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July 16, 2009

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COMMISSION
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Ms. Ann Cole, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket Nos. 080677-EI & 090130-EI

Dear Ms. Cole:

Enclosed for filing, on behalf of the Citizens of the State of Florida, are the original and 15 copies of the Direct Testimony of Daniel J. Lawton.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

Joseph A. McGlothlin
Associate Public Counsel

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	ECR	—
	GCL	2
	OPC	—
Enclosures	RCP	1
JAS:bsr	SSC	1
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	ADM	—
	CLK	J. Kelly

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for increase in rates by Florida Power & Light Company.)	Docket No. 080677-EI
_____)	
In Re: 2009 depreciation and dismantlement study by Florida Power & Light Company.)	Docket No. 090130-EI
_____)	FILED: July 16, 2009

DIRECT TESTIMONY

OF

DANIEL J. LAWTON

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

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EXHIBIT __ (DJL-1) – Resume of Daniel J. Lawton

EXHIBIT __ (DJL-2) – Commission Recovery Adjustments

EXHIBIT __ (DJL-3) – Excess Reserve / Function

EXHIBIT __ (DJL-4) – Cash Flow Impacts

EXHIBIT __ (DJL-5) – Filed Case Cash Flow

EXHIBIT __ (DJL-6) – FPL Financial Ratios

1 **DIRECT TESTIMONY**

2 **OF**

3 **DANIEL J. LAWTON**

4
5 On Behalf of the Office of Public Counsel

6 Before the

7 Florida Public Service Commission

8 Docket Nos. 080677-EI & 090130-EI

9
10 **I. INTRODUCTION/BACKGROUND/SUMMARY**

11 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

12 A. My name is Daniel J. Lawton. My business address is 701 Brazos, Suite 500,
13 Austin, Texas 78701.

14
15 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK**
16 **EXPERIENCE.**

17 A. I have been working in the utility consulting business as an economist since 1983.
18 Consulting engagements have included electric utility load and revenue forecasting,
19 cost of capital analyses, revenue requirements/cost of service reviews, and rate
20 design analyses in litigated rate proceedings before federal, state and local regulatory
21 authorities. I have worked with municipal utilities developing electric rate cost of
22 service studies for reviewing and setting rates. In addition, I have a law practice
23 based in Austin, Texas. My main areas of legal practice include administrative law

1 representing municipalities in electric and gas rate proceedings and other litigation
2 and contract matters. I have included a brief description of my relevant educational
3 background and professional work experience in Exhibit__(DJL-1).

4
5 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN RATE**
6 **PROCEEDINGS?**

7 A. Yes. A list of cases where I have previously filed testimony is included in
8 Exhibit__(DJL-1).

9
10 **Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS**
11 **PROCEEDING?**

12 A. I am testifying on behalf of the Florida Office of Public Counsel (OPC).

13
14 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
15 **PROCEEDING?**

16 A. My testimony will address the ratemaking policy and financial implications before
17 the Florida Public Service Commission (“Commission”) surrounding the
18 overrecoveries of depreciation expenses by Florida Power & Light Company
19 (“FPL”) and FPL’s associated excess depreciation reserve. I address and pull
20 together the recommended excess depreciation reserve flow-back proposal addressed
21 in the testimony of Mr. Pous, the ratemaking treatment of Mr. Pous’ proposal
22 addressed in the cost of service testimony of Ms. Brown, and the implications of

1 these adjustments on Florida Power & Light Company's ("FPL" or "Company")
2 financial metrics addressed in Mr. Woolridge's testimony.

3
4 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS IN THIS CASE.**

5 A. As the evidence relates to the FPL depreciation reserve, I conclude and recommend
6 the following:

7 1) The Company's past depreciation rates have resulted in over-collecting at least
8 \$1,245,360,415 of depreciation expense, resulting in an excess depreciation reserve
9 that FPL measures to be \$1,245,360,415;

10
11 2) Mr. Pous' proposal to recommend a return to customers of \$1,245,360,415 is
12 conservative in light of the numerous additional adjustments to the requested level of
13 depreciation expenses he recommends, which indicate the excess depreciation
14 reserve is more than two times the \$1.245 billion level recognized by FPL's own
15 study;

16
17 3) Mr. Pous' recommendation to amortize the portion of the excess reserve
18 acknowledged by FPL over a four year period as an offset to current depreciation
19 expense will result in a significant correction to the excess reserve, and is consistent
20 with sound regulatory policy and ratemaking guidelines;

21
22 4) Correcting the portion of the excess depreciation reserve targeted by Mr. Pous over a
23 four year period will not harm FPL's financial integrity or financial metrics; and

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5) Mr. Pous' excess depreciation reserve correction proposal assures that the customers that paid the excessive depreciation charges will likely be the same customers that receive the benefits associated with correcting the excess depreciation reserve.

II. DEPRECIATION EXPENSE AND DEPRECIATION RESERVES

Q. PLEASE SUMMARIZE THE ISSUES THAT ARE BEFORE THE COMMISSION REGARDING THE EXCESS DEPRECIATION RESERVE.

A. There are three basic questions that are before the Commission in this case related to excess depreciation reserves. The first issue is: Does an excess depreciation reserve exist and what is the amount of the excess reserve? Given that the Company's own evidence (depreciation study of Clarke) identifies an excess reserve in the amount of \$1,245,360,415, there should be little controversy regarding this matter.

In addition, the \$1,245,360,415 is a conservative estimate of the excess reserve that accepts FPL's depreciation calculations in their entirety. Mr. Pous recommends numerous additional adjustments to the Company's depreciation study – the results of which show an excess depreciation reserve approaching \$2.7 billion, or more than twice the level of the excess reserve adjustment proposed in this case.

The second issue is: How can the excess reserve be corrected? Again, Mr. Pous provides an answer by proposing a four year amortization of a significant portion of the excess reserve to assure that depreciation rates on a going forward basis are cost based.

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The third issue is: Does the correction to the depreciation reserve proposed by Mr. Pous allow the Company to maintain its financial integrity, and is the correction consistent with sound ratemaking guidelines? I address this last issue in the following testimony. As is shown below, the correction to the excess depreciation reserve proposed in the testimony of the OPC witnesses is consistent with sound ratemaking policy, consistent with cost based rates, does not impair the Company's financial integrity, and is a conservative estimate of the excess depreciation reserve level.

