BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

PETITION FOR INCREASE IN RATES BY FLORIDA POWER & LIGHT COMPANY. DOCKET NO. 080677-EI

2009 DEPRECIATION AND DISMANTLEMENT STUDY BY FLORIDA POWER & LIGHT COMPANY. DOCKET NO. 090130-EI

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VOLUME 23
Pages 3092 through 3323

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PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN MATTHEW M. CARTER
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Thursday, September 3, 2009

TIME: Commenced at 9:39 a.m.

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

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

APPEARANCES: (As heretofore noted.)

I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID.	ADMTD.
37	Staff's Composite Exhibit 37	3184	3184
207	Woolridge - Appendix A	3187	3319
208	JRW-1	3187	3319
209	JRW-2	3187	3319
210	JRW-3	3187	3319
211	JRW-4	3187	3319
212	JRW-5	3187	3319
213	JRW-6	3187	3319
214	JRW-7	3187	3319
215	JRW-8	3187	3319
216	JRW-9	3187	3319
217	JRW-10	3187	3319
218	JRW-11	3187	3319
219	JRW-12	3187	3319
220	JRW-13	3187	3319
221	JRW-14	3187	3319
222	JRW-15	3187	3319
291	LK-1	3105	3183
292	LK-2	3105	3183
293	LK-3	3105	3183
294	LK-4	3105	3183
295	LK-5	3105	3183
296	LK-6	3105	3183

EXHIBITS

NUMBER:		ID.	ADMTD.
297	LK-7	3105	3183
298	LK-8	3105	3183
299	LK-9	3105	3183
300	LK-10	3105	3183
301	LK-11	3105	3183
302	LK-12	3105	3183
303	LK-13	3105	3183
304	LK-14	3105	3183
305	LK-15	3105	3183
306	LK-16	3105	3183
307	LK-17	3105	3183
308	LK-18	3105	3183
309	LK-19	3105	3183
310	LK-20	3105	3183
311	LK-21	3105	3183
312	LK-22	3105	3183
313	LK-23	3105	3183
314	LK-24	3105	3183
315	LK-25	3105	3183
316	LK-26	3105	3183
317	LK-27	3105	3183
318	LK-28	3105	3183
319	LK-29	3105	3183

EXHIBITS

NUMBER:		ID.	ADMTD.
320	LK-30	3105	3183
321	LK-31	3105	3183
322	LK-32	3105	3183
323	LK-33	3105	3183
324	LK-34	3105	3183
325	LK-35	3105	3183
326	LK-36	3105	3183
327	LK-37	3105	3183
328	LK-38	3105	3183
457	Woolridge Cross-Marked Exhibits	3285	3319
458	FPL & OPC Equity Dollars Difference	3291	3319
459	Excerpt from FPL 2008 10K	3299	3320
460	S&P Ratings Methodology-Imputed Debt	3301	3320
461	S&P Report on FPL Dated 8/20/08	3302	3321
462	Major Electric Rate Case Decisions	3306	3321

P R O C E E D I N G

(Transcript follows in sequence from Volume 22.)

CHAIRMAN CARTER: Good morning to one and all. I'd like to call this hearing to order. And before we get started, there's a preliminary matter I'd like to take care of.

Ms. Clark, good morning. You are recognized.

MS. CLARK: Thank you, Mr. Chairman. I have two things. Yesterday for Witness Pollock we agreed to revise Exhibit 455 and take out some pages. We have that now. I think it's been passed out.

CHAIRMAN CARTER: Yes.

MS. CLARK: So --

CHAIRMAN CARTER: Just the chart.

MS. CLARK: Just the chart.

CHAIRMAN CARTER: Okay. Does everyone have that? You guys have this?

Okay. You may proceed.

MS. CLARK: And I guess I feel like I've been, the scheduling has been falling to me somewhat to give you an idea.

CHAIRMAN CARTER: Yeah, Mr. McGlothlin, Mr. McGlothlin threw you under the bus on that one, so you're it.

MS. CLARK: Well, so what I did, Mr. Chairman, was last night I spent some time reviewing the witness schedule and how we could realize your optimism of finishing the hearing on time, and at least by Saturday. And I'm going to -- we developed a schedule -- not a schedule. A summary of how to get there; I want to be clear it's a summary of how to get there.

CHAIRMAN CARTER: Okay.

MS. CLARK: What we did was we estimated the actual time for these two and a half days. I have to say, Mr. Chairman, I assumed we would go Saturday. So what we figured out was we had roughly 19 hours, counting lunch and stuff, to get all these witnesses heard.

And as you can see from the sheet, that would mean that on average for summary, cross-examination, redirect, we would have to average roughly an hour for each witness. I want to be clear at the top, we show the three Intervenor witnesses we will take up today, and FP&L would commit to no more than an hour for those Intervenors.

But the bottom line is we think this is a summary that provides a realistic assessment of where we are for purposes of developing a timely schedule to complete the hearing. So, frankly, I took a cue from

your lighting system and said how much time do we have to allot for each one. That doesn't mean -- that's just an average time. We understand that some would be more and some would, would be less.

And I want to be clear, I have not spoken to the Intervenors about this and if it's possible, but it is the road map that we could use to get to a conclusion.

CHAIRMAN CARTER: Okay. Notwithstanding the time, at least it's a good layout in terms of where we're proceeding in the order of witnesses. I think we can all agree on that, that part. Am I right in terms of the order of witnesses? Notwithstanding the time, but am I, everybody, are we on the same page? We get a different sheet every day.

But notwithstanding the time, let's just break -- this is my understanding, from looking at the, the other sheets that we were on, that this is the order of witnesses; is that correct?

MS. CHRISTENSEN: Yeah. That seems to be correct.

CHAIRMAN CARTER: Okay. Good. Good. And, I mean, I'm optimistic. You know, I was --

COMMISSIONER EDGAR: Mr. Chairman?

CHAIRMAN CARTER: Yes, ma'am.

COMMISSIONER EDGAR: It looks to me like this was put together by a working mother.

CHAIRMAN CARTER: A multi, multitasker, multitasker. How do you say that anyway? I've got, I've got that right brain thing --

MS. CLARK: We'd like to work with the Intervenors to see if we can, you know, get on a schedule to get this, this done. And this was just for, frankly, for purposes of laying out the math.

CHAIRMAN CARTER: Okay. And we did that also because some of the witnesses have travel arrangements and some could only be available -- I know that Dr. Woolridge was only available for Thursday; right?

MS. CLARK: Uh-huh.

MS. CHRISTENSEN: Correct.

CHAIRMAN CARTER: And we were able to accommodate Mr. Stall for Wednesday and Clarke for Wednesday.

MS. CLARK: The other person --

CHAIRMAN CARTER: What day is it?

MS. CLARK: Thursday.

CHAIRMAN CARTER: Thursday.

Okay. Ms. Clark?

MS. CLARK: The other thing is Mr. Meischeid, we had him today. We believe we can move him to

tomorrow if he doesn't come up today.

CHAIRMAN CARTER: Okay. All right. Everyone kind of look it over in terms of the order of witnesses and we'll, we'll, you know, obviously, you know, we'll give everyone an ample time to present their case.

Mr. Moyle, good morning, sir.

MR. MOYLE: Good morning. Good morning. And FIPUG has a preliminary matter --

CHAIRMAN CARTER: You're recognized.

MR. MOYLE: -- with respect to interrogatories that were used last night with Mr. Pollock. I think staff had wanted to move in certain interrogatories. Ms. Kaufman was here and handling that.

CHAIRMAN CARTER: She promised to give us a complete list.

MR. MOYLE: And I, I have hopefully fulfilled her promise of giving you a complete listing of the interrogatories, which at the appropriate time we'll need to have marked and moved into the record.

I appreciate Ms., Ms. Clark working on this list. I think it helps give, give us an indication as to where we are. I reviewed it briefly and I, you know, I think we all want to move forward and do our best to get this resolved while not diminishing the quality of the evidence that comes in.

And kind of just kicking it around with some, some folks, I did rough math and said, you know, we're, we're, if you have 1.5 billion of a rate increase times ten days, that's 150 million a day. Ten hours is 15 million an hour. So that gets close to Tiger Wood's kind of compensation.

So anyway, but I think we can use this as an outline, but I don't want to -- obviously with some key witnesses like, like Mr. Avera and Mr. Pimentel, they've covered a lot of ground. I don't know that we'd be able to get them done in an hour. But I commend her for taking the effort to try to do it.

CHAIRMAN CARTER: Yeah. It's a great outline in terms of where we're going. I mean, the time is the time, and obviously as we get into a stream of consciousness and sometimes a person may say something that, you know, causes you to go down another line of questions, that's fine, that's fine to do.

Ms. Christensen, how are you doing this morning?

MS. CHRISTENSEN: Doing fine, Mr. Chairman.

CHAIRMAN CARTER: And that's Mr. McGlothlin behind you, not Mr. Reilly. Okay?

MS. CHRISTENSEN: Okay.

CHAIRMAN CARTER: Okay. Any other preliminary

matters from any of the parties?

MS. BROWN: Mr. Chairman?

CHAIRMAN CARTER: Staff, you're recognized.

MS. BROWN: Mr. Chairman, just to contribute to the conversation, staff has three witnesses that it would be willing to stipulate rebuttal in, and we'll get with the parties to see if we could arrange that.

CHAIRMAN CARTER: Okay. I'll tell you what we'll do, guys and dolls, is we've been kind of, I've been using this word, it may not even be a word, but fluidity was the word I was using in terms of our court reporters. If you noticed, we've been able to trade in and trade out without disrupting things.

But we'll probably take a break and give you an opportunity to discuss some things. I know that a lot of you just saw the list in terms of the outline. Mr. Moyle has the list of interrogatories that will be part of the exhibit that staff has already moved in, that we've already approved in that needs to be marked and put with that.

Also, the parties may want to get together and talk about some of these witnesses, whether there is agreement on some or not and all, and we can do that. So I'll probably, depending on the flow, take a break and give you guys an opportunity to chit-chat. How

about that? Okay.

Anything further? Okay. Then call your next witness.

MS. GRIFFITHS: SFHHA calls Mr. Lane Kollen.

CHAIRMAN CARTER: Okay. Mr. Kollen, have you been sworn?

THE WITNESS: I have, yes.

CHAIRMAN CARTER: You know about my lights; right?

THE WITNESS: I do.

LANE KOLLEN

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

DIRECT EXAMINATION

BY MS. GRIFFITHS:

Q. Good morning. Could you please state your name and your business address for the record.

A. Yes. My name is Lane Kollen, and my business address is J. Kennedy and Associates, 570 Colonial Park Drive, Suite 305, Roswell, Georgia 30075.

Q. And by whom are you employed?

A. The firm of J. Kennedy and Associates.

Q. And are you the same Lane Kollen that filed direct testimony and exhibits in this proceeding on

behalf of South Florida Hospital and Healthcare Association?

A. Yes.

Q. And are you the same Lane Kollen that filed exhibits attached to that direct testimony, which were marked as Exhibits LK-1 through LK-38 and are marked in staff's Comprehensive Exhibit List as hearing Exhibits 291 through 328?

A. Yes.

(Exhibits 291 through 328 marked for identification.)

Q. And if I were to ask you the same questions that you were asked in your testimony, would your answers still be the same today?

A. Yes.

MS. GRIFFITHS: All right. At this moment, I would ask the Chairman to submit Mr. Kollen's prefiled direct testimony into the record as if it were read.

CHAIRMAN CARTER: The prefiled testimony of the witness will be inserted into the record as though read.

BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

IN RE:

PETITION FOR RATE INCREASE BY) DOCKET NO. 080677-EI
FLORIDA POWER & LIGHT COMPANY)

DIRECT TESTIMONY OF LANE KOLLEN

I. QUALIFICATIONS AND SUMMARY

Qualifications

Q. Please state your name and business address.

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

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

A. I am a utility rate and planning consultant holding the position of Vice President and Principal with Kennedy and Associates.

Q. Please describe your education and professional experience.

A. I earned a Bachelor of Business Administration in Accounting degree and a Master of Business Administration degree, both from the University of Toledo. I also earned a Master of Arts degree from Luther Rice University. I am a Certified

Public Accountant, with a practice license, and a Certified Management Accountant.

I have been an active participant in the utility industry for more than thirty years, both as a consultant and as an employee. Since 1986, I have been a consultant with Kennedy and Associates, providing services to consumers of utility services and state and local government agencies in the areas of utility planning, ratemaking, accounting, taxes, financial reporting, financing and management decision-making. From 1983 to 1986, I was a consultant with Energy Management Associates, providing services to investor and consumer owned utility companies in the areas of planning, financial reporting, financing, ratemaking and management decision-making. From 1976 to 1983, I was employed by The Toledo Edison Company in a series of positions providing services in the areas of planning, accounting, financial and statistical reporting and taxes.

I have appeared as an expert witness on utility planning, ratemaking, accounting, reporting, financing, and tax issues before state and federal regulatory commissions and courts on nearly two hundred occasions. In many of those proceedings, I have represented state and local ratemaking agencies or their Staffs, including the Louisiana Public Service Commission, Georgia Public Service Commission and various groups of Cities with original rate jurisdiction in Texas. I also have appeared before the Florida Public Service Commission

("Commission") in numerous proceedings, including the two most recent Florida Power & Light Company ("FPL" or "Company") base rate proceedings in Docket Nos. 050045-EI (2005) and 001148-EI (2002). I have developed and presented papers at various industry conferences on ratemaking, accounting, and tax issues. My qualifications and regulatory appearances are further detailed in my Exhibit___(LK-1).

Summary

Q. On whose behalf are you testifying?

A. I am offering testimony on behalf of the South Florida Hospital and Healthcare Association ("SFHHA") and individual healthcare institutions (collectively, the "Hospitals") taking electric service on the FPL system.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the Company's proposed series of base rate and recovery clause increases and to make recommendations on the appropriate rate increase amounts.

Q. Please summarize your testimony.

A. The Company has requested an unprecedented series of rate increases in this proceeding of more than $1,550 million, the magnitude of which may not be immediately evident, and which would represent a radical change in the Commission's ratemaking process. These increases consist of a base rate increase

of $1,044 million on January 1, 2010, another series of increases on January 1, 2010 summing to $77 million through various recovery clauses due to transfers in the recovery of such costs between base rates and the clauses, another base rate increase of $247 million on January 1, 2011, an estimated initial base rate increase of $182 million through a Generation Base Rate Adjustment ("GBRA") mechanism for West County Energy Center Unit 3 ("WCEC 3") on June 1, 2011 and another series of unknown future base rate increases through the GBRA for future generation costs.

I recommend that the Commission reject the Company's proposals in this proceeding for all base rate increases after January 1, 2010. Instead, the Company should file for future base rate increases closer to the effective dates of such increases using then current costs and assumptions. The Commission realistically cannot determine at this time the reasonable level of revenues and costs that should be recovered through base rates some three or more years into the future, particularly given the present economic uncertainty. Further, the Commission should not adopt a GBRA that provides the Company an almost unfettered ability to automatically impose base rate increases to recover selective increases in certain costs without consideration of increases in revenues and reductions in all other costs.

In addition, I recommend that the Commission reduce the Company's base rates by at least $336.338 million (net of transfers of costs between base rates and

various recovery clauses) on January 1, 2010 compared to the Company's requested increase of $1,044 million. My recommendation reflects the SFHHA adjustments to remove the excessive and inappropriate costs that affect the rate base, operating income and rate of return that are included in the Company's request. I have summarized the effects of the SFHHA recommendations on the following table.

FLORIDA POWER AND LIGHT BASE RATE INCREASE
SUMMARY OF SFHHA RECOMMENDATIONS
TEST YEAR ENDING DECEMBER 31, 2010
($ MILLIONS)

	Amount
FPL Requested Base Rate Increase	**$ 1,043.535**
Operating Income Adjustments:	
Reduce O&M Expenses - Other (Maintain Status Quo)	(169.256)
Reduce O&M Expenses - DOE Settlement Refunds	(9.030)
Reduce O&M Expenses - AMI Deployment Savings	(5.685)
Reduce O&M Expenses - Development of New CIS	(7.274)
Remove Annual Storm Damage Expense Accrual	(149.162)
Reduce O&M Labor, Payroll Taxes, and Fringe Benefits - Productivity Improvements	(38.641)
Reduce O&M Labor, Payroll Taxes, and Fringe Benefits - Nuclear Staffing	(21.925)
Remove Depreciation Expense - Development of New CIS	(0.506)
Reduce Depreciation Expense - Capital Cost Reductions	(26.719)
Reduce Depreciation Expense - Five Year Amortization of Depreciation Reserve Surplus	(247.556)
Reduce Depreciation Expense - No Acceleration of Capital Recovery Costs	(63.605)
Reduce Depreciation Expense - Forty Year Service Life for Combined Cycle Gas Units	(123.730)
Reduce Depreciation Expense - Economic Stimulus Grants for AMI Deployment	(1.584)
Rate Base Adjustments:	
Reflect Capitalization/Deferral of CIS O&M Expenses	0.428
Reduce Plant for Capital Expenditure Reductions	(92.520)
Restate Accum Depr to Reflect Capital Expenditure Reductions	3.668
Restate Accum Depr to Reflect Five Year Amortization of Depreciation Reserve Surplus	14.559
Restate Accum Depr to Adjust Amortization Periods for Capital Recovery Costs	3.741
Restate Accum Depr to Reflect Forty Year Service Lives for Combined Cycle Gas Units	7.276
Restate Gross Plant and Accum Depr to Reflect Economic Stimulus for AMI Deployment	(2.267)
Capital Structure and Rate of Return Adjustments:	
Rebalance Common Equity and Debt in Capital Structure	(121.424)
Rebalance Long and Short Term Debt in Capital Structure	(11.018)
Eliminate FIN 48 Adjustment to Accumulated Deferred Income Tax	(17.643)
Reallocate Pro Rata Adjustments to Exclude Cust Deposits, ADIT, ITC	(48.695)
Increase ADIT for Depreciation Changes	(8.909)
Restate ROE at 10.4%	(232.610)
Restate Short Term Debt Interest Rate	(11.785)
Total SFHHA Adjustments	**($1,379.873)**
SFHHA Recommendation for Base Rate Change on January 1, 2010	**($336.338)**

The remainder of my testimony is structured to follow the sequence of my summary. In the next section, I address the Company's proposed base rate increases effective on January 1, 2011 and beyond and why the Commission should reject those increases in this proceeding. In the subsequent sections, I focus on the Company's proposed base rate increase effective on January 1, 2010 and the appropriate adjustments to that proposed increase by major ratemaking component (operating income, rate base, and capitalization and rate of return) and by issue affecting each of those major ratemaking components.

Economic Uncertainty and Requested Base Increase on January 1, 2011 and GBRA Increase on June 1, 2011

Q. Should the Commission approve a second base rate increase to be effective on January 1, 2011 based on a "subsequent" test year of 2011?

A. No. First, the Commission cannot determine at this time what the reasonable revenues and costs will be in 2011 given the present economic uncertainty. It will be difficult enough to determine the reasonable level of revenues and costs for the 2010 test year, which itself is two years removed from actual experience and is based on a budgeting process covering 2009 and 2010, but which began in mid-2008 prior to the meltdown in the financial markets and the recession. Since 2008, the Company has engaged in extensive cost reductions compared to its 2009 budget, thus rendering the 2009 budget unreliable as the basis for the 2010 test year forecast, and even more so for the 2011 subsequent test year forecast. I

subsequently describe the Company's cost reductions in both capital expenditures and operating expenses compared to 2008 actual amounts and compared to the Company's 2009 budget.

Second, there is no evidence that there will be actual savings to ratepayers resulting from the avoidance of a separate proceeding sometime in 2010 for rates that will be effective in 2011. Company witness Ms. Kim Ousdahl asserts that the Commission should determine the 2011 rate increase in this proceeding to "avoid the cost and distraction for all parties of back-to-back rate proceedings." [Ousdahl Direct at 12]. However, if the Company's 2011 test year costs are reduced as the result of the Company's cost cutting efforts compared to the projections in the Company's 2011 subsequent year forecasts in this proceeding, then the cost of a separate proceeding in 2010 or in some future year is likely to pale against the effect of such savings in a subsequent proceeding. It would be far better to incur the cost of another rate proceeding in 2010 or later and to endure the alleged "distraction" of such a proceeding in order to avoid an excessive increase for 2011 that is not merited and that cannot be reasonably determined at this time. The reasonable levels of revenues and costs in 2011 are not known and measurable today.

Third, the Company is not harmed if the Commission rejects the proposed 2011 subsequent year increase because it can file another case in 2010 using more current assumptions and data. Company witness Ms. Ousdahl recognizes that the

Commission may reject the Company's request for the January 1, 2011 base rate increase and concludes that this may result in another rate filing. [Ousdahl Direct at 4]. That may be and the Commission can consider such a request after it is filed, if one is filed. Regardless, Ms. Ousdahl does not claim that the Company will harmed if it must make a subsequent filing, nor could it reasonably make such a claim.

Fourth, it may very well be that the Company will not file another case in 2010 if it continues to reduce its costs through additional reductions in capital expenditures and operating expenses as it addresses the lack of growth in sales and revenues due to the economic recession. In any event, it is premature both for the Commission and the Company to make a determination at this time as to the Company's revenue requirement in 2011 given the present uncertainty.

Q. Should the Commission approve the Company's proposed GBRA?

A. No. The Company's proposed GBRA mechanism represents a radical departure from the traditional ratemaking process and should be rejected for several reasons. First, the Company's proposed GBRA will be a permanent mechanism that will operate to automatically implement significant future base rate increases as the Company adds new generation. The Company effectively will self-implement those base rate increases without the normal regulatory scrutiny and resulting cost-control discipline that accompanies the filing, review and adjudication of a comprehensive base rate case. The proposed GBRA will not be limited only to

the West County Energy Center Unit 3 revenue requirement, but also will include all future generation and related transmission costs.

Second, the circumstances and nature of the proposed GBRA differ from those of the expiring GBRA. The expiring GBRA was implemented in conjunction with a settlement in Docket Nos. 050045-EI and 050188-EI, which provided for no base rate increases for the next four years except for costs recovered through various adjustment mechanisms, including the GBRA and various clauses, unless the Company's earnings fell below a threshold level. In addition, the GBRA mechanism was temporary and will expire at the end of this year unless it is re-established in this proceeding.

Third, the proposed GBRA mechanism constitutes a single issue and one-way base rate increase mechanism that fails to consider cost reductions that the Company may achieve in other areas. For example, the proposed mechanism will not reflect cost reductions due to the continued depreciation on or retirement of existing production plant investment as acknowledged by the Company in response to SFHHA Interrogatory 112. The proposed GBRA mechanism allows the Company to retain the savings resulting from ongoing recoveries of existing plant investment through depreciation from ratepayers, the cost free capital resulting from ongoing accelerated tax depreciation, increases in revenues due to customer and usage growth and capital expenditure and expense cost reductions. This fundamental flaw will be accentuated the longer the period between

comprehensive base rate proceedings. I have attached a copy of the Company's response to SFHHA Interrogatory 112 as my Exhibit___(LK-2)

Third, the GBRA recovery will be based on the Company's first year estimate of the revenue requirement of the new generation and related transmission when that revenue requirement is at its peak level. Once the Company self-implements a base rate increase when a new project enters commercial operation, that rate increase will be permanent and remain at the level when implemented, at least until the next comprehensive base rate proceeding. Once the increase is implemented, base revenues will not be revised downward as the underlying rate base amount declines due to increases in accumulated depreciation or as the related cost of capital declines due to increases in cost-free accumulated deferred income taxes and apparently never is trued-up to actual. This approach allows the Company to increase base rates when the revenue requirement is at the maximum level and then to retain any savings due to the declining rate base or actual expenses that are less than initially projected until the next comprehensive base rate proceeding. This approach also will allow the Company to avoid or at least defer a voluntary comprehensive review of its base rates absent growth in its other base rate costs that exceeds such savings.

Fourth, the GBRA mechanism is not even a proposed tariff even though it is self-implementing. There is no proposed tariff to review. There is not even a detailed description of the mechanism and the revenue requirement computations in the

testimony of any FPL witness. Company witness Ms. Ousdahl simply refers to the existing GBRA in her testimony. However, the description of the existing GBRA mechanism in paragraph 17 of the settlement agreement in Docket Nos. 050045-EI and 050188-EI and approved by the Commission in Order No. PSC-05-0902-S-EI is not sufficiently detailed for a permanent self-implementing base rate increase mechanism. I have attached a copy of the settlement agreement in that proceeding as my Exhibit___(LK-3) for ease of reference.

Fifth, based on the Company's computation of the proposed West County Energy Center 3 revenue requirement, there are serious computational problems in the Company's proposed GBRA, all of which serve to improperly increase the Company's revenue requirement.

Q. Please describe the computational problems with the Company's proposed GBRA.

A. There are numerous problems that are evident from a review of the Company's separate computation of the WCEC 3 revenue requirement for the first year of its operation that the Company provided in this proceeding. The Commission should not allow the use (or misuse) of a GBRA to provide the Company with excessive revenues. First, the proposed rate of return is overstated due to an excessive common equity ratio of 55.80%. A reasonable capital structure consists of 50.0% common equity and 50.0% debt for rating agency reporting purposes and 53.46%

common equity and 46.54% debt for ratemaking purposes, according to SFHHA witness Mr. Richard Baudino's testimony in this proceeding.

Second, the proposed rate of return is overstated due to the Company's use of the so-called "incremental" cost of debt rather than the weighted average cost of debt outstanding. For example, the Company's computations reflect a 6.43% cost of debt on Schedule D-1a for the WCEC 3 revenue requirement compared to the 5.81% weighted average cost of debt on Schedule D-1a for the 2011 subsequent test year revenue requirement.

Third, the proposed rate of return is overstated due to the failure to include low-cost short term debt in the capital structure. If the WCEC 3 rate base investment was included in the rate base for the base revenue requirement, then the return applied to the rate base investment would include short-term debt.

Fourth, the rate of return is overstated because it does not include any cost-free ADIT in the capital structure. The Company should not be allowed to retain this benefit by computationally assuming that it does not exist.

Fifth, the depreciation expense is overstated because it is based on a 25 year life for the WCEC 3 facility. Such a facility has a reasonable service life of 40 years and depreciation expense should be based on the reasonable service life, not an accelerated life established only to accelerate and increase near-term ratemaking

recovery. I address the appropriate service lives for depreciation expense in the Operating Income section of my testimony.

Q. How should the Company recover its costs associated with the West County Energy Center Unit 3 and future generation facilities?

A. If the Company believes that it has or will have a revenue deficiency for 2011, then it should file a request to increase its base rates some time in 2010. Similarly, if the Company believes that it has or will have a revenue deficiency in years after 2011, then it should file requests to increase its base rates in those years.

II. OPERATING INCOME ISSUES

Operation and Maintenance Expense – Summary

Q. How does the Company's proposed O&M expense compare to the Company's most recent actual O&M expense?

A. The Company proposes an incredible increase in O&M expense for the test year compared to the actual O&M expense for the most recent three historical years as summarized on its MFR Schedules C-1 and C-36. In contrast to its actual success in controlling expenses in 2008 and prior years, the Company projects an increase in non-fuel O&M expense recovered through base rates of $387.414 million, from $1,306.953 million in 2008 to $1,694.367 million in the 2010 test year, as shown on MFR Schedule C-1. However, this increase masks the full magnitude of the proposed increase because the Company proposes that $20.880 million of the projected 2010 expense be transferred to clause recovery. Thus, the actual proposed increase is $408.294 million, which is an increase of more than 31% compared the Company's actual 2008 O&M expense.

This requested growth is excessive when compared to the Company's actual experience in recent years. The Company's MFR Schedule C-36 compares the O&M expense in the years 2007 through the 2010 test year (although MFR Schedule C-36 includes only the "Commission" proforma adjustments and does not include the "Company" proforma adjustments), the annual percentage increase in the O&M expense, and the annual percentage increase in the CPI. The

results show that the Company effectively managed its total non-fuel O&M expense each year to levels less than the actual CPI growth and even reduced its actual non-fuel O&M expense in 2008 by an absolute $26.842 million, or 2.0%, compared to the actual O&M expense in 2007. In other words, the Company achieved significant productivity gains in its O&M expenses over the last several years, offsetting and even surpassing the growth in these expenses caused by inflation.

This requested growth also is excessive when compared to the Company's actual O&M expenses for the first quarter this year compared to the same quarter last year. The Company has further reduced its O&M expense in 2009 compared to 2008 and compared to its 2009 budget. The Company's SEC 10-Q for the 1st Quarter 2009 indicates that it has reduced its actual O&M expense in the first quarter by $38 million compared to 2008, of which $9 million was due to the DOE settlement that I subsequently discuss. In its press release announcing first quarter earnings, FPL Group cited the Company's reduction in O&M expense as the driver of the Company's increased earnings in the first quarter 2009 compared to the first quarter 2008. [redacted] I have attached a copy of the relevant pages from the Company's 10-Q as my Exhibit___(LK-4), a copy of the FPL Group press release as my

Exhibit___(LK-5), and a copy of the [redacted] as my Exhibit___(LK-6) (confidential).

Q. Are expense increases of this magnitude justified?

A. No. This level of increase is wildly excessive and cannot reasonably be justified given the present economic circumstances, particularly in South Florida, the Company's proven ability to implement cost reductions, including the effects of productivity improvements through capital investment and continued efficiency improvements through the adoption of best practices, and given the Company's actual cost reductions compared to 2008 and compared to its budget that it already has implemented to-date in 2009.

The Company's test year O&M expenses should be no more than the actual 2008 expenses, a "status quo" basis, except for limited known and measurable changes. Only certain of the increases in expenses are known and measurable at this time, and thus potentially justified, such as the expenses due to the commercial operation of new generation, specifically the West County Energy Center Units 1 and 2 in 2009. However, the increases in other expenses are not known and measurable, but rather represent significant and largely unjustified expansions of programs, proposed increases in staffing levels, and other general increases resulting from inflation and other forecasting assumptions that tend to increase expenses when used to support a proposed rate increase.

Q. How do you propose the Commission proceed on the Company's requested level of O&M expense increases?

A. I recommend a significant reduction in the Company's proposed non-fuel O&M expense, which I address through both a "top-down" approach and a "bottom-up" approach. Under the top-down approach, I recommend that the Commission limit the test year O&M expenses to the actual 2008 O&M expenses, adjusted only for appropriate known and measurable changes, such as transfers between base rates and clause recoveries and increases to incorporate the WCEC 1 and 2 expenses. Under the bottom-up approach, I recommend that the Commission reduce the Company's proposed test year O&M expense to reflect specific adjustments to the Company's requested amount. Given the Company's reductions in O&M expenses in the first quarter of this year to levels below 2008, the Commission may wish to consider these reductions on an annualized basis as a further reduction in the test year O&M expense under either a top-down or bottom-up approach.

Q. Please describe the top-down approach to determine the reasonable level of test year O&M expense.

A. The top-down approach reflects the "status quo" and relies on the use of the historic test year as the best evidence of the Company's expenses, but with adjustments for known and measurable changes to those expenses that the Company likely will incur in the projected test year. The Commission should reject the concept that the Company's projected O&M expenses are known and

measurable in the abstract based on its budget and forecasting process and that the Company cannot or will not manage its expenses in its self-interest.

