BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for increase in rates by Florida Power & Light Company.	DOCKET NO. 120015-EI DATED: August 3, 2012

PREHEARING STATEMENT OF JOHN W. HENDRICKS

John W. Hendricks hereby submits this Prehearing Statement.

APPEARANCES:

John W. Hendricks

1. WITTNESSES:

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2. EXHIBITS:

JWH-1	Components of the Cost of Investor Capital
JWH-2	Utility Proxy Group Two Dimensional View
JWH-3	Utility Proxy Group with FPL & NEE N-R
JWH-4	Historical Utility and Treasury Bond Yields
JWH-5 A & B	Historical Relationship between Utility Allowed ROE and Bond Yields
JWH-6	Customer View of Cost of Capital vs. Equity Percentage
JWH-7	Comparison of Alternative Capital Structure and ROE Combinations

3. STATEMENT OF BASIC POSITION

FPL's petition seeks to increase base rates in 2013 with an additional step increase when the new Cape Canaveral plant comes online. The decisions facing the Commission in this case are many and complex. The outcome will impact electricity rates and the cost of living and doing business for millions of ratepayers of Florida's largest utility, and perhaps set precedents with an even broader reach. I commend the Commissioners for serving in this demanding decision making role and encourage the Commission to be open to change and not too tightly bound by past practices.

As an individual intervener I have tried to focus my necessarily limited efforts on the cost of capital issues and understanding them from a ratepayers' point of view and in the context of current opportunities. I have observed that FPL has been doing a good job of modernizing generation assets, but will argue that their requested capital financing is inefficient.

My basic position is that FPL is requesting an inefficient combination of regulatory capital structure and ROE. There are reasonable alternatives that would reduce costs and the risks of even higher costs in the future for ratepayers, while still providing the appropriate returns to the shareholders and bondholders who invest in FPL assets.

The proposed regulatory capital financing is inefficient in three ways. First, it burdens ratepayers with funding over one-half billion dollars in income tax provisions to compensate for the corporate income taxes of FPL/NEE, which would be substantially reduced with the use of more long term debt that does not incur this cost. Second, ratepayer funds that go to Washington as taxes do not benefit the investors so reducing them should not harm investors. Third, allowing an almost 60% investor equity ratio limits the opportunity for ratepayers to benefit from locking-in historically low (and tax advantaged) debt costs for a larger share of the investments they will be expected pay for as a part of the rates. This increases the risk of future rate increases to fund the cost of equity which can change with each rate case.

Determining the appropriate regulatory ROE is difficult and I have opted to recommend a balance between the levels recommend by OPC (and other interveners) and by FPL, pending additional information and analysis.

Please consider the potential for rebalancing the equity ratio with appropriate adjustments to ROE and debt costs as a way to reduce the costs and risks for ratepayers while appropriately meeting investor requirements.

STATEMENT OF FACTUAL ISSUES AND POSITIONS

I have no position at this time on issues in the Preliminary Issues List other than those listed below.

Issue 17: Should FPL's adjustment to extend the amortization period of the new SAP general ledger system from 5 years to 20 years be approved?

JWH: Yes. I have not seen any specific data on this project, but offer the following general observation since I have extensive experience planning and assessing large systems projects. A complex GL implementation is a major project and should have a useful life in the 20 year range.

Issue 49: What is the appropriate cost rate for long-term debt for the 2013 projected test year?

JWH: 6.3%. Assuming that the Commission adopts my recommended equity ratio as specified in the response to Issue 51 and explained in context in the response to Issue 60, the appropriate cost rate for long-term debt is approximately 6.3%. The appropriate cost rate for long-term debt for 2013 is higher than the FPL request because I am recommending a higher percentage of debt. This shifts more risk to the debt holders, reduces risk for the FPL ratepayers and will contribute to reducing overall costs to the ratepayers. The table in the response to Issue 60 indicates how this recommendation would vary with different assumptions and choices.

