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BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 160021-EI

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

DOCKET NO. 160061-EI

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

DOCKET NO. 160062-EI

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

DOCKET NO. 160088-EI

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

VOLUME ~~18~~ 17
PAGES 1993 - 2218

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING:
CHAIRMAN JULIE I. BROWN
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER ART GRAHAM
COMMISSIONER RONALD A. BRISÉ
COMMISSIONER JIMMY PATRONIS

DATE: Thursday, August 25, 2016

TIME: Commenced at 11:50 a.m.
Concluded at 3:30 p.m.

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

REPORTED BY: DEBRA KRICK
Court Reporter
(850) 894-0828

APPEARANCES: (As heretofore noted.)

PREMIER REPORTING
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I N D E X

WITNESSES

EXHIBITS

NUMBER:		ID	ADMTD
115-122	Previously identified	2034	
649	Previously identified	2034	
650	Previously identified	2035	
651-655	Previously identified	2035	
123	Previously identified	2118	
656	ROE 2015 and 2016 averages as 656	2208	~~2208~~
657	ROE 2016 averages as 657	2209	~~2209~~

CM

P R O C E E D I N G S

(Transcript follows in sequence from Volume 16.)

EXAMINATION

BY MR. MOYLE:

Q Okay. So I don't -- I am not that familiar with the pension, but I understand how it works, and I may not have the math exactly right given what you just said about the 4.5 percent for the first five years, is that right?

A Yes.

Q And then after that, it goes to --

A Six percent.

Q So -- so how -- again, I am -- I was hired in 2010, how many years would I have to work before I have get 100 percent payout on my pension?

A Are you asking me to calculate how many years until that adds up to $100,000?

MR. LITCHFIELD: We are not hiring Mr. Moyle, by the way.

BY MR. MOYLE:

Q I did it this way. I did $100,000, and if you took four percent a year, I would have to work 25 years. That's -- that's like taking four quarters and combining them for a dollar, I could do that, but is that roughly

right?

A You have confused me, Mr. Moyle. I apologize.

CHAIRMAN BROWN: He does that.

THE WITNESS: I will say that because our pension plan is not a final average pay plan like a traditional pension plan, like we used to have before 1997, the final benefit is not expressed in terms of a percentage of final average pay, such as a single-life annuity, or 55 percent of final average play, it's not expressed that way. It's a cash balance style plan, and I believe I have described how it works.

BY MR. MOYLE:

Q I am familiar with the State retirement system, and like for a correctional officer, they get a little bit of a higher portion on an annual basis, and at the end when they retire they get, you know, 60, 70, you know, whatever, you add that -- their average -- their annual amount that they get per year times the number of years times their high five salary. So that's --

A That' a final average pay.

Q -- the frame of reference.

A Yes, that's a final average pay pension plan, and when we did away with ours in 1997, we reduced our pension obligation about $200 million because of the much less rich plan that we adopted, the cash balance plan.

Q And what's a cash balance plan?

A It's what I just described. It accumulates at, you know, 4.5 percent of base salary for the first five years, six percent thereafter, and receives an interest crediting rate per year.

Q Okay. So it does represent a percent that you will get going future, you just a fund it at four-and-a-half percent or four percent?

A No. It does not work the same way and -- I mean, quite frankly, public sector jobs, such as the one you are describing, definitely have a different compensation of benefits model than our company, and it's not a relevant comparator or benchmark for what I do in my job.

Q What's the vacation provided? Two weeks? Three weeks? A month?

A It's scaled based on number every years of service.

Q How about for executives, what's the vacation?

A It's the same policy as for nonexecutives, and its scaled based on years of service. So an employee starts out in the first four years with two weeks of

vacation, after six months probationary period.
Q And then when does it accrue to more than two weeks?
A At the fifth anniversary.
Q And you get three?
A Yes.
Q And when do you get four?
A I believe after 15 years of service.
Q Is it capped at four?
A It's capped at five, after 23 years of service, I believe, subject to check.
Q Okay. So in response -- just flipping through the interrogatory, in response to a question where I asked you how much are the benefits worth on a per employee basis, you were not able to answer that question. But if you flip to page -- this is Interrogatory 28, page one of five.
CHAIRMAN BROWN: Which is marked as Exhibit 654, correct?
MR. MOYLE: 654, yes, ma'am.
BY MR. MOYLE:
Q The medical is over 10,000, is that right?
A Well, the medical per employee per year expense --
Q Yes, ma'am.

A -- is what's reflected here. And I believe this is just the employer portion.

Q Well, that's what I am interested in, because that's what you are asking ratepayers to pay, right?

A Well, I have demonstrated on Exhibit KS-7 of my testimony that our per employee per year total medical cost is more than 15 percent below the utility benchmark. We have an extremely aggressive management on medical costs.

Q I understand, and you have the testimony. I just am trying, during cross-examination, to focus you kind of keenly on a few point -- a few topics to make a point --

A Okay.

Q -- that I want to make. So you didn't answer my question, which was, is the per employee per year cost for medical $10,225?

A Yes, it is. I just -- I am not sure if we are -- if this is the all in cost for the company. I will have to double check.

Q You think it's less or more?

A No, I think this is the employer portion, and what's demonstrated on KS-7 in my testimony is the employer plus employee.

Q Okay. So -- and I am not going to do this,

but in this chart, there is costs per employee -- employee on a number of things, and you think, when it costs per employee, that that's really the employer number; is that right?

A   This is what it costs the company. One important point about per employee per year costs, Mr. Moyle, is not all employees enroll in medical or dental, so that means that you cannot calculate the budget or the forecasted costs by taking headcount times this figure.

In addition, for medical, our employees who become disabled and qualify for long-term disability, who are no longer in our active employee headcount, are also part of our medical plan. And we have COBRA continuance on medical and dental following separation that are also included in our medical and dental plans.

Q   And all those people represent a very small fraction of your employees, correct?

A   I believe it would be a small percentage. I don't know about a small fraction.

Q   Do you know the specifics, how many are on ERISA or --

CHAIRMAN BROWN: Asked and answered. She just answered the question.

BY MR. MOYLE:

Q Okay. So just to be clear on this exhibit, all of the costs that are shown on the far right-hand column, for example, on page two of five, that defined contribution, 33 million, that's a cost for which you are seeking recovery in this case; is that right?

A Yes, these are the test year costs that tie to MRF C-35.

Q And 9.3 million in post-retirement, this is for people who are with the company, and then are no longer with the company but they still are receiving medical and prescription drugs, and life insurance benefits, and things like that, that's a 10 million -- $9.3 million item; is that right?

A That's correct.

Q And I think we got this, but the supplemental -- I know we got that. Never mind. Strike that.

So the last exhibit I have for you is incentive compensation goals?

A Yes.

Q And this is a question that was asked of you about providing, from 2011 to 2015, a detailed summary of the corporate and/or group goals. Can you -- before we walk through the exhibit, can you tell me how

judgments are made whether someone achieved a goal or didn't achieve a goal?

A Yes. And I know I answered an interrogatory in this, it's a rather long explanation.

We have a comprehensive performance management program, and the foundation of it is our partners in performance process, where each individual employee, non-bargaining, meets with his or her supervisors at goals in advance of the year, and then meets midyear to see how they are doing, and then meets at the end of the year to assess final performance. And their goals are aligned to their business unit goals, which are aligned to the company's goals, which are -- the foundation of which is our customer focus performance measures around reliability, customer service, safety compliance and cost-effectiveness.

So the partners in performance process is really the answer to your question. That's how we determine if individuals meet their goals.

Q Okay. And would you agree that goals should be clear and measurable, and as objective as possible?

A Yes. Our philosophy is that goals should be SMART -- which is an acronym, S-M-A-R-T, specific, measurable, aligned, realistic but challenging and time bound. And one of the ways that we ensure that we have robustness around our goals setting process is that, wherever possible, we rely on industry benchmarks so that we can set our goals at top quartile or above, and sometimes top decile or above.

Q Okay. So I think you said yes when you -- before you responded to that, is that right?

A Yes, I did.

Q Okay. And you are involved in setting these goals, is that right?

MS. CLARK: Asked and answered.

MR. MOYLE: Okay.

CHAIRMAN BROWN: Move along, please.

BY MR. MOYLE:

Q Will you be comfortable if I asked you about some of the indicators, the specifics of them?

A Yes.

Q Okay. So let me flip you to page two of five. Down at the bottom, there is a goal -- there is an indicator, what's an indicator?

A It's a performance ob -- performance measure.

Q There is a performance measure, or an indicator, that says, completion of base rate proceeding. And then the goal is, fair outcome for customers and shareholders.

Do you have a -- when you set this goal in

2012, do you have a measurable way to figure out whether there is a fair outcome for customers in a rate proceeding? Do you say, like, well, if the Commission awards them 25 percent of FPL ask, that's fair? I mean, is there some number that you use to measure this, given the response to my last question about -- about how you measure goals?

A I am not aware of what the senior leadership objectives were around this. We want to a fair outcome for shareholders, as well as customers, but customers are the focus of our plan.

And it's important to note the reason that we have this as a performance measure in '12. I mention the words aligned with regard to SMART goals. And when you have the entire organization working to produce thousands of filings that are accurate and timely, and that is what is, quite frankly, exhausting them throughout the year, they have to see alignment between what they are being asked to do and what's important for the year, and what their business unit in the company is trying to achieve. So we include it, as is appropriate, in a year where that many employees are working on it. And then at the end of the year of, the senior leadership meets to determine if the outcome was fair to customers and shareholders.

Q Okay. Well -- and that answer, I am a little confused, because that answer sounded to me like the measurement is, you know, did all of the boxes, you know, get here, and were they ordered correctly, and did they not staple documents improperly like I did? I mean, those are measurable -- more measurable goals, I would think, than a fair -- a fair outcome for customers; do you agree?

A I don't believe I agree. I mean, I am describing the reason why it's important that an individual employee at a lower level in the organization should have alignment between what they are doing and what the company's objectives are. But going back to your question, I am not -- I am not part of the senior leadership discussions or meetings around the assessment or the performance of this goal.

Q Do you think it's -- do you think it's fair for a goal to be specifically tied to a decision of a third-party over which someone may or may not have any influence?

MS. CLARK: Madam Chairman, I object to this question. She has answered the reason for the goal in the -- as an indicator, and indicated why it is important. So I think this is just going down the same line of questions that she's already answered.

MR. MOYLE: I -- respectfully I disagree. I mean, I want to ask her a couple more questions, because if people have -- are taking the stand, and they have, you know, a goal that they get additional compensation for depending on the result, I think that's something that -- that we should know about. It may or may not impact their testimony, but we should be able to ask that question.

CHAIRMAN BROWN: I will allow it and see if she knows -- has an answer for it. If she doesn't, then you can move along and skip over those questions.

BY MR. MOYLE:

Q So the question, do you know -- do you know if some -- the fair outcome process, do you know if that takes into consideration this commission's decision in the rate case?

A Certainly, yes. The assessment of whether the outcome is fair, we take into consideration what the outcome of the rate case is. As I said before, whenever possible, these performance objectives are set on the basis of industry benchmarks. This is one of those rare goals that doesn't have a benchmark, so it would require some decision-making on the part of senior leadership, but that's completely reasonable with something as important to the company as a rate case.

Q Was this goal met after the 2008 rate case?

A I believe it was, but I don't -- I don't recall how we assessed it.

MR. MOYLE: Let me check my notes.

That's all I have. Thank you.

CHAIRMAN BROWN: Thank you, Mr. Moyle.

We are going to move on to hospitals. I will let everyone know that we will be breaking around 12:30 today for lunch, and take a little bit longer lunch break so that the intervenors can work out their schedule for next week. Is that fair, Mr. Wiseman?

MR. WISEMAN: Yes.

CHAIRMAN BROWN: Okay. You may proceed.

MR. WISEMAN: I have no questions for this witness.

CHAIRMAN BROWN: Thank you.

Retail Federation.

MR. LAVIA: No questions. Thank you.

CHAIRMAN BROWN: Thank you.

Mr. Jernigan.

MR. JERNIGAN: No questions, ma'am.

CHAIRMAN BROWN: Thank you.

Sierra.

MS. CSANK: No questions.

CHAIRMAN BROWN: Thank you.

Wal-Mart.

MS. ROBERTS: No questions.

CHAIRMAN BROWN: Thank you.

Where did AARP go?

All right. Larsons.

MR. SKOP: Thank you, Madam Chair. Just a few questions.

EXAMINATION

BY MR. SKOP:

Q Good morning, Ms. -- excuse me. Good morning, Ms. Slattery.

A Good morning, Mr. Skop.

Q I just wanted to follow up on an exhibit which has been marked for identification purposes as 652, which I believe that you and Mr. Moyle briefly discussed.

With respect to FPL's distribution of incentive compensation for its employees, does FPL utilize an annual employee performance evaluation process?

A Yes. It's the process I described previously to Mr. Moyle as the partners in performance process.

Q Okay. And within that process, is there a required ranking distribution of employees?

A Yes. We have a one-through-five rating scale, if you will.

Q Okay. And in that rating scale of one to five, one represents the top performing employees and five would represent the best or --

A No, it's the opposite. So five is far exceeded objectives, four is exceeded objectives, three is, you know, highly valued met objectives, and then two and one are below that.

Q Okay. And is there a distribution percentage that -- or a forced ranking for each of those one through five rankings for employees?

A No. We do not use a forced ranking system.

Q Okay. Is there any percentage where, similar to GE, or other companies, that this certain number of employees, like, say for example, 10 percent have to be at the bottom in order to continue to improve the talent pool, if you will?

A No. We try to avoid the term forced ranking, and we try not to force distribution. However, we do robust analytics around how, you know, the performance measures are being used. So human resources does take a look at what the distribution is across the company and by business unit, but we don't force rankings, and we don't force distributions.

Q Okay. And for the most recent employee performance evaluation process, approximately how many employees would be in the lowest tier, to your knowledge?

A I do not recall. I do know that when an employee is rated -- ranked, you know, a one, you know, failed to achieve objectives by a large measure, then generally that's a person with, you know -- they are being performance managed and it's going to resolve itself with them either increasing their performance and meeting their objectives, or them choosing not to be with the organization, something like that.

So we don't have many one's, if you will. By the time it gets to that point, there is very few. And -- but again, we don't do forced rankings.

Q Okay. And in the age of the millennial generation, are you familiar with the term "performance award"?

A Yes.

Q Okay. So I guess what I am struggling to understand is the apparent lack of correlation between what has been identified in Exhibit 652 with Mr. Moyle's percentages of employees that did not receive an

incentive compensation award, which appears to be an abnormally low percentage in light of, you know, typical performance ranking processes, and if you could just elaborate on that, please.

A Well, I disagree with you, Mr. Skop, that these percentages are abnormally low. First of all, as I mentioned previously in my discussion with Mr. Moyle, and I am not -- I just alluded to, we don't allow employees to continue to underperform and stay in the organization.

We have -- we work with them to try to improve their performance. Sometimes we identify that they are not in the right job and they need to move into a position that's more aligned with their skills and experience so that they can contribute more appropriately to our goals. But ultimately, if we have poor performers, they generally, you know, choose to go somewhere else where they fit in better, or we help them with that choice.

So we have a very low percentage of low-performing employees because of our robust performance measurement system. And we also exclude from our analytics new hires, because, you know, we want to make sure just those who have contributed to either the full year, or the majority of the year included are in these analytics. We think these are perfectly appropriate percentages, and we do robust pay for performance analytics around every merit distribution to ensure appropriate use of our system.

MR. SKOP: And just one follow-up question, Madam Chair.

BY MR. SKOP:

Q Thank you, Ms. Slattery. Looking at the 200 -- I mean, the 2015 line item on that exhibit, and approximately 107 employees did not receive awards out of 4,173 that were eligible -- and, again, according to Mr. Moyle's math, which is always subject to check. That seems to be a percentage which is typically far lower than what you would expect to see in a typical employee evaluation process for lower tier employees. I mean, is --

CHAIRMAN BROWN: Mr. Skop, is that a question?

MR. SKOP: Well -- yes, it is.

BY MR. SKOP:

Q So, again, you are stating that this number of 2.3 percent is -- 2.3 percent of the entire -- excuse me, let me restate that.

Are you stating that the calculated percentage of 2.3 percent of the employees that did not receive awards over the eligible distribution pool is appropriate to receive incentive compensation?

MS. BROWNLESS: Asked and answered, Your Honor.

CHAIRMAN BROWN: Sustained. Please move along.

MR. SKOP: I think I have no further questions. Thank you.

CHAIRMAN BROWN: Thank you.

Staff.

MS. BROWNLESS: Yes, ma'am.

CHAIRMAN BROWN: Do you have questions?

MS. BROWNLESS: We have two questions.

EXAMINATION

BY MS. BROWNLESS:

Q If you can refer to what's been marked as Exhibit No. 654, the employee benefit program, and to the last page of that interrogatory response, which is page five of five.

A Yes, I am there.

Q Okay. Now, is it fair for me to say that, according to this exhibit, the SERP is based on salary and annual incentive pay?

A Yes.

Q And has the company adjusted the amount requested in the rate case to remove a portion of the

SERP associated with executive incentive compensation?

A Let me make sure I understand your question. Could you please --

Q You want me to go back?

A Yes, if you would, please.

Q Sure. Has the company adjusted the amount requested in the rate case to remove the portion of the SERP associated with executive incentive compensation?

A No, it has not; because, as I stated before, the entire benefit is necessary to provide any kind of competitive or market competitive retirement benefit to higher level employees, as based on our benchmarking. And it's a necessary component to attract and retain these -- these high level leaders. We have not made any adjustment.

Q Well, my understanding here is that you have removed from your rate case request all executive incentive compensation.

A That is correct. We have removed all compensation related to executives incentives, both cash and equity, but we have not removed any portion of the retirement benefits.

Q Okay. For those of us who are a tad slow, so that means that you have removed them for expense purposes, but not for the calculation of this program?

A That's correct.

MS. BROWNLESS: Thank you so much.

CHAIRMAN BROWN: Commissioners. Commissioner Graham.

COMMISSIONER GRAHAM: Thank you, Madam Chair.

Ms. Slattery, welcome.

THE WITNESS: Thank you.

COMMISSIONER GRAHAM: I asked this question of Ms. Santos, and she pointed it to you, so you can thank her later.

THE WITNESS: Okay.

COMMISSIONER GRAHAM: I was talking about customer service, and trying to understand how the bonuses are tied to people working in customer service. Do you know -- as you said, they would sit down with their boss, and they will go through what their goals are. And so the typical person is going to answer the phone in customer service, what would their goals look like, their annual goals? What sort of the things do they have to achieve?

THE WITNESS: I believe that in customer service, a customer service representative would have goals that are used pretty much for all customer service representatives regarding -- you know, there are a lot of statistics kept about the phone calls, about how many they take; how quickly they take them; how accurately and timely they handle them. And those goals would have a clear line of sight to the business unit's objectives and the company's objectives of providing superior customer service to customers, and that's evidenced by the fact that the annual incentive plan at the company level has two customer service goals for providing customer service that meets residential and business unit customer satisfaction scores through surveys.

So there is very clear line of sight from what a customer service representative does to what their business unit expects to achieve, and what the company's goals are, and it's customer-focused incentive plan goals.

COMMISSIONER GRAHAM: So what are those goals? I mean, the goals are --

THE WITNESS: Sure.

COMMISSIONER GRAHAM: -- all calls are going to be returned in 30 seconds, that sort of thing?

THE WITNESS: I believe that, yeah, there are very specific performance measures around customer service, and they are focused on timeliness, accuracy and number -- volume of calls.

I don't have a copy of, you know, of one of those customer service reps partners in performance objectives with me, but I am familiar with them. And it is a good example of the kind of line of sight that individual employees have to the company's objectives, and what they are trying to deliver to customers.

COMMISSIONER GRAHAM: Now, do those sort of things ramp up every year, or you -- I guess you hit a level where you say, something reasonable is every 15 seconds? I mean, I our calls should be answered in 15 seconds to 30 seconds.

THE WITNESS: Well, I don't know because I haven't done a comparison study with what our customer service representatives goals have been over the years, but you do -- you make an important point. Our annual incentive performance objective represent a balanced scorecard, because we have to balance -- you know, the customers want excellent customer service and reliability, safety compliance, and so forth, but they also want cost-effective service. So we have to balance, you know, our nonfuel O&M budget goal in the plan with what our, you know, customer service satisfaction score goals and reliability goals are as well.

COMMISSIONER GRAHAM: All right. So now how does that relate to -- you have the person that answers the phone, and then you have that person's direct supervisor. How is their bonus tied to that?

THE WITNESS: Well, one thing, going back, the customer service reps are hourly employees, so they are not eligible to participate in the incentive plan, but the supervisors who manage those departments are exempt employees who do. And, again, there is line of sight between what each individual team member is asked to accomplish, what the supervisor is responsible for, what senior leadership of the business unit is responsible for, and so on.

COMMISSIONER GRAHAM: Now, are any of those bonuses tied to some of these awards that you guys receive? I mean, does that add to?

THE WITNESS: I am not familiar with all of the partners in performance, you know, goals for every employee, every non-bargaining employee, but I am just not sure. I know that the fact that we have, you know, been ranked number one by JD Power and Associates in the southeast is something that the supervisors and managers in customer service are very proud of. And I am sure that the achievement of their teams and those scores are taken into account when we assess their performance, but I have not seen individual supervisors' partners in performance documentation to be able to comment.

COMMISSIONER GRAHAM: All right. Let's go back to the question -- well, the line of questioning that Ms. Brownless was asking earlier about -- in the 2012 rate case, my understanding was the -- only half of the bonuses that were paid out were looking to get through revenue requirements, is that correct?

THE WITNESS: Well, no, by 2012 we had already taken out 100 percent of executive incentive compensation --

COMMISSIONER GRAHAM: Okay.

THE WITNESS: -- and 50 percent of nonexecutive equity compensation.

COMMISSIONER GRAHAM: Now, the 50 percent, is that 50 percent of the employees or 50 percent of the total dollar amount?

THE WITNESS: Dollars, not employees.

COMMISSIONER GRAHAM: Okay. Now, the same -- I guess, my understanding is the same thing is in this rate case as well --

THE WITNESS: That's correct.

COMMISSIONER GRAHAM: -- the same zero for the executives, and half for the rest of the bonuses?

THE WITNESS: That's correct. In this case, our revenue requirement contains no dollars associated with executive incentive compensation, neither cash nor equity, and we have also removed 50 percent of the nonexecutive equity compensation.

COMMISSIONER GRAHAM: Do you know what that dollar amount would be if it were included?

THE WITNESS: The executives? Yes, because we have several interrogatories that calculated it.

So the adjustments that were made to O&M and capital are detailed in an interrogatory that we responded to that was in OPC's fourth set of interrogatories, Interrogatory No. 139.

So the -- the adjustment -- let's see. The 2017 test year adjustment to net operating income on C-3 per book was 26,957,000.

COMMISSIONER GRAHAM: That 26 million -- well, roughly $27 million was not included?

THE WITNESS: Not included.

COMMISSIONER GRAHAM: Okay. Thank you.

CHAIRMAN BROWN: Thank you.

Commissioner Brisé.

COMMISSIONER BRISE: Thank you, Madam Chair. And thank you for your testimony this morning.

When Mr. Silagy testified, I got the sense that there was a certain value placed on diversity of the workforce, okay. And recognizing that within the next -- well, at this year, in essence, 26 percent is eligible for retirement, and in five years, 47 percent of your workforce is eligible for retirement. Does FPL benchmark itself against or with other utilities to see where they rank in terms of minority employment across the board across the organization?

THE WITNESS: I want to talk a little bit about our diversity inclusion initiatives.

COMMISSIONER BRISE: Sure.

THE WITNESS: But regarding benchmarking, I am not familiar enough with that benchmarking to know if our benchmarks are with utilities or general industry. I don't perform that benchmarking myself.

But we have a very strong commitment to diversity inclusion in our workforce in a number of initiatives to ensure that it's not only a goal, but it's a value. We have a corporate diversity council comprised of leaders across the company that meet and set these initiatives and objectives for the company. Senior leadership looks at how we are doing against our objectives on a monthly basis.

We -- we are very concerned about the retirement bubble coming up, and we have determined that one of the best ways to ensure that we, you know, replace the retiring workforce with a diverse slate of candidates is to start with a lot of college recruiting.

So we are participating in, you know, college fairs. I think we had 26 last year that we participated in. And we always go to a number of historically black colleges and universities to ensure that we are able to bring back a diverse slate of candidates for hiring for our supervisors.

In addition, we have reached out and formed relationships with a lot of national associations and organizations that are great pipelines for diverse talent for both, you know, females and minorities.

For example, the National Association of Black Engineers, we have a strong relationship with them, and we will participate in regional training with them. When we go to college campuses, we will reach out to the local chapters on campus of those organizations and invite the students in. We want to do everything we can to make sure we have a pipeline of talent that's extremely diverse. And we do check on, not only the hiring statistics, but internal promotions of females and minorities, including specifically African-Americans, to make sure we are doing well against our objectives there.

COMMISSIONER BRISE: So you all keep internal goals that you want to meet?

THE WITNESS: Yes, we do. And one of the things we do internally also is we have 19 employee resource groups, which are sometimes referred to as affinity groups, but they are open to everybody, and it allows for networking on campus, if you will, at the company of, you know, a diverse group of folks, and we will reach out and try to get them to recommend external hires, for example, from their associations and their networks. And that improves the inclusiveness within our workforce.

We are convinced that an inclusive, diverse organization will drive innovation and high quality. And we are committing to make sure that our organization has that as a core value.

COMMISSIONER BRISE: And for the record, this doesn't add much in terms of a fiscal impact in terms of bonus?

THE WITNESS: It doesn't. It doesn't. Really, this doesn't cost a lot.

COMMISSIONER BRISE: Sure. Thank you.

CHAIRMAN BROWN: Ms. Slattery, thank you for your testimony. Are you an ERISA attorney?

THE WITNESS: I am not an ERISA attorney. Although, I am a non-practicing attorney.

CHAIRMAN BROWN: Lucky. As am I.

Question for you on page 21 of your direct testimony. You talk about the various medical benefits. Medical costs, according to the Aon Hewitt forecasting from 2016 to 2018, they are rising. I mean, we know it is a fact, medical costs are rising, and they predict 19 percent --

THE WITNESS: Yes.

CHAIRMAN BROWN: -- but FPL, in this rate case proceeding, is decreasing the medical costs?

THE WITNESS: Yes. We have -- we have done -- we are very proud of the job we have done in aggressively managing medical costs, and getting ahead of the trend. So whereas Aon Hewitt predicts that, in the utility industry, medical trend will rise at a rate of about six-and-a-half percent for each of 2017 and 2018. We are trying to beat 2.6 percent, and the way we are doing this is through kind of a diverse -- diverse strategy that includes providing plans that encourage medical consumers in among out employees, providing on-line tools for them to do cost comparisons, aggressively managing rising pharmacy costs, providing case management and a slate of employee health and well-being initiatives to encourage healthy lifestyles and behaviors to improve health so that we can have a lot of preventive, you know, measures to future rising costs.

CHAIRMAN BROWN: Do you have any knowledge of how that compares to other Florida IOUs, electric IOUs? Are your costs -- I mean, are they seeing -- do you know if they are seeing an increase in how you faired?

THE WITNESS: I don't, because Exhibit KS-7, which shows our per employee per year medical costs being 15 percent below the utility benchmark, it's not specific to Florida. I don't have the data stratified by Florida utilities.

CHAIRMAN BROWN: Okay. Turning to KS-2,

that -- which is the total salary and wages. And you have a customer per dollar, and KS-3 has it, I think behind that, actually, it has based on per megawatts an hour, and FPL falls at $217 per customer. Of the groups that you outline here, which would you -- of the utilities is comparable in terms of size based number of customers?