The top-down status quo approach assumes that there should be and will be no general increase in non-fuel O&M expense increase in the 2010 test year compared to the 2008 actual expense. The top-down approach assumes that the 2008 level of expense not only was adequate in that year but will remain adequate in the future absent known and measurable changes and that increases in expenses due to inflation, if any, in 2009 and 2010, will be at least offset by reductions in expenses due to productivity improvements and other cost reductions. The top-down approach is consistent with the manner in which the Company actually manages its O&M expense and the Company's reductions in non-fuel O&M expenses for the first quarter this year compared to the same quarter last year.

In addition, the top-down approach recognizes that there are and should be savings in O&M expense resulting from the costs of new "long-term infrastructure investments" to "better manage work, assets, people, and finances" [Barrett at 27] that are included in rate base. The rate base investments have the effect of "reducing costs while enhancing many aspects of service to customers." [Barrett at 27]. The Commission should ensure that ratepayers actually get the benefit of the expense reductions due to the investments made to achieve those reductions.

Finally, the top-down approach recognizes that utilities manage their O&M expenses in response to the timing and level of ratemaking recoveries. The Company aggressively manages its O&M expense when it cannot contemporaneously recover increases and is able to retain the earnings benefits from its actions. However, if the Company is provided excessive recoveries based on inflated forecasts, such recoveries will allow the Company to increase its expenses without consequence, and override the normal self-interest in cost-control. [redacted] I have attached these [redacted] as my Exhibit___(LK-7 (confidential) and Exhibit___(8) (confidential) [redacted], respectively.

In conjunction with the top-down approach, the Commission should adjust the "status quo" O&M expense for known and measurable adjustments to: 1) subtract expenses that no longer will be incurred or no longer recovered through base rates, such as those transferred to various clauses for recovery, and 2) add specific and unavoidable cost increases, such as the increases in non-fuel O&M expense associated with WCEC 1 and 2.

Q. Please describe the bottom-up approach to determine the reasonable level of test year O&M expense.

A. I recommend that the Commission also review the specifics of the Company's

projected 2010 test year expense through a bottom-up approach to determine if the requested amounts are reasonable. Amounts that are not reasonable should be specifically disallowed. In this manner, the Commission can determine the overall reasonable level of O&M expense through the top-down approach, but confirm and refine the result of the top-down approach by starting with the Company's request and reducing it for unreasonable expenses through the bottom-up approach.

Q. What is your recommendation on the test year O&M expense?

A. I recommend that the Commission reduce the Company's test year O&M expense by $397.648 million. This reduces the Company's requested test year O&M expense from the $1,694.367 million requested to the $1,306.953 million actual 2008 adjusted downward on a net basis to $1,296.719 million for the following known and measurable changes: 1) the reduction in O&M expense due to the transfer of certain expenses to various clauses for recovery ($20.880 million), 2) the increase in O&M expense for WCEC 1 and 2 ($18.918 million), and 3) the reduction due to the DOE refunds that I subsequently discuss ($9.000 million), and 4) the increase due to all other Company adjustments reflected on MFR Schedule C-2, except for the storm damage expense ($0.728 million).

I obtained the Company's proposed known and measurable changes from the Company adjustments shown on MFR Schedule C-2. I obtained the O&M expense amount for WCEC 1 and 2 from the Company's response to SFHHA

Interrogatory 119. I attached a copy of this response as my Exhibit___(LK-9). I discuss and provide the source of the DOE refund amount in a subsequent section of my testimony.

Although I recommend this net reduction in O&M expense based on the top-down approach, I also have disaggregated the net reduction into various specific adjustments and disallowances that are based on the bottom-up approach. I have characterized the difference between the net reduction based on the top-down approach and the sum of the specific adjustments based on the bottom-up approach as an "other" adjustment on the table in the Summary section of my testimony.

Q. Please describe your bottom-up review of the Company's proposed test year O&M expense.

A. First, I reviewed the forecast assumptions reflected in the Company's projected 2010 O&M expense to identify assumption-driven reasons for the proposed increase in O&M expenses. Second, I reviewed the Company's O&M expense benchmark analysis summarized on MFR Schedule C-41 to identify specific functional areas where the Company proposed growth in test year expenses above and beyond the levels indicated by the benchmark computations. Third, I compared the Company's O&M expense in the test year to 2008 actual levels to identify specific functional areas where the Company proposed excessive growth in O&M expenses. Finally, I reviewed the Company's responses to the SFHHA

discovery as well as the responses to other parties' discovery to identify inappropriate and excessive expenses. I subsequently address each of the bottom-up specific adjustments that I recommend and reflect the amount of each adjustment on the table in the Summary section of my testimony.

Operation and Maintenance Expense – Productivity Savings

Q. Did the Company include an explicit assumption regarding productivity improvements and the resulting expense reductions given the Company's history of controlling the growth in payroll costs below the rate of inflation?

A. No. The Company reflected significant increases in payroll costs, including inflation and merit increases and staffing increases, but did not explicitly reflect an offset against these proposed expense increases for productivity improvements.

Q. Is the Company's failure to explicitly take into account productivity improvements in its O&M expense consistent with its historic experience?

A. No. In recent years and as I previously described, the Company has successfully managed its O&M expenses so that annual increases are less than the rate of inflation.

Q. What is the source of the Company's productivity improvements?

A. The Company achieves such productivity improvements through capital investment in assets that reduce maintenance requirements and allow fewer employees to do more in less time as well as the adoption of best practices in

managing processes. Company witness J. A. Stall described how the Company's nuclear production business unit achieves such efficiencies. Mr. Stall states that: "we continuously pursue standardization of programs and procedures and share best practices among our nuclear fleet, improving safety, efficiencies, and reducing costs." [Stall Direct at 15]. Mr. Stall also described the Turkey Point Excellence project, stating: "In the "process category, the project focuses on implementing a procedure upgrade program, reducing the corrective action backlog, upgrading training programs, and implementing process improvements consistent with industry best practices. In the "plant improvement" category, the project is focused on reducing on-line and outage maintenance and corrective action backlogs, proactive management of age-related corrosion and coatings related issues, improving operational margin, and implementing a preventative maintenance optimization program." [*Id.*, 22-23]. In addition to the Turkey Point Excellence program, the Company has replaced major equipment components, including steam generators, reactor pressure vessel heads, and a pressurizer at its nuclear units. [*Id.*, 14]. The Company has invested hundreds of millions of dollars in capital expenditures to replace and upgrade other equipment and is now engaged in numerous long-term equipment reliability projects at the nuclear units. [*Id.*, 28].

Q. Are the Company's historic productivity achievements consistent with the productivity improvements across the national economy?

A. Yes. The following table summarizes the national non-farm productivity improvements in recent years. The indices were obtained from the U.S. Bureau of Labor Statistics website. I added the column labeled "% Increase" and computed the 5 year simple average, 10 year simple average and the most recent annualized level in the first quarter 2009.

BLS Productivity Statistics

Series Id: PRS85006093
Duration: index, 1992 = 100
Measure: Output Per Hour
Sector: Nonfarm Business

Year	Qtr1	Qtr2	Qtr3	Qtr4	Annual	% Increase
1998	108.356	108.675	109.902	110.476	109.358	
1999						2.9%
2000	113.914	115.938	115.713	116.824	115.687	2.8%
2001						2.5%
2002	122.685	122.88	124.208	124.098	123.468	4.1%
2003						3.7%
2004	130.225	131.73	132.242	132.245	131.614	2.8%
2005						1.7%
2006	134.832	135.642	135.086	134.938	135.123	0.9%
2007						1.4%
2008	139.385	140.98	141.732	141.533	140.897	2.8%
2009						
5 Year Simple Average						1.9%
10 Year Simple Average						2.6%
Most Recent Annualized 1st Qtr						1.9%

Q. Should the Commission reflect ongoing productivity improvements since 2008 in the test year?

A. Yes. The Commission should reduce the Company's proposed test year payroll expense to reflect productivity improvements and thus, reductions in payroll and related expenses. In addition to the Company's demonstrated ability to restrain

growth in O&M expenses below inflation, the Commission also should consider the Company's capital investment incurred to achieve these savings that is included in rate base. The Company's ratepayers should receive the full benefit of their investment in rate base. If the Commission does not restate the Company's proposed test year O&M expense to reflect these savings, then the Company either will retain the savings or otherwise increase its actual O&M expenses to the levels included in the revenue requirement or some combination of the two.

Q. Have you quantified the effect of your recommendation?

A. Yes. The effect is to reduce O&M expense by $36.519 million and the revenue requirement by $36.641 million. I assumed that the Company would achieve productivity gains of 2.0% annually, which will offset the Company's general inflation assumption of 2.0% annually. I based this assumption not only on the Company's most recent experience at more than offsetting inflation increases in 2008, but also on the most recent national historic trends in productivity improvement, which converge on a 2.0% annual improvement as reflected in the preceding table.

The recognition of a 2.0% annual productivity improvements will have the effect of reducing the Company's proposed $765.261 million in payroll expense amount by $30.917 million, or 4.04% reflecting the cumulative and compounded effect of the 2009 and 2010 productivity improvements compared to 2008. I obtained the

O&M expense portion of the Company's projected 2010 payroll expense from the Company's response to SFHHA Interrogatory 297, a copy of which I have attached as my Exhibit___(LK-10).

In addition, there will be reductions of $1.995 million in the related payroll tax expense and $3.607 million in the related fringe benefits expense. To compute these amounts, I applied the same 4.04% cumulative productivity factor to these expense amounts. I obtained the payroll tax expense from the Company's MFR Schedule C-20 and the base recovery portion of the fringe benefits expense from the Company's response to SFHHA Interrogatory 297.

My computations of the reductions in payroll and related expenses are detailed on my Exhibit___(LK-11).

Operation and Maintenance Expense – Nuclear Staffing

Q. Does the Company propose an increase in nuclear production O&M expense to reflect staffing increases?

A. Yes. The Company proposes an increase in nuclear staffing of 270 employees, ostensibly to address its employee attrition and training requirements and for its Turkey Point Excellence program. The Company cited employee attrition and training requirements as one reason for the proposed $37.298 million in excess over the benchmark level proposed for nuclear production on its MFR Schedule C-41.

The increase of 270 employees also was cited by Company witness J. A. Stall in his testimony as one of the reasons for the $43.4 million increase in nuclear production O&M expense in the test year compared to 2008 actual expenses. The Company proposes an increase to $424.3 million in the test year from the $380.9 million actually incurred in 2008, according to Exhibit JAS-10 attached to Mr. Stall's Direct Testimony.

The Company also provided a list and brief description of the primary reasons and the amounts related to each of those primary reasons for the proposed increases in nuclear production O&M expense in response to SFHHA Interrogatory 240, a copy of which I have attached as my Exhibit___(LK-12). In this discovery response, the single largest reason identified by the Company was an increase in payroll costs to reflect a significant increase in staffing levels. In that response, the Company quantified the payroll expense effect of adding these employees at $18.5 million for the test year compared to 2008.

Q. How have the Company's actual nuclear staffing levels increased since 2006 and what are the reasons cited by the Company for these increases?

A. The Company previously increased its nuclear staffing levels by 199 positions in 2007 and 2008, or 12%, from 2006 levels, according to the Company's response to SFHHA Interrogatory 291. I have attached a copy of the Company's supplemental response as my Exhibit___(LK-13). The primary reason cited by

the Company for the increased nuclear staffing was to "anticipate and ultimately compensate for attrition and retirements."

Q. Is this the same primary reason cited by the Company for the proposed increase of another 270 positions reflected in O&M expense for the test year?

A. Yes. The Company cites the "Apprenticeship Program and operations training pipeline" as the primary reasons for the proposed increases in staffing levels in the test year compared to year end 2008, according to the Company's response to SFHHA Interrogatory 291.

Q. How has the Company's nuclear staffing actually changed since the end of 2008?

A. The Company has been systematically reducing nuclear staffing since September 2008, contrary to the increase in staffing the Company assumed in both its 2009 and 2010 budgets and thus, in the test year O&M expense. In the Company's supplemental response to SFHHA Interrogatory 291, the Company's nuclear staffing peaked in September 2008 and has been steadily declining each month since then.

Q. Should the Commission reflect the additional increases in nuclear production staffing in the test year ostensibly necessary for the Apprenticeship Program and the operations training pipeline?

A. No. The Commission should reject the increase in nuclear production O&M

expense for an additional 270 positions. First, the Company already increased nuclear production staffing by 12% from 2006 to 2008, primarily for this same reason. The Company's proposal will result in a cumulative staffing increase of 23% from 2006 to 2010. Increases of this magnitude for this reason are not reasonable. In effect, the Company claims that it is necessary to increase staffing by 23% over its normal requirements so that it can perpetually train additional personnel to replace employees who will retire or otherwise terminate employment at some future date, but who will not have done so prior to or within the test year. That is not reasonable.

Second, the evidence is that the Company has been steadily reducing nuclear staffing now that the recession has bitten deeper, particularly in the South Florida economy and the Company has been forced to engage in cost reductions compared to its budget.

Third, the Company's proposed increase in staffing levels is inconsistent with the significant capital investments the Company has made and included in rate base to improve the performance and material condition of its nuclear facilities that should reduce staffing levels and O&M expense, not increase it year after year for the same facilities. In addition, the proposed increase in staffing levels is inconsistent with the Company's expense "investments" incurred through such efforts as the Turkey Point Excellence project, reducing maintenance backlogs, reducing attrition rates, and improving employee efficiency consistent with

industry best practices. These activities and investments are described extensively by Company witness J. A. Stall in his testimony. At some point, the Company and its ratepayers must reap the expense savings benefit from these large capital and expense investments, the resulting reductions in maintenance activities, and efficiency improvements. Otherwise, there is no justification for the investments or their inclusion in rate base. The point at which ratepayers should reap those benefits is during the test year that serves as the basis for setting the Company's revenue requirement.

Q. What is your recommendation regarding the proposed increase nuclear production staffing expense?

A. I recommend that the Commission reduce the Company's nuclear production O&M expense by $21.852 million to eliminate the Company's request for increased staffing to meet its alleged and seemingly never ending and growing attrition and training requirements. This amount consists of the $18.5 million reduction in O&M payroll expense compared to 2008 levels included in the test ostensibly for this purpose, which was quantified by the Company, plus the related expenses of $1.194 million in payroll taxes and $2.158 million in employee fringe benefits. The computations of the related payroll taxes and employee fringe benefits expenses are detailed on my Exhibit___(LK-14).

Operation and Maintenance Expense – DOE Settlement

Q. Please describe the litigation and settlement between FPL and the U.S. Department of Energy related to the disposal of spent nuclear fuel.

A. FPL and other parties sued the U.S. Department of Energy ("DOE") seeking damages caused by the DOE's failure to dispose of spent fuel from the Company's nuclear generating facilities. FPL described the litigation and the settlement of that litigation in its SEC Form 10-Q for the quarter ending March 31, 2009 as follows:

> **In March 2009, FPL, certain subsidiaries of NextEra Energy Resources and certain nuclear plant joint owners signed a settlement agreement with the U.S. Government (settlement agreement) agreeing to dismiss with prejudice lawsuits filed against the U.S. Government seeking damages caused by the U.S. Department of Energy's failure to dispose of spent nuclear fuel from FPL's and NextEra Energy Resources' nuclear plants. In connection with the settlement agreement, FPL Group established an approximately $153 million ($100 million for FPL) receivable from the U.S. Government and a liability to nuclear plant join owners of $22 million ($5 million for FPL), which are included with other receivables and other current liabilities, respectively, in the condensed consolidated balance sheets at March 31, 2009. In addition, FPL Group reduced its March 31, 2009 property, plant and equipment balances by $107 million ($83 million for FPL) and, for the three months ended March 31, 2009, reduced operating expenses by $15 million ($12 million for FPL) and increased operating revenues by $9 million. The payments due from the U.S. Government under the settlement agreement increased FPL Group's net income for the three months ended March 31, 2009 by approximately $16 million ($9 million for FPL). A substantial portion of the amount due from the U.S. Government is expected during the second quarter of 2009. FPL and NextEra Energy Resources will continue to pay fees to the U.S. Government's nuclear waste fund.**

The Company also described the settlement, providing additional detail, in response to SFHHA Interrogatory 237, a copy of which I have attached as my Exhibit___(LK-15).

Q. How did the Company reflect the results of the DOE settlement in the test year?

A. The Company reflected the reduction in plant in service in the test year rate base, but failed to reflect any reduction in expenses for the ongoing reimbursement from the DOE. In response to SFHHA Interrogatory 237, the Company stated the following:

> **Therefore, the 2010 plant balances used to calculate test year results reflect this estimated reduction and customers will receive the benefits associated with the SNF settlement through future rates. Reductions in prospective costs should likewise occur as DOE reimburses FPL for SNF costs incurred in 2009 and beyond. These refunds were not forecasted in the Test Year and Subsequent Year revenue requirements?**

Q. Should the ongoing DOE refunds be reflected in the test year as a reduction to the revenue requirement?

A. Yes. The failure to reflect the refunds in the test year clearly was an error in the Company's filing given the ongoing nature of the DOE reimbursements resulting from the litigation settlement.

Q. What amount should the Commission reflect in the test year?

A. I recommend that the Commission use the actual $9 million amount reimbursed by the DOE and used by the Company to reduce expense in 2009 as a reasonable estimate for the test year. The revenue requirement effect is $9.030 million.

Customer Accounts and Sales Expense - AMI

Q. Please describe the costs included in the Company's test year revenue requirement for the deployment of AMI meters and related infrastructure.

A. The Company included $7.4 million in account 902 expense for the deployment of its new advanced metering initiative meters and related infrastructure. The Company provided a summary of its deployment schedule and the projected costs to develop the system separated into expense and capital amounts in response to SFHHA Interrogatories 120, 289 and 290. I have attached a copy of each of these responses as my Exhibit___(LK-16), Exhibit___(LK-17) and Exhibit___(LK-18), respectively. The Company described the types of costs expensed by the Company in response to SFHHA Interrogatory 283, a copy of which I have attached as my Exhibit___(LK-19).

Q. How many of the proposed AMI meters will be deployed in the test year?

A. The Company's test year reflects an average of 734,000 meters deployed and a total of 1,298,000 deployed by the end of the test year, according to its response to SFHHA Interrogatory 289. The Company plans to deploy a total of 4,346,000 meters by the end of 2013. Thus, the Company will have deployed 16.9% of the total AMI meters on average during the test year or 30.0% of the total by the end of the test year.

Q. Does the Company expect that the AMI meters will result in expense savings related to the removal of the old non-AMI meters that will offset the increases due to the new AMI meters?

A. Yes. The Company estimates annual expense savings of $36 million after all AMI meters are deployed, according to SFHHA Interrogatory 243, a copy of which I have attached as my Exhibit___(LK-20).

Q. What amount of expense savings has the Company reflected in the test year?

A. The Company has reflected only $0.418 million in expense savings in the test year, according to its response to SFHHA Interrogatory 289 (replicated as my Exhibit__(LK-17). This is only 1.2% of the annualized savings the Company projects upon full deployment.

Q. Is the Company's estimate of savings in the test year reasonable?

A. No. The Company's estimate of 1.2% of the annualized savings compared to the nearly 16.9% of the total investment in rate base for the test year is unreasonable. Upon deployment of these AMI meters, the Company will reduce expenses compared to the levels necessary for its existing non-AMI meters, which include meter reading payroll and related expenses, vehicle expenses, and connect and disconnect expenses, among others, in approximately the same proportion as it has deployed the AMI meters. The Commission should match the savings with the costs and reflect 16.9% of the annualized O&M expense savings consistent

with the inclusion in rate base of 16.9% of the cost of the total AMI meters the Company plans to deploy.

Q. Have you quantified the amount of expense savings that should be reflected in the test year?

A. Yes. The Commission should increase the expense savings by $5.666 million to $6.084 million in order to match the savings in expense to the investment included in rate base. I computed this amount by multiplying the 16.9% times the $36 million annualized savings upon full deployment and subtracted the $0.418 million in savings reflected in the Company's projected test year expenses.

Customer Accounts and Sales Expense - CIS

Q. Please describe the expenses included in the Company's test year revenue requirement for the development of a new customer information system.

A. The Company included $7.250 million in account 903 expense and $0.504 in depreciation expense for the development of a new customer information system ("CIS"). The Company provided a summary of its development schedule and the projected costs to develop the system separated into expense and capital amounts in response to SFHHA Interrogatories 287 and 288. I have attached a copy of each of these responses as my Exhibit___(LK-21) and Exhibit___(LK-22), respectively.

The costs the Company included as expense are for the preparation of a detailed project plan, review of scope and preliminary project requirements, approval of scoping study documentation and preparation for data conversion, according to the Company's response to SFHHA Interrogatory 284. I have attached a copy of this response as my Exhibit___(LK-23).

Q. Should any of the CIS developmental costs be expensed for ratemaking purposes?

A. No. These costs should be either capitalized to the CIS plant costs or deferred as a regulatory asset for ratemaking purposes rather than expensed in the test year. The Company has determined that the costs should be expensed for accounting purposes, according to its response to SFHHA Interrogatory 284; however, the accounting does not and should not control the ratemaking treatment even assuming that the Company's proposed accounting treatment is correct, which is a matter of judgment. The costs should be capitalized or deferred because they will be incurred for the development of the new CIS, which will be capitalized as intangible plant. The Company will not continue to incur these costs after the new CIS is implemented in June 2012. Thus, the costs are not recurring in nature and should be appended to the CIS capitalized asset or deferred for ratemaking purposes and then depreciated or amortized and recovered over the same expected useful service life as the CIS asset.

Q. Have you quantified the revenue requirement effect of your recommendation to capitalize or defer this expense?

A. Yes. The Commission should reduce the revenue requirement by $7.274 million to reflect the reduction in expense. In addition, the Commission should increase the revenue requirement by $0.428 million to reflect the increase in rate base. The computations are detailed on my Exhibit___(LK-24).

Administrative and General Expense – Storm Damage Accrual

Q. Please describe the Company's proposal to "reestablish" an annual accrual for the Company's storm damage reserve.

A. The Company proposes to recover through base rates an annual storm damage expense accrual amount of $148.667 million ($150 million total Company). This request has a revenue requirement effect of $149.162 million. The Company presently recovers no storm damage expense through base rates. Instead, the Company presently recovers storm damage expense through a surcharge. The Company does not propose a reduction in the surcharge amounts.

The Company's rate request is sponsored by Company witness Mr. Armando Pimentel, but it is based on a probabilistic loss analysis performed by Company witness Mr. Stephen P. Harris of ABS Consulting using a proprietary probabilistic simulation model.

Q. Please describe the Commission's historic framework for FPL's recovery of its storm damage costs.

A. Prior to its Order approving the settlement of the 2005 rate case, the Commission historically allowed recovery of storm damage costs in base rates through a storm damage expense accrual. This expense amount was recovered from ratepayers and added to the storm damage reserve. When actual storm damage costs were incurred, FPL charged these costs to the reserve, regardless of whether they were costs that normally would be capitalized to plant or expensed and regardless of whether they were "incremental" to costs that already were recovered through base rates.

At any point in time, the storm damage reserve is in either a surplus or a deficiency. The Company's storm damage reserve historically was in a surplus until a series of severe hurricanes and storms in 2004 depleted the reserve and the storm damage reserve became a deficiency. The Commission authorized a provisional storm restoration surcharge in Docket No. 041291-EI, which it affirmed in Order No. PSC-05-0937-FOF-EI, to provide the Company recovery of the reserve deficit over three years. In addition, the Commission required a change in the types of costs that could be charged to the reserve, thus reducing the amount of annual expense accrual and the target reserve levels, all else equal. The Commission determined that only "incremental" storm damage costs could be charged to the reserve. This change meant that costs normally capitalized to plant in service no longer could be charged against the storm damage reserve and

were required to be capitalized to plant in service. This change also meant that other costs recovered in base rates could not be charged against the storm damage reserve to avoid recovering the same costs twice.

The Commission also changed the form of storm damage recovery in 2005 by removing all such recoveries from base rates and instead providing all recoveries through a storm damage surcharge rider. In the Company's last base rate increase proceeding, Docket No. 050045-EI, the parties reached a settlement whereby the Company no longer would recover a storm damage expense accrual through base rates. Instead, the Company was permitted to recover its reasonable and prudently incurred storm restoration costs and to replenish the storm damage reserve through a surcharge pursuant to a newly approved securitization financing law (Section 366.8260, Florida Statutes) and/or through a surcharge similar to the one approved for storm damage recovery in 2004. The Commission approved this settlement agreement by Order No. PSC-05-0902-S-EI on September 14, 2005.

The Commission affirmed this change in the form of recovery from base rates to a surcharge in yet another proceeding to recover the Company's storm damage costs that it incurred in 2005. These costs were incurred as the result of several more severe hurricanes that resulted in significant storm damage losses and another storm damage reserve deficiency. To recover these storm damage costs, the Company sought surcharge recovery of the costs based on the issuance of

low-cost securitization financing sufficient to recover not only the costs incurred but also to replenish the storm damage reserve. The surcharge in conjunction with securitization financing was made possible by a statute newly enacted for the express purpose of reducing the costs to ratepayers of storm damage loss recovery. In Order No. PSC-06-0464-FOF-EI, the Commission approved a levelized surcharge to recover the securitization and related costs over a 12 year period, approved the recovery of only "incremental" costs despite the Company's request for costs that otherwise would have been capitalized to plant in service or that otherwise were already recovered in base rates, approved the securitization financing, and approved the replenishment of the reserve fund in excess of the storm damage reserve deficiency by $200 million while rejecting the Company's request for $650 million. The Commission summarized its decision in Order No. PSC-06-0464-FOF-EI as follows:

> **In this Financing Order, we find that the issuance of storm-recovery bonds and the imposition of related storm-recovery charges to finance the recovery of FPL's reasonable and prudently incurred storm-recovery costs, the replenishment of FPL's storm-recovery reserve, and related financing costs are reasonably expected to significantly mitigate rate impacts to customers as compared with alternative methods of recovery of storm-recovery costs and replenishment of the storm-recovery reserve.** [Order at 5].

Regarding its decision to limit recovery to only "incremental" storm damage costs, the Commission stated:

> **Under FPL's Actual Restoration Cost Approach, all costs – both normal and incremental – that were related to storm damage activities are charged to FPL's Reserve. We find that the inclusion of**

> **normal costs results in a double recovery, once through base rates and again through the Reserve. Accordingly, we find that an incremental cost approach, including an adjustment to remove normal capital costs, is the appropriate methodology to be used for booking FPL's 2005 storm-recovery costs to its Reserve.** [*Id.*, 17].

Regarding its decision to limit the replenishment of the reserve to $200 million rather than FPL's request for $650 million, the Commission stated the following:

> **Given that FPL has the opportunity to seek recovery of future storm restoration costs through either a surcharge or securitization pursuant to the 2005 Settlement Agreement and applicable law, and given the preference of FPL's customers to face that risk when such costs actually materialize, we decline to approve funding of FPL's Reserve to a level of $650 million through the storm-recovery bonds authorized to be issued under the terms of this Order. We find that funding FPL's Reserve to a level of $200 million is appropriate and will (i) reduce the incidental costs associated with issuance of the storm-recovery bonds authorized to be issued under the terms of this Order, (ii) provide more critical review of FPL's charges to its Reserve, and (iii) result in lower overall storm-recovery charges at this time.** *[Id.*, 25].

Finally, the Commission found that the storm damage surcharge in conjunction with securitization resulted in a significant reduction in the rate impacts to ratepayers compared to more traditional methods of financing or recovering storm-recovery costs and replenishing the reserve. The Commission stated the following:

> **Thus, we find that the issuance of the storm-recovery bonds and the imposition of the storm-recovery charges authorized by this Order are reasonably expected to significantly mitigate rate impacts to customers as compared with alternative, more traditional methods of financing or recovering storm-recovery costs and replenishing the Reserve. Likewise, through implementation of the required standards and procedures established in this Order, we find that the structuring,**

marketing, pricing, and financing costs of the storm-recovery bonds are reasonably expected to significantly mitigate rate impacts to customers as compared with alternative methods of financing or recovery storm-recovery costs and replenishing the Reserve. [*Id.*, 32].

Q. Should the Commission revert to the recovery of storm damage expense through base rates?

A. No. There is no reason for the Commission to revisit its conclusions in the Orders previously cited resulting in the exclusive use of surcharge recoveries in conjunction with securitization to minimize the costs to ratepayers. The Commission should continue to use the surcharge approach in conjunction with securitization of unusually large storm restoration costs resulting in storm damage reserve deficiencies. The use of a surcharge approach in conjunction with securitization provides the Company full and timely recovery of prudently incurred storm damage costs, avoids the need to engage in speculation regarding future storm damage costs, and results in substantially lower costs to ratepayers.

The present storm damage surcharge not only provides the Company recovery of its prior storm damage reserve deficiencies, but also provides recovery of $200 million in future storm damage amounts. That is because the Company's securitization financing provided a "replenishment" of the storm damage reserve in the amount of $200 million. The surcharge is designed to recover the debt service not only to repay FPL for its actual prudently incurred storm restoration costs prior to that date, but also to fund the additional $200 million to the reserve available for future storm damage cost. The Company estimates on MFR

Schedule B-21 that the test year storm damage reserve will have a surplus of $192.966 million after adding the earnings on that $200 million and subtracting charges for subsequent storm damage amounts charged to the reserve since the securitization financing.

To the extent that there are severe storms that deplete this reserve surplus in the future, then the Commission can reset the storm damage surcharge or establish a new surcharge, and authorize the Company to securitize the storm damage reserve deficiency at that time, including amounts necessary to replenish the reserve.

The surcharge approach also avoids the need to engage in speculation over an appropriate storm damage expense amount to include in base rates. The most sophisticated models, including the ABS probabilistic simulation model employed by Company witness Mr. Harris, cannot possibly accurately predict the magnitude or the timing of actual storm damage costs.

Finally, the use of the surcharge approach in conjunction with securitization financing is the least cost and most economically efficient approach. This is true for several reasons. First, the use of the surcharge approach to recover the securitization debt service ensures that there is no tax penalty because the revenues match the expense. In contrast, the recovery of excessive expense accruals through base rates to prefund a surplus in the storm damage reserve results in a tax penalty because such recoveries are included in taxable income,

but the expense accrual is not deductible from taxable income (only actual costs incurred are deductible). Under the Company's approach, there is an immediate tax penalty of 38.58% (combined federal and state income tax rate) against the storm damage expense accrual amounts collected through base rates that reduces the amount that can be funded to the reserve. Thus, under the Company's approach, ratepayers are required to make unnecessary payments to the federal and state governments and then are penalized further through a reduction in the actual funds in the storm damage reserve fund that can earn income.

Second, the surcharge approach in conjunction with securitization allows significant savings to ratepayers by using 100% highly rated and lower cost securitization debt instead of financing reserve deficiencies with conventional financing. The costs of conventional financing include a combination of higher cost debt and an even greater cost of common equity, including the income taxes on the return on common equity.

Third, the use of the surcharge approach minimizes the investment the ratepayers must make in the storm damage reserve and the lost return on their investment by comparison to the Company's return on its rate base investment. The earnings on the storm damage reserve funds are extremely low due to the nature of the investments and the need to maintain liquidity. Thus, while ratepayers will be required to pay the Company an 11.80% return before tax on its rate base investments (based on its request in this proceeding), ratepayers will earn only a

7.2% return before tax on their investment in the storm damage reserve fund (based on the Company's trust fund earnings assumptions reflected on MFR Schedule B-21).