Q. PLEASE DESCRIBE THE EXCESS DEPRECIATION RESERVE YOU HAVE BEEN DISCUSSING.

A. As a result of the analysis by the Company and Mr. Pous of the Company's most current depreciation rates, it has been determined that the Company's depreciation reserve has an excess or surplus of at least \$1,245,360,415; Mr. Pous puts the excess at \$2.7 billion. This means that customers have overpaid, through rates and charges, depreciation expense.

Q. PLEASE DESCRIBE DEPRECIATION EXPENSE.

A. Depreciation expense is a charge to a company's operating expense to reflect the annual recovery or amortization of previously expended capital investment. The annual depreciation expense or charge is a non-cash expenditure or charge included

1 in a company's annual revenue requirement to recover the previously expended
2 capital investment over the useful life of an asset investment.

3
4 **Q. PLEASE EXPLAIN WHY YOU REFER TO DEPRECIATION AS A NON-**
5 **CASH EXPENSE.**

6 A. Depreciation expense does not involve a specific payment during the test period that
7 is subject to reimbursement in revenue requirements. Unlike test period labor or
8 operating and maintenance expenses, which are out-of-pocket cash payments,
9 depreciation charges are not additional cash payments. While both cash
10 expenditures such as labor and other ordinary costs and non-cash depreciation
11 charges are included on the income statement and in the revenue requirement for
12 setting rates and charges, there are no additional cash flows out of the company for
13 depreciation charges. Rather than reducing cash for depreciation charges, the
14 depreciation expense charged to cost of service is simultaneously debited from the
15 balance sheet by increasing the accumulated provision for depreciation, which is an
16 offset to gross plant accounts. Depreciation is the recovery of previous balance sheet
17 or rate base investments – the return of capital.

18
19 **Q. PLEASE EXPLAIN THE ACCUMULATED DEPRECIATION CONCEPT**
20 **YOU ADDRESSED IN YOUR LAST ANSWER.**

21 A. Accumulated depreciation is the measure of all previously recorded depreciation.
22 Thus, an asset of \$100 with a five year life, depreciated at \$20 per year, after two
23 years would have a gross plant value of \$100 (the original cost), an accumulated

1 depreciation of \$40 (two years of depreciation recorded) and a net plant or rate base
2 value of \$60 (\$100 gross plant less \$40 of accumulated depreciation). Thus, the \$40
3 accumulated depreciation in the above example, is a record of the two years'
4 depreciation payments on the return of invested capital to the Company.

5
6 **Q. DOES THE ACCUMULATED RESERVE REPRESENT A CASH ACCOUNT**
7 **OR POT OF DOLLARS IN RESERVE?**

8 A. No. The reserve for accumulated depreciation reflects the recovery of depreciation
9 from a book perspective. The annual dollars of depreciation expense recovered by a
10 company will be commingled with all other funds and spent on salaries, dividends,
11 or reinvested into the company to fund other capital projects.

12
13 **Q. PLEASE EXPLAIN THE INTERRELATIONSHIP OF DEPRECIATION**
14 **EXPENSE AND DEPRECIATION RESERVES.**

15 A. Companies such as FPL make numerous capital investments in production,
16 transmission, distribution and general plant facilities to generate, transmit and
17 ultimately deliver electricity to a customer's delivery point, i.e. the meter. These
18 various capital investments made by the Company are made with funds from capital
19 markets (debt, equity, or preferred stocks), or internally generated funds from annual
20 earnings.

21
22 Once these capital investments are made (if prudent and included by the regulator as
23 part of invested capital used and useful in providing service), the utility, through cost

1 of service and charges to customers, is allowed to earn a return on capital investment
2 and a return of capital investment. The return on capital is the return necessary for
3 the utility to recover its carrying costs (cost of borrowing) to fund these capital
4 investments. The return of capital is the annual recovery of the initial capital
5 investment over the useful life of the facility. This annual recovery of capital is
6 depreciation expense.

7
8 As the annual return of capital (depreciation) is recovered by the Company, an equal
9 and offsetting adjustment is made to invested capital rate base. In other words, as
10 capital is recovered through rates, the amount of outstanding capital for which the
11 company needs to earn a return declines, as it has been returned or paid off through
12 depreciation rate recovery.

13
14 **Q. WHAT ARE THE GENERAL RATEMAKING GOALS OF CAPITAL**
15 **RECOVERY OR DEPRECIATION RATES?**

16 A. Generally, regulatory authorities set depreciation rates on a straight-line basis to
17 recover a capital investment over the useful life of an asset. By straight-line
18 recovery, I mean a recovery of an equal amount in each year of the asset. Thus, as
19 an example, if an investment of \$100 in plant is expected to have a useful life of five
20 years, a depreciation expense of \$20.00 per year included in rates would allow
21 recovery of \$100 over the five year asset life. This example assumes no salvage
22 value or cost of removal associated with the asset.

23

1 **Q. WHAT ARE THE CONSEQUENCES OF A LOW DEPRECIATION RATE**
2 **FOR CAPITAL RECOVERY?**

3 A. If the depreciation rate is set too low, then at some point in the asset life depreciation
4 recovery will need to be accelerated to fully recover the asset costs over the asset
5 life. The impact is that customers in early years did not pay the full cost of the asset
6 and future customers are required to pay higher rates to make up for the early year
7 shortfall in capital recovery.

8

9 **Q. WHAT ARE THE CONSEQUENCES OF AN ARTIFICIALLY HIGH**
10 **DEPRECIATION RATE?**

11 A. When depreciation rates are too high, early year customers end up paying more of
12 the costs than future customers. In this case rates (depreciation) must be reduced to
13 avoid further cost shifting.

14

15 Setting depreciation rates and capital recovery streams is a continuous estimating
16 process involving forecasts of numerous variables, thus perfection is not possible or
17 likely in the rate setting process. But, when over or under-recoveries are found to
18 exist, the goal should be to correct such capital recovery errors to avoid
19 compounding the rate inequities.