THE WITNESS: Let's see -- let me see if I have that with me. I tend to -- in compensation, we tend to focus on size measures that are largely revenue driven, because that's sort of the gold standard of compensation as far as determining comparable companies. So I do not have memorized the number of customers, but I do have it with me. So for average customers, the closest to us would be Southern California Edison.

CHAIRMAN BROWN: Okay.

THE WITNESS: They have 4.9 million to our 4.7.

CHAIRMAN BROWN: Okay.

THE WITNESS: And that is the closest.

CHAIRMAN BROWN: Nope, that's a good barometer.

THE WITNESS: Okay.

CHAIRMAN BROWN: Your Exhibit 652, you had a couple of questions on this from Mr. Moyle. If you could pull that up, please.

THE WITNESS: Yes, I have it.

CHAIRMAN BROWN: Okay. And interesting data here. I am curious about the received award, and what would -- if you have the figures for this, what would the -- a typical award appear like? Cash bonus? Stock options? Various?

THE WITNESS: This is cash -- this is cash incentive, and what it would look like is -- basically it's shown on KS-4, Exhibit KS-4 to my testimony, around 12 percent of base salary in the form of a cash incentive.

CHAIRMAN BROWN: Fair enough.

Thank you so much.

THE WITNESS: Thank you.

CHAIRMAN BROWN: Redirect?

MR. REHWINKEL: Madam Chairman, before you go to redirect, would you indulge me to ask you to allow me to ask -- she responded to a question from Commissioner Graham, and she referenced MFR C-3, and she gave a number. And I was just wondering, for clarity of the record, if she could point us to that. It would -- would you permit me to ask that?

CHAIRMAN BROWN: Seeing no objection, go

ahead.

FURTHER EXAMINATION

BY MR. REHWINKEL:

Q You referenced C-3, and I think a $26 million number.

A Well, the one thing I -- my number was pretax, I believe it's possible C-3 is after tax.

Q Okay. Can we just ask is what -- does that relate to the executive compensation adjustment on line eight, lines 2017 C-3?

A I don't have a copy of C-3 with me.

MR. REHWINKEL: Would you allow me to hand it to her?

CHAIRMAN BROWN: Yes. Counsel, he is going to hand her a copy of that.

MS. CLARK: Yes.

MR. LITCHFIELD: And, Madam Chair, I would suggest, also, if Mr. Rehwinkle is looking to get at the revenue requirement number, that would be a question he could also put to Ms. Ousdahl when she returns to the stand, if that would be easier.

CHAIRMAN BROWN: Mr. Rehwinkle.

MR. REHWINKEL: Yeah, I just wanted to have some connection to the --

CHAIRMAN BROWN: Absolutely.

MR. REHWINKEL: -- to that number, yeah.

BY MR. REHWINKEL:

Q And I would be happy to pursue it with Ms. Ousdahl.

A If you would. I don't feel comfortable commenting on her response of C-3.

m.r r: I understand. Thank you.

CHAIRMAN BROWN: Okay. Thank you.

Redirect.

MS. CLARK: Thank you, Madam Chairman. I just have a couple.

FURTHER EXAMINATION

BY MS. CLARK:

Q Ms. Slattery, you were asked questions about Exhibit 654, and benefits provided by FPL, and also about your KS-5. Can you explain, relating to KS-5, where does NextEra stand relative to other utilities?

A On Exhibit KS-5, NextEra's benchmark position was below that of all the other utilities in the peer group, and below the composite utility industry benchmark for Aon Hewitt, as well as below general industry in Fortune 500 companies for its benefits value provided to employees.

Q And the chairman asked you some questions, as well as others, on Exhibit 652. Regarding the number,

it shows the number of employees who received the awards and those who did not. What does this exhibit say about the level of awards to individual employees?

A This exhibit does not say anything about the level of awards; rather, Exhibit KS-4 to my direct testimony, demonstrates that the level of awards is at market median and not above market.

Q But in terms of -- it's not the same award for every employee, is that right?

A No, it's absolutely not. And we have a pay for performance culture that ensures stratification of the awards based on performance, contributions and impact.

Q You have had some questions regarding headcount and its relation to FPL's proposal as far as compensation and benefits. What is the best means of determining the appropriateness of the level of compensation and benefits that is being requested in this case?

A Through comparisons to benchmarks, which are comparing like jobs to those of, you know, comparable companies with similar size, scale and complexity, and ensuring that the jobs are similar in skills, experience, certifications, activities, duties and responsibilities. We perform that benchmarking every year for every non-bargaining position in the company, and we have presented the results of that benchmarking to the Commission here today in exhibits KS-3 and 4 to my testimony. Our compensation benefits are reasonable. They are at market. They are not above market.

Q One last question. How do the changes in total employee compensation between 2013 and 2017 compare to the CPI over this same period?

A Let's see -- could you please repeat the question? Was that regarding a comparison to CPI?

Q Yes.

MR. MOYLE: I'm not that's proper redirect. I am not sure that it goes to a question that was asked?

MS. CLARK: I believe it does go to the reasonableness of the compensation.

CHAIRMAN BROWN: I will allow it.

THE WITNESS: So total compensation costs are projected to increase 1.2 percent between 2013 and 2017, compared to CPI rising at 6.3 percent over the same period.

MS. CLARK: Thank you.

CHAIRMAN BROWN: Okay. Any more redirect?

MS. CLARK: No. Thank you.

CHAIRMAN BROWN: Okay. We are on to exhibits.

Ms. Slattery has a few attached to her prefiled of 115 through 122.

MS. CLARK: We would move those into the record.

CHAIRMAN BROWN: Are there any objections?

Seeing none, we will move in Exhibit 115 through 122 and on to a few other exhibits that were sponsored here.

(Whereupon, Exhibit Nos. 115 - 122 were received into evidence.)

CHAIRMAN BROWN: OPC -- no, I am sorry, staff.

MS. BROWNLESS: Yes, ma'am. We have Exhibit 649. We would request that the response to 396 be removed, and that the title be amended to OPC's 19th set of interrogatory, numbers 392 to 395, and with that to be to ask that it be entered into the record.

CHAIRMAN BROWN: Seeing no objections with the removal of 396, we will move into the record Exhibit 649.

(Whereupon, Exhibit No. 649 was received into evidence.)

CHAIRMAN BROWN: OPC.

MR. REHWINKEL: We would move 650.

CHAIRMAN BROWN: Any objections?

MS. CLARK: No objection.

CHAIRMAN BROWN: We will move in 650.

(Whereupon, Exhibit No. 650 was received into evidence.)

CHAIRMAN BROWN: FIPUG, you have a few, 651 through 655.

MR. MOYLE: Yes, ma'am. We would move in if we could.

CHAIRMAN BROWN: Any objections?

MS. CLARK: No objection.

CHAIRMAN BROWN: Seeing none, we move in 651 through 655.

(Whereupon, Exhibit Nos. 651 - 655 were received into evidence.)

CHAIRMAN BROWN: We are at our lunch break, but would you like this witness excused for the day?

MS. CLARK: I would. Thank you.

CHAIRMAN BROWN: Thank you, Ms. Slattery.

THE WITNESS: Thank you.

(Witness excused.)

CHAIRMAN BROWN: We will reconvene at 1:30. Enjoy your lunch.

MR. MOYLE: Thank you.

(Lunch recess.)

CHAIRMAN BROWN: All right. I believe there are two procedural housekeeping items at this time.

MS. BROWNLESS: Yes, ma'am.

CHAIRMAN BROWN: Mr. Wiseman.

MR. WISEMAN: Thank you, Madam Chair.

During a break, the intervenors got together and talked about their witnesses travel abilities, and we have come up with a schedule for the intervenor witnesses. We have not circulated it to FPL yet, but the plan would be that all intervenor witnesses would appear Monday, Tuesday, and some on Wednesday.

And FPL had asked that we -- it said it didn't -- John, correct me if I have said anything wrong -- that they were indifferent as to the order our witnesses appeared in so long as all intervenor witnesses appeared before FPL put on his rebuttal case, and that's consistent with the schedule that we have put together.

CHAIRMAN BROWN: Mr. Butler.

MR. BUTLER: That's right.

CHAIRMAN BROWN: Okay. What happens if we fit in all -- if we potentially could fit in all of the intervenor testimony on one or two days?

MR. WISEMAN: Apologies for interrupting.

The --

CHAIRMAN BROWN: Can you please, whoever -- please continue.

MR. WISEMAN: The only problem with that, as I understand it, they are not our witnesses, but there are a couple of intervenor witnesses who cannot be here before Wednesday. What we have, by my count -- give me one second. Monday -- well, I will just tell you the witness is. Monday would be Mr. Baudino --

CHAIRMAN BROWN: We don't have to spend the time right now going over that. Staff will -- has kind of a spreadsheet of all of that. You can work with staff.

I just -- this hearing has been noticed for many months -- many, many months. And these witnesses that you have retained, and that the parties have retained, should have also been on notice that we have this hearing and should be made available as the hearing progresses. So I am -- I would love to accommodate, but I also want to have the caveat that we do need to be an efficient process. And so if we do get done with them, we are going to have to keep moving.

MR. WISEMAN: Like I said, without naming names, there are probably about seven or eight witnesses on Monday and Tuesday each day, the way we have scheduled it, and then there would only be two left on Wednesday. And I don't -- they are not SFHHA's witnesses, so I can't tell you what their travel --

CHAIRMAN BROWN: Could we potentially move on to rebuttal if we get done with the intervenor witness, FPL?

MR. BUTLER: That would not be our preference. Who are the witnesses who need to go on Wednesday?

MR. WRIGHT: It's Mr. Smith for OPC, and Mr. Chriss for Wal-Mart.

MS. CHRISTENSEN: That's correct. We are also putting a call out to Mr. Smith to see if -- he is traveling on Tuesday night, and we are trying to find out if he will be available at any point on Tuesday night. If he can be here on Tuesday night, we will let you know and have that as an option for his availability so we can complete it by Tuesday night, but we will have to let you know. We put the call out.

CHAIRMAN BROWN: Okay. Again, just try to understand our position. This hearing has been noticed for so many months, and you have had an opportunity to afford and avail your witnesses and apprize them that they need to be ready any time during the two weeks. So just so you know, that's the position that we are in.

Wal-Mart.

MS. ROBERTS: It's my understanding that Mr. Chriss' flight gets in at lunch, 12:00 o'clock, on Wednesday. I can call him again and see if he can come sooner. We were just trying to pace it based on our understanding of how quickly we were going, as well as me having made Ms. Brownless aware of his time need to know for flight to get out here.

CHAIRMAN BROWN: Okay.

MS. ROBERTS: I will contact him and see if he can come sooner than that.

CHAIRMAN BROWN: Okay. Thank you. And I know it's very difficult to get in and out of Tallahassee. Gotta love that, so I understand that. So really, it goes back to FPL.

MR. BUTLER: And whether we are willing to take them in the middle of our rebuttal case?

CHAIRMAN BROWN: Those two witnesses.

MR. BUTLER: We will have to discuss this and get back to you --

CHAIRMAN BROWN: Okay.

MR. BUTLER: -- see whether we need to have questions for them. If we do, how we can accommodate that.

CHAIRMAN BROWN: Fair enough.

Any other procedural -- yes.

MS. CHRISTENSEN: And we were just going to ask, since -- while we are inquiring of Mr. Smith, if, at the conclusion of FPL witnesses tomorrow, if he could get in here and testify on Friday, if the Commission would want to entertain that as an option.

CHAIRMAN BROWN: I really just blanked for like the entire time you were talking. Can you repeat that please?

MS. CHRISTENSEN: Absolutely. I know it was the Chair's intent to conclude for the weekend after the direct case for FPL. Would the Chair want to entertain, if Mr. Smith could get in here by Friday, hearing him on Friday?

CHAIRMAN BROWN: Tomorrow.

MR. BUTLER: Tomorrow.

CHAIRMAN BROWN: And that is the same person that was available on Wednesday, or not available on Wednesday?

MS. CHRISTENSEN: Was only available after

Wednesday.

CHAIRMAN BROWN: Tomorrow, yes.

MS. CHRISTENSEN: All right. So we will check into that option as well, and we will let you know whether he can come Tuesday night or tomorrow after -- by afternoon.

CHAIRMAN BROWN: I would suggest him try to get in in the morning, though, just to be here on the safe side, be here in the day, if possible.

MS. CHRISTENSEN: Certainly, if he can come in tomorrow, we will also explore that option. Thank you.

CHAIRMAN BROWN: Thank you.

All right. Any other procedural housekeeping items?

MS. BROWNLESS: Yes, ma'am.

CHAIRMAN BROWN: Okay.

MS. BROWNLESS: We do have one. We have distributed a revised Exhibit 640, and everyone should have a copy of it, and that -- the title of that is OPC Second Set of Interrogatories, Interrogatory No. 105 Amended.

Unfortunately, when we looked more closely at the Exhibit 640 that we marked and placed into evidence, although the first page said amended, the attachments to them were the original attachments and not the amended attachments. What you have now is the amended verbiage as well as the amended attachments.

We have provided this to the clerk, and we would ask that it be substituted for the materials that were marked and admitted as 640.

CHAIRMAN BROWN: All right. Mr. Moyle.

MR. MOYLE: Just so the record is clear. I think I had asked some questions on this exhibit, and I assumed that -- so that the record is clear -- like, the amendments didn't relate to the areas I was questioning about.

CHAIRMAN BROWN: Clarification, Ms. Brownless, can you --

MS. BROWNLESS: I do not believe so, Jon.

MR. BUTLER: Actually, yes. That's how I realized that what had been handed out --

CHAIRMAN BROWN: There is a lot of chatter going on, and it really is hard for me to hear.

MR. BUTLER: The only change, Jon, is that you asked questions about the McDaniel property. The original had the incorrect date of a December 2019 projected use for the property. The revised sheet, as it should, refers to December 2020, and so that's the difference between the two.

CHAIRMAN BROWN: Mr. Moyle.

MR. BUTLER: Now, Mr. -- well, was it Mr. Barrett you asked -- I can't remember -- or Ms. Ousdahl? Both of them will be back on rebuttal. I wouldn't have any objection to your asking them if you have any follow-up question based on the change of the year there, that you could ask them that.

CHAIRMAN BROWN: That of seems reasonable.

MR. MOYLE: Yeah. And I am -- just because there is so much paper, when things are getting put into the record, and other things are being taken out, it would be helpful with a little, like, here, we are amending it because of this, and then there is no surprises, but I am fine with this.

CHAIRMAN BROWN: Okay.

MR. MOYLE: No objection. And thanks, Mr. Butler, for saying I can ask more questions.

CHAIRMAN BROWN: Okay. Thank you.

MR. BUTLER: A limited scope of additional questions.

CHAIRMAN BROWN: I don't think he actually said that.

MR. BUTLER: I am sorry. I have a couple of other housekeeping items before we move on to the witness.

CHAIRMAN BROWN: Okay. Hold on one second.

Ms. Brownless, are there any other?

MS. BROWNLESS: No, ma'am.

CHAIRMAN BROWN: Okay.

MS. BROWNLESS: Thank you, ma'am.

CHAIRMAN BROWN: That substitution is noted for the record.

Go ahead.

MR. BUTLER: First of all, as many of you know, we have at least a potential tropical storm/hurricane headed it toward South Florida. I don't know whether that will happen yet or not, but Mr. Miranda has, you know, central responsibilities for whatever response is required there. We would like to have him appear tomorrow for his rebuttal testimony, and be able, therefore, to get excused before the weekend so that he can, you know, return to his responsibilities in organizing whatever storm response is required.

And we have checked with the parties. I don't believe there are any objections to doing that under the sort of extraordinary circumstances of his other commitments, and would ask that the

Commission indulge that change of schedule.

CHAIRMAN BROWN: Okay. I just want to confirm with the parties.

Mr. Moyle.

MR. MOYLE: Yes, we -- things happen, so just like these other witnesses, we are happy to do that. We -- his rebuttal is 25, 30 pages, so some of us need to spend to little time looking at it before he takes the stand, so as long as that can be provided, you know, we are not --

CHAIRMAN BROWN: What are you asking me?

MR. MOYLE: Maybe not start at eight o'clock or 8:30 or 9:00.

CHAIRMAN BROWN: I can make no promises of that sort, but let's see how the day progresses and keep that into consideration.

So do any of the intervenors have a problem with Mr. Miranda appearing tomorrow due to the extraordinary circumstances of the hurricane -- the tropical storm?

MR. COFFMAN: We have no objection to accommodating other parties.

MR. WRIGHT: Retail Federation has no problem with that at all.

CHAIRMAN BROWN: Public Counsel.

MS. CHRISTENSEN: Office of Public Counsel doesn't have any objection to asking Mr. Miranda's cross questions. And, you know, we are obviously used to accommodating all the witnesses, so, you, know, as you are accommodating our witnesses, we are happy to accommodate others.

CHAIRMAN BROWN: Thank you.

MS. ROBERTS: Wal-Mart has no objection.

CHAIRMAN BROWN: Larsons.

COMMISSIONER SKOP: I am sure the Larsons have though objection.

CHAIRMAN BROWN: Sierra.

MS. CSANK: Nor does the Sierra Club.

CHAIRMAN BROWN: FEA.

MR. JERNIGAN: No objections. Just to be clear, is he going first on Friday or is he going at the end of the day?

CHAIRMAN BROWN: Not sure.

MR. JERNIGAN: Not sure.

CHAIRMAN BROWN: Hospitals.

MR. WISEMAN: South Florida Hospitals are happy to accommodate the request.

CHAIRMAN BROWN: Okay. So we have -- yeah, you are good.

Staff, any --

MS. BROWNLESS: No objection. Thank you.
CHAIRMAN BROWN: Commissioners, any thoughts or comments?
Okay, your request is granted.
MR. BUTLER: Thank you very much.
Last procedural item before we get to Mr. Forrest is that we have prepared response to Commissioner Brisé's questions about the call center metrics, have just a very short exhibit here that we can hand out and mark, if it's your pleasure.
MR. MOYLE: I thought this was going to be given to the parties first, and then we will were going to have a time to look at it, and then figure out whether we had an objection as to compared to doing this live.
CHAIRMAN BROWN: Yes.
MR. BUTLER: You want me to hand it to the parties first --
CHAIRMAN BROWN: Yes.
MR. BUTLER: -- and see what their position is?
CHAIRMAN BROWN: Yes.
MR. BUTLER: Okay. We can do that.
CHAIRMAN BROWN: Okay.

MR. BUTLER: With that, then, we would -- are we ready to move on to Mr. Forrest?

CHAIRMAN BROWN: We absolutely are.

MR. BUTLER: Absolutely are, okay.

CHAIRMAN BROWN: You read my mind.

MR. BUTLER: I don't think Mr. Forrest has been sworn.

CHAIRMAN BROWN: Mr. Forrest, please stand and raise your right hand.

Whereupon,

SAM FORREST

was called as a witness, having been first duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

CHAIRMAN BROWN: Thank you, and welcome.

THE WITNESS: Thank you.

EXAMINATION

BY MR. BUTLER:

Q Would you please state your name and business addresses for the record?

A Sam Forrest, at 700 Universe Boulevard, Juno Beach, Florida.

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

A I am the Vice-President of Energy, Marketing and Trading for Florida Power & Light.

Q Have you prepared and caused to be filed 15 pages of direct testimony with respect to FPL's proposed incentive mechanism in docket number 160088?

A Yes, I have.

Q Okay. On August 16, 2016, FPL filed an errata sheet for your direct testimony. Beyond those filed errata, do you have any further changes or revisions to your prepared testimony?

A No, I do not.

Q Okay. So with those changes, if I asked you the questions contained in your direct testimony, would your answers be the same today?

A Yes, they would.

MR. BUTLER: Madam Chair, I would ask that Mr. Forrest's prepared direct testimony be inserted into the record as though read.

CHAIRMAN BROWN: Mr. Forrest's prefiled direct testimony will be inserted into the record as though read.

(Prefiled direct testimony inserted into the record as though read.)

ERRATA SHEET

WITNESS: **SAM FORREST – DIRECT TESTIMONY AND EXHIBITS**

PAGE #	**LINE #**	**CHANGE**
14	10	Change “$0.97/MWh” to “$0.65/MWh”
14	14	After “160021-EI”, add “ ,as well as FPL’s decision to remove from the calculation $0.32/MWh related to CT parts depreciation.”

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Sam Forrest. My business address is Florida Power & Light Company, 700 Universe Boulevard, Juno Beach, Florida 33408.

Q. By whom are you employed and what is your position?

A. I am employed by Florida Power & Light Company ("FPL" or the "Company") as Vice President of the Energy Marketing and Trading ("EMT") Business Unit.

Q. Please describe your educational background and professional experience.

A. I hold a Bachelor of Science in Electrical Engineering from Texas A&M University and a Masters of Business Administration from the University of Houston. Prior to being named Vice President of EMT for FPL in 2007, I was employed by Constellation Energy Commodities Group as Vice President, Origination. In this capacity, I was responsible for managing a team of power originators marketing structured electric power products in Texas, the Western United States, and Canada. Prior to my responsibilities in the West, I was responsible for Constellation's business development activities in the Southeast U.S.

Before joining Constellation, from 2001 to 2004, I held a variety of energy marketing and trading management positions at Duke Energy North America ("DENA"). Prior to DENA, I was employed by Entergy Power Marketing

Corp. ("EPMC") in several positions of increasing responsibility, including Vice President – Power Marketing following EMPC's entry into a joint venture with Koch Energy Trading.

Prior to my entry into the energy sector, I was involved with a successful start-up organization in the automotive industry from 1996 to 1998. From 1987 to 1996, I worked for AlliedSignal Aerospace at the Johnson Space Center in Houston, Texas, in increasing roles of responsibility.

Q. Please describe your duties and responsibilities in your current position.

A. I am responsible for the overall direction and management of the EMT Business Unit, which handles FPL's short-term and long-term fuel management and operations. These fuels include natural gas, residual and distillate fuel oils, and coal. Additionally, EMT is responsible for FPL's fuel hedging program, long-term fuel transportation and storage contracts, power origination activities and short-term power trading and operations. EMT is an active participant in the short-term and long-term natural gas markets throughout the Southeastern United States.

Q. Are you sponsoring an exhibit in this case?

A. Yes. I am sponsoring the following exhibit, which is attached to my direct testimony:

- SAF-1 Incentive Mechanism Comparison for Period 2013-2015 (pages 1-4)

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

A. The purpose of my testimony is to explain and support FPL's request to extend the current incentive mechanism that was approved as part of FPL's 2012 rate case settlement agreement by Order No. PSC-13-0023-S-EI (the "Incentive Mechanism"). I will provide (i) a description of the Incentive Mechanism under which FPL operates, including a review of the results compared to the sharing mechanism used prior to 2013, (ii) the details of FPL's request to modify specific aspects of the Incentive Mechanism, and (iii) an overview of ongoing optimization costs.

Q. Please provide a brief summary of your testimony.

A. The Incentive Mechanism that was approved as part of FPL's 2012 rate case settlement agreement was designed to expand opportunities for FPL to create gains on short-term wholesale power transactions ("economy sales" and "economy purchases", which are transactions of less than one year in term) and optimize the availability and utilization of other assets to provide increased value for FPL's customers while also providing an incentive to FPL if certain customer-value thresholds were achieved. It has absolutely worked as intended and designed. Customers have benefitted from the expanded focus on asset optimization. However, the Incentive Mechanism will automatically be terminated at the end of 2016 (when the 2012 settlement agreement terminates), unless the Commission acts to keep it in effect.

While the Incentive Mechanism has worked very well, both for customers and FPL, there are two elements of the program that need to be adjusted to reflect changed circumstances since the Incentive Mechanism was originally approved. The first adjustment is to the sharing threshold, to recognize that FPL's Unit Power Sales ("UPS") contract with the Southern Company expired at the end of 2015 and was not renewed as customer economics were not favorable. That contract facilitated roughly $10 million of gains each year that will no longer be achievable, and so the sharing threshold needs to be adjusted accordingly. Second, when the Incentive Mechanism was originally approved, FPL's 2013 test year reflected base rate recovery of the variable power plant O&M costs needed to support 514,000 MWh of economy sales. The 2017 and 2018 test years in FPL's current rate case filing reflect no such base rate recovery, and so the basis for recovering variable power plant O&M costs through the Incentive Mechanism needs to be adjusted accordingly. This second adjustment will benefit customers by eliminating an asymmetry in recovery of such costs that is currently part of the Incentive Mechanism and will treat variable power plant O&M in a very straightforward manner.

FPL proposes to renew the Incentive Mechanism, with these two adjustments, for the four-year term of FPL's base rate request (i.e., 2017-2020). This is the most straightforward and transparent way to maintain appropriate incentives for FPL to continue identifying and acting upon opportunities for gains that create substantial value for customers.

II. BACKGROUND ON THE INCENTIVE MECHANISM

Q. What were the circumstances that led FPL to propose the Incentive Mechanism?

A. Prior to the 2012 rate case settlement, FPL operated under the Commission's standard sharing mechanism for gains on economy sales ("Prior Mechanism"). Sharing by FPL occurred if gains on economy power sales exceeded the three prior year average of gains on sales. While the Prior Mechanism provided an incentive for creating gains for customers, for FPL's circumstances it proved overly narrow and restrictive in two important respects. First, it only applied to economy *sales.* There are market conditions that provide substantial opportunities to create customer gains from economy *purchases* as well. Second, the Prior Mechanism did not address the opportunities to create gains from optimizing the use of other utility assets, such as natural gas transportation and gas storage rights. Accordingly, FPL proposed as part of the 2012 rate case settlement to substitute the more broadly-based Incentive Mechanism in place of the Prior Mechanism. The Commission agreed to let FPL operate under the Incentive Mechanism as "a four-year pilot program," which expires at the end of 2016.

Q. Please describe the current Incentive Mechanism.

A. The Incentive Mechanism is designed to create additional value for FPL's customers while also providing an incentive to FPL if certain customer-value thresholds are achieved. The Incentive Mechanism is very straightforward in that it simply adds incentives for FPL to create additional value for customers above the levels that were projected at the time the mechanism was approved. As part of the original proposal that created the Incentive Mechanism, FPL established a threshold of $46 million that had to be exceeded before FPL shared in any savings. This threshold was comprised of a $36 million "Customer Savings Threshold," which was based on FPL's 2013 projections for economy power sales gains and economy purchased power savings, and an incremental $10 million which represented the additional value that FPL was seeking to create for its customers through expansion of it optimization program. The combination of the two thresholds resulted in FPL's customers receiving 100 percent of the benefits up to $46 million. As approved by the Commission, incremental gains above the $46 million are shared between FPL and customers as follows: FPL retains 60 percent and customers receive 40 percent of incremental gains between $46 million and $100 million; and FPL retains 50 percent and customers receive 50 percent of all incremental gains in excess of $100 million. The customers' portion of all gains is reflected as a reduction to fuel costs recovered through the Fuel Clause.

Under the Incentive Mechanism, FPL has created additional value by expanding economy sales into other regions beyond the southeast, as well as adding new activities such as natural gas storage optimization, natural gas sales, capacity releases of natural gas transportation and selling rights on third-party electric transmission when they are not needed by FPL. Additionally, FPL has, on occasion, outsourced a small portion of the optimization function of assets such as natural gas transportation to a third party in the form of an asset management agreement ("AMA") in exchange for being paid a premium. The revenues from such AMAs also are included under the Incentive Mechanism.

