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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 36
PAGES 5469 - 5749

PROCEEDINGS:	HEARING
COMMISSIONERS PARTICIPATING:	CHAIRMAN JULIE I. BROWN COMMISSIONER LISA POLAK EDGAR COMMISSIONER ART GRAHAM COMMISSIONER RONALD A. BRISÉ COMMISSIONER JIMMY PATRONIS
DATE:	Wednesday, August 31, 2016
TIME:	Commenced at 9:05 p.m. Concluded at 11:30 p.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	LISA GAINEY Court Reporter

(850) 894-0828

APPEARANCES: (As heretofore noted.)

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WITNESSES

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 35.)

(Continued testimony of Renae Deaton.)

* * * * *

CHAIRMAN BROWN: All right. If you guys could take your seats, that would be much appreciated. All right. So, we are on Wal-Mart.

MR. WILLIAMSON: Yes, ma'am, just a couple of questions.

EXAMINATION

BY MR. WILLIAMSON:

Q Ms. Deaton, Page 8 of your rebuttal testimony, Lines 14 and 15.

A Yes.

Q You cite Witness Chriss in your testimony here for the proposition that allocating a portion of production costs is energy related is a judgmental determination. Do you recall that testimony?

A Yes.

Q Do you recall if Mr. Chriss actually used the used the term "judgmental determination"?

A Used the what? I'm sorry.

Q The term that you used on Line 14, judgmental determination. Do you recall if he used the

term judgmental determination?

A Honestly, I don't recall if he used that exact same term.

Q Would you accept subject to check --

MS. CLARK: Madam Chairman, I would like to give her a copy of Mr. Chriss' testimony which I think is okay with counsel for Wal-Mart.

A I have it, if you can refer me to a page.

Q Sure. Well, I'm going to refer to the pages you cite in your testimony, which is Page 15, Lines 8 through 15. You cite his testimony in support of the proposition you stated.

A I might have the wrong reference here.

Q I don't believe you have the wrong reference, ma'am. I just don't think he used that term "judgmental determination." Would you agree with that having reviewed the cited material?

A I don't know why I would have quoted it if he didn't use that term.

Q Would you agree that at Line 11 of his testimony in the middle and at Line 9 of his testimony on that page in the middle, he uses the term "arbitrary designation"?

A Yes, I see that.

Q When you used the term "judgmental

determination" -- you did not quote him, by the way. I'm just trying to clarify why you said it was his testimony. When you used the term "judgmental determination," what were you referring to?

A Well, I thought I was referring to Witness Chriss' testimony, actually, but there is an allocation methodology in the NARUC Manual that discusses judgmental allocations.

Q So, I think you're right. I think that in the NARUC Manual there's a reference to the judgmental weightings. That is in a footnote photo of the bottom of Page 18 of Mr. Chriss' testimony?

A That must be where I got it.

Q But Mr. Chriss himself doesn't use the term "judgmental determination," does he? I think you already answered the question. Strike that question.

A Yes. This is where I saw it.

Q And you don't separately define the term "judgmental determination" of your own volition?

A No.

MR. WILLIAMSON: All right. Thank you, ma'am.

CHAIRMAN BROWN: Thank you. All right. Moving on to Larsons.

EXAMINATION

BY MR. SKOP:

Q Madam Chairman, just one full question, if I may. Ms. Deaton, you were asked a question by Sierra Club in relation to an exhibit by Mr. Barrett. You indicated that you had no knowledge with respect to that response; is that correct?

A Yes.

Q All right. So, with respect to decisions that are made by integrated resource planning, once you get those datasets, you just incorporate that data into your planning function, is that correct, for cost allocation?

A No.

Q What do you do with that --

CHAIRMAN BROWN: You did say one question, by the way.

MR. SKOP: Thank you, Madam Chairman. I'll make it very quick.

BY MR. SKOP:

Q What do you do with those data inputs?

A Nothing. I use the accounting and financial data from our system on plant in service and accumulated depreciation, expenses, working capital. I don't use anything from resource planning other than

Dr. Morley's load forecast.

MR. SKOP: Thank you, Madame Chair.

CHAIRMAN BROWN: Thank you, Mr. Skop. Staff.

MS. BROWNLESS: No, ma'am, thank you.

CHAIRMAN BROWN: Commissioner Edgar.

COMMISSIONER EDGAR: Thank you, Madam Chairman.

EXAMINATION

BY COMMISSIONER EDGAR:

Q Very briefly, earlier in the cross to you this evening, Mr. Moyle asked you some questions about cost causer. These are going to be my words, but I think it's like a theoretical principle for ratemaking.

A Right.

Q And we have also heard testimony about parity being also a principle for ratemaking and that within the current FPL request, there are some efforts to improve parity. I'm not sure that improve is the right word.

A Yes.

Q So, is the principle of cost causer in ratemaking and parity in ratemaking -- do those two principles always work together or are they sometimes in conflict?

A Well, to the extent you can't bring customers up to parity, then they are in conflict, but no, I think they work together. We identify the costs that should be recovered from each class, identify what their parity is at present rate and try to bring proposed rates.

Witness Cohen talks about trying to allocate the revenue so that proposed rates are closer to parity and closer to what the cost-of-service results are.

COMMISSIONER EDGAR: Okay. Thank you.

CHAIRMAN BROWN: Thank you, Commissioner Edgar. Redirect.

REDIRECT EXAMINATION

BY MS. CLARK:

Q Ms. Deaton, as part of the questioning by Mr. Wiseman, he asked you about a comparison of FPL service territory to New York City. Do you know what the rates are for electric service in New York City?

A A thousand kilowatt bill for ConEd is $230, and that's 147 percent higher than FPL's bill. And I would add that their customer charge which, using MDS, tends to increase customer unit cost, and their customer charge is, I believe, about $16 now.

And I would also add that moving to MDS under the allocations proposed by the intervenors would

increase FPL's unit cost for customer charge residential from about $8 to $12.

MS. CLARK: Madam Chairman, that's all I have.

CHAIRMAN BROWN: All right. This witness has Exhibits 390 through 396 attached as part of her rebuttal.

MS. CLARK: I would move those into the record, Madam Chairman.

CHAIRMAN BROWN: Are there any objections?

MR. MOYLE: No, but I'm reflecting back on the answer to the question about ConEd that opened a big door that all this stuff came through that I don't think was ever brought up before in any way, shape or form.

CHAIRMAN BROWN: Mr. Moyle --

MR. MOYLE: I don't think it's appropriate. Move to strike it.

CHAIRMAN BROWN: -- objections must be made timely. I was looking around and I saw blank faces and nobody --

MR. MOYLE: We were stunned.

(Laughter.)

CHAIRMAN BROWN: Nonetheless, it's already in because their objection was not made timely.

MR. MOYLE: Could I move to strike it, please?

MS. CLARK: I don't see on what basis he moves to strike it. Mr. Wiseman asked about New York City.

MR. MOYLE: Well, the basis would be that he asked about New York City. And then the next thing you know, she's saying, oh, here I've done a study on MDS in Florida. First of all, we think it's inconsistent with information --

CHAIRMAN BROWN: Didn't you say something earlier about the car door?

MR. MOYLE: The what?

CHAIRMAN BROWN: The car door being opened?

MR. MOYLE: Yeah, but you ask about New York and you get Florida? That's a long way.

CHAIRMAN BROWN: All right. Staff.

MS. BROWNLESS: Forgive me, Madam Chairman, I'm going to defer to Ms. Helton because I didn't hear that last exchange.

CHAIRMAN BROWN: Ms. Helton.

MS. HELTON: I have to say I did not hear the exchange, but I agree with what you said that if he did not make a timely objection, that time has passed and I think you can move on.

CHAIRMAN BROWN: Okay. Thank you for that advice.

MR. MOYLE: So, that would be a denial of the motion to strike?

CHAIRMAN BROWN: Yes.

MR. MOYLE: I do think that's an alternative mechanism. I understand your ruling, but it really was. You can read it back. It was way beyond --

CHAIRMAN BROWN: Commissioner Graham has a question for you.

COMMISSIONER GRAHAM: Actually, I had the gavel when he asked the question. He opened the door, in my opinion.

CHAIRMAN BROWN: Thank you for that corroborating support there. So, we've already moved in Ms. Deaton's -- we're moving in 390 through 396. Seeing no objections from any of the intervenors -- is that correct? All right. We've moved those in.

(Exhibits 390 through 396 were admitted.)

CHAIRMAN BROWN: Moving on to Ms. Deaton's -- FIPUG, you have 781 and 782, but the letter which is 781 was not used. Would you like to move in 782?

MR. MOYLE: 782 was the --

CHAIRMAN BROWN: Energy changes, 12 CP, 25 percent compared to 12 CP, 1/13th.

MR. MOYLE: No, but we would like to move the letter in.

MS. CLARK: Madam Chairman, I object to the letter being moved into evidence.

CHAIRMAN BROWN: I object to the letter.

MR. MOYLE: It doesn't come in as a business record?

CHAIRMAN BROWN: There was literally no relevance or predicate or anything established.

MR. MOYLE: And just so we have a clear record on the motion to strike, that was denied; is that right?

CHAIRMAN BROWN: That was denied. 782. Mr. Moyle, would you like to move that in?

MR. MOYLE: No, thank you.

CHAIRMAN BROWN: No, thank you.

MS. BROWNLESS: He doesn't want 782?

CHAIRMAN BROWN: No, he does not?

MR. MOYLE: Is it going to get objected to? I'll move it.

CHAIRMAN BROWN: Is there any objection? Seeing no objection, we're going to move in 782.

(Exhibit 782 admitted.)

CHAIRMAN BROWN: Hospitals, you have 783 through 786.

MR. WISEMAN: I would move the admission of those with one explanation. FPL has asked that we put in it entirety of the discovery responses related to 786. I've told them they came in response to three different discovery requests, so I'm going to identify those for FPL, and then they will supply the documents to the court reporter.

CHAIRMAN BROWN: So, to be real clear, 783 through 785?

MR. WISEMAN: No, 786.

CHAIRMAN BROWN: Just 786.

MR. WISEMAN: Yeah, it was just a clarification of what will be provided. A fuller document will be provided with respect to 786.

CHAIRMAN BROWN: Okay. Is there any objection to 783 through 786 with the understanding that 786 will be provided in a full complete form?

MS. CLARK: Yes, and he will tell us which evidently multiple documents or multiple discovery requests -- yes, Madam Chairman, we will do that.

CHAIRMAN BROWN: Thank you. And you will

provide the same to the clerk as well.

MR. WISEMAN: Yes. I think we're going to be doing the providing and, yes, we will do so.

(Exhibits 783 through 786 admitted.)

CHAIRMAN BROWN: Thank you. Sierra Club, you have 787.

MS. CSANK: I would move that in, Madam Chairman

MS. CLARK: We object to that. This is a response to a late-filed deposition which it does not belong to Ms. Deaton. I believe she said she wasn't familiar with it.

CHAIRMAN BROWN: I'm going to defer to Commissioner Graham. He had the gavel at the time.

COMMISSIONER GRAHAM: Ms. Deaton said she wasn't familiar with the document at all.

CHAIRMAN BROWN: Okay. I'm sorry. It won't come in. Would you like your witness excused at the time?

MS. CLARK: Yes, Madam Chairman, we would.

CHAIRMAN BROWN: Ms. Deaton, have a great night and safe travels.

We are on to Mr. Hevert.

MR. SAYLER: Just for the last three

witnesses, the intervenor parties have agreed to doing like we did on direct with all the other intervenors going first followed by OPC and then followed by South Florida Hospital. So, that means FIPUG would be the lead-off batter.

MR. LITCHFIELD: Madam Chair, FPL will defer to your judgment. I would simply note, however, that the last time that we opted for that order, it didn't exactly streamline the conversation.

CHAIRMAN BROWN: I think it did the opposite of streamlining. Can you give me the rationale for the change in order? Originally, it was proposed -- I'm pretty flexible on this, but I just want to understand what the rationale is.

MR. SAYLER: Certainly. We still think it streamlines it, and I do know that this go-around myself, I'm not trying to introduce or use 11 different testimonies from 11 different jurisdictions with this witness.

I may not have any exhibits with this witness at this go-around.

CHAIRMAN BROWN: So, it would be public counsel before hospitals or hospitals before public counsel?

MR. SAYLER: Public counsel and then the

hospitals.

CHAIRMAN BROWN: Hospitals closing before staff. Okay.

MR. SAYLER: Yes, ma'am.

CHAIRMAN BROWN: Let's try it out on this witness.

MR. SAYLER: All right. Thank you.

CHAIRMAN BROWN: Okay. FPL, are you prepared to move forward right now?

MR. LITCHFIELD: Yes, Madam Chairman, we are. Mr. Hevert is in the witness chair, and he has previously been sworn in this proceeding.

CHAIRMAN BROWN: Thank you.

* * * * *

ROBERT HEVERT

was called as a witness, having been previously sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. LITCHFIELD:

Q Good evening, Mr. Hevert.

A Good evening.

Q You prepared and filed 159 pages of rebuttal testimony in this proceeding, correct?

A Yes, I did.

Q And you've also filed errata sheets with

regard to your rebuttal testimony on August 16th, 18th and 26th respectively?

A Yes, that's right.

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

A I do not.

Q With those changes if I were to ask you the same questions this evening contained in your rebuttal testimony, would your answers be the same?

A Yes, they would.

Q Do the changes contained in your errata affect your recommendations in this case?

A No, they do not.