20

21 **Q. HOW DOES A REGULATORY AUTHORITY DETERMINE WHETHER**
22 **DEPRECIATION RECOVERY AND ASSOCIATED RESERVES ARE**
23 **ADEQUATE?**

1 A. As noted above, depreciation cost recovery estimates are based on forecasts of
2 numerous variables. Recognizing forecasts are inherently imperfect, regulatory
3 authorities typically require periodic depreciation study updates (usually four to five
4 years) to assure useful life and/or net salvage estimates remain reasonable and
5 reliable for setting rates.

6
7 To determine the adequacy of the depreciation reserve or accrual, a theoretical
8 reserve is often calculated in new depreciation studies. A theoretical reserve is the
9 accumulated provision for depreciation at a point in time, assuming the most current
10 depreciation parameters and estimates had been historically applied in setting rates.
11 The theoretical reserve is compared to the actual reserve to determine whether there
12 has been an over/under recovery of depreciation. In this case, applying all of FPL's
13 assumptions in the Company's depreciation study results in a theoretical reserve that
14 indicates that the actual depreciation reserve is over-funded by more than \$1.2
15 billion.

16
17 **Q. HAS THIS COMMISSION ADDRESSED DEPRECIATION RESERVE**
18 **ISSUES IN PAST RATE PROCEEDINGS?**

19 A. Yes. In FPL's last rate proceeding, Docket No. 050045-EI and 050188-EI, the
20 Settlement of that case, which was approved by this Commission, included a
21 provision to permit FPL to record depreciation credits and thereby reduce the
22 depreciation reserve by \$125 million per year. In FPL's 1997 rate proceeding,

1 Docket No. 970410-EI, depreciation reserve deficiencies were addressed pursuant to
2 a previous Florida Public Service Commission Order No. PSC-97-0499-FOF-EI.

3
4 It should be noted, that in Docket No. 97-0410-EI, FPL witness Hugh Gower pointed
5 to a number of cases in which this Commission corrected prior depreciation reserve
6 deficiencies. I have duplicated Mr. Gower's Exhibit (HAG-1) from that case in my
7 Exhibit__(DJI-2). There are a number of other instances in which this Commission
8 has addressed the depreciation reserve issue and these cases are discussed in the
9 direct testimony of Mr. Pous.

10
11 Thus, the issue of correcting over/under recoveries of capital amortization is not a
12 new issue. This Commission has recognized the need for such corrections in
13 numerous cases to assure rates are just and reasonable.

14
15 **III. FPL'S CURRENT EXCESS DEPRECIATION RESERVE**

16 **Q. IS THERE AN EXCESS RESERVE IN THIS CASE?**

17 A. Yes. Based on the Company's most current depreciation study, the Company has
18 been collecting excessive amounts of depreciation. This means that current
19 customers have been overpaying for electric service and future customers will be
20 subsidized if this problem is not addressed.

21
22 **Q. WHAT IS THE AMOUNT OF THE EXCESS DEPRECIATION RESERVE?**

1 A. Based on the Company's depreciation study and information provided by witness
2 Pous, FPL identifies the amount of excess depreciation charged to customers as
3 \$1,245,360,415. I have included in my Exhibit__(DJI-3) a breakdown of the excess
4 depreciation reserve calculated by FPL by operating function.

5

6 As is demonstrated in Exhibit__(DJI-3), based on the Company's current best
7 estimates, customers of FPL have been charged \$1,245,360,415 in excess
8 depreciation. In other words, past customers have been overcharged for depreciation
9 and future customers will be charged less than full cost of service if this problem of
10 past excess depreciation charges is not addressed.

11

12 It is important to note that this \$1,245,360,415 excess depreciation accumulation has
13 occurred despite the fact that the Company has returned about \$125 million per year
14 of previously accrued excess depreciation since the settlement of the last case. In
15 other words, absent the provisions of the last rate case settlement, the excess
16 depreciation reserve would be about \$1.8 billion today. Further, Mr. Pous sponsors
17 testimony that shows FPL's calculation seriously understates the excess. Mr. Pous
18 calculates the excess to be \$2.75 billion.

19

20 **Q. WHAT DOES THE DEPRECIATION RESERVE SURPLUS INDICATE**
21 **REGARDING PAST DEPRECIATION RATES AND CHARGES TO**
22 **CUSTOMERS?**

1 A. These reserve surpluses mean that FPL should have been recording and charging
2 substantially lower depreciation expenses in prior years to recover the costs of using
3 assets serving customers. But instead, customers have been charged excessive costs
4 and the depreciation reserve is overstated. Only by reversing these excess charges
5 by amortizing the excess reserve over the next few years will customers that paid the
6 excessive rates be compensated, and the depreciation reserve corrected. Any further
7 delay in correcting this excess reserve or employing a longer amortization period
8 will inevitably result in continued intergenerational inequities.

9

10 **IV. EXCESS DEPRECIATION RESERVE PROPOSED SOLUTION**

11 **Q. HOW SHOULD THE EXCESS RESERVE PROBLEM BE ADDRESSED IN**
12 **THIS CASE?**

13 A. Mr. Pous has proposed that \$1.25 billion of the excess reserve be flowed back or
14 corrected over a four year period. First, Mr. Pous employs \$314,223,000 of the
15 reserve at \$78,555,750 per year to address the Company's proposed capital recovery
16 surcharge. The remaining \$931,137,415 of excess reserve is amortized over four
17 years at \$232,784,354 per year to fund annual depreciation expense requirements.
18 Quite simply, \$314,223,000 of excess depreciation reserve is being employed to fund
19 a like amount of currently requested depreciation and amortization expense in this
20 case.

21

22 Mr. Pous' four year amortization proposal addresses the excess depreciation reserve
23 problem over a period of time which is consistent with the expected time period

1 between rate increase requests. It is important to note that the last case demonstrated
2 how depreciation credits of \$125 million annually could simultaneously reduce the
3 excess in the reserve by \$500 million over a four year period. Waiting for future
4 studies will only result in estimating larger future excess depreciation reserves and
5 an even larger problem to resolve. As I noted earlier, had the excess reserve problem
6 not been addressed in the last case (the Settlement), the excess reserve acknowledged
7 by FPL would be approaching \$2 billion in this proceeding.