As part of the program, FPL is entitled to recover through the Fuel Clause the reasonable and prudent incremental O&M costs incurred in implementing its expanded asset optimization measures. These include the incremental personnel, software and associated hardware costs incurred by FPL (which are not included in FPL's current base rate request), as well as the variable power plant O&M costs (non-fuel O&M expenses and costs for capital replacement parts that vary as a function of a power plant's output) incurred by FPL to generate additional output in order to make economy sales. For the term of the 2012 rate case settlement agreement (i.e., 2013-2016), FPL reflected the estimate from its filed MFRs that the variable power plant O&M costs for 514,000 megawatt-hours ("MWh") of economy sales would be recovered through base rates, while FPL would be allowed to recover through the Fuel Clause variable power plant O&M costs to support sales above that threshold. This assumption was predicated upon the 2013 test year forecast prepared by EMT, which estimated that the power plants that FPL operates would serve 514,000 MWh of economy sales in addition to the forecasted native load.

Q. Overall, how has the Incentive Mechanism performed?

A. As can be seen in Exhibit SAF-1, the Incentive Mechanism has worked as intended for both FPL's customers and FPL. Using the actual results of 2013-2015, after incremental O&M expenses are netted out, there was a total benefit of $137.9 million from all Incentive Mechanism activities to be shared between FPL and its customers. From page 4 of the exhibit, one can see greater than 90 percent of the benefits have been received by FPL's customers, with FPL receiving the balance.

Q. Has the current Incentive Mechanism delivered greater value to FPL's customers than would have been the case under the Prior Mechanism?

A. Yes. It is difficult to make a complete comparison of the benefits to customers under the two mechanisms because FPL was already actively engaged in both economy sales and purchases when the current Incentive Mechanism was approved, although it has expanded its activities within these areas. However, a simple and conservative comparison is to look at the value that FPL has generated from the natural gas transportation, storage and trading optimization activities that are incented under the Incentive Mechanism and are essentially all new since that mechanism was approved. By that conservative measure, customers have received additional benefits to the tune of $21.7 million for the years 2013, 2014, and 2015:

- Under the Prior Mechanism, the benefits that FPL would have delivered for the three-year period totaled $113.2 million (see page 4 of Exhibit SAF-1, "Total Optimization Benefits"). This total includes the benefits achieved from optimization activities for economy power sales and purchases, as well as short-term releases of electric transmission capacity, as FPL was engaging in those activities prior to the Commission's approval of the current Incentive Mechanism. Looking at the period 2013-

2015 and applying the sharing methodology of the Prior Mechanism would have yielded net benefits to FPL's customers of $102.6 million, while FPL would have retained $10.6 million because the three-year rolling average threshold for economy sales would have been exceeded in each of the three years. These amounts correlate to a sharing split of 90.7% to customers and 9.3% to FPL.

- In contrast, as shown on page 4 of Exhibit SAF-1, FPL has generated nearly $33 million of additional benefits over the three-year period from the natural gas transportation, storage and trading optimization activities that FPL is incented to pursue under the current Incentive Mechanism. When one takes into account these additional benefits, the result is that the Total Optimization Benefits under the current Incentive Mechanism increased to $139.1 million, with customers receiving $124.4 million and FPL receiving $13.5 million after incremental O&M expenses are netted out. These amounts correlate to a sharing split of 90.2% to customers and 9.8% to FPL which is nearly identical to the split that would have occurred under the Prior Mechanism.
- Thus, over the period 2013-2015, customers received more than $21.7 million of additional benefits under the Incentive Mechanism – $124.4 million under the Incentive Mechanism vs. the $102.6 million that they would have received under the Prior Mechanism. This is proof that the Incentive Mechanism is working to deliver added value for customers as FPL and the Commission envisioned when it was approved.

III. UPDATING THE INCENTIVE MECHANISM

Q. Is FPL proposing any changes to the Incentive Mechanism as it was approved in 2012?

A. Yes. FPL is proposing two changes to the Incentive Mechanism. The first is to lower the sharing threshold from $46 million to $36 million. From the data shown on Exhibit SAF-1, $46 million appears to have been an appropriate threshold as FPL averaged $46.4 million in total gains over the 2013-2015 period (i.e., $139.1 million in Total Optimization Benefits ÷ 3 years = $46.4 million per year). However, this average reflects the results of optimizing FPL's UPS contract with the Southern Company that expired in December 2015. The UPS contract allowed for the purchase of 928 MW of capacity and energy, supplied by Southern from a mix of gas- and coal-fired units. Additionally, there was accompanying transmission capacity made available to FPL under the UPS contract, to allow the energy to be delivered into FPL's electric transmission grid in peninsular Florida. Over the period of 2013-2015, optimization of the UPS contract and associated electric transmission resulted in an average of $10.5 million in gains that were reflected in the Incentive Mechanism sharing calculations. The UPS contract made energy and idle electric transmission available in SERC for optimization when it was not needed for dispatch into FPL's system. However, due to changes in fuel prices and other factors since the UPS contract was originally entered into, it would not have been in the overall economic best interest of customers to renew it in December 2015, and there is no equivalent way of capturing the optimization opportunities in SERC from the balance of FPL's portfolio. Subtracting the average annual UPS-related gains of $10.5 million from the current sharing threshold of $46 million would reduce the threshold to $35.5 million. In order to keep the Incentive Mechanism working properly, the Commission should lower the sharing threshold to $36 million (rounded up from $35.5 million) now that the UPS contract and associated electric transmission are no longer part of the portfolio.

The second proposed change has to do with the variable power plant O&M costs incurred to generate economy sales. As mentioned earlier, under the Incentive Mechanism, FPL is allowed to recover variable power plant O&M costs beyond the 514,000 MWh of such sales that were projected in the MFRs that supported FPL's 2013 Test Year. The per-MWh rate that was reflected in the 2013 Test Year MFRs and that is currently utilized by FPL for economy sales over the 514,000 MWh threshold is $1.51/MWh.

For the 2017 and 2018 test years included in FPL's current rate case filing, FPL has not included any economy sales or economy purchases in the base rate forecast. Rather, FPL is proposing to eliminate the 514,000 MWh threshold altogether and simply net economy sales and purchases in order to determine the impact of variable power plant O&M. If FPL executes more economy sales than economy purchases, we will recover the net amount of variable power plant O&M incurred in a given year. If economy purchases are greater than economy sales, FPL's customers will receive a credit for the net variable power plant O&M that has been saved in that year. This is a much fairer and straightforward approach both for customers and for FPL, as only the O&M costs actually incurred (or saved) will be passed through (or credited) to customers.

Q. Is FPL proposing a change to the per-MWh variable power plant O&M rate?

A. Yes. FPL calculated a new per-MWh rate for variable power plant O&M based on the 2017 Test Year MFRs utilizing the same methodology that was applied to the 2013 Test Year MFRs. The updated calculation results in a substantial decrease in the per-MWh rate, from $1.51/MWh to $0.97/MWh. In large part, this decrease is a result of FPL's success in reducing fossil fleet O&M and CAPEX associated with operating and maintaining its fleet, as described in the testimony of FPL witness Roxane Kennedy in Docket No. 160021-EI.

IV. EXTENDING THE INCENTIVE MECHANISM

Q. Should the Incentive Mechanism be extended past the expiration of the 2012 rate case settlement at the end of December 2016?

A. Yes. The Incentive Mechanism has worked well, and it is in the mutual best interests of FPL's customers and FPL for it to remain in effect. FPL proposes that the Commission authorize FPL to continue using the Incentive Mechanism, modified to reduce the Customer Savings Threshold to $36 million and to eliminate the variable power plant O&M threshold for the reasons I just discussed, for four more years.

Q. Why is FPL only asking for a four year extension rather than a permanent extension of the Incentive Mechanism?

A. FPL sees value in having stability in the program over time: it would be disruptive and diminish the effectiveness of the incentives if FPL could not depend on them remaining in place on known terms for more than a year at a time. On the other hand, FPL recognizes that it is appropriate to revisit the appropriateness of the Incentive Mechanism periodically. In FPL's current rate case proceeding, FPL has made a four-year rate proposal that covers the period 2017-2020. FPL believes that it would be appropriate for the Incentive Mechanism to cover this same period. This would be easy to administer and would allow for the Incentive Mechanism to be revisited as a natural component of the next rate review.

Q. Does this conclude your direct testimony?

A. Yes.

BY MR. BUTLER:

Q Mr. Forrest, do you have an exhibit that was identified as SAF-1 attached to your prepared direct testimony?

A Yes.

MR. BUTLER: Madam Chair, I would note that has been marked for identification as Exhibit 123.

CHAIRMAN BROWN: So noted.

Staff.

MS. BROWNLESS: Yes, ma'am.

EXAMINATION

BY MS. BROWNLESS:

Q After afternoon, Mr. Forrest.

A Good afternoon.

Q Have you had an opportunity to look at Exhibit No. 579, and to review the materials that are listed under your name?

A Yes, I have.

Q And are those materials true and accurate to the best of your knowledge and belief?

A Yes, they are.

Q Did you prepare the responses to those materials, or were they prepared under your supervision?

A Yes.

Q Do those materials contain any confidential

materials?

A There is no confidential information on the CD.

Q Thank you.

A You are welcome.

CHAIRMAN BROWN: FPL.

MR. BUTLER: Thank you.

FURTHER EXAMINATION

BY MR. BUTLER:

Q Mr. Forrest, would you please summarize your direct testimony?

A Yes.

MR. WISEMAN: Madam Chair, I have a preliminary objection I would like to make before Mr. Forrest starts, please.

CHAIRMAN BROWN: Okay.

MR. WISEMAN: Mr. Silagy testified the first day of the hearing that among the cadre of witnesses who are testifying for FPL, that each witness was the most qualified to talk about the items discussed in the individual's testimony.

Yesterday, during cross-examination of Mr. Barrett, Mr. Sundback, on behalf of SFHHA, asked Mr. Barrett numerous questions about contracting matters related to the Florida Southeast

Connection. Mr. Barrett, in a number of those instances, said that he was not qualified to answer those questions, that Mr. Forrest was more qualified to answer those questions than Mr. Barrett.

There is nothing in Mr. Barrett's, either his direct testimony on the incentive mechanism, or in his rebuttal testimony, that concerns the Florida Southeast Connection. As a result, we have sought no discovery from FPL related to Mr. Barrett -- I am sorry -- Mr. --

CHAIRMAN BROWN: Forest.

MR. WISEMAN: -- Forrest's testimony related to the Florida Southeast Connection.

CHAIRMAN BROWN: You want some water? Would you like some water?

MR. WISEMAN: I would. I don't have any. Thank you. Thank you. Much better.

Had we been advised that Mr. Forrest was the appropriate witness to talk to about those items, had we been apprized of that in his testimonies, we would have sought his deposition. We obviously didn't do that because we had not been apprized of his expertise in that area.

So we think, at this point, if Mr. Forrest is permitted to talk about the Florida Southeast Connection, that that would be a violation of our due process rights, and we request that he be barred from talking about those matters.

CHAIRMAN BROWN: I wasn't expecting that.

FPL.

MR. BUTLER: Neither was I.

Mr. Forrest's direct testimony doesn't cover that topic. It won't come up unless somebody asks him about it. If somebody asks him about it, he has knowledge and can address it, but we are not bringing him in here for the purpose of addressing that topic, and, you know, think that, frankly, the questions were irrelevant as to Mr. Barrett yesterday, and would not press to have Mr. Forrest provide answers to them today.

CHAIRMAN BROWN: Mr. Wiseman.

MR. WISEMAN: As long as he doesn't -- if FPL doesn't elicit that testimony from him, and that's not had his prepared statement, and -- well, we will see if -- I know we will not be asking him questions about that subject. I guess, for right now, it's fine, and if the subject comes up, we can cross that bridge when we get there.

CHAIRMAN BROWN: That sounds good.

MR. WISEMAN: Thank you very much.
MR. BUTLER: The only thing I would add to that is, you know, we won't bring it up. In fact, we would not be able to bring it up on redirect unless somebody has raised it. If somebody raises it, I am not waiving my right to conduct appropriate redirect of whatever somebody asked on cross; but subject to that, we do not intend to have Mr. Forrest testify in that area.
CHAIRMAN BROWN: That's fair.
Sierra Club.
MS. CSANK: If I may. I will second SFHHA's objection. I had a similar issue with respect to Witness Forrest, and therefore, will not be asking him about pipeline related matters. But as we heard from other witnesses, it is an issue that relates to the gas peakers, and so I will just make note of that in the record.
CHAIRMAN BROWN: Thank you.
MS. CSANK: Thank you.
MR. MOYLE: Maybe this is the best time to raise this, because I, likewise --
CHAIRMAN BROWN: I am sorry, there is a few of you.
MR. MOYLE: Well, a lot of people said, when

we were talking about the peakers, and that they are gas constrained, and they said, well, how are you going to solve that problem? They said ask Mr. Forrest. And I don't want to ask Mr. Forrest and, you know, and kind of do that.

So can we understand, if we are talking about the Broward gas constraint, can we inquire into that without getting into this transfer -- the transfer issue seems like it's a jurisdictional FERC signed kind of thing without that, but -- I think it's cleaner to have a ruling than all of a sudden me ask questions and then, you know, say you opened the door, and then I don't have a happy suitemate here.

CHAIRMAN BROWN: Mr. Butler.

MR. BUTLER: Well, I guess I can only redirect on things that are legitimately within the scope of what he has been crossed on. If he is not crossed on that topic, I will have no redirect on it.

CHAIRMAN BROWN: Someone was raising an objection over here.

MR. SKOP: Yes, Madam Chair, Larsons raised a similar concern, again, when they had questions yesterday of the FPL witness, he also referred him to Mr. Forrest, but again we show consideration to the other concerns raised by the intervenors.

CHAIRMAN BROWN: Any other parties wish to address?

All right, staff.

MS. BROWNLESS: I think it's appropriate if the questions were referred to Mr. Forrest and an intervenor asks Mr. Forrest about it for FPL to be allowed to do redirect on that, because in essence, then the intervenors have expanded the scope of Mr. Forrest's testimony. However, I would note that we have always tried to limit both the direct and cross-examination here to the testimony specifically stated in their direct testimony.

CHAIRMAN BROWN: Okay. Commissioner Graham actually has a question before we get to --

COMMISSIONER GRAHAM: I guess you have kind of lost me on that one. I don't think the intervenors expanded the scope. I think Florida Power & Light expanded that scope, because those questions were kicked to Mr. Forrest.

MS. BROWNLESS: And to the extent that Mr. Forrest is the person who's appropriate to answer them, then I think that -- that does expand the scope of the testimony beyond the prefiled direct.

The point I was trying to make is that you can go two ways here. You can either say, we will not allow any questions in this area because it is beyond the scope of his direct, which is what traditionally we have done, and, therefore, no cross-examination, et cetera. Or you can say just exactly what you have said, Commissioner, which is, to the extent that FPL has expanded it beyond the scope of the written testimonies, parties should be allowed to pursue it.

CHAIRMAN BROWN: Okay. I saw you reaching for your button.

MR. BUTLER: I did, but I have decided I don't need to say anything further. Thank you.

CHAIRMAN BROWN: It's always best.

Are we going to leave this in and see how we proceed?

MR. BUTLER: That's fine with me. Like I said, Mr. Forrest will cover his direct testimony, which relates to the incentive mechanism. He won't cover these other issues if parties don't feel a need to examine him about them. If they do, he will answer their questions. And if it raises appropriate redirect, I will ask him about them.

CHAIRMAN BROWN: Okay.

MR. WISEMAN: And gist so it's clear, I might be -- I hope I am not placed in this very unusual position, but if one of the other intervenors asks a question about this, I am going to object as being beyond the scope of his testimony.

CHAIRMAN BROWN: Sounds good.

MR. WISEMAN: Thank you.

CHAIRMAN BROWN: All right. Are we ready to --

MR. BUTLER: I always appreciate offense in-depth on that point. Thank you, Mr. Wiseman.

With that would Mr. Forrest give the summary of his direct testimony?

CHAIRMAN BROWN: Thank you, and welcome.

THE WITNESS: Thank you. Good afternoon, Madam Chair, Commissioners.

The incentive Mitchell that was approved as part of FPL's 2012 rate case settlement agreement was designed simply to create opportunities for FPL to provide increased value for FPL's customers. It has worked just as intended, as customers have benefited from FPL's expanded focus on asset optimization. However, this incentive mechanism will automatically terminate at the end of 2016 unless the Commission acts to keep it in effect. FPL believes it is in the best interest of customers to continue the program with FPL's proposed modifications.

Under the incentive mechanism, FPL has created additional value by expanding economy sales into other regions beyond the southeast, as well as adding new activities such as natural gas storage and transportation optimization, natural gas sales and selling rights on third-party electric transmission when the assets are not needed by FPL to serve customers.

The incentive mechanism has worked well for both customers and for FPL. Conservatively, by looking at just the value added from the new asset optimization activities approved under the incentive mechanism, customers have received direct correct benefits of over $21 million for the years 2013 through 2015. During that same period, the sharing percentages have remained essentially unchanged from the prior mechanism. The upshot is that customers have received $21 million more in benefits than they would have under the prior mechanism, clear proof that the incentive mechanism is working to deliver added value for customers as FPL and the Commission envisioned when it was approved back in 2012.

There are two elements of the program that need to be adjusted to reflect changed circumstances since the incentive mechanism was originally approved.

The first adjustment is to the sharing threshold, to recognize that FPL's unit power sales, or UPS contracts, with Southern company expired at the end of 2015. These contracts facilitated roughly $10 million in gains each year that will no longer be achievable given the expiration, and so the sharing threshold should be adjusted accordingly.

Second, when the incentive mechanism was originally approved, FPL's 2013 test year reflected base rate recovery of variable power plant O&M costs needed to support 514,000 megawatt hours of economy sales. However, the 2017 and 2018 test years in FPL's current rate case filing reflect no base rate recovery for the O&M on an initially block of economy sales. Therefore, the basis for recovering variable power plant O&M costs through the incentive mechanism needs to be adjusted.

Our proposal is to net economy purchases against economy sales, and then apply the variable O&M costs per megawatt hour to the difference. FPL believes the proposed adjustment will clearly benefit customers because it treats variable power plant O&M in a symmetrical and very straightforward manner.

FPL believes that it would be appropriate to renew the incentive mechanism with these a adjustments for the four-year term of FPL's base rate request from 2017 through 2020. That is the most straightforward and transparent way to maintain appropriate incentives for FPL to continue identifying an acting upon opportunities for gains that create substantial value for customers. This four-year renewal would be easy to administer, and would allow for the incentive mechanism to be revisited as a natural component of FPL's next rate review.

And this concludes my summary.

BY MR. BUTLER:

Q Thank you, Mr. Forest.

MR. BUTLER: I tender the witness for cross-examination.

CHAIRMAN BROWN: Thank you, Ms. Christensen.

MS. CHRISTENSEN: No questions.

CHAIRMAN BROWN: Thank you.

Mr. Moyle.

MR. MOYLE: I do have some questions. Thank you.

EXAMINATION

BY MR. MOYLE:

Q Good afternoon, Mr. Forrest.

A Good afternoon.

Q You said that one of the adjustments you are seeking -- well, you know, actually, I need to see if I can agree -- get you to agree to some ground rules that I want to explore with you.

A I am listening.

Q I don't want -- I don't want any information, and I don't particularly have strong feelings about who owns a piece of pipe that connects Martin to Riviera, okay? So if I ask you questions about getting gas to Broward, you would agree it's not particularly material about who owns that -- or let me ask you that.

Is it material -- is it material if I ask you about future gas transportation plans, is it material in your mind about who owns the pipe?

A Yeah, I think it is very material, given the contractual rights that we have to deliver gas to those particular facilities.

Q So If I want to explore up questions that were sent to you that said, well, you know, I don't know. We

don't have enough gas in Broward to run the peakers, but you got to ask Mr. Forrest. If I ask you those questions, then you are telling me that's going to then get you in to who owns the situation; is that right?

A I think I probably can talk generically about it without having to talk about who owns the pipe, but I do think it's relevant given --

Q Could we agree that we will have generic conversations that won't get into who owns the pipe?

A I will do my best.

Q When you go to sleep at night, do you close the door and lock it?

A The front door or my bedroom door?

Q That's what I am trying do here with who owns the pipe issue. I don't want there to be, oh, you opened the door, Mr. Moyle, so are we good?

A I understand.

Q Okay. You had told the Commission that one of the adjustments you are seeking is because of the expiration of a contract that you have with the Scherer unit, the UPS contract; is that right?

A Yeah, the UPS contracts, yes, the UPS -- or actually it was three contracts made up of a couple of gas plants and a coal planted, which was Scherer, yes.

Q And you said roughly 10 million, that you are

seeking an adjustment for 10 million, do I understand that, is how much money you made off that contract cumulatively?

A Not cumulative -- no, not cumulatively. It was about $30 million over the three-year period, 2013 through 2015, the UPS contracts facilitated about $10 million a year on average of gains for the asset optimization program.

Q Okay. Do you know the precise number or no?

A The precise number was $31.4 million.

Q And that was for the whole deal, and of that, the UPS contract represented a percent, correct?

A No, that is not correct. No.

The UPS contract -- so maybe it will help to understand that there were three contracts with Southern Company that comprised the UPS agreement, or the UPS replacement agreement as it was. There was a 600-megawatt gas-fired facility, which was one contract, 190-megawatt gas-fired facility, which was a second, and then part of the Scherer plan, which was 160 megawatts, totaled up to about 950 megawatts.

Those facilities were approved by this commission -- those contracts were approved by this commission back in 2005 timeframe, went into effect in June of 2010, and expired at the end of 2015.

Those contracts were primarily used in the early years to dispatch into our system when it was needed to serve native load. They are no longer part of the asset base that we because they expired, but during the period of the asset optimization program, we were actually able to, when it wasn't needed to serve our load, to sell those into the southeast markets and make money off of those. That contribution, purely from the UPS contract, totaled up to about $31.4 million over the three years, and that's just in pure optimization dollars.

Q Did you make money off the coal contract?

A I am not entirely positive what the split was between the three different assets, but there were opportunities for us to sell those assets into the southeast, yes.

Q So do you know with respect -- I don't want you to speculate, I was am curious about coal. You said there were three contracts, one of them has coal. Was that part of your --

A Yeah.

Q -- asset optimization, and you made money on it --

A Yes.

Q -- and it was a good thing to have?

A It was the smallest of the three contracts, but, yes, there were opportunities to sell that into the southeast.

Q Okay. Would similar opportunities exist for Cedar Bay? That's a coal-fired unit, right?

A Cedar Bay is a coal-fired unit. We don't dispatch individual assets within our portfolio here in Florida to make sales. We sell off of a system, not individual assets, so it would be part of any of sell that we made if it was running.

Q Well, that's how you did the asset optimization off of the system, right? You didn't do it off individual plants? Or did you do it off individual plants?

A The only individual plants that we dispatched for the purposes of asset optimization were the UPS contracts, which have since expired.

Within the FPL system, the way we optimize our generation fleet was to sell off of the marginal units. So whatever the highest unit, the marginal unit, was we were either selling or purchasing around that marginal unit. There was not -- but it wasn't specific to an asset. It was part of a system-wide sale.

Q Okay. And, Mr. Forrest, my client, FIPUG, was par of the settlement agreement where this was included

as something for the Commission to consider, correct?

A That is correct, yes.

Q And you are also aware that that was a negotiated item in the settlement contract, correct?

A I agree.

Q So this isn't really a negotiating session, but it's a good time to talk about it, I think, given your proposal that it be included with the Commission, so I am going to spend some time on this, just wanted to touch on that.

So your title is Vice-President of Energy, Marketing and Trading?

A Yes. That's correct.

Q Okay. And you are employed by whom?

A By Florida Power & Light.

Q And do you wear any other hats?

A I do wear other hats, yes.

Q And tell me what those other hats are.

A I am -- by specific title, I am not exactly sure, but in some cases, I am President of the Cedar Bay Holding Company, which we now own that Cedar Bay asset. I am President of FPL Energy Services, and also President of GR Woodford, which was our investment in the gas reserves project.

Q I didn't catch the last one.

A GR Woodford, it's our gas reserves project.

Q Do you know, for 2015, how your time was allocated between Florida Power & Light and other entities?

A Well, in 2015, the Cedar Bay asset, as well as the GR Woodford asset, were part of FPL's portfolio, so my time was allocated to FPL on those. FPL Energy Services, I roughly spend about 15 percent of my time, and those costs are allocated to FPLES.

Q Okay. So things have changed with respect to Cedar Bay and Woodford, let me ask the question with respect to '16. How do you -- better question, how do you typically allocate your costs between your responsibilities that you described for other companies and FPL? Is it 25 percent each? Or just give us a flavor of that.

A Well, I would maybe disagree with your characterization of Cedar Bay. Nothing has changed on Cedar Bay. It's still part of our asset portfolio, which FPL is managing. But with respect to FPL, yes, I monitor my times. I determine how much time I am spending with them managing that group, and that's how I allocate my time. And then with the GR Woodford, which has just now moved out of FPL, I am starting to monitor how much sometime I spend with that, and then my time will be allocated accordingly.

Q Right. So can you tell me, just roughly, in the last six months how you spent your time?

A I believe I just did.

Q Well, percentage-wise. I mean, you told me you allocate them, but you didn't tell me I spent -- all my time is spent on FPL, helping them with the gas, it's like 90 percent, and the other stuff is two-and-a-half percent each, or -- I mean, just give me the sense of allocation of your time.

MR. BUTLER: I am going to object to this line of questioning. I don't think it relates to his direct testimony regarding the incentive mechanism, and we had a lot of conversation about trying to stick closely to the testimony as filed. This seems to be pretty well beyond it.

CHAIRMAN BROWN: I tend to agree.

Mr. Moyle, can you move along with your questions, please?

MR. MOYLE: Sure.

BY MR. MOYLE:

Q Do you know -- do most utilities have a Vice-President for Energy, Marketing and Trading?

A I am not aware of other utilities with respect to what their titles are, but there are generally, yes vice-presidents that are in charge their fuels group, or commodities trading group, or however they title them, yes.

Q Okay. I -- in your previous history, you have been involved in competitive markets trading gas a lot, is that fair?

A Yes, that is fair.

Q Okay. And that includes time with Constellation --

A Correct.

Q -- doing deals, and also in Texas, right?

A That is correct.

Q And Texas is a deregulated market?

A I was based out of Texas, but I didn't do a lot of business in Texas. Most of my work as either in the southeast or the midwest or the west.

Q Okay. In Western United States, were you involved in a lot of ISO markets, RTO markets?

A Some, yes.

Q So, to kind of get to the point that I was wanting to do, it's -- what, really, you are asking, as I understand it -- and you can correct me, I know you will if I get it wrong. But essentially what this is is a gas trading operation that you are in charge of that's using assets that ratepayers have paid for, and to the

extent you make money, we are talking about how will that money get split; is that fair?

A Well, I think that -- yes and no. I think it probably maybe understates a little bit what my group is responsible for. I mean, our first and foremost priority every day is the reliable purchase of fuel as economically as we can. And we have always been a procurement organization with respect to trying to bring fuel to the power plants. This is an expanded focus on some of those assets that we have in our portfolio that may be idle on a daily basis, depending upon what our loads are and what our system needs are, this is an effort for us to try and go out and trying to optimize those to bring value.

So, you know, there is a gas trading component to it, but for the most part, we are a procurement organization, and always have been.

Q Do your responsibilities include hedging?

A Yes, they do. Like my team's responsibility is hedging, yes.

Q Okay. And just to be clear, the assets that you are asking be optimized, those are all assets that have been paid for by the ratepayers?

A They are recovered through a clause through base rates, yes.

Q The arrangement that was negotiated and approved by the Commission had ratepayers getting the first $46 million worth of -- is it okay if I call them profits?

A Of gains and savings, yes.

Q Okay -- the first 46 million, and then after that, anything between the 46 and the hundred was split with FPL getting 60 and the customers getting 40; is that right?

A That is correct.

Q And then anything over 100, it was a 50-50 split?

A That's correct. We never came close to the hundred, but that is correct.

Q Are you suggesting that those percentages be modified?

