to support FPL's ROE request. I identified a number of flaws regarding the specific models relied on by Mr. Coyne together with the assumptions that form part of his analysis. As a result of these flaws, it is my strong opinion that Mr. Coyne's analysis does not reasonably measure investors' required rate of return and therefore provides inadequate, unreliable, and unpersuasive support for FPL's requested ROE.

Third, I reviewed FPL's support for its requested financial equity ratio of 59.6% and found it to be inadequate to support FPL's request. For instance, Mr. Coyne's comparison to the operating companies of the parent companies included in his proxy group does not support FPL's request given that, in addition to the inappropriateness of making such a comparison in the first place, all of the calculated equity ratios attributed to each proxy group member are lower than FPL's request and only two equity ratios results are within 1 percentage point of FPL's request. Each of the remaining twelve equity ratio results are 5.46 percentage points, or more, lower than FPL's request. Moreover, I assessed the reasonableness of the request through

comparing it to the equity ratios of the electric utility proxy group I relied upon in my ROE analysis and found that FPL's request was well above both the median and the high-end equity ratios for that group of utilities. Based on this analysis it is clear that FPL's requested equity ratio is much higher than those of comparable utilities. Additionally, based on a comparison to the equity ratios of the parent companies included in Mr. Coyne's less-risk comparable proxy group it is evident that FPL's request is 2.2 percentage greater the highest equity ratio and over 15 percentage points greater than the median result. Thus, I recommend that the PSC impute a financial equity ratio for ratemaking purposes of 55.4%.[132]

Finally, I evaluated whether my ROE and financial equity ratio recommendations could unduly impact FPL's financial integrity through an examination of how certain credit rating agencies' financial strength metrics may be impacted. This examination led me to conclude that FPL's financial integrity would not be compromised.

Q. Can you provide an estimate of the impact that setting FPL's rates on the basis of your recommendations would have on the revenue requirements for FPL, including Gulf Power, in this case?

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[132] As discussed above, the 55.4% financial equity ratio is based on a capital structure that includes short-term debt. If the short-term debt were to be excluded, the financial equity ratio would be converted to 56.3%.

A. Yes. Assuming that the PSC were to allow FPL to recover all of its projected O&M costs in the 2022 test year, and further assuming that the PSC were to recognize all of FPL's projected rate base as reasonable, prudent, and necessary to support FPL's provision of safe and reliable service, if the PSC were only to use my recommended ROE and equity ratio, instead of FPL's requested values, the costs to customers for FPL to provide safe and reliable service would be approximately $1,230 million less in 2022 than the amount requested by FPL.[133]

Q. In your opinion, would this outcome be fair, just, and reasonable to FPL and its shareholder and to FPL's customers?

A. Yes. This outcome would provide the necessary fair and symmetrical treatment between FPL and its customers under the guiding principles of utility rate regulation in the United States. FPL would, assuming efficient management, be able to recover its operating costs and debt service expenses, and to raise needed equity and debt capital to support its projected investments, which is what it effectively represents it needs to provide safe and reliable service, and still earn a fair, just, and reasonable rate of return. Moreover, my analyses rely on appropriately designed market-based data

[133] *See* Exhibit BTM 7.2, page 2.

and analyses that satisfy the criteria set forth in *Hope* and *Bluefield* and protects both investors and customers alike.

Q. Does this conclude your direct testimony?

A. Yes, it does.