8
9 Further, Mr. Pous' analysis indicates that the excess depreciation reserve is actually
10 on the order of \$2.7 billion. Thus, accepting Mr. Pous' recommendations indicates
11 that this excess reserve problem is likely to continue. Only by addressing the \$1.2
12 billion excess reserve in this case will this problem be minimized.

13
14 **Q. WILL MR. POUS' PROPOSAL TO CREDIT DEPRECIATION EXPENSE**
15 **CREATE OR HAVE ANY PRICING IMPLICATIONS?**

16 A. No. As I understand Mr. Pous' proposal, the depreciation excess reserves will be
17 credited based on functional category. In other words, production excess reserves go
18 to credit production depreciation expense, transmission to transmission expense and
19 so on as to other functions. Thus, no pricing or allocation problems are created by
20 Mr. Pous' proposal – the excess reserves are returned or credited to customers by
21 function in the same fashion as the excess depreciation was paid. Thus, Mr. Pous'
22 proposal is both fair and equitable.

23

1 **Q. WHAT IS YOUR UNDERSTANDING OF HOW MR. POUS' PROPOSED**
2 **ADJUSTMENT TO CORRECT THE EXCESS DEPRECIATION RESERVE**
3 **WILL BE TREATED IN COST OF SERVICE?**

4 A. Mr. Pous' recommendation is to amortize \$1,245,360,415, the level of excess reserve
5 that is consistent with the Company's own study, over four years rather than over the
6 remaining lives of the related assets. Amortizing this amount over a four year period
7 results in a \$311,340,104 annual adjustment (reduction) to depreciation expense. It
8 is my understanding that Ms. Brown will reduce depreciation expense in cost of
9 service by the \$311,340,104 recommendation and increase rate base by one half of
10 the annual expense adjustment or \$155,670,052.

11

12 **Q. WHAT IS THE CASH FLOW IMPACT TO THE COMPANY OF**
13 **CORRECTING THE EXCESS DEPRECIATION RESERVE?**

14 A. The cash flow impact is a \$311,340,104 reduction in depreciation expense offset by a
15 \$20,341,966 increase in return and taxes associated with the increase in rate base. I
16 have included this calculation in my Exhibit__(DJL4). Thus, the net impact to the
17 Company's pre-tax cash flow is a net reduction of about \$290,998,138.

18

19 **Q. HOW WILL MR. POUS' PROPOSAL TO AMORTIZE THE \$1.245 BILLION**
20 **EXCESS DEPRECIATION RESERVE OVER FOUR YEARS IMPACT FPL?**

21 A. First, with the four year amortization, annual depreciation expenses will be reduced
22 by about \$311 million per year. This adjustment will reduce cost of service dollar
23 for dollar; that is, \$311 million. Given that depreciation is not a cash expense, there

1 is no forgone cash recovery by FPL. Instead, the flow of cash to FPL will be
2 reduced. The rate of recovery of depreciation is adjusted so as to correct the
3 identified excess reserve deficiency. Because recovery of capital is changed by the
4 depreciation adjustment, after four years the level of invested capital will be \$1.2
5 billion higher than it would be absent this adjustment. Again, FPL is not being
6 denied recovery of any cash expense, rather the rate of amortizing invested capital is
7 changed to correct for past accelerated capital recoveries.

8
9 **Q. WILL MR. POUS' ADJUSTMENT TO CORRECT THE EXCESS**
10 **DEPRECIATION RESERVE IMPACT FPL'S CASH FLOW?**

11 A. Yes. By reducing revenue requirements by about \$311 million per year, the direct
12 result for a non-cash expense (depreciation), the cash flow paid by customers to the
13 Company will be reduced by this \$311 million amount. The cash flow to the
14 Company consists of net income (revenues less expenses) plus depreciation, plus
15 deferred income taxes.

16
17 Various measures of cash flow from operations are employed as measures of a firm's
18 financial metrics. One simple measure as described above can be calculated off the
19 Company's rate filing schedule MFR No. E-1, Attachment 2 of 3, page 1 of 2 as
20 shown in my Exhibit___(DJL-5).

21
22 Thus, under the Company's rate filing assumptions, FPL would have (if the full rate
23 increase were to be granted) \$3,084,666,000 of cash before income taxes. This

1 amount reflects \$1,364,746,000 of return to pay interest on debt, preferred stock, and
2 income or return for equity shareholders. The \$1,075,373,000 is the depreciation
3 and amortization request of the Company, which, if granted, represents the return of
4 capital investment. Lastly, the \$644,545,000 of income taxes represents federal and
5 state current and deferred taxes. The deferred tax component is approximately
6 \$171,299,000. Deferred taxes are taxes not currently payable to the taxing authority
7 and are funds available (cash flow) for other business purposes.

8
9 Generally, the impact of Mr. Pous' depreciation correction to the excess reserve is to
10 reduce the claimed non-cash depreciation expense of \$1,075,373,000 by about \$311
11 million. The impact of this adjustment is to reduce cash flow by about \$311 million.
12 In other words, rather than a cash flow of \$3,084,666,000 (shown in Exhibit__ (DJL-
13 5) the annual Company cash flow will be about \$2,773,666,000 (\$3,084,666,000-
14 \$311,000,000).

15
16 **Q. WILL MR. POUS' CORRECTION OF EXCESS DEPRECIATION IMPACT**
17 **THE EARNINGS OF THE COMPANY?**

18 A. No. The return authorized by this Commission will not be impacted by correcting
19 the excess depreciation reserve.

20
21 **Q. WILL THERE BE AN IMPACT ON EXPENSES FOR CALCULATING**
22 **INCOME TAXES AS A RESULT OF MR. POUS' CORRECTION TO THE**
23 **ACCUMULATED DEPRECIATION RESERVE?**

1 A. No. Whatever depreciation expense is allowed by the Commission will still be used
2 in the tax calculation. Under Mr. Pous' recommendation, about \$311 million of the
3 annual depreciation expense is funded not from increasing customer rates, but
4 instead by reducing the excess depreciation reserve (which was paid by customers in
5 past years).