A No, sir, we are not. We feel like the percentages, as they were proposed, worked extremely well. If you go back and look at the data, under the prior mechanism over the last three years, we would have earned right at about 10 percent of the overall savings. That's almost exactly what we earned, we are off, like, about a half percent different under this new mechanism. We benefited by about $3 million as a result of that, FPL did, which is terrific. We are very pleased for that. And customers benefited to the tune of 21 plus million dollars, so we felt like it was a very fair split, so we are not recommending any change to those -- to the sharing mechanism.

Q And there were a lot of things in that settlement agreement, including credits for large industrial customers, right?

A Not my expertise, but I do agree there were a lot of things in that settlement agreement.

Q So this would be an appropriate time for the Commission to take a good look at this, I think, right?

A Well, absolutely. This is, you know, a program that expires at the end of 2016. So absent the discussion here, this program dies at the end of 2016, which I think would be a complete disservice to customers, given all the value that's been added.

Q And you said to the Commission, hey, we only want this program to go on -- I think they actually -- that you took a two-year look, or there was something about the Commission could come back and do an early checkup on it, isn't that right?

A Yes, there was an opportunity to look at at the end of the two years. We proposed the four-year program, obviously, to match up with the settlement agreement. We are, again, proposing another four-year extension of it. I am not calling that a pilot. I just think it's appropriate to review the percentages and the thresholds about every four years so we, again, match up with our request in this rate request.

Q Okay. And then one other -- I think I am about to talk about Broward, but you sell -- you sell all over the country with these assets, right, beyond the southeast?

A We do go beyond the southeast, yes. I wouldn't say all over the country. We have made it as far up as PJM and MISO, primarily in the southeast and Florida is, obviously, our number one market.

Q You said PJM and MISO, what are those?

A PJM, they are reliability councils in sort of the mid-Atlantic, Pennsylvania, Jersey Maryland is the PJM. And then MISO is the midwest.

Q And they have markets that energy is being traded every day, is that correct?

A That is correct, yes.

Q You answered an interrogatory -- I think I can do it without referencing it to you, but it related to gas supply -- you have some gas supply assets in Mobile, right?

A Maybe you could rephrase that.

Q FPL, that there is some storage -- I'm sorry,

gas storage --

MR. BUTLER: Storage?

THE WITNESS: Yes, we have a storage contract with a facility in Mobile Bay, yes.

BY MR. MOYLE:

Q Okay. And there is a way that you can use that storage facility to -- is arbitrage the right words?

A I would consider it could be arbitrage, yes.

Q Okay. Can you -- there is -- there is two terms, one is if the stock market is higher than the forward market, and then the other is the reverse. Can you describe how you make money with your storage, please?

MR. BUTLER: Mr. Forrest, I would caution you to be careful with the confidentiality of this.

We designated that interrogatory response as confidential, because some of the specifics of the way that we make money, we would kind of like other people not to know the details of it.

CHAIRMAN BROWN: Okay.

MR. MOYLE: Well, I read it in that CD that was provided out. It wasn't marked confidential, I don't believe, when I read it.

THE WITNESS: Yeah, I believe I can cover this in somewhat generic terms.

CHAIRMAN BROWN: Thank you.

THE WITNESS: So the idea behind what we do with our gas storage position is, it's is a four-billion-cubic-feet-a-day of storage, or not a day, but it's a cavern, it has four-billion-cubic-feet of storage that we have access to. A certain percentage of that, we maintain for reliability reasons, so it's there for us from a customer perspective to ensure that this they have the gas that they need when they need it. It also gives us the ability to inject gas and withdraw gas as changes in our load profile, with weather and other things, happen.

But there is a portion of that, depending upon the time of year, where we actually do optimize the portfolio. And so we will look at opportunities, and maybe just a real simple example of, if I can buy gas in September for $2.80 and inject it into the storage facility, and then sell gas in December for $3.15, that's a 35-cent gain, I would then withdraw that gas in December to complete the sale.

So you are looking at time spreads. And that's just a pure arbitrage opportunity, where you are buying and selling, almost instantaneously, to lock in a spread that exists, and the storage facility is what helps facilitate that. So we are constantly looking at opportunities around ways of optimizing the storage facility, and we are looking at time spreads, and the value and difference in different trading periods just to see if there is ways of locking in that value.

BY MR. MOYLE:

Q And what is contango?

A Contango is -- it's a market term that you would normally describe that as kind of a normal market, if you will, in that prices where are lower in the front end than they are on the back end. So it has kind of a natural progression of prices rising over time.

Q And the other word is backward --

A Backwardation. Backwardation is an inverted market, it's kind of the opposite -- it is the opposite of that. You have got prices in the front end that are lower -- excuse me -- that are higher than those in the back end.

Q Okay. And you can make money, given your situation, on either of those?

A On either of those opportunities, yes.

Q Okay.

MR. MOYLE: I don't need the exhibit.

BY MR. MOYLE:

Q I think you may have been deferred a question about the frequency by which you prepare gas, natural gas forecasts. Is that something you are responsible for?

A My team is responsible for forecasting natural gas prices, yes --

Q Okay.

A -- or compiling them, yes.

Q Okay. So how often do you all prepare natural gas forecasts? Is it every week? Every month?

A We do a couple of different forecasting exercises. We -- on a monthly basis, we prepare a new natural gas forecast, which is utilized by a couple of different departments, including our own, which is to continually monitor our hedging program. The other one is for internal bill projections, so that's a shorter term forecast.

Our longer term forecasts are typically done as needed. So in the case of either the undertaking here, with the rate case, we would have put together a long-term price forecast for all the fuels, which would have then been utilized by different teams to work on the rate case. So our last official forecast was done on January 4th. We are putting together another forecast, I think, for the fuel filing that we are doing coming up, so --

Q When you do these forecasts, do you do high, medium and low? Is that part of the standard work you do?

A There is. We do a medium forecast, which is our base forecast, and then use a volatility mechanism to forecast kind of a one standard deviation away from that to come up with a high and low band forecast.

Q Okay. And a that's standard practice to do it that way?

A I am not sure if it's a standard practice. There is -- typically, there are high and low band forecasts that somebody would do. EIA, the Energy Information Administration, publishes their own forecast every year. They do an annual energy outlook. They publish a reference case, which is their base case, as well as high and low cases, and then sensitivities on those. So I think it's pretty standard to do multiple to casts, a high and a low, along with the base case.

Q Okay. And that was -- you answered that question with respect to the industry. I was trying to get you to answer it with respect to FPL.

A Yes. That is a standard for us to do a high low when we do a long-term forecast, yes.

Q Okay. So to the extent that someone with FPL said, well, we only could run it with a base case, that would be inconsistent with your standard business practice with respect to gas forecasting?

A It depends on the purpose that the fuel curve was developed for.

Q If you were developing a fuel curve for somebody, wouldn't you do it consistent with your standard practice?

A When we do our long-term forecast, when it's requested, then, yes, when we do the high and low band forecast --

Q Okay.

A -- it's if it's requested.

Q Are you comfortable if I ask you some questions about the peaker projects, and what the plan is to fuel them?

A I am comfortable with that, yes.

Q All right. And we are good with our agreement on the door thing, right?

A I will do my best. Yes, sir.

Q Okay. So let's start -- let's start with Ft. Myers.

A Sure.

Q What will the -- well, what are the current

Ft. Myers peakers run on in terms of fuel source?

A I think as Roxane Kennedy explained -- or Witness Kennedy explained, whatever the most efficient and cheapest fuel is at the time it's available to the plant. So it really is load dependent, in all honesty, as well as generation dependent.

If we are in a situation where we have gas available, we will run those -- the peakers, and whether we are talking about the GTs that exist today -- well, the GTs -- the two CTs that exist today at that site, and the new CTs that will come on-line there. If there is gas available, they will certainly run.

In a peak condition, there is not enough gas at that facility to run all of the CTs that will be there. So the -- there is probably enough to run maybe one of them, and the rest of them will have to dispatch on oil.

Q As part of your planning purposes, are you -- would it -- is it good idea, or is it a plan to try to have enough gas to run the peakers on gas at Ft. Myers?

A I will do my best to stay away from the topic that you want to stay away from. We always look at opportunities to expand the portfolio from a gas delivery perspective. We have conversations with multiple pipelines throughout the year, constantly looking at ways of upgrading the system, bringing new gas into the system.

I will tell you, these facilities -- the new CTs that are going in have relatively low capacity factors. So they are running when needed at the top of the stack for reliability reasons primarily. It is not good business to build hundreds and hundreds of millions of dollars of pipelines to serve assets that run that little. It is a -- it is the reality of it that, at times, they will have to burn oil when it is a more economic choice to do so than to try and build a multi hundred million dollar pipeline to serve them.

MR. BUTLER: Madam Chairman, I am sorry, I just need to make a comment here. What Mr. Moyle is exploring now is not at all in Mr. Forrest's direct testimony. It is, indeed, one of these issues that had been deferred from an earlier witness to Mr. Forrest. And I don't have an objection to Mr. Moyle asking about it. I don't think it's fair to Mr. Forrest to say, answer these questions, but answer in a certain way where you don't talk about what's relevant to the question.

So if he is asking these questions, whatever Mr. Forrest needs to talk about to answer it, you know, I would want Mr. Forrest to be able to do that.

We are not playing a game here. We don't have some hidden agenda to get certain information into the record at all, but I just -- I don't want Mr. Forrest feeling like that he can't talk about what is the natural answer to a question Mr. Moyle is asking that is completely outside the scope of Mr. Forrest's direct testimony.

MR. MOYLE: And I don't want him to feel like he is constrained with respect to his --

CHAIRMAN BROWN: Although, you are telling him.

MR. MOYLE: Well, because he can just, you know, raise a flag. Or just say, Mr. Moyle, this is getting into the area you don't want to get into, and I will figure out another way or move on.

CHAIRMAN BROWN: That may be the more a appropriate way to do it, but I agree 100 percent of with Mr. Butler's statement, and the line of questions that you are going down has not been objected to up until this -- or commented one, but it is not -- I will note that it does not -- it's not contained in his direct.

MR. MOYLE: Right. And I think this gets us to the broader point that was raised, because a number of witnesses have said, this is Forrest, then they punted to him --

CHAIRMAN BROWN: I agree.

MR. MOYLE: -- and it's not fair to him to go, well, you know, here, it's not here. So I am operating under the idea that people punted it to him, I am trying to have him catch and answer.

CHAIRMAN BROWN: Until I hear an objection otherwise, I am going to let you proceed.

MR. MOYLE: Thank you. All right. Could you read back the last question, please? I lost my place.

(Whereupon, the court reporter read the requested portion of the record.)

CHAIRMAN BROWN: Mr. Moyle.

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

BY MR. MOYLE:

Q When you -- when you economically dispatched, do you consider emissions when you are making decisions with respect to which plants to run, or is it all based on economics per your earlier answer?

A Yes and no. There are emissions constraints, permitting constraints at certain facilities that are limited to the number of hours that can run oil versus gags, so it's more of a permitting issue. But generally speaking, when we dispatch -- when we run our economic production cost modeling, emissions are not taken into consideration in the short-term, no.

MR. MOYLE: I think I am going to just take a cautious path and call it a day.

CHAIRMAN BROWN: Fair enough, Mr. Moyle.

All right, Mr. Wiseman.

MR. WISEMAN: Thank you, Madam Chair.

EXAMINATION

BY MR. WISEMAN:

Q Mr. Forrest, I just have a few questions for you.

Do you recall -- I am going to follow up on something Mr. Moyle asked you a bit ago. Do you recall he asked you whether other utilities have VPs of Energy, Marketing and Trading?

A Yes.

Q And I don't want to characterize your answer, but I think what you said was basically the title might be different, but the officers would oversee a group that would engage in the same type of activities; is that right?

A Yeah. That is correct.

Q Okay. Now, can you turn to page five of your testimony, please?

A I am there.

Q All right. On page -- I am sorry, on lines 13 and 14, you used two terms, economy sales and economy purchases, do you see that?

A Yes, sir.

Q Okay. Can you explain what those are?

A Economy transactions, purchases and sales, are short-term transaction made in the wholesale market where we are either buying or selling power around our generating assets. And so what we do is we establish a -- we have a production cost model that's determines what out marginal cost is, and then we go out and canvas the market to look for either an opportunity to sell higher than that marginal cost, or purchase lower than that marginal cost. And so those are considered economy transactions, given that there is no firm commitment. They are non-firm transactions that we can recall if we have a system issue.

Q Okay. And have these -- when -- you just said that other utilities have officers who oversee groups who engage in the same types of activities that your group engages in. Were you talking about these economy sales and economy purchases?

A Yes. I don't know that they are structured exactly like the Energy, Marketing and Trading group is.

I can't speak for their groups. I do know that, you know, TECO has a group that is participating in the wholesale market. Duke-Florida has a group that is participating. There is a number of entities out there that are participating in the wholesale markets at all times.

MR. WISEMAN: Thank you, Mr. Forrest. Those are all my questions?

CHAIRMAN BROWN: Thank you, Mr. Wiseman.

Retail Federation.

MR. WRIGHT: No questions, Madam Chair.

CHAIRMAN BROWN: Thank you.

FEA.

MR. JERNIGAN: No questions. Thank you.

CHAIRMAN BROWN: Thank you.

Sierra, Ms. Csank.

MS. CSANK: No questions, Madam Chair.

CHAIRMAN BROWN: Okay. Wal-Mart.

MS. ROBERTS: No questions.

CHAIRMAN BROWN: AARP.

MR. COFFMAN: No questions, Your Honor.

CHAIRMAN BROWN: Larsons.

MR. SKOP: Thank you, Madam Chair. Just a few questions.

EXAMINATION

BY MR. SKOP:

Q Good afternoon, Mr. Forrest.

A Good afternoon.

Q If I could ask you to turn to page eight, lines 20 through 21, of your prefiled direct testimony, please.

A I am there.

Q And give me one second, please. And on lines 20 and 21, you discuss capacity releases of natural gas transportation, correct?

A That is correct. Yes.

Q All right. And that would be the release of firm transportation capacity, correct?

A Yes, that's correct. The FERC allows for short-term temporary releases of capacity. And again, in our case, we are doing it when it's not needed to serve our own native load, so there is a FERC governed process which allows that. It's done through the electronic bulletin board on the pipelines, and it's picked up on a temporary basis by a counter-party who utilizes it for their own needs, but it is done on a temporary basis.

Q Okay. And you would agree that the FPL customers have already paid for the firm transportation capacity, correct?

A I would agree that they have paid for it, yes. It's being paid for whether it's being utilized or not.

Q Okay. So the incentive mechanism effectively incentivizes FPL further for something that its ratepayers have already paid for, correct?

A That is correct. This commission has demonstrated over time that they believe in incentives, and we certainly believe in this particular case it has worked just as planned.

Q Okay. If I could ask you to go to page 12, lines five through six, of your prefiled direct testimony, please.

A I am sorry, what lines were that?

Q It's page 12, lines five through six.

A Okay.

Q And in that testimony, you discuss two proposals -- excuse me, my computer has decided to scroll down. Bear with me.

MR. SKOP: May I have a moment, Madam Chair?

CHAIRMAN BROWN: Sure.

MR. SKOP: Okay. I am sorry.

BY MR. SKOP:

Q So on page 12, lines five through six, of your prefiled testimony, you discussed a lowering of the threshold sharing bar, correct?

A That is correct. Yes.

Q Okay. So under that proposed change to the incentive mechanism that was adopted in the 2012 settlement, FPL is proposing to lower the bar and stands to share in incentives at a lower dollar threshold level, correct?

A Yes. That is correct. As I mentioned earlier, with the loss of the UPS agreement, it's taken a fairly substantive asset out of the portfolio that is no longer available to us to optimize, so we felt like it was appropriate to lower the incentive mechanism to reflect that. It is -- the opportunities that we have seen within Florida, obviously, are -- they are robust, but they are lower than they were having the UPS agreement available to us, certainly.

Q Okay. But you would agree that there are other methodologies in your direct testimony other than the UPS agreement where FPL is incentivized to optimize and create value for its ratepayers and itself, correct?

A That is correct, and I believe that we do that on a daily basis. I think we are creative and innovative in terms of how we have approached it. I think we are in the process of filing our 2017 fuel projections, which will include an estimate of what our -- what we believe the optimization activities will deliver in 2017, and it's about $28.3 million or so, somewhere in that neighborhood.

That is certainly, you know, includes all of the fuel optimization, as well as power economy purchases and sales. It's an estimate that's still $8 million short of that, so we then have to go out and sort of beat the bushes, so to speak, to try and find the incremental opportunities to get us to the 36 before we ever start sharing in it, so we feel like it's -- as Mr. Skop said, there is a lot of opportunities, but it still takes a lot of effort to go get it done.

Q Thank you.

Did I just hear, in your response to my question, you stated that the loss of the UPS opportunity was $8 million? I thought you mentioned $8 million.

A No. It's 10 million on average -- actually it's 10-and-a-half million on average per year.

Q All right. Thank you. If I could ask you now to turn to page 13, lines nine through 24, of your prefiled direct testimony, please?

A Nine through 24?

Q Yes, sir.

A I am there.

Q Okay. And in the second proposed change, FPL

seeks to optimize in furtherance of what is more beneficial for FPL rather than its customers, correct?

A I don't believe so. I think this is a very fair way of allocating costs associated with variable power plan O&M.

Q But, in fact, are you not again lowering the bar by removing the 514,000-megawatt threshold all together?

A Well, the way I would describe it, no. The -- the way that this will work is, in the previous -- in the previous case in 2012, we had 514,000-megawatt hours of sales projected in our test year. So there was 514,000-megawatt hours that were built into the power generation division's budget.

What we are suggesting here is a fair allocation of the way that both economy sales and economies purchases will work together. If, in a given month, we have more economy sales than we do purchases, we will charge customers for the variable O&M on the net amount. If, like this past January -- excuse me, this past July that we just went through, we have more purchases than we do sales, customers will actually receive a credit back. There was no method for that under the old one, so we feel it's a very fair and symmetrical way of balancing out the risks associated with these transactions.

Q Okay. And based upon to the proposed adjustments to the existing incentive mechanism, you would agree that a company that benchmarks on superior performance wouldn't seek to lower the bar to incentivize itself over its customers, correct?

A I don't agree with the characterization. I think that what we are doing is we are reflecting the market realities. So we are adjusting the threshold to reflect the market reality of where we are today.

Q All right. Thank you.

MR. SKOP: No further questions.

CHAIRMAN BROWN: Thank you, Mr. Skop.

Staff.

MS. BROWNLESS: Yes, ma'am.

EXAMINATION

BY MS. BROWNLESS:

Q Good afternoon, Mr. Forrest.

A Good afternoon.

Q Can you please refer to your direct testimony on page 15, lines three through 14?

A Yes, ma'am. I am there.

Q Oakie-doke. And I am trying to figure out exactly what the request is that's being made with regard to the duration of your modifications to the

proposed incentive mechanism. So are you requesting that the current incentive mechanism, as modified in your testimony, be expended for a four-year period, and end in 2020 or 2021, I guess?

A No, ma'am. Actually what we are asking is for a permanent extension of the agreement.

Q Forever?

A We will address the thresholds and different mechanisms within the incentive mechanism at the end of 2020 to ensure that we can update it again to reflect the market realities as they exist at that point.

Q Okay. So for -- so you are not suggesting -- or not proposing that the -- if the incentive mechanism is modified in this proceeding, that it will automatically expire at the end of four years?

A No, ma'am. We would file basically similar testimony at that point to talk about, you know, where the thresholds should be. Again, if you look at where we are over the last three-and-a-half years or so, we have averaged almost exactly $46 million in incentives -- incentive gains through the program. So the first year we were a little short of the $46 million. The second year, we exceeded it pretty good. And then last year, we were just above the $46 million. It's averaged out to almost exactly 46 million.

So we feel like the threshold, as it was designed back in 2012, has worked really, really well, and has come into fruition just exactly as the Commission suggested. What we are doing is lowering it to 36. We will go through another four years, and then come back and make adjustments as necessary as we have seen these four years play out.

Q Okay. So let's assume that, at the end of four years, Florida Power & Light does not want to come back for another rate case, is it your testimony that you will come back in another four years with a limited petition to address the status of the incentive mechanism?

A Yeah, I would probably defer to legal counsel on it, but, yes, I think that -- again, we are asking for a four-year extension of it, so --

Q Okay. Yesterday, Mr. Barrett directed questions to you regarding CO2 emissions.

A Yes, ma'am.

Q Does FPL include the cost of CO2 emissions in its negotiated purchase power agreements with renewable facilities?

A No, we don't. The environmental attributes and renewable attributes, both, of anything we would negotiate with a qualifying facility are retained by the owner of the facility. It's theirs to go monetize however they want. We do tend to negotiate right of first refusal on those attributes, such that if they do find an opportunity, we have the right to purchase or match whatever opportunity they find. But they do retain the value of both the emissions, the environmental attributes, as well as any renewable attributes that exist.

Q Okay. And does FPL include the cost of CO2 emissions in its standard offer contracts that it files with the Commission, which we approve on an annual basis?

A No, we don't. Again, since the QF is retaining the environmental attributes, we didn't feel it appropriate that we would pay for something that our customers aren't receiving.

Q And I want to go back to the incentive mechanism again. If the Commission should decide not to renew, or not to allow the incentive mechanism --

MR. MOYLE: I am sorry.

CHAIRMAN BROWN: You failed to raise an objection?

MR. MOYLE: Well, I was thinking about moving to strike, but that last question and answer is puzzling, because I don't think anything related to what's in the standard offer renewable contract is part of his testimony, and I just get nervous when stuff like this happens. So I guess the objection would be relevancy.

CHAIRMAN BROWN: I didn't hear any objection and he proceeded to provide an answer.

Staff.

MS. BROWNLESS: Well, I believe that these questions were asked of Mr. Barrett when they were talking about the extensive testimony, and the extensive cross-examination that you made with regard to natural gas and the natural gas GT and CT things. So he talked about -- he deferred that to Mr. Barrett, and we are following up because we were direct today ask Mr. Barrett, so there you go.

MR. MOYLE: About the standard offer renewable contract?

MS. BROWNLESS: About CO2 emissions, and the effect of CO2 emissions on cost-effectiveness of the CT substitutions and expansions that are included in the 2018 rate base.

CHAIRMAN BROWN: Okay.

MR. MOYLE: Okay.

CHAIRMAN BROWN: Please proceed.

MR. WISEMAN: Madam Chair, if I could object as well.

CHAIRMAN BROWN: These are untimely objections, as you know.

MR. WISEMAN: Well, I am not -- I am objecting to further questioning on this line, for the reason it's the exact same issue we discussed earlier with respect to the Florida Southeast Connection. Simply because one witness punts a question to another witness doesn't make it all of a sudden that the subject becomes appropriately within the scope of the other witness' testimony. There is nothing in Mr. Forrest's testimony about CO2 emissions. And, yes, Mr. Barrett punted the question to him, but this is all outside the scope of his testimony. So it's -- and on that basis, it's improper, whether it was punted to him or not.

CHAIRMAN BROWN: Is that a objection to her next question?

MR. WISEMAN: Yes, it is. It's an objection to further questions about this subject.

CHAIRMAN BROWN: Maryann.

MR. MOYLE: We would join in that objection as well.

MS. BROWNLESS: Would it be helpful to know we are not going to ask any more questions about that?

MS. HELTON: And maybe it would be helpful if a question does get punted to another witness, for the party asking the question, to ask an additional question, and is that within the scope of their testimony, so we know whether it's a matter we can actually pursue or not, or whether it's a matter that's actually addressed in the hearing.

CHAIRMAN BROWN: Well, of course that would help, but at this point --

MS. HELTON: But it sounds like Ms. Brownless is done with that line of questions --

MS. BROWNLESS: I am finished.

MS. HELTON: -- and moving on to a different line.

CHAIRMAN BROWN: Okay.

MR. BUTLER: Excuse me, I have one observation I feel I need to make, which is that the question of whether, you know, environmental attributes, environmental credits were included in standard offer contracts or negotiated QF contracts isn't in Mr. Barrett's testimony either. It's something he was asked in the course of examination in an area that related to topics he had covered, and he did what he should have done, which is try to identify someone who could answer the question as posed.

And that's all that we were offering to do then, and it's all that Mr. Forrest is doing now.

CHAIRMAN BROWN: Fair enough.

Let's just move on.

MS. BROWNLESS: We are just going to talk about the incentive mechanisms again, which I believe are covered in Mr. Forrest's testimony.

CHAIRMAN BROWN: That's safe territory.

MS. BROWNLESS: Thank you.

BY MS. BROWNLESS:

Q What if Florida Power & Light does not file a proceeding in prior to December of 2016 with regard to the incentive mechanism if it is denied here, what are your plans with regard to the incentive mechanism?

A I may need you to ask that question again.

Q Here's what we are trying to figure out, because your testimony is a bit unclear. You -- are you proposing that the incentive mechanism, as modified here, be permanent for Florida Power & Light, or expire at the end of four years?

MR. MOYLE: I'm going to object to the extent it's been asked and answered. I think he just answered that, and he said, our plan is -- so he has testimony on it -- our plan is, we are going to have it for four years if the Commission approves it, and then we are going to come back in at the end and file a petition.

CHAIRMAN BROWN: Objection sustained.

MS. BROWNLESS: Actually, I would object to that characterization of Mr. Forrest' testimony.

CHAIRMAN BROWN: Ms. Brownless, can you continue with your questions?

MS. BROWNLESS: I will be glad to.

BY MS. BROWNLESS:

Q If the Commission decides that they are not going to modify the incentive mechanism and are, in fact, going to allow it to expire, as it currently stands, at the end of this year, is there another incentive mechanism associated with wholesale electric transactions that Florida Power & Light can take advantage of?

A Yes. There is the prior mechanism that we performed under previously, which included economy sales. I am hopeful, obviously, that the Commission will extend the program because I think it's worked out extremely well for customers. But, yes, I think we would fallback to the prior mechanism under economy sales, and just pick up where we left off, and we will do the same great job we were doing prior.

Q And that is the same incentive that TECO, Duke

and Gulf have at this time?

A Yes, ma'am.

MS. BROWNLESS: Thank you.

CHAIRMAN BROWN: No further questions?

MS. BROWNLESS: No, ma'am.

CHAIRMAN BROWN: All right.

Commissioners, any questions?

Redirect?

MR. BUTLER: Briefly.

FURTHER EXAMINATION

BY MR. BUTLER:

Q Mr. Forrest, you have been asked by a couple of counsel about the UPS contracts, and the value that they brought -- have brought over the last three years. In view of the gains that you have been able to achieve under the UPS contracts over the last three years under the incentive mechanism, can you explain to the Commission why FPL elected not to renew the UPS contracts?

A Yes. So the UPS contracts themselves, which expired at the end of 2012, just weren't economic for customers, despite the fact that there was good value in the optimization of those assets, they were -- you know, the two gas plants this an effective heat rate of about nine. We have got a system heat rate in the 7,500 range, as Ms. Kennedy talked about yesterday or the day before. They just weren't economic in the system. And probably the biggest sort of hurdle to the economics of those contracts was the transmission. We had to purchase electric transmission to move power from Southern Company to the Florida-Georgia border, where we picked it up on our own transmission system. That burden was about $31-and-a-half million before we ever paid a penny for the generation.

So it was a pretty significant hurdle to overcome that kind of cost. So it just wasn't economic, and we chose not to extend the agreements. We looked at other contracts outside of the UPS agreements in the southeast, they were not economic either, so we just chose not to renew.

MR. BUTLER: Thank you. That's all the redirect that I have.

CHAIRMAN BROWN: Thank you.

I believe there is only one exhibit for this witness.

MR. BUTLER: I think that's right, Exhibit 123, and I would move that into the record.

CHAIRMAN BROWN: Are there any objections to Exhibit 123?