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

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

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

ERRATA SHEET

WITNESS: ROBERT B. HEVERT – REBUTTAL TESTIMONY

PAGE #	**LINE #**	**CHANGE**
RBH-26 Pages 1-3	Note 7	Replace “[7] Equals [4] + [8]” with “[7] Equals [2] + [6]

ERRATA SHEET

WITNESS: ROBERT B. HEVERT – REBUTTAL TESTIMONY

PAGE #	LINE #	CHANGE
118	4	"D. Roger Morin"
		Should read "Dr. Roger Morin"
120	7	"Mr. Baudino calculates a total growth rate for the market of 10.44 percent"
		Should read "Mr. Baudino calculates a total growth rate for the market of 9.00 percent"
133	17	"Chriss did"
		Should read "Mr. Chriss did"
135	4	"(see Table 6, below)"
		Should read "(see Exhibit RBH-42)"
136	18	"since 200 Wal-Mart's"
		Should read "since 2000 Wal-Mart's"

I. INTRODUCTION AND PURPOSE

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

A. My name is Robert B. Hevert. I am a Partner with ScottMadden, Inc. ("ScottMadden"), and my business address is 1900 West Park Drive, Suite 250, Westborough, MA 01581.

Q. Are you the same Robert B. Hevert who previously provided Direct Testimony in this proceeding?

A. Yes. At the time my Direct Testimony was filed, I was Managing Partner of Sussex Economic Advisors, LLC ("Sussex"). Effective June 1, 2016 Sussex became part of ScottMadden, and I assumed my current position as Partner.

Q. What is the purpose of your Rebuttal Testimony?

A. The purpose of my Rebuttal Testimony is to respond to the direct testimonies of: (1) Dr. J. Randall Woolridge on behalf of Florida Office of Public Counsel ("OPC"); (2) Mr. Michael Gorman on behalf of the Federal Executive Agencies ("FEA"); (3) Mr. Richard A. Baudino on behalf of the South Florida Hospital and Health Care Association ("SFHHA"); (4) Mr. Steve Chriss on behalf of Wal-Mart Stores East, LP and Sam's East, Inc. ("Wal-Mart"); (5) Mr. Michael Brosch on behalf of AARP; (6) Mr. Jeffry Pollock on behalf of the Florida Industrial Power Users Group ("FIPUG") (referred to herein, collectively, as the "opposing ROE witnesses"); (7) Mr. Kevin W. O'Donnell on behalf of OPC; and (8) Mr. Daniel Lawton on behalf of OPC, as their testimonies relate to the Company's Return on Equity ("ROE") or capital structure.

Q. Have you prepared any Rebuttal Exhibits?

A. Yes. My analyses and conclusions are supported by the data presented in Exhibits RBH-11 through RBH-44, which have been prepared by me or under my direct supervision.

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

A. In my Direct Testimony I recommended an ROE of 11.00 percent, within a range of 10.50 percent to 11.50 percent. As my Direct Testimony discussed, my ROE recommendation and the analytical results on which it is based consider a variety of factors, including certain risks faced by FPL such as vulnerability to severe weather conditions, exposure to new regulatory requirements associated with nuclear generation, and the risk of adverse capital market changes during the pendency of the Company's proposed four-year rate plan.

Because the application of financial models and the interpretation of their results are often sources of disagreement among analysts in regulatory proceedings, I believe it is important to review and consider a variety of data points; doing so enables us to put in context both quantitative analyses and the associated recommendations. As such, I have updated many of the analyses contained in my Direct Testimony, and I have provided several new analyses in response to issues raised by the opposing ROE witnesses. As discussed throughout the balance of

my Rebuttal Testimony, those analyses continue to support my ROE range and recommendation.

As to the capital structure, I continue to recommend the Company's existing capital structure of 40.40 percent long-term debt and 59.60 percent common equity. I further conclude that the Company's capital structure is within the range of equity ratios used by its peers, is consistent with rating agency criteria, and therefore, is reasonable.

Q. Please now provide an overview of your response to the ROE recommendations made by the opposing ROE witnesses.

A. It is important to keep in mind that no one financial model is more reliable than others at all times and under all market conditions; at times, certain model results simply do not make sense. Determining the Cost of Equity therefore is not always a strict mathematical exercise. Rather, it requires reasoned judgment in vetting the models and assumptions used by various analysts, and in assessing the reasonableness of their recommendations. That judgment may lead to the conclusion that the emphasis applied to a particular method in a prior proceeding or under prior market conditions is not appropriate in the current instance.

The opposing ROE witnesses have given considerable weight to a single method - the Discounted Cash Flow ("DCF") approach – even though their models produce ROE estimates that are 100 basis points, and more, below the returns authorized

for other electric utilities.[1] Given their dependence on a method that produces unduly low estimates, it is not surprising that their recommendations fall within a range that is far below the returns authorized for electric utilities in other jurisdictions.

The fact that the opposing ROE witnesses' recommendations are similar does not mean that their approaches are appropriate or that their conclusions are sound. For the reasons discussed throughout the balance of my Rebuttal Testimony, it is my view that, if adopted, the opposing ROE witnesses' recommendations would increase the Company's regulatory and financial risk, diminish its ability to compete for capital, and have the counter-productive effect of increasing FPL's overall cost of capital, ultimately to the detriment of its customers.

Q. Please now provide an overview of your response to the ROE recommendations made by the opposing ROE witnesses.

A. Although there are many areas in which I disagree with their methods and conclusions, there are certain issues that commonly serve to reduce the opposing ROE witnesses' recommendations:

- *Application of Discounted Cash Flow methods.* As a general matter, DCF based methods define the Cost of Equity as the discount rate that sets the current market price of a stock equal to the present value of the cash flows expected from owning that stock. In calculating expected cash flows, the

[1] Direct Testimony of J. Randall Woolridge, at 53 and Exhibit JRW-10, at 1. Direct Testimony of Michael P. Gorman, at 31, 33, Exhibit MPG-6 and Exhibit MPG-9. Direct Testimony of Richard A. Baudino, at 33 and Exhibit No.___(RAB-7).

opposing ROE witnesses rely on growth rates that are inappropriately low, or that are constrained by what they may consider to be "sustainable" levels of perpetual growth. Regardless of how they develop their models, DCF estimates as low as 8.15 percent[2] fail to meet the *Hope* and *Bluefield* "end result" standard, and should be given no weight in determining the Company's ROE.

- *Application of Risk Premium Models.* Risk Premium methods are based on the financial principle that equity investors assume greater risk than do debt investors and, therefore, require higher returns. The measure of that incremental return is the "Equity Risk Premium," or the difference between the required return on debt and the required Return on Equity. It is important to recognize that the Equity Risk Premium is not constant over time. Rather, as interest rates fall, the Equity Risk Premium increases, even when we consider additional measures of market risk. By not properly reflecting that well-documented relationship, certain of the opposing ROE witnesses have under-estimated FPL's Cost of Equity.
- *Application of the Capital Asset Pricing Model ("CAPM").* The CAPM, which also is a risk premium-based method, assumes that investors must be compensated for the time value of money, and for taking on additional risk. The time value of money is measured by long-term Treasury yields; compensation for additional risk is measured by the stock's Beta coefficient and the expected Market Risk Premium ("MRP"). The Market Risk Premium,

[2] Direct Testimony of Richard A. Baudino, at 41, and Exhibit RAB-7.

which weighs heavily in CAPM estimates, reflects the additional return that investors expect to receive by investing in the market as a whole over the return they would receive by investing only in long-term Treasury bonds. Certain of the opposing ROE witnesses have developed MRP estimates based on historical market returns and interest rates, and have assumed relationships between those two variables that do not reasonably reflect current or expected market conditions. As a result, their ROE estimates are unreasonably low.

- *Assessment of the Company's relative risk.* Determination of required ROE is a risk-comparable exercise. The opposing ROE witnesses do not fully consider the range of business risks and other factors when determining where FPL's required ROE falls within the range of analytical results.[3]

On balance, and after considering the issues summarized above, I have maintained the recommendations contained in my Direct Testimony.

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

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

- Section II – Contains my response to OPC witness Woolridge;
- Section III – Contains my response to FEA witness Gorman;
- Section IV – Contains my response to SFHHA witness Baudino;
- Section V – Contains my response to Wal-Mart witness Chriss;

[3] *See*, Direct Testimony and Exhibits of Robert B. Hevert, at 37-50.

- Section VI – Contains my response to AARP witness Brosch and FIPUG witness Pollock;
- Section VII – Contains my response to OPC witness O'Donnell regarding the Company's capital structure;
- Section VIII – Contains my response to OPC witness Lawton regarding the Company's financial integrity;
- Section IX – Summarizes my updated analyses; and
- Section X – Summarizes my conclusions and recommendations.

II. RESPONSE TO THE TESTIMONY OF OPC WITNESS WOOLRIDGE

Q. Please provide a brief summary of Dr. Woolridge's testimony and ROE recommendation.

A. Dr. Woolridge recommends an ROE of 8.75 percent, which is near the upper end of his DCF and CAPM results. Dr. Woolridge makes clear, however, that his recommendation relies primarily on his Constant Growth DCF model results.[4]

Q. What are the principal areas of disagreement between you and Dr. Woolridge?

A. There are several areas in which I disagree with Dr. Woolridge. In general, those areas include: (1) the composition and selection of the proxy group companies; (2) the growth rates applied in the Constant Growth DCF model; (3) the application of the Multi-Stage DCF model; (4) the application of the CAPM; (5)

[4] Direct Testimony of J. Randall Woolridge, at 63.

the reasonableness of the Bond Yield Plus Risk Premium analysis; (6) the relevance of Market-to-Book ("M/B") ratios in excess of unity; (7) the relevance of flotation costs in determining the Company's Cost of Equity; and (8) the business risk of FPL relative to the proxy group. In addition, I disagree with Dr. Woolridge's presentation and interpretation of certain data relating to capital market conditions.

Regardless of how he arrived at his recommendation, it is very difficult to reconcile an ROE of 8.75 percent with past, current, and expected market environments.

A. Proxy Group Selection

Q. Please describe the screening criteria by which Dr. Woolridge developed his Proxy Group.

A. Dr. Woolridge relied on six screening criteria to develop his sample of 29 companies:

1. Proxy companies must derive at least 50.00 percent of revenues from regulated electric operations;
2. Each company selected must be listed as an Electric Utility by Value Line and as an Electric Utility or Combination Electric and Gas company by AUS Utilities Reports;
3. Selected companies must have an investment grade bond rating;
4. Companies must have a consistent dividend record with no cuts or omissions for the past six months;

5. Each company must not be involved in an acquisition, or be the target of an acquisition in the past six months; and
6. Proxy companies must have long-term Earnings Per Share ("EPS") growth forecasts available from Yahoo!, Reuters, or Zacks.[5]

Q. Do you agree with Dr. Woolridge's screening criteria?

A. Not entirely. Although we do have certain criteria in common (for example we both exclude companies that are party to a significant corporate transaction[6] or that do not consistently pay dividends), I do not believe that Dr. Woolridge's screens render a group of companies that is sufficiently comparable to FPL.

Q. Do any of Dr. Woolridge's proxy companies fail his proxy group screening criteria?

A. I believe so. Dr. Woolridge included in his proxy group Dominion Resources, Inc. ("Dominion"), Black Hills Corporation ("Black Hills"), Duke Energy Corporation ("Duke"), and Southern Company ("Southern"), all of which are party to significant acquisitions: Dominion announced its proposed acquisition of Questar Corporation on February 1, 2016;[7] Black Hills acquired SourceGas Holdings LLC on February 12, 2016;[8] Duke announced its proposed acquisition of Piedmont Natural Gas Company, Inc. on October 26, 2015;[9] and Southern

[5] Direct Testimony of J. Randall Woolridge, at 28.
[6] Subsequent to the filing of my Direct Testimony, Dominion Resources, Inc. entered into an agreement to acquire Questar Corp. on February 1, 2015 and Great Plains Energy Inc. entered into an agreement to acquire Westar Energy Inc. on May 29, 2016.
[7] Dominion Resources, Inc., SEC Form 8-K, January 31, 2016.
[8] Black Hills Corporation, SEC Form 8-K, July 12, 2015.
[9] Duke Energy Corporation, SEC Form 8-K, October 24, 2015.

completed its acquisition of AGL Resources Inc. on July 1, 2016.[10] As such, those companies should be removed from the proxy group.

Q. What is your concern with Dr. Woolridge's use of revenue, rather than income, as a screening criterion?

A. Measures of income are far more likely to be considered by the financial community in making credit assessments and investment decisions than are measures of revenue. From the perspective of credit markets, measures of financial strength and liquidity are focused on cash from operations, which is directly derivative of earnings, as opposed to revenue. For example, Moody's assigns a 40.00 percent weight to measures of financial strength and liquidity, of which 32.50 percent specifically relates to the ability to cover debt obligations with cash from operations.[11]

Just as rating agencies focus on measures of cash from operations, equity investors prefer measures of income in assessing equity valuation levels; common measures of relative equity valuation include the Price/Earnings ratio, and the ratio of Enterprise Value/EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization). Revenue, however, may be several steps removed from the earnings and cash flows that that are the basis of equity valuations. Energy trading and marketing units, for example, often represent high

[10] Southern Company, SEC Form 8-K, August 23, 2015.

[11] *See*, Moody's Investors Service, Rating Methodology, *Regulated Electric and Gas Utilities*, December 23, 2013, at 10-14. I address the ratings process in more detail in my response to Mr. Lawton.

revenue but low margin operations. Those operations may generate a comparatively large proportion of the combined entity's revenue, but only a small percentage of its income. In such cases, focusing on revenue may mislead the analyst into assuming that a given operating unit is the primary driver of expected growth, when other business segments create the majority of earnings and cash flows. Here, we are considering whether the underlying utility is the principal source of long-term growth and as such, it could be misleading to focus on revenue rather than earnings for the purpose of identifying proxy companies.