6

7 **V. IMPACTS ON FINANCIAL INTEGRITY**

8 **Q. IN YOUR OPINION, WILL CORRECTING THE EXCESS RESERVE**
9 **EMPLOYING A FOUR YEAR AMORTIZATION HARM FPL'S FINANCIAL**
10 **INTEGRITY?**

11 A. OPC's witnesses were mindful of the need to preserve FPL's financial integrity
12 when quantifying the portion of the excess reserve to return to customers more
13 quickly than the remaining lives. Mr. Pous' recommendation will not harm the
14 Company's financial integrity, although there will be an impact on cash flow
15 financial metrics. It is important to note that under Mr. Pous' proposal cash will
16 decrease by \$290,998,138 per annum, but at the end of four years rate base will be
17 higher in the amount of \$1,245,360,415. Thus, Mr. Pous' correction decreases the
18 accumulated provision for depreciation (a rate base reduction) and corrects the
19 depreciation reserve to more appropriate or theoretically correct levels. Over the
20 term (four years), the Company remains whole. Only the recovery period of capital
21 investment changes – no adjustment or reduction is made to the Company's
22 investment.

23

1 **Q. WHAT FINANCIAL RATIOS AND METRICS ARE IMPORTANT IN**
2 **EVALUATING A COMPANY'S FINANCIAL INTEGRITY?**

3 A. There is no one key financial metric or group of financial ratios that if attained will
4 result in achieving a particular bond rating level. But, the ratios are helpful in
5 evaluating a company's financial integrity, as these financial ratios are helpful in
6 broadly defining a particular company's position relative to a bond rating category.
7 Again, these financial ratios are not used by rating agencies as a prerequisite for
8 achieving or maintaining a specific debt rating.

9
10 Key financial metrics and ratios include cash flow-to-debt ratios, a short-term
11 measure of leverage risk, interest coverage ratios measuring earnings coverage of
12 fixed cost interest, and debt to total capital ratio – another measure of leverage. For
13 electric utilities the financial ratio medians by bond rating category are shown in my
14 Exhibit__(DJL-6).

15
16 **Q. HAVE YOU CALCULATED THE COMPANY'S FINANCIAL METRICS**
17 **ASSUMING MR. POUS' \$1.2 BILLION EXCESS RESERVE ADJUSTMENT**
18 **IS IMPLEMENTED IN THIS PROCEEDING?**

19 A. Yes. Included in Exhibirt__(DJL-6) are the results of the excess reserve correction
20 on the financials of the Company. First, this analysis evaluates the impact of only
21 the excess reserve adjustment, so that the Commission can evaluate the impact of
22 correcting the excess reserve on the Company. As is discussed below, correcting the
23 excess reserve has a small impact on FPL's cash flow financials. Second, only cash

1 flow is affected by this adjustment. Financial ratios such as “debt ratio” are
2 unaffected by the correction of the excess reserve.

3
4 As is demonstrated by the results shown in Exhibit__(DJL-6), the Company’s cash
5 flow ratios decline slightly, but remain well above industry averages. FPL maintains
6 strong financial integrity after correcting for the excess depreciation.

7

8 **Q. WHAT DO YOU CONCLUDE REGARDING THE IMPACT OF**
9 **CORRECTING THE EXCESS DEPRECIATION RESERVE ON THE**
10 **COMPANY’S FINANCIAL METRICS?**

11 A. Correcting the excess reserve is warranted in that the impact on customers of this
12 correction far outweighs the slight impact on the Company’s cash flow financial
13 measures.

14

15 **Q. IN YOUR CASH FLOW ANALYSIS, HAVE YOU TAKEN INTO**
16 **CONSIDERATION OTHER CASH FLOW IMPACTS TO FPL?**

17 A. No. There will be a number of witnesses in this case that make additional
18 adjustment proposals that will impact cash flow. For example, alternative return,
19 depreciation, and income tax recommendations will come before the Commission in
20 this case. My analysis focuses solely on the excess depreciation reserve impact and
21 demonstrates that the cash flow reduction allows FPL to maintain solid financial
22 metrics.

23

1 **Q. BASED ON YOUR ANALYSIS OF THE EXCESS DEPRECIATION**
2 **RESERVE AND THE CORRECTION PROPOSED BY MR. POUS, WHAT**
3 **ARE YOUR CONCLUSIONS IN THIS CASE?**

4 A. The excess depreciation reserve, which currently exceeds \$1.2 billion of excess
5 depreciation costs collected from customers, should be corrected in this case as
6 recommended by witness Pous. First, if not corrected the situation, in terms of cost
7 shifting, is likely to become worse, not better. As demonstrated by the results of
8 FPL's previous rate settlement, wherein about \$500 million of excess reserve was
9 corrected at a rate of \$125 million per year – the excess reserve has continued to
10 grow and is now in excess of \$1.2 billion.

11

12 FPL's financials were not harmed as a result of previous corrections to the
13 depreciation reserve and, as current analysis shows, FPL's financials remain strong
14 with the correction of the excess depreciation reserve. Moreover, correcting the
15 excess depreciation reserve does not cut one dollar of cash expense from FPL –
16 correction of the excess depreciation reserve addresses timing of recovery.
17 Customers have paid excess depreciation in past years, thereby accelerating FPL's
18 capital recovery. Correcting the excess reserve assures customers pay the true cost
19 of service: no more, no less. FPL will still recover its capital investment, but on a
20 less accelerated basis.

21

22 **Q. ARE THERE ADDITIONAL REASONS WHY THE COMMISSION**
23 **SHOULD CORRECT THE EXCESS DEPRECIATION RESERVE?**

1 A. Yes. The Company has requested an enormous increase -- approximately a 25%
2 base rate annual increase in this case. The economic times and conditions faced by
3 the Company and consumers are well documented and slow recovery is expected.
4 The correction of the excess reserve is an opportunity for this Commission to correct
5 the excess reserve and reduce the rate increase by over \$300 million without harming
6 FPL. Such rate reduction does not disallow cash expenditures, but instead corrects
7 the rate of asset recovery. For all of these reasons the Commission should correct
8 the excess reserve at this time as proposed by OPC witness Pous.