Seeing none, we will move Exhibit 123 into the record.

(Whereupon, Exhibit No. 123 was received into evidence.)

CHAIRMAN BROWN: Would you like to excuse the witness?

MR. BUTLER: That would be great. May he be excused, please?

THE WITNESS: Thank you.

CHAIRMAN BROWN: Have a good afternoon. Bye-bye, Mr. Forrest.

(Witness excused.)

CHAIRMAN BROWN: FPL, will you call your next witness?

MR. BUTLER: We will.

MS. MONCADA: FPL calls Mr. Hevert to the stand.

MR. SAYLER: Madam Chair, Erik Sayler with Public Counsel's office. The intervenors have a proposal which we think will hopefully speed up the cross-examination with this witness and the next witness. Whenever you are ready, we will be able to share it with you.

CHAIRMAN BROWN: Just -- sorry, just trying to adjust the little notebooks here. We are ready.

MR. SAYLER: All right. I polled the entire intervenor side, and we have agreed to change up the order just a little bit, keep the same order but take up Office of Public Counsel and South Florida Hospital's last, because we believe that that will just hopefully expedite things, because I know I have a lot of cross, and I know that the hospitals do as well.

CHAIRMAN BROWN: Okay. Just for clarification, are you saying for the rest of this proceeding, or just for this witness?

MR. SAYLER: No, just for Witness Hevert and Witness Dewhurst. The next two witnesses in line.

CHAIRMAN BROWN: So it would be Public Counsel and --

MR. SAYLER: The hospitals -- South Florida Hospital Association. If there was a batting order, we would go eighth, they would go ninth.

CHAIRMAN BROWN: So after the Larsons.

MR. SAYLER: Yes.

CHAIRMAN BROWN: You said they would go eighth, you would go ninth, or vice-versa?

MR. SAYLER: Vice-versa. They would back cleanup.

CHAIRMAN BROWN: Does anybody have -- and I don't see a problem with that. Does anybody have a problem with that?

MR. LAVIA: I guess I have an observation. It's just not clear to me how that actually streamlines things, because if those two individuals have a lot of cross, and they are going last, we may have cross by the folks that go before them that they otherwise would have covered, whereas, if they are going first, the others will have a chance to see what ground they have covered and we will not be recovering the same ground.

So I understand the proposal. I don't see the efficiency merits of it.

MR. SAYLER: And we promise if any of the other intervenors cover our line of cross, we will certainly delete that. It's a two-way street on that matter.

CHAIRMAN BROWN: I don't have a problem with it, so it's fine. If it will serve you better, that's fine with me.

MR. SAYLER: Yes, ma'am. We appreciate that.

CHAIRMAN BROWN: So just to confirm, so after the Larsons, you would go first?

MR. SAYLER: OPC, and then the hospitals.

CHAIRMAN BROWN: Got it. Okay. I don't have a problem with it.

MR. SAYLER: And then after the hospital, staff, and then however the normal course is. Thank you.

CHAIRMAN BROWN: All right. Thank you.

Counsel, has Mr. Hevert --

MR. LITCHFIELD: I do not believe Mr. Hevert has been sworn.

CHAIRMAN BROWN: That's why he is standing.

MR. LITCHFIELD: That's why.

Whereupon,

ROBERT HEVERET

was called as a witness, having been first duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

CHAIRMAN BROWN: Thank you, please be seated.

THE WITNESS: Thank you.

CHAIRMAN BROWN: Welcome. Good afternoon.

THE WITNESS: Good afternoon.

CHAIRMAN BROWN: Mr. Litchfield.

MR. LITCHFIELD: Thank you, Madam Chair.

EXAMINATION

BY MR. LITCHFIELD:

Q **Mr. Hevert, would you please state your name and business address?**

A Robert Hevert. Last name is spelled

H-E-V-E-R-T. And my business address is 1900 West Park Drive in Westboro, Massachusetts.

Q And by whom are you employed, and in what capacity?

A I am a partner at ScottMadden, Incorporated.

Q Have you prepared and caused to be filed 69 pages of direct testimony in this proceeding?

A Yes, I have.

Q And on August 16, 2016, FPL filed an errata sheet on your behalf of your direct testimony; is that correct?

A That is correct.

Q Beyond those filed errata, do you have any further changes or revisions to your direct testimony?

A I do not.

Q With those changes, if I asked you the same questions contained in your direct testimony, would your answers be the same?

A Yes, they would.

MR. LITCHFIELD: Madam Chair, I would ask that Mr. Hevert's direct testimony be inserted into the record as though read.

CHAIRMAN BROWN: We will insert Mr. Hevert's prefiled direct testimony into the record as though read.

(Prefiled direct testimony inserted into the record as though read.)

ERRATA SHEET

WITNESS: **ROBERT B. HEVERT – DIRECT TESTIMONY**

PAGE #	**LINE #**	**CHANGE**
51	13	Replace "The price of FPL shares" with "The value of FPL equity"

I. WITNESS IDENTIFICATION AND QUALIFICATIONS

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

A. My name is Robert B. Hevert. I am Managing Partner of Sussex Economic Advisors, LLC ("Sussex"). My business address is 1900 West Park Drive, Suite 250, Westborough, Massachusetts 01581.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this direct testimony ("Direct Testimony") to the Florida Public Service Commission ("Commission") on behalf of Florida Power and Light Company ("FPL" or the "Company"), which is a wholly owned subsidiary of NextEra Energy, Inc.

Q. Please describe your educational background.

A. I hold a Bachelor's degree in Business and Economics from the University of Delaware, and an MBA with a concentration in Finance from the University of Massachusetts. I also hold the Chartered Financial Analyst designation.

Q. Please describe your experience in the energy and utility industries.

A. I have worked in regulated industries for over twenty-five years, having served as an executive and manager with consulting firms, a financial officer of a publicly-traded natural gas utility (at the time, Bay State Gas Company), and an analyst at a telecommunications utility. In my role as a consultant, I have advised numerous energy and utility clients on a wide range of financial and economic issues including corporate and asset-based transactions, asset and enterprise valuation, transaction due diligence, dividend policy, and strategic matters. As an expert witness, I have provided testimony in approximately 150 proceedings regarding various financial and regulatory matters before numerous state utility regulatory agencies and the Federal Energy Regulatory Commission. A summary of my professional and educational background, including a list of my testimony in prior proceedings, is included in Exhibit RBH-1.

II. PURPOSE AND OVERVIEW OF TESTIMONY

Q. What is the purpose of your Direct Testimony?

A. The purpose of my Direct Testimony is to present evidence and provide the Commission with a recommendation regarding FPL's Return on Equity ("ROE") and to provide an assessment of the capital structure to be used for ratemaking purposes, as proposed in the Direct Testimony of FPL witness Dewhurst.[1] The analyses and conclusions contained in my Direct Testimony are supported by the data presented in Exhibit RBH-2 through Exhibit RBH-10, which have been prepared by me or under my direction.

Q. What are your conclusions regarding the appropriate Cost of Equity for FPL?

A. My analyses indicate that FPL's Cost of Equity currently is in the range of 10.50 percent to 11.50 percent. Based on the quantitative and qualitative

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1 Throughout my Direct Testimony, I interchangeably use the terms "ROE" and "Cost of Equity".

analyses discussed throughout my Direct Testimony and the Company's risk profile, I conclude that an ROE of 11.00 percent is a reasonable estimate of FPL's Cost of Equity.

Q. Please provide a brief overview of the analyses that led to your ROE recommendation.

A. Because all financial models are subject to various assumptions and constraints, equity analysts and investors tend to use multiple methods to develop their return requirements. I therefore relied on three widely accepted approaches: (1) the Capital Asset Pricing Model ("CAPM"); (2) the Bond Yield Plus Risk Premium approach; and (3) the Discounted Cash Flow ("DCF") model, including the Constant Growth, and Multi-Stage forms.

In addition to the methodologies noted above, my recommendation also takes into consideration: (1) the Company's geographic risk, including its vulnerability to severe weather conditions; (2) the Company's need to access external capital; (3) the potential for new regulatory requirements associated with nuclear generation; (4) the need to account for flotation costs; and (5) the potential for an increase in the Cost of Equity over the Company's proposed four year rate period.

I also have considered several market-related factors, including:

- Widespread expectations for increases in interest rates, as revealed in both market data and economists' consensus projections, which weigh in the evaluation of the CAPM, Bond Yield Plus Risk Premium, and DCF results;

- An increasing degree of equity market volatility as the Federal Reserve has begun its process of monetary policy normalization, indicating a level of market uncertainty that has not been observed on a sustained basis for several years; and
- Widening credit spreads on utility bonds, indicating investors' views that the risks associated with the utility sector have increased.

Although I did not make explicit adjustments to my ROE estimates for factors other than flotation costs, I did take them into consideration in determining where the Company's Cost of Equity falls within the range of analytical results.

Q. Please now summarize your ROE results and your ROE recommendation.

A. My analytical results range from 8.61 percent to 13.21 percent. In developing my recommendation, I recognized that the low and high ends of the range of results (set by the Constant Growth DCF analyses, and the CAPM analyses, respectively) are not likely to be reasonable estimates of the Company's Cost of Equity. For example, the DCF-based results fail to adequately reflect increasing capital market risk and volatility and, as discussed in Section VII, may be affected by Federal Reserve monetary policy. Because Risk Premium-based methods specifically reflect measures of capital market risk, they are more likely than other approaches (such as the Constant Growth DCF method) to provide reliable estimates of the Cost of Equity during periods of market instability. As noted above (and discussed in Section VII below), measures such as equity market volatility and expanding utility credit spreads suggest that currently is the case.

Looking at the entire range of results, and taking into consideration the issues summarized above and discussed throughout my Direct Testimony, I believe the Company's required ROE lies above the mean of the analytical results. Giving somewhat more weight to the risk premium based approaches, I recommend an ROE in the range of 10.50 percent to 11.50 percent. Within that range, it is my view that an ROE of 11.00 percent is reasonable and appropriate.

Q. How is the remainder of your Direct Testimony organized?

A. The remainder of my Direct Testimony is organized as follows:

- <u>Section III</u> – discusses the regulatory guidelines and financial considerations pertinent to the development of the cost of capital;
- <u>Section IV</u> – explains my selection of the proxy companies used to develop my analytical results;
- <u>Section V</u> – explains my analyses and the analytical bases for my ROE recommendation;
- <u>Section VI</u> – provides a discussion of specific business risks and other considerations that have a direct bearing on FPL's Cost of Equity;

- Section VII – briefly discusses the current capital market conditions and their effect on FPL's Cost of Equity;
- Section VIII – discusses the appropriateness of the Company's capital structure;
- Section IX – summarizes my conclusions and recommendations.

III. REGULATORY GUIDELINES AND FINANCIAL CONSIDERATIONS

Q. Please provide an overview of the issues surrounding the Cost of Equity in regulatory proceedings, generally.

A. In very general terms, the Cost of Equity is the return that investors require to make an equity investment in a firm. That is, investors will provide funds to a firm only if the return that they *expect* is equal to, or greater than, the return that they *require* in order to accept the risk of providing funds to the firm. From the firm's perspective, that required return, whether it is provided to debt or equity investors, has a cost. Individually, we speak of the "cost of debt" and the "Cost of Equity" as measures of those costs; together, they are referred to as the "cost of capital."

The cost of capital (including the costs of both debt and equity) is based on the economic principle of "opportunity costs." Investing in any asset, whether debt or equity securities, implies a forgone opportunity to invest in alternative assets. For any investment to be sensible, its expected return must be at least equal to the return expected on alternative, comparable risk investment opportunities.

Although both debt and equity have required costs, they differ in certain fundamental ways. Most noticeably, from the perspective of the issuer, the cost of debt is contractually defined and can be directly observed as the interest rate or yield on debt securities.[2] The Cost of Equity, on the other hand, is neither directly observable nor a contractual obligation. Rather, equity investors have a claim on cash flows only after debt holders are paid; the uncertainty (or risk) associated with those residual cash flows determines the Cost of Equity. Because equity investors bear the "residual risk," they take greater risks and require higher returns than debt holders. In that basic sense, equity and debt investors differ: they invest in different securities, face different risks, and require different returns.

Whereas the cost of debt can be directly observed, the Cost of Equity must be estimated or inferred based on market data and various financial models. As discussed throughout my Direct Testimony, each of those models is subject to certain assumptions, which may be more or less applicable under differing market conditions. In addition, because the Cost of Equity is premised on opportunity costs, the models typically are applied to a group of "comparable"

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2 The observed interest rate may be adjusted to reflect issuance or other directly observable costs.

or "proxy" companies. The choice of models (including their inputs), the selection of proxy companies, and the interpretation of the model results all require the application of informed and reasoned judgment. That judgment should consider data and information that is not necessarily included in the models themselves. In the end, the estimated Cost of Equity should reflect the return that investors require in light of the subject company's risks, and the returns available on comparable investments.

Q. Please provide a brief summary of the guidelines established by the United States Supreme Court ("the Court") for the purpose of determining the Return on Equity.

A. The Court established the guiding principles for establishing a fair return for capital in two cases: (1) *Bluefield Water Works and Improvement Co. v. Public Service Comm'n.* (*"Bluefield"*);[3] and (2) *Federal Power Comm'n v. Hope Natural Gas Co.* (*"Hope"*).[4] In *Bluefield*, the Court stated:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for

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3 Bluefield Waterworks & Improvement Co., v. Public Service Commission of West Virginia, 262 U.S. 679, 692-93 (1923).

4 Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

the proper discharge of its public duties.[5]

The Court therefore recognized that: (1) a regulated company cannot remain financially sound unless the return it is allowed to earn on its invested capital is at least equal to the cost of capital (the principle relating to the demand for capital); and (2) a regulated company will not be able to attract capital if it does not offer investors an opportunity to earn a return on their investment equal to the return they expect to earn on other investments of the same risk (the principle relating to the supply of capital).

In *Hope*, the Court reiterated the financial integrity and capital attraction principles of the *Bluefield* case:

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock... By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[6]

In summary, the Court clearly has recognized that the fair Rate of Return on Equity should be: (1) comparable to returns investors expect to earn on other investments of similar risk; (2) sufficient to assure confidence in the

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5 Bluefield Waterworks & Improvement Co., v. Public Service Commission of West Virginia, 262 U.S. 679, 692-93 (1923).

6 Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

company's financial integrity; and (3) adequate to maintain and support the company's credit and to attract capital.

Q. Does the Florida Commission provide similar guidance?

A. Yes, the Commission applies the precedents of the *Hope* and *Bluefield* cases. For example, in Tampa Electric's 2008 rate proceeding the Commission found that the authorized ROE "satisfies the standards set forth in the Hope and Bluefield decisions of the U.S. Supreme Court regarding a fair and reasonable return for the provision of regulated service."[7]

Based on the guidance provided by the Court and the Commission, the ROE authorized in this proceeding should provide FPL the opportunity to earn a fair and reasonable return, and should enable efficient access to external capital under a variety of market conditions.

Q. Aside from the standards established by the Court and the Commission, why is it important for a utility to be allowed the opportunity to earn a return adequate to attract equity capital at reasonable terms?

A. Having the opportunity to earn an adequate return on equity contributes to the utility's financial integrity and thereby facilitates its ability to access both long term and short-term capital markets on reasonable terms, even under difficult market conditions. Maintaining such access to capital is essential for the utility to be able to continue to provide safe, reliable electric service

[7] Order No. PSC 09-0283-FOF-EI, Docket No. 080317-EI, at 48.

throughout economic cycles. While the "capital attraction" and "financial integrity" standards are important principles in normal economic conditions, the practical implications of those standards are even more pronounced when, as with FPL, the utility has substantial capital investment plans. That is particularly the case when, as discussed in more detail in Section VII, market data and consensus projections for long-term Treasury yields suggest rates likely will rise. The Company's need for regular and cost-effective access to both debt and equity capital, therefore, increase the importance of maintaining a strong financial profile and favorable credit ratings.

Q. How is the Cost of Equity estimated in regulatory proceedings?

A. As noted earlier, and as discussed in more detail later in my Direct Testimony, the Cost of Equity is estimated by the use of various financial models. By their very nature, those models produce a range of results from which the Cost of Equity is determined. That determination therefore must be based on a comprehensive review of relevant data and information; it does not necessarily lend itself to a strict mathematical or formulaic solution. The key consideration in determining the Cost of Equity is to ensure that the overall analysis reasonably reflects investors' view of the financial markets in general, and the subject company (in the context of the proxy companies) in particular. Both practitioners and academics, however, recognize that financial models simply are tools to be used in the Cost of Equity estimation process, and that strict adherence to any single approach, or to the results of any single approach, can lead to flawed or misleading conclusions. That position is consistent with the *Hope* and *Bluefield* principle that it is the result, as opposed to the analytical methodology employed that is controlling in arriving at Cost of Equity determinations.[8] Thus, a reasonable Cost of Equity estimate appropriately considers alternative methodologies and the reasonableness of their individual and collective results in the context of observable, relevant market information.

IV. PROXY GROUP SELECTION

Q. As a preliminary matter, why is it necessary to select a group of proxy companies to determine the Cost of Equity for FPL?

A. Because Cost of Equity is a market-based concept and FPL, which is a wholly owned operating subsidiary of NextEra Energy, Inc., is not a publicly traded entity, it is necessary to establish a group of comparable, publicly traded companies to serve as its "proxy." Even if FPL were a publicly traded entity, short-term events could bias its market value during a given period of time. A significant benefit of using a proxy group is that it moderates the effects of anomalous, temporary events associated with any one company.

Q. Does the selection of a proxy group suggest that analytical results will be tightly clustered around average (*i.e.*, mean) results?

A. No. For example, the Constant Growth DCF approach defines the Cost of Equity as the sum of the expected dividend yield and projected long-term

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[8] *See*, Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944).

growth. Despite the care taken to maximize risk comparability, market expectations with respect to future risks and growth opportunities will vary from company to company. Therefore, even within a group of similarly situated companies, it is common for analytical results to reflect a seemingly wide range. Consequently, at issue is how to estimate the Cost of Equity from within that range. Such a determination necessarily must consider a wide range of both quantitative and qualitative information.

Q. Please provide a summary profile of FPL.

A. FPL provides electric generation, transmission and distribution services to approximately 4.8 million retail customers in Florida.[9] FPL's long-term issuer credit ratings from Standard & Poor's, Moody's, and Fitch Ratings currently are A-, A1, and A, respectively.[10]

Q. How did you select the companies included in your proxy group?

A. I began with the universe of companies that Value Line classifies as Electric Utilities, and excluded companies that:

- Do not consistently pay quarterly cash dividends;
- Were not covered by at least two utility industry equity analysts;
- Do not have investment grade senior unsecured bond and/or corporate credit ratings from S&P;

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9 *See* NextEra Energy Inc., SEC Form 10-K for the fiscal year ended December 31, 2015, at 5.
10 Source: SNL Financial.

- Are not vertically integrated, *i.e.* utilities that own and operate regulated generation, transmission, and distribution assets;
- Have less than 60.00 percent of total net operating income derived from regulated utility operations over the three most recently reported fiscal years;
- Have regulated electric operating income over the three most recently reported fiscal years representing less than 60.00 percent of total regulated operating income; or
- Are currently known to be party to a merger or other significant transaction.

Q. Did you include NextEra Energy, Inc. in your analysis?

A. No. In order to avoid the circular logic that otherwise would occur, it is my practice to exclude the subject company, or its parent holding company, from the proxy group. Additionally, NextEra Energy Inc. is currently party to a merger, and would be excluded from my proxy group based on that criterion.[11]

Q. What companies met those screening criteria?

A. The criteria discussed above resulted in a proxy group of the following 19 companies:

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[11] *See*, Press Release dated December 3, 2014, "NextEra Energy and Hawaiian Electric Industries to Combine."

Table 1: Proxy Group Screening Results

Company	Ticker
ALLETE, Inc.	ALE
Alliant Energy Corporation	LNT
Ameren Corporation	AEE
American Electric Power Company, Inc.	AEP
Avista Corporation	AVA
CMS Energy Corporation	CMS
Dominion Resources, Inc.	D
DTE Energy Company	DTE
Great Plains Energy Inc.	GXP
IDACORP, Inc.	IDA
NorthWestern Corporation	NWE
OGE Energy Corp.	OGE
Otter Tail Corporation	OTTR
Pinnacle West Capital Corporation	PNW
PNM Resources, Inc.	PNM
Portland General Electric Company	POR
SCANA Corporation	SCG
Westar Energy, Inc.	WR
Xcel Energy Inc.	XEL

V. COST OF EQUITY ESTIMATION

Q. Please briefly discuss the Cost of Equity in the context of the regulated rate of return.

A. Regulated utilities primarily use common stock and long-term debt to finance their permanent property, plant, and equipment. The overall cost of capital or cost rate of return ("ROR") for a regulated utility is based on its weighted average cost of capital, in which the costs of the individual sources of capital are weighted by their respective book values. As noted above, the Cost of

Equity is market-based and, therefore, must be estimated based on observable market information.

Q. How is the required Cost of Equity determined?

A. Because the Cost of Equity is not directly observable it must be estimated based on both quantitative and qualitative information. Although a number of empirical models have been developed for that purpose, all are subject to limiting assumptions or other constraints. Consequently, many finance texts recommend using multiple approaches to estimate the Cost of Equity.[12] When faced with the task of estimating the Cost of Equity, analysts and investors are inclined to gather and evaluate as much relevant data as reasonably can be analyzed and, therefore, rely on multiple analytical approaches.

Because all models are based on underlying assumptions as market conditions change the reliability of individual models will vary. Therefore, it is both prudent and appropriate to use multiple methodologies in order to mitigate the effects of assumptions and inputs associated with any single approach. Accordingly, I have considered the results of the Capital Asset Pricing Model, the Bond Yield Plus Risk Premium approach, and the Constant Growth and Multi-Stage forms of the DCF model.

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12 *See*, *e.g.*, Eugene Brigham, Louis Gapenski, Financial Management: Theory and Practice, 7th Ed., 1994, at 341, and Tom Copeland, Tim Koller and Jack Murrin, Valuation: Measuring and Managing the Value of Companies, 3rd ed., 2000, at 214.

CAPM Analysis

Q. Please briefly describe the general form of the CAPM.

A. The CAPM is a risk premium method that estimates the Cost of Equity for a given security as a function of a risk-free return plus a risk premium (to compensate investors for the non-diversifiable or "systematic" risk of that security). As shown in Equation [1], the CAPM is defined by four components, each of which theoretically must be a forward-looking estimate:

$$K_e = r_f + \beta(r_m - r_f) \quad \text{Equation [1]}$$

where:

K_e = the required market Cost of Equity;

β = Beta of an individual security;

r_f = the risk free rate of return; and

r_m = the required return on the market as a whole.

In Equation [1], the term (r_m – r_f) represents the Market Risk Premium.[13] According to the theory underlying the CAPM, since unsystematic risk can be diversified away by adding securities to investment portfolios, investors should be concerned only with systematic or non-diversifiable risk. Non-diversifiable risk is measured by the Beta coefficient, which is defined as:

$$\beta_j = \frac{\sigma_j}{\sigma_m} \times \rho_{j,m} \quad \text{Equation [2]}$$

13 The Market Risk Premium is defined as the incremental return of the market portfolio over the risk-free rate.

where σ_j is the standard deviation of returns for company "*j*"; σ_m is the standard deviation of returns for the broad market (as measured, for example, by the S&P 500 Index), and $\rho_{j,m}$ is the correlation of returns between company *j* and the broad market. The Beta coefficient therefore represents both relative volatility (*i.e.,* the standard deviation) of returns, and the correlation in returns between the subject company and the overall market. Intuitively, higher Beta coefficients indicate that the subject company's returns have been relatively volatile, and have moved in tandem with the overall market. Consequently, if a company has a Beta coefficient of 1.00, it is as risky as the market and does not provide any diversification benefit.

Q. What risk-free rate assumptions did you include in your CAPM analysis?

A. First, because utility assets represent long-duration investments, I relied on estimates of the 30-year Treasury yield as the risk-free rate component of the CAPM analysis. Because FPL is proposing a four year rate proposal, I considered the current the 30-day average yield on 30-year Treasury bonds (*i.e.*, 2.96 percent), as well as the range of projected 30-year Treasury yields reported by Blue Chip Financial Forecasts for the rate proposal period (*i.e.*, 4.00 percent in 2017 to 4.80 percent in 2020).

Q. Why have you relied on the 30-year Treasury yield for your CAPM analysis?

A. In determining the security most relevant to the application of the CAPM, it is important to select the term (or maturity) that best matches the life of the underlying investment. Electric utilities typically are long-duration investments; for example, FPL's average electric utility plant depreciation rate ranged from approximately 3.30 percent to 3.40 percent from 2013 to 2015, suggesting an average useful life of 29 to 30 years.[14] On balance, therefore, the 30-year Treasury yield is the appropriate measure of the risk-free rate for the purpose of the CAPM.

Q. Please describe your *ex-ante* (*i.e.*, forward-looking) approach to estimating the Market Risk Premium.

A. The approach is based on the market-required return, less the current 30-year Treasury yield. To estimate the market required return, I calculated the market capitalization weighted average total return based on the Constant Growth DCF model (which is discussed below). To do so, I relied on data from two sources: (1) Bloomberg; and (2) Value Line.[15] With respect to Bloomberg-derived growth estimates, I calculated the expected dividend yield (using the same one-half growth rate assumption described earlier), and combined that amount with the projected earnings growth rate to arrive at the market capitalization weighted average DCF result. I performed that calculation for each of the S&P 500 companies for which Bloomberg provided consensus growth rates (the companies with such projections represent 99.61 percent of the index market capitalization). I then subtracted the current 30-year Treasury yield from that amount to arrive at the market

14 See NextEra Energy Inc., SEC Form 10-K for the fiscal year ended December 31, 2015, at 85.
15 *See* Exhibit RBH-6.

DCF-derived *ex-ante* market risk premium estimate. In the case of Value Line, I performed the same calculation, again using all companies for which five-year earnings growth rates were available (the companies with such projections represent 95.22 percent of the index market capitalization). The results of those calculations are provided in Exhibit RBH-6.

Q. How did you apply your expected Market Risk Premium and risk-free rate estimates?

A. I relied on the *ex-ante* Market Risk Premia discussed above, together with the current and near-term projected 30-year Treasury yields as inputs to my CAPM analyses.

Q. What Beta coefficient did you use in your CAPM model?

A. As shown in Exhibit RBH-7, I considered the Beta coefficients reported by two sources: Bloomberg and Value Line. Although both of those services adjust their calculated (or "raw") Beta coefficients to reflect the tendency of the Beta coefficient to regress to the market mean of 1.00, Value Line calculates the Beta coefficient over a five-year period, whereas Bloomberg's calculation is based on two years of data.

Q. What are the results of your CAPM analyses?

A. As shown in Table 2 (below) the CAPM analyses suggest an ROE range of 9.08 percent to 13.21 percent (*see* also Exhibit RBH-2).[16]

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[16] Including flotation costs.