Q. Have you made any changes to the proxy group used in your ROE analyses?

A. Yes, I have. Although I believe my proxy group reasonably reflects FPL's risk, I also recognize that in certain circumstances it is possible to have reasonable disagreements as to the definition and application of screening criteria. Consequently, I have developed a proxy group that contains all the companies used by Dr. Woolridge, Mr. Gorman, Mr. Baudino, and me in this proceeding, but for companies that: (1) have recently been party to mergers or significant transactions; (2) that do not have regulated generation assets; or (3) are affected by significant ongoing uncertainties that may be affecting their market data and investors' expectations of their future performance (I refer to that group as the "Combined Proxy Group"). Exhibit RBH-19 provides a comparison of the various proxy groups used by ROE witnesses in this proceeding and explains the reason certain companies were excluded from the Combined Proxy Group. As discussed in Section IX, the Cost of Equity estimates derived from the Combined Proxy Group support my ROE recommendation.

B. Application of the Constant Growth DCF Approach

Q. Please summarize your concerns with the Constant Growth DCF model and Dr. Woolridge's application of the model.

A. There are several aspects of Dr. Woolridge's DCF analyses and conclusions that are incompatible with market conditions, and inconsistent with the practical interpretation of the models' results. For example, the market data used in Dr. Woolridge's DCF analyses conflict with the models' underlying assumptions. In particular, the market prices used to calculate the dividend yield were taken from a period during which utilities in general, and the proxy companies in particular, traded at unusually high, and likely unsustainable, levels. In fact, during Dr. Woolridge's study period, utility Price/Earnings ("P/E") ratios exceeded their long-term average, and were similar to the market P/E ratio (as measured by the S&P 500).[12] The elevated P/E ratios are an important factor simply because the Constant Growth DCF model assumes constant P/E ratios in perpetuity. Consequently, the basis of Dr. Woolridge's recommendation – the Constant Growth DCF model – assumes data that are inconsistent with the model's fundamental assumptions.

Lastly, Dr. Woolridge's application of the Constant Growth DCF model includes a degree of subjectivity that prevents us from replicating his results. It is quite likely that analysts looking at the same data would come to different conclusions. For example, based on his review of historical and projected dividend, book

[12] Source: SNL Financial, Bloomberg Professional.

value, earnings and "sustainable" growth rates, Dr. Woolridge assumes a growth rate of 4.88 percent for the companies in his proxy group, although it is unclear how he calculates that estimate. Moreover, Dr. Woolridge's judgment is to give "primary weight"[13] to growth rate projections produced by equity analysts, despite his position that those analysts knowingly and persistently produce biased forecasts.

Q. What growth rates did Dr. Woolridge review in his Constant Growth DCF analysis?

A. Dr. Woolridge reviewed a number of growth rates, including historical and projected Dividends Per Share ("DPS"), Book Value Per Share ("BVPS"), and EPS growth rates as reported by Value Line; analysts' consensus EPS growth rate projections from Yahoo!, Reuters, and Zacks; and an estimate of "sustainable growth" derived from data provided by Value Line. Dr. Woolridge states that in arriving at his 8.75 percent DCF estimate, he gave more weight to projected EPS growth rates.[14]

[13] Direct Testimony of J. Randall Woolridge, at 52.
[14] *See*, Direct Testimony of J. Randall Woolridge, at 52.

Table 1: Summary of Dr. Woolridge's Growth Rate Estimates[15]

	Dr. Woolridge's Proxy Group
Value Line Historical Growth Rates (DPS, BVPS, EPS)	4.30%
Value Line Projected Growth Rates (DPS, BVPS, EPS)	4.80%
Sustainable Growth	3.90%
Analyst Projected EPS Growth Rates (excl. Value Line) – Mean/Median	4.80%/5.00%
Dr. Woolridge's Assumed DCF Growth Rate	4.88%

Q. Do you agree with Dr. Woolridge's sustainable growth rate estimate?

A. No, I do not. As discussed in more detail in my response to Mr. Baudino, the "sustainable growth" rate does not account for externally generated funds associated with issuances of new equity.

Q. Are there reasons to doubt the results of a DCF analysis that uses the sustainable growth rate for electric utilities in particular?

A. Yes. As noted below, the projected realized Return on Common Equity for many of the proxy companies is significantly diluted by recent or projected additions to net plant. The assumption that the Cost of Equity would materially decrease as capital investments increase, however, is contrary to market evidence.

[15] *See*, Direct Testimony of J. Randall Woolridge, Exhibit JRW-10, at 1 and 6.

Q. Have you conducted any analyses to demonstrate how the proxy companies' earned ROE projections are diluted by ongoing capital expenditures?

A. Yes, I have. As discussed in my Direct Testimony, I analyzed Value Line's earned ROE projections using the "DuPont" formula, which 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).[16] That analysis (see Exhibit RBH-8) showed that because 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 dilute the Asset Turnover ratio, at least in the near term. In the context of the sustainable growth model, the pressure on earned ROE would lead to the counter-intuitive conclusion that increased capital investments lead to decreased return requirements.

Q. Do Dr. Woolridge's analyses account for abnormally elevated P/E ratios?

A. Not on a consistent basis. As discussed throughout my Rebuttal Testimony, DCF-based methods, such as the Constant Growth model on which Dr. Woolridge (and the other opposing witnesses) relies, depend on recent stock prices as a principal input, and (in the case of the Constant Growth model) assume that Price/Earnings ratios, and resulting Cost of Equity will remain constant in perpetuity. As noted

[16] Direct Testimony of Robert B. Hevert, at 40.

above, an important analytical issue is that utility sector P/E ratios recently have been unstable and recently have been moved well above their historical levels.[17]

To support his Capital Asset Pricing Model analysis, Dr. Woolridge refers to "Building Block" approaches as part of the studies he uses to estimate the Market Risk Premium (*see* Exhibit JRW-11, pages 5 and 6). Among the "Building Block" studies included in that review are those produced by Ibbotson and Chen. The Morningstar 2015 Classic Yearbook also discusses the "Building Block" model.[18] In that discussion, Morningstar reviews the effect of increasing P/E ratios on the market return, and concludes that "reported earnings are affected not only by the long-term productivity, but also by 'one-time' items that do not necessarily have the same consistent impact year after year."[19] Morningstar therefore uses three-year average P/E ratios to develop its Supply-Side market return estimate.

Dr. Woolridge therefore recognized and adjusted his analyses to reflect the abnormal expansion in P/E ratios in his Building Blocks calculation, but did not acknowledge the same principle in his DCF analysis. That is, Dr. Woolridge relies on an analysis that adjusts abnormally high P/E ratios in a manner that reduces his CAPM estimate (the Building Blocks approach to developing the

[17] Since the beginning of 2000, the long-term average P/E ratio for Dr. Woolridge's proxy group was 17.08. The 30-day average P/E ratio for the period ending June 2016 was 21.63 for Dr. Woolridge's proxy group. Source: SNL Financial. Looking forward, indicators suggest that the industry's current valuation levels may not persist. Value Line, for example, expects a decline in the P/E ratio for all of the companies in Dr. Woolridge's proxy group over the coming three to five years (*see*, Exhibit RBH-20).

[18] Morningstar refers to the method as the "Supply Side" approach.

[19] Morningstar, Inc., 2015 Classic Yearbook, at 157.

Equity Risk Premium),[20] and at the same time relies on DCF estimates that do not recognize or adjust for the abnormal expansion in P/E ratios for his proxy companies.

Q. Please summarize Dr. Woolridge's reference to a March 2015 report by Moody's regarding the effect of ROEs on utilities' near-term credit profiles.

A. Dr. Woolridge points to the article and concludes (among other things) that lower authorized ROEs are not impairing utilities' credit profiles, and are not "deterring them from raising record amounts of capital."[21] Dr. Woolridge further states that the Moody's article "supports the prevailing/emerging belief that lower authorized ROEs are unlikely to hurt the financial integrity of utilities or their ability to attract capital."[22]

Q. What is your response to Dr. Woolridge in that regard?

A. The Moody's article makes clear that utilities' cash flow have benefited from increased deferred taxes, which are due to bonus depreciation. As Moody's noted, the rise in deferred taxes eventually will reverse.[23] That may be one reason that the Moody's study refers to "near-term credit profiles"; in the longer-term, utilities will not have the benefits of bonus depreciation to offset lower authorized returns.

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20 *See*, Direct Testimony of J. Randall Woolridge, Exhibit JRW-11, at 5-6 and Morningstar, Inc., 2015 Classic Yearbook, at 157.

21 Direct Testimony of J. Randall Woolridge, at 66.

22 *Ibid.*

23 Moody's Investors Service, *Lower Authorized Returns Will Not Hurt Near-Term Credit Profiles*, March 10, 2015, at 4.

Moody's also observed that although interest rates remain at relatively low levels, they "will go up, eventually." When they do, Moody's warns, "this could spell trouble for utilities." Moody's concludes, "[f]or now, utilities can enjoy their (historically) high equity valuations in terms of dividend yield and price-earnings ratios."[24] That is, in March 2015, Moody's observed that the then-current valuations were unusual, and that some degree of reversion toward long-term means was likely. For the electric utility sector, that was the case, as the S&P Electric Utility Index P/E ratio fell from 18.09 on February 1, 2015 to 15.40 on July 1, 2015.[25] That observation is consistent with a point made earlier in my Rebuttal Testimony: unusually high P/E ratios are unlikely to persist and, therefore, Dr. Woolridge's approach of giving primary weight to his Constant Growth DCF estimates should be viewed with considerable caution.

Dr. Woolridge further argues that the Moody's article supports the notion that elevated P/E ratios are a result of cost recovery mechanisms reducing utilities' risk.[26] As a preliminary matter, neither the article nor Dr. Woolridge provides any evidence or analysis to support the basis for the claim that cost recovery mechanisms have led to higher P/E multiples. To be clear, Moody's does not state that the cause of higher P/E multiples is cost recovery mechanisms. As stated in my Direct Testimony, the Federal Reserve's monetary policy actions intentionally lowered long-term interest rates (another of the factors cited in the

[24] Moody's Investors Service, *Lower Authorized Returns Will Not Hurt Near-Term Credit Profiles*, March 10, 2015, at 5.

[25] Source: Bloomberg Professional. Represents 30-day moving average.

[26] Direct Testimony of J. Randall Woolridge, at 75-76.

Moody's article) and have affected utility P/E ratios.[27] In any case, as noted above, electric utility P/E ratios declined by nearly 15.00 percent shortly after the Moody's article was published.

Nonetheless, if Dr. Woolridge is concerned that recovery mechanisms have supported, and will continue to support, elevated P/E ratios, one method of addressing that position is to assume that the terminal value in the Multi-Stage DCF analysis is calculated on the basis of current P/E ratios. As discussed later in my Rebuttal Testimony, I therefore included the current 30-day average proxy group P/E ratio in the updated Multi-Stage DCF results.[28]

Q. Do you have any concerns with Dr. Woolridge's belief that analysts' projections are consistently biased?

A. Yes, I do. Dr. Woolridge asserts that there is an upward bias in analysts' growth estimates and as such, "the DCF growth rate needs to be adjusted downward from the projected EPS growth rate."[29] Dr. Woolridge argues that analysts' earnings growth estimates are "overly optimistic and upwardly biased," and that relying on such estimates is a methodological error.[30] His position, however, is based on observations with respect to the broad market; Dr. Woolridge has provided no evidence that any of the growth rates used in our respective DCF analyses are the result of a consistent and pervasive bias on the part of the analysts providing those

27 Direct Testimony of Robert B. Hevert, at 55.
28 Exhibit RBH-14.
29 Direct Testimony of J. Randall Woolridge, at 50.
30 *Ibid.*, at 49.

projections. Despite his view that they are biased, Dr. Woolridge states that it was by "giving primary weight to the projected EPS growth rate of Wall Street analysts" that he arrived at his assumed growth rates.[31]

Q. What is your response to Dr. Woolridge in that regard?

A. There is no reason to believe that the analyst growth rates used in our respective DCF analyses are biased. As a practical matter, the October 2003 Global Research Analyst Settlement required financial institutions to insulate investment banking from analysis, prohibited analysts from participating in "road shows," and required the settling financial institutions to fund independent third-party research.[32] I have reviewed the Letters of Acceptance, Waiver and Consent signed by financial institutions that were party to the Global Settlement, and found no reference to misconduct by analysts following the utility sector.

Pursuant to Regulation AC, which became effective in April 2003, analysts must certify that "…the views expressed in the report accurately reflect his or her personal views, and disclose whether or not the analyst received compensation or other payments in connection with his or her specific recommendations or views."[33] I understand that industry practice is to avoid conflicts of interest by ensuring that compensation is not directly or indirectly linked to the opinions

[31] *Ibid.*, at 52.

[32] The 2002 Global Financial Settlement resolved an investigation by the U.S. Securities and Exchange Commission and the New York Attorney General's Office of a number of investment banks related to concerns about conflicts of interest that might influence the independence of investment research provided by equity analysts.

[33] Securities and Exchange Commission, 17 CFR PART 242 [Release Nos. 33-8193; 34-47384; File No. S7-30-02], RIN 3235-AI60 Regulation Analyst Certification.

contained in those reports. Dr. Woolridge has not explained why any of the analysts covering our respective proxy companies would bias their projections in light of those certification requirements, or why investors would be more inclined to rely on his growth rate estimates than those of the analysts that base their projections on fundamental company-specific research.