Issue 51: What is the appropriate equity ratio that should be used for FPL for ratemaking purposes in this case?

JWH: 45%. If the Commission adopts my recommended ROE as specified in the response to Issue 58 and explained in context in the response to Issue 60, the appropriate equity ratio for investor sources is approximately 45%. The appropriate equity ratio depends on the regulatory ROE and the current and reasonably expected financial market conditions during the next several years. The table in the response to Issue 60 indicates how this recommendation would vary with different assumptions and choices.

The table in response to Issue 60 shows my estimate that a 45% equity ratio will reduce the revenue requirement by about 4.5% relative to FPL's equity ratio recommendation, even if the FPL requested ROE is retained and adjusted for the recommended equity ratio. This is due to the reduction in income taxes in the revenue multiplier. Even more importantly, the 45% equity ratio will provide incentives for FPL to lock-in long term fixed rate financing for a much larger portion of capital and substantially reduce ratepayers' dependence on volatile equity financing for the longer run.

Issue 54: Should FPL's request for a 25 basis point performance adder to the authorized return on equity and proposed annual review mechanism be approved?

JWH: No. FPL proposes this incentive for keeping the lowest typical bill in the state, but as long as natural gas prices remain low for the next few years this is not likely to require any extraordinary effort beyond current expectations.

Issue 58: What is the appropriate authorized return on equity (ROE) to use in establishing FPL's revenue requirement?

JWH: 10.75%. If the Commission adopts my recommended equity ratio as specified in the response to Issue 51 and explained in context in the response to Issue 60, the appropriate ROE is approximately 10.75%. The appropriate ROE depends on the regulatory capital structure and a table in the response to Issue 60 indicates how this recommendation would vary with different assumptions and choices. My assumption of constant investor-capital WACC, with adjustments for the increasing percentage of long-term fixed rate debt, results in ROE estimates that increase with debt percentage as one would expect. My ROE recommendation is based on the mid-point between relying on the ROE request of FPL (which yields 12.25%) and the ROE recommendation of OPC (which yields 9.25%) as most appropriate estimate.

Issue 59: What is the appropriate capital structure that should be used by FPL for ratemaking purposes in this case?

JWH: The appropriate investor capital structure is 45% common equity and 55% long-term debt. I have not investigated the non-investor sources of capital and take no position on them, except to assert that the common equity and long term debt components should be as recommended.

Issue 60: Is the combination of regulatory ROE, debt costs, capital structure and performance adder (if any) appropriate?

JWH: No, FPL's proposed capital financing is not appropriate. It is far too equity heavy for a time when long term debt is available at historically low rates and the gap between average utility ROE and debt costs is so high. When viewed from the ratepayer perspective, the PreTax Weighted Cost of investor Capital (PTWACC), which drives the revenue requirement, is more meaningful than the WACC.
I found the supporting analysis for both FPL and other interveners ROE to have merit and would encourage the Commissioners and Commission Staff to focus on assessing their differences. My analysis suggests that a lower equity ratio is strongly advantageous at this time but the appropriate ROE is not so clear.

Comparison of Alternative Capital Structure and ROE Combinations

Case #		Equity %	ROE	Log Term Debt %	LT Debt Interest Rate	Wgtd Avg Cost Invest Capital	Income Tax in Rev Req	PreTax Wgtd Avg Cost Invest Capital	% Reduction in Rev Req from FPL Req
1	FPL Requested	59.6%	11.50%	40.4%	5.26%	8.98%	3.84%	12.82%	0.00%
3	FPL CS, OPC ROE	59.6%	8.50%	40.4%	5.26%	7.19%	2.84%	10.03%	-27.81%
4	OPC Midpoint CS Option	55%	8.75%	45.0%	5.41%	7.25%	2.70%	9.94%	-28.92%
2	OPC Recommended	50%	9.00%	50.0%	5.63%	7.32%	2.52%	9.84%	-30.31%
5	JWH Rec CS w/FPL ROE	45%	12.25%	55.0%	6.68%	9.19%	3.09%	12.27%	-4.44%
6	**JWH Rec CS w/ midpoint ROE**	**45%**	**10.75%**	**55.0%**	**6.28%**	**8.29%**	**2.71%**	**11.00%**	**-16.52%**
7	JWH Rec CS w/OPC ROE	45%	9.25%	55.0%	5.88%	7.40%	2.33%	9.73%	-31.75%

Issue 61: What is the appropriate weighted average cost of capital?