9

10 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

11 A. Yes.

CERTIFICATE OF SERVICE
DOCKET NOS. 080677-EI & 090130-EI

I HEREBY CERTIFY that a copy of the foregoing **DIRECT TESTIMONY OF DANIEL J. LAWTON** has been furnished by U.S. mail to the following parties on this 16th day of July, 2009 to the following:

R. Wade Litchfield Florida Power & Light Company 215 South Monroe Street Suite 810 Tallahassee, FL 32301-1859	Robert A. Sugarman/D. Marcus Braswell, Jr. Sugarman & Susskind, P.A. 100 Miracle Mile, Suite 300 Coral Gables, FL 33134	John W. McWhirter, Jr. Florida Industrial Power Users Group c/o McWhirter Law Firm P.O. Box 3350 Tampa, FL 33601
John T. Butler Florida Power & Light Company 700 Universe Blvd. Juno Beach, FL 33408-0420	Bryan S. Anderson Senior Attorney Florida Power & Light Company 700 Universe Blvd. Juno beach, FL 33408-0420	Vicki Gordon Kaufman Jon C. Moyle, Jr. Keefe Law Firm 118 North Gadsden Street Tallahassee, FL 32301
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DANIEL J. LAWTON
LAWTON CONSULTING
B.A. ECONOMICS, MERRIMACK COLLEGE
M.A. ECONOMICS, TUFTS UNIVERSITY

Prior to beginning his own consulting practice Diversified Utility Consultants, Inc., in 1986 where he practiced as a firm principal through December 31, 2005, Mr. Lawton had been in the utility consulting business with a national engineering and consulting firm. In addition, Mr. Lawton has been employed as a senior analyst and statistical analyst with the Department of Public Service in Minnesota. Prior to Mr. Lawton's involvement in utility regulation and consulting he taught economics, econometrics, statistics and computer science at Doane College.

Mr. Lawton has conducted numerous financial and cost of capital studies on electric, gas and telephone utilities for various interveners before local, state and federal regulatory bodies. In addition, Mr. Lawton has provided studies, analyses, and expert testimony on statistics, econometrics, account, forecasting, and cost of service issues. Other projects in which Mr. Lawton has been involved include rate design and analyses, prudence analyses, fuel cost reviews and regulatory policy issues for electric, gas and telephone utilities. Mr. Lawton has developed software systems, databases and management systems for cost of service analyses.

In addition, Mr. Lawton has developed and reviewed numerous forecasts of energy and demand used for utility generation expansion studies as well as municipal financing. Mr. Lawton has represented numerous municipalities as a negotiator in utility related matters. Such negotiations ranges from the settlement of electric rate cases to the negotiation of provisions in purchase power contracts.

A list of cases in which Mr. Lawton has provided testimony is attached.

**UTILITY RATE PROCEEDINGS IN WHICH
 TESTIMONY HAS BEEN PRESENTED BY DANIEL J. LAWTON**

JURISDICTION/COMPANY	DOCKET NO.	TESTIMONY TOPIC
ALASKA REGULATORY COMMISSION		
Beluga Pipe Line Company	P-04-81	Cost of Capital

FEDERAL ENERGY REGULATORY COMMISSION		
Alabama Power Company	ER83-369-000	Cost of Capital
Arizona Public Service Company	ER84-450-000	Cost of Capital
Florida Power & Light	EL83-24-000	Cost Allocation, Rate Design
Florida Power & Light	ER84-379-000	Cost of Capital, Rate Design, Cost of Service
Southern California Edison	ER82-427-000	Forecasting

LOUISIANA PUBLIC SERVICE COMMISSION		
Louisiana Power & Light	U-15684	Cost of Capital, Depreciation
Louisiana Power & Light	U-16518	Interim Rate Relief
Louisiana Power & Light	U-16945	Nuclear Prudence, Cost of Service

MINNESOTA PUBLIC UTILITIES COMMISSION		
Continental Telephone	P407/GR-81-700	Cost of Capital
Interstate Power Co.	E001/GR-81-345	Financial
Montana Dakota Utilities	G009/GR-81-448	Financial, Cost of Capital

New ULM Telephone Company	P419/GR81767	Financial
Norman County Telephone	P420/GR-81-230	Rate Design, Cost of Capital
Northern States Power	G002/GR80556	Statistical Forecasting, Cost of Capital
Northwestern Bell	P421/GR80911	Rate Design, Forecasting

FLORIDA PUBLIC SERVICE COMMISSION		
Progress Energy	070052-EI	Cost Recovery

NORTH CAROLINA UTILITIES COMMISSION		
North Carolina Natural Gas	G-21, Sub 235	Forecasting, Cost of Capital, Cost of Service

OKLAHOMA PUBLIC SERVICE COMMISSION		
Arkansas Oklahoma Gas Corporation	200300088	Cost of Capital
Public Service Company of Oklahoma	200600285	Cost of Capital
Public Service Company of Oklahoma	200800144	Cost of Capital

PUBLIC SERVICE COMMISSION OF INDIANA		
Kokomo Gas & Fuel Company	38096	Cost of Capital

PUBLIC UTILITY COMMISSION OF NEVADA		
Nevada Bell	99-9017	Cost of Capital
Nevada Power Company	99-4005	Cost of Capital
Sierra Pacific Power Company	99-4002	Cost of Capital

PUBLIC SERVICE COMMISSION OF UTAH		
PacifiCorp	04-035-42	Cost of Capital
Rocky Mountain Power	08-035-38	Cost of Capital

SOUTH CAROLINA PUBLIC SERVICE COMMISSION		
Piedmont Municipal Power	82-352-E	Forecasting

PUBLIC UTILITY COMMISSION OF TEXAS		
Central Power & Light Company	6375	Cost of Capital, Financial Integrity
Central Power & Light Company	9561	Cost of Capital, Revenue Requirements
Central Power & Light Company	7560	Deferred Accounting
Central Power & Light Company	8646	Rate Design, Excess Capacity
Central Power & Light Company	12820	STP Adj. Cost of Capital, Post Test-year adjustments, Rate Case Expenses
Central Power & Light Company	14965	Salary & Wage Exp., Self-Ins. Reserve, Plant Held for Future use, Post Test Year Adjustments, Demand Side Management, Rate Case Exp.
Central Power & Light Company	21528	Securitization of Regulatory Assets
El Paso Electric Company	9945	Cost of Capital, Revenue Requirements, Decommissioning Funding