Q. Is the use of analysts' earnings growth projections in the DCF model supported by financial literature?

A. Yes, it is. The relationship between various growth rates and stock valuation metrics has been the subject of much academic research.[34] As noted over 40 years ago by Charles Phillips in The Economics of Regulation:

> For many years, it was thought that investors bought utility stocks largely on the basis of dividends. More recently, however, studies indicate that the market is valuing utility stocks with reference to total per share earnings, so that the earnings-price ratio has assumed increased emphasis in rate cases.[35]

Subsequent academic research has clearly and consistently indicated that measures of earnings and cash flow are strongly related to returns, and that analysts' forecasts of growth are superior to other measures of growth in predicting stock prices.[36] For example, Vander Weide and Carleton state that, "[our] results … are consistent with the hypothesis that investors use analysts' forecasts, rather than historically oriented growth calculations, in making stock

[34] *See*, Harris, Robert, Using Analysts' Growth Forecasts to Estimate Shareholder Required Rate of Return, Financial Management (Spring 1986).

[35] Charles F. Phillips, Jr., The Economics of Regulation, at 285 (Rev. ed. 1969).

[36] *See*, *e.g.*, Christofi, Christofi, Lori and Moliver, Evaluating Common Stocks Using Value Line's Projected Cash Flows and Implied Growth Rate, Journal of Investing (Spring 1999); Harris and Marston, Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts, Financial Management, 21 (Summer 1992); and Vander Weide and Carleton, Investor Growth Expectations: Analysts vs. History, The Journal of Portfolio Management (Spring 1988).

buy-and-sell decisions."[37] Other research specifically notes the importance of analysts' growth estimates in determining the Cost of Equity, and in the valuation of equity securities. Dr. Robert Harris noted that "a growing body of knowledge shows that analysts' earnings forecast are indeed reflected in stock prices."[38] Citing Cragg and Malkiel, Dr. Harris notes that those authors "found that the evaluations of companies that analysts make are the sorts of ones on which market valuation is based."[39] Similarly, Brigham, Shome, and Vinson noted that "evidence in the current literature indicates that (i) analysts' forecasts are superior to forecasts based solely on time series data; and (ii) investors do rely on analysts' forecasts."[40]

In addition to the studies presented above, there have been other peer reviewed, published articles that specifically support the use of analysts' earnings growth projections in the DCF model.[41]

37 Vander Weide and Carleton, Investor Growth Expectations: Analysts vs. History, The Journal of Portfolio Management (Spring 1988).

38 Robert S. Harris, Using Analysts' Growth Forecasts to Estimate Shareholder Required Rate of Return, Financial Management (Spring 1986).

39 Robert S. Harris, Using Analysts' Growth Forecasts to Estimate Shareholder Required Rate of Return, Financial Management (Spring 1986).

40 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).

41 *See*, for example, Robert S. Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rates of Return*, Financial Management, 1986; Robert S. Harris, Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Financial Management, Summer 1992, at 63; and Advanced Research Center, *Investor Growth Expectations*, Summer, 2004.

Q. Do you agree with Dr. Woolridge's assertion that "the DCF growth rate needs to be adjusted downward from the projected EPS growth rate to reflect the upward bias"? [42]

A. No, I do not. First, if current stock prices (and therefore the dividend yield) already reflect analysts' bias, it is unclear why it is necessary to adjust the growth rate. In addition, although Dr. Woolridge asserts that "…long-term EPS growth rate forecasts of Wall Street securities analysts are overly optimistic and upwardly biased"[43] in general, he has not demonstrated that to be true for the electric companies in our proxy groups, in particular. To that point, I reviewed quarterly earnings presentations for several of the companies in Dr. Woolridge's proxy group and found that if anything, the analysts' growth rate projections were toward the lower end of the long-term growth rate ranges provided by the companies' management teams (*see* Table 2, below). I therefore disagree that the earnings projections included in our respective analyses are likely to be systemically biased.

[42] Direct Testimony of J. Randall Woolridge, at 50.
[43] *Ibid.*, at 76-77.

Table 2: Analysts' Earnings Growth Projections Relative to Management Presentations[44]

Company	Ticker	Zacks Earnings Growth	First Call Earnings Growth	Value Line Earnings Growth	Investor Presentation Earnings Growth
Alliant Energy Corporation	LNT	6.10%	6.60%	6.00%	5.00% - 7.00%
Ameren Corporation	AEE	6.10%	5.20%	6.00%	5.00% - 8.00%
American Electric Power Company, Inc.	AEP	4.90%	4.10%	4.00%	4.00% - 6.00%
Avista Corporation	AVA	5.00%	5.00%	5.00%	4.00% - 5.00%
CMS Energy Corporation	CMS	6.40%	7.24%	6.00%	6.00% - 8.00%
Eversource Energy	ES	6.30%	5.49%	6.00%	5.00% - 7.00%
PNM Resources, Inc.	PNM	7.60%	8.76%	9.00%	7.00% - 9.00%
SCANA Corporation	SCG	5.30%	5.40%	4.50%	4.00% - 6.00%
Xcel Energy Inc.	XEL	5.30%	5.27%	5.50%	4.00% - 6.00%

Q. Do you agree with Dr. Woolridge that dividend and book value growth rates are appropriate measures of expected growth for the Constant Growth DCF model?[45]

A. No, I do not. Earnings growth is the fundamental driver of the ability to pay dividends. As noted in my Direct Testimony, to reduce growth to a single measure we assume a fixed payout ratio, and a constant growth rate for EPS, DPS, and BVPS.[46] Exhibit RBH-21 illustrates that under the strict assumptions of the Constant Growth DCF model, earnings, dividends, book value, and stock

[44] Source: Zacks, Yahoo Finance, Value Line, and individual company first quarter 2016 earnings presentations and investor presentations. *See*, also, Anup Agrawal and Mark A. Chen, *Do Analysts Conflicts Matter? Evidence from Stock Recommendations*, Journal of Law and Economics, August 2008, at 503-537.

[45] *See*, Direct Testimony of J. Randall Woolridge, at 45.

[46] *See* Direct Testimony of Robert B. Hevert, at 27-28.

prices all grow at the same, constant rate in perpetuity. Because earnings are the fundamental driver of dividends, and knowing that investors tend to value common equity on the basis of Price/Earnings ratios, the Cost of Equity is a function of the expected growth in earnings, not dividends. That is, earnings growth enables both dividend and book value growth. Book value can increase over time only through the addition of retained earnings, or with the issuance of new equity. Both of those factors are derivative of earnings: retained earnings increases with the amount of earnings not distributed as dividends; and the price at which new equity is issued is a function of the EPS and the then-current P/E ratio. Similarly, earnings are the fundamental driver of a company's ability to pay dividends.[47]

In addition, Value Line is the only service on which Dr. Woolridge relies that provides DPS, BVPS, or sustainable growth projections. To the extent that the earnings projections services such as Zacks and First Call represent consensus estimates, the results are less likely to be skewed in one direction or another as a result of an individual analyst.

[47] *See*, Direct Testimony of Robert B. Hevert, at 27-28; and Jing Liu, Doron Nissim, and Jacob Thomas, *Is Cash Flow King in Valuations?*, Financial Analysts Journal, Volume 63, Number 2, 2007.

Q. Do you agree with Dr. Woolridge that historical growth rates are appropriate measures of expected growth for the Constant Growth DCF model?[48]

A. No, I do not. The growth component of the Constant Growth DCF model is a *forward-looking* measure. To the extent historical growth influences investors' expectations of future growth, it already will be reflected in analysts' consensus earnings estimates. Carleton and Vander Weide, for example, found "overwhelming evidence that consensus analysts' forecast of future growth is superior to historically oriented growth measures in predicting the firm's stock price."[49] Consequently, I do not believe that historical growth rates are appropriate for the Constant Growth DCF model.

Q. Have you conducted any analyses to determine which measures of growth are statistically related to the proxy companies' stock valuation levels?

A. Yes, I have. My analysis is based on the methodological approach used by Professors Carleton and Vander Weide, who compared the predictive capability of historical growth estimates and analysts' forecasts on the valuation levels of sixty-five utility companies.[50] I structured the analysis to assess whether earnings, dividend, book value, or sustainable growth rates best explain utility stock valuations. In particular, my analysis examined the statistical relationship between the P/E ratios of the companies included in Dr. Woolridge's proxy group,

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48 *See*, Direct Testimony of J. Randall Woolridge, at 45.

49 Vander Weide and Carleton, Investor Growth Expectations: Analysts vs. History, The Journal of Portfolio Management (Spring 1988).

50 James H. Vander Weide and Willard T. Carleton, *Investor Growth Expectations: Analysts vs. history*, The Journal of Portfolio Management, Spring 1988.

and the projected EPS, DPS, and BVPS reported by Value Line, and sustainable growth rate calculated using Value Line data. To determine which, if any, of those growth rates are statistically related to utility stock valuations, I performed a series of regression analyses in which the projected growth rates were explanatory variables and the P/E ratio was the dependent variable. The results of those analyses are presented in Table 3, below.

Table 3: Regression Results- Price to Earnings and Growth Rates[51]

	Intercept	Coefficient	Standard Error	T-Statistic	F-Statistic
Scenario 1- Projected EPS	13.736	34.462	15.108	2.281	5.203
Scenario 2- Projected DPS	16.778	-21.296	14.886	-1.431	2.047
Scenario 3- Projected BVPS	14.629	22.832	39.329	0.581	0.337
Scenario 4- BR+SV Sustainable Growth	15.138	11.442	40.453	0.283	0.080
Scenario 5- Projected EPS Projected DPS Projected BVPS BR+SV Sustainable Growth	15.283	41.198 -26.857 37.759 -50.037	17.400 14.974 42.387 44.299	2.368 -1.794 0.891 -1.130	2.454

In the first set of analyses (Scenarios 1-4), I considered each growth rate separately (*i.e.*, I performed four separate regressions with P/E as the dependent variable and projected EPS, DPS, BVPS and the sustainable growth rate, respectively, as the independent variable). I also performed a single regression analysis that included all five variables as potential explanatory variables

[51] *See*, Exhibit RBH-22.

(Scenario 5). I then reviewed the T- and F-Statistics to determine whether the variables and equations were statistically significant.[52]

Q. What did those analyses reveal?

A. The only growth rate that was statistically significant was Earnings Per Share. Because the DCF Model assumes that the current market value is a function of expected growth and, given that EPS growth is the only growth rate that is statistically related to electric utility valuation, earnings, not dividends or book value, is the proper measure of growth in the Constant Growth DCF Model.

Q. Is it possible to replicate Dr. Woolridge's DCF analysis?

A. No. As noted above, Dr. Woolridge's analysis is based on his personal view as to what constitutes a reasonable long-term growth rate. Because different analysts may well come to different conclusions based on their review of his growth rate data, we cannot replicate Dr. Woolridge's analyses.

Q. Do you have any concerns with the projected analysts' EPS growth rates relied on by Dr. Woolridge?

A. Yes. In determining his projected analysts' EPS growth rate, Dr. Woolridge includes negative growth projections. In doing so, Dr. Woolridge has implicitly assumed that investors would consider committing capital to a company that is expected to have negative growth, in perpetuity. As Exhibit RBH-23 demonstrates, eliminating negative growth rates from Dr. Woolridge's DCF

[52] In general, a T-Statistic of 2.00 or greater indicates that the variable is likely to be different than zero, or "statistically significant." The F-Statistic is used to determine whether the model as a whole has statistically significant predictive capability.

analysis increases the mean projected EPS growth rate by 52 basis points. However, given that Dr. Woolridge's 4.88 percent growth rate is based on his personal judgment, it is difficult to say how removing negative growth rates would affect his analyses and recommendation.

C. Application of Multi-Stage DCF Approach

Q. Please briefly summarize Dr. Woolridge's observations regarding your Multi-Stage DCF analysis.

A. First, Dr. Woolridge does not appear to disagree with the structure of the model itself. For example, in his Exhibit JRW-9, page 1 of 2, Dr. Woolridge describes the "dividend discount model", which takes the same structure as my Multi-Stage DCF model. At page 41 of his Testimony, Dr. Woolridge explains that in the second, or "Transition" stage, the dividend payout ratio increases because there are fewer investment opportunities. The assumption of increasing payout ratios as capital investments decline also is consistent with my Multi-Stage analysis. Although the dividend discount model is consistent in structure with my model, Dr. Woolridge argues that the terminal growth rate (that is, the long-term growth rate in the third, or "terminal period") applied in my model is overstated.[53]

Q. Before responding to those points, please describe the Multi-Stage DCF model, and explain how the terminal growth rate is derived and applied.

A. As discussed in my Direct Testimony, the Multi-Stage DCF model enables analysts to model growth in three stages, rather than a single growth rate in

[53] *See*, Direct Testimony of J. Randall Woolridge, at 77-82.