Q. If the Commission determines that there should be some amount of storm damage expense recovery through base rates, should it adopt the Company's proposed $148.667 million amount?

A. No. The proposed $148.667 million expense amount is wildly excessive and should be set at $0 if the Commission deems it appropriate to reconsider the form of storm damage expense recovery in this proceeding. First, the proposed amount is based on an insurance-type probabilistic model of risk exposure and replacement property damage. This type of analysis may be appropriate for the insurance industry, but it does not reflect the substance or form of the ratemaking process, or more specifically, this Commission's ratemaking for storm damage costs.

Unlike the insurance companies, it is not necessary for the Company to preemptively recover excessive amounts through rates in order to build up a loss reserve or a "cushion" for potential significant future losses. This is true because the Commission has stated repeatedly in its orders that the Company is entitled to recovery of its reasonable and prudently incurred storm damage costs, regardless of whether there is a sufficient amount in the storm damage reserve. If there is a

deficiency, then the Commission historically has allowed the Company to recover the deficiency through a surcharge.

In addition, the analysis performed and the quantification provided by Company witness Mr. Harris is overstated because it is not based on the "incremental" cost for which the Commission allows recovery. Instead, his analysis provides a gross damages estimate comparable to what the Company in prior storm damage proceedings referred to as an "actual restoration cost approach." The Commission rejected this approach in the two most recent storm damage orders that I previously addressed and instead adopted the "incremental" cost approach. The incremental cost approach excludes all costs that otherwise would be capitalized to plant in service and excludes all costs already recovered through base rates, such as the litany of such costs identified and removed by the Commission in its PSC-06-0464-FOF-EI Order.

Finally, the analysis performed by Mr. Harris is overstated because it is based on the Company's proposal for a target reserve surplus of $650 million. The Commission previously rejected that approach and specifically rejected the $650 million target amount and found that a $200 million reserve surplus was reasonable. There is no valid reason for the Commission to revisit its most recent determination on this issue.

Depreciation Expense - New Customer Information System

Q. Please describe the depreciation expense included in the Company's test year for the development of a new customer information system.

A. The Company included $0.504 million in depreciation expense on capitalized plant in service costs for a new CIS. This has a revenue requirement effect of $0.506 million. The Company expects to commence development of the new CIS in January 2010 and to complete and implement it in June 2012. The Company provided a summary of its development schedule in response to SFHHA Interrogatory 287 and the depreciation expense included in the test year revenue requirement in response to SFHHA Interrogatory 288. I have attached a copy of each of these responses as my Exhibit___(LK-21) and Exhibit___(LK-22), respectively.

Q. Should the Company have included depreciation expense for the new CIS in the test year?

A. No. The new CIS is not scheduled to be implemented ("go live") until June 2012, according to its response to SFHHA Interrogatory 287. No amounts should be transferred from construction work in progress to plant in service until the date the new system is placed in service. Consequently, depreciation expense should not commence until June 2012 in accordance with generally accepted accounting principles ("GAAP") and the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA").

Depreciation Expense – Capital Expenditure Reductions

Q. In the Rate Base section of your testimony, you address capital expenditure reductions and the effects on rate base and the revenue requirement. Is there also a related effect on depreciation expense?

A. Yes. A reduction in the plant in service amounts for the test year will result in less depreciation expense than reflected in the Company's projected test year amounts.

Q. Have you quantified the effect of your recommendation?

A. Yes. The effect is to reduce depreciation expense by $26.883 million and to reduce the revenue requirement by $26.719 million. I address the effects on rate base and the resulting reduction in the revenue requirement related to that component in the rate base section of my testimony. The computations are detailed on my Exhibit___(LK-25). I used a composite depreciation rate for all plant accounts to compute the reduction in depreciation expense based on the assumption that the reduction in the plant investment due to capital expenditure reductions was proportional to the Company's plant investment reflected in its depreciation study.

Depreciation Expense – Depreciation Reserve Surplus

Q. Does the Company presently have a depreciation reserve surplus?

A. Yes. Despite the reduction of the Company's reserve surplus over the last four years by $500 million ($125 million annually from 2006 through 2009) as the result of the settlement reached in Docket Nos. 050045-EI and 050188-EI, the

Company still has an estimated reserve surplus of $1,245 million at January 1, 2010. The Company's computations of the reserve surplus are summarized on page 53 of the depreciation study attached to Mr. C. Richard Clarke's Direct Testimony as Exhibit CRC-1. I have attached a copy of this page from the Company's depreciation study as my Exhibit__(LK-26) for reference purposes.

The Company has a depreciation reserve surplus for every functional plant category, except for transmission plant. The following table summarizes the composition of the reserve surplus computed by the Company at December 31, 2009 by functional plant category.

Florida Power & Light Company
Excess Reserve as of December 31, 2009
($ Millions)

Function	Excess Reserve
Steam Generation	410.110
Nuclear Generation	377.507
Combined Cycle Generation	25.945
Combustion Turbine Generation	28.028
Transmission	(15.637)
Distribution	340.529
General	78.879
Total Excess Depreciation Reserve	1,245.360

Q. How should the Commission address the reserve surplus in this proceeding?

A. I recommend that the Commission amortize the reserve surplus over five years in a manner similar to that which it approved in Order No. PSC-05-0902-S-EI approving the settlement in the Company's 2005 rate case. In that proceeding, the Company was allowed to amortize $125 million of its reserve surplus as a reduction to depreciation expense each year from 2006 through 2009 for a cumulative total of $500 million. The Company did so and allocated the amortization over the plant accounts on a *pro rata* basis to reduce the actual depreciation expense and accumulated depreciation recorded on its accounting books each year.

Q. Why is it appropriate to amortize the reserve surplus over a five year period?

A. The Commission should attempt to refund this surplus over a reasonably short period to as closely as possible return the amounts to the ratepayers who overpaid for depreciation expense in prior years based on prior life and salvage estimates. The reserve surplus means that depreciation expense in prior years was excessive compared to present expectations for the service lives, retirements and salvage estimates of plant assets.

Q. Have you quantified the effect of your recommendation?

A. Yes. The effect is to reduce depreciation expense by $246.735 million and to reduce the revenue requirement by $247.556 million. In addition, there is an offsetting increase of $14.559 million in the revenue requirement for the rate of

return on the rate base, which will be more than the Company projected due to the reduction in accumulated depreciation. The computations are detailed on my Exhibit___(LK-27).

Depreciation Expense – Capital Recovery

Q. Please describe the Company's request for "capital recovery" of certain plant investment costs.

A. The Company proposes a four year amortization of the net book value of numerous costs as of December 31, 2009. These costs include the remaining undepreciated costs of the Cape Canaveral Units 1 and 2 and common, the Riviera Units 3 and 4 and common; the remaining undepreciated nuclear uprate costs of St. Lucie Units 1 and 2 and Turkey Point Units 3 and 4 and common; and the undepreciated costs of the Company's existing meter investment that will be replaced with advanced meters under the Company's advanced metering initiative ("AMI").

The Company plans to remove the Cape Canaveral facilities from service in 2010 and commence a "modernization" of the facilities as combined cycle units. Similarly, the Company plans to remove the Riviera facilities from service in 2011 and commence a modernization of the Riviera facilities as combined cycle units. The Company simply proposes to amortize the nuclear uprate costs over four years with no rationale provided by any witness. Finally, the Company plans

to amortize the remaining investment in its existing meters over four years due to its planned AMI meter deployment.

The following table summarizes the net book value at December 31, 2009 of each of these capital recovery costs and the Company's proposed depreciation expense based on a four year capital recovery period.

Florida Power & Light Company
Unrecovered Capital Costs as of December 31, 2009
($ Millions)

Description	Unrecovered Costs
Cape Canaveral Common	3.539
Cape Canaveral Unit 1	23.148
Cape Canaveral Unit 2	8.616
Riviera Common	0.057
Riviera Unit 1	5.664
Riviera Unit 2	3.883
St. Lucie Unit 1	40.821
St. Lucie Unit 2	37.448
Turkey Point Common	2.149
Turkey Point Unit 3	43.931
Turkey Point Unit 4	43.886
Acct 370 Meters Made Obsolete by AMI	101.082
Total Unrecovered Costs	314.223

Q. Should the Commission authorize depreciation over a four year period for the undepreciated costs of the Cape Canaveral and Riviera facilities?

A. No. The Commission should direct the Company to cease depreciation on these facilities, add the remaining net book value to the costs of the modernization, and then depreciate the costs along with the modernization costs over the estimated

service lives of the modernized facilities. The Company's witnesses have offered no valid rationale to accelerate the recovery of these capital costs to four years.

To the extent the facilities are retired for property accounting purposes, the retirement amounts will be used to reduce gross plant in service and accumulated depreciation by the same amounts in accordance with GAAP and the FERC USOA. In this manner, the remaining net plant associated with these facilities will be reflected as an asset amount of accumulated deprecation. In addition, depreciation expense will cease because there no longer will be any gross plant in service.

Once the modernization is completed, then the Commission should allow the Company to recover both the modernization costs and the asset accumulated depreciation related to the retired assets over the expected service lives of the new facilities. This is similar in concept to the cost of reacquiring debt and replacing it with lower cost debt. In that situation, the cost of reacquiring the old debt is deferred and then amortized over the life of the new debt issue.

Alternatively, the Commission should direct the Company to defer the net remaining book value at December 31, 2009 and then amortize the deferred amounts using the existing depreciation rates.

Q. Should the Commission authorize depreciation over a four year period for the nuclear uprate costs incurred through December 31, 2009?

A. No. The Commission should depreciate these costs over the remaining extended license life of the nuclear units. These costs are capital costs that were incurred to substantially improve and increase the output of the nuclear facilities over their extended lives. There is no valid reason that these capital costs should be segregated from the other capital costs of these facilities and depreciated over any period shorter than their estimated useful service lives in the same manner as any other capitalized plant cost.

Q. Should the Commission authorize depreciation over a four year period for the existing meter investment?

A. No. The Commission should use the same depreciation or amortization rate for these costs as it adopts for the remaining existing meter investment that will not be replaced by AMI meters. There is no valid reason to accelerate the recovery of the Company's existing meter investment, particularly when the Company's revenue requirement also includes the costs of the replacement AMI meters. The Company's proposal has the effect not only of "doubling up" the recovery of old non-AMI and new AMI meter investment, but also of accelerating the recovery of the old meter investment from the present recovery using a 3.26% depreciation rate to a 25% depreciation rate.

Q. Have you quantified the effect of your recommendations on the Company's proposed capital recovery amounts?

A. Yes. The effect is to reduce depreciation expense by $63.394 million and to reduce the revenue requirement by $63.605 million for the three capital recovery components. In addition, there is an offsetting increase in the revenue requirement of $3.741 million to reflect the return on rate base resulting from the reduction in accumulated depreciation compared to the Company's requested rate base amount. The expense and rate base revenue requirement effects are shown separately in the table in the Summary section of my testimony. The computations are detailed on my Exhibit___(LK-28).

Depreciation Expense – Service Lives

Q. Please describe the Company's proposed service lives used to develop the depreciation rates and depreciation expense for its combined cycle generating facilities, including WCEC 1 and 2, reflected in its requested test year revenue requirement and for the WCEC 3 facilities reflected in its proposed GBRA.

A. The Company proposes a service life of 25 years for all such facilities, except for those that would be retired prior to June 2020 if it had continued to use that service life assumption for those facilities, or ten years after the test year, according to the depreciation study attached to the Direct Testimony of C. Richard Clarke as his Exhibit CRC-1. The Company offered no support for the proposed 25 year service life.

Q. Is the Company's proposed 25 year service life reasonable?

A. No. I recommend a 40 year service life. The service life used for depreciation purposes should reflect the expected useful life of the facility, not some arbitrary shorter period. The Company proposes depreciation rates assuming 25 year service lives based on probable retirement dates 25 years after the commercial in-service dates for its combined cycle units with the exception of the Putnam units.

The Putnam 1 unit went into commercial operation in 1977 and Putnam 2 in 1978, according to the Company's FERC Form 1. I have attached a copy of page 402 from the Company's 2008 Form 1 filing as my Exhibit___(LK-29). The Company originally claimed that the units had a service life of 25 years for depreciation purposes and the Commission set depreciation rates based on that assumption. However, Putnam 1 was not retired in 2002 and Putnam 3 was not retired in 2003, their respective 25th anniversary dates and the assumed end of their service lives. Instead, the Company continues to operate both units. The Company now asserts that the Putnam 1 and 2 units both have a probable retirement date of June 2020 for depreciation purposes, which means that the Company has no plans to retire the units before that date and may continue to operate the units beyond that date. The June 2020 retirement date indicates that the Putnam 1 unit has a service life of at least 43 years and Putnam 2 of at least 42 years. The Company provided this information on page 132 of Company witness Mr. C. Richard Clarke's Exhibit CRC-1, the Company's depreciation study. I

have attached a copy of this page as my Exhibit___(LK-30) for reference purposes. These probable retirement dates for the Putnam units demonstrate that in reality the Company's combined cycle units have service lives of at least 40 years.

In addition to the experience of the Company's own units, other utilities use a 40 year service life for planning and depreciation purposes. For example, PacifiCorp uses a 40 year life for its combined cycle combustion turbine facilities. I have attached a copy of the cover and the relevant page from PacifiCorp's 2008 IRP, which shows PacifiCorp's service life assumptions for such facilities used in its resource planning process, as my Exhibit___(LK-31).

Finally, as a practical matter, utilities do not retire generating units if they remain economic to generate. Thus, the Commission should assume that the Company will continue to operate these units for at least 40 years unless the Company can demonstrate conclusively that they will be operated only for 25 years.

Q. Have you quantified the effect of your recommendation?

A. Yes. The effect is to reduce depreciation expense by $123.319 million and to reduce the revenue requirement by $123.730 million. In addition, there is an offsetting increase in the revenue requirement of $7.726 million to reflect the return on rate base resulting from the reduction in accumulated depreciation compared to the Company's requested rate base amount. The expense and rate

base revenue requirement effects are shown separately in the table in the Summary section of my testimony. The computations are detailed on my Exhibit___(LK-32).

Income Tax Expense – Economic Stimulus Bill

Q. Has the Company reflected any of the tax benefits resulting from the federal Economic Stimulus Bill in its filing?

A. No. Company witness Ms. Ousdahl acknowledged that "many provisions of the bill are effective for the 2009 tax year," but stated that "[a] this time, the Company has not quantified or captured the potential benefits." [Ousdahl Direct at 36].

Q. Should the tax benefits resulting from the American Recovery and Reinvestment Act of 2009 ("Stimulus Bill") be reflected in the Company's revenue requirement?

A. Yes. There are numerous provisions that provide grants or other subsidies for utility investment in generation, transmission and distribution infrastructure. Many of the provisions are effective already in 2009 and extend into subsequent years.

Q. Should these tax benefits be reflected in the Company's revenue requirement?

A. Yes. At a minimum, the Commission should reflect a $20 million grant available to the Company to reduce the costs of advanced (AMI) meters and other smart grid investment. The Company's filing includes the costs of deploying advanced meters and the related smart grid infrastructure. It is axiomatic that any grants or other savings resulting from that deployment should be used to reduce the costs included in the revenue requirement.

The Stimulus Bill modified the provisions of the Energy Independence and Security Act ("EISA") of 2007 addressing smart grid technology deployment. Section 405 of the Stimulus Bill modified Section 1304 of the EISA to provide a subsidy of up to 50% (up from 20% under EISA) of the cost of smart grid technology deployment in the form of grants to utilities for qualified costs. The Department of Energy ("DOE") issued a draft notice of its "Funding Opportunity Announcement (FOA) for the Smart Grid Investment Grant Program" providing for grants of up to $20 million for this purpose, although I was recently informed by an AEP employee in another rate proceeding that the $20 million cap has been removed and more grant funds are available.

Q. Has the Company applied to the DOE for the matching grants for smart grid investment?

A. Yes. The website www.smartmeter.com reported on April 20, 2009 that FPL planned to install a million fully functioning "smart meters" for all Miami residents within the next two years. The article reported that "[t]he utility is

applying for a matching grant from the stimulus package that Hay [FPL CEO Lewis Hay] says will allow FP&L to complete the project within two years." I have attached a copy of the article as my Exhibit___(LK-33).

Q. Should the Commission incorporate this benefit in the revenue requirement even if the Company has not yet received grant funds?

A. Yes. The entire test year is a projection of the Company's revenues and costs based on assumptions. The Commission should assume that the Company will seek these funds and obtain the maximum amount available to individual utilities. The alternative is to assume that the Company will not seek these funds and/or will not obtain any funding. On the spectrum of possibilities, the probability of the former, while not certain because it represents an assumption regarding the future, is far greater than the latter. Alternatively, but with essentially the same result, the Commission could exclude at least $20 million from the Company's proposed rate base and the related depreciation expense and instead allow the Company to defer $20 million of its AMI deployment costs to this account rather than capitalizing it to plant in service. The deferred asset amount then would be reduced by the entirety of any grants received from the DOE. Any residual (positive or negative) could be included by the Company in rate base in a future rate proceeding.

Q. Have you quantified the effect of your recommendation to include the DOE smart grid grant of $20 million?

A. Yes. The effect is to reduce the Company's proposed revenue requirement by $3.846 million. I quantified this effect in two steps. First, I computed the reduction in depreciation expense by applying the Company's proposed depreciation rate for the new AMI meters of 7.97% to the $20 million grant amount. This had the effect of reducing depreciation expense by $1.579 million on a jurisdictional basis and reducing the revenue requirement by $1.584 million. Second, I computed the reduction in the return by multiplying the Company's proposed 11.80% grossed-up rate of return times the net reduction in rate base of $19.210 million (reflecting half year of depreciation expense in accumulated depreciation). This had the effect of reducing the Company's revenue requirement by an additional $2.267 million. The computations are detailed on my Exhibit___(LK-34).

Q. How should the Commission address other tax benefits resulting from the Stimulus Bill?

A. The Commission should direct the Company to capture and defer as a regulatory liability all tax benefits that obtained, but for which the Company failed to reflect the estimated savings in its requested revenue requirement. The Commission then should use these amounts to reduce the Company's revenue requirement in a subsequent rate proceeding. The Commission should require that the Company document these tax benefits along with its efforts to maximize the value of those tax benefits for the Commission's review in a subsequent rate proceeding.

III. RATE BASE ISSUES

Capital Expenditure Reductions Since Budgets/Forecasts Were Developed

Q. Has the Company cut its actual capital expenditures significantly from budgeted levels to date in 2009?

A. Yes. For the first four months of 2009, the Company cut its capital expenditures by $170 million from budget levels, from $897 million to $727 million. This is a reduction of 19.0% or $529 million on an annual basis compared to the Company's $2,790 million 2009 capital expenditure budget. The actual and budget amounts were provided in response to SFHHA Interrogatory 279, a copy of which I have attached as Exhibit___(LK-35). These reductions are in addition to $469 million in capital expenditure reductions already incorporated in the 2009 approved budget compared to the 2009 proposed budget, according to FPL witness Barrett's Exhibit REB-16.

Q. Should the Commission reflect these cost reductions in the 2010 test year revenue requirement?

A. Yes. The Company's plant investment included in rate base should be reduced to reflect these capital expenditure reductions on an annualized basis, both for the annualized 2009 reductions carried forward into 2010 and for reductions of similar magnitude in 2010.

Q. Have you quantified the effect of your recommendations?

A. Yes. The effect is to reduce gross plant included in rate base by $784 million and the revenue requirement by $92.520 million based on the Company's proposed rate of return. In addition, there is an offsetting reduction to accumulated depreciation that increases rate base by $31.080 million and increases the revenue requirement by $3.668 million. The computations are detailed on my Exhibit___(LK-25). I discuss the related depreciation expense effect in the Operating Income section of my testimony.

Capital Recovery and Related Accumulated Depreciation

Q. Have you quantified the effect of your depreciation expense recommendations on rate base and the related revenue requirement?

A. Yes. The effect of this issue is to reduce rate base by $31.697 million and the revenue requirement by $3.741 million. The quantifications are detailed on my Exhibit___(LK-28). I discuss the related depreciation expense effects in the Operating Income section of my testimony.

Depreciation Lives and Related Accumulated Depreciation

Q. Have you quantified the effect of your depreciation expense recommendations on rate base and the related revenue requirement?

A. Yes. The effect of this issue is to increase rate base by $61.660 million and the revenue requirement by $7.276 million. The quantifications are detailed on my Exhibit___(LK-32). I discuss the related depreciation expense effects in the Operating Income section of my testimony.

IV. CAPITAL STRUCTURE AND RATE OF RETURN ISSUES

Capital Structure – Common Equity

Q. SFHHA witness Mr. Richard Baudino recommends adjustments to the Company's proposed capital structure that reduce the common equity ratio and increase the debt ratio used to develop the rate of return applied to rate base. Have you quantified the effect of Mr. Baudino's recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $121.424 million. I computed the revenue requirement effect in three steps. First, I computed the Company's requested rate of return grossed-up for income taxes on the equity component. Second, I computed Mr. Baudino's adjusted rate of return grossed-up for income taxes on the equity component. Third, I computed the revenue requirement by multiplying the difference in the two rates of return times the rate base that I recommend. The computations are detailed on my Exhibit___(LK-36) in Sections I and II.

Capital Structure – Short Term Debt

Q. SFHHA witness Mr. Baudino recommends adjustments to the Company's proposed capital structure that increase the short term debt ratio and reduce the long term debt ratio used to develop the rate of return applied to rate base. Have you quantified the effect of Mr. Baudino's recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $11.018 million in addition to the reduction from the first of Mr. Baudino's capital

structure recommendations. I computed the revenue requirement effect in the same manner as for the first of Mr. Baudino's recommendations. The computations are detailed on my Exhibit___(LK-36) in Sections II and III.

Capital Structure – Accumulated Deferred Income Taxes Related to FIN 48

Q. Should the Commission increase the amount of accumulated deferred income taxes reflected in the Company's proposed capital structure?

A. Yes. The Company inappropriately has reduced the ADIT included in its proposed capital structure by $168.598 million for the effects of FIN 48. The Company provided this amount in response to SFHHA Interrogatory No. 278, a copy of which I have attached as my Exhibit___(LK-37). FIN 48 is a new accounting standard that was implemented by the Company in 2007. FIN 48 requires the Company to establish a "reserve" for future income tax audit adjustments that may increase the Company's income tax liability and thus reduce the ADIT recorded on its accounting books. The FIN 48 adjustment reduces the net liability ADIT reflected in the Company's proposed capital structure as cost free capital.

Q. Why should the Commission restore the full amount of the net liability ADIT and exclude the FIN 48 adjustment in the capital structure?

A. There are several reasons. First, the FIN 48 adjustment does not actually reduce the Company's cost free capital. It is nothing more than the Company's educated guess at the outcome of the Company's future tax audits for deductions that

already have been taken and that already are reflected in its tax returns. Second, if the Company's educated guess was pessimistic, then there never will be a ratepayer true-up for the lost return because of the assumption that the Company had less cost-free capital than it actually had. Third, the Commission has not previously reduced the Company's ADIT for potential future audit adjustments. Fourth, to the extent that there are future audit adjustments that actually reduce the tax benefits reflected in the ADIT amounts, then the per books amounts will be properly reduced for those effects in future rate proceedings. Thus, the Company's adjustment is speculative at best, and completely unnecessary as the Company will be fully protected if and when there are actual audit adjustments.

Q. Have you quantified the revenue requirement effect of your recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $17.643 million in addition to the reductions due to Mr. Baudino's capital structure recommendations. To compute this effect, I increased the ADIT included in the capital structure by the FIN 48 amount, computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return reflecting only Mr. Baudino's capital structure adjustments and then multiplied this difference times the rate base that I recommend. The computations are detailed on my Exhibit___(LK-36) in Sections III and IV.

Capital Structure – Customer Deposits and Accumulated Deferred Income Taxes

Q. Are there other adjustments that should be made to the Company's proposed capital structure?

A. Yes. The Company has improperly diluted the low-cost capital provided by customer deposits and the cost-free capital provided by ADIT by allocating the sum of the prorata adjustments to these capital components.

Q. Why is this improper?

A. These capital amounts should be directly assigned to ratepayers in the same manner as if the amounts had been used to reduce rate base. Customer deposits and ADIT were not used to finance the amounts that comprise the total of the prorata adjustments detailed on MFR Schedule D-1B. The prorata adjustments detailed on MFR Schedule D-1B are primarily to reconcile the total capitalization to rate base, which excludes certain construction work in progress and the capital costs recovered through various riders.

Q. Have you quantified the revenue requirement effect of your recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $48.695 million in addition to the reductions due to the SFHHA capital structure recommendations that I previously quantified. To compute this effect, I reallocated the prorata adjustments to all capital components except customer deposits, ADIT and investment tax credits. I then computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return

reflecting the prior SFHHA capital structure recommendations and multiplied this difference times the rate base that I recommend. The computations are detailed on my Exhibit___(LK-36) in Sections IV and V.

Capital Structure – Accumulated Deferred Income Taxes Related to Changes in Depreciation Expense

Q. Is it necessary to change the ADIT included in the capital structure to reflect the changes in depreciation expense and accumulated depreciation that your recommend?

A. Yes. If depreciation expense and accumulated depreciation are reduced from the levels proposed by the Company for the adjustments to those amounts that I previously discussed, then there also must be an increase to the related ADIT compared to the levels proposed by the Company in the capital structure. In other words, a reduction in depreciation expense results in an increase in deferred income tax expense and thus, an increase in ADIT.

Q. Have you quantified the revenue requirement effect of your recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $8.909 million in addition to the reductions due to the SFHHA capital structure recommendations that I previously quantified. To compute this effect, I increased the ADIT by multiplying the Company's 38.58% combined federal and state income tax rate times the net reduction in accumulated depreciation resulting

from my depreciation expense recommendations. I then computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return reflecting the prior SFHHA capital structure recommendations and multiplied this difference times the rate base that I recommend. The computations are detailed on my Exhibit___(LK-36) in Sections V and VI.

Return on Common Equity

Q. Have you quantified the revenue requirement effect of SFHHA witness Mr. Baudino's return on equity recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $232.610 million in addition to the reductions due to the SFHHA capital structure recommendations that I previously quantified. To compute this effect, I substituted Mr. Baudino's return on equity for the Company's requested 12.50% return on equity. I then computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return reflecting the prior SFHHA capital structure recommendations and multiplied this difference times the rate base that I recommend. The computations are detailed on my Exhibit___(LK-36) in Sections VI and VII.

Cost of Short-Term Debt

Q. Have you quantified the revenue requirement effect of SFHHA witness Mr. Baudino's cost of short term debt recommendation?

A. Yes. The effect is to reduce the Company's revenue requirement by $11.785 million in addition to the reductions due to the SFHHA capital structure and return on equity recommendations that I previously quantified. To compute this effect, I substituted Mr. Baudino's proposed 0.60% cost of short term debt for the Company's 2.96% cost of short term debt. I then computed the difference between the resulting grossed-up rate of return and the grossed-up rate of return reflecting the prior SFHHA capital structure recommendations and multiplied this difference times the rate base that I recommend. Finally, I offset this reduction due only to the interest rate differential to include the $1.661 million in annual interest expense for the facility and administrative fees for the Company's credit term loan facilities, which increases the Company's interest expense to include these fees and increases the revenue requirement. I obtained these amounts from the Company's response to SFHHA Interrogatory 280, a copy of which I have attached as my Exhibit___(LK-38). Mr. Baudino addresses the reasons why the Commission should exclude the facility and administrative fees from the interest rate applied to rate base and instead add the expense separately to the revenue requirement. The computations are detailed on my Exhibit___(LK-36) in Sections VII and VIII.

Q. Does this complete your testimony?

A. Yes.

BY MS. GRIFFITHS:

Q. Have you prepared a prehearing statement, Mr. Kollen?

A. I have. And I see the green light is on.

Good morning, Commissioners. I address the company's proposed series of base rate and recovery clause increases and make recommendations on the appropriate rate increase amounts.

The company requests an unprecedented series of rate increases in this proceeding totaling nearly $1.5 billion, the magnitude of which may not be immediately evident.

To put the magnitude of FP&L's rate increases in perspective, I've been an expert in the utility industry for more than 30 years, and FP&L's rate increase is the largest I've ever seen. And to put the timing of FP&L's rate increase in perspective, it is obviously coming at a time when the Florida economy is in the midst of a serious downturn.

Accordingly, it is more important than ever that the Commission carefully scrutinize FP&L's rate request to determine whether the requested rates are just and reasonable. I do not believe that they are.

I make several recommendations regarding FP&L's proposed rate increases and I will briefly

describe them.

First, I recommend that the Commission reject the company's proposals in this proceeding for all base rate increases after January 1, 2010. This includes the 2011 rate increase and the GBRA rate increases. Instead, the company should file for future base rate increases closer to the effective dates of such increases, using then current costs and assumptions. The Commission cannot realistically determine at this time the reasonable level of revenues and costs that should be recovered through base rates some three or more years into the future.

This point is further supported by FP&L's own rebuttal testimony in which FP&L now acknowledges that its original rate request for 2010 and 2011 were overstated.

Second, I recommend that the Commission reject FP&L's proposed GBRA because the GBRA would provide the company an almost unfettered ability to automatically impose excessive base rate increases for new generation and transmission projects and costs without consideration of other revenues and costs, and it fails to consider the reductions in cost of service from depreciation recovery. The GBRA will result in Florida ratepayers paying more for new generation and

transmission assets.

Third, I recommend that the Commission reduce the company's base rates by at least $336 million effective on January 1, 2010. My recommendation reflects the SFHHA adjustments to remove the excessive and inappropriate costs that affect the operating income, rate base and rate of return included in the company's request.

I have summarized the effects of the group's recommendation on the company's proposed January 1, 2010, rate increase on Page 8 of my testimony. There's a summary table. It shows by issue the revenue requirement effect.

I propose six adjustments to reduce operation and maintenance expense. The company's proposed O&M expense reflects significant increases over 2008 levels. I recommend that the Commission limit the test year O&M expense to the 2008 status quo, adjusted only for certain known and measurable changes. In addition, I propose adjustments to recognize productivity improvements, the resulting decreases in expenses, a reduction in the proposed increase in nuclear staffing, reimbursements from the U.S. Department of Energy for spent nuclear fuel, capitalization of amounts expensed for a new customer information system that will not be

in service in the test year and to properly capture savings resulting from the deployment of the new automated meters.

I also propose that the Commission deny the company's request for storm damage recovery through base rates. The company presently recovers storm damage expense through a surcharge, which already includes recovery of $200 million for future storm damage. In addition, unlike the base rate recovery, the surcharge approach allows the company to securitize storm damage costs which result in substantially lower costs to ratepayers through lower financing costs. My recommendation ensures that FP&L will recover its storm costs but at the least cost to ratepayers.

And I propose six adjustments to depreciation expense. These depreciation expense adjustments will not have any impact on FP&L's actual earnings. The largest depreciation adjustment is to return to ratepayers the depreciation reserve surplus over a five-year period. I also recommend that the Commission reject the company's proposal to recover certain plant costs over an accelerated four-year recovery period. These costs are in effect interim retirements that should be recovered over the remaining lives of the replacement assets. In addition, I recommend that the

Commission use a 40-year life span for combined cycle units rather than the company's proposed 25-year lifespan.