El Paso Electric Company	12700	Cost of Capital, Rate Moderation Plan, CWIP, Rate Case Expenses
Entergy Gulf States Incorporated	16705	Cost of Service, Rate Base, Revenues, Cost of Capital, Quality of Service
Entergy Gulf States Incorporated	21111	Cost Allocation
Entergy Gulf States Incorporated	21984	Unbundling
Entergy Gulf States Incorporated	22344	Capital Structure
Entergy Gulf States Incorporated	22356	Unbundling
Entergy Gulf States Incorporated	24336	Price to Beat
Gulf States Utilities Company	5560	Cost of Service
Gulf States Utilities Company	6525	Cost of Capital, Financial Integrity
Gulf States Utilities Company	6755/7195	Cost of Service, Cost of Capital, Excess Capacity
Gulf States Utilities Company	8702	Deferred Accounting, Cost of Capital, Cost of Service
Gulf States Utilities Company	10894	Affiliate Transaction
Gulf States Utilities Company	11793	Section 63, Affiliate Transaction
Gulf States Utilities Company	12852	Deferred acctng., self-Ins. reserve, contra AFUDC adj., River Bend Plant specifically assignable to Louisiana, River Bend Decomm., Cost of Capital, Financial Integrity, Cost of Service, Rate Case Expenses
GTE Southwest, Inc.	15332	Rate Case Expenses
Houston Lighting & Power	6765	Forecasting
Houston Lighting & Power	18465	Stranded costs
Lower Colorado River Authority	8400	Debt Service Coverage, Rate Design
Southwestern Electric Power Company	5301	Cost of Service

Southwestern Electric Power Company	4628	Rate Design, Financial Forecasting
Southwestern Electric Power Company	24449	Price to Beat Fuel Factor
Southwestern Bell Telephone Company	8585	Yellow Pages
Southwestern Bell Telephone Company	18509	Rate Group Re-Classification
Southwestern Public Service Company	13456	Interruptible Rates
Southwestern Public Service Company	11520	Cost of Capital
Southwestern Public Service Company	14174	Fuel Reconciliation
Southwestern Public Service Company	14499	TUCO Acquisition
Southwestern Public Service Company	19512	Fuel Reconciliation
Texas-New Mexico Power Company	9491	Cost of Capital, Revenue Requirements, Prudence
Texas-New Mexico Power Company	10200	Prudence
Texas-New Mexico Power Company	17751	Rate Case Expenses
Texas-New Mexico Power Company	21112	Acquisition risks/merger benefits
Texas Utilities Electric Company	9300	Cost of Service, Cost of Capital
Texas Utilities Electric Company	11735	Revenue Requirements
TXU Electric Company	21527	Securitization of Regulatory Assets
West Texas Utilities Company	7510	Cost of Capital, Cost of Service
West Texas Utilities Company	13369	Rate Design

RAILROAD COMMISSION OF TEXAS		
Energas Company	5793	Cost of Capital
Energas Company	8205	Cost of Capital
Energas Company	9002-9135	Cost of Capital, Revenues, Allocation
Lone Star Gas Company	8664	Rate Design, Cost of Capital, Accumulated Depr. & DFIT, Rate Case Exp.
Lone Star Gas Company-Transmission	8935	Implementation of Billing Cycle Adjustment
Southern Union Gas Company	6968	Rate Relief
Southern Union Gas Company	8878	Test Year Revenues, Joint and Common Costs
Texas Gas Service Company	9465	Cost of Capital, Cost of Service, Allocation
TXU Lone Star Pipeline	8976	Cost of Capital, Capital Structure
TXU-Gas Distribution	9145-9151	Cost of Capital, Transport Fee, Cost Allocation, Adjustment Clause
TXU-Gas Distribution	9400	Cost of Service, Allocation, Rate Base, Cost of Capital, Rate Design
Westar Transmission Company	4892/5168	Cost of Capital, Cost of Service
Westar Transmission Company	5787	Cost of Capital, Revenue Requirement

TEXAS WATER COMMISSION		
Southern Utilities Company	7371-R	Cost of Capital, Cost of Service

SCOTTSBLUFF, NEBRASKA CITY COUNCIL		
K. N. Energy, Inc.		Cost of Capital

HOUSTON CITY COUNCIL		
Houston Lighting & Power Company		Forecasting

PUBLIC UTILITY REGULATION BOARD OF EL PASO, TEXAS		
Southern Union Gas Company		Cost of Capital

DISTRICT COURT CAMERON COUNTY, TEXAS		
City of San Benito, et. al. vs. PGE Gas Transmission et. al.	96-12-7404	Fairness Hearing

DISTRICT COURT HARRIS COUNTY, TEXAS		
City of Wharton, et al vs. Houston Lighting & Power	96-016613	Franchise fees

DISTRICT COURT TRAVIS COUNTY, TEXAS		
City of Round Rock, et al vs. Railroad Commission of Texas et al	GV 304,700	Mandamus

EXAMPLES OF COSTS SUBJECT TO SPECIAL RECOVERY
APPROVED BY THE FLORIDA PUBLIC SERVICE COMMISSION

LINE NO.	(COLUMN 1) DATE	(COLUMN 2) DOCKET/ORDER NO.	(COLUMN 3) COMPANY	(COLUMN 4) COSTS SUBJECT TO SPECIAL RECOVERY	(COLUMN 5) RECOVERY TERMS
1	06-17-83	12148	United Telephone Company of Florida	Attrition Allowance	\$1,029,190 excess attrition allowance collections credited to depreciation reserve
2	07-22-83	12290	Southern Bell Telephone and Telegraph Company	Depreciation Reserve Deficiency and Near-Term Retirements	\$123,000,000 depreciation reserve deficiency amortized over 5 years; \$99,564,000 near-term retirements amortized over 3 years.
3	11-03-83	12654	Central Telephone Company	Depreciation Reserve Deficiency and Near-Term Retirements	\$9.1 million depreciation reserve deficiency amortized over 5 years; \$13 million near-term retirements amortized over 1 to 5 years
4	08-27-84	13624	United Telephone Company of Florida	Central Office Equipment	\$8,650,000 of 1984 excess earnings credited to depreciation reserve
5	12-31-84	13951	Central Telephone Company	Central Office Equipment and Station Connections	\$16,223,000 of 1984 excess earnings credited to depreciation reserve
6	06-19-86	16257	Southern Bell Telephone and Telegraph Company; General Telephone Company, et al	JDIC Interest Synchronization Revenue Requirements	\$48 million of over-collections credited to reserves for depreciation