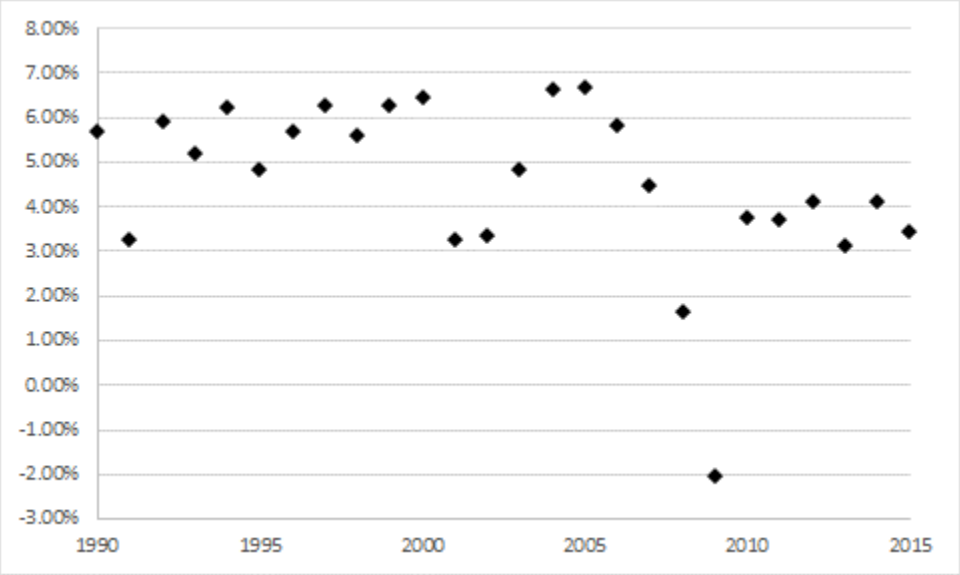
perpetuity (as the Constant Growth DCF model assumes).[54] The terminal, or third stage growth rate, represents investors' expectations for long-term (that is, perpetual) growth beginning in the third stage. Because the model assumes five-year periods for the first and second stage, the terminal stage (and, therefore, the terminal growth rate) begins in the eleventh year.

Q. What is the basis of Dr. Woolridge's concern with your assumed long-term growth rate based on expected GDP growth?

A. Dr. Woolridge states that "nominal GDP growth in recent decades has slowed and that a figure in the range of 4.0% to 5.0% is more appropriate today for the U.S. economy."[55] To support his position, Dr. Woolridge reviews average nominal GDP growth over periods of ten to 50 years, and concludes, "economic growth in the U.S. has slowed considerably in recent decades."[56] As shown on Chart 1 (below), however, since 1990 (*i.e.*, in "recent decades") the annual nominal growth rate in GDP has remained relatively stable, but for the period 2008 to 2012, which included the recent recession. Over that time, annual nominal GDP growth rates greater than 5.00 percent (the high end of Dr. Woolridge's suggested range) occurred in twelve of 26 years; growth rates of at least 5.35 percent occurred in eleven of 26 years.

54 *See*, Direct Testimony of Robert B. Hevert, at 31-32.
55 Direct Testimony of J. Randall Woolridge, at 80.
56 *Ibid.*, at 79.

Chart 1: Annual Nominal GDP Growth Rates[57]



Moreover, historical nominal GDP growth rates since 1960 reflect periods of differing inflation rates. For example, the real GDP growth rates in 1980 and 2008 were nearly identical at negative 0.24 percent and negative 0.29 percent, respectively. On a nominal basis, however, the growth rates were vastly different, at 8.75 percent and 1.66 percent. Knowing that inflation was significantly higher in the 1970s and early 1980s than it was in 2008, it is not surprising that nominal GDP rates are lower when viewed within the context of shorter term averages (*i.e.*, over the last ten or twenty years as Dr. Woolridge has done).

In addition, as shown in Table 4 (below), the recent economic downturn has had a significant effect on the real GDP growth rate calculated over shorter periods.

[57] Source: Bureau of Economic Analysis, June 28, 2016 update.

Table 4: Average Real GDP Growth Rates[58]

Average Length	As Of 2015	As Of 2007
10-Year Average	1.41%	3.04%
20-Year Average	2.41%	3.07%
30-Year Average	2.60%	3.12%
40-Year Average	2.83%	3.14%
50-Year Average	2.89%	3.38%

As Table 4 demonstrates, prior to the recent recession the difference between the average GDP growth rates measured over varying time periods was minimal. Subsequent to the recession the differences have been quite large. Because I apply the long-term growth rate beginning ten years in the future, it would be inappropriate to give undue weight to short-term trends in the time series, as Dr. Woolridge suggests.

As to the inflation portion of the expected nominal growth rate, Dr. Woolridge does not seem to disagree with my expected inflation rate of 2.00 percent, as he noted that the current inflation is "in the 2% to 3% range."[59] I also note that on page 85 of Dr. Woolridge's Direct Testimony, he provides the average growth rates (since 1960) for nominal GDP, the S&P 500 Index, the S&P 500 earnings per share, and the S&P 500 dividends per share. The average of those measures is 6.42 percent, which is 107 basis points above the 5.35 percent long-term GDP growth rate estimate included in my Direct Testimony. The 6.42 percent average

[58] Source: Bureau of Economic Analysis, June 28, 2016 update.

[59] Direct Testimony of J. Randall Woolridge, at 87. Note, the expected inflation rate has been updated to 2.02 percent in my Rebuttal Testimony Multi-Stage DCF analysis.

growth rate noted above also is 22 basis points greater than the approximately 6.20 percent long-term nominal GDP growth rate reported by the Bureau of Economic Analysis.[60] I therefore disagree with Dr. Woolridge's view that my assumed terminal growth rates are excessive.

Q. Are there examples in financial literature that support your calculation of the long-term growth rate based on GDP?

A. Yes. The use of expected long-term GDP growth in the terminal period is consistent with practice and financial literature.[61] Morningstar, a source on which Dr. Woolridge relies for Market Risk Premium estimates, describes an approach for calculating the long-term growth estimate that is similar to that which is included in my model.[62] As with my approach, Morningstar's method combines the historical average real GDP growth rate with a measure of inflation calculated using the TIPS spread.[63]

Q. Does Dr. Woolridge provide any other data that supports your terminal growth rate assumption?

A. Yes, Dr. Woolridge cites to certain research to support his view that analysts' earnings estimates are "overly optimistic and upwardly biased,"[64] including a

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60 Source: Bureau of Economic Analysis, June 28, 2016 update. Compound annual return from 1929 – 2015.

61 Dr. Roger Morin, for example, writes "[i]t is useful to remember that eventually all company growth rates, especially utility services growth rates, converge to a level consistent with the growth rate of the aggregate economy." *See*, Roger A. Morin, New Regulatory Finance, Public Utilities Report, Inc., 2006, at 308.

62 *See*, Ibbotson SBBI 2013 Valuation Yearbook, Morningstar, Inc., at 50-52.

63 Implied Expected Nominal GDP = ((1 + Historical Real GDP Growth) x (1 + Implied Forward Inflation)) – 1, or 5.32 percent = ((1 + 3.24 percent) x (1 + 2.02 percent)) - 1.

64 Testimony and Exhibits of J. Randall Woolridge, at 49.

2010 report by McKinsey & Company ("McKinsey").[65] The McKinsey report observes that "…long-term earnings growth for the market as a whole is unlikely to differ significantly from growth in GDP, as prior McKinsey research has shown."[66] In a footnote to that sentence, McKinsey further states that "[r]eal GDP has averaged 3 to 4 percent over past (*sic*) seven or eight decades, which would indeed be consistent with nominal growth of 5 to 7 percent given current inflation of 2 to 3 percent."[67] The McKinsey report therefore supports the terminal growth rate used in my Multi-Stage DCF model based on expected GDP; it represents the combination of historical real GDP growth and expected inflation, and is toward the lower end of the 5.00 percent to 7.00 percent range noted by McKinsey.[68]

Q. What is your response to Dr. Woolridge's reference to GDP forecasts provided by the *Survey of Professional Forecasters*, the Energy Information Administration ("EIA"), and the Congressional Budget Office ("CBO")?[69]

A. In the case of the *Survey of Professional Forecasters*, as Dr. Woolridge points out, it relates to the 2016 to 2026 period. That is, it does not apply to the terminal period, which begins in 2026. As to the CBO and EIA forecast, those projections cover only fifteen years of a perpetual period, and represent forecasts from single

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65 *Equity Analysts: Still too bullish*, McKinsey & Company, McKinsey on Finance, Number 35, Spring 2010.

66 *Ibid.*, at 16-17.

67 *Ibid.*, at 17.

68 Please also note that consistent with the McKinsey approach, the terminal growth rate used in my Multi-Stage DCF model (*see* Exhibit RBH-14) is the product of real GDP growth (3.24 percent) and expected inflation (2.02 percent).

69 *See*, Direct Testimony of J. Randall Woolridge, at 80-81.

entities. As such, I do not agree that those sources invalidate the growth rate used in my analysis.

In addition, the CBO provides updates regarding its forecasting record. In that context, the CBO discusses comparisons to other forecasts, and notes that "[d]espite their value, comparisons of forecasting errors can be misleading when forecasts are made for different purposes."[70] In essence, the CBO notes that comparisons to other forecasts are not always apt, at least in part because they may be based on different assumptions and used for different purposes. Moreover, the CBO states that it is required to assume that future fiscal policy will reflect current law, so that it may "provide a benchmark" against which proposed changes in law may be assessed.[71] Given that purpose and structure, I disagree that the CBO's forecast invalidates the growth rate used in my Multi-Stage DCF analysis.

The CBO also notes that among its two-year forecasts (since the early 1980's), the forecast error for "real output growth" and inflation (measured by the Consumer Price Index) has been 1.40 percentage points, and 0.80 percentage points,

70 *CBO's Economic Forecasting Record: 2015 Update*, February 2015, at 4-5.

71 "In particular, forecasters in the private sector attempt to predict the future stance of federal fiscal policy, and the Administration's forecasts assume the adoption of the fiscal policy reflected in the President's proposed budget. CBO, however, is required to assume that fiscal policy in the future will generally reflect the provisions in current law, an approach that derives from the agency's responsibility to provide a benchmark for lawmakers as they consider proposed changes in law. Forecasting errors may be driven by those different assumptions, particularly when policymakers are considering major changes in the fiscal policy embedded in current law."

respectively.[72] That range of error, if applied to the 4.30 percent long-term CBO forecast noted by Dr. Woolridge, suggests that the 5.35 percent rate applied in my Direct Testimony is within the range of the CBO's projections.[73]

Q. Do you have any other observations regarding Dr. Woolridge's position that you should rely on economists' forecasts of real GDP growth beginning ten years in the future?

A. Yes, I do. Dr. Woolridge is quite critical of economists' projections of interest rates, noting that in hindsight, they often are incorrect.[74] At the same time, he is critical of the fact that I do not rely on economists' real GDP growth rate projections.[75] Putting aside the fact that the Multi-Stage DCF model requires forecasts beginning ten years from now, not as of the present, Dr. Woolridge does not explain why economists' near-term interest rate projections are improper, but their long-term real GDP growth rate projections are sound.

Q. Did you perform any analyses in response to Dr. Woolridge's contention that the currently elevated P/E ratios are expected to continue?

A. In response to Dr. Woolridge's assumption that current P/E ratios will persist in perpetuity, I also have included a series of Multi-Stage DCF analyses that assume

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72 *CBO's Economic Forecasting Record: 2015 Update*, February 2015, at 1.

73 As to the use of expected inflation, I note that the TIPS spread has been affected by low levels of inflation, which likely are affected by recently low oil prices. As noted at page 30 of the Federal Reserve's February 2016 *Monetary Policy Report*, "Inflation is expected to remain low in the near term, in part because of recent further declines in energy prices, but to rise to 2 percent over the medium term as the transitory effects of declines in energy and import prices dissipate and the labor market strengthens further."

74 *See*, Direct Testimony of J. Randall Woolridge, at 16-18.

75 The Philadelphia Federal Reserve publishes the list of economists that provide forecasts with attribution. *See* http://www.frbsf.org/economic-research/publications.

that the current P/E ratio will remain in place by calculating the terminal value in the Multi-Stage DCF analysis on the basis of the Combined Proxy Group's current 30-day average P/E ratio. The results of my Multi-Stage DCF analyses are shown on Table 10 in Section IX (*see also*, Exhibit RBH-14).

D. Application of the CAPM

Q. Please briefly describe Dr. Woolridge's CAPM analysis and results.

A. Dr. Woolridge's CAPM analyses produce an estimated Cost of Equity of 7.90 percent to 8.10 percent.[76] Although Dr. Woolridge relies primarily on his DCF analysis, he also considers his CAPM results in determining what he considers an appropriate range of the Company's Cost of Equity.[77] As with Dr. Woolridge's DCF results, I strongly disagree that a CAPM result of 7.90 percent to 8.10 percent is a reasonable estimate of the Company's ROE. As discussed below, Dr. Woolridge's unduly low CAPM estimates primarily are the result of his estimated Market Risk Premium.

Q. Please describe how Dr. Woolridge calculates his Market Risk Premium estimate.

A. Dr. Woolridge reviews a series of studies that calculate the MRP using different methodologies; he also considers the results of his "Building Blocks" approach.

[76] *See*, Direct Testimony of J. Randall Woolridge, Exhibit JRW-11, at 1.
[77] *See*, Direct Testimony of J. Randall Woolridge, at 63.