Table 2: Summary of CAPM Results Including Flotation Costs[17]

	Bloomberg Derived Market Risk Premium	Value Line Derived Market Risk Premium
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury	9.57%	9.08%
Blue Chip 2017 Consensus 30-Year Treasury	10.61%	10.12%
Blue Chip 2020 Consensus 30-Year Treasury	11.41%	10.92%
Average Value Line Beta Coefficient		
Current 30-Year Treasury	11.36%	10.73%
Blue Chip 2017 Consensus 30-Year Treasury	12.41%	11.78%
Blue Chip 2020 Consensus 30-Year Treasury	13.21%	12.58%

Bond Yield Plus Risk Premium Analysis

Q. Please describe the Bond Yield Plus Risk Premium approach.

A. This approach is based on the basic financial tenet that equity investors bear the residual risk associated with ownership and therefore require a premium over the return they would have earned as a bondholder. That is, since returns to equity holders are more risky than returns to bondholders, equity investors must be compensated for bearing that additional risk. Risk premium approaches, therefore, estimate the Cost of Equity as the sum of the equity risk premium and the yield on a particular class of bonds. As noted in my discussion of the CAPM, since the equity risk premium is not directly observable, it typically is estimated using a variety of approaches, some of which incorporate *ex-ante*, or forward-looking estimates of the Cost of Equity,

17 *See* Exhibit RBH-2.

and others that consider historical, or *ex-post*, estimates. An alternative approach is to use actual authorized returns for electric utilities to estimate the Equity Risk Premium.[18]

Q. Please explain how you performed your Bond Yield Plus Risk Premium analysis.

A. As suggested above, I first defined the Risk Premium as the difference between the authorized ROE and the then-prevailing level of long-term (*i.e.*, 30-year) Treasury yield. I then gathered data for 1,468 electric utility rate proceedings between January 1980 and January 15, 2016. In addition to the authorized ROE, I also calculated the average period between the filing of the case and the date of the final order (the "lag period"). In order to reflect the prevailing level of interest rates during the pendency of the proceedings, I calculated the average 30-year Treasury yield over the average lag period (approximately 200 days).

Because the data cover a number of economic cycles, the analysis also may be used to assess the stability of the Equity Risk Premium. Prior research, for example, has shown that the Equity Risk Premium is inversely related to the level of interest rates.[19] That analysis is particularly relevant given the relatively low, but increasing level of current Treasury yields.

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[18] In my experience, U.S. regulatory commissions follow the *Hope* and *Bluefield* standards and therefore provide a reasonable measure of the required Return on Equity.

[19] See, e.g., Robert S. Harris and Felicia C. Marston, *The Market Risk Premium: Expectational*

Q. How did you analyze the relationship between interest rates and the Equity Risk Premium?

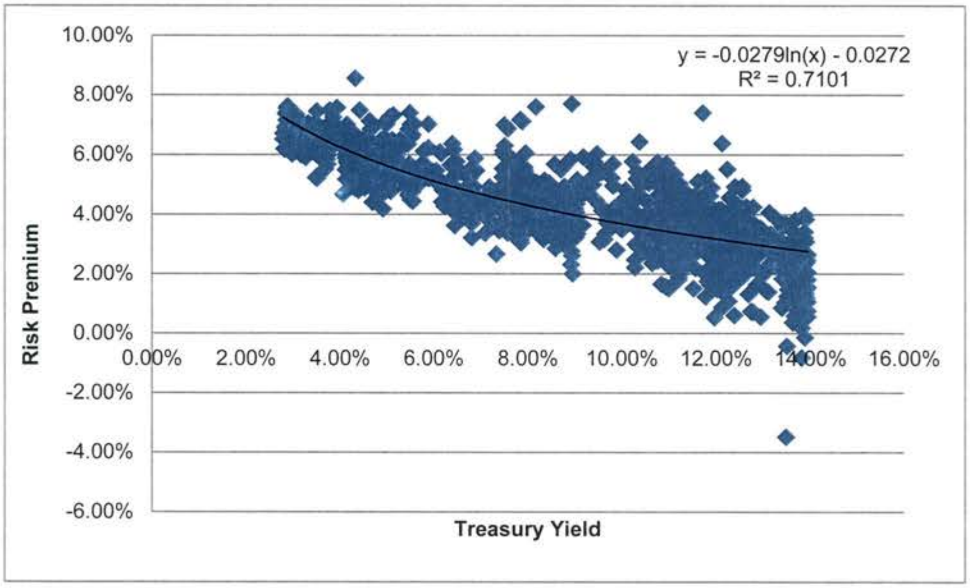
A. The basic method used was regression analysis, in which the observed Equity Risk Premium is the dependent variable, and the average 30-year Treasury yield is the independent variable. Relative to the long-term historical average, the analytical period includes interest rates and authorized ROEs that are quite high during one period (*i.e.*, the 1980s) and that are quite low during another (*i.e.*, the post-Lehman bankruptcy period). To account for that variability, I used the semi-log regression, in which the Equity Risk Premium is expressed as a function of the natural log of the 30-year Treasury yield:

$$RP = \alpha + \beta(LN(T_{30})) \quad \text{Equation [3]}$$

As shown on Chart 1 (below), the semi-log form is useful when measuring an absolute change in the dependent variable (in this case, the Risk Premium) relative to a proportional change in the independent variable (the 30-year Treasury yield).

Estimates Using Analysts' Forecasts, Journal of Applied Finance, Vol. 11, No. 1, 2001, at 11-12; Eugene F. Brigham, Dilip K. Shome, and Steve R. Vinson, *The Risk Premium Approach to Measuring a Utility's Cost of Equity*, Financial Management, Spring 1985, at 33-45; and Farris M. Maddox, Donna T. Pippert, and Rodney N. Sullivan, *An Empirical Study of Ex Ante Risk Premiums for the Electric Utility Industry*, Financial Management, Autumn 1995, at 89-95.

Chart 1: Equity Risk Premium[20]



As Chart 1 illustrates, over the past 35 years there has been a statistically significant, negative relationship between the 30-year Treasury yield and the Equity Risk Premium. Consequently, simply applying the long-term average Equity Risk Premium of 4.50 percent would significantly understate the Cost of Equity and produce results well below any reasonable estimate. Based on the regression coefficients in Chart 1, however, the implied ROE is between 10.04 percent and 10.53 percent (*see* Table 3 and Exhibit RBH-3).

Table 3: Summary of Bond Yield Plus Risk Premium Results

	Return on Equity
Current 30-Year Treasury (2.96%)	10.04%
Blue Chip 2017 Consensus 30-Year Treasury (4.00%)	10.24%
Blue Chip 2020 Consensus 30-Year Treasury (4.80%)	10.53%

20 *See* Exhibit RBH-3.

Constant Growth DCF Model

Q. Please describe the Constant Growth DCF approach.

A. The Constant Growth DCF approach is based on the theory that a stock's current price represents the present value of all expected future cash flows. In its simplest form, the Constant Growth DCF model expresses the Cost of Equity as the discount rate that sets the current price equal to expected cash flows:

$$P_0 = \frac{D_1}{(1+k)} + \frac{D_2}{(1+k)^2} + \ldots + \frac{D_\infty}{(1+k)^\infty} \quad \text{Equation [4]}$$

where P_0 represents the current stock price, D_1 … D_∞ represent expected future dividends, and k is the discount rate, or required ROE. Equation [4] is a standard present value calculation that can be simplified and rearranged into the familiar form:

$$k = \frac{D(1+g)}{P_0} + g \quad \text{Equation [5]}$$

Equation [5] is often referred to as the "Constant Growth DCF" model in which the first term is the expected dividend yield and the second term is the expected long-term growth rate.

Q. What assumptions are required for the Constant Growth DCF model?

A. The Constant Growth DCF model assumes: (1) earnings, book value, and dividends all grow at the same, constant rate in perpetuity; (2) the dividend payout ratio remains constant; (3) a Price to Earnings ("P/E") multiple remains constant in perpetuity; and (4) the discount rate is greater than the expected growth rate.

Q. What market data did you use to calculate the dividend yield in your DCF model?

A. The dividend yield is based on the proxy companies' current annualized dividend and average closing stock prices over the 30-, 90-, and 180-trading day periods as of January 15, 2016.

Q. Why did you use three averaging periods to calculate an average stock price?

A. I did so to ensure that the model's results are not skewed by anomalous events that may affect stock prices on any given trading day. At the same time, the averaging period should be reasonably representative of expected capital market conditions over the long term. In my view, using 30-, 90-, and 180-day averaging periods reasonably balances those concerns.

Q. Did you make any adjustments to the dividend yield to account for periodic growth in dividends?

A. Yes, I did. Because utility companies tend to increase their quarterly dividends at different times throughout the year, it is reasonable to assume that dividend increases will be evenly distributed over calendar quarters. Given that assumption, it is appropriate to calculate the expected dividend yield by applying one-half of the long-term growth rate to the current dividend yield. That adjustment ensures that the expected dividend yield is, on average, representative of the coming twelve-month period, and does not overstate the dividends to be paid during that time.

Q. Is it important to select appropriate measures of long-term growth in applying the DCF model?

A. Yes. In its Constant Growth form, the DCF model (*i.e.*, as presented in Equation [5] above) assumes a single growth estimate in perpetuity. Accordingly, in order to reduce the long-term growth rate to a single measure, one must assume a fixed payout ratio, and the same constant growth rate for earnings per share ("EPS"), dividends per share, and book value per share. Because dividend growth can only be sustained by earnings growth, the model should incorporate a variety of measures of long-term earnings growth. Because operating and capital allocation decisions may directly affect near-term dividend payout ratios, estimates of earnings growth are more indicative of long-term investor expectations than are dividend growth estimates. For the purposes of the Constant Growth DCF model, therefore, growth in EPS represents the appropriate measure of long-term growth.

Q. Please summarize your inputs to the Constant Growth DCF model.

A. I applied the DCF model to the proxy group of electric utility companies using the following inputs for the price and dividend terms:

- The average daily closing prices for the 30-trading days, 90-trading days, and 180-trading days ended January 15, 2016, for the term P_0; and

- The annualized dividend per share as of January 15, 2016 for the term D_0.

I then calculated the DCF results using each of the following growth terms:

- The Zack's consensus long-term earnings growth estimates;
- The First Call consensus long-term earnings growth estimates; and
- The Value Line earnings growth estimates.

Q. How did you calculate the DCF results?

A. For each proxy company, I calculated the mean, mean high, and mean low results. For the mean result, I combined the average of the EPS growth rate estimates reported by Value Line, Zacks, and First Call with the subject company's dividend yield for each proxy company and then calculated the average result for those estimates. I calculated the high DCF result by combining the maximum EPS growth rate estimate as reported by Value Line, Zacks, and First Call with the subject company's dividend yield. The mean high result simply is the average of those estimates. I used the same approach to calculate the low DCF result, using instead the minimum of the Value Line, Zacks, and First Call estimate for each proxy company, and calculating the average result for those estimates.

Q. What are the results of your DCF analyses?

A. My Constant Growth DCF results are summarized in Table 4 below (*see* also Exhibit RBH-4).

Table 4: Mean DCF Results Including Flotation Costs

	Mean Low	Mean	Mean High
30-Day Average	8.61%	9.31%	10.09%
90-Day Average	8.64%	9.35%	10.12%
180-Day Average	8.72%	9.42%	10.20%

Multi-Stage DCF Model

Q. What other form of the DCF model have you used to estimate the Company's Cost of Equity?

A. To address certain limiting assumptions underlying the Constant Growth form of the DCF model, I also considered the Multi-Stage (three-stage) DCF Model. The Multi-Stage model, which is an extension of the Constant Growth form, enables the analyst to specify growth rates over three distinct stages. As with the Constant Growth form of the DCF model, the Multi-Stage form defines the Cost of Equity as the discount rate that sets the current price equal to the discounted value of future cash flows. Unlike the Constant Growth form, however, the Multi-Stage model must be solved in an iterative fashion.

Q. Please generally describe the structure of your Multi-Stage DCF model.

A. The Multi-Stage DCF model sets the subject company's stock price equal to the present value of future cash flows received over three "stages." In the first two stages, "cash flows" are defined as projected dividends. In the third stage, "cash flows" equal both dividends and the expected price at which the stock will be sold at the end of the period (*i.e.,* the terminal price). I calculated the terminal price based on the Gordon model,[21] which defines the price as the expected dividend divided by the difference between the Cost of Equity (*i.e.*, the discount rate) and the long-term expected growth rate. In essence, the terminal price is defined by the present value of the remaining "cash flows" in perpetuity. In each of the three stages, the dividend is the product of the projected earnings per share and the expected dividend payout ratio. A summary description of the model is provided in Table 5 (below).

Table 5: Multi-Stage DCF Structure

Stage	**0**	**1**	**2**	**3**
Cash Flow Component	Initial Stock Price	Expected Dividend	Expected Dividend	Expected Dividend + Terminal Value
Inputs	Stock Price; Earnings Per Share ("EPS"); Dividends Per Share ("DPS")	Expected EPS; Expected DPS	Expected EPS; Expected DPS	Expected EPS; Expected DPS; Terminal Value
Assumptions	30-, 90-, and 180-day average stock price	EPS Growth Rate; Payout Ratio	Growth Rate Change; Payout Ratio Change	Long-term Growth Rate; Long-term Payout Ratio

Q. What are the analytical benefits of the three-stage DCF model?

A. The principal benefits relate to the flexibility provided by the model's formulation. Because the model provides the ability to specify near,

[21] *See* Morningstar, Inc., 2013 Ibbotson Stocks, Bonds, Bills and Inflation Valuation Yearbook, at 48-52.

intermediate and long-term growth rates, for example, it avoids the sometimes limiting assumption that the subject company will grow at the same, constant rate in perpetuity. In addition, by calculating the dividend as the product of earnings per share and the dividend payout ratio, the model enables analysts to reflect assumptions regarding the timing and extent of changes in the payout ratio to reflect, for example, increases or decreases in expected capital spending, or transition from current payout levels to long-term expected levels. In that regard, because the model relies on multiple sources of earnings growth rate assumptions, it is not limited to a single source, such as Value Line, for all inputs, and mitigates the potential bias associated with relying on a single source of growth estimates.[22]

The model also enables analysts to assess the reasonableness of the inputs and results by reference to certain market-based metrics. For example, the stock price estimate can be divided by the expected EPS in the final year to calculate an average P/E ratio. Similarly, the terminal P/E ratio can be divided by the terminal growth rate to develop a Price to Earnings Growth ("PEG") ratio. To the extent that either the projected P/E or PEG ratios are inconsistent with either historical or expected levels, it may indicate incorrect or inconsistent assumptions within the balance of the model.

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[22] *See* Harris and Marston, Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts, Financial Management 21 (Summer 1992).

Q. Please summarize your inputs to the Multi-Stage DCF model.

A. I applied the Multi-Stage DCF model to the proxy group described earlier in my Direct Testimony. My assumptions with respect to the various model inputs are described in Table 6 (below).

Table 6: Multi-Stage DCF Model Assumptions

Stage	Initial	First	Transition	Terminal
Stock Price	30-, 90-, and 180-day average stock price as of January 15, 2016			
Earnings Growth	2014 actual EPS escalated by Period 1 growth rate	EPS growth as average of (1) Value Line; (2) Zacks; and (3) First Call	Transition to Long-term GDP[23] growth	Long-term GDP growth
Payout Ratio	Value Line company-specific	Value Line company-specific	Transition to long-term industry payout ratio	Long-term expected payout ratio
Terminal Value				Expected dividend in final year divided by solved Cost of Equity less long-term growth rate

[23] Gross Domestic Product.

Q. How did you calculate the long-term Gross Domestic Product ("GDP") growth rate?

A. The long-term growth rate of 5.35 percent is based on the real GDP growth rate of 3.25 percent from 1929 through 2014, and an inflation rate of 2.04 percent. The GDP growth rate is calculated as the compound growth rate in the chain-weighted GDP for the period from 1929 through 2014.[24] The rate of inflation of 2.04 percent is an average of two components: (1) the compound annual forward rate starting in ten years (*i.e.*, 2025, which is the beginning of the terminal period) based on the 180-day average spread between yields on long-term nominal Treasury Securities and long-term Treasury Inflation Protected Securities, known as the "TIPS spread" of 1.87 percent;[25] and (2) and the projected Blue Chip Financial Forecast of CPI for 2022 – 2026 of 2.20 percent.[26]

I averaged those two measures of inflation because nominal Treasury yields are related to inflation, which includes the effect of commodities such as oil, which may cause the current TIPS spread to somewhat understate long-term expected inflation. To account for that effect, I also considered the 2.20 percent long-term projected rate of inflation as provided by Blue Chip

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24 *See* Bureau of Economic Analysis, "Current-Dollar and 'Real' Gross Domestic Product," December 22, 2015 update.

25 *See* Board of Governors of the Federal Reserve System, "Table H.15 Selected Interest Rates."

26 *Blue Chip Financial Forecasts*, December 1, 2015, at 14.

Financial Forecast.[27] My long-term inflation rate, therefore, is the average of those two estimates, or 2.04 percent.

Q. What were your specific assumptions with respect to the payout ratio?

A. As noted in Table 6, for the first two periods, I relied on the first year and long-term projected payout ratios reported by Value Line[28] for each of the proxy companies. I then assumed that by the end of the second period (*i.e.*, the end of year 10), the payout ratio will converge to the historical industry average payout ratio of 67.30 percent.[29]

Q. What are the results of your Multi-Stage DCF analysis?

A. Table 7 (*see* also Exhibit RBH-5) presents the Multi-Stage DCF analysis results. Using the Gordon model to calculate the terminal stock price, the Multi-Stage DCF analysis produces a range of results from 9.63 percent to 10.22 percent.[30]

Table 7: Multi-Stage DCF Model Results Including Flotation Costs

	Mean Low	Mean	Mean High
30-Day Average	9.63%	9.84%	10.09%
90-Day Average	9.66%	9.88%	10.13%
180-Day Average	9.75%	9.96%	10.22%

27 *Blue Chip Financial Forecasts*, December 1, 2015, at 14.

28 As reported in the Value Line Investment Survey company reports as "All Div'ds to Net Prof."

29 Source: Bloomberg Professional

30 Including flotation costs.

VI. BUSINESS RISKS AND OTHER CONSIDERATIONS

Q. Do the mean CAPM, Risk Premium, and DCF results for the proxy group provide an appropriate estimate for the Cost of Equity for FPL?

A. No, the mean results do not necessarily provide an appropriate estimate of FPL's Cost of Equity. In my view, there are additional factors that must be taken into consideration when determining where FPL's Cost of Equity falls within the range of results, including: (1) the Company's geographic risk; (2) the Company's need to access external capital; (3) the potential for new regulatory requirements associated with nuclear generation; (4) the need to account for flotation costs; and (5) the potential for an increase in the Cost of Equity over the Company's proposed four year rate period. Those factors, which are discussed below, should be considered in terms of their overall effect on FPL's business risk and investor earnings and, therefore, on the Company's Cost of Equity.

Geographic Risk

Q. Please describe the risk associated with severe weather activity in FPL's service territory.

A. FPL faces the risk of sudden, unexpected damage from severe storms. The prevalence of hurricanes, such as Katrina, Rita, and Wilma in 2005, make FPL's operating area an especially high risk area for incurring weather-related infrastructure repair costs and service disruptions. For example, FPL incurred more than $1.9 billion in storm recovery costs to restore electric transmission and distribution services during 2004 and 2005, which was equivalent to 15 percent of the average rate base for FPL in 2005. In addition to the need to fund repair costs, severe weather causes the Company to incur unplanned expenses (such as labor costs that aren't recovered in existing rates) and results in lower sales due to damage of transmission and distribution infrastructure or the disruption of generating capacity. Together, these effects can reduce FPL's revenue and put strain on the Company's operating cash flow.

As of December 31, 2015, FPL had the capacity to absorb up to approximately $119 million in future prudently incurred storm restoration costs without seeking recovery through a rate adjustment from the FPSC or filing a petition with the FPSC.[31] However, restoration costs, such as those incurred during the 2004 and 2005 storm season, can be significantly higher than this amount.

Capital Access

Q. Please summarize FPL's capital expenditure plans.

A. FPL currently plans to invest approximately $14 billion to $16 billion of additional capital over the period including 2015-2018.[32] That amount includes investments in FPL's distribution, transmission and generation

[31] See NextEra Energy Inc., SEC Form 10-K for the fiscal year ended December 31, 2015, at 58.

[32] NextEra Energy, Inc. Edison Electric Institute Conference Presentation, Slide 19, November 8-11, 2015.

system, including generation modernization and additional capacity. Thus, the Company is continuing to make substantial investments in its utility operations that will require it to access the capital markets during the period of time that rates established in this proceeding will be in effect.

Q. Why is it important for a utility to be allowed the opportunity to earn a return that is adequate to attract capital at reasonable terms?

A. The allowed ROE should enable the subject utility to finance capital expenditures and working capital requirements at reasonable rates, and to maintain its financial integrity in a variety of economic and capital market conditions. As discussed throughout my Direct Testimony, a return that is adequate to attract capital at reasonable terms enables the utility to provide safe, reliable service while maintaining its financial soundness. To the extent a utility is provided the opportunity to earn its market-based cost of capital, neither customers nor shareholders should be disadvantaged.

Further, the financial community carefully monitors utility companies' current and expected financial conditions, as well as the regulatory environment in which those companies operate. In that respect, the regulatory environment is one of the most important factors considered in both debt and equity investors' assessments of risk. That is especially important during periods in which the utility expects to make significant capital investments and, therefore, may require access to capital markets.

Q. Have you also considered the relationship between capital expenditures and the earned return on common equity?

A. Yes, I have. The "DuPont" formula decomposes the Return on Common Equity into three components: (1) the Profit Margin (net income/revenues); (2) Asset Turnover (revenues/net plant); and (3) the Equity Multiplier (net plant/equity).[33] As Exhibit RBH-8 demonstrates, the proxy companies' Asset Turnover rate declined from 2003 through 2015 from 61.30 percent to 36.80 percent and is expected to remain at approximately the same level through Value Line's 2018 – 2020 projection period. Over that same period (*i.e.*, 2003 through 2018 – 2020), according to Value Line data, average Net Plant is expected to experience a cumulative increase of approximately 201.67 percent. Because, as noted above, the utility industry is going through a period of increased capital investment, the lag between the addition of net plant and revenue generated by those investments dilutes the Asset Turnover ratio, at least in the near term.

To gain an additional perspective on the relationship between plant additions and Asset Turnover, I performed a regression analysis in which the annual change in the Asset Turnover rate was the dependent variable, and the annual change in Net Plant was the independent variable. As shown in Exhibit RBH-8, that analysis indicates a statistically significant negative relationship

33 The DuPont formula is commonly used by financial analysts to monitor specific operational and financial drivers of a company's earned ROE. The formula expands the calculation of the ROE into the product of three financial metrics: Profit Margin, Asset Turnover and the Equity Multiplier. That is, ROE = (earnings / revenue) x (revenue / assets) x (assets / equity).

between the two variables, such that as annual net plant increases, the Asset Turnover ratio decreases. This, in turn, suggests that an increase in capital expenditures also negatively affects the Return on Common Equity, causing greater financial stress to the utility because, under the assumptions of the "DuPont" formula, the Asset Turnover ratio is a component of the Return on Common Equity. Therefore, as capital expenditures (*i.e.*, net plant) increase, the Asset Turnover ratio decreases, resulting in a decrease in the Return on Common Equity. To the extent investors value a company based on earnings and cash flow, this additional financial strain is a key concern.

Q. What are your conclusions regarding the effect of FPL's capital investment plan on its risk profile and cost of capital?

A. FPL's capital expenditure program is significant, and will provide significant benefits to customers as evidenced by FPL's witnesses; however, it will place additional pressure on its cash flows making regulatory support more important in terms of FPL's ability to finance these expenditures, deliver benefits to customers, and earn a reasonable return on its planned investments. The stability and continuity of the Company's financial integrity is important given the magnitude and duration of its capital expenditure program, which enables the Company to maintain a superior level of service. Therefore, the Commission's decision in this proceeding should allow the Company to continue to maintain a strong financial profile that will allow the Company to raise capital at reasonable cost rates as it undertakes these significant investments.

Nuclear Generation Regulatory Requirements

Q. Please explain the risk associated with the Company's nuclear generation.

A. Nuclear generating resources are regulated by the U.S. Nuclear Regulatory Commission ("NRC"). FPL is subject to NRC mandates to meet licensing and safety related standards that may require increased capital spending and incremental operating costs to ensure the continued operation of this very low-cost and emission-free generating source. With respect to the potential for new regulatory requirements, NextEra Energy's SEC Form 10-K specifically noted:

> NRC orders or new regulations related to increased security measures and any future safety requirements promulgated by the NRC could require NEE and FPL to incur substantial operating and capital expenditures at their nuclear generation facilities. The NRC has broad authority to impose licensing and safety related requirements for the operation and maintenance of nuclear generation facilities, the addition of capacity at existing nuclear generation facilities and the construction of nuclear generation facilities, and these requirements are subject to change. In the event of noncompliance, the NRC has the authority to impose fines or shut down a nuclear generation facility, or to take both of these actions, depending upon its assessment of the severity of the situation, until compliance is achieved. Any of the

> foregoing events could require NEE and FPL to incur increased costs and capital expenditures, and could reduce revenues. Any serious nuclear incident occurring at a NEE or FPL plant could result in substantial remediation costs and other expenses. A major incident at a nuclear facility anywhere in the world could cause the NRC to limit or prohibit the operation or licensing of any domestic nuclear generation facility. An incident at a nuclear facility anywhere in the world also could cause the NRC to impose additional conditions or other requirements on the industry, or on certain types of nuclear generation units, which could increase costs, reduce revenues and result in additional capital expenditures.[34]

Q. Does the Company's generation portfolio include nuclear generating assets?

A. Yes. FPL's generation portfolio includes approximately 3,453 MW of owned operating nuclear generating capacity. Specifically, the Company owns 1,821 MW of existing operating capacity at the St. Lucie plant (which excludes Orlando Utilities Commission's and the Florida Municipal Power Agency's approximate 15 percent ownership interest in St. Lucie Unit No. 2) and 1,632

[34] NextEra Energy, Inc. SEC 10-K, for the fiscal year ended December 31, 2015, at 33-34.

MW of operating capacity at the Turkey Point plant.[35] In addition, FPL is currently undertaking activities to obtain the permits, licenses and approvals required to add 2,200 MW of additional operating capacity to the Turkey Point plant, with an estimated in-service date of 2027 to 2028.[36]

Q. Are there examples of the increased risk of new regulatory requirements that nuclear generation plant operators face?

A. Yes. One example is the increased oversight and regulatory requirements put in place following a March 11, 2011 earthquake and tsunami, which caused significant damage to the Fukushima Daiichi nuclear complex and threatened the public health. After the Fukushima accident, the NRC put together a task force to assess current regulation and determine if new measures were required to ensure safety. The task force issued a report in July 2011 that included a set of recommendations for NRC consideration, and NRC staff issued the first related regulatory requirements in March 2012.[37] Regarding the evolving requirements from the NRC, NextEra Energy noted in its SEC Form 10-K for the year ended 2014:

> The lessons learned from the events in Japan and the results of the NRC's actions have and will continue to, among other things, result in new licensing and safety related

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[35] FPL owns 3,453 MW of nuclear capacity out of a total owned capacity of 25,092 MW, or 13.76 percent of the total. *See*, NextEra Energy, Inc. SEC 10-K, for the fiscal year ended December 31, 2015, at 37.

[36] NextEra Energy, Inc. SEC 10-K, for the fiscal year ended December 31, 2015, at 9.

[37] *See*, http://www.nrc.gov/reading-rm/doc-collections/fact-sheets/japan-events.html.

> requirements for U.S. nuclear facilities. Any new requirements could, among other things, impact future licensing and operations of U.S. nuclear facilities, including FPL's existing nuclear facilities and NRC approval of two additional nuclear units at FPL's Turkey Point site, and could, among other things, result in increased cost and capital expenditures associated with the operation and maintenance of FPL's nuclear units.[38]

The Fukushima accident clearly shows that additional regulatory oversight and requirements, which affect the cost of operating FPL's nuclear plants, can result from events wholly unrelated to FPL or its facilities.[39]

Another example of nuclear risk is the ongoing and long-term uncertainty in regard to nuclear waste disposal. On June 8, 2012, the Court of Appeals vacated the NRC's rulemaking regarding storage and permanent disposal of nuclear waste. The Court of Appeals found the NRC rulemaking was deficient because: (1) it "did not calculate the environmental effects of failing to secure permanent storage," and (2) "in determining that spent fuel can safely be stored on site at nuclear plants for sixty years after the expiration of a plant's license, the Commission failed to properly examine future dangers

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[38] NextEra Energy, Inc. SEC 10-K, for the fiscal year ended December 31, 2014, at 11.