EXCESS DEPRECIATION RESERVE
BY OPERATING FUNCTION

LINE NO.	FUNCTION	AMOUNT
1	Steam	\$410,110,174
2	Nuclear	377,507,259
3	Combined Cycle	25,944,710
4	Gas Turbine	28,027,786
5	Transmission	<15,637,436>
6	Distribution	340,529,349
7	General	78,878,573
8	Total	\$1,245,360,415

**ESIMATE OF CASH FLOW IMPACT
OF CORRECTING EXCESS DEPRECIATION RESERVE**

LINE NO.	DESCRIPTION	AMOUNT
1	Expense Reduction	\$311,340,104
2	Rate Base Increase	\$155,670,052 ¹
3	Requested RoR	8.0% ²
4	Return Increase	\$12,453,604 ³
5	Tax Expansion Factor	1.63342 ⁴
6	Increase Revenue Requirement	\$20,341,967 ⁵
7	Revenue Requirement Impact / Cash Flow	\$290,998,138 ⁶

¹ Line 1 divided by 2, average rate base impact

² Schedule A-1

³ Line 3 times Line 2

⁴ Schedule C-44

⁵ Line 5 times Line 4

⁶ Line 6 Less Line 1

FPL CASH FLOW PER RATE REQUEST
TEST YEAR ENDING DECEMBER 31, 2010

LINE NO.	DESCRIPTION	AMOUNT (000'S)
1	Net Operating Income	\$1,364,746 ¹
2	Depreciation & Amortization	\$1,075,373 ²
3	Income Taxes	\$644,545 ³
4	Cash Flow Before Tax	\$3,084,666
5	Cash Flow After Current Income Tax	\$2,611,420

¹ Company Schedule A-1

² MFR E-1, Attachment 2 of 3, Page 1 of 2

³ Id. Deferred Income Tax is estimated at \$171,299

**FPL FINANCIAL METRICS PER RATE REQUEST
AND ADJUSTED FOR EXCESS DEPRECIATION RESERVE**

LINE NO	DESCRIPTION	FPL REQUESTED		CORRECTED		
		AMOUNT	MFR SOURCES	DEPREC. RESERVE		
1	RATE BASE	\$17,063,586	B-1	\$17,063,586		
2	RATE OF RETURN	8.00%	D-1A	8.00%		
3	REQUESTED RETURN	\$1,364,748	1*3	\$1,364,748		
4	CURRENT INCOME	\$725,883	C-1	\$725,883		
5	CLAIMED DEFICIENCY	\$638,865	3-4	\$638,865		
6	TAX EXPANSION FACTOR	1.63342	C-44	1.63342		
7	REQUESTED INCREASE	\$1,043,535	5*6	\$1,043,535		
8						
9	DEPRECIATION & AMORTIZATION	\$1,075,373	E-1	\$784,375		
10	INCOME TAXES	\$644,545	E-1	\$644,545		
11	CASH FLOW BEFORE FIT	\$3,084,666	SUM LINES 3,9,10	\$2,793,668		
12	CASH FLOW W/O FIT	\$2,440,121	SUM LINES 3,9	\$2,149,123		
13						
14	INTEREST	\$362,457	C-23	\$362,457		
15	DEBT	\$5,377,787	D-1A	\$5,377,787		
16	ADJUSTED DEBT	\$6,327,047	EX. AP-7	\$6,327,047		S&P GUIDELINES
17	PRE-TAX METRICS					MEDIUM A RATING
18	CFO (EBITA) INTEREST X	8.51	LN11/LN14	7.71		3.0-4.5
19	CFO (EBITA) DEBT	57.36%	LN11/LN15	51.95%		25%-45%
20	CFO (EBITA) ADJUSTED DEBT	48.75%	LN11/LN16	44.15%		25%-45%
21	DEBT PERCENTAGE	43.10%	EX AP-7	43.10%		35%-50%
22						S&P GUIDELINES
23	AFTER TAX METRICS					MEDIUM A RATING
24	CFO (EBITA) INTEREST X	6.73	LN12/LN14	5.93		3.0-4.5
25	CFO (EBITA) DEBT	45.37%	LN12/LN15	39.96%		25%-45%
26	CFO (EBITA) ADJUSTED DEBT	38.57%	LN12/LN16	33.97%		25%-45%
27	DEBT PERCENTAGE	43.10%	EX AP-7	43.10%		35%-50%

	4 Year Amortization
1	4 Year Amortization
2	Annual Amortization \$311,340,104
3	Rate Base Impact \$155,670,052
4	Return \$12,453,604
5	GrossUp \$20,341,966
6	Added Rev. Requirement
7	Net Cash Flow Impact \$290,998,138

KEY UTILITY FINANCIAL RATIOS

DESCRIPTION	Bond Rating		
	AA	A	BBB
EBIT interest coverage (x)	4.2	3.4	2.8
Total Debt/Capital (%)	51.7	55.9	58.8
Funds from Operations interest coverage	5.1	4.0	3.5
Funds from operations / total debt	35.5	23.8	20.4

Where:

1) EBIT interest coverage =

$$\frac{\text{earnings from operations before interest and taxes}}{\text{gross interest less (capitalized interest + interest income)}}$$

*EBITA interest coverage =

$$\text{Earnings from operations before interest, tax, depreciation, amortization}$$

2) Total Debt / Capital =

$$\frac{\text{Long-term debt + debt equivalents}}{\text{Total capital (debt, preferred, equity)}}$$

3) Funds from operation interest coverage =

$$\frac{\text{Net income from operations + (depreciation, amortization, deferred tax)}}{\text{Gross interest -- (capitalized interest + interest income)}}$$