Based on those reviews, Dr. Woolridge concludes that the MRP ranges from 4.00 percent to 6.00 percent and, within that range, 5.50 percent is reasonable.[78]

Q. Does Dr. Woolridge express any concerns regarding your CAPM analysis?

A. Dr. Woolridge's principal disagreement with my CAPM analysis involves the Market Risk Premium component of the model. As to my use of expected market returns, Dr. Woolridge states that the result is "inflated due to errors and bias in [my] study."[79] Dr. Woolridge also points to the long-term EPS growth rates for the S&P 500 based on the data from Bloomberg and Value Line, respectively,[80] and notes that they "are not consistent with historic or projected economic and earnings growth."[81] In support of his position that the expected market return included in my CAPM analysis is overstated, Dr. Woolridge cites two surveys: the Duke Chief Financial Officers ("CFO") survey, and the Philadelphia Federal Reserve Survey of Professional Forecasters.[82]

Q. What is your response to Dr. Woolridge on those points?

A. First, by referring to the survey by the Federal Reserve Bank of Philadelphia, Dr. Woolridge suggests that my estimated market return is inconsistent with those used by professional forecasters.[83] On reviewing that survey, I note that only 18 of 40 survey participants responded to the question regarding the expected return

78 *Ibid.*, at 61; Exhibit JRW-11, at 1, 5-6.
79 *Ibid.*, at 88. [Clarification added]
80 *Ibid.*, at 84.
81 *Ibid.*, at 85.
82 *Ibid.*, at 88.
83 *Ibid.*

for the S&P 500 over the next ten years.[84] Similarly, 26 of 40 responded to the question regarding expected return on ten-year Treasury bonds. Because a considerable portion of the survey respondents did not answer those questions, it is difficult to have confidence that the estimates represent the market's expected total return.

Even if all 40 economists provided expected market returns and Treasury yields, as noted earlier Dr. Woolridge gives economists' interest rate projections little weight, going so far as to note that in a Bloomberg survey, "100% of the economists were wrong."[85] Yet, Dr. Woolridge gives economists' forecasts of market returns and interest rates considerable weight in supporting his expected Market Risk Premium.

As to the Duke CFO survey, Dr. Woolridge's 8.75 percent ROE recommendation, which applies to a company that is less risky than the overall market,[86] is 245 basis points above the expected market return suggested by the survey results. If the survey were a reasonable method of determining the expected market return, Dr. Woolridge's ROE recommendation would be no higher than 6.30 percent.[87] Moreover, as shown in Table 5 below, the survey respondents have provided estimates that, on average, significantly underestimated actual market returns.

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84 *See*, Federal Reserve Bank of Philadelphia, Survey of Professional Forecasters, First Quarter of 2016, at 17.

85 Direct Testimony of J. Randall Woolridge, at 16. [emphasis included]

86 Dr. Woolridge and I agree that Beta coefficients for our proxy companies are less than 1.0.

87 6.30 percent equals the expected market return suggested by the Duke CFO survey.

Table 5: S&P 500 Market Return: Accuracy of Survey Estimates[88]

	Actual	Graham Harvey Estimate
2015	1.38%	6.07%
2014	13.69%	5.00%
2013	32.39%	3.40%
2012	16.00%	4.00%
2011	2.11%	5.30%
2010	15.06%	6.28%
Average	13.44%	5.01%

Further, the Duke CFO Survey authors have noted a distinction between the expected market return on one hand, and the hurdle rate on the other. In prior surveys, the hurdle rate was significantly higher than the expected market return. For example, the authors' survey showed that the reported average hurdle rate, which is the return required for capital investments, was above 13.00 percent.[89] The author further reported that the Weighted Average Cost of Capital ("WACC") exceeded the expected market return, even though the WACC includes the cost of debt. For example, in 2012 the reported WACC was 9.30 percent even though the expected market return was 6.00 percent.[90] Dr. Woolridge's reference to the 4.55 percent expected Market Risk Premium, which relies on the survey's expected market return, therefore should be given little weight.

88 Source: Morningstar, Inc., 2016 SBBI Appendix A, at 3-5, 21-23; http://www.cfosurvey.org (1-year return estimates as of fourth quarter of the previous year).

89 Graham, John R. and Harvey, Campbell R, *The Equity Risk Premium* in 2015 (June 25, 2015), at 8, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2611793. At page 9, the authors note that hurdle rates are "used for actual investment decisions."

90 Duke/CFO Magazine Global Business Outlook survey – U.S., Second Quarter 2012 at 139, 159.

Q. Do any of the authors cited in Woolridge's Equity Risk Premium survey provide support for your approach to estimating the current MRP?

A. Yes. A study by Pablo Fernandez titled "Market Risk Premium used in 71 countries in 2016: a survey with 6,932 answers" discusses how the required Equity Risk Premium is commonly calculated using a Constant Growth DCF approach.[91] That study states:

> [t]he [implied equity premium] is the implicit [required equity premium] used in the valuation of a stock (or market index) that matches the current market price. The most widely used model to calculate the [implied equity premium] is the dividend discount model: the current price (P0) is the present value of expected dividends discounted at the required rate of return (Ke). If d1 is the dividend per share expected to be received in year 1, and g the expected long term growth rate in dividends per share:
>
> $P_0 = d_1 / (Ke - g)$, which implies:
>
> [implied equity premium] = $d_1/P_0 + g - R_f$[92]

As discussed in my Direct Testimony, I calculated the *ex-ante* MRP in a similar manner using a market capitalization weighted Constant Growth DCF calculation on the individual companies in the S&P 500 Index.

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[91] Dr. Woolridge cites Pablo Fernandez's research; *see* Direct Testimony of J. Randall Woolridge, Exhibit JRW-11, at 5.

[92] Pablo Fernandez, Alberto Ortiz, and Isabel Fernandez Acín, *Market Risk Premium used in 71 countries in 2016: a survey with 6,932 answers*, IESE Business School, at 10.

Q. Do you have any other observations regarding Dr. Woolridge's Equity Risk Premium estimates?

A. Yes. Many of Dr. Woolridge's Equity Risk Premium estimates assume market returns nearly equal to, or below the Company's required return and as such, do not make either theoretical or practical sense. For example, Exhibit JRW-11, page 5 of 6 indicates that the average estimated Equity Risk Premium over all the articles included in the survey is 4.64 percent. Combining that estimate with Dr. Woolridge's 4.00 percent estimated Risk-Free Rate (Exhibit JRW-11, page 1 of 6) produces an estimated market return of 8.64 percent, which is 11 basis points below Dr. Woolridge's 8.75 percent recommendation.

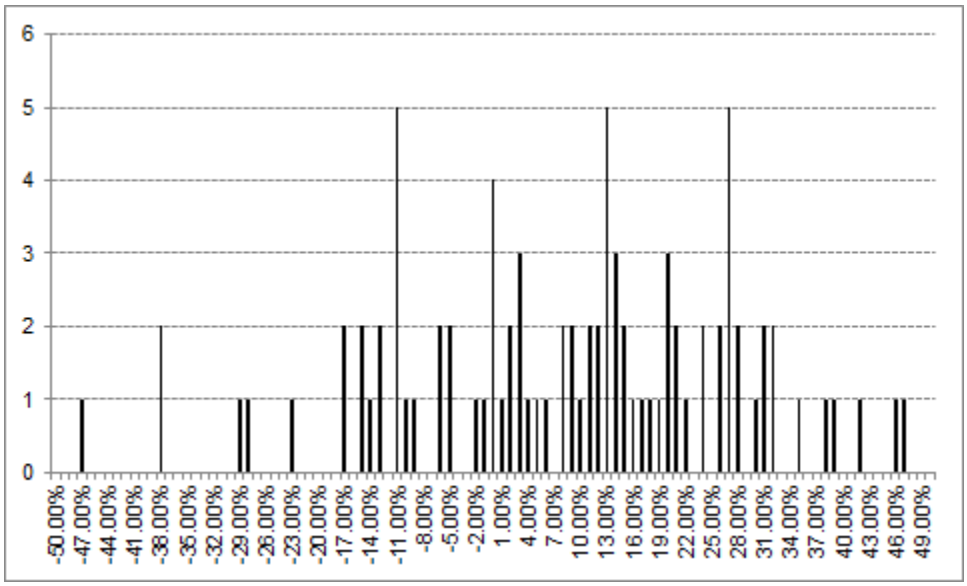
Dr. Woolridge observes that "…a regulated public utility is less risky than the market," and should have a Beta coefficient less than 1.0.[93] Because his implied 8.64 percent market return is below his 8.75 percent ROE recommendation, its relevance to investors' actual required returns is questionable. Even focusing on studies from the 2010 to 2015 period (Exhibit JRW-11, page 6 of 6), the expected market return would be approximately 8.92 percent, which is only 17 basis points above Dr. Woolridge's 8.75 recommendation for FPL. Because such important elements of his CAPM analyses contradict each other, Dr. Woolridge's CAPM results are not reliable.

[93] Direct Testimony of J. Randall Woolridge, at 56.

Q. Turning to Dr. Woolridge's position that the EPS growth rates used to develop your estimated market return are too high, did you consider where your estimates fall within the range of historical observations?

A. Yes, I gathered the annual capital appreciation return on Large Company Stocks reported by Morningstar for the years 1926 through 2015, produced a histogram of those observations, and calculated the probability that a given capital appreciation return estimate would be observed. The results of that analysis, which are presented in Chart 2 (below), demonstrate that capital appreciation rates of 9.87 percent to 10.68 percent and higher actually occurred quite often.[94]

Chart 2: Frequency Distribution of Observed Capital Appreciation Rates 1926 – 2015[95]



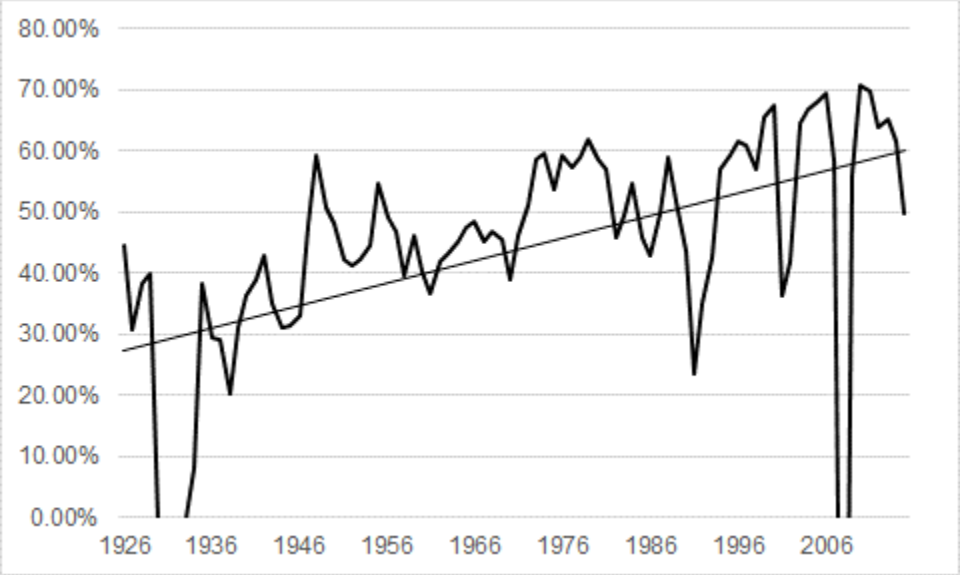
[94] Under the Constant Growth DCF model's assumptions, the growth rate equals the rate of capital appreciation.

[95] Source: Morningstar, Inc., 2016 Morningstar Stocks, Bonds, Bills and Inflation, Table A-3.

In fact, the growth rates Dr. Woolridge asserts are "overstated" by historical standards represent approximately the 49th to 51st percentile of the actual capital appreciation rates observed from 1926 to 2015.

Lastly, under the sustainable growth model, if the retention ratio is higher now than it historically has been, there would be reason to believe that expected growth rates would be higher than historical growth rates. To determine whether that has been the case, I calculated the annual retention ratio from 1926 to 2015 using earnings and dividends data published by Dr. Robert J. Shiller. As shown in Chart 3 (below), that data indicates the S&P 500 earnings retention has trended upward over time, and is currently well above its historical average. Consequently, the sustainable growth model included in Dr. Woolridge's DCF analysis suggests that the future growth of the S&P 500 could outpace its historical growth.

Chart 3: S&P 500 Annual Earnings Retention Ratio, 1926 - 2015[96]



E. Bond Yield Plus Risk Premium Analysis

Q. Please summarize Dr. Woolridge's response to your Bond Yield Plus Risk Premium analysis.

A. Dr. Woolridge believes that the Risk Premium derived from the analysis is "inflated" and "is a gauge of *commission* behavior and not *investor* behavior."[97] Dr. Woolridge further observes that my Risk Premium approach and results "reflect other factors used by utility commissions in authorizing ROEs in addition to capital costs."[98] In particular, Dr. Woolridge points to a potential discrepancy between settled and litigated cases.[99] In addition, Dr. Woolridge reasons that the analysis overstates the actual ROE, because the estimated risk premium is based

96 Source: http://www.econ.yale.edu/~shiller/data.htm.
97 Direct Testimony of J. Randall Woolridge, at 90. [emphasis included]
98 *Ibid.*, at 14.
99 *Ibid.*

on historical Treasury yields, whereas the model is applied to current and expected yields.[100]

Q. What is your response to Dr. Woolridge's position that the Risk Premium analysis is a study of utility commissions' behavior, rather than investor behavior?

A. Those cases, and their associated decisions, reflect the same type of market-based analyses at issue in this proceeding. Moreover, given that authorized returns are publicly available, it is difficult to imagine that such data is not reflected, at least to some degree, in investors' return expectations and requirements (American Electric Power, one of Dr. Woolridge's proxy companies, discloses authorized returns, by jurisdiction, in its 2015 SEC Form 10-K). Consequently, it is reasonable to assume that authorized returns are a reasonable (although not the only) measure of investor-required returns.