I propose seven adjustments to rate base. The largest adjustment is to reflect the reduction in the company's capital expenditures this year compared to the amounts that are reflected in its budget and therefore rolled forward into the test year.

And finally, I propose three adjustments to the rate of return and quantify the revenue requirements of Mr. Baudino's recommendations.

That completes my summary. Thank you.

CHAIRMAN CARTER: Thank you very much.

MS. GRIFFITHS: I tender Mr. Kollen for cross-examination.

CHAIRMAN CARTER: Thank you.

Ms. Christensen.

MS. CHRISTENSEN: No questions.

CHAIRMAN CARTER: Ms. Bradley?

MS. BRADLEY: No questions.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: Just one question.

CROSS EXAMINATION

BY MR. MOYLE:

Q. You had said in your summary that based on

your years of experience that this was the largest rate increase that you're familiar with in the country. Is that in terms of percentage or dollars, or can you explain that?

A. It's a combination of the two, but I would start with the largest, with the dollar amount. It is the single largest dollar amount of rate increase that I have seen in more than 30 years in this business.

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

CHAIRMAN CARTER: I didn't get you, Mr. Moyle.

MR. MOYLE: That's all I had. Thank you.

CHAIRMAN CARTER: Thank you.

Mr. Wright?

MR. WRIGHT: No questions, Mr. Chairman. Thank you.

CHAIRMAN CARTER: Thank you, Mr. Wright.

Mr. Anderson -- oh, wait a minute.

MS. PERDUE: No questions.

CHAIRMAN CARTER: Mr. Anderson.

MR. ANDERSON: Consistent with what we said about trying to move things along, we'll ask no questions of this witness.

CHAIRMAN CARTER: Thank you.

Staff, you're recognized.

MS. WILLIAMS: Yes. I had previously passed

out to all the parties staff's exhibits that we wanted entered through this witness, so if we could find out if they have any objections.

CHAIRMAN CARTER: Are there any objections from any of the parties based upon the exhibit that staff has passed out for this witness?

MS. GRIFFITHS: Not from SFHHA, Mr. Chairman.

CHAIRMAN CARTER: Any of the parties?

Ms. Christensen?

MS. CHRISTENSEN: No objections.

CHAIRMAN CARTER: Ms. Bradley?

COMMISSIONER BRADLEY: None.

CHAIRMAN CARTER: Mr. Moyle?

MR. MOYLE: None.

CHAIRMAN CARTER: Mr. Wright?

MR. WRIGHT: No objections. Thank you.

CHAIRMAN CARTER: Mr. Wiseman or --

MS. GRIFFITHS: No, Mr. Chairman.

CHAIRMAN CARTER: Is it Ms. Spina? Did I get it right today?

MS. GRIFFITHS: Ms. Griffiths today. We should wear name tags.

CHAIRMAN CARTER: That's all right. I know Mr. Mendiola and Mr. Wiseman, so. Okay. No objections.

Okay. Staff, there's no objections, so where

does that put you in the context of your cross-examination?

MS. WILLIAMS: That means we can just enter the exhibits and we won't have any questions.

CHAIRMAN CARTER: Okay. Is there any redirect, Ms. Griffiths?

MS. GRIFFITHS: No, Mr. Chairman.

CHAIRMAN CARTER: Okay. Exhibits.

MS. WILLIAMS: Okay. Staff's exhibits are SFHHA's responses to staff's first set of interrogatories.

CHAIRMAN CARTER: Hold the phone. Hold the phone. Wait your turn.

MS. WILLIAMS: Oh, okay. Sorry.

MS. GRIFFITHS: Mr. Chairman, SFHHA would offer the direct testimony, which we already did, and Exhibits LK-1 through LK-38, which are marked as hearing Exhibits 291 through 328 on staff's Comprehensive Exhibit List.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done. Let me mark those before. That goes to 328 on staff's composite?

(Exhibits 291 through 328 admitted into the record.)

MS. GRIFFITHS: That's correct.

CHAIRMAN CARTER: Okay. Staff, you're recognized for exhibits.

MS. WILLIAMS: Yay. I got excited there. These are from staff's composite Exhibit Number 37, Items 71 through 85, and those are SFHHA's responses to staff's first set of interrogatories Numbers 8 through 22.

CHAIRMAN CARTER: Is that it?

(Exhibit 37 marked for identification and admitted into the record.)

MS. WILLIAMS: That's it.

CHAIRMAN CARTER: Okay. Anything further for this witness from any of the parties?

Thank you, Mr. Kollen. Have a great day.

THE WITNESS: Thank you. You too.

CHAIRMAN CARTER: Okay. Call your next witness. Oh, that would be Mr. Woolridge?

MR. McGLOTHLIN: OPC calls Dr. Randall Woolridge. I believe Dr. Woolridge was not present when you swore the other witnesses.

CHAIRMAN CARTER: Okay.

Dr. Woolridge, would you please stand and raise your right hand. And, by the way, if there are any further witnesses that are here today that will be testifying that have not been sworn, would you please

stand and raise your right hand. Okay.

(Witnesses collectively sworn.)

Please be seated. You may proceed.

J. RANDALL WOOLRIDGE

was called as a witness on behalf of the Office of Public Counsel and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. McGLOTHLIN:

Q. Please state your name and business address.

A. My name is the initial J, Randall Woolridge, and that's spelled W-O-O-L-R-I-D-G-E. My business address is 120 Haymaker Circle, State College, Pennsylvania.

Q. By whom are you employed, sir, and in what capacity?

A. I'm employed by the Pennsylvania State University and I'm a professor of finance.

Q. On behalf of the Office of Public Counsel, did you prepare testimony to be prefiled in this case?

A. Yes.

Q. Do you have that document entitled Direct Testimony of J. Randall Woolridge dated July 16th, 2009, before you?

A. Yes.

Q. Do you have any changes or corrections to make to your prefiled testimony?

A. I have two.

CHAIRMAN CARTER: Would you pull your mike a little closer to you?

THE WITNESS: Okay. Sorry. I have two quick changes. Page 59, there's a table at the top of the page. The risk-free rate in the table is indicated as 4.75 percent. That should be 4.50 percent.

The second change is in Exhibit JRW-10, Page 6. In the table the second figure, which is the Projected Value Line Growth in EPS, DPS, and BVPS, that should be 5.3 percent, not 4.3 percent.

BY MR. McGLOTHLIN:

Q. With those changes, Dr. Woolridge, do you adopt the questions and answers contained in this prefiled document as your testimony before the Commission today?

A. Yes.

Q. And did you prepare the exhibits that are attached to the prefiled testimony?

A. Yes.

Q. I ask that the prefiled testimony be inserted at the record -- in the record at this point.

CHAIRMAN CARTER: The prefiled testimony of

the witness will be inserted into the record as though read.

(Exhibits 207 through 222 marked for identification.)

DIRECT TESTIMONY

OF

J. Randall Woolridge

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket Nos. 080677-EI and 090130-EI

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

A. My name is J. Randall Woolridge. My business address is 120 Haymaker Circle, State College, PA 16801. I am a Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed University Fellow in Business Administration at the University Park Campus of the Pennsylvania State University. I am also the Director of the Smeal College Trading Room and President of the Nittany Lion Fund, LLC. A summary of my educational background, research, and related business experience is provided in Appendix A.

I. SUBJECT OF TESTIMONY AND SUMMARY OF RECOMMENDATIONS

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I have been asked by the Florida Office of Public Counsel ("OPC") to provide an opinion as to the overall fair rate of return or cost of capital for the Florida Power & Light Company ("FP&L" or "Company") and to evaluate FP&L's rate of return testimony in this proceeding.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. First I will review my cost of capital recommendation for FP&L, and review the primary areas of contention between FP&L's rate of return position and OPC. Second, I provide an assessment of capital costs in today's capital markets. Third, I discuss my proxy group of electric utility companies for estimating the cost of capital for FP&L. Fourth, I present my recommendations for the Company's capital structure and debt cost rate. Fifth, I discuss the concept of the cost of equity capital, and then estimate the equity cost rate for FP&L. Finally, I critique Company's rate of return analysis and testimony. I have a table of contents just after the title page for a more detailed outline.

Q. PLEASE REVIEW YOUR RECOMMENDATIONS REGARDING THE APPROPRIATE RATE OF RETURN FOR FP&L.

A. I have developed a capital structure for FP&L that reflects the Company's prospective capitalization used by investors. Even with my adjustments, this capital structure has a considerably higher equity component than the capitalizations of most electric utility companies. I have adjusted FP&L's debt cost rate to reflect current market interest rates. I have applied the Discounted

Cash Flow Model ("DCF") and the Capital Asset Pricing Model ("CAPM") to a proxy group of publicly-held electric utility companies ("Electric Proxy Group"). Based on market conditions and FPL's low risk profile due to its high common equity ratio, my analysis indicates an equity cost rate of 9.50% is appropriate for FP&L. Using my capital structure and debt and equity cost rates, I am recommending an overall rate of return of 6.17% for the test year 2010. These findings are summarized in Exhibit JRW-1.

Q. PLEASE SUMMARIZE THE PRIMARY ISSUES REGARDING RATE OF RETURN IN THIS PROCEEDING.

A. The Company's proposed cost of capital is provided in MFR Schedule D. My analysis reveals that the Company's recommended capital structure has a common equity ratio of 59.62%, which is well in excess of the common equity ratios of electric utility companies. In its analysis the Company's includes imputed debt of $950 million in its adjusted capital structure as a means of justifying its extremely high common equity ratio. In my testimony, I show that the imputed debt is unwarranted, and serves to mask a very high equity ratio. Even my recommended capital structure, which reflects the capitalization of FP&L as viewed by investors, has a higher common equity ratio than the capitalizations of electric utility companies. I have also adjusted the Company's proposed debt cost rate to reflect market interest rates.

FP&L witness Dr. William E. Avera provides the Company's proposed common equity cost rate. Dr. Avera's equity cost rate estimate is in

the 12.0% to 13.0% range. I have recommended an equity cost rate of 9.50% for FP&L. One key element of my recommendation is the recognition that I give to the very high common equity ratio of FP&L relative to the publicly-held electric utilities used to develop an equity cost rate.

Both Dr. Avera and I have applied the DCF and the CAPM approaches to groups of publicly-held electric utility companies. Dr. Avera has also used an Expected Earnings approach to estimate an equity cost rate for FP&L. Dr. Avera employs a proxy group that includes several companies which receive a low percentage of revenues from regulated electric utility operations. I demonstrate that FP&L's risk is below the average of Dr. Avera's utility proxy group. Dr. Avera also employs the equity cost rate results for an inappropriate proxy group of non-utility companies. With respect to the application of the DCF model, the major area of disagreement is the expected DCF growth rate. Dr. Avera relies exclusively on the earnings per share ("EPS") growth rate forecasts of Wall Street analysts and *Value Line* for his DCF growth rate. I demonstrate that there is an upward bias to these growth rate forecasts.

The CAPM approach requires an estimate of the risk-free interest rate, beta, and the equity risk premium. The primary error in Dr. Avera's CAPM is his equity risk premium of 10.0%. I provide evidence that: (1) this equity risk premium is based on an expected stock market return that is not reflective of current market fundamentals; (2) this expected stock market return is based on an expected EPS growth rate that is not reasonable given prospective

economic and earnings growth; and (3) the equity risk premium is well above the equity risk premiums used in the real world of finance. On the other hand, I use a market risk premium which (1) uses alternative approaches to estimating a market premium and (2) employs the results of over thirty studies and surveys of the market risk premium. As I note, my market risk premium is consistent with the market risk premiums (1) discovered in recent academic studies by leading finance scholars, (2) employed by leading investment banks and management consulting firms, and (3) that result from surveys of financial forecasters and corporate CFOs.

Finally, Dr. Avera's Expected Earnings approach is subject to a number of errors and does not provide reliable estimates of the Company's cost of equity capital. Furthermore, this methodology, which is not market-based, has not been used by regulatory commissions for years as an equity cost rate approach.

In the end, the most significant areas of disagreement in measuring FP&L's cost of capital are: (1) the appropriate capital structure, and whether the imputation of debt is appropriate to justify a high common equity ratio in a utility rate case; (2) FP&L's short-term and long-term debt cost rates; (3) the appropriate proxy group to use in estimating an equity cost rate for FP&L, and the riskiness of FP&L relative to the proxy group; (4) the use of the earnings per share growth rates of Wall Street analysts to measure expected DCF growth; (5) the measurement and magnitude of the equity risk premium used in a CAPM approach; and (6) whether or not an adjustment is needed to account for flotation costs.

II. CAPITAL COSTS IN TODAY'S MARKETS

Q. PLEASE DISCUSS CAPITAL COSTS IN U.S. MARKETS.

A. Long-term capital cost rates for U.S. corporations are a function of the required returns on risk-free securities plus a risk premium. The risk-free rate of interest is the yield on long-term U.S Treasury yields. The yields on ten-year U.S. Treasury bonds are provided on page 1 of Exhibit JRW-2 from 1953 to the present. These yields peaked in the early 1980s and have generally declined since that time. In the summer of 2003 these yields hit a 60-year low at 3.33%. They subsequently increased and fluctuated between the 4.0% and 5.0% levels over the next four years in response to ebbs and flows in the economy. Ten-year Treasury yields began to decline in mid-2007 at the beginning of the current financial crisis. In 2008 Treasury yields declined to below 3.0% as a result of the expansion of the mortgage and sub-prime market credit crisis, the turmoil in the financial sector, the government bailout of financial institutions, and the economic recession. Overall, these economic developments led investors to seek out low risk investments. This 'flight to quality' in the fixed income market has driven Treasury yields to historically low levels.

Panel B on page 1 of Exhibit JRW-2 shows the differences in yields between ten-year Treasuries and Moody's Baa rated bonds since the year 2000. This differential primarily reflects the additional risk required by bond

investors for the risk associated with investing in corporate bonds. The difference also reflects, to a much lesser degree, yield curve changes over time. The Baa rating is the lowest of the investment grade bond ratings for corporate bonds. The yield differential hovered in the 2.0% to 3.0% area until 2005, declined to 1.5% until late 2007, and then increased significantly in response to the current financial crisis. This differential peaked at 6.0% in November of 2008, at the height of the financial crisis, due to tightening in credit markets which increased corporate bond yields and the 'flight to quality' which decreased treasury yields. The differential has declined over the past several months.

As noted, the risk premium is the return premium required by investors to purchase riskier securities. As illustrated in Panel B of Exhibit JRW-2, the risk premium required by investors to buy corporate bonds is observable based on yield differentials in the markets. The equity risk premium is the return premium required to purchase stocks as opposed to bonds. The equity risk premium is not readily observable in the markets (as are bond risk premiums) since expected stock market returns are not readily observable. As a result, equity risk premiums must be estimated using market data. There are alternative methodologies to estimating the equity risk premium, and the alternative approaches and equity risk premium results are subject to much debate. One way to estimate the equity risk premium is to compare the mean returns on bonds and stocks over long historical periods. Measured in this manner, the equity risk premium has been in the 5-7 percent range. But

studies by leading academics indicate the forward-looking equity risk premium is in the 4.0 percent range.

Q. PLEASE DISCUSS THE FINANCIAL CRISIS AND THE RESPONSE OF THE U.S. GOVERNMENT.

A. The mortgage crisis, subprime crisis, credit crisis, economic recession and the restructuring of financial institutions has had tremendous global economic implications. This issue first surfaced in the summer of 2007 as a mortgage crisis. It expanded into the subprime area in late 2008 and led to the collapse of certain financial institutions, notably Bear Stearns, in the first quarter of 2008. Commodity and energy prices peaked and then began to decline in the summer of 2008 as the crisis in the financial markets spread to the global economy. The turmoil in the financial sector peaked in September with the failure of several large financial institutions, Bank of America's buyout of Merrill Lynch, and the government takeover of Fannie Mae and Freddie Mac.

The spillover to the economy has been ongoing. According to the National Bureau of Economic Research, the economy slipped into a recession in the 4th quarter of 2007 and remains there. The unemployment rate has increased steadily and was at 9.5% in June of 2009. Certain industries - especially those tied to discretionary spending, commodities, and industrial goods – have been especially hard hit. Inflationary pressures--which were tied to global growth and increases in commodity prices until mid-2008-- largely disappeared in late 2008 and early 2009. A barrel of oil, which was nearly

$150 in mid-2008, declined to the $30 range and now has increased to almost $70. Other commodity prices also peaked last year, bottomed out in the first quarter of 2009, and now have rebounded. The stock market bottomed out in early March, and has increased some 20% since that time. The increase in commodity and energy prices and the stock market since the first quarter of this year provides evidence that the worst of the financial crisis and economic recession is over.

In response to the market crisis, the Federal Reserve took extraordinary steps in an effort to stabilize capital markets. Most significantly, the Fed has opened its lending facilities to numerous banking and investment firms to promote credit markets. As a result, the balance sheet of the Federal Reserve has grown by hundreds of billions of dollars in support of the financial system. The federal government has taken a series of measures to shore up the economy and the markets. The Troubled Asset Relief Program ("TARP") is aimed at providing over $700B in government funds into the banking system in the form of equity investments. The federal government has spent billions bailing out a number of prominent financial institutions, including AIG, Citigroup, and Bank of America. The government is also moving to bail out other industries, most notably the auto industry. Earlier this year, President Obama's signed into law his $787B economic stimulus, which includes significant tax cuts and government spending aimed at creating jobs and turning around the economy.

In summary, the Federal Reserve and government have taken never-

before seen actions and have provided or will provide extraordinary sums of money in various ways to rescue the economy, certain industries, and the credit markets.

Q. PLEASE DISCUSS THE RESPONSE OF THE FINANCIAL MARKETS TO THE ACTIONS OF THE U.S. GOVERNMENT.

A. In response to the financial crisis, United States ("U. S.") Treasury Rates declined to levels not seen since the 1950s. This reflects the 'flight to quality' in the credit markets, as investors have sought out low risk investments. The credit market for corporate and utility debt has experienced higher rates due to the credit crisis. The short-term credit markets were initially hit with credit issues, leading to the demise of several large financial institutions. The primary indicator of the short-term credit market is the 3-month London Interbank Offered Rate ("LIBOR") rate. LIBOR peaked in the third quarter of 2008 at 4.75%. It has declined to below 1.0% as the short-term credit markets have opened up and Treasury rates have continued to decline.

The long-term credit market has remained tighter, but has improved significantly over the first half of 2009. The credit crisis is associated with concerns among credit providers – mainly financial institutions – in terms of making loans and investing in bonds due to the overleveraging and perceived weakness of the economy. Panel A of page 1 of Exhibit JRW-3 provides the yields on A, BBB+, and BBB rated public utility bonds. These yields peaked in November and have since declined by over 150 basis points. For example,

the yields on 'A' rated utility bonds, which peaked at over 7.50% in November of 2008, have declined to below 6.0% in recent weeks. Panel B of Exhibit JRW-3 provides the yield spreads on A, BBB+, and BBB rated public utility bonds relative to Treasury bonds. These yield spreads increased dramatically in the third quarter during the peak of the financial crisis and have since decreased by about 200 basis points.

Thus, the yields and yield spreads have declined in response to the federal government's unprecedented actions in response to the financial crisis. Public utility debt in particular has found favor with fixed income investors. Pages 2 and 3 of Exhibit JRW-3 contain an article from the *Wall Street Journal* which highlights the fact that the market for the bonds of utilities came back significantly in early 2009. In particular, the article highlights the fact that utility bonds are viewed as a 'safe haven' in the current market and that yields on utility bonds declined significantly and bond issuances picked up early in 2009. It quotes from the CFO of Progress Energy, who says:

> "People have turned the page on 2008 and spreads have come down for people like us," said Mark Mulhern, Progress Energy's chief financial officer.

In sum, it appears that the massive government spending and Federal Reserve actions have had an effect on the credit markets. The Obama administration is clearly committed to bringing the economy around. The worst of the credit crisis appears to be over. The short-term credit market has loosened up considerably. LIBOR rates peaked in the fall and have declined.

Likewise, the long-term credit market has loosening and credit spreads have declined significantly. In addition, the stock market has rebounded from its lows in March of this year.

Q. PLEASE PROVIDE YOUR ASSESSMENT OF THE IMPACT OF RECENT CAPITAL MARKET CONDITIONS ON THE VOLATILITY OF STOCKS AND BONDS.

A. To assess the effect of recent capital market volatility on the equity risk premium and the equity cost rate, one must look at the volatility of stocks relative to bonds. To compare the volatility of stocks and bonds, one must standardize the volatility measure. This is normally done by dividing the volatility measure, the standard deviation, by the mean. This standardized volatility measure is known as the Coefficient of Variation ("CV").

I have performed an analysis of the volatility of stocks relative to bonds since 2000. I have used the S&P 500 and the Bear Sterns Bond Price Index ("BSBPI") to compute the CV using a twenty-two day mean and standard deviation. A twenty-two day period approximates one month of trading. In Panel C of Exhibit JRW-3, page 4, I have graphed the CV for the S&P 500 and the BSBPI since the year 2000. In association with the unprecedented economic events in the third quarter of 2008, there is a dramatic increase in the volatility of stocks and a not so dramatic increase in the volatility of bonds. After the September – October time frame, stock volatility declined significantly while bond volatility increased. In the first

quarter of 2009, there was another increase in the volatility of stocks relative to bonds. However, stock volatility has declined over the past two months. Panel D of page 4 of Exhibit JRW-3 shows the ratio of the CV(Stock CV)/CV(Bond CV). Hence, this graph shows the standardized volatility of stocks relative to bonds. Higher levels of this ratio represent time periods when stock volatility is high relative to bond volatility, and low levels of this ratio occur during time periods when stock volatility is low relative to bonds. As such, the volatility of stocks relative to bonds has declined over the past two months, suggesting that the markets have settled somewhat compared to the third quarter of 2008 and the first quarter of 2009.

Q. HAVE LEADING FINANCIAL PRACTITIONERS WEIGHED IN ON THE IMPACT OF THE FINANCIAL CRISIS ON THE COST OF EQUITY CAPITAL?

A. Yes. McKinsey & Co., recognized as the leading management consulting firm in the world, recently published a study entitled "Why the Crisis Hasn't Shaken the Cost of Capital." In the study, the authors contend the financial crisis has not significantly changed the firm's long-term estimate of the equity risk premium, which is in the 3.5 to 4 percent range. McKinsey develops an equity risk premium based on the price level of the S&P 500, GDP growth, and corporate profits. In summing up their analysis of the impact of the financial crisis on S&P 500, GDP growth, and corporate profits, they

conclude: "Taking all these factors into account, we think there has been no significant change in the long-term cost of equity capital.[1]"

III. PROXY GROUP SELECTION

Q. PLEASE DESCRIBE YOUR APPROACH TO DEVELOPING A FAIR RATE OF RETURN RECOMMENDATION FOR FP&L.

A. To develop a fair rate of return recommendation for FP&L, I have evaluated the return requirements of investors on the common stock of a proxy group of publicly-held electric utility companies.

Q. PLEASE DESCRIBE YOUR PROXY GROUP OF ELECTRIC UTILITY COMPANIES.

A. My proxy group consists of ten electric utility companies. This group includes companies that meet the following criteria: (1) listed as an electric utility or combination gas and electric utility by *AUS Utility Reports*, (2) regulated electric revenues must be at least 70% of total revenues; (3) revenues of at least $5B; (4) current data available in the Standard Edition of the *Value Line Investment Survey*; (5) an investment grade bond rating by Moody's and/or Standard & Poor's; and (6) an annual dividend history of three years, with no rumored or actual dividend cuts.

[1]Richard Dobbs, Bin Jang, and Timothy Koeller, "Why the Crisis Hasn't Shaken the Cost of Capital," *McKinsey Quarterly* (December 2008), p. 6.

Summary financial statistics for the proxy group are listed in Exhibit JRW-4. The average operating revenues, net plant, and market capitalization for the Electric Proxy Group are $12,936.9M and $23,503.9, respectively. On average, the group receives 84% of revenues from regulated electric utility operations, has an 'A-' S&P bond rating, a common equity ratio of 40%, an earned return on common equity of 12.2%, and sells at a market-to-book ratio of 1.3X. Compared to this group, FP&L's revenues and net plant are slightly smaller than the group. The Company's S&P and Moody's bond rating and pre-tax interest coverage are higher than the average for the Electric Proxy Group. Most significantly, FP&L's common equity ratio of 57% is much higher than the average for the group, which is only 40%. Overall, especially due to the much higher common equity ratio, and in addition due to the higher pre-tax interest coverage ratio and bond ratings, FP&L appears to be somewhat less risky than the group. On the other hand, FP&L's parent, FPL Group, is more similar to the Electric Proxy Group in terms of common equity ratio. But, FPL Group does have a slightly higher pre-tax interest coverage and bond ratings.

IV. CAPITAL STRUCTURE RATIOS AND DEBT COST RATES

Q. WHAT IS THE RECOMMENDED CAPITAL STRUCTURE OF THE COMPANY?

A. The Company's claimed recommended capital structure, based on investor provided capital, is shown in Panel A of page 1 of Exhibit JRW-5. The

Company is requesting a capital structure consisting 1.10% short-term debt, 43.11% long-term debt, and a 55.76% common equity. However, this capital structure includes $950 million of "imputed debt." As discussed at length later in my testimony, imputed debt is a non-GAAP adjustment to the capital structure of the company. As such, it is an adjustment not found in the company's financial statements and SEC filings. Panel B of page 1 of Exhibit JRW-5 shows FP&L's recommended capital structure, based on investor provided capital, without the imputed debt. Therefore, FP&L is actually requesting a capital structure (based on investor provided capital) consisting 1.18% short-term debt, 39.20% long-term debt, and 59.62% common equity.

Q. IS THE COMPANY'S RECOMMENDED CAPITAL STRUCTURE APPROPRIATE FOR RATEMAKING PURPOSES?

A. No. This capital structure is not appropriate for three reasons. First, the capital structure includes an actual common equity ratio (59.62%) which is much higher than the common equity ratios of electric utility companies. Second, the company has attempted to claim that its recommended capital structure includes a common equity ratio of 55.76%. This claim is based on incorrectly including the $950 million in imputed debt. Third, the Company's recommended capital structure includes more common equity than is projected for the Company.

Q. BEFORE DISCUSSING YOUR RECOMMENDED CAPITAL STRUCTURE, PLEASE REVIEW THE CAPITAL STRUCTURES FOR FP&L AND ITS PARENT COMPANY, FPL GROUP.

A. In panels C and D of Exhibit JRW-5, page 1, the average capitalization ratios for FP&L and FPL Group are shown over the past five years. These ratios highlight the fact that FPL Group employs much more debt and much less equity than FP&L. Hence, FPL Group has a higher degree of financial risk than FP&L. These ratios also show that FPL Group finances its other businesses, such as NextEra Energy Resources, with more debt than FP&L.

Q. PLEASE DISCUSS THE CAPITAL STRUCTURE RATIOS OF YOUR ELECTRIC PROXY GROUP.

A. The capital structures for the Electric Proxy Group are shown in Panel E of Exhibit JRW-5. The average capitalization ratios for the group over the past four quarters are 8.50% short-term debt, 50.59% long-term debt, 0.88% preferred stock, and a 40.03% common equity. These ratios indicate that: (1) the Electric Proxy Group has, on average, a much lower common equity ratio and higher financial risk than FP&L; and (2) the average capitalization of the Electric Proxy Group is similar to FP&L's parent, FPL Group.

Q. WHAT CAPITAL STRUCTURE RATIOS ARE YOU EMPLOYING FOR FP&L?

A. Panel F (page 2) of Exhibit JRW-5 provides FP&L projected actual capitalization for the years 2009 and 2010 based on investor provided capital.

These figures represent the projected capitalizations per the company books, and therefore these are the figures that investors would have access to and use. The average capitalization ratios are 3.76% short-term debt, 41.80% long-term debt, and a 54.43% common equity. While these capitalization ratios include a much higher common equity ratio than the Electric Proxy Group, they are a much more realistic view of the expected capitalization of the company as viewed by investors.

Q. YOU HAVE REFERRED SEVERAL TIMES TO THE DIFFERING EQUITY RATIOS OF YOUR PROXY UTILITY GROUP, FPL GROUP, AND FLORIDA POWER & LIGHT COMPANY. PLEASE ELABORATE ON THE SIGNIFICANCE OF THE AMOUNT OF EQUITY THAT IS INCLUDED IN AN ELECTRIC UTILITY'S CAPITAL STRUCTURE.

A. An electric utility's decision as to the amount of equity capital it will incorporate in its capital structure involves fundamental trade-offs relating to the amount of financial risk the firm carries, the overall revenue requirements its customers are required to bear through the rates they pay, and the return on equity that investors will require.

Q. PLEASE DISCUSS A UTILITY'S USE OF USING DEBT VERSUS EQUITY TO MEET ITS CAPITAL NEEDS.

A. Utilities satisfy their capital needs through a mix of equity and debt. Because equity capital is more expensive than debt, the issuance of debt enables a

utility to raise more capital with a given commitment of dollars than it could raise with just equity. Debt is therefore a means of "leveraging" capital dollars. However, as the amount of debt in the capital structure increases, its financial risk increases and the risk of the utility perceived by equity investors also increases. Significantly for this case, the converse is also true. As the amount of debt in the capital structure decreases, the financial risk decreases. The required return on equity capital is a function of the amount of overall risk that investors perceive, including financial risk in the form of debt.

Q. WHY IS THIS RELATIONSHIP IMPORTANT TO THE UTILITY'S CUSTOMERS?

A. Just as there is a direct correlation between the utility's authorized return on equity and the utility's revenue requirements (the higher the return, the greater the revenue requirement), there is a direct correlation between the amount of equity in the capital structure and the revenue requirements the customers are called on to bear. Again, equity capital is more expensive than debt. Not only does equity command a higher cost rate, it also adds more to the income tax burden that ratepayers are required to pay through rates. As the equity ratio increases, the utility's revenue requirements increase and rates paid by customers increase. If the proportion of equity is too high, rates will be higher than they need to be. For this reason, the utility's management must pursue a capital acquisition strategy that results in the proper balance in the capital structure.

Q. HOW HAVE ELECTRIC UTILITIES TYPICALLY STRUCK THIS BALANCE?

A. Due to regulation and the essential nature of its output, an electric utility is exposed to less business risk than other companies that are not regulated. This means that an electric utility can reasonably carry relatively more debt in its capital structure than can most unregulated companies. Typically, one may see equity ratios for electric utilities range from the 40% to 50% range. As I stated earlier, the average amount of common equity in the average capital structure of the utilities in my proxy group is 42%. In my experience, this value is typical for large electric utilities. It is also significant that FPL Group has significantly less equity in its capital structure—i.e., is significantly more leveraged—than is its subsidiary, FPL.

Q. TURNING TO FPL'S PROPOSED CAPITAL STRUCTURE, HOW DOES FPL'S EQUITY RATIO RELATE TO THIS DISCUSSION?

A. FPL's real equity ratio is 59.62%. I have made adjustments to reflect the sources of capital that future investors will see. Even with those adjustments, FPL's common equity ratio is 54.43%.