[39] FPL is currently recovering Fukushima-related costs through the Capacity Clause.

and key consequences."[40] In August 2014, the NRC issued its Continued Storage of Spent Nuclear Fuel Rule, however the rule has been challenged and a Court of Appeals decision is pending.[41] License application and all work related to a permanent waste disposal facility has been suspended.[42] As an interim storage solution, the industry is continuing to pursue on-site dry storage and considering development of interim, off-site dry storage facilities.[43] Nuclear operators therefore face future capital expenditures related to expansion of nuclear waste storage while a more permanent solution is considered, and may face additional costs to meet safety standards if the NRC's latest ruling is modified subsequent to a Court of Appeal's ruling.[44]

To the extent further mandates are promulgated by the NRC, additional spending may be required. Any increase to the Company's capital investment plans will place pressure on credit metrics, as discussed above.

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40 U.S. Court of Appeals For the District of Columbia Circuit, *On Petitions for Review of Orders of the Nuclear Regulatory Commission*, Case No. 11-1045, Decided June 8, 2012, at 3.

41 United States Nuclear Regulatory Commission Press Release, "NRC Approves Final Rule on Spent Fuel Storage and Ends Suspension of Final Licensing Actions for Nuclear Plants and Renewals," August 26, 2014. *See also*, U.S. Nuclear Regulatory Commission Memorandum and Order, CLI-14-08, August 26, 2014 and U.S. Court of Appeals For The District Of Columbia Circuit, *New York v. NRC,* Docket Nos. 14-1210, 14-1212, 14-1216, and 14-1217 (Consolidated), October 24, 2014

42 Holt, Mark, "Civilian Nuclear Waste Disposal" Congressional Research Service Report, August 5, 2015, at 1-2.

43 *Ibid.*, at 24-25.

44 As part of a settlement agreement to resolve lawsuits against the DOE, FPL is permitted to make annual filings to recover certain incurred spent fuel storage costs from the U.S. government. *See* NextEra Energy, Inc. SEC 10-K, for the fiscal year ended December 31, 2015, at 10.

Flotation Costs

Q. What are flotation costs?

A. Flotation costs are the costs associated with the sale of new issues of common stock. These costs include out-of-pocket expenditures for preparation and filing, as well as underwriting fees and other issuance costs of common stock.

Q. Why is it important to recognize flotation costs in the allowed ROE?

A. Equity financing cannot occur without incurring flotation costs. Therefore, in order to attract and retain new investors, a regulated utility must have the opportunity to recover these costs. To the extent that a company is denied the opportunity to recover prudently incurred flotation costs, actual returns will fall short of expected (or required) returns, thereby diminishing its ability to attract adequate capital on reasonable terms.

Q. Are flotation costs part of the utility's invested costs or part of the utility's expenses?

A. Flotation costs are part of the invested costs of the utility, which are properly reflected on the balance sheet under "paid in capital." They are not current expenses, and therefore are not reflected on the income statement. Rather, like investments in rate base or the issuance costs of long-term debt, flotation costs are incurred over time. As a result, the great majority of a utility's flotation cost is incurred prior to the test year, but remains part of the cost structure that exists during the test year and beyond, and as such, should be recognized for ratemaking purposes. Therefore, recovery of flotation costs is appropriate even if no new issuances are planned in the near future because failure to allow such cost recovery may deny FPL the opportunity to earn its required rate of return in the future.

Q. Is the need to consider flotation costs eliminated because FPL is a wholly-owned subsidiary of NextEra Energy Inc.?

A. No. Although FPL is a wholly owned subsidiary of NextEra Energy Inc., it is appropriate to consider flotation costs because wholly owned subsidiaries receive equity capital from their parents and provide returns on the capital that roll up to the parent, which is designated to attract and raise capital based on the returns of those subsidiaries. To deny recovery of issuance costs associated with the capital that is invested in the subsidiaries would penalize the investors that fund the utility operations and would inhibit the utility's ability to obtain new equity capital at a reasonable cost. This is important for companies such as FPL that are planning continued capital expenditures in the near term, and for which access to capital (at reasonable cost rates) to fund such required expenditures will be critical.

Q. Do the CAPM and DCF models already incorporate investor expectations of a return in order to compensate for flotation costs?

A. No. The models used to estimate the appropriate ROE assume no "friction" or transaction costs, as these costs are not reflected in the market price (in the case of the DCF model) or risk premium (in the case of the CAPM and the Bond Yield Plus Risk Premium model). Therefore, it is appropriate to consider flotation costs when determining where within the range of reasonable results FPL's Cost of Equity should fall.

Q. Is the need to consider flotation costs recognized by the academic and financial communities?

A. Yes. The need to reimburse investors for equity issuance costs is recognized by the academic and financial communities in the same spirit that investors are reimbursed for the costs of issuing debt. This treatment is consistent with the philosophy of a fair rate of return. As explained by Dr. Shannon Pratt:

> Flotation costs occur when a company issues new stock. The business usually incurs several kinds of flotation or transaction costs, which reduce the actual proceeds received by the business. Some of these are direct out-of-pocket outlays, such as fees paid to underwriters, legal expenses, and prospectus preparation costs. Because of this reduction in proceeds, the business's required returns must be greater to compensate for the additional costs. Flotation costs can be accounted for either by amortizing the cost, thus reducing the net cash flow to discount, or by incorporating the cost into the cost of equity capital. Since flotation costs typically are not applied to operating cash flow, they must be incorporated into the cost of equity capital.[45]

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[45] Shannon P. Pratt, Roger J. Grabowski, Cost of Capital: Applications and Examples, 4th ed.

Q. Have you calculated the effect of flotation costs on the return on equity?

A. Yes, I have. I modified the DCF calculation to derive the dividend yield that would reimburse investors for direct issuance costs. Based on the weighted average issuance costs shown in Exhibit RBH-9, a reasonable estimate of flotation costs is approximately 0.12 percent (12 basis points). This cost has been added to the results of my CAPM and DCF analyses shown in Tables 2, 4 and 7.

Four Year Rate Proposal

Q. What are the implications for the Company's Cost of Equity of a multi-year rate plan?

A. A multi-year rate plan limits the ability of the utility company to request a modification to rates in response to changes in benchmark interest rates or other factors. This inability to seek recovery of higher costs of capital increases the utility's risk and its Cost of Equity.

In light of the relatively low level of long-term Treasury rates compared to their historical range, it is particularly important to consider the potential effect that increases in the level of interest rates would have on the Company's stock price and its Cost of Equity. As discussed earlier, electric utility companies are long duration investments whose valuations are sensitive to changes in the required rate of return. Consequently, the interest rate risk to

(John Wiley & Sons, Inc., 2010), page 586.

which equity holders are exposed relate to the long end of the yield curve, *i.e.*, the 30-year Treasury yield. For the reasons discussed in Section VII below, it is reasonable to assume that on balance, long-term rates are more likely to increase than decrease during the term of the Company's rate proposal, representing a significant element of risk for equity investors.

Q. Aside from interest rates, are there additional factors that may affect the Company's Cost of Equity over the rate proposal period?

A. Yes, there are. The CAPM and DCF equations presented in Section V show that the Cost of Equity is a positive function of five factors: long-term Treasury yields, Beta coefficients, the Market Risk Premium, dividend yields, and growth rates. If any of those factors increases during the multi-year rate period, the Cost of Equity will rise without a corresponding increase in allowed ROE. The price of FPL shares, all else remaining equal, will fall.

For example, equity valuations remain at risk to increases in broad market instability, movement of investments (rotation) out of the utility sector on the part of institutional investors, unexpected credit contractions, and other factors that affect both fundamental equity valuations and investor trading patterns. Changes in equity valuations or stock price volatility could increase dividend yields, Beta coefficients and the Market Risk Premium, increasing the required ROE.

Q. What are your conclusions related to the four year rate proposal?

A. A multi-year stay-out agreement imposes multiple risks on FPL shareholders, including unexpected increases in long-term Treasury bond yields and dividend yields. If such factors rise and the ROE is left unadjusted, FPL shareholders will be prevented from realizing their required return. It is appropriate that FPL shareholders are compensated for the additional risk they will bear by foregoing the option to seek rate relief in an increasing capital cost environment.

VII. CAPITAL MARKET ENVIRONMENT

Q. Do economic conditions influence the required cost of capital and required return on common equity?

A. Yes. As discussed in Section V, the models used to estimate the Cost of Equity are meant to reflect, and therefore are influenced by, current and expected capital market conditions. As to the analyses used to estimate the Cost of Equity, it is important to assess the reasonableness of any financial model's results in the context of observable market data. To the extent that certain ROE estimates are incompatible with such data or inconsistent with basic financial principles, it is appropriate to consider whether alternative estimation techniques are likely to provide more meaningful and reliable results.

Federal Reserve Market Intervention

Q. Do you have any general observations regarding the relationship between Federal Reserve monetary policy, capital market conditions and FPL's Cost of Equity?

A. Yes, I do. Much has been reported about the Federal Reserve's Quantitative Easing policy, and its effect on interest rates. Although the Federal Reserve completed its Quantitative Easing initiative in October 2014, it was not until December 2015 that it raised the Federal Funds rate, and began the process of rate normalization.[46] A significant issue, then, is how investors will react as that process continues, and eventually is completed. A viable outcome is that investors will perceive greater chances for economic growth, which will increase the growth rates included in the Constant Growth DCF model. At the same time, higher growth and the absence of Federal market intervention could provide the opportunity for interest rates to increase, thereby increasing the dividend yield portion of the DCF model. In that case, both terms of the Constant Growth DCF model would increase, producing increased ROE estimates.

At this time, however, market data is somewhat disjointed. As a consequence, it is difficult to rely on a single model to estimate the Company's Cost of Equity. A more reasoned approach is to understand the relationships among Federal Reserve policies, interest rates and risk, and assess how those factors

46 *See* Federal Reserve Press Release (December 16, 2015).

may affect different models and their results. For the reasons discussed below, the current market is one in which it is very important to consider a broad range of data and models when determining the Cost of Equity.

Q. Please summarize the effect of recent Federal Reserve policies on interest rates and the cost of capital.

A. Beginning in 2008, the Federal Reserve proceeded on a steady path of initiatives intended to lower long-term Treasury yields.[47] The Federal Reserve policy actions "were designed to put downward pressure on longer-term interest rates by having the Federal Reserve take onto its balance sheet some of the duration and prepayment risks that would otherwise have been borne by private investors."[48] Under that policy, "Securities held outright" on the Federal Reserve's balance sheet increased from approximately $489 billion at the beginning of October 2008 to $4.24 trillion by mid-January 2016.[49] To put that increase in context, the securities held by the Federal Reserve represented approximately 3.29 percent of GDP at the end of September 2008, and had risen to approximately 23.50 percent of GDP in January 2016.[50] As such, the Federal Reserve policy actions have represented a significant source of liquidity, and have had a substantial effect on capital markets.

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47 *See* Federal Reserve Press Release (June 19, 2013).

48 Federal Reserve Bank of New York, *Domestic Open Market Operations During 2012*, April 2013, at 29.

49 Source: Federal Reserve Board Schedule H.4.1. "Securities held outright" include U.S. Treasury securities, Federal agency debt securities, and mortgage-backed securities.

50 Source: Federal Reserve Board Schedule H.4.1; Bureau of Economic Analysis, 2013 data as of the fourth calendar quarter.

Q. Has the Federal Reserve's quantitative easing policy been associated with changes in the proxy companies' trading levels?

A. Yes, that appears to be the case. From January 2000 through the end of August 2012 (that is, immediately prior to the third round of Quantitative Easing), the proxy group's average P/E ratio traded at a 7.00 percent discount to the market. From September 2012 through May 2013, when the Federal Reserve announced it would begin to taper its asset purchases, the proxy group traded at a 22.00 percent premium to the market. Following the end of Quantitative Easing, however, the proxy group's relative P/E ratio has reverted closer its historical average. For example, since the beginning of September 2015, the proxy group's average P/E ratio fell to approximately 105.00 percent of the market P/E (i.e., a 5.00 percent premium). While that valuation level is closer to the long-term relationship, it is still significantly above its historical average.

The sustainability of recent utility company valuations is a significant analytical issue. Because DCF-based methods depend on recent stock prices as a principal input, and (in the case of the Constant Growth model) assume that P/E ratios and the Cost of Equity will remain constant in perpetuity, the lingering effects of Federal Reserve intervention may be weighing on DCF results.

Equity Market Volatility

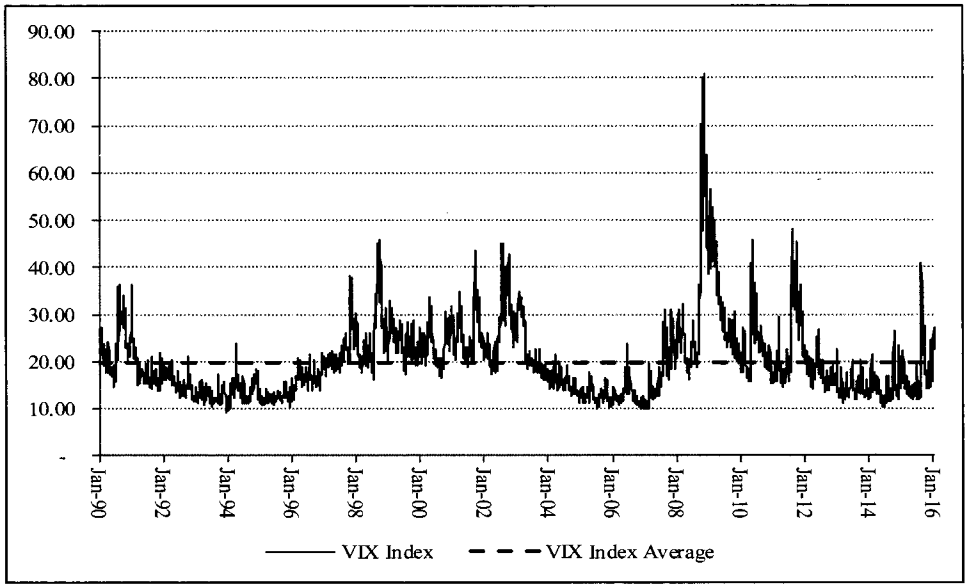
Q. Please discuss changes in equity market volatility.

A. One measure of the expected volatility, or risk, of the stock market is the Chicago Board Options Exchange Volatility Index (known as the "VIX"). VIX is a highly visible, and often-reported barometer of investor risk sentiments which measures market expectations of near-term volatility of the stock market implied by near- and next-term options on the S&P 500 Index.

Although the VIX is not presented as a percentage, it should be understood as such. That is, if the VIX stood at 17.00, it would be interpreted as an expected standard deviation in annual returns on the market index of 17.00 percent over the coming 30 trading days. As shown on Chart 2, the VIX has averaged approximately 19.83 since 1990. That average is quite close to the long-term standard deviation of annual returns on the S&P 500, which has been 20.55 percent.[51]

[51] Source: Bloomberg Professional.

Chart 2: VIX Daily Levels and Long-Term Average[52]



As shown in Chart 3, VIX was at relatively low levels from 2012 – 2015 (which, as discussed below, appears to be an outcome of Federal Reserve monetary policy). The average VIX over the last six months of 2012 (the period prior to the Commission's final Order in FPL's last rate case) was approximately 16.48, nearly 17.00 percent lower than its long-term average. The average in 2014 was 14.18. Beginning in the latter portion of 2015, however, volatility returned in both markets and year-to-date the VIX has averaged 23.56. From that broad perspective, equity risk currently is elevated relative to the long-term average.

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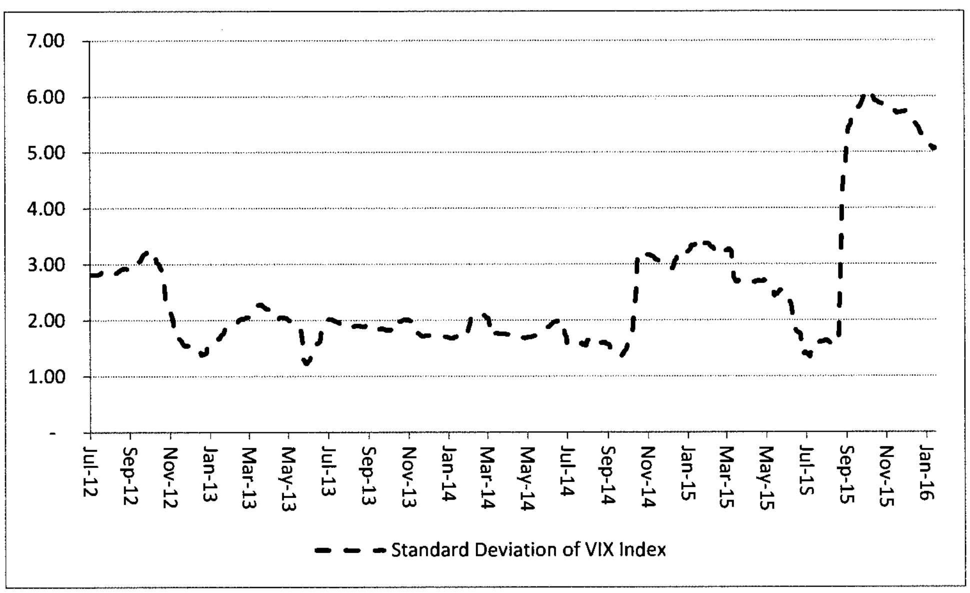
52 Source: Bloomberg Professional.

A further measure of market uncertainty is the volatility of the VIX itself. That is, we can look to the volatility of volatility, as measured by the standard deviation of the VIX. As Chart 3 (below) notes, the volatility of the VIX moved in a relatively narrow range since mid-2012, but noticeably increased at the end of 2015. Such volatility indicates that, although interest rates are still near historical lows in the U.S. capital markets, there remains significant, if not greater, uncertainty in today's equity markets, with investors requiring greater returns to bear that risk.

Chart 3: Standard Deviation (100 days) of VIX[53]



Those findings are consistent with the VVIX, which is a traded index of the expected volatility of the VIX. Over the long-term, the VVIX has averaged approximately 85.00. In 2015, the VVIX increased to (on average) 94.82, and to date in 2016, has averaged 110.34; the 2015-2016 average has been 95.41.

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53 Source: Bloomberg Professional.

Just as the backward-looking standard deviation of the VIX indicates that observed volatility increased considerably in 2015 and 2016, the VVIX indicates that expected volatility also has been well above long-term average levels.[54]

Q. Has the Federal Reserve's quantitative easing policy affected market volatility?

A. Yes. Just as market intervention by the Federal Reserve has reduced interest rates, it also has had the effect of reducing market volatility. As shown in Chart 4 (below), each time the Federal Reserve began to purchase bonds (as evidenced by the increase in "Securities Held Outright" on its balance sheet), volatility subsequently declined. In fact, in September 2012, when the Federal Reserve began to purchase long-term securities at a pace of $85 billion per month, volatility (as measured by the CBOE Volatility Index, known as the "VIX") fell, and through October 2014 remained in a relatively narrow range. The reason is quite straight-forward: Investors became confident that the Federal Reserve would intervene if markets were to become unstable.

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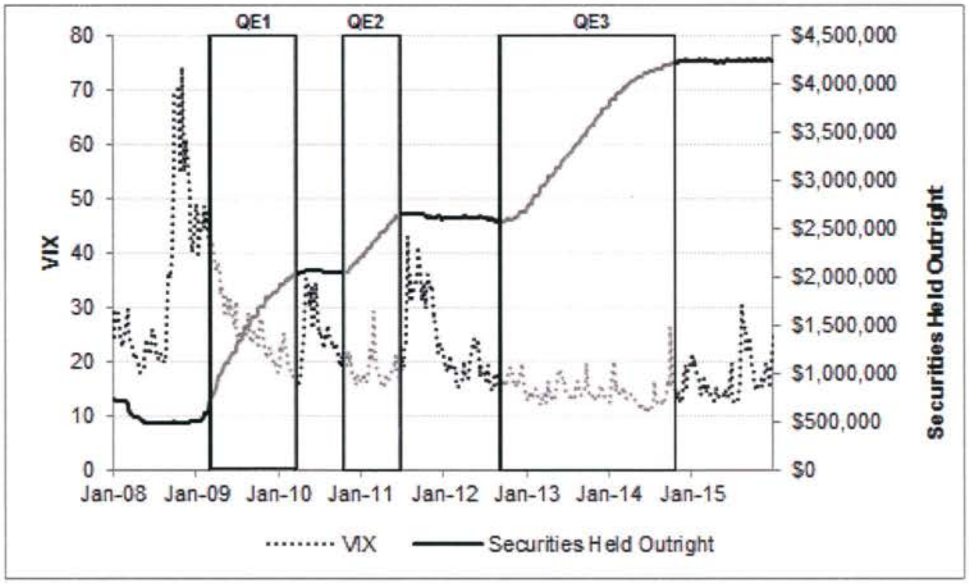
[54] Source: Bloomberg Professional.

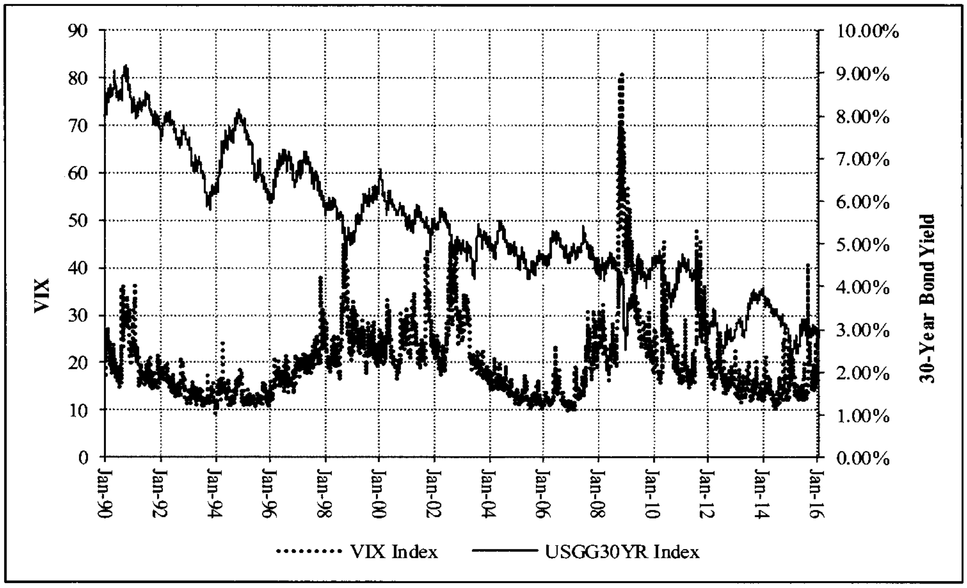
Chart 4: VIX and Federal Reserve Asset Purchases[55]



Even with the effect of the Federal Reserve intervention, periods of increased equity market volatility have been associated with unusually low Government bond yields. That relationship makes sense, given that investors increasingly focus on capital preservation during turbulent markets. As Chart 5 (below) demonstrates, when volatility peaks (as measured by the VIX), Government bond yields fall; that is the case since increased demand for safe-haven securities will bid up their price, and down their yield.

55 Source: Federal Reserve Economic Data (FRED), Federal Reserve Bank of St. Louis; Federal Reserve Statistical Release H.4.1, Factors Affecting Reserve Balances.

Chart 5: VIX and U.S. Treasury Yields[56]



The important analytical issue is whether we can infer from the level of Government bond yields that risk aversion among investors is at a historically low level, implying a correspondingly lower Cost of Equity. Given the negative correlation between the expansion of the Federal Reserve's balance sheet and equity market volatility (as measured by the VIX), and in light of the fact that volatility now is considerably above its prior levels, it is difficult to conclude that fundamental risk aversion and investor return requirements have fallen.

Interest Rate Environment and Credit Spreads

Q. Does your recommendation also consider the interest rate environment?

A. Yes, it does. From an analytical perspective, it is important that the inputs and assumptions used to arrive at an ROE recommendation, including assessments

56 Source: Bloomberg Professional.

of capital market conditions, are consistent with the recommendation itself. Although I appreciate that all analyses require an element of judgment, the application of that judgment must be made in the context of the quantitative and qualitative information available to the analyst and the capital market environment in which the analyses were undertaken.

The low interest rate environment associated with central bank intervention may lead some analysts to conclude that current capital costs, including the Cost of Equity, are low and will remain as such. Putting aside the increases in volatility discussed above, that conclusion only holds true under the hypothesis of Perfectly Competitive Capital Markets ("PCCM") and the classical valuation framework which, under normal economic and capital market conditions, underpin the traditional Cost of Equity models. Perfectly Competitive Capital Markets are those in which no single trader, or "market-mover", would have the power to change the prices of goods or services, including bond and common stock securities. In other words, under the PCCM hypothesis, no single trader would have a significant effect on market prices.

Classic valuation theory assumes that investors trade securities rationally, with prices reflecting their perceptions of value. Although central banks have the ability to set benchmark interest rates, they have been maintaining below normal rates to stimulate continued economic and capital market recovery. It therefore is reasonable to conclude that the Federal Reserve and other central banks have been acting as market-movers, thereby having a significant effect on the market prices of both bonds and stocks. The presence of market-movers, such as the Federal Reserve, runs counter to the PCCM hypothesis, which underlies traditional Cost of Equity models. Consequently, the results of those models should be considered in the context of both quantitative and qualitative information.

Q. Are interest rates expected to increase going forward?

A. Yes, they are. For example, the approximately 50 economists surveyed by Blue Chip Financial Forecast see the 30-year Treasury yield as increasing to 4.00 percent by 2017.[57] Those projections are supported by the fact that investors currently are willing to pay about twice the premium for the option to sell long-term Government bonds in January 2018 (with an exercise price equal to the current price) than they are will to pay for the option to buy those bonds.[58] Because the prices of bonds move inversely to interest rates,[59] those option prices indicate that investors believe it is considerably more likely that interest rates will increase over the coming year, than it is likely that they will decrease.

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57 *See,* Blue Chip Financial Forecast, Vol. 34 No. 12, December 1, 2015, at 14.

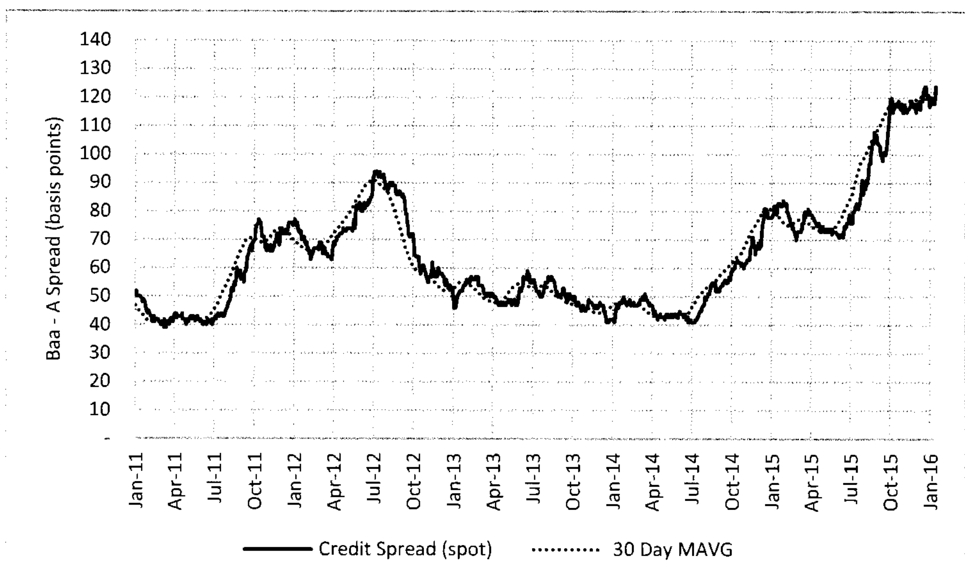
58 Source: http://www.nasdaq.com/symbol/tlt/option-chain?dateindex=7

59 That is, as interest rates move up (down), bond prices move down (up).

Q. What other indicators suggest investor risk aversion has increased?

A. "Credit spreads", which are the incremental return required by debt investors to take on the default risk associated with securities of differing credit quality, have increased significantly over the past year. As chart 6 (below) demonstrates, the estimated credit spread (on both a spot and 30-day moving average basis) has widened, such that it currently well exceeds the levels seen from 2011 through 2014. By way of example, since the order in FPL's last rate case (December 13, 2012), the 30-day average spread increased by approximately 70 basis points, or by 134.62 percent.