Q. What is your response to Dr. Woolridge's statement that your analysis applies an historical risk premium to projected rates and as such, overstates the Cost of Equity?[101]

A. I applied both historical and projected interest rates to the regression coefficients developed in my Risk Premium analysis, not to an average historical risk premium. As discussed in my Direct Testimony, the regression coefficients specifically recognize that as interest rates increase the Equity Risk Premium

100 *Ibid.*

101 Direct Testimony of J. Randall Woolridge, at 89-91.

decreases.[102] A consequence of that relationship is that interest rates and the Cost of Equity generally move in the same direction, although not on a one-to-one basis. As projected interest rates increase, the Cost of Equity also will increase, but not to the same degree. Dr. Woolridge's concern that I have applied projected interest rates to an historical risk premium is misplaced in that (1) my analysis does not rely on an historical risk premium; and (2) because the estimated risk premium does not increase in lock step with interest rates, the resulting ROE estimate does not overstate the Cost of Equity.

Q. What is your response to Dr. Woolridge's position that your Risk Premium analysis must take into consideration the specific aspects of this proceeding relative to all others?[103]

A. First, every case has its unique set of issues and circumstances; there is no disagreement on that point. Looking at over 1,000 cases over many economic cycles, and using that data to quantify the relationship between the Equity Risk Premium and interest rates, mitigates that concern. I do agree, however, that the Risk Premium model results should be considered an industry average ROE estimate. To the extent FPL equity investors face incremental risks, its ROE should be adjusted.

102 *See*, Direct Testimony of Robert B. Hevert, Exhibit RBH-3.
103 Direct Testimony of J. Randall Woolridge, at 90-91.

Q. Do you believe that it is a concern, as Dr. Woolridge states, to include both fully litigated and settled rate cases in your Risk Premium analysis?[104]

A. No, I do not. Of the rate cases in my Risk Premium analysis, 373 were settled and 1,102 were fully litigated. More recently (from 2012 through June 2016), 75 cases were litigated and 84 were settled. The difference in average authorized returns between the two, however, was only three basis points. Equally importantly, and as illustrated on Exhibit RBH-24, the same inverse relationship between interest rates and the Equity Risk Premium is present whether the analysis includes fully litigated rate cases, settled rate cases, or both. I therefore disagree with Dr. Woolridge's concern that the distinction between settled and litigated cases is meaningful.

Q. Are authorized returns in other jurisdictions a relevant benchmark in assessing the reasonableness of ROE estimates and recommendations?

A. Yes, they are. It is important to recognize that in establishing their return requirements, investors consider a broad range of data, including returns authorized in other jurisdictions. Equity investors have many options available to them, and allocate their capital based on the expected risks and returns associated with those alternatives. Given that investors consider such data in framing their investment decisions, return recommendations that materially depart from observed industry norms – such as such as Dr. Woolridge's 8.75 percent recommendation – should be supported by clear and unambiguous reasons.

[104] *Ibid.*

I also disagree with Dr. Woolridge's position that authorized returns are not meaningful because they are measures of "commission behavior" as opposed to measures of investors' return expectations.[105] There is no reason to believe that other regulatory commissions do not consider the same type of market-related factors at issue in this proceeding. Nor is there reason to assume that investors dismiss authorized returns in establishing their return expectations. Rather, the fact that companies such as American Electric Power – one of Dr. Woolridge's proxy companies – report authorized returns in their annual Securities Exchange Commission Form 10-K indicates that they are quite relevant to investors.

The implications of not reconciling his ROE recommendation with authorized returns are particularly acute given that Dr. Woolridge's conclusion is based principally on his application of a single model for which his inputs are quite subjective, his results cannot be replicated, and whose underlying assumptions are incompatible with prevailing market conditions.

Q. What is your response to Dr. Woolridge's statement that the current norm is for utility commissions to authorize ROEs below 10.00 percent?

A. First, from January 2014 through June 2016, utility commissions have authorized ROEs of 10.00 percent or higher for 12 vertically integrated electric utilities. None, however, has authorized a return as low as 8.75 percent.[106] Second, although Dr. Woolridge acknowledges that his recommendation is "below the

[105] Direct Testimony of J. Randall Woolridge, at 90.
[106] Source: SNL Financial, excluding formula-based rate plans and limited issue riders.

average authorized ROEs for electric companies,"[107] the lowest authorized ROE for a vertically integrated electric utility since January 2014 was 55 basis points *above* Dr. Woolridge's 8.75 percent recommendation. Here again, Dr. Woolridge's conclusions are incompatible with observable market data.

F. Market-To-Book Ratios and the Cost of Equity

Q. Please briefly summarize Dr. Woolridge's position regarding the relationship between Market/Book ratios and the Cost of Equity.

A. Dr. Woolridge suggests that M/B ratios in excess of unity indicate that the subject company's earned Return on Equity exceeds its Cost of Equity.[108] In support of that position, Dr. Woolridge provides a series of three regression analyses reflecting the relationship between the Return on Equity and M/B ratios for electric, natural gas, and water utilities, respectively. Because the Coefficient of Determination (sometimes referred to as the "R^2") ranges from 77.00 percent in the case of electric utilities, to 56.00 percent in the case of natural gas utilities, Dr. Woolridge concludes that "there is a strong positive relationship" between M/B ratios and the ROE for utilities.[109]

Q. What is your response to Dr. Woolridge on those points?

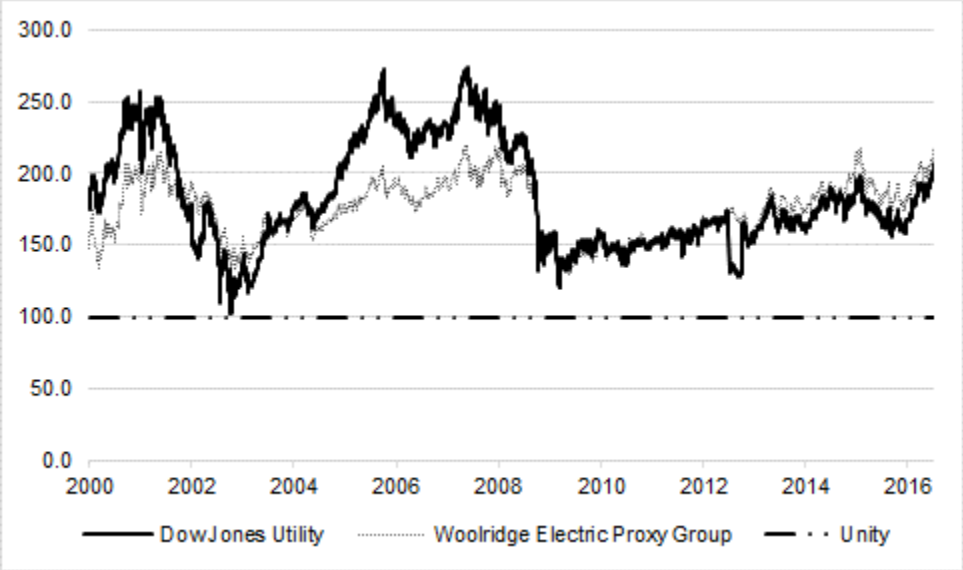
A. First, it is important to note that the M/B ratio equals the market value (or stock price) per share, divided by the total common equity (or the book equity) per share. Book value per share is an accounting construct, which reflects historical

[107] Direct Testimony of J. Randall Woolridge, at 67.
[108] *Ibid*., at 33.
[109] *See*, Direct Testimony of J. Randall Woolridge, at 35 and Exhibit JRW-6. Please note that there were only nine observations for the water group and twelve for the gas company group.

costs. In contrast, market value per share (*i.e.*, the stock price) is forward-looking, and a function of many variables, including (but not limited to) expected earnings and cash flow growth, expected payout ratios, measures of "earnings quality", the regulatory climate, the equity ratio, expected capital expenditures, and the earned return on common equity.[110] As discussed below, because the numerator (market value per share) and the denominator (book value per share) are a function of different variables, M/B ratios over 100.00 percent do not demonstrate that regulatory commissions have consistently authorized returns in excess of the true Cost of Equity. To put the issue in context, the M/B ratio for the companies in the Dow Jones Utility Index, as well as Dr. Woolridge's proxy group have been well in excess of 1.00 since at least 2000 (*see* Chart 4, below).

[110] *See*, for example, Roger A. Morin, New Regulatory Finance, Public Utility Reports, Inc., 2006, at 366. Please note that Dr. Morin cites several academic articles that address the various factors that affect the M/B ratio for utilities. In addition, the notion that book values should be set at a value approaching unity by regulatory commissions has been refuted for many years. As noted by Stewart Myers in 1972: "In short, a straightforward application of the cost of capital to a book value rate base does not automatically imply that market and book values will be equal. This is an obvious but important point. If straightforward approaches did imply equality of market and book values, then there would be no need to estimate the cost of capital. It would suffice to lower (raise) allowed earnings whenever markets were above (below) book." Stewart C. Myers, *The Application of Finance Theory to Public Utility Rate Cases*, The Bell Journal of Economics and Management Science, Vol. 3, No. 1 (Spring 1972), at 76.

Chart 4: Market/Book Ratios Over Time[111]



In the context of rate-setting, the M/B ratio often is discussed relative to the Constant Growth DCF model. Under certain restrictive assumptions, that model can be rewritten to express the M/B ratio as follows:

$$\frac{M}{B} = \frac{ROE - G}{ke - G} \quad \text{Equation [1]}$$

where *ROE* is the return on book equity, k_e is the risk-adjusted discount rate, and *G* is the long-term growth rate in dividends per share. Taking Equation [1] at face value, if M/B exceeds unity, then ROE exceeds k_e. Branch *et al.* point out that M/B is generally greater than or equal to one because the value of the firm as a going concern (price per share) generally exceeds the liquidation value (book value per share) and "…firms having going concern values greater than their

[111] Source: SNL Financial and Bloomberg Professional.

liquidation values (most firms) and firms having finite prices (all firms) should have $ROE > k_e > G$."[112]

Any inferences drawn as to the relationship among M/B, *ROE*, and k_e from Equation [1] rely on the acceptance of all assumptions of the Constant Growth DCF model. Equally important, Equation [1] only can be solved from the Constant Growth DCF model if we further assume: (1) a constant dividend payout ratio in perpetuity; (2) no stock issuances or repurchases; and (3) that the firm is in a steady state, in which the book equity growth rate equals the dividend growth rate. Taken together, those assumptions are quite restrictive, and call into question a definitive linkage between M/B, *ROE*, and k_e.

As Dr. Morin states, it is rarely the case in cost of service-based regulation that M/B ratios equal 1.00:

> The third and perhaps most important reason for caution and skepticism is that application of the DCF model produces estimates of common equity cost that are consistent with investors' expected return only when stock price and book value are reasonably similar, that is, when the M/B is close to unity. As shown below, application of the standard DCF model to utility stocks understates the investor's expected return when the market-to-book (M/B) ratio of a given stock

[112] Ben Branch, Anurag Sharma, Chetan Chawla, and Feng Tu; *An Updated Model of Price-to-Book*, Journal of Applied Finance, November 1, 2014, at 78.

> exceeds unity. This was particularly relevant in the capital market environment of the 1990s and 2000s where utility stocks were trading at M/B ratios well above unity and have been for nearly two decades. The converse is also true, that is, the DCF model overstates the investor's return when the stock's M/B ratio is less than unity. The reason for the distortion is that the DCF market return is applied to a book value rate base by the regulator, that is, a utility's earnings are limited to earnings on a book value rate base. [113]

Because the Constant Growth DCF model traditionally used in rate regulation assumes a M/B of unity, it would understate investors' required return rate when market value exceeds book value. It would do so because investors evaluate and receive their returns on the market value of a utility's equity, whereas regulators authorize returns on book common equity. Consequently, the market-based DCF model will result in a total annual dollar return on book common equity equal to the total annual dollar return expected by investors only when market and book values are equal, a rare and unlikely situation.

In essence, M/B ratios in excess of unity simply means that the firm is worth more as a going concern than the book value of its assets. If Dr. Woolridge is of the view that M/B ratios in excess of unity reflect earned returns in excess of the Cost of Equity, it would follow that he also is of the view that utility commissions have

[113] Roger A. Morin, New Regulatory Finance, Public Utilities Reports, Inc., 2006, at 434. [emphasis added]

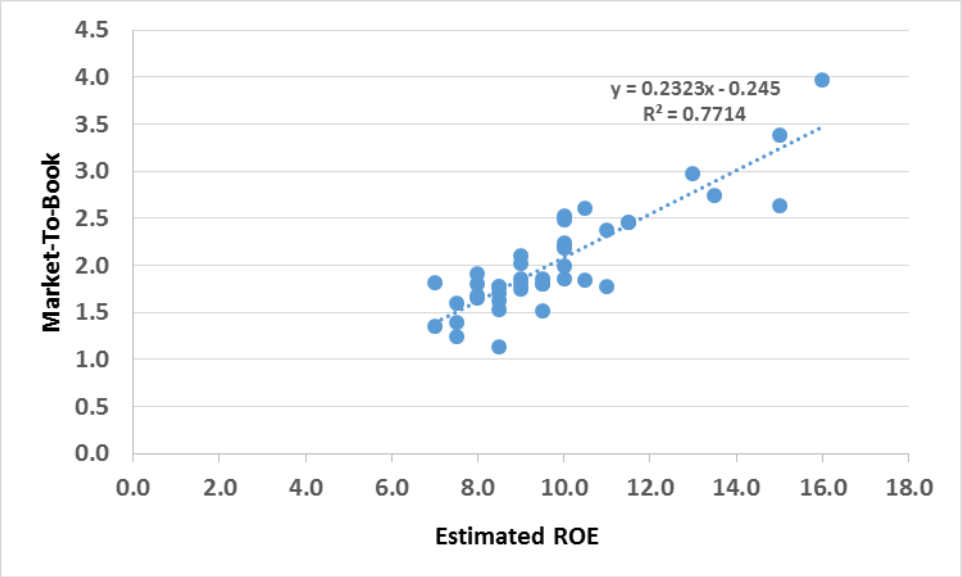
been consistently authorizing returns in excess of the Cost of Equity for at least the last fifteen years. Since Dr. Woolridge does not provide any additional support for his position beyond the general observation that M/B ratios for electric utilities have been greater than 100.00 percent, I disagree with that conclusion.