Q. DO YOU BELIEVE THAT EQUITY RATIOS IN THE RANGE OF 54-59% ARE APPROPRIATE FOR FPL?

A. I believe that even as adjusted FPL's equity ratio is higher than would be

warranted by its risk profile.

Q. GIVEN YOUR VIEW THAT FPL'S EQUITY RATIO IS HIGHER THAN IS WARRANTED BY ITS RISK PROFILE, WHAT SHOULD THE COMMISSION DO IN THIS RATEMAKING PROCEEDING?

A. When a regulated electric utility's actual capital structure contains too high an equity ratio, the options are: (1) to impute a more reasonable capital structure and reflect the imputed capital structure in revenue requirements; or (2) to recognize the downward impact that an unusually high equity ratio will have on financial risk of a utility and authorize a lower common equity cost rate.

Q. PLEASE ELABORATE ON THIS "DOWNWARD IMPACT."

A. As I stated earlier, there is a direct correlation between the amount of debt in a utility's capital structure and the risk that an equity investor will associate with that utility. A relatively lower proportion of debt translates into a lower required return on equity, all other things being equal. Stated differently, a utility cannot expect to "have it both ways." Specifically, a utility cannot maintain an unusually high equity ratio and not expect to have the resulting lower risk reflected in its authorized return on equity. The fundamental relationship between the lower risk and the appropriate authorized return should not be ignored.

Q. OF THE TWO OPTIONS FOR ADDRESSING AN

INAPPROPRIATELY HIGH EQUITY RATIO, WHICH HAVE YOU EMPLOYED IN THIS CASE?

A. I have used the "real" equity ratio of 54.43%. Concurrently, I have taken into account the relatively lower financial risk of FPL that is associated with this high equity ratio in my recommendation that the Commission authorize a return on equity of 9.50%.

Q. PLEASE SUMMARIZE YOUR RECOMMENDED CAPITAL STRUCTURE FOR RATEMAKING PURPOSES

A. My recommended capital structure for ratemaking purposes is provided in Panel G (page 2) of Exhibit JRW-5. I have included the per books amounts of customer deposits, deferred income tax, and investment tax credits from FP&L Schedule D-1A along with my recommended amounts of short-term and long-term debt and common equity.

Q. WHY IS YOUR RECOMMENDED CAPITAL STRUCTURE MORE APPROPRIATE FOR FP&L?

A. My recommended capital structure is more appropriate for three reasons: (1) FP&L's proposed capital structure ratios do not reflect the actual capitalization of FP&L or FPL Group; (2) FP&L's proposed capital structure ratios do not reflect the capitalization of electric utility companies; and (3) FP&L's proposed capital structure is not based on the company book figures but reflects a number of adjustments, most notably imputed debt. My capital

structure much more accurately reflects the Company's capital structure as viewed by investors.

Q. WHAT SHORT-TERM AND LONG-TERM DEBT COST RATES ARE YOU USING IN THE COST OF CAPITAL FOR FP&L?

A. I am employing the Company's projected short-term and long-term debt cost rates for 2009. These figures reflect current market interest rates and are not based on speculative forecasts of interest rates. The short-term and long-term debt cost rates are 2.27% and 5.14% and are based on company provided figures.

V. THE COST OF COMMON EQUITY CAPITAL

A. Overview

Q. WHY MUST AN OVERALL COST OF CAPITAL OR FAIR RATE OF RETURN BE ESTABLISHED FOR A PUBLIC UTILITY?

A. In a competitive industry, the return on a firm's common equity capital is determined through the competitive market for its goods and services. Due to the capital requirements needed to provide utility services, however and to the economic benefit to society from avoiding duplication of these services, some public utilities are monopolies. It is not appropriate to permit monopoly utilities to set their own prices because of the lack of competition and the essential nature of the services. Thus, regulation seeks to establish prices that are fair to consumers and at the same time are sufficient to meet the operating

and capital costs of the utility (i.e., provide an adequate return on capital to attract investors).

Q. PLEASE PROVIDE AN OVERVIEW OF THE COST OF CAPITAL IN THE CONTEXT OF THE THEORY OF THE FIRM.

A. The total cost of operating a business includes the cost of capital. The cost of common equity capital is the expected return on a firm's common stock that the marginal investor would deem sufficient to compensate for risk and the time value of money. In equilibrium, the expected and required rates of return on a company's common stock are equal.

Normative economic models of the firm, developed under very restrictive assumptions, provide insight into the relationship between firm performance or profitability, capital costs, and the value of the firm. Under the economist's ideal model of perfect competition where entry and exit is costless, products are undifferentiated, and there are increasing marginal costs of production, firms produce up to the point where price equals marginal cost. Over time, a long-run equilibrium is established where price equals average cost, including the firm's capital costs. In equilibrium, total revenues equal total costs, and because capital costs represent investors' required return on the firm's capital, actual returns equal required returns and the market value and the book value of the firm's securities must be equal.

In the real world, firms can achieve competitive advantage due to product market imperfections. Most notably, companies can gain competitive

advantage through product differentiation (adding real or perceived value to products) and by achieving economies of scale (decreasing marginal costs of production). Competitive advantage allows firms to price products above average cost and thereby earn accounting profits greater than those required to cover capital costs. When these profits are in excess of that required by investors, or when a firm earns a return on equity in excess of its cost of equity, investors respond by valuing the firm's equity in excess of its book value.

James M. McTaggart, founder of the international management consulting firm Marakon Associates, has described this essential relationship between the return on equity, the cost of equity, and the market-to-book ratio in the following manner:[2]

> Fundamentally, the value of a company is determined by the cash flow it generates over time for its owners, and the minimum acceptable rate of return required by capital investors. This "cost of equity capital" is used to discount the expected equity cash flow, converting it to a present value. The cash flow is, in turn, produced by the interaction of a company's return on equity and the annual rate of equity growth. High return on equity (ROE) companies in low-growth markets, such as Kellogg, are prodigious generators of cash flow, while low ROE companies in high-growth markets, such as Texas Instruments, barely generate enough cash flow to finance growth.
>
> A company's ROE over time, relative to its cost of equity, also determines whether it is worth more or less than its book value. If its ROE is consistently greater than the cost of equity capital (the investor's minimum acceptable return), the business is economically

[2] James M. McTaggart, "The Ultimate Poison Pill: Closing the Value Gap," *Commentary* (Spring 1988), p. 2.

> profitable and its market value will exceed book value. If, however, the business earns an ROE consistently less than its cost of equity, it is economically unprofitable and its market value will be less than book value.

As such, the relationship between a firm's return on equity, cost of equity, and market-to-book ratio is relatively straightforward. A firm that earns a return on equity above its cost of equity will see its common stock sell at a price above its book value. Conversely, a firm that earns a return on equity below its cost of equity will see its common stock sell at a price below its book value.

Q. PLEASE PROVIDE ADDITIONAL INSIGHTS INTO THE RELATIONSHIP BETWEEN RETURN ON EQUITY AND MARKET-TO-BOOK RATIOS.

A. This relationship is discussed in a classic Harvard Business School case study entitled "A Note on Value Drivers." On page 2 of that case study, the author describes the relationship very succinctly:[3]

> For a given industry, more profitable firms -- those able to generate higher returns per dollar of equity – should have higher market-to-book ratios. Conversely, firms which are unable to generate returns in excess of their cost of equity should sell for less than book value.

Profitability	*Value*
If ROE > K	*then Market/Book > 1*
If ROE = K	*then Market/Book =1*
If ROE < K	*then Market/Book < 1*

[3] Benjamin Esty, "A Note on Value Drivers," Harvard Business School, Case No. 9-297-082, April 7, 1997.

To assess the relationship by industry, as suggested above, I have performed a regression study between estimated return on equity and market-to-book ratios using natural gas distribution, electric utility and water utility companies. I used all companies in these three industries which are covered by *Value Line* and who have estimated return on equity and market-to-book ratio data. The results are presented in Panels A-C of Exhibit JRW-6. The average R-squares for the electric, gas, and water companies are 0.65, 0.60, and 0.92.[4] This demonstrates the strong positive relationship between ROEs and market-to-book ratios for public utilities. This means that utilities with higher expected ROEs sell at higher market-to-book ratios.

Q. WHAT ECONOMIC FACTORS HAVE AFFECTED THE COST OF EQUITY CAPITAL FOR PUBLIC UTILITIES?

A. Exhibit JRW-7 provides indicators of the equity cost rates for the Electric Proxy Group over the past decade. Page 1 shows the monthly yields on long-term 'A' rated public utility bonds. These yields peaked in the early 2000s at over 8.0%, declined to about 5.0% in 2005, and rose to 6.0% in 2007. They stayed in that 6.0% range until the third quarter of 2008 when they spiked to almost 8.0%. They have since retreated to the 6.0% range again.

[4] R-square measures the percent of variation in one variable (e.g., market-to-book ratios) explained by another variable (e.g., expected return on equity). R-squares vary between zero and 1.0, with values closer to 1.0 indicating a higher relationship between two variables.

Page 2 provides the dividend yields for the Electric Proxy Group over the past decade. These yields peaked in 2000 at 5.0%, declined to the 3.3% as of 2007, and increased in 2008 to 3.9%.

Average earned returns on common equity and market-to-book ratios for the group are given on page 3 of Exhibit JRW-7. Over the past decade, earned returns on common equity have been in the 8.0%-12.0% range. The average ROE has gradually risen in recent years and peaked at 12.0% in 2008. Over the past decade, the average market-to-book ratios for this group have been between 1.20 to 2.0. As of 2008, the average market-to-book for the group was 1.75.

Q. WHAT FACTORS DETERMINE INVESTORS' EXPECTED OR REQUIRED RATE OF RETURN ON EQUITY?

A. The expected or required rate of return on common stock is a function of market-wide, as well as company-specific, factors. The most important market factor is the time value of money as indicated by the level of interest rates in the economy. Common stock investor requirements generally increase and decrease with like changes in interest rates. The perceived risk of a firm is the predominant factor that influences investor return requirements on a company-specific basis. A firm's investment risk is often separated into business and financial risk. Business risk encompasses all factors that affect a firm's operating revenues and expenses. Financial risk results from incurring fixed obligations in the form of debt in financing its assets.

Q. HOW DOES THE INVESTMENT RISK OF ELECTRIC UTILITY COMPANIES COMPARE WITH THAT OF OTHER INDUSTRIES?

A. Due to the essential nature of their service as well as their regulated status, public utilities are exposed to a lesser degree of business risk than other, non-regulated businesses. The relatively low level of business risk allows public utilities to meet much of their capital requirements through borrowing in the financial markets, thereby incurring greater than average financial risk. Nonetheless, the overall investment risk of public utilities is below most other industries.

Exhibit JRW-8 provides an assessment of investment risk for 100 industries as measured by beta, which according to modern capital market theory is the only relevant measure of investment risk that need be of concern for investors. These betas come from the *Value Line Investment Survey* and are compiled by Aswath Damodoran of New York University.[5] The study shows that the investment risk of public utilities is relatively low. The average beta for electric utilities of 0.88 is in the bottom twenty percent of all industries and well below the *Value Line* average of 1.24. As such, the cost of equity for the electric utility industry is among the lowest of all industries in the U.S.

Q. HOW CAN THE EXPECTED OR REQUIRED RATE OF RETURN ON COMMON EQUITY CAPITAL BE DETERMINED?

[5] They may be found on the Internet at http:// www.stern.nyu.edu/~adamodar.

A. The costs of debt and preferred stock are normally based on historical or book values and can be determined with a great degree of accuracy. The cost of common equity capital, however, cannot be determined precisely and must instead be estimated from market data and informed judgment. This return to the stockholder should be commensurate with returns on investments in other enterprises having comparable risks.

According to valuation principles, the present value of an asset equals the discounted value of its expected future cash flows. Investors discount these expected cash flows at their required rate of return that, as noted above, reflects the time value of money and the perceived riskiness of the expected future cash flows. As such, the cost of common equity is the rate at which investors discount expected cash flows associated with common stock ownership.

Models have been developed to ascertain the cost of common equity capital for a firm. Each model, however, has been developed using restrictive economic assumptions. Consequently, judgment is required in selecting appropriate financial valuation models to estimate a firm's cost of common equity capital, in determining the data inputs for these models, and in interpreting the models' results. All of these decisions must take into consideration the firm involved as well as current conditions in the economy and the financial markets.

Q. HOW DO YOU PLAN TO ESTIMATE THE COST OF EQUITY CAPITAL FOR THE COMPANY?

A. I rely primarily on the DCF model to estimate the cost of equity capital. Given the investment valuation process and the relative stability of the utility business, I believe that the DCF model provides the best measure of equity cost rates for public utilities. It is my experience that this Commission has traditionally relied on the DCF method. I have also performed a CAPM study, but I give these results less weight because I believe that risk premium studies, of which the CAPM is one form, provide a less reliable indication of equity cost rates for public utilities.

B. <u>Discounted Cash Flow Analysis</u>

Q. DESCRIBE THE THEORY BEHIND THE TRADITIONAL DCF MODEL.

A. According to the DCF model, the current stock price is equal to the discounted value of all future dividends that investors expect to receive from investment in the firm. As such, stockholders' returns ultimately result from current as well as future dividends. As owners of a corporation, common stockholders are entitled to a pro-rata share of the firm's earnings. The DCF model presumes that earnings that are not paid out in the form of dividends are reinvested in the firm so as to provide for future growth in earnings and dividends. The rate at which investors discount future dividends, which reflects the timing and riskiness of the expected cash flows, is interpreted as

the market's expected or required return on the common stock. Therefore, this discount rate represents the cost of common equity. Algebraically, the DCF model can be expressed as:

$$P = \frac{D_1}{(1+k)^1} + \frac{D_2}{(1+k)^2} + \ldots \frac{D_n}{(1+k)^n}$$

where P is the current stock price, D_n is the dividend in year n, and k is the cost of common equity.

Q. IS THE DCF MODEL CONSISTENT WITH VALUATION TECHNIQUES EMPLOYED BY INVESTMENT FIRMS?

A. Yes. Virtually all investment firms use some form of the DCF model as a valuation technique. One common application for investment firms is called the three-stage DCF or dividend discount model ("DDM"). The stages in a three-stage DCF model are discussed below. This model presumes that a company's dividend payout progresses initially through a growth stage, then proceeds through a transition stage, and finally assumes a steady-state stage. The dividend-payment stage of a firm depends on the profitability of its internal investments, which, in turn, is largely a function of the life cycle of the product or service. These stages are depicted in the graphic in Exhibit JRW-9.[6]

[6] This description comes from William F. Sharp, Gordon J. Alexander, and Jeffrey V. Bailey, *Investments* (Prentice-Hall, 1995), pp. 590-91.

1. Growth stage: Characterized by rapidly expanding sales, high profit margins, and abnormally high growth in earnings per share. Because of highly profitable expected investment opportunities, the payout ratio is low. Competitors are attracted by the unusually high earnings, leading to a decline in the growth rate.

2. Transition stage: In later years increased competition reduces profit margins and earnings growth slows. With fewer new investment opportunities, the company begins to pay out a larger percentage of earnings.

3. Maturity (steady-state) stage: Eventually the company reaches a position where its new investment opportunities offer, on average, only slightly attractive returns on equity. At that time its earnings growth rate, payout ratio, and return on equity stabilize for the remainder of its life. The constant-growth DCF model is appropriate when a firm is in the maturity stage of the life cycle.

In using this model to estimate a firm's cost of equity capital, dividends are projected into the future using the different growth rates in the alternative stages, and then the equity cost rate is the discount rate that equates the present value of the future dividends to the current stock price.

Q. HOW DO YOU ESTIMATE STOCKHOLDERS' EXPECTED OR REQUIRED RATE OF RETURN USING THE DCF MODEL?

A. Under certain assumptions, including a constant and infinite expected growth rate, and constant dividend/earnings and price/earnings ratios, the DCF model can be simplified to the following:

$$P = \frac{D_1}{k - g}$$

where D_1 represents the expected dividend over the coming year and g is the expected growth rate of dividends. This is known as the constant-growth version of the DCF model. To use the constant-growth DCF model to estimate a firm's cost of equity, one solves for k in the above expression to obtain the following:

$$k = \frac{D_1}{P} + g$$

Q. *IN YOUR OPINION, IS THE CONSTANT-GROWTH DCF MODEL APPROPRIATE FOR PUBLIC UTILITIES?*

A. Yes. The economics of the public utility business indicate that the industry is in the steady-state or constant-growth stage of a three-stage DCF. The economics include the relative stability of the utility business, the maturity of the demand for public utility services, and the regulated status of public utilities (especially the fact that their returns on investment are effectively set through the ratemaking process). The DCF valuation procedure for companies in this stage is the constant-growth DCF. In the constant-growth version of

the DCF model, the current dividend payment and stock price are directly observable. However, the primary problem and controversy in applying the DCF model to estimate equity cost rates entails estimating investors' expected dividend growth rate.

Q. WHAT FACTORS SHOULD ONE CONSIDER WHEN APPLYING THE DCF METHODOLOGY?

A. One should be sensitive to several factors when using the DCF model to estimate a firm's cost of equity capital. In general, one must recognize the assumptions under which the DCF model was developed in estimating its components (the dividend yield and expected growth rate). The dividend yield can be measured precisely at any point in time, but tends to vary somewhat over time. Estimation of expected growth is considerably more difficult. One must consider recent firm performance, in conjunction with current economic developments and other information available to investors, to accurately estimate investors' expectations.

Q. PLEASE DISCUSS EXHIBIT JRW-10.

A. My DCF analysis is provided in Exhibit JRW-10. The DCF summary is on page 1 of this Exhibit, and the supporting data and analysis for the dividend yield and expected growth rate are provided on the following pages of the Exhibit.

Q. WHAT DIVIDEND YIELDS ARE YOU EMPLOYING IN YOUR DCF ANALYSIS FOR THE PROXY GROUP?

A. The dividend yields on the common stock for the companies in the Electric Proxy Group are provided on page 2 of Exhibit JRW-10 for the six-month period ending July 2009. For the DCF dividend yields for the group, I am using the average of the six month and July 2009 dividend yields. The table below shows these dividend yields.

Proxy Group	6-Month Average Dividend Yield	July 2009 Dividend Yield	DCF Dividend Yield
Electric Proxy Group	4.9%	4.5%	4.7%

Q. PLEASE DISCUSS THE APPROPRIATE ADJUSTMENT TO THE SPOT DIVIDEND YIELD.

A. According to the traditional DCF model, the dividend yield term relates to the dividend yield over the coming period. As indicated by Professor Myron Gordon, who is commonly associated with the development of the DCF model for popular use, this is obtained by: (1) multiplying the expected dividend over the coming quarter by 4 and (2) dividing this dividend by the current stock price to determine the appropriate dividend yield for a firm, that pays dividends on a quarterly basis.[7]

[7] *Petition for Modification of Prescribed Rate of Return*, Federal Communications Commission, Docket No. 79-05, Direct Testimony of Myron J. Gordon and Lawrence I. Gould at 62 (April 1980).

In applying the DCF model, some analysts adjust the current dividend for growth over the coming year as opposed to the coming quarter. This can be complicated because firms tend to announce changes in dividends at different times during the year. As such, the dividend yield computed based on presumed growth over the coming quarter as opposed to the coming year can be quite different. Consequently, it is common for analysts to adjust the dividend yield by some fraction of the long-term expected growth rate.

The appropriate adjustment to the dividend yield is further complicated in the regulatory process when the overall .cost of capital is applied to a projected rate base. The net effect of this application is an overstatement of the equity cost rate estimate derived from the DCF model. In the context of the constant-growth DCF model, both the adjusted dividend yield and the growth component are overstated. The overstatement results from applying an equity cost rate computed using current market data to a future or test-year-end rate base which includes growth associated with the retention of earnings during the year. In other words, an equity cost rate times a future, yet to be achieved rate base, results in an inflated dividend yield and growth rate.

Q. GIVEN THIS DISCUSSION, WHAT ADJUSTMENT FACTOR WILL YOU USE FOR YOUR DIVIDEND YIELD?

A. I will adjust the dividend yield by one-half (1/2) the expected growth so as to reflect growth over the coming year.

Q. PLEASE DISCUSS THE GROWTH RATE COMPONENT OF THE DCF MODEL.

A. There is much debate as to the proper methodology to employ in estimating the growth component of the DCF model. By definition, this component is investors' expectation of the long-term dividend growth rate. Presumably, investors use some combination of historical and/or projected growth rates for earnings and dividends per share and for internal or book value growth to assess long-term potential.

Q. WHAT GROWTH DATA HAVE YOU REVIEWED FOR THE PROXY GROUP?

A. I have analyzed a number of measures of growth for companies in the proxy group. I have reviewed *Value Line's* historical and projected growth rate estimates for earnings per share ("EPS"), dividends per share ("DPS"), and book value per share ("BVPS"). In addition, I have utilized the average EPS growth rate forecasts of Wall Street analysts as provided by Yahoo First Call, Reuters, and Zacks. These services solicit five-year earnings growth rate projections from securities analysts and compile and publish the means and medians of these forecasts. Finally, I have also assessed prospective growth as measured by prospective earnings retention rates and earned returns on common equity.

Q. PLEASE DISCUSS HISTORICAL GROWTH IN EARNINGS AND DIVIDENDS AS WELL AS INTERNAL GROWTH.

A. Historical growth rates for EPS, DPS, and BVPS are readily available to virtually all investors and presumably an important ingredient in forming expectations concerning future growth. However, one must use historical growth numbers as measures of investors' expectations with caution. In some cases, past growth may not reflect future growth potential. Also, employing a single growth rate number (for example, for five or ten years), is unlikely to accurately measure investors' expectations due to the sensitivity of a single growth rate figure to fluctuations in individual firm performance as well as overall economic fluctuations (i.e., business cycles). However, one must appraise the context in which the growth rate is being employed. According to the conventional DCF model, the expected return on a security is equal to the sum of the dividend yield and the expected long-term growth in dividends. Therefore, to best estimate the cost of common equity capital using the conventional DCF model, one must look to long-term growth rate expectations.

Internally generated growth is a function of the percentage of earnings retained within the firm (the earnings retention rate) and the rate of return earned on those earnings (the return on equity). The internal growth rate is computed as the retention rate times the return on equity. Internal growth is significant in determining long-run earnings and therefore, dividends. Investors recognize the importance of internally generated growth and pay premiums for stocks of companies that retain earnings and earn high returns on internal investments.

Q. WHY ARE YOU NOT RELYING EXCLUSIVELY ON THE EPS FORECASTS OF WALL STREET ANALYSTS IN ARRIVING AT A DCF GROWTH RATE FOR THE PROXY GROUP?

A. There are several issues with using the EPS growth rate forecasts of Wall Street analysts as DCF growth rates. First, the appropriate growth rate in the DCF model is the dividend growth rate, not the earnings growth rate. Nonetheless, over the very long-term, dividend and earnings will have to grow at a similar growth rate. Therefore, in my opinion, consideration must be given to other indicators of growth, including prospective dividend growth, internal growth, as well as projected earnings growth. Second, and most significantly, it is well-known that the EPS growth rate forecasts of Wall Street securities analysts are overly optimistic and upwardly biased. Hence, using these growth rates as a DCF growth rate will provide an overstated equity cost rate. This issue is discussed at length in the section of this testimony in which I comment on Dr. Avera's testimony.

Q. PLEASE DISCUSS THE HISTORICAL GROWTH OF THE COMPANIES IN THE ELECTRIC PROXY GROUP AS PROVIDED IN THE *VALUE LINE INVESTMENT SURVEY.*

A. Historic growth rates for the companies in the group, as published in the *Value Line Investment Survey*, are provided on page 3 of Exhibit JRW-10. Due to the presence of outliers among the historic growth rate figures, both the mean

and medians are used in the analysis.[8] The historical growth measures in EPS, DPS, and BVPS for the Electric Proxy Group, as measured by the means and medians, range from 1.5% to 7.4%, with an average of 4.0%.

Q. PLEASE SUMMARIZE *VALUE LINE'S* PROJECTED GROWTH RATES FOR THE COMPANIES IN THE ELECTRIC PROXY GROUP.

A. *Value Line's* projections of EPS, DPS, and BVPS growth for the companies in the proxy group are shown on page 4 of Exhibit JRW-10. As above, due to the presence of outliers, both the mean and medians are used in the analysis. For the Electric Proxy Group, the central tendency measures range from 4.5% to 6.0%, with an average of 5.3%.

Also provided on page 4 of Exhibit JRW-10 is prospective internal growth for the proxy group as measured by *Value Line*'s average projected retention rate and return on shareholders' equity. As noted above, internal growth is significant in a primary driver of long-run earnings growth. For the Electric Proxy Group, the average prospective internal growth rate is 5.6%.

Q. PLEASE ASSESS GROWTH FOR THE PROXY GROUP AS MEASURED BY ANALYSTS' FORECASTS OF EXPECTED 5-YEAR EPS GROWTH.

[8] Outliers are observations that are much larger or smaller than the majority of the observations that are being evaluated.

A. Yahoo First Call, Reuters, and Zacks collect, summarize, and publish Wall Street analysts' five-year EPS growth rate forecasts for the companies in the proxy group. These forecasts are provided for the companies in the proxy group on page 5 of Exhibit JRW-10. The median of the analysts' projected EPS growth rates for the Electric Proxy Group is 6.3%.[9]

Q. PLEASE SUMMARIZE YOUR ANALYSIS OF THE HISTORICAL AND PROSPECTIVE GROWTH OF THE PROXY GROUP.

A. Page 6 of Exhibit JRW-10 shows the summary DCF growth rate indicators for the proxy group. The average of the growth rate indicators is 5.2%. Giving greater weight to the projected growth rate indicators and to prospective internal growth, an expected DCF growth rate in the 5.5% range is reasonable for the Electric Proxy Group.

Q. BASED ON THE ABOVE ANALYSIS, WHAT ARE YOUR INDICATED COMMON EQUITY COST RATES FROM THE DCF MODEL FOR THE GROUP?

A. My DCF-derived equity cost rate for the group is:

$$\text{DCF Equity Cost Rate (k)} = \frac{D}{P} + g$$

[9] Since there is considerable overlap in analyst coverage between the three services, and not all of the companies have forecasts from the different services, I have averaged the expected five-year EPS growth rates from the three services for each company to arrive at an expected EPS growth rate by company.

DCF Equity Cost Rate

	Dividend Yield	½ Growth Adjustment	DCF Growth Rate	Equity Cost Rate
Electric Proxy Group	**4.7%**	**1.0275**	**5.50%**	**10.33%**

These results are summarized on page 1 of Exhibit JRW-10.

C. Capital Asset Pricing Model Results

Q. PLEASE DISCUSS THE CAPITAL ASSET PRICING MODEL ("CAPM").

A. The CAPM is a risk premium approach to gauging a firm's cost of equity capital. According to the risk premium approach, the cost of equity is the sum of the interest rate on a risk-free bond (R_f) and a risk premium (RP), as in the following:

$$k = R_f + RP$$

The yield on long-term Treasury securities is normally used as R_f. Risk premiums are measured in different ways. The CAPM is a theory of the risk and expected returns of common stocks. In the CAPM, two types of risk are associated with a stock: firm-specific risk or unsystematic risk, and market or systematic risk, which is measured by a firm's beta. The only risk that investors receive a return for bearing is systematic risk.

According to the CAPM, the expected return on a company's stock, which is also the equity cost rate (K), is equal to:

$$K = (R_f) + ß * [E(R_m) - (R_f)]$$

Where:

- K represents the estimated rate of return on the stock;
- $E(R_m)$ represents the expected return on the overall stock market. Frequently, the 'market' refers to the S&P 500;
- (R_f) represents the risk-free rate of interest;
- $[E(R_m) - (R_f)]$ represents the expected equity or market risk premium—the excess return that an investor expects to receive above the risk-free rate for investing in risky stocks; and
- *Beta*—(ß) is a measure of the systematic risk of an asset.

To estimate the required return or cost of equity using the CAPM requires three inputs: the risk-free rate of interest (R_f), the beta (ß), and the expected equity or market risk premium $[E(R_m) - (R_f)]$. R_f is the easiest of the inputs to measure – it is the yield on long-term Treasury bonds. ß, the measure of systematic risk, is a little more difficult to measure because there are different opinions about what adjustments, if any, should be made to historical betas due to their tendency to regress to 1.0 over time. And finally, an even more difficult input to measure is the expected equity or market risk premium $(E(R_m) - (R_f))$. I will discuss each of these inputs below.

Q. PLEASE DISCUSS EXHIBIT JRW-11.

A. Exhibit JRW-11 provides the summary results for my CAPM study. Page 1 shows the results, and the following pages contain the supporting data.

Q. PLEASE DISCUSS THE RISK-FREE INTEREST RATE.

A. The yield on long-term U.S. Treasury bonds has usually been viewed as the risk-free rate of interest in the CAPM. The yield on long-term U.S. Treasury bonds, in turn, has been considered to be the yield on U.S. Treasury bonds with 30-year maturities. However, when the Treasury's issuance of 30-year bonds was interrupted for a period of time in recent years, the yield on 10-year U.S. Treasury bonds replaced the yield on 30-year U.S. Treasury bonds as the benchmark long-term Treasury rate. Ten-year Treasury yields began to decline in mid-2007 at the beginning of the financial crisis, and fell below 3.0% as the housing and sub-prime mortgage crises led to an overall credit crisis and economic recession. These rates bottomed out in December of 2008 and have increased since that time as prospects for an economic recovery have increased.

Q. WHAT RISK-FREE INTEREST RATE ARE YOU USING IN YOUR CAPM?

A. The U.S. Treasury began to issue the 30-year bond in the early 2000s as the U.S. budget deficit increased. As such, the market has once again focused on its yield as the benchmark for long-term capital costs in the U.S. As of July 6, 2009, as shown on page 2 of Exhibit JRW-11, the rates on 10- and 30- U.S. Treasury Bonds were 3.55% and 4.38%, respectively. Given this recent trend of increasing 30-year Treasury yields, I believe that a long-term Treasury rate in the 4.50% is reasonable for the near future. I will use this as the risk-free rate, or R_f, in my CAPM.

Q. WHAT BETAS ARE YOU EMPLOYING IN YOUR CAPM?

A. Beta (ß) is a measure of the systematic risk of a stock. The market, usually taken to be the S&P 500, has a beta of 1.0. The beta of a stock with the same price movement as the market also has a beta of 1.0. A stock whose price movement is greater than that of the market, such as a technology stock, is riskier than the market and has a beta greater than 1.0. A stock with below average price movement, such as that of a regulated public utility, is less risky than the market and has a beta less than 1.0. Estimating a stock's beta involves running a linear regression of a stock's return on the market return.

As shown on page 3 of Exhibit JRW-11, the slope of the regression line is the stock's ß. A steeper line indicates the stock is more sensitive to the return on the overall market. This means that the stock has a higher ß and greater than average market risk. A less steep line indicates a lower ß and less market risk.

Numerous online investment information services, such as Yahoo! and Reuters, provide estimates of stock betas. Usually these services report different betas for the same stock. The differences are usually due to: (1) the time period over which the ß is measured; and (2) any adjustments that are made to reflect the fact that betas tend to regress to 1.0 over time. In estimating an equity cost rate for the proxy group, I am using the betas for the companies as provided in the *Value Line Investment Survey*. As shown on

page 3 of Exhibit JRW-11, the average beta for the companies in Electric Proxy Group is 0.70.