JWH: The appropriate weighted average cost of capital from investor sources (common equity and long-term debt) is approximately 8.29%, which is the midpoint between my estimates based on FPL's request and OPC's recommendation. I have not investigated the non-investor sources of capital and take no position on the WACC that includes them, except to assert that the common equity and long term debt components should be as recommended.

Issue 62: Has FPL maximized the sources of net jurisdictional revenue that are projected to be reasonably available and technically viable for the 2013 test year? If not, what action, if any, should the Commission take in setting FPL's rates in this case? (For purposes of this issue, "net jurisdictional revenue" **may** include net revenue related to the supply of CO_2 captured from an FPL facility.)

JWH: This issue refers to "revenue related to supply of CO_2 captured from an FPL facility," but to the best of my knowledge utility scale capture of CO_2 is not economically feasible. A recent International Energy Agency (IEA) white paper projects it will not be ready before 2020, and even then it would be immature technology requiring large capital investments and substantially reducing fuel efficiency. This is an interesting research and development area, but it would not be appropriate for FPL ratepayers to bear any costs of investigating CO_2 sales as a revenue source until carbon capture becomes economically feasible at a utility scale.

Issue 85: Should FPL salaries, costs and overheads for activities associated with (a) public relations or external affairs, (b) shareholder services, (c) attempted acquisitions of electric facilities, and (d) efforts opposing municipalizations pursuant to a franchise agreement be removed from operating expenses?

JWH: No, assuming they are for appropriate and reasonable activities.

Issue 86: Should FPL costs to pay contractors for legal, public relations or other consulting services be borne by customers or FPL shareholders?

JWH: Yes, as long as these contractors and consultants are providing appropriate services under reasonable terms.

Issue 131: What is the appropriate weighted average cost of investor capital, including the proper components, amounts and cost rates associated with the capital structure, to calculate the base rate step adjustment for the Canaveral Modernization Project?

JWH: The appropriate weighted average cost of capital for the CC project is 8.29% with a 45% investor equity ratio as recommended for the base rate. Even if the Commission might have some concerns about this being too rapid a shift for the base rate, it should be adopted for the CC step increase and any other major projects implemented while this rate structure is in place. The historically very low interest rates now prevailing provide a rare opportunity to lock-in more low cost fixed rate financing that will reduce the risks of future rate increases. The current wide gap between bond and equity costs presents an opportunity to reduce risks that should not be ignored. With these rates available, the tax savings of shifting from equity to debt more than compensate for the slightly higher WACC required.

Issue 134: Is FPL's requested base rate step increase of $173,851,000 for the Canaveral Modernization Project appropriate?

JWH: No. If the recommended equity ratio and ROE are adopted the required increase should be reduced by about 17% while also reducing the risk of future rate increases to support this facility.

4. STIPULATED ISSUES

None.

5. PENDING MOTIONS

None.

6. STATEMENT OF PARTY'S PENDING REQUESTS OR CLAIMS FOR CONFIDENTIALITY:

None.

7. OBJECTIONS TO QUALIFICATION OF WITNESSES AS AN EXPERT:

None at this time.

8. STATEMENT OF COMPLIANCE WITH ORDER EXTABLISHING PRODEDURE:

There are no requirements of the Order Establishing Procedure with which we cannot comply.

Dated this 3rd Day of August, 2012

Respectfully submitted,

s/ John W. Hendricks

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