Chart 6: Moody's Utility Bond Index Baa-A Credit Spread[60]



To the extent that credit spreads have increased, it is an observable measure of the capital markets' increased risk aversion; increased risk aversion by investors leads to an increased Cost of Equity. In addition, there is a clear and

60 Source: Bloomberg Professional.

well-established inverse relationship between the level of interest rates and the equity risk premium.[61] Consequently, lower Treasury yields do not necessarily imply a correspondingly lower Cost of Equity, particularly considering the current level of credit spreads is significantly higher than seen over the past five years.

Q. What conclusions do you draw from those analyses?

A. First, these data clearly demonstrate that the current capital market is experiencing increasing levels of risk version, volatility and instability. Given that: (1) Federal monetary policy has begun its process of "normalization"; (2) equity market volatility has increased and is expected to remain elevated; (3) market data indicate expectations for increasing interest rates into 2017 and beyond; and (4) credit spreads have widened, I believe that my 11.00 percent ROE recommendation properly reflects the current capital market.

VIII. CAPITAL STRUCTURE

Q. What is FPL's recommended capital structure?

A. As described in more detail in FPL witness Dewhurst's testimony, FPL's recommended capital structure consists of 40.40 percent long-term debt and 59.60 percent common equity (based on investor-supplied capital).

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61 *See* Chart 1.

Q. Does FPL have a separate capital structure that is recognized by investors?

A. Yes. FPL is a separate corporate entity that has its own capital structure and issues its own debt. FPL's capital structure is reflected in registrations of its debt with the Securities Exchange Commission. It therefore is clear that FPL maintains a capital structure that is reported separately from its parent, NextEra Energy, Inc. and that is recognized by the investor community.

Q. How does the capital structure affect the Cost of Equity?

A. The capital structure relates to financial risk, which represents the risk that a company may not have adequate cash flows to meet its financial obligations, and is a function of the percentage of debt (or financial leverage) in its capital structure. In that regard, as the percentage of debt in the capital structure increases, so do the fixed obligations for the repayment of that debt. Consequently, as the degree of financial leverage increases, the risk of financial distress (*i.e.*, financial risk) also increases. Since the capital structure can affect the subject company's overall level of risk,[62] it is an important consideration in establishing a just and reasonable Return on Equity.

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[62] *See* Roger A. Morin, New Regulatory Finance, Public Utility Reports, Inc., 2006, at 45-46.

Q. Are there additional considerations when determining the reasonableness of FPL's requested capital structure?

A. Yes, there are. Maintaining an equity ratio that supports the Company's financial integrity will enable the company to access capital at reasonable rates to fund its extensive capital spending program; a supportive capital structure will also help facilitate access to liquidity if FPL faces significant costs associated with future storm damage or other event. As discussed by FPL witness Dewhurst, the Company's 59.60 percent recommended equity ratio reflects the capital structure FPL has used to finance its operations over a long period of time. FPL's stable equity ratio has supported the Company's credit rating and overall credit profile and allowed it to maintain financial flexibility following both natural disasters (e.g., the 2004/2005 hurricanes) and financial market disruptions (e.g., the 2008/2009 financial crisis).

Q. Please discuss your analysis of the capital structures of the proxy group companies.

A. I reviewed the last eight quarters of long-term debt and common equity ratios of the operating utilities owned by each of my proxy companies. As shown in Exhibit RBH-10, the proxy group actual equity ratios range from 46.50 percent to 66.01 percent. Based on that review, it is apparent that the capital structure proposed by FPL witness Dewhurst is consistent with the proxy companies and reasonable for the purposes of determining FPL's rate of return.

Q. What is your conclusion regarding the Company's proposed capital structure?

A. Considering the Company's capital expenditure plans, the need to maintain adequate liquidity in the event of certain risks, and the average actual common equity ratios in place at the proxy group companies, I believe that FPL's proposed common equity ratio of 59.60 percent is reasonable.

IX. CONCLUSIONS AND RECOMMENDATIONS

Q. What is your conclusion regarding the Company's Cost of Equity?

A. As discussed throughout my testimony, it is important to consider a variety of empirical and qualitative information in reviewing analytical results and arriving at ROE recommendations. Here, we have a situation in which the proxy companies have traded at P/E ratios well in excess of their historical average and, for a time, in excess of the market. Because that condition is unlikely to persist, it violates a principal assumption of the Constant Growth DCF model, *i.e.,* that the P/E ratio will not change, ever. As a practical matter, the Constant Growth DCF results are well below a highly observable and relevant benchmark: the returns authorized for vertically integrated electric utilities. A more balanced approach therefore would be to consider multiple methods, including the Multi-Stage DCF model, the CAPM approach, and the Bond Yield Plus Risk Premium model.

Reviewing those results, I believe that an ROE in the range of 10.50 percent to 11.50 percent represents the range of equity investors' required ROE for investment in integrated electric utilities in today's capital markets. Within that range, I recommend an ROE of 11.00 percent for FPL. That recommendation considers a variety of factors including the current financial environment, flotation costs, FPL's need to access capital and FPL's relative risk profile. Based on those factors, it is appropriate to establish an ROE that is above the proxy group mean results. As such, an ROE of 11.00 percent reasonably represents the return required to invest in a company with a risk profile comparable to FPL.

Q. Does this conclude your pre-filed direct testimony?

A. Yes, it does.

BY MR. LITCHFIELD:

Q Mr. Hevert, you have exhibits identified as RBH-1 to RBH-10 attached to your direct testimony?

A Yes, I do.

Q They were prepared under your direction or supervision?

A They were.

MR. LITCHFIELD: Madam Chair, I would note that those prefiled exhibits have been identified in staff's comprehensive list as Exhibits 124 -- let me say it differently, 124 through 133.

CHAIRMAN BROWN: So noted.

Staff.

MS. BROWNLESS: Yes, ma'am.

EXAMINATION

BY MS. BROWNLESS:

Q Mr. Hevert, have you been -- have you looked at Exhibit No. 579, Staff's Exhibit 579?

A Oh, yes, I have, ma'am.

Q Okay. And have you reviewed the exhibits listed there associated with your name?

A Yes, I have.

Q Okay. And did you prepare those exhibits, or were they prepared under your direct supervision and control?

A Yes, they were.

Q And are those exhibit responses true and correct to the best of your knowledge and belief?

A Yes, they are.

Q And if you were asked those same questions today, would your answers be the same?

A Yes, they would.

Q And with the exception of 479, are any of the workpapers that you prepared associated with 479, or any of the other exhibits, confidential?

A Not that I am aware of. No.

CHAIRMAN BROWN: Thank you so much. Thank you.

FURTHER EXAMINATION

BY MR. LITCHFIELD:

Q Mr. Hevert, would you please provide a summary of your direct testimony to the Commission today?

A Yes. Thank you.

Madam Chair and Commissioners, thank you for the opportunity to speak with you today. The purpose of my direct testimony in this proceeding is to present evidence, and to provide a recommendation regarding FPL's current return on equity, and to provide an assessment of its proposed capital structure.

The return on equity, which often is

remembered to as the cost of equity, is the return that equity investors require to take on the risks of ownership. Unlike the cost of debt, the cost of equity is unobservable. We can observe cost of debt in interest rates and yields. The cost of equity is not contractually defined. And the cost of equity relates to a security whose life is perpetual. Because of those differences and because of the nature of equity, the cost of equity must be estimated based on market data applied to various financial models.

Now, all of the models used to estimate the cost of equity are based on a series of simplifying assumptions, and as market conditions change, those assumptions become more or less suitable with current market conditions. And as a consequence of the assumption, as a consequence of the inherent limitations in some of those models, analysts tend to use multiple methodologies, and they tend to give different weight to those methods as times change.

To develop my estimates, I used four models, the constant growth discounted cash flow model, the multistage discounted cash flow model, the capital asset pricing model and the bond yield plus risk premium approach.

Now, all of those approaches -- all of those models necessarily will produce a range of estimates, and you must apply some judgment, and we must review a lot of relevant data in determining where the cost of equity lies in that range. In that regard, I will often say -- and I have heard it said before -- that estimate being the cost of equity is an empirical, but it's not an entirely mathematical exercise. It's important to apply judgment, and that judgment needs to apply in the selection of models, in the selection of inputs to those models, and in the interpretation of their results.

As I have applied the models, or as I have selected them, I have applied my judgment, and my judgments tends to be based on my practical experience in the area of corporate finance, as well as my training and background in that area.

And when I arrived at my recommended range, I considered current and expected market conditions, and the extent to which those conditions comport with each of the models that I just mentioned. I also took into consideration several other factors, not all of which necessarily lend themselves to quantification, but I think they are all reviewed -- I think they are all considered by investors; issues such as the risks associated with severe weather, the company's need to maintain access to capital structure, the need to account for floatation costs, and the need to recover the cost of capital in the case of rising interest rates over the course of a proposed four-year multiyear rate plan.

Based on those models, and based on those assessments, I recommend an ROE in the range of 10.5 percent to 11.5 percent. And within that range, I recommend an ROE of 11 percent.

As to the company's capital structure, which includes 59.6 percent common equity on an investor supplied basis, I found that it is within the range of equity ratios in place at other vertically integrated electric utilities. It also is consistent with the capital structure that the company has used to finance its operations over a long period of time, and that capital structure has supported the company's credit rating and credit profile and has allowed to maintain the flexibility and liquidity that it needs to finance its operations.

So in summary, taking into account current markets conditions, the results of multiple methods applied to a group of what I consider to be comparable vertically integrated electric utilities, and taking into account the company's specific positions, I believe an ROE in the range of 10.5 percent to 11.5 percent is reasonable, and within that range, I recommend a specific return of 11 percent.

In addition, as to the company's capital structure --

CHAIRMAN BROWN: 30 seconds.

THE WITNESS: I believe it's with -- perfect -- I believe it's within the range of those in place at similar vertically integrated operating companies, and it historically has enabled the company to maintain its financial flexibility.

Thank you for your time and consideration, and that does complete my summary.

MR. LITCHFIELD: Thank you, Mr. Hevert.

Madam Chairman, Mr. Hevert is available for cross-examination.

CHAIRMAN BROWN: Thank you.

And good afternoon, Mr. Hevert.

THE WITNESS: Good afternoon.

CHAIRMAN BROWN: FIPUG, you are up.

MR. MOYLE: Thank you, Madam Chair. I wasn't sure where I got put in the lineup, but --

CHAIRMAN BROWN: You are number one.

MR. MOYLE: All right. Well, I will bunt.

THE WITNESS: That's good, because I am slow off the mound.

EXAMINATION

BY MR. MOYLE:

Q Good afternoon, sir.

A Good afternoon.

Q Your job is to help the Commission substitute its judgment for what would be a fair profit rate for the utility to earn, is that right?

A I would not put it that way. I look at my job as to help the Commission understand how investors -- how you the market looks at this issue. I don't believe it's a substitution of it judgment. I believe it's understanding the judgment, and understanding the perspective of the market.

Q Okay. So I just want to make sure I got this right. So we got three judgments here, I think we are talking about. One is the judgments that investors will be -- are making with respect to the market, is that fair?

A Yes, that's right.

Q All right. And then you are making a judgment about how investors are looking at the market, fair?

A That's correct.

Q And then you are providing testimony to this commission to help them make a determination about what return on equity level to allow for Florida Power &

Light, is that right?

A I think that's fair, with the one qualification being that, again, my judgment, and what I will try to communicate to the Commission, is what the investors require. So that's -- that's really, at essence, what we are trying to get to.

Q And what's return on equity?

A The return on equity is -- it's often, again, often referred to as the cost of equity. It's the return that investors require in order to take on the risks of ownership of a given equity security.

Q And if -- it's referred to the amount that a utility is given an opportunity to earn a profit on, do you disagree with that characterization?

A As it is applied in the rate-making concept, I agree with that.

Q Okay. So if I -- sometimes I get going and don't -- I use my own terms. But if we are talking about a profit, the amount that the Commission is going to allow the Commission to profit, can we agree that that represents the return on equity for the purposes of our conversation?

A For the purposes of this conversation, yes.

Q Okay. Now, you, I believe, said that part of what your job is to do is to try to understand how

investors are looking at current market conditions, is that right?

A That's right. There is two pieces to that. One is understanding how investors look at current market. And secondly, understanding how investors may be interpreting expected market conditions. The cost of equity, the return on equity is inherently a forward-looking issue.

Q Okay. So the first part is easier probably to decide -- or to make judgments on than the second, because the first part relies on historical information and the second part is a bit of a forecast?

A Well, I am not sure I would thoroughly agree with that. What I will agree with you on is that we can observe current market conditions, and we can observe current historical market conditions. As to how investors interpret those conditions, and as to how they weight those conditions in arriving at their return requirements, I think that's an equally difficult exercise as the forward-looking portion.

Q Okay. And when this commission sets a return on equity, that -- that is based on a snapshot in time with respect to what the markets are doing, correct?

A Well, that's an interesting question.

Q Can you answer it yes, no or --

A I think it's going to be yes and no --

Q Okay.

A -- I am sorry, but -- and the yes is that I agree with you that data is observable at a given point in time. I think where I disagree with you is that solely the data at that point in time is the foundation of investors' return requirements. But if your question is, at a given point in time, is there data that's observable, I would agree with that.

Q Okay. And I didn't do a good job asking, I am just trying to get your understanding with respect to this commission. Let's say, you know, we are three months down the road, and they are making a decision on return on equity, and they say X. That X then governs things for three, four years, whenever, until in the next rate case; is that right?

A I see your question. Yes, I agree with that.

Q Notwithstanding the fact that it's sort of based on market conditions, there is no index or variable, at least in Florida, that says, well, we are going to adjust this based on Federal Reserve spreads, or anything like that, correct?

A That's right. In Florida, as best I am aware, there is no such adjustment. There are in other jurisdictions. But again, that brings up another good point that you are setting the rate now, but you are also, at the same time, understanding that market conditions are likely to change going forward, and that's why it's important to understand the current market, that's why it's important to what's driving the current market as we make an assessment of, not only what investors require now, but they may require over the next four years.

Q And when you say current markets, are you talking equities market? Debit market? What market are you saying?

A All of the above. When I talk about the market, I generally use the term the capital markets. And the capital markets would include debt, and they generally would include equity, and I am looking at long-term securities. But I suppose, for the purposes of this discussion, we can generally define capital markets as those for debt and equity.

Q Okay. And a debt market would be bonds, when corporations say, you know, I need to borrow some money, how much are you going to charge me interest, that's the debt market, right?

A That's the debt market.

Q And the equity market is when people are saying, well, I have some extra money, should I buy a

stock, and they invest in the company; is that right?

A I am not sure I would agree with the premise that, hey, I have got some extra money, but --

Q Or I have a 401(k) plan, or -- I mean, explain for the equity market. That may be better.

A Sure. The equity market is fundamentally different than the debt market because equity is fundamentally different from debt. Equity is stock. You buy stock in a company and you hope to get dividends from it. You hope to get capital appreciation from it. That is you hope that the price of the stock will increase over time, but you have no guarantees of either. The stock can depreciate in value. Dividends can be cut.

The debt market, on the other hand, you are buying an obligation of the company to pay you both interest and principle at predetermined times, and under pre determined conditions. That's why debt and equity are fundamentally different markets, but I think they generally both would fall under the category of capital markets.

Q Okay. And debt is less expensive than equity, correct?

A As a general proposition, yes.

Q And that's largely because of what you just

described, with debt, if I have debt, I have a contractual arrangement typically where someone says, I can pay you back, and if they don't pay me back, I can sue them maybe and go get some of their assets, right?

A That may be one provision. Debt often is collateralized. Again, debit has the contractual provisions, and so, for the most part, in general, I would say that debt is less expensive than equity for that reason.

We sometimes refer to equity investors as bearing the residual risk. The residual risk meaning that equity investors have a claim on cash flows only after debtholders are paid off. And because they are second in line, because they don't have the protections, because they don't have the priority position, they are considered more risky than debtholders.

Q Is the line only two?

A Well, the line can be -- there can be lots of gradients within that line, but just for the general sake of discussion, if we want to talk broadly about debt and equity, we can do it that way.

Q I always thought equity was at the end of the line. Is that --

A That's my point. Equity is at the end of the line.

Q Okay.

A There could be preferred securities. There could be hybrid securities. As I said, there could be many securities in between.

Q I got you.

A But to your point, equity holders bear the residual risk.

Q Okay. And then you had talked about measuring market conditions. Do you have an understanding of the debt -- well, the debt and equity conditions as they existed when the Commission last made a decision about return on equity?

A Do I have a sense of what the debt and equity markets were like -- I am not --

Q What the market conditions were with respect to ROE, if you will.

A I am sorry, could you --

Q Yeah, that's not a good question.

When this -- do you know what the current ROE is for FPL?

A Yes, 10.5 percent.

Q Okay. And that was set by the Commission back when?

A December 2012.

Q Okay. And the Commission looked at what when

they decided to set that at 10.5?

A Well, I would not speak to what the Commission looked at, but I do know that, like me, the cost of equity experts here would typically look at some measures, such as the level of treasury yields, the issues that are driving the level of treasury yields, the performative various equity sectors.

Q Let me ask it this way: Has the average awarded return on equity since the time the Commission last took a look at this issue, has it gone up or down?

A I think the answer, again, is yes and no. That's a question that you have to look at the data in a fairly fine manner. If you were to look at the data broadly, including, for example, returns that are authorized in Virginia that include premia, incentive premia, then perhaps it is not moved that much. If you are to look at returns authorized by what Regulatory Research Associates might consider more constructive jurisdictions, it probably has not moved all that much.

If you were to look at the data on an average annual basis, you might think it's moved down a little bit. But if you look at the data on a discrete basis, that is at every individual case over time, I don't think there is quite a clear downward trend.

So I don't mean to obfuscate the answer. I don't me mean to try to evade your question, but when you look at the data, you have to look at it a number of different ways.

Q Okay. So you had referenced the Virginia situation. That's not a good example, because they have an ROE -- a statutory ROE that gives them a bump because of renewable energy, or some other program; isn't that right?

A That's what I just said. That's right.

Q Right. So that -- that's not one to consider. But then you said, the data prepared by who may be something that's good to look at, Regulatory Research?

A Right. Regulatory Research Associates is the firm that people generally will look at that aggregate this type of data. And they will look at each individual case as it was ordered on the date of the order and provide the authorized rate of return.

Q Do you rely on them for informing your judgment?

A I rely on them for data, yes. In fact, in some of the exhibits that I have are based on data from Regulatory Research Associates.

Q So you -- I assume, given the fact that you use these as exhibits, then it's information you want the Commission to have and look at in making their

decision?

A It's information that I think is good to have, yes. And, in fact, I think, especially the way -- and I don't want you to take this the wrong way -- but I think it's especially good the way I look at it.

Q Well, we have a difference of opinion, because I think I looked at it in a much simpler way than you do.

A I thought that may be the case.

MR. MOYLE: Could I get help with two exhibits, please?

CHAIRMAN BROWN: Staff, can you help Mr. Moyle out, please?

Mr. Moyle, we will be at Exhibit 656.

Mr. Moyle, would you like this labeled at this time?

MR. MOYLE: Yes. Let's label ROE 2015 and 2016 averages as 656, if we could.

CHAIRMAN BROWN: Hold on one sec. My apologies.

Okay. We will mark ROE 2015 and 2016 averages as 656.

(Whereupon, Exhibit No. 656 was marked for identification.)

MR. MOYLE: Right. And the second one, ROE

2006 averages as 657.

CHAIRMAN BROWN: Okay, let's me make sure everybody has a copy of them, but we will mark ROE 2016 averages as 657.

(Whereupon, Exhibit No. 657 was marked for identification.)

MR. LITCHFIELD: Madam Chair, I would just ask if counsel could be a little earlier in the queue on the distribution of exhibits when our witnesses are being crossed, that would be helpful. Thank you.

CHAIRMAN BROWN: I have been saying that all along. Thank you.

Mr. Hevert, do you have a copy of the exhibits in front of you?

THE WITNESS: Yes, ma'am, I do.

CHAIRMAN BROWN: Mr. Moyle.

BY MR. MOYLE:

Q So would you take a look at 656, and --

A I am sorry, these don't appear to be numbered.

Q I am sorry?

A These don't appear to be numbered, which one are you looking at?

Q You have to write it under the Exhibit No. at the top?

BY MR. MOYLE:

Q The one that has 2015 and '16 averages.

A Okay. And that would be?

Q 656.

A Okay. Thank you.

Q So I want to refer you to the second page of the exhibit, the first page with substantive information on it.

A Yes.

Q You sponsored this exhibit, right?

A Yes. That's right.

Q Okay. And is this an exhibit that you have relied on, and that you want the Commission to rely on with respect to your testimony?

A It is an exhibit that I included in my rebuttal testimony.

Q Okay.

MR. LITCHFIELD: Madam Chair, I assume that counsel is going to clarify this, but the handwriting on the exhibit, that would not be Mr. Hevert's, I assume.

CHAIRMAN BROWN: Mr. Moyle.

MR. MOYLE: His would be not handwritten, so this is mine.

CHAIRMAN BROWN: You will acknowledge that.

MR. MOYLE: I agree to that to that, right. Yes, acknowledge that.

THE WITNESS: I would also agree, mine wouldn't be this clear, so --

BY MR. MOYLE:

Q All right. So this is something that we did just to look at the average ROE from 2015 to 2016 out of all of the jurisdictions that have considered ROE. And we endeavored to average them in the way that you had them displayed. So the way you had them displayed, as I understand it, is you kind of broke them up into ones that were above average, and then average, and then below average with respect to all cases; is that right?

A Yes. That's right.

Q Okay. So --

MR. LITCHFIELD: I am sorry, Madam Chair. I need to ask counsel for a clarification before he continues with the line.

CHAIRMAN BROWN: Sure.

MR. LITCHFIELD: Just to make sure, Mr. Moyle, when you did your math, I want to make sure I understand exactly what you were summing. Was it the entire list beginning all the way back from 2013, or could you clarify that, please?

MR. MOYLE: Sure. And the title should

reflect that ROEs from 2015 and 2016 average. So what we did, you see the line that is on page two of two? There is a line that goes between Colorado and Wyoming, and Wyoming was decided on 1/23/15, so that's below the line, is included in the calculation; and Colorado was decided on 12/18/2014, that's above the line, that's not included. So we drew a line, took all of the results and did an average.

MR. LITCHFIELD: Thank you.

BY MR. MOYLE:

Q And, sir, I guess, Commissioners, to follow along, if you flip to the third -- the second page in there, the witness -- you ranked these above average, average and below average; is that right?

A I did not rank these. These are the ranks provided by Regulatory Research Associates.

Q Okay. So this is the work of someone else with respect to making judgments about above average, average or below average?

A That's right.

Q Have you endeavored to look at it in determining whether you agree with that characterization or not?

A No, I -- to be to be honest with you, I never really have. My objective here is to, again, look at data that the investing community would look at. So, no, I have not put my judgment on top of RRA's for that purpose.

Q So just so -- you would agree that with respect -- since 2015, for all of the jurisdictions around the country that have looked at ROE, that the above average ROE averages out to 9.95, if my math was done correctly?

A Right. The other thing I would observe, of course, is that's a total of three observations.

Q Okay. And you would then agree also that the average middle -- or they call it average ROE, is slightly lower, at 9.55, and based on all cases decided in 2015 and '16?

A Right. And that 9.55 includes the both vertically integrated and distribution only companies. And there is about a 40 -- four zero -- basis point difference.

Q The 9.55 I am looking at is the second -- the secondhand written number.

A Right, 40 basis points between that and the three observations that form the basis of the 9.95.

Q Okay. And then the third column is below average, and that's a 9.49 --

A Right --

Q -- number?

A Oh, yes, I am sorry. I didn't mean to interrupt you, but that's right.

Q Okay. And then there is another column that's vertically integrated, right?

A That's right.

Q So what's the difference between all cases and vertically integrated?

A So all cases would include both vertically integrated companies and companies that Regulatory Research Associates classifies as distribution utilities. And you can see that, sort of in the middle of the page, there is a column that goes down, and it says, distribution vertically integrated, et cetera.

Q All right. So then just to quickly run through this. The vertically integrated, the above average number in the last two years, 2015-'16 is, again, 9.95?

A Well, wait, did you say two years?

Q 2015 and 2016, is that right?

A Yeah, that's not been two years, but since the beginning of 2015, right.

Q And then the average is 9.70?

A Yes. I am sorry. I see that. Yes.

Q And then the below average is 9.64?

A 9.64.

Q And flipping to the more recent ROEs, this is Exhibit 657, which is taken from your exhibit, but the line -- there is another line drawn here that makes a distinction between cases decided in 2015 and 2016; do you see that?

A I am sorry. Hold on. So which one are we on now?

Q This is the next exhibit.

A Okay.

Q Do you see that?

A Yes, I see that.

Q Okay. And just confirm for me that, with respect to the exhibit that shows the return on equity decisions made by other jurisdictions in the United States in 2016, that the above average ROE is 9.85?

A Right. Right, for the one -- the one case.

Q And then for the average, it's 9.41?

A Excuse me for one second. Yes, that's right, for five cases.

Q Right. It is what it is. And then the below average is 9.62?

A And what it is it's for two cases, right.

Q And the numbers that are set forth for the

vertically integrated, 9.85 for above average, 9.63 for average and 9.48 for below average --

A Right, and again -- and not to belabor the point, but it's one observation, two observations, one observation.

Q Well, they are important enough for you to include in your exhibit, right?

A Not in the way you have used them, but yes.

Q That be another disagreement we have.

A There are so few, though.

Q I got a couple more things I want to inquire about. In your testimony, you actually call out a couple of things as risk. Part of what you are doing is looking at business risk that Florida Power & Light faces, is that right?

A That's part of it, correct.

Q Okay. And with respect to geographic risk, did you try to do a compare and contrast analysis that -- this is not a term, I don't believe, that is used in your business, but kind of the all eggs in one basket electric company as compared to an electric company that has more diversification, more spread geographically.

A Let me see if I can rephrase your question so that I understand it.

If you are question is, is there more risk associated with a company that is geographically confined, it doesn't have the diversification across geography that would diversify weather, that would diversify regulation, those sorts of things, did I take that into account, and recognize that FPL is a single jurisdiction entity, that's not one of the things I specifically considered.

Q Okay. How about with respect to risk associated with weather, did you -- you are aware that, say, there is a -- are you aware of Tampa Electric Company?

A I am, yes.

Q And do you know where they serve -- how many counties they serve, and where it is?

A I could not tell you how many counties, but I could tell you it's in the Tampa area, yes. It's -- I think it's called an aptonym.

(Transcript continues in sequence in Volume 18.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, DEBRA KRICK, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

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

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

DATED this 26th day of August, 2016.

Debbie R Krick

DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #GG015952
EXPIRES JULY 27, 2020