Q. PLEASE DISCUSS THE ALTERNATIVE VIEWS REGARDING THE EQUITY RISK PREMIUM.

A. The equity or market risk premium - $(E(R_m) - R_f)$ - is equal to the expected return on the stock market (e.g., the expected return on the S&P 500 ($E(R_m)$) minus the risk-free rate of interest (R_f). The equity premium is the difference in the expected total return between investing in equities and investing in "safe" fixed-income assets, such as long-term government bonds. However, while the equity risk premium is easy to define conceptually, it is difficult to measure because it requires an estimate of the expected return on the market.

Q. PLEASE DISCUSS THE ALTERNATIVE APPROACHES TO ESTIMATING THE EQUITY RISK PREMIUM.

A. Page 4 of Exhibit JRW-11 highlights the primary approaches to, and issues in, estimating the expected equity risk premium. The traditional way to measure the equity risk premium was to use the difference between historical average stock and bond returns. In this case, historical stock and bond returns, also called ex post returns, were used as the measures of the market's expected return (known as the ex ante or forward-looking expected return). This type of historical evaluation of stock and bond returns is often called the "Ibbotson approach" after Professor Roger Ibbotson who popularized this method of using historical financial market returns as measures of expected returns.

Most historical assessments of the equity risk premium suggest an equity risk premium of 5-7 percent above the rate on long-term U.S. Treasury bonds. However, this can be a problem because: (1) ex post returns are not the same as ex ante expectations, (2) market risk premiums can change over time, increasing when investors become more risk-averse and decreasing when investors become less risk-averse, and (3) market conditions can change such that ex post historical returns are poor estimates of ex ante expectations.

The use of historical returns as market expectations has been criticized in numerous academic studies.[10] The general theme of these studies is that the large equity risk premium discovered in historical stock and bond returns cannot be justified by the fundamental data. These studies, which fall under the category "Ex Ante Models and Market Data," compute ex ante expected returns using market data to arrive at an expected equity risk premium. These studies have also been called "Puzzle Research" after the famous study by Mehra and Prescott in which the authors first questioned the magnitude of historical equity risk premiums relative to fundamentals.[11]

Q. PLEASE PROVIDE A SUMMARY OF THE EQUITY RISK PREMIUM STUDIES.

A. Derrig and Orr (2003), Fernandez (2007), and Song (2007) have completed the most comprehensive reviews to date of the research on the equity risk

[10] The problems with using ex post historical returns as measures of ex ante expectations will be discussed at length later in my testimony.

[11] R. Mehra and Edward Prescott, "The Equity Premium: A Puzzle," *Journal of Monetary Economics* (1985).

premium.[12] Derrig and Orr's study evaluated the various approaches to estimating equity risk premiums as well as the issues with the alternative approaches and summarized the findings of the published research on the equity risk premium. Fernandez examined four alternative measures of the equity risk premium – historical, expected, required, and implied. He also reviewed the major studies of the equity risk premium and presented the summary equity risk premium results. Song provides an annotated bibliography and highlights the alternative approaches to estimating the equity risk summary.

Page 5 of Exhibit JRW-11 provides a summary of the results of the primary risk premium studies reviewed by Derrig and Orr, Fernandez, and Song. In developing page 5 of Exhibit JRW-11, I have categorized the studies as discussed on page 4 of Exhibit JRW-11. I have also included the results of the "Building Blocks" approach to estimating the equity risk premium, including a study I performed, which is presented below. The Building Blocks approach is a hybrid approach employing elements of both historic and ex ante models.

Q. PLEASE DISCUSS YOUR DEVELOPMENT OF AN EQUITY RISK PREMIUM COMPUTED USING THE BUILDING BLOCKS METHODOLOGY.

[12] Richard Derrig and Elisha Orr, "Equity Risk Premium: Expectations Great and Small," Working Paper (version 3.0), Automobile Insurers Bureau of Massachusetts, (August 28, 2003), Pablo Fernandez, "Equity Premium: Historical, Expected, Required, and Implied," IESE Business School Working Paper, (2007), and Zhiyi Song, "The Equity Risk Premium: An Annotated Bibliography," CFA Institute, (2007).

A. Ibbotson and Chen (2003) evaluate the ex post historical mean stock and bond returns in what is called the Building Blocks approach.[13] They use 75 years of data and relate the compounded historical returns to the different fundamental variables employed by different researchers in building ex ante expected equity risk premiums. Among the variables included were inflation, real EPS and DPS growth, ROE and book value growth, and price-earnings ("P/E") ratios. By relating the fundamental factors to the ex post historical returns, the methodology bridges the gap between the ex post and ex ante equity risk premiums. Ilmanen (2003) illustrates this approach using the geometric returns and five fundamental variables – inflation ("CPI"), dividend yield ("D/P"), real earnings growth ("RG"), repricing gains ("PEGAIN") and return interaction/reinvestment ("INT").[14] This is shown on page 7 of Exhibit JRW-11. The first column breaks the 1926-2000 geometric mean stock return of 10.7% into the different return components demanded by investors: the historical U.S. Treasury bond return (5.2%), the excess equity return (5.2%), and a small interaction term (0.3%). This 10.7% annual stock return over the 1926-2000 period can then be broken down into the following fundamental elements: inflation (3.1%), dividend yield (4.3%), real earnings growth (1.8%), repricing gains (1.3%) associated with higher P/E ratios, and a small interaction term (0.2%).

[13] Roger Ibbotson and Peng Chen, "Long Run Returns: Participating in the Real Economy," *Financial Analysts Journal*, (January 2003).

[14] Antti Ilmanen, Expected Returns on Stocks and Bonds," *Journal of Portfolio Management*, (Winter 2003), p. 11.

Q. HOW ARE YOU USING THIS METHODOLOGY TO DERIVE AN EX ANTE EXPECTED EQUITY RISK PREMIUM?

A. The third column in the graph on page 7 of Exhibit JRW-11 shows current inputs to estimate an ex ante expected market return. These inputs include the following:

CPI – To assess expected inflation, I have employed expectations of the short-term and long-term inflation rate. Long term inflation forecasts are available in the Federal Reserve Bank of Philadelphia's publication entitled *Survey of Professional Forecasters*.[15] This survey of professional economists has been published for almost 50 years. While this survey is published quarterly, only the first quarter survey includes long-term forecasts of gross domestic product ("GDP") growth, inflation, and market returns. In the first quarter 2009 survey, published on February 13, 2009, the median long-term (10-year) expected inflation rate as measured by the CPI was 2.4% (see page 8 of Exhibit JRW-11).

The University of Michigan's Survey Research Center surveys consumers on their short-term (one-year) inflation expectations on a monthly basis. As shown on page 9 of Exhibit JRW-11, the current short-term expected inflation rate is 2.8%.

[15]Federal Reserve Bank of Philadelphia, *Survey of Professional Forecasters,* (February 13, 2009). The *Survey of Professional Forecasters* was formerly conducted by the American Statistical Association ("ASA") and the National Bureau of Economic Research ("NBER") and was known as the ASA/NBER survey. The survey, which began in 1968, is conducted each quarter. The Federal Reserve Bank of Philadelphia, in cooperation with the NBER, assumed responsibility for the survey in June 1990.

As a measure of expected inflation, I will use the average of the long-term (2.4%) and short-term (2.8%) inflation rate measures, or 2.6%.

D/P – As shown on page 10 of Exhibit JRW-11, the dividend yield on the S&P 500 has decreased gradually over the past decade. Today, it is below its average of 4.3% over the 1926-2000 time period. The S&P dividend yield bottomed out at less than 1.4% in 2000. Currently, as shown on page 10 of Exhibit JRW-11, the S&P 500 dividend yield is 2.5%. I will use this figure in my ex ante risk premium analysis.

RG – To measure expected real growth in earnings, I use the historical real earnings growth rate for the S&P 500 and the expected real GDP growth. The S&P 500 was created in 1960. It includes 500 companies which come from ten different sectors of the economy. On page 11 of Exhibit JRW-11, real EPS growth is computed using the CPI as a measure of inflation. The real growth figure over 1960-2008 period for the S&P 500 is 2.3%.

The second input for expected real earnings growth is expected real GDP growth. The rationale is that over the long-term, corporate profits have averaged a relatively consistent 5.50% of U.S. GDP.[16] Real GDP growth, according to McKinsey, has averaged 3.5% over the past 80 years. Expected GDP growth, according to the Federal Reserve Bank of Philadelphia's *Survey of Professional Forecasters,* is 2.6% (see page 8 of Exhibit JRW-11).

[16]Marc. H. Goedhart, et al, "The Real Cost of Equity," *McKinsey on Finance* (Autumn 2002), p.14.

Given these results, I will use 2.50%, for real earnings growth.

PEGAIN – PEGAIN is the repricing gain associated with an increase in the P/E ratio. It accounted for 1.3% of the 10.7% annual stock return in the 1926-2000 period. In estimating an ex ante expected stock market return, one issue is whether investors expect P/E ratios to increase from their current levels. The P/E ratios for the S&P 500 over the past 25 years are shown on page 10 of Exhibit JRW-11. The run-up and eventual peak in P/Es in the year 2000 is very evident in the chart. The average P/E declined until late 2006, and then increased, primarily due to the decline in EPS as a result of the financial crisis and the recession. As shown on page 10 of Exhibit JRW-11, the average P/E for the S&P 500 as of May 31, 2009 was 127.48.

Given the current economic and capital markets environment, I do not believe that investors expect even higher P/E ratios. Therefore, a PEGAIN would not be appropriate in estimating an ex ante expected stock market return. The current P/E for the S&P 500 is well above the average historical S&P 500 P/E ratio of approximately 16.0. Hence, investors are not likely to expect to get stock market gains from lower interest rates and higher P/E ratios.

Q. GIVEN THIS DISCUSSION, WHAT IS YOUR EX ANTE EXPECTED MARKET RETURN AND EQUITY RISK PREMIUM USING THE "BUILDING BLOCKS METHODOLOGY"?

A. My expected market return is represented by the last column on the right in the graph entitled "Decomposing Equity Market Returns: The Building Blocks Methodology" set forth on page 7 of Exhibit JRW-11. As shown, my expected market return of 7.60% is composed of 2.60% expected inflation, 2.50% dividend yield, and 2.50% real earnings growth rate.

Q. GIVEN THAT THE HISTORICAL COMPOUNDED ANNUAL MARKET RETURN IS IN EXCESS OF 10%, WHY DO YOU BELIEVE THAT YOUR EXPECTED MARKET RETURN OF 7.60% IS REASONABLE?

A. As discussed above, in the development of the expected market return, stock prices are still high at the present time in relation to earnings and dividends, and interest rates are relatively low. Hence, it is unlikely that investors are going to experience high stock market returns due to higher P/E ratios and/or lower interest rates. In addition, as shown in the decomposition of equity market returns, whereas the dividend portion of the return was historically 4.3%, the current dividend yield is only 2.5%. Due to these reasons, lower market returns are expected for the future.

Q. IS YOUR EXPECTED MARKET RETURN OF 7.60% CONSISTENT WITH THE FORECASTS OF MARKET PROFESSIONALS?

A. Yes. In the first quarter 2009 *Survey of Financial Forecasters*, published on February 13, 2009 by the Federal Reserve Bank of Philadelphia, the mean

long-term expected return on the S&P 500 was 6.62% (see page 8 of Exhibit JRW-11).

Q. IS YOUR EXPECTED MARKET RETURN CONSISTENT WITH THE EXPECTED MARKET RETURNS OF CORPORATE CHIEF FINANCIAL OFFICERS (CFOs)?

A. Yes. John Graham and Campbell Harvey of Duke University conduct a quarterly survey of corporate CFOs. The survey is a joint project of Duke University and *CFO Magazine*. In the June 2009 survey, the mean expected return on the S&P 500 over the next ten years was 7.31%.[17]

Q. GIVEN THIS EXPECTED MARKET RETURN, WHAT IS YOUR EX ANTE EQUITY RISK PREMIUM USING THE BUILDING BLOCKS METHODOLOGY?

A. As shown on page 2 of Exhibit JRW-11, the current 30-year U.S. Treasury yield is 4.38%. My ex ante equity risk premium is simply the expected market return from the Building Blocks methodology minus this risk-free rate:

Ex Ante Equity Risk Premium = 7.60% - 4.38% = 3.22%

Q. GIVEN THIS DISCUSSION, HOW ARE YOU MEASURING AN EXPECTED EQUITY RISK PREMIUM IN THIS PROCEEDING?

[17] The survey results are available at www.cfosurvey.org.

A. As discussed above, page 5 of Exhibit JRW-11 provides a summary of the results of the equity risk premium studies that I have reviewed. These include the results of: (1) the various studies of the historical risk premium, (2) ex ante equity risk premium studies, (3) equity risk premium surveys of CFOs, Financial Forecasters, and academics, and (4) the Building Block approaches to the equity risk premium. There are results reported for over thirty studies, and the average equity risk premium is 4.36%.

Q. SOME OF THE EQUITY RISK PREMIUM STUDIES THAT YOU USE IN YOUR EQUITY RISK PREMIUM STUDY DATE BACK INTO THE EARLY 2000S. *IF YOU ELIMINATE THE OLDER STUDIES,* HOW DOES THAT AFFECT YOUR EQUITY RISK PREMIUM?

A. In developing my equity risk premium study, I have used all equity risk premium studies and surveys I could identify that were published over the past decade and that provided an equity risk premium estimate. Since some of these studies were published in the early 2000s at the market peak, one could argue that these results are not as relevant today. However, I must add that most of these studies used data over long periods of time (as long as fifty years of data) and so they were not estimating an equity risk premium as of a point in time (e.g., the year 2001). Nonetheless, to assess as to whether the studies published in the early 2000s significantly affect my equity risk premium results, on page 6 of Exhibit JRW-11 I have reconstructed page 5 of Exhibit JRW-11, but I have eliminated all studies published before 2005.

The average for this subset of studies is 4.35%. Therefore, eliminating the earlier studies does not have a significant impact on my equity risk premium estimate.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EQUITY RISK PREMIUMS USED BY CFOS?

A. Yes. In the previously referenced June 2009 CFO survey conducted by *CFO Magazine* and Duke University, the expected 10-year equity risk premium was 4.11%.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EX ANTE EQUITY RISK PREMIUMS OF PROFESSIONAL FORECASTERS?

A. Yes. The financial forecasters in the previously referenced Federal Reserve Bank of Philadelphia survey project both stock and bond returns. As shown on page 8 of Exhibit JRW-11, the mean long-term expected stock and bond returns were 6.62% and 4.68%, respectively. This provides an ex ante equity risk premium of 1.94%.

Q. IS YOUR EX ANTE EQUITY RISK PREMIUM CONSISTENT WITH THE EQUITY RISK PREMIUMS USED BY THE LEADING CONSULTING FIRMS?

A. Yes. McKinsey & Co. is widely recognized as the leading management consulting firm in the world. It published a study entitled "The Real Cost of

Equity" in which the McKinsey authors developed an ex ante equity risk premium for the U.S. In reference to the decline in the equity risk premium, as well as what is the appropriate equity risk premium to employ for corporate valuation purposes, the McKinsey authors concluded the following:

> We attribute this decline not to equities becoming less risky (the inflation-adjusted cost of equity has not changed) but to investors demanding higher returns in real terms on government bonds after the inflation shocks of the late 1970s and early 1980s. We believe that using an equity risk premium of 3.5 to 4 percent in the current environment better reflects the true long-term opportunity cost of equity capital and hence will yield more accurate valuations for companies.[18]

Q. HAS MCKINSEY RECENTLY REAFFIRMED ITS OPINION ON THE EQUITY RISK PREMIUM IN LIGHT OF THE FINANCIAL TURMOIL OF THE LAST TWO YEARS?

A. Yes. As previously discussed, McKinsey has recently published a study in which they reaffirm their estimate of the equity risk premium in light of the financial turmoil of the past two years.[19]

Q. WHAT EQUITY COST RATES ARE INDICATED BY YOUR CAPM ANALYSIS?

A. The results of my CAPM study for the proxy group are provided below.

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[18] Marc H. Goedhart, et al, "The Real Cost of Equity," *McKinsey on Finance* (Autumn 2002), p. 15.

[19] Richard Dobbs, Bin Jang, and Timothy Koeller, "Why the Crisis Hasn't Shaken the Cost of Capital," *McKinsey Quarterly* (December 2008), p. 1-6.

$$K = (R_f) + \beta * [E(R_m) - (R_f)]$$

	Risk-Free Rate	Beta	Equity Risk Premium	Equity Cost Rate
Electric Proxy Group	~~4.75%~~ 4.60%	0.70	4.36%	7.6%

These results are summarized on page 1 of Exhibit JRW-11.

D. Equity Cost Rate Summary

Q. PLEASE SUMMARIZE YOUR EQUITY COST RATE STUDY.

A. The results for my DCF and CAPM analyses for the proxy group of electric utility companies are indicated below:

	DCF	CAPM
Electric Proxy Group	10.3%	7.6%

Q. GIVEN THESE RESULTS, WHAT IS YOUR ESTIMATED EQUITY COST RATE FOR THE GROUP?

A. Given these results, I conclude that the appropriate equity cost rate for Electric Proxy Group in the 7.6%-10.3% range. The midpoint of this range is 9.0%. In my opinion, this wide range reflects the uncertainty and volatility in today's capital markets. In recognition of this uncertainty and volatility, I believe that an equity cost rate in the upper end of this range is appropriate at this time. Therefore, in my opinion, the relevant range is 9.50% to 10.25%. Within this range, and recognizing the relative low financial risk of FP&L, I believe that an equity cost rate of 9.50% is an appropriate equity cost rate for FP&L.

VI. CRITIQUE OF FP&L'S RATE OF RETURN TESTIMONY

Q. PLEASE EVALUATE THE COMPANY'S RATE OF RETURN POSITION.

A. The Company's proposed rate of return is inflated due to an inappropriate capital structure and overstated debt and equity cost rates. The debt cost rate was previously discussed. I will now discuss the errors in the proposed capital structure and with Dr. Avera's equity cost rate analysis.

A. Capital Structure

Q. WHAT IS THE COMPANY'S PROPOSED CAPITAL STRUCTURE?

A. The Company's claimed recommended capital structure, based on investor provided capital, includes 1.10% short-term debt, 43.11% long-term debt, and a 55.76% common equity. However, this capital structure includes $950 million in imputed debt. This is not actual debt, and its does not appear on the Company's financial statements provided by the Company to investors. FP&L's recommended capital structure, based on investor provided capital and without the imputed debt, actually consists of 1.18% short-term debt, 39.20% long-term debt, a 59.62% common equity.

Q. WHY IS THE COMPANY'S PROPOSED CAPITAL STRUCTURE NOT APPROPRIATE FOR FP&L FOR RATEMAKING PURPOSES?

A. This capital structure is not appropriate for ratemaking purposes for FP&L for several reasons: (1) the capital structure includes an actual common equity

ratio (59.62%) which is much higher than the common equity ratios of electric utility companies; (2) the company has included imputed debt in its adjusted capital structure to make it appear that it is requesting a capital structure with a common equity ratio of 55.76%; and (3) the Company's recommended capital structure includes more common equity than is projected for the Company.

Q. PLEASE HIGHLIGHT THE DIFFERENCE IN THE CAPITAL STRUCTURES OF FP&L AND ITS PARENT COMPANY, FPL GROUP.

A. Panels C and D of Exhibit JRW-5 shows the average capitalization ratios for FP&L and FPL Group, respectively over the past five years. These ratios highlight the fact that FPL Group employs much more debt and much less equity than FP&L. Hence, FPL Group has a much higher degree of financial risk than FP&L.

Q. PLEASE DISCUSS THE CAPITAL STRUCTURE RATIOS OF YOUR ELECTRIC PROXY GROUP.

A. The average capitalization ratios for my Electric Proxy Group are 8.50% short-term debt, 50.59% long-term debt, 0.88% preferred stock, and a 40.03% common equity. These ratios indicate that FP&L has a much higher common equity ratio than other electric utilities as indicated by the Electric Proxy Group.

Q. ARE THE CAPITAL STRUCTURE RATIOS OF DR. AVERA'S PROXY GROUP SIMILAR TO THOSE OF FP&L?

A. No. As discussed below, the average common equity ratio for the Dr. Avera's proxy group is ten percentage points below FP&L's 2008 year-end common equity ratio (47% vs. 57%).

Q. PLEASE SUMMARIZE YOUR ISSUES WITH THE CAPITAL STRUCTURE RECOMMENDED BY FP&L.

A. First, FP&L's proposed capital structure ratios do not reflect the actual capitalization of FP&L or FPL Group. Second. FP&L's proposed capital structure ratios do not reflect the capitalization of electric utility companies. Third, FP&L's proposed capital structure is not based on the company book figures but reflects a number of adjustments, most notably imputed debt.

Q. PLEASE REVIEW THE COMPANY'S ADJUSTED CAPITAL STRUCTURE THAT INCLUDES IMPUTED DEBT.

A. To make the Company's recommended capital structure appear more reasonable, FP&L has imputed $950 million in debt and included it in its "adjusted capital structure." This is shown in Exhibit AP-7, page 1. Mr. Pimentel has increased FP&L's debt by $950 million to account for the Company's Purchased Power Agreements ("PPAs"). The $950 million is computed by multiplying a risk factor of 25% to the present value of the Company's capacity contracts. In computing credit rating metrics, S&P applies such a risk factor ranging from 0% to 100% which is intended to reflect the risk of recovery of the PPA payments.

However, S&P does not indicate how the risk factor that ranges from 0% to 100% is determined. Given a recovery mechanism for PPA payments, the financial condition of an electric utility company is not impaired by entering into these contracts. Hence, providing incremental revenues through a higher equity ratio and a higher overall rate of return is unnecessary and would result in an unwarranted revenue benefit to the utility. I have identified several flaws in the adjustment.

Risk Factor

Given the methodology for imputing debt from PPAs, the risk factor is extremely important. FP&L has presumed that a risk factor of 25% is appropriate for the Company. However, S&P does not indicate how the risk factor that ranges from 0% to 100% is determined. Hence, the S&P risk factor for imputing debt is not well defined and cannot be assessed in this situation. Given the Commission's support for the collection of long-term contractual payments, the risk of non-recovery appears to be extremely low (perhaps even zero percent). Hence, a risk factor as high as 25% seems out of line. But, given the lack of guidance from S&P, it is impossible to properly assess the risk factor in this situation.

In addition, as opposed to S&P, Moody's appears to recognize some of the benefits of PPAs and looks at them in a more positive manner. For example, Moody's states:[20]

[20] Moody's Rating Methodology: Global Regulated Electric Utilities, March 2005, page 10.

> "If a utility enters into a PPA for the purpose of providing an assured supply and there is reasonable assurance that regulators will allow the costs to be recovered in regulated rates, Moody's may view the PPA as being most akin to an operating cost. In this circumstance, there most likely will be no imputed adjustment to the obligations of the utility."

In other words, under this scenario Moody's would rate the risk factor at 0% and there would be no imputed debt.

S&P Adjustments are Not GAAP Accounting

Even if debt were imputed by S&P from a PPA (assuming a risk factor greater than 0%), no changes would be made to the company's GAAP financial statements. Hence, investors would not see the impact of S&P's adjustment. In addition, the Company does not incur a liability on its GAAP-based financial statements for the PPAs. Furthermore, given a regulatory-mandated recovery method for the payments, investors should be indifferent to a utility entering into a PPA.

From a Regulatory Perspective, PPA Payments are Unlike Debt

In a regulatory setting, a utility is given the 'opportunity to earn' its cost of debt as well as its overall cost of capital through the ratemaking process. Given the many uncertainties associated with revenues and expenses between rate cases, there is no guarantee that the overall cost of debt can be earned. However, with long-term PPAs, the timely and certain recovery of fixed payments is assured. That is, PPA costs do not feature the uncertainty associated with the 'opportunity

to earn' as do debt payments. In sum, given S&P's lack of guidance on the risk factor, the Commission's support for the collection of payments for PPAs, the notion that these are not GAAP adjustments that are not recorded as liabilities on the books of the company, and the fact that, from a regulatory perspective, PPA payments are unlike debt, the PPA adjustment to the Company's capital structure is inappropriate.

B. Equity Cost Rate

Q. PLEASE REVIEW DR. AVERA'S EQUITY COST RATE APPROACHES.

A. Dr. Avera uses a proxy group of electric companies as well as a proxy group of non-utility companies and employs DCF, CAPM, and Expected Earnings equity cost rate approaches.

Q. PLEASE SUMMARIZE DR. AVERA'S EQUITY COST RATE RESULTS.

A. Dr. Avera's equity cost rate estimates for FP&L are summarized in Panel A of Exhibit JRW-12. Based on these figures, he concludes that the appropriate equity cost rate for the Company is in the range of 12.0% to 13.0%%.

Q. PLEASE DISCUSS YOUR ISSUES WITH DR. AVERA'S RECOMMENDED EQUITY COST RATE.

A. Dr. Avera's proposed return on common equity is too high primarily due to: (a) some of the companies in his utility proxy group, as well as his use of a non-utility proxy group; (b) an excessive adjustment to the dividend yield and an inflated growth rate in his DCF approach; (c) overstated equity risk premium estimates in his CAPM approach; (d) an ROE adjustment for flotation costs; and (e) a flawed Expected Earnings approach.

Proxy Groups

Q. PLEASE DISCUSS THE PROBLEM WITH DR. AVERA'S UTILITY PROXY GROUP.

A. Dr. Avera's utility proxy group includes a number of companies that are not appropriate because their operating revenues are from sources other than regulated electric utility services. Page 1 of Exhibit JRW-13 provides summary financial and capitalization statistics for Dr. Avera's utility proxy group. The average percentage of revenues from regulated electric utility service is only 62%. In addition, several companies are outliers on this issue. These companies, and their percentages of regulated electric revenues, include: Integrys– 10%, MDU Resources – 4%, and Vectren – 22%. In addition, the average bond rating indicates that the group has more risk than FP&L. The average Moody's bond rating is A2, while FP&L's bond rating is A1. However, the big issue is the common equity ratio. The average common equity ratio for the group is 47%, a full ten percentage points below FP&L's 57% common equity ratio.

Q. PLEASE DISCUSS THE PROBLEM WITH DR. AVERA'S NON-UTILITY PROXY GROUP.

A. Dr. Avera has estimated an equity cost rate for FP&L using a proxy group of 66 non-utility companies. These companies are listed in Exhibit WEA-9. This group includes such companies as Abbott Labs, Coca-Cola, General Mills, Hewlett Packard, IBM, Johnson & Johnson, McDonald's, Medtronic, Microsoft, and NIKE. While many of these companies are large and successful, their lines of business are vastly different from the electric utility business and they do not operate in a highly regulated environment. As such, the non-utility group is not an appropriate proxy for FP&L, and therefore the equity cost rate results for this group should be ignored.

DCF Approach

Q. PLEASE SUMMARIZE DR. AVERA'S DCF ESTIMATES.

A. On pages 42-56 of his testimony and in Exhibits WEA-7 – WEA-10, Dr. Avera develops an equity cost rate by applying a DCF model to his utility and non-utility proxy groups. In the traditional DCF approach, the equity cost rate is the sum of the dividend yield and expected growth. For the DCF growth rate, Dr. Avera uses four measures of projected EPS growth – the projected EPS growth of Wall Street analysts as compiled by Thompson and Zack's, *Value Line* projected EPS growth, and the sum of internal ("br") and external ("sv") growth. Dr. Avera's DCF results are summarized in Panel B of Exhibit JRW-12. The

range of DCF results for his utility proxy group is 10.6%-11.5% and for his non-utility proxy group is 12.9%-13.4%.

Q. PLEASE EXPRESS YOUR CONCERNS WITH DR. AVERA'S DCF STUDY.

A. I have several issues with Dr. Avera's DCF equity cost rate. These are the utility and non-utility proxy groups, and the DCF growth rate measures. The errors in the proxy groups were discussed above. The DCF growth rate measures are reviewed below.

Q. PLEASE CRITIQUE DR. AVERA'S DCF GROWTH RATE MEASURES.

A. Dr. Avera employs four different DCF growth rate measures - the projected EPS growth of Wall Street analysts as compiled by IBES, First Call, and Zack's in addition to *Value Line* projected EPS growth, and a sustainable growth rate as measured by the sum of internal ("br") and external ("sv") growth.

Q. PLEASE INITIALLY DISCUSS DR. AVERA'S EXCLUSIVE RELIANCE ON THE PROJECTED EPS GROWTH RATES OF WALL STREET ANALYSTS AND *VALUE LINE.*

A. It seems highly unlikely that investors today would rely exclusively on the forecasts of securities analysts and ignore historical growth in arriving at expected growth. It is well known in the academic world that the EPS forecasts of securities analysts are overly optimistic and biased upwards. In

addition, as I show below, *Value Line*'s EPS forecasts are excessive and unrealistic.

Q. PLEASE REVIEW THE BIAS IN ANALYSTS' GROWTH RATE FORECASTS.

A. Analysts' growth rate forecasts are collected and published by Zacks, First Call, IBES, and Reuters. These services retrieve and compile EPS forecasts from Wall Street analysts. These analysts come from both the sell side (Merrill Lynch, Paine Webber) and the buy side (Prudential Insurance, Fidelity).

The problem with using these forecasts to estimate a DCF growth rate is that the objectivity of Wall Street research has been challenged, and many have argued that analysts' EPS forecasts are overly optimistic and biased upwards. To evaluate the accuracy of analysts' EPS forecasts, I have compared actual 3-5 year EPS growth rates with forecasted EPS growth rates on a quarterly basis over the past 20 years for all companies covered by the I/B/E/S data base. In Panel A of page 1 of Exhibit JRW-14, I show the average analysts' forecasted 3-5 year EPS growth rate with the average actual 3-5 year EPS growth rate. Because of the necessary 3-5 year follow-up period to measure actual growth, the analysis in this graph only: (1) covers forecasted and actual EPS growth rates through 1999 and (2) includes only companies that have 3-5 years of actual EPS data following the forecast period.

The following example shows how the results can be interpreted. For the 3-5-year period prior to the first quarter of 1999, analysts had projected an

EPS growth rate of 15.13%, but companies only generated an average annual EPS growth rate over the 3-5 years of 9.37%. This projected EPS growth rate figure represented the average projected growth rate for over 1,510 companies, with an average of 4.88 analysts' forecasts per company. For the entire twenty-year period of the study, for each quarter there were on average 5.60 analysts' EPS projections for 1,281 companies. Overall, my findings indicate that forecast errors for long-term estimates are predominantly positive, which indicates an upward bias in growth rate estimates. The mean and median forecast errors over the observation period are 143.06% and 75.08%, respectively. The forecast errors are negative for only eleven of the eighty quarterly time periods: five consecutive quarters starting at the end of 1995 and six consecutive quarters starting in 2006. As shown in the figure below, the quarters with negative forecast errors were for the 3-5 year periods following earnings declines associated with the 1991 and 2001 economic recessions in the U.S. Overall, there is evidence of a persistent upward bias in long-term EPS growth forecasts.

The post-1999 period has seen the boom and then the bust in the stock market, an economic recession, 9/11, and the Iraq war. Furthermore, and highly significant in the context of this study, we have also had the New York State investigation of Wall Street firms and the subsequent Global Securities Settlement in which nine major brokerage firms paid a fine of $1.5B for their biased investment research.

To evaluate the impact of these events on analysts' forecasts, the graph

below provides the average 3-5-year EPS growth rate projections for all companies provided in the I/B/E/S database on a quarterly basis from 1988 to 2007. In Panel B of page 1 of Exhibit JRW-14, no comparison is made to actual EPS growth rates. Hence, these results are for a larger sample of firms since companies do not drop out from the database due to mergers, acquisitions, bankruptcies, and the like. Analysts' forecasts for EPS growth were higher for this larger sample of firms, with a more pronounced run-up and then decline around the stock market peak in 2000. The average projected growth rate hovered in the 14.5%-17.5% range until 1995 and then increased dramatically over the next five years to 23.3% in the fourth quarter of the year 2000. Forecasted EPS growth has since declined to the 15.0% range.

Q. WHAT IMPACT HAVE NEW STOCK MARKET AND REGULATORY DEVELOPMENTS HAD ON ANALYSTS' EPS GROWTH RATE FORECASTS?

A. Analysts' EPS growth rate forecasts have subsided somewhat since the stock market peak of 2000. In addition, the apparent conflict of interest within investment firms with investment banking and analysts operations was addressed in the Global Analysts Research Settlements ("GARS"). GARS, as agreed upon on April 23, 2003 between the SEC, NASD, NYSE and ten of the largest U.S. investment firms, includes a number of regulations that were introduced to prevent investment bankers from pressuring analysts to provide favorable projections. Nonetheless, despite the new regulations, analysts'

EPS growth rate forecasts have not significantly changed and continue to be overly-optimistic. Analysts' long-term EPS growth rate forecasts before and after the GARS, are about two times the level of historic GDP growth. Furthermore, as discussed later in my testimony, historic growth in GDP and corporate earnings has been in the 7% range.

Finally, these observations are supported by a *Wall Street Journal* article entitled "Analysts Still Coming Up Rosy – Over-Optimism on Growth Rates is Rampant – and the Estimates Help to Buoy the Market's Valuation." The following quote provides insight into the continuing bias in analysts' forecasts:

> Hope springs eternal, says Mark Donovan, who manages Boston Partners Large Cap Value Fund. "You would have thought that, given what happened in the last three years, people would have given up the ghost. But in large measure they have not."
>
> These overly optimistic growth estimates also show that, even with all the regulatory focus on too-bullish analysts allegedly influenced by their firms' investment-banking relationships, a lot of things haven't changed: Research remains rosy and many believe it always will.[21]

Q. IS THE BIAS IN ANALYSTS' GROWTH RATE FORECASTS GENERALLY KNOWN IN THE MARKETS?

[21] Ken Brown, "Analysts Still Coming Up Rosy – Over-Optimism on Growth Rates is Rampant – and the Estimates Help to Buoy the Market's Valuation." *Wall Street Journal*, (January 27, 2003), p. C1.

A. Yes. Page 2 of Exhibit JRW-14 provides a recent article published in the *Wall Street Journal* that discusses the upward bias in analysts' EPS growth rate forecasts.

Q. ARE ANALYSTS' EPS GROWTH RATE FORECASTS LIKEWISE UPWARDLY BIASED FOR ELECTRIC UTILITY COMPANIES?

A. Yes. To evaluate whether analysts' EPS growth rate forecasts are upwardly biased for electric utility companies, I conducted a study similar to the one described above using a group of electric utility companies. The results are shown on page 3 of Exhibit JRW-14. The projected EPS growth rates have declined from about six percent in the 1990s to about five percent in the 2000s. As shown, the achieved EPS growth rates have been volatile. Overall, the upward bias in EPS growth rate projections is not as pronounced for electric utility companies it is for all companies. Over the entire period, the average quarterly 3-5 year projected and actual EPS growth rates are 4.59% and 2.90%, respectively. These results are consistent with the results for companies in general -- analysts' projected EPS growth rate forecasts are upwardly-biased for utility companies.

Q. ARE *VALUE LINE*'S GROWTH RATE FORECASTS SIMILARILY UPWARDLY BIASED?

A. Yes. *Value Line* has a decidedly positive bias to its earnings growth rate forecasts as well. To assess *Value Line*'s earnings growth rate forecasts, I used

the *Value Line Investment Analyzer*. The results are summarized on page 4 of Exhibit JRW-14. I initially filtered the database and found that *Value Line* has 3-5 year EPS growth rate forecasts for 2,619 firms. As shown in Panel A, The average projected EPS growth rate was 13.28%. This is high given that the average historical EPS growth rate in the U.S. is about 7%. A major factor seems to be that *Value Line* only predicts negative EPS growth for 123 companies. This is less than five percent of the companies covered by *Value Line*. Given the ups and downs of corporate earnings, this is unreasonable.

To put this figure in perspective, I screened the *Value Line* companies to see what percent of companies covered by *Value Line* had experienced negative EPS growth rates over the past five years. As shown in Panel B, *Value Line* reported a five-year historic growth rate for 2,281companies and the average 5-year historic growth rate was 14.12%. *Value Line* reported negative historic growth for 421 firms, which represent 18.46% of these companies.

These results indicate that *Value Line*'s EPS forecasts are excessive and unrealistic. It appears that the analysts at *Value Line* are similar to their Wall Street brethren in that they are reluctant to forecast negative earnings growth.

Q. PLEASE DISCUSS THE ISSUE INVOLVING DR. AVERA'S SUSTAINABLE GROWTH ANALYSIS.

A. Dr. Avera's sustainable growth rate analysis, as found in Exhibit WEA-7 for the utility proxy group, indicates an average growth rate for the group of 5.7% (column F of WEA-3). The primary error with his approach is that his

sustainable growth rate figure of 5.7% is higher than the average *Value Line*'s projected BVPS growth rate, which is only 4.9% (see page 5 of Exhibit JRW-14). This suggests that his methodology is flawed, in that it produces higher sustainable growth rates (using *Value Line* data) than the sustainable growth that *Value Line* actually is forecasting.

Q. PLEASE SUMMARIZE YOUR ASSESSMENT OF DR. AVERA'S DCF GROWTH RATE.

A. Dr. Avera's DCF equity cost rate is overstated because he has relied so heavily on the upwardly biased EPS growth rate forecasts of Wall Street analysts and *Value Line*. In addition, his sustainable growth rate methodology is flawed, since it produces higher sustainable growth rates (using *Value Line* data) than the sustainable growth that *Value Line* actually is forecasting.

CAPM Analysis

Q. PLEASE DISCUSS DR. AVERA'S CAPM.

A. On pages 56 to 61 and Exhibits WEA-11 and WEA-12, Dr. Avera applies the CAPM method to his utility and non-utility proxy groups. His results are summarized in Panel C of Exhibit JRW-12.

Q. WHAT ARE THE ERRORS IN DR. AVERA'S CAPM ANALYSIS?

A. There are two flaws with Dr. Avera's CAPM analysis: (1) his use of the non-

utility proxy group; and (2) his equity risk premium of 10.0%.

Q. PLEASE DISCUSS DR. AVERA'S NON-UTILITY PROXY GROUP.

A. As noted above, Dr. Avera's non-utility proxy group is not an appropriate group to estimate an equity cost rate for FP&L. In the application of the CAPM, the average beta for the non-utility group (0.83) is somewhat above that of the average for the utility proxy group (0.73).

Q. PLEASE REVIEW DR. AVERA'S EQUITY OR MARKET RISK PREMIUM IN HIS CAPM APPROACH.

A. The primary problem with Dr. Avera's CAPM analysis is the size of the market or equity risk premium. Dr. Avera develops an expected market risk premium of 10.0% by: (1) applying the DCF model to the S&P 500 to get an expected market return; and (2) subtracting the risk-free rate of interest. Dr. Avera's estimated market return of 13.2% for the S&P 500 equals the sum of the dividend yield of 3.4% and expected EPS growth rate of 9.6%. The expected EPS growth rate is the average of the expected EPS growth rates from IBES, First Call, Zacks, and *Value Line*. The primary error in this approach is his expected DCF growth rate. As previously discussed, the expected EPS growth rates of Wall Street analysts and *Value Line* are upwardly biased. Therefore, as explained below, this produces an overstated expected market return and equity risk premium.

Q. BEYOND YOUR PREVIOUS DISCUSSION OF THE UPWARD BIAS IN WALL STREET ANALYSTS' AND *VALUE LINE*'S EPS GROWTH RATE FORECASTS, WHAT OTHER EVIDENCE CAN YOU PROVIDE THAT THE DR. AVERA'S S&P 500 GROWTH RATE IS EXCESSIVE?

A. A long-term EPS growth rate of 9.6% is inconsistent with economic and earnings growth in the U.S. The long-term economic and earnings growth rate in the U.S. has been only about 7%. I have performed a study of the growth in nominal GDP, S&P 500 stock price appreciation, and S&P 500 EPS and DPS growth since 1960. The results are provided on page 1 of Exhibit JRW-15, and a summary is given in the table below.

GDP, S&P 500 Stock Price, EPS, and DPS Growth 1960-Present

Nominal GDP	**7.20%**
S&P 500 Stock Price Appreciation	**5.88%**
S&P 500 EPS	**6.56%**
S&P 500 DPS	**5.68%**
Average	**6.33%**

These results offer compelling evidence that a long-run growth rate of in the 6%-7% is appropriate for companies in the U.S. By comparison, Dr. Avera's long-run growth rate projection of 9.6% is clearly not realistic. These estimates suggest that companies in the U.S. would be expected to: (1) increase their growth rate of EPS by 50% in the future and (2) maintain that growth indefinitely in an economy that is expected to grow at about one half

his projected growth rates. Such a scenario is not economically feasible or reasonable.

Q. PLEASE PROVIDE A SUMMARY ASSESSMENT OF DR. AVERA'S EQUITY RISK PREMIUM OF 10.0% DERIVED USING AN EXPECTED MARKET RETURN OF 13.2%.

A. Dr. Avera's equity risk premium derived from an expected market return of 13.2% is inflated and does not reflect current market fundamentals or prospective economic and earnings growth. As previously discussed, at the present time stock prices (relative to earnings and dividends) are high while interest rates are low. Major stock market upswings that produce above average returns tend to occur when stock prices are low and interest rates are high. Thus, current market conditions do not suggest above-average expected market return. Consistent with this observation, the financial forecasters in the Federal Reserve Bank of Philadelphia survey expect a market return of 6.80% over the next ten years. In addition, the *CFO Magazine* – Duke University Survey of over 500 CFOs published in June of 2009 shows an expected return on the S&P 500 of 7.31% over the next ten years.

Q. TO CONCLUDE THIS DISCUSSION, PLEASE SUMMARIZE DR. AVERA'S MARKET RISK PREMIUM AND CAPM RESULTS IN LIGHT OF THE EVIDENCE ON RISK PREMIUMS IN TODAY'S MARKETS.

A. Dr. Avera's market risk premium of 10.0% is well in excess of the equity risk premium estimates discovered in recent academic studies by leading finance scholars and is especially out of touch with the real world of finance. Investment banks, consulting firms, and CFOs use the equity risk premium concept every day in making financing, investment, and valuation decisions. The results of studies and surveys from the real world of finance indicate an equity risk premium in the 4% to 5% percent range and not in the 10% percent range.

Expected Earnings Approach

Q. PLEASE DISCUSS DR. AVERA'S EXPECTED EARNINGS ANALYSIS.

A. In pages 61-63 of his testimony and Exhibit WEA-13, Dr. Avera estimates an equity cost rate of 11.7% for the Company employing an approach he calls the Expected Earnings ("EE") approach. His methodology simply involves using the expected ROE for the companies in his utility proxy group as estimated by *Value Line*. This approach is fundamentally flawed for several reasons. First, these results include the profits associated with the unregulated operations of the utility proxy group. As previously noted, the unregulated operations are significant for several of the utility proxy companies. More importantly, since Dr. Avera has not evaluated the market-to-book ratios for these companies, he cannot indicate whether the past and projected returns on common equity are

above or below investors' requirements. These returns on common equity are excessive if the market-to-book ratios for these companies are above 1.0.

Flotation Costs

Q. PLEASE DISCUSS DR. AVERA'S ADJUSTMENT FOR FLOTATION COSTS.

A. Dr. Avera claims that an upward adjustment to the equity cost rate is necessary for flotation costs. This adjustment factor is erroneous for several reasons. First, the Company has not identified any actual flotation costs for the Company. Therefore, the Company is requesting annual revenues in the form of a higher return on equity for flotation costs that have not been identified. Second, it is commonly argued that a flotation cost adjustment (such as that used by the Company) is necessary to prevent the dilution of the existing shareholders. In this case, a flotation cost adjustment is justified by reference to bonds and the manner in which issuance costs are recovered by including the amortization of bond flotation costs in annual financing costs. However, this is incorrect for several reasons:

(1) If an equity flotation cost adjustment is similar to a debt flotation cost adjustment, the fact that the market-to-book ratios for electric utility companies are over 1.3X actually suggests that there should be a flotation cost reduction (and not increase) to the equity cost rate. This is because when (a) a bond is issued at a price in excess of face or book value, and (b) the difference

between market price and the book value is greater than the flotation or issuance costs, the cost of that debt is lower than the coupon rate of the debt. The amount by which market values of electric utility companies are in excess of book values is much greater than flotation costs. Hence, if common stock flotation costs were exactly like bond flotation costs, and one was making an explicit flotation cost adjustment to the cost of common equity, the adjustment would be downward;

(2) If a flotation cost adjustment is needed to prevent dilution of existing stockholders' investment, then the reduction of the book value of stockholder investment associated with flotation costs can occur only when a company's stock is selling at a market price at/or below its book value. As noted above, electric utility companies are selling at market prices well in excess of book value. Hence, when new shares are sold, existing shareholders realize an increase in the book value per share of their investment, not a decrease;

(3) Flotation costs consist primarily of the underwriting spread or fee and not out-of-pocket expenses. On a per share basis, the underwriting spread is the difference between the price the investment banker receives from investors and the price the investment banker pays to the company. Hence, these are not expenses that must be recovered through the regulatory process. Furthermore, the underwriting spread is known to the investors who are buying the new issue of stock, who are well aware of the difference between the price they are paying to buy the stock and the price that the Company is receiving. The offering price which they pay is what matters when investors

decide to buy a stock based on its expected return and risk prospects. Therefore, the company is not entitled to an adjustment to the allowed return to account for those costs; and

(4) Flotation costs, in the form of the underwriting spread, are a form of a transaction cost in the market. They represent the difference between the price paid by investors and the amount received by the issuing company. Whereas the Company believes that it should be compensated for these transactions costs, they have not accounted for other market transaction costs in determining a cost of equity for the Company. Most notably, brokerage fees that investors pay when they buy shares in the open market are another market transaction cost. Brokerage fees increase the effective stock price paid by investors to buy shares. If the Company had included these brokerage fees or transaction costs in their DCF analysis, the higher effective stock prices paid for stocks would lead to lower dividend yields and equity cost rates. This would result in a downward adjustment to their DCF equity cost rate.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BY MR. McGLOTHLIN:

Q. Dr. Woolridge, would you please summarize your testimony for the record.

CHAIRMAN CARTER: Dr. Woolridge, before you begin, were you here when I described the timing lights?

THE WITNESS: Yes. I'm aware of the timing lights.

CHAIRMAN CARTER: Okay. Yes, sir. Thank you.

BY MR. McGLOTHLIN:

Q. Please summarize your testimony.

A. Okay. In the area of cost of capital there's two primary issues, the capital structure and the equity cost rate.

On the capital structure, the company's position is to have a projected capital structure which has a common equity ratio of 59.62 percent. Now they claim this number is actually 55.76 percent, but that includes $950 million of imputed debt. I have used the average of the 2009, 2010 capitalizations and it includes a common equity ratio of 54.45 percent, and this is based on the projected balance sheets of the company.

A major fact that I emphasize, that the company's projected capital structure includes a common equity ratio that is well above the common equity ratio

of FPL Group and also well above the common equity ratio of the electric utility industry. FPL's average common equity ratio is in the 43 percent range. The average common equity ratio of my electric proxy group is about 40 percent, and the average common equity ratio of Dr. Avera's group is about 47 percent. Therefore, my capital structure includes a common equity ratio which is much more in line with the industry and with my common -- with my proxy group. The fact is that FP&L's common equity ratio is extremely high by industry standards.

Now on the equity cost rate, Dr. Avera's estimated an equity cost rate between 12 and 13 percent. I've estimated an equity cost rate of 9.5 percent. We've both used a discounted cash flow and Capital Asset Pricing Model approaches.

As I see it, there's three big issues. Issue number one is the DCF growth rate. Dr. Avera has used the projected earnings per share growth rate of Wall Street analysts as his sole indicator of projected growth. I've used various measures of growth, some historic, but primarily projected growth and earnings, dividends, book value and the like. As I show in studies in my testimony, it's well known that the projected earnings per share growth rates of Wall Street

analysts are overly optimistic and upwardly biased.

Particularly with respect to these forecasts, I have shown that on average they project growth for companies to be over three to five years to be in the 15 percent or so area, and companies actually achieved growth rates of about 6 to 7 percent. So as a result investors would understand this and know that the Wall Street analysts tend to overly, overly -- to overemphasize or overestimate the growth rates that companies are actually going to achieve.

The second particular issue deals with the Capital Asset Pricing Model and specifically the equity risk premium. Dr. Avera uses an equity risk premium of 10 percent. That is based on one study that he has performed. I've used an equity risk premium of 4.5 percent, which is based on 30 studies which use historic approaches to the equity risk premium, it uses forecasts, I mean, surveys of CFOs and others who make projections into the future. It also includes studies of the equity risk premium by leading scholars.

In the end, Dr. Avera's equity risk premium is tied to again analysts' earnings per share growth rate forecast, and as a result the equity risk premium he uses, which is 10 percent, is upwardly biased and too high. As a reality test on this, I compare, show that

historically the GDP in the U.S. has grown 6 to 7 percent, and so have corporate earnings. They don't grow at the 9 or 10 percent levels that he estimates.

The third big issue is the riskiness of Florida Power & Light. Dr. Avera makes various comparisons between his proxy group and Florida Power & Light. But in fact this is to -- the comparisons are made to FPL Group, not to Florida Power & Light. The bond ratings and that sort of thing for Florida Power & Light are a function of the financial profile of FPL Group. Remember, FPL Group has a common equity ratio in the range of 43 percent, not in the range of 59 percent which the company has proposed in this case.

MR. McGLOTHLIN: Does that complete your summary?

THE WITNESS: Yes.

MR. McGLOTHLIN: We tender the witness.

CHAIRMAN CARTER: Outstanding, Dr. Woolridge. And I'm not going to mess with you like I did last time about, you know, University, Penn State University and Florida State University. So we'll talk about that during the break.

THE WITNESS: Okay.

CHAIRMAN CARTER: Okay. Mr. Wiseman.

MR. WISEMAN: No questions.

CHAIRMAN CARTER: Ms. Bradley.

MS. BRADLEY: No questions.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: Just a couple of brief questions.

CHAIRMAN CARTER: You're recognized, sir.

CROSS EXAMINATION

BY MR. MOYLE:

Q. Now you're suggesting a 10 percent ROE; is that right?

A. 9.5.

Q. I'm sorry. 9.5. Now people say that that may not, that may hinder access to capital markets. How do you address that point?

A. No, I don't see the way that would. I mean, obviously capital markets have changed over the last five or six months. If you look at my testimony, I provide evidence that yield spreads have come down significantly. If you look at projected growth rates, they've come down. So capital costs have declined from, say, five or six months ago.

Q. So in your professional opinion you don't think a 9.5 ROE will, will detrimentally or materially impact FPL's ability to access capital?

MR. ANDERSON: Chairman Carter, we'd like, we'd like to object to this. This is obviously friendly

cross-examination of just the type we've been trying to avoid and we object strenuously. Thank you.

CHAIRMAN CARTER: Mr. Moyle, to the objection.

MR. MOYLE: I think I've been pretty good about not engaging in a wide breadth of friendly cooperation. I wanted to ask him that question and one follow-up question related to risk, so I think it's pretty limited.

MR. ANDERSON: That does not respond to the point that it's friendly cross and it's not proper.

CHAIRMAN CARTER: Ms. Brubaker, good morning.

MS. BRUBAKER: Good morning, Chairman. My understanding of where we've tried to focus in order to avoid friendly cross is to have the questioner identify what point he's seeking clarification on or where his interests are adverse to the witness's, and perhaps Mr. Moyle could, could inform us of that.

CHAIRMAN CARTER: Mr. Moyle.

MR. MOYLE: Well, I mean, the point of clarification is with respect to understanding better and making sure the record is developed with respect to the divergence of views on ROE and how they impact access to the capital markets. That was the point of clarification that I was trying to get at. And the other one I want to try to get at is the idea of risk

and how it relates to ROE.

MS. BRUBAKER: Mr. Chairman, with that suggestion, I suppose my next question would be to FPL as the objector to see if they can point out where that information is spelled out in the testimony.

CHAIRMAN CARTER: I'm going to short-circuit the process. Let's move on. Go ahead, Mr. Moyle.

BY MR. MOYLE:

Q. Okay. Again, I just want to understand with respect to the point about access to capital, it's your professional belief in your, as a professor at Penn State that you don't think that a 9.5 will materially hinder access to capital?

A. No. And part of that deals with the risk profile of Florida Power & Light as well.

Q. Okay. The question I wanted to ask you about risk, are you aware that in this case that FPL is proposing more recovery through adjustments and clauses as compared to the status quo, like the GBRA?

MR. ANDERSON: Same objection. Same objection, Chairman Carter.

CHAIRMAN CARTER: Mr. Moyle, to the objection.

MR. MOYLE: Well, it's the second point I want to have clarified with respect to the risk profile.

CHAIRMAN CARTER: I'll give you leeway, but

tread lightly. Okay?

BY MR. MOYLE:

Q. Sir, if you can answer the question.

CHAIRMAN CARTER: I'm not going to rule on the objection at this time, Mr. Anderson.

THE WITNESS: Yes. I'm aware that they've proposed a number of adjustment mechanisms which would serve obviously, all else equal, to lower their risk profile.

BY MR. MOYLE:

Q. And to the extent the risk profile was lowered, would that argue for a lower ROE in your professional opinion?

A. Yes. I mean, in my testimony I highlight, I believe, that Florida Power & Light is, the risk profile of Florida Power & Light is low relative to other electric utilities.

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

CHAIRMAN CARTER: Thank you, Mr. Moyle.

Mr. Wright.

MR. WRIGHT: I'm going to try one bottom line clarifying question.

CHAIRMAN CARTER: Okay. Let's see.

CROSS EXAMINATION

BY MR. WRIGHT:

Q. Good morning, Dr. Woolridge.

A. Good morning.

Q. You testify extensively about return on equity, adequacy of return on equity and capital structure. I want to just bring it all down to one question. My clients, like everybody, are concerned about FPL's ability to provide safe, adequate, reliable service at the lowest possible cost.

My question is if the Commission adopts your recommendations on ROE and capital structure, do you have an opinion as to whether that will adversely affect FPL's ability to provide safe, adequate, reliable service at the lowest possible cost?

MR. ANDERSON: Chairman Carter, please pardon me, but this question has just been asked by Mr. Moyle. It's additional friendly cross-examination. We've made every effort, we've skipped cross of a witness, we've truncated our lines of examination of other people, and this type of just asking so-called clarifying questions of witnesses who one is aligned with is the heart and soul of friendly cross, which we don't practice here.

CHAIRMAN CARTER: Mr. Wright, to the objection.

MR. WRIGHT: Mr. Chairman, it is one

clarifying question as to the bottom line impact of his testimony.

CHAIRMAN CARTER: Ms. Brubaker, let's try again.

MS. BRUBAKER: To quote Ms. Helton, I'm a little bit struggling with this one. Mr. Wright's questions asked about safe, adequate service. Mr. Moyle's, if I remember correctly, were talking about FPL's ability to attract capital. Nevertheless, they do seem largely aligned in nature. I'm --

CHAIRMAN CARTER: Can you tighten it up, Mr. Wright?

MR. WRIGHT: Mr. Chairman, I'm not sure I can make it any tighter than I did. I really was just trying to, to find out, ask the witness does he have an opinion on the body of his testimony and recommendations as it relates to the fundamental obligation of FPL to provide safe, adequate, reliable service.

MR. ANDERSON: Same objection. This party has adopted the position of OPC on all cost of capital issues. It's precisely what we should not be getting into.

CHAIRMAN CARTER: Objection sustained.

MR. WRIGHT: That's all I had. Thank you, Mr. Chairman.

CHAIRMAN CARTER: Okay. Let me see here. Where are my notes? You know the one thing, when my writing gets cold, it's hard to read.

Ms. Perdue?

MS. PERDUE: Just a few questions, Mr. Chair.

CHAIRMAN CARTER: You're recognized.

CROSS EXAMINATION

BY MS. PERDUE:

Q. Good morning, Dr. Woolridge. Have you assessed how the magnitude of FPL's proposed capital expenditures compare to other businesses in the State of Florida?

A. No, I have not.

Q. Would you agree with me that FPL is one of the largest if not the largest private sector investor in infrastructure in the State of Florida?

A. Yes.

Q. Doesn't that investment mean jobs to more Floridians?

A. I would -- yes.

Q. And doesn't that also mean investment in Florida's economy?

A. It would be a factor that supports the economy, yes.

Q. Turning to your direct testimony on Page 28,

Lines 17 through 21, you discuss perceived risk and how risk plays in an investor's decision. Do you recall that testimony or know where I'm referring?

A. Yes.

Q. Would you agree with me that when an investor is contemplating making an investment in a regulated entity, that part of their risk evaluation is the regulatory environment in which that entity operates?

A. Yes.

Q. And then my last line of questioning, beginning on Page 77 of your testimony and going through the top of Page 78, really all of Page 77, you discuss and provide results of a study that you performed of the growth in nominal GDP S&P 500 stock price appreciation and S&P 500 EPS and DPS growth since 1960. Do you recall that study and are you familiar with the area I'm referring?

A. Yes.

Q. And on Page 77, Lines 15 through 17 -- or, I'm sorry, 15 and 16, you state that the results offer compelling evidence that a long-run growth rate of in the 6 percent to 7 percent -- I guess you mean range -- is appropriate for companies in the U.S. Is that an accurate depiction of your results?

A. Yes.

Q. Does that study that you have referred to that you completed, does that include both regulated and nonregulated companies?

A. Yes.

Q. And are you suggesting then that the growth projection in economic growth and earnings growth for companies should fall into that average range regardless of a company's performance in other areas, such as above-average reliability, above-average customer service or other performance factors in which that company would be above average?

A. No. This is just the average for the S&P 500. It's 500 companies which includes some utilities. Some companies are going to grow faster than that, some companies are going to grow slower than that. The S&P 500 is probably the best known index for things like earnings and returns, that sort of thing. So it includes companies that are growing faster and slower. But part of the study focused on the fact that historically the GDP in the U.S. has grown about 6 or 7 percent, and that's slowing by the way, and earnings have too.

Q. But you did say though that companies that perform better are able to grow at faster rates; is that correct?

A. Yes. But in each case we're looking at the market and all, the market is the S&P 500, what is the average for the overall market? It's 6 to 7 percent.

Q. So that was all you were trying to show the Commission was that was the average of the market?

A. Yes.

Q. Okay. Thank you.

MS. PERDUE: That's the only questions I have.

CHAIRMAN CARTER: Thank you.

Mr. Anderson.

MR. ANDERSON: Thank you, Chairman Carter.

Good morning, Commissioners.

CROSS EXAMINATION

BY MR. ANDERSON:

Q. Good morning, Dr. Woolridge.

A. Good morning.

Q. Your position is that the amount of equity approved for FPL's capital structure should be based on projected capitalizations per the company's books, which are the figures that investors would have access to and use; is that right?

A. Well, yes, figures that investors would see.

Q. Your position is that FPL is asking the Commission to include more dollars in common equity in its requested capital structure than the company

actually projects investing; is that right?

A. No. I don't understand that question.

Q. What I'd like you to do, please, is turn to Page 16 of your testimony, Lines 18 to 20.

A. Okay.

Q. Are you there?

A. Yes.

Q. At Line 18 you state, "Third, the Company's recommended capital structure includes more common equity than is projected for the Company." That's what you testified; correct?

A. Well, it includes the 400 -- 950 million of imputed debt.

Q. Let's get to the bottom of the issue about who's proposing what in terms of common equity investment.

And what I like to do is distribute an exhibit.

CHAIRMAN CARTER: Do you need a number, Mr. Anderson?

MR. ANDERSON: Yes, please, Chairman Carter. I believe we're at Exhibit --

CHAIRMAN CARTER: 457, Commissioners.

MR. ANDERSON: Yes, sir.

CHAIRMAN CARTER: Number 457. Short title.

MR. ANDERSON: Woolridge Cross-Marked Exhibits.

(Exhibit 457 marked for identification.)

CHAIRMAN CARTER: Okay.

MR. ANDERSON: And to be clear, what I've done is taken Dr. Woolridge's exhibits, I've done a little highlighting, a little line numbering, just so we can all follow along a little more easily.

CHAIRMAN CARTER: You may proceed.

MR. ANDERSON: Thank you.

BY MR. ANDERSON:

Q. Please turn in this cross-marked exhibit so we can all follow along to JRW-5, Page 2 of 3. Do you have that?

A. Yes.

Q. This is Exhibit 212 in staff's premarked list. Please look at Panel G; do you see that?

A. Yes.

Q. It says, "OPC Recommended Capital Structure for FP&L"; right?

A. Yes.

Q. That's your recommended capital structure in this case; right?

A. Yes.

Q. If I understand this correctly, and I'm

looking at your source notes underneath that table, you have taken from MFR D-2 the beginning and ending capitalization and you averaged those for short-term debt, long-term debt and common equity, and that's what's shown in your exhibit; right?

A. Yes.

Q. Can you tell me where the other numbers for customer deposits, deferred income taxes, investment tax credits in your recommended capital structure came from?

A. They came from the figures -- the per book, the book figures that -- I'll have to check. They were --

Q. Go ahead.

A. -- work papers from MFR D-2, I believe.

Q. I think they're D-1A. Why don't you just flip back to this marked exhibit where it's highlighted Schedule D-1A.

A. Yes.

Q. And you see the number, customer deposits 626,383,000?

A. Yes.

Q. That's where that came from; right?

A. Yes.

Q. Same column, company total per books for deferred income taxes; right?

A. Yes.

Q. Investment tax credits; right?

A. Yes.

Q. And your use of the company per books information from D-1A, which we just talked about, that's consistent with the position you expressed that we should, that your recommendations are based on projected capitalizations per books; right?

A. Yes. And -- yes.

Q. Then you inserted your recommendations for short-term debt, long-term debt and common equity, and you used MFR D-2 for that, according to your Panel F; right?

A. Yes.

Q. And just so we can all follow along, we're looking at Panel G, OPC's Recommended Capital Structure. You can see that short-term debt number, 629,647. I put a little number seven next to it. You can look up above there in Panel F, and that's where he took the 629,647 from, and then just down the line the number seven just for our purposes here denotes that they all came from that table above, which were the, derived in the way the witness just said. Is that a fair recapitulation, sir?

A. Yes.

MR. ANDERSON: At this point I'd like to ask

one of my colleagues to assist me, and taking into account Mr. McGlothlin's observation that it was difficult to see the easel, I'm handing out a worksheet, and this went back to second grade thinking for me. It really helped my thinking in understanding this. That we can kind of follow along, we're just going to fill in three numbers together, I request, we'll show it on the easel, and I think that will help here.

CHAIRMAN CARTER: You notice Mr. Anderson looked at me when he said second grade, you know. I don't know what he's trying to say.

MR. ANDERSON: Well, Chairman Carter, I've taken to heart, you know, you made a comment some time ago about we need to express ourselves so our customers in Pompano Beach, everyone can understand. So we're just -- I'm right there with you and trying to do just that.

CHAIRMAN CARTER: Okay. Mr. Anderson, you may proceed.

MR. ANDERSON: And I like Pompano Beach.

CHAIRMAN CARTER: It's a great city, isn't it?

MR. ANDERSON: Yes, sir.

CHAIRMAN CARTER: There you go. My aunt still lives there, by the way, my Aunt Geneva.

BY MR. ANDERSON:

Q. And we've written up here on top just a label, "FPL and OPC Recommended Common Equity." And I'll turn to you, Dr. Woolridge. Let's look at the actual dollars of equity that OPC is recommending that the Commission include in FPL's capital structure in this case. So we're all following along, it would be Panel G of JRW-5; right?

A. Yes.

Q. And that number is, and I'll ask my colleague to write right next to -- and anybody who wants to follow along -- OPC's recommended common equity, it's 9,103,999,000. And for our table we left out the zeros because they're up at the top. So 9,103,999. That's your proposed common equity figure; right?

A. Yes.

Q. Okay. Just above that line, let's all write FPL's recommended common equity figure. And what I'll ask that Dr. Woolridge and all of us do is turn back to that schedule which is in the marked Woolridge exhibits, the D-1A. Do you have that, Dr. Woolridge?

A. Yes. Yes.

Q. Thanks. And looking at Line 4, common equity, company total per books, that's where the number FPL is proposing; right?

A. Yes.

Q. Nine -- yeah. 9,188,265. So if we all write that on the line next to FPL's recommended common equity, 9,188,265. And so so far we've written the two numbers laying out your recommended common equity for OPC and FPL's; right?

A. Yes.

Q. Okay. And if we just subtract and find the difference, would you agree, subject to check, and please feel free to check, the difference is $84,266,000. So it's 84,266 for this.

A. Yes. I'd agree.

Q. So that's the absolute amount of dollar difference between OPC's recommendation for capital and FPL's recommendation for capital. And sometimes it's helpful to express things as a percentage; you'd agree?

A. Yes.

Q. And if you divide that $84,266,000 difference we just talked about by FPL's projection or request, 9,188,265,000, that computes out to a, subject to check, .00917 percent difference.

A. Yes, I agree.

Q. So there is a less than 1 percent difference between OPC's recommended equity dollars and FPL's recommended equity dollars; right?

A. Yes.

MR. ANDERSON: And just for housekeeping purposes, Chairman Carter, recognizing that again we wrote it on the easel and we've all kind of handwritten, this just puts the same information in exactly the same kind of format we talked about so we have it for the record.

CHAIRMAN CARTER: This is 458?

MR. ANDERSON: Yes, sir.

CHAIRMAN CARTER: Commissioners, 458 for your notes.

And the short title, Mr. Anderson?

MR. ANDERSON: FPL and OPC Equity Dollars Difference.

(Exhibit 458 marked for identification.)

CHAIRMAN CARTER: Mr. Anderson, you may proceed.

MR. ANDERSON: Thank you. I'm seeing if my colleagues have one little handout which to close out this line.

CHAIRMAN CARTER: Take a minute. Okay. Take a minute.

MR. ANDERSON: Actually, I'm being unfair to my good colleagues, because it's actually the next page in my marked exhibit. I'm very sorry.

CHAIRMAN CARTER: Well, let's do that then.

MR. ANDERSON: I forgot my car keys yesterday too.

CHAIRMAN CARTER: I left my badge downstairs. Where are we, upstairs or downstairs?

COMMISSIONER EDGAR: I left mine at home.

CHAIRMAN CARTER: One of those days. Oh, no. It's going to be -- well, let's hope it's not going to be one of those days, guys and dolls.

BY MR. ANDERSON:

Q. Okay. And to move on now. Isn't it true, Dr. Woolridge, that what accounts for even that less than 1 percent difference in the dollars of equity proposed by OPC and FPL is the fact that your Exhibit JRW-5, Panel F, used a two-point average beginning and ending balance and FPL's D-1A, which was the source of the FPL number, used a 13-month average, which is what we do for MFRs here? Do you know that?

A. Yes, I do. And so that could account for a small difference. I used the year-end figures, which is pretty common.

Q. Okay. But then looking at the MFR D-2 exhibit, Exhibit AP-12, Page 1 of 1, you can see where Mr. Avera computed the equity, we see the yellow line and we see the starting number and, and ending

number and all the in-between numbers; right?

A. Yes.

Q. And when all those numbers are averaged together, you get the 13-month average, which we put up on the board, the FPL recommended number 9,188,265; right?

A. Yes.

Q. So if we corrected your number, respecting you just did a two-point average, but instead we use the 13 months, the dollar amount is the same between the two equity numbers; right?

A. Yes. And the averages -- I mean, you know, if you read my testimony in here, I focus on the percentages, as you did here. If you look at the percentages here, the average percent of equity is 55 percent, which is pretty close to my 54 percent, 54.76 percent.

Q. And one of the reasons for kind of having this conversation, Dr. Woolridge, is in the case people talk about a lot of different percentages and things, but when we talk about debt equity ratios and percentage of equity to debt, we're talking here about the numerator in all those different fractions, right, the amount of equity?

A. Yes. But, I mean, if you go back to my

testimony on Page 16, it focuses on percentages.

Q. My -- I understand --

A. And the entire discussion --

MR. McGLOTHLIN: Excuse me. Let him finish his answer.

THE WITNESS: The entire discussion I have on Page 16 is not the dollar amount, it's the percentage amount.

BY MR. ANDERSON:

Q. Rates are set on dollar amounts and the purpose of the proceeding is to set how much money is charged for service; isn't that right?

A. And my discussion is about the percentages and where they fall relative to other standards, including electric utilities.

Q. Is the answer to my question yes?

A. Yes.

Q. Thank you. We'll move on to another topic.

MR. ANDERSON: Chairman Carter, we're distributing courtesy copies of a document. We don't need to mark this, but it's just a little easier again to -- these are from Dr. Woolridge's exhibits.

CHAIRMAN CARTER: You may proceed.

MR. ANDERSON: Thank you.

BY MR. ANDERSON:

Q. I want to talk about your application of the discounted cash flow, DCF method. You adjust the dividend yield by half of the growth rate to get the forward-looking dividend yield; right?

A. Yes.

Q. And that's the same method that Mr. Baudino used when he testified in this case too; right?

A. I believe so.

Q. And I think you used some of the same sources that Mr. Baudino used for EPS growth rates, Value Line, Zack's, and so forth; right?

A. Yeah. I believe so.

Q. Your historical dividend yields are shown on JRW-10, Page 2 of 6, which we've just handed out; right?

A. Yes.

Q. There, if we look at FPL Group, we can see its dividend yield was 3.6 percent for the six months and 3.5 percent in July. Am I reading that right?

A. Yes.

Q. Since you averaged the six month and July, that averaging would be a dividend yield of 3.55 percent, right in the middle; right?

A. Yes.

Q. The next page I handed out, on JRW-10, Page 4 of 6, we see the Value Line growth rates; right?

A. Yes.

Q. For example, under FPL Group we find the number 10 percent; right?

A. Yes.

Q. And that's the same number that Mr. Baudino used for his Value Line table like that; right?

A. I don't know.

Q. Okay. And then under the column Return on Equity we see 13.5 percent; right?

A. Yes.

Q. Then on Exhibit JRW-10, Page 5 of 6, we see that FPL Group's growth rates by Yahoo First Call, Zack's and Reuters, they average, per your chart here, right-hand column, 9.36 percent; right?

A. Yes.

Q. If someone says to you someone is wearing a mask or trying to mask something, that gives the idea that people are trying to hide something; wouldn't you agree?

A. Yes.

Q. Okay. Let's look at your testimony, Page 3, Lines 15 to 17, and here you're talking about imputed debt, and you say, "In my testimony I show that the imputed debt is unwarranted and serves to mask a very high equity ratio." Those are the words here; right?

A. Yes.

Q. Then turning to Page 16 of your testimony, please, Lines 2 to 3, you say FPL's, quote, "capital structure includes $950 million of 'imputed debt.'" Right?

A. Yes. Well, yes.

Q. Go back to the Woolridge marked exhibits, Schedule D-1A. Are you there?

A. I'm sorry. Which exhibits?

Q. Thank you. It was the first set of marked exhibits, Number 457.

CHAIRMAN CARTER: He may not have marked it, sir. You might want to describe it to him.

MR. ANDERSON: Thank you. This would be the ones that have the yellow markings and the pen markings. That's why I called them marked.

THE WITNESS: Yes.

CHAIRMAN CARTER: You may proceed.

MR. ANDERSON: Okay. Thank you.

BY MR. ANDERSON:

Q. Schedule D-1A, which shows us the cost of capital and all these types of things, can you tell us, can you show where FPL on this exhibit, where's the 950 millions of debt in this requested capital structure?

A. Well, the 950 million is what is used in Mr. Pimentel's exhibits to see -- he has, I forget the exhibit number he had, but he had their capital structure, and then part of the justification process was making this adjustment to impute debt that took the capital structure ratio from 59 percent to 55 percent.

Q. It's true, though, that there's no listing of imputed debt in the amount of 950 million or any amount shown on D-1A. What FPL is actually asking is that the Commission consider the impact of off balance sheet obligations when evaluating the reasonableness of FPL's requested capital structure. That's what FPL said. It's not that we said we're listing it on our schedule; right?

A. Right. And they used that -- I mean, Mr. Pimentel's exhibit highlights that, where it -- and as I, as I discuss in my testimony, it highlights the fact that the, the common equity ratio, once you impute that debt, is, what, 55.76 percent. So that's not actual debt that's on the balance sheet. That's imputed.

Q. Okay. Your position is that imputed debt is a non-GAAP adjustment to the capital structure of the company. It's not found in the company's financial statements and SEC filings; right?

A. It's not on their books.

Q. Okay.

CHAIRMAN CARTER: Do you need a number, Mr. Anderson?

MR. ANDERSON: Yes, please. Yes, please, Mr. Chairman.

CHAIRMAN CARTER: Commissioners, the next number in our sequence will be 459, 459.

A title, Mr. Anderson?

MR. ANDERSON: Excerpt from FPL 2008 10K.

(Exhibit 459 marked for identification.)

BY MR. ANDERSON:

Q. Looking at Exhibit 459, please look at the bottom of what's labeled as Page 59. It says, "The accompanying notes to consolidated financial statements are an integral part of the statements." Right?

A. Yes.

Q. Turn the page in Exhibit 459, please.

A. Yes.

Q. Page 94 I've highlighted in yellow. It states, "FPL has various agreements with several electricity suppliers to purchase an aggregate of up to approximately 870 megawatts of power with expiration dates ranging from April 2009 to 2012. In general, the agreements require FPL to make capacity (phonetic)

payments and supply the fuel consumed by the plants on the contracts." That's what's stated here; right?

A. Yes. And as I indicate, the 950 million is not on the balance sheet.

Q. Well, let's look further down this page, Page 94. We see a disclosure in this SEC disclosure document filed under SEC rules of a table stating that -- it says on Page 94, "The required capacity and minimum payments under the contracts as of December 31, 2008." Right?

A. Yes.

Q. And the information is provided in the SEC disclosures, investors can see it and investors can rely on it; right?

A. Yes. And as I said, the 950 million is not here and it's not on the balance sheet.

I would also note, by the way, Footnote B says "Energy payments in these contracts are recoverable through the fuel clause." They highlight the fact that they are recoverable.

Q. Turning to Page 63 of your testimony, Lines 11 to 13.

MR. McGLOTHLIN: Which page number, please?

MR. ANDERSON: 63.

BY MR. ANDERSON:

Q. You state, "FPL has presumed that a risk

factor of 25 percent is appropriate for the Company. However, S&P does not indicate how the risk factor that ranges from zero to 100 percent is determined." Right?

A. Yes.

CHAIRMAN CARTER: Do you need a number, Mr. Anderson?

MR. ANDERSON: I need 460, please.

CHAIRMAN CARTER: 460.

MR. ANDERSON: Yes, sir.

CHAIRMAN CARTER: Title?

MR. ANDERSON: S&P Ratings Methodology-Imputed Debt.

CHAIRMAN CARTER: Okay. S&P Ratings Methodology-Imputed Debt.

(Exhibit 460 marked for identification.)

You may proceed.

BY MR. ANDERSON:

Q. Please turn to Page 3 of 5 this Exhibit 460, S&P Ratings Methodology-Imputed Debt. Do you have that?

A. Yes.

Q. Looking at the bottom of Page 3, it's highlighted. "In cases where a regulator has established a power cost adjustment mechanism that recovers all prudent PPA costs, we employ a risk factor of 25 percent because the recovery hurdle is lower than

it is for a utility that must litigate time and time again its right to recover costs." Right?

A. Yes. And as I indicated, you know, there's a lack of guidance about how they determine 25 percent. It's their number. I cite Moody's as being another view on this. So, I mean, again, there's no idea how they come up with 25 percent and whether that's appropriate here.

MR. MOYLE: Mr. Chairman?

CHAIRMAN CARTER: Mr. Moyle.

MR. MAILHOT: We also had a conversation I think a couple of days ago with staff counsel about hearsay and whether a finding of fact can be based on hearsay. And I think she indicated that, that objections did not need to be registered in her view, and I guess Commission practice with respect to hearsay --

CHAIRMAN CARTER: The objection stands. The same ruling.

MR. MOYLE: Okay.

CHAIRMAN CARTER: I didn't forget.

It would be 461. Short title?

MR. ANDERSON: S&P Report on FPL Dated 8/20/08.

(Exhibit 461 marked for identification.)

CHAIRMAN CARTER: You may proceed.

BY MR. ANDERSON:

Q. Dr. Woolridge, you agree this is the Standard & Poor's report dated August 20, 2008, for Florida Power & Light Company; right?

A. Yes.

Q. Turning to Page 5 of the document, under Standard and Poor's Adjustments, do you see that, in Table 3?

A. Yes.

Q. Do you see the yellow marking Power Purchase Agreements?

A. Yes.

Q. 1,165,000,000. Right?

A. Yes. And as I highlight, that's a non-GAAP adjustment. And that, that's based off of their risk factor and that sort of thing, which we really don't know how anybody comes up with it. S&P doesn't tell you how they come up with it. Moody's has a different approach. And so, you know, maybe S&P should be here as part of this hearing to explain to us what they do to impute this debt.

MR. MOYLE: And that's the point we object on hearsay grounds to this coming in.

BY MR. ANDERSON:

Q. Do people look at Standard & Poor's when they make investment decisions?

A. I think most fixed income investors would.

Q. Right. And the point is that this information is out there in the public for investors to consider in making their investment decisions, this adjustment made by S&P using their methodology; right?

A. Yes. And, again, I'll say, you know, no one know how it's done. It's kind of a black box. And if it's a big issue, maybe S&P should come here and testify about how they do this and get to these numbers.

Q. You've never been employed by a public company as a chief financial officer; is that right?

A. No.

Q. Not employed in the finance function for any public company?

A. No.

Q. Not been responsible for developing a financing plan for any public company?

A. No. I mean, I've worked as consultants, as a consultant to companies, but I haven't worked as a CFO. No.

Q. You've not been responsible for Securities and Exchange Commission reporting for any company?

A. No.

Q. Not responsible for issuing bonds at any company?

A. No.

Q. Issuing stock at any company?

A. No.

Q. It's FPL's executive team, not OPC, that's responsible for raising the debt and raising equity to fund investments for its customers; right?

A. Yes.

Q. You've never been responsible for maintaining a public company's rating with the rating agencies?

A. No.

Q. Never employed by Standard & Poor's?

A. No.

Q. Moody's?

A. No.

Q. Fitch?

A. No.

MR. ANDERSON: FPL has no further questions. Thanks.

CHAIRMAN CARTER: Thank you, Mr. Anderson.

Commissioners, I'm going to go to staff and I'll come back to the bench.

Staff, you're recognized.

MS. BENNETT: Mr. Chairman, we have one exhibit that we would like to have marked. I guess that would be Number 462.

CHAIRMAN CARTER: 462. Short title?

MS. BENNETT: The short title --

CHAIRMAN CARTER: Well, give it a shot.

MS. BENNETT: You know me too well. Major Electric Rate Case Decisions.

CHAIRMAN CARTER: Okay. Thank you.

(Exhibit 462 marked for identification.)

You may proceed.

BY MS. BENNETT:

Q. Mr. Woolridge, my name is Lisa Bennett. I'm one of the staff attorneys for the Commission. And are you familiar with Regulatory Research Associates?

A. Yes.

Q. Would you agree -- well, I'm going to call it RRA for short. Would you agree RRA compiles information on rate cases from around the country?

A. Yes.

Q. And referring to the exhibit, would you agree, subject to check, that this schedule shows the major rate decisions rendered in 2009 for all electric utilities followed by RRA?

A. Well, actually I think this includes decisions

from 2007, 2008 and 2009.

Q. Very good. Under the heading Increase Authorized on the far right of the schedule and the column Return on Equity, would you agree that RRA reported only one decision that resulted in an ROE less than 10 percent?

A. Yes.

Q. Looking at the same column, would you agree that RRA reported only three decisions that resulted in an ROE of 11 percent or more?

A. Yes.

MS. BENNETT: That's all the questions that staff has. Oh.

CHAIRMAN CARTER: Hang on a second. We're all -- we're waiting on you, Ms. Bennett. We'll wait on you.

MS. BENNETT: Thank you.

BY MS. BENNETT:

Q. I think I want to have you turn back to the exhibit marked 461 that FPL passed out. Do you have that?

THE WITNESS: Mine don't have numbers on them.

MS. BENNETT: Oh, dear.

CHAIRMAN CARTER: You have to describe it to him.

BY MS. BENNETT:

Q. It's the S&P report for Florida Power & Light dated August 20th, 2008.

A. Oh, I, I do -- okay. I do have that.

Q. Can you please turn to Page 3 of the report.

A. Yes.

Q. And would you read aloud the paragraph under the heading Outlook?

A. The entire paragraph?

Q. Yes, please.

A. Okay. The paragraph reads, "The stable outlook on FPL and subsidiaries reflects predictable cash flow from FP&L, a favorable regulatory environment, and growing service territory. The rating could be pressured if growth in the unregulated portfolio increases the consolidated company's business risk, the forecast becomes more dependent on growth at FPL Energy or the projected cash flow is insufficient to maintain the current financial profile. Any failures to sufficiently manage the considerable market liquidity and operational and regulatory risks faced by the company, especially in the merchant energy and energy marketing and trading subsidiaries, would imperil ratings and a stable outlook. Merger acquisitions that do not demonstrate a commitment to credit quality could

result in lower ratings regardless of the timing or outcome of the transaction. An improvement in the rating is possible if FPL can demonstrate that the recent strong financial performance is reasonably sustainable, even though less robust market conditions -- even through less robust market conditions."

Q. And, Mr. Woolridge, would you please describe your impressions of what S&P describes as the impact of FPL Group's nonregulated operations as it has on FPL's credit quality?

A. Well, I mean, clearly they highlight the risk factors associated with those. And that goes back to my earlier comment that the risk assessment done by Dr. Avera is based on FPL Group, not Florida Power & Light. In fact, you go to Page 1 of this, this report, and it says the ratings on Florida Power & Light are based on the consolidated credit profile of parent FPL Group.

I mean, and so the ratings are not -- the risk comparisons that have been done here are not on Florida Power & Light, it's on FPL Group.

MS. BENNETT: Thank you, Mr. Woolridge.

Thank you, Commissioners.

CHAIRMAN CARTER: Thank you.

Redirect?

MR. McGLOTHLIN: Yes, sir.

REDIRECT EXAMINATION

BY MR. McGLOTHLIN:

Q. Dr. Woolridge, please turn back to Page 77 of your prefiled testimony, which is one of the pages of testimony to which questioners referred you.

CHAIRMAN CARTER: Did you say 7 or 77?

MR. McGLOTHLIN: 77.

CHAIRMAN CARTER: Thank you.

BY MR. McGLOTHLIN:

Q. In response to one of the questions you said that a growth rate of 6 to 7 percent is appropriate for companies in the United States. Do you see that statement and remember that question and answer?

A. Yes.

Q. To put that in context, that statement is a portion of the answer to the question posed beginning at Line 1 of that Page 77. Would you read that question to show the Commissioners in what way you were referring to the 6 to 7 percent?

A. The question reads, "Beyond your previous discussion of the upward bias in Wall Street analysts' and Value Line's EPS growth rate forecasts, what other evidence can you provide that Dr. Avera's S&P growth

rate is excessive?"

Q. So the purpose of your reference to 6 to 7 percent was in the way of comparing your position with respect to Dr. Avera's growth rate expectations; correct?

A. Yes. And I was simply highlighting the fact that the economy in the U.S. historically has grown about 7 -- 6 to 7 percent. So have corporate earnings. And if you look at the numbers, these things are slowing down.

Q. And what was Dr. Avera's long-term growth rate projection?

A. Well, he used the, the analyst growth rate estimate, which was for the S&P companies, of 9.6 percent.

Q. What are the implications of the assumption that the long-term growth rate is 9.6 percent? What would have to happen for that to be a valid assumption?

A. Well, in my opinion, you'd have to be a significant change in the economy in the United States. I mean, the economy in the United States is growing now more like at 5 percent. You know, we're not in India where it's 8 or 10 percent. But historically the numbers indicate that corporate earnings are going to grow about the same rate as GDP.

Q. And in fact in the portion of your answer to which counsel did not direct you, you identified certain things that would have to happen for Dr. Avera's projections to hold true, did you not?

A. Yes.

Q. Referring you to Lines 18 through 20, if you read those parentheticals that carry over to the top of the next page.

A. I make the point that, "These estimates suggest that companies in the U.S. would be expected to: (1) increase their growth rate of EPS by 50 percent in the future and (2) maintain that growth rate indefinitely in an economy that is expected to growth about one half his projected growth rates. Such a scenario is not economically feasible or reasonable."

Q. Now counsel for FP&L asked you several questions that required you to compare the total dollars of equity that FPL used in its presentation with the total dollars of equity that you used for purposes of your calculation. Do you recall that question and answer?

A. Yes.

Q. And in the course of answering his questions, you said that you thought it was more important to stress percentages. And I'll ask you to explain to the

Commissioners which percentages you had in mind when you made that answer.

A. Well, I mean, I think if you go back and read my testimony, I'm talking about the percentages in terms of what is the, what is the cost of capital when you consider the percentages of capital sources as well as the cost of those capital sources. And my indication was, I highlighted the fact the company's common equity ratio projected is 59.56 percent or something like that, and it's, that ratio is much higher than actually -- than the, the common equity ratios of other electric utilities, FPL, that sort of thing. So I focus on the percentages.

Q. Which is more important for the Commission's purposes, a comparison of FPL's total dollars versus your total dollars of equity or a comparison of the percentage of equity contained in the overall capital structure?

A. Well, in the end you use the percentages times the cost rates to determine the cost of capital.

Q. And you also compare those percentages, 59 percent in the case of FP&L, 54 percent in the case of your recommendation, to the corresponding percentages of other utilities, do you not?

A. Yes.

Q. And what is that comparison?

A. Well, the comparison is, I mean, actually, I mean, the comparison is, you know, they're projecting, they're asking for 59.5. We, I mean, my number is 54. And as it turns out, if you look at, you know, the average comp for my electric utility group, which is primarily large electric utilities, it's about 40 percent. For FP&L it's about 42 percent. And actually I was looking at the staff's rate case history, the exhibit handed out, and they have a common equity ratio. So they report the common equity ratios here that are approved, and you don't find anything as high as 59.5 percent.

Q. You also in your testimony compare the percentage of equity in the overall capital structure to that which would be appropriate and warranted by a particular company's risk profile, do you not?

A. Yes.

Q. And with respect to both the 59 percent that is associated with FP&L's calculation and the 54 percent equity ratio that you have used for your purposes, in your opinion is either of those appropriate or commensurate with the risk profile of Florida Power & Light Company?

A. Well, I think, you know, I highlight in my

testimony I think our recommended common equity ratio of 54 percent, 54.56, I believe, is very fair, given the common equity ratios of all these companies we've used to measure the common equity cost rate. It's also very fair considering in some states we would be using the common equity ratios of the parent company, which would be Florida Power & Light. In Ohio they use the parent company. If you did that, we would be recommending common equity ratio in the area of 43 percent.

Q. Now taking into consideration that you've used 54 percent, whereas other utilities are in the range of 43 to 48 percent, what does that imply with respect to the risk, relative risk of those two groups of companies, FP&L versus others?

A. Well, clearly our recommendation has less financial risk than these other companies.

Q. That being the case, what are the implications for the use of the 54 percent or 59 percent equity ratio on the appropriate return on equity that should be approved for Florida Power & Light Company?

A. That's, well, it's one of the reasons why I picked a number that was at the lower end of the range, because obviously, I mean, if you look at the, the risk characteristics of FP&L, they're low. And you add to that a high, relatively high common equity ratio, the

overall risk level is at a lower level.

Q. Focusing on the FP&L request of 59 percent and your use of 54 percent, what is the significance in the case where the Commission is going to identify the revenue requirements to be generated and borne by customers and the rates they pay?

MR. ANDERSON: At this point I'd like to interpose an objection. This is again just more restatement of the witness's direct testimony and far beyond the scope of anything that we asked. And I've let a number of questions and answers go by, thinking it would end. It has not. Therefore, I interpose this objection.

CHAIRMAN CARTER: Mr. McGlothlin, to the objection.

MR. McGLOTHLIN: During his questions, counsel for FP&L tried to make the point that there's very little difference in FPL's position and OPC's position by comparing the dollars of equity in their capital structure with the dollars of equity in Dr. Woolridge's capital structure, and concluded that the, the difference is less than 1 percent.

I'm allowing Dr. Woolridge to describe to the Commissioners what the real import of the difference is. And the real import is not a comparison of small

percentages. The real import is the difference in hundreds, a hundred million dollars of revenue requirements that FPL wants the customers to pay.

CHAIRMAN CARTER: Ms. Brubaker?

MS. BRUBAKER: Mr. Chairman, it appears to me that this door was opened by counsel for FPL, and this does appear to me to be a proper scope of redirect.

CHAIRMAN CARTER: Overruled.

BY MR. McGLOTHLIN:

Q. Dr. Woolridge, with respect to the impact on revenue requirements that will ultimately be borne in the rates that customers pay, what is the significance of FPL's use of the 59 percent equity ratio and your recommendation of the 54 percent ratio?

A. Well, I don't know the dollar amount, but it's rather significant I know. I mean, because you're, you're obviously using a significantly higher common equity ratio than, than the 54 percent.

Q. During a series of questions relating to the S&P method of incorporating some imputed debt to correspond with power purchase agreements, you pointed to that language in the FP&L statement which stated that FPL is able to recover PPA charges through a cost recovery clause. Do you remember that question and answer?

A. Yes.

Q. What is the significance of FPL's ability to, to flow purchase power agreement payments through a cost recovery clause?

A. Well, I mean, obviously it's, it's a fairly automatic recovery. I explain in my testimony it's not like debt payments where you're given an opportunity to earn it. It's a pretty direct recovery process. So it's not -- it doesn't have the risk of some of the other regulatory elements we deal with.

Q. You also referred to Moody's in the course of answering a question about the PPAs. For what purpose did you refer to Moody's?

A. Well, they, they make the comment, and I highlight in my testimony, if it's viewed more as an operating expense, there's no reason for an adjustment.

Q. To be clear, when you say no reason for an adjustment, what adjustment are you describing?

A. The imputed debt onto the, making that debt imputation calculation.

MR. McGLOTHLIN: I have no further redirect.

CHAIRMAN CARTER: Exhibits? Oh, wait. Hang on. Anything from the bench? I was on a roll there. Sorry, Commissioners. Exhibits?

MR. McGLOTHLIN: OPC moves the prefiled

exhibits, which I believe are 27 -- excuse me, 207 through 222.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done. Hang on a second before we go to the back pages, guys. 207 to 222. Is that correct? Okay.

(Exhibits 207 through 222 admitted into the record.)

Let's go to the back pages. Hang on a second. We've got 457. Mr. Anderson.

MR. ANDERSON: FPL offers 457 into evidence.

CHAIRMAN CARTER: Are there any objections?

MR. McGLOTHLIN: No objection.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 457 entered into the record.)

458?

MR. ANDERSON: FPL offers 458 into evidence.

MR. McGLOTHLIN: No objection.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 458 entered into the record.)

MR. ANDERSON: FPL offers 459 into evidence.

MR. McGLOTHLIN: No objection.

CHAIRMAN CARTER: 459, without objection, show

it done.

(Exhibit 459 entered into the record.)

MR. ANDERSON: FPL offers 460 into evidence.

MR. McGLOTHLIN: No objection from OPC.

CHAIRMAN CARTER: Without objection, show it done.

(Exhibit 460 entered into the record.)

MR. MOYLE: Could we just -- on those points, I mean our objection would be standing with respect to hearsay, so I don't feel compelled to make it every --

CHAIRMAN CARTER: No. I told you that before, Mr. Moyle.

MR. MOYLE: Just so we're on the same page.

CHAIRMAN CARTER: I remember it was from, like last week or so, whatever, when we did that with Ms. Helton. And I told you that your objection would be preserved, so that's why I say no objection.

Okay. 461.

MR. ANDERSON: Was 460 admitted, sir?

CHAIRMAN CARTER: Yes. Without objection.

MR. ANDERSON: Thank you. FPL offers 461.

CHAIRMAN CARTER: When I say without objection, obviously, Mr. Moyle, I gave you the opportunity to preserve your objection, so that's not indicative of your waiving your, your objections. Okay?

MR. MOYLE: Right. I just don't want -- because I didn't object when you offered that specific one, somebody to say, well, you waived it because you didn't object. My understanding is we have -- we objected during the cross contemporaneously with the exhibit. I just want to make sure it's preserved.

CHAIRMAN CARTER: Okay. Done.

(Exhibit 461 entered into the record.)

462, staff.

MS. BENNETT: Staff moves 462 into the record.

CHAIRMAN CARTER: Are there any objections? Without objection, show it done.

(Exhibit 462 entered into the record.)

Let's do this. I told you I'd give you guys a break to kind of talk a little about the calendar. It looks like we're beginning to make some progress here.

Let me do this. Let me give you guys an opportunity to talk, give staff an opportunity to get adjusted, give our attorneys an opportunity to take a break.

Commissioners, we're going to come back at -- let me do the math in my -- well, that's never a good idea to do the math in my head.

I got this watch from -- I won't call the store's name just in case it doesn't work. How about we

come back at 20 after?

(Recess taken.)

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

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

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

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

DATED THIS 8th day of September, 2009.

Linda Boles

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