Lastly, although the earned Return on Equity may be one factor explaining M/B ratios, it is not the only factor. If it were, the regression equations presented in Exhibit JRW-6 would produce reasonable ROE estimates when the M/B ratio equals unity.

Q. In that regard, have you reviewed the ROE and M/B ratio data provided in Exhibit JRW-6?

A. Yes, I have reproduced the chart contained in Exhibit JRW-6, Panel A (Electric Companies), including the regression coefficients, in Chart 5 (below).

Chart 5: Exhibit JRW-6, Panel A, With Regression Coefficients[114]



Based on that data, an M/B ratio of 1.00 is associated with an ROE of 5.36 percent.[115] That estimate is only about 75 basis points above the Company's cost of debt (*i.e.*, 4.62 percent). In other words, for the M/B ratio to equal 1.00, the Cost of Equity would be nearly equal to the cost of debt, a condition that is highly improbable. Dr. Woolridge's own data therefore do not support his theory that ROEs in excess of unity indicate that the subject company's return exceeds investors' required returns.

[114] Source: Value Line. Note that as with Dr. Woolridge's Exhibit JRW-6, Panel A, my analyses include 42 observations and produce an R^2 of approximately 0.77.

[115] 1.00 = -0.245 + (5.36 percent x 0.232).

Q. Have you analyzed whether the actual earned Return on Equity explains the M/B ratios for Dr. Woolridge's proxy group?

A. Yes, I have. Based on data from SNL Financial, I performed a regression analysis in which the M/B ratio was the dependent variable, and the most recent twelve-month Return on Average Common Equity ("ROACE") was the explanatory variable. As shown in Exhibit RBH-25, the R^2 was approximately 48.00 percent (the coefficients and equation were statistically significant). Thus, other factors explain up to 52.00 percent of M/B ratios for Dr. Woolridge's proxy group.[116] Those results support the position that although the earned return on equity is a factor that explains M/B ratios, it is not the only factor. In any case, the regression equation indicates that a M/B ratio of 1.00 is associated with a Return on Common Equity of 2.29 percent; an M/B ratio of 1.10 relates to an ROACE of 3.27 percent. Because those estimates are far below the Company's 4.62 percent cost of debt, I do not agree that M/B ratios in excess of unity demonstrate earnings in excess of investors' requirements.

Q. Do you have any other points regarding this issue?

A. Yes. It is important to keep in mind that, like P/E multiples, M/B ratios tend to be used in practice as measures of relative, rather than absolute valuation. That is, investors often use M/B ratios to value an individual company based on the average M/B ratio of its peers. Such "market comparable" approaches to valuation are useful because no one financial model is accepted as the true measure of value at all times and under all conditions.

[116] 0.52 = (1 - 0.48).

G. Relative Risk

Q. Do you believe that credit ratings are an appropriate measure to determine the equity risk of FPL relative to the proxy group?

A. Although I agree that in general, credit ratings, and by extension credit spreads, are directionally related to the Cost of Equity, [117] I do not agree that changes in one is a direct measure of changes in the other. Debt and equity are different securities with different risk/return characteristics, different lives, and different investors. To that point, debt investors have a contractual, priority claim on cash flows not available to equity investors and as such, equity investors bear the residual risk of ownership. Moreover, because the life of debt is finite, debt investors' exposure to business and financial risk likewise is finite. Equity, on the other hand is perpetual and as such, equity investors are exposed to residual risk in perpetuity. Because debt and equity are distinct securities with different risk and return profiles, debt and equity investors themselves have different risk and return requirements. As such, any inferences drawn from credit ratings for the Company's Cost of Equity should be drawn with caution.

A visible measure of the distinction of the risks to which debt and equity investors are exposed is the difference in their respective Beta coefficients. Although I disagree with his application of the CAPM, Dr. Woolridge recommends average

[117] As noted by Robert S. Harris and Felicia C. Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Financial Management, Summer 1992, at 68, "equity risk premia... increased with the increases in the spread between corporate and government bond yields".

Beta coefficients of 0.70 and 0.75 for our respective proxy groups.[118] Duff & Phelps notes that as of December 2015, Beta coefficients for A-rated debt was negative .07[119]. That is, the Beta coefficients of A-rated debt are well below those of the equity Beta coefficients assumed by Dr. Woolridge. In fact, debt Beta coefficients in the range of .31 to .61 are associated with Ba and B rated debt, both of which are considered to be below investment grade.[120] Those differences are a clear indication that the risks assumed by debt investors are far different than those assumed by equity investors.

Q. Did you perform any analyses to determine whether Dr. Woolridge's data supports the assumption that there is a quantifiable difference in the Cost of Equity for companies with different bond credit ratings?

A. Yes, I did. I first produced Constant Growth DCF results for each of the comparison companies using the growth rates and dividend yields reported by Dr. Woolridge. I then applied "credit scores" to Dr. Woolridge's comparison companies by converting the S&P bond ratings reported in his Direct Testimony to a numerical value. If there is a quantifiable relationship between the proxy companies' credit ratings and Cost of Equity, there should be a positive, statistically significant relationship between the credit score and the DCF results. That is, as credit quality deteriorates (resulting in a higher score), the Cost of Equity should increase. I therefore performed a regression analysis, in which the

118 Exhibit JRW-11, at 3.
119 Duff & Phelps 2016 Valuation Handbook, John Wiley & Sons, Inc., 2016, at Appendix 3b.
120 Duff & Phelps 2016 Valuation Handbook, John Wiley & Sons, Inc., 2016, at Appendix 3b. Debt Beta coefficients for BBB-rated companies were .08.

dependent variable was the DCF result, and the explanatory variable was the credit score. As shown in Exhibit RBH-26, the regression analysis showed no statistically significant statistical relationship between the two. In fact, the R-squared of the regression was only about 2.20 percent, which indicates that credit ratings accounted for only 2.20 percent of the change in the DCF-estimated Cost of Equity.

H. Flotation Costs

Q. Did Dr. Woolridge address the issue of flotation costs in his direct testimony?

A. Yes, Dr. Woolridge devotes several pages of his testimony discussing various reasons why he believes such an adjustment is not necessary.[121] Dr. Woolridge does not account for flotation costs, reasoning that flotation costs for stock issuances are not out-of-pocket costs and, even if they were, current market conditions suggest that a *reduction* to the Cost of Equity is required to account for flotation costs.[122]

Q. Please respond to Dr. Woolridge in that regard.

A. First, I disagree with Dr. Woolridge's position that flotation costs for stock issuances are different than issuance costs associated with long-term debt. Companies pay the same types of fees (both direct and indirect) regardless of whether they are issuing equity or debt. As to Dr. Woolridge's observation that

[121] *See*, Direct Testimony of J. Randall Woolridge, at 91-93.
[122] *Ibid.*

underwriter fees are not "out-of-pocket" expenses,[123] I view that to be a distinction without a meaningful difference. Whether paid directly or via an underwriting discount, the cost results in net proceeds that are less than the gross proceeds.

I also disagree with Dr. Woolridge's position that flotation costs could represent a *reduction* in Cost of Equity. Flotation costs are true and necessary costs to the issuer, and represent funds that otherwise would be invested in long-lived assets. As explained in my Direct Testimony, to the extent flotation costs are not recovered, the issuing company is denied a portion of the opportunity to earn its expected (or required) return.[124]

I have provided an illustrative example of the effect of flotation costs on the ROE in Exhibit RBH-27.[125] As shown in that schedule, due to the effect of flotation costs, an authorized return of 11.15 percent would be required to realize an ROE of 11.00 percent (*i.e.*, a 15 basis point flotation cost adjustment). If flotation costs are not recovered, the growth rate falls and the ROE decreases to 10.85 percent (*i.e.*, below the required return).[126]

123 *Ibid.*, at 92.

124 *See*, Direct Testimony of Robert B. Hevert, at 47.

125 This example is based on an analysis performed by Dr. Roger Morin. *See*, Roger A. Morin, *New Regulatory Finance*, Public Utility Reports, Inc., 2006, at 330-332.

126 Exhibit RBH-27 is provided for illustrative purposes only. I have not relied on the results of the analysis in determining my recommended ROE and range.

I. Capital Structure

Q. Please summarize Dr. Woolridge's position on the Company's capital structure.

A. I disagree with Dr. Woolridge's conclusion that the Company's capital structure suggests less financial risk than the proxy companies.[127] To support his conclusion, Dr. Woolridge compares the Company's capital structure to the capital structures in place at the holding company level. As discussed in my Direct Testimony, I analyzed the actual capital structures in place at the operating companies held within my proxy group. Doing so reflects the nature of assets financed by vertically integrated utilities such as FPL. Based on that review, it is apparent that the Company's capital structure is generally consistent with the capital structures of the proxy companies.

Q. Is there a specific example that demonstrates the varied nature of a utility holding company's unregulated operations and capital structures?

A. Yes, there is. NextEra Energy Resources, ("NEER"), a wholly owned, indirect subsidiary of NEE, owns approximately 21,100MW of generating capacity across the U.S. and Canada.[128] As of 2015, approximately 66.00 percent of NEER's generating capacity was fully committed under long-term contracts, with a weighted average life of approximately fifteen years.[129] NEER's generating portfolio is diverse, with wind, natural gas and nuclear assets representing 91.00

127 *See*, Direct Testimony of J. Randall Woolridge, at 31.
128 NextEra Energy, Inc., SEC Form 10-K for the Fiscal Year Ended December 31, 2015, at 4.
129 *Ibid.*, at 16.

percent of the capacity.[130] In fact, NEER owns 2,721 MW of nuclear generating capacity, of which 1,621 MW is contracted.[131] NEER is responsible for the ultimate decommissioning of those plants.[132] Although Dr. Woolridge suggests that parent company capital structures are the better comparator of FPL's operating capital structure, he does not seem to have considered the effect of non-utility, project-financed assets at the consolidated parent level.

Lastly, and as discussed in my response to Mr. O'Donnell, my updated capital structure analysis continues to support the reasonableness of the Company's current capital structure.

III. RESPONSE TO THE TESTIMONY OF FEA WITNESS GORMAN

Q. Please briefly summarize Mr. Gorman's recommendation regarding the Company's Cost of Equity.

A. Mr. Gorman recommends an ROE of 9.25 percent, within a recommended range of 8.90 to 9.60 percent.[133] Mr. Gorman establishes his recommended ROE by reference to: (1) his constant growth DCF model using both consensus analyst growth rates and a sustainable growth rate (with median and average results ranging from 7.34 percent to 8.89 percent);[134] (2) his Multi-Stage DCF method (with mean and median results of 8.00 percent and 8.01 percent, respectively);[135]

130 *Ibid.*
131 *Ibid.*, at 16, 18.
132 *Ibid.*, at 18.
133 *See* Direct Testimony of Michael P. Gorman, at 2.
134 *Ibid.*, at 24, 41.
135 *Ibid.*

(3) his Risk Premium estimates (ranging 9.50 percent to 9.60 percent, with a point estimate of 9.55 percent);[136] and (4) his Capital Asset Pricing Model analyses (ranging from 7.90 percent to 9.25 percent).[137] In particular, Mr. Gorman's 9.25 percent recommendation represents the midpoint of his DCF (8.90 percent) and Risk Premium (9.60 percent) analyses.[138]

Q. What are the principal analytical areas in which you disagree with Mr. Gorman?

A. The principal analytical areas in which I disagree with Mr. Gorman include:

1. Proxy group composition;
2. The application of the Constant Growth DCF model, and interpretation of its results;
3. The Market Risk Premium component of his CAPM analysis, in particular the expected market return from which the MRP is calculated;
4. The assumptions and methods underlying Mr. Gorman's Risk Premium analyses;
5. The need for a flotation cost adjustment; and
6. Mr. Gorman's assessment of the Company's relative risk.

136 *Ibid.*, at 47.
137 *Ibid.*, at 53.
138 *Ibid.*, at 54.

A. Proxy Group Composition

Q. Do you agree with Mr. Gorman's exclusion of Dominion Resources, Great Plains Energy, Westar Energy, and Otter Tail Corporation from the proxy group?[139]

A. I agree with the exclusion of Dominion Resource, Great Plains Energy, and Westar Energy; as discussed in my response to Dr. Woolridge, I also have excluded those companies due to their recent merger and acquisition activity. However, I continue to include Otter Tail Corporation ("OTTR") in my analyses. Mr. Gorman excluded OTTR from his proxy group because analyst earnings growth rates estimates were not available from any of the data sources he relies on (Zacks, SNL Financial and Reuters). Because two of the data sources I rely on for earnings growth estimates (Yahoo and Value Line) report earnings growth rates for OTTR, I continue to include the company in my proxy group.

B. Constant Growth DCF Model

Q. As a preliminary matter, does Mr. Gorman give his Constant Growth DCF results any weight in arriving at his 9.25 percent ROE recommendation?

A. Yes, as noted earlier, Mr. Gorman's 9.25 percent recommendation represents the midpoint of his 8.90 percent to 9.60 percent recommended range. The bottom end of that range (8.90 percent) is based on Mr. Gorman's Constant Growth DCF

[139] *Ibid.*, at 25.

median result of 8.89 percent,[140] and the upper bound (9.60 percent) represents the point estimate of his Risk Premium results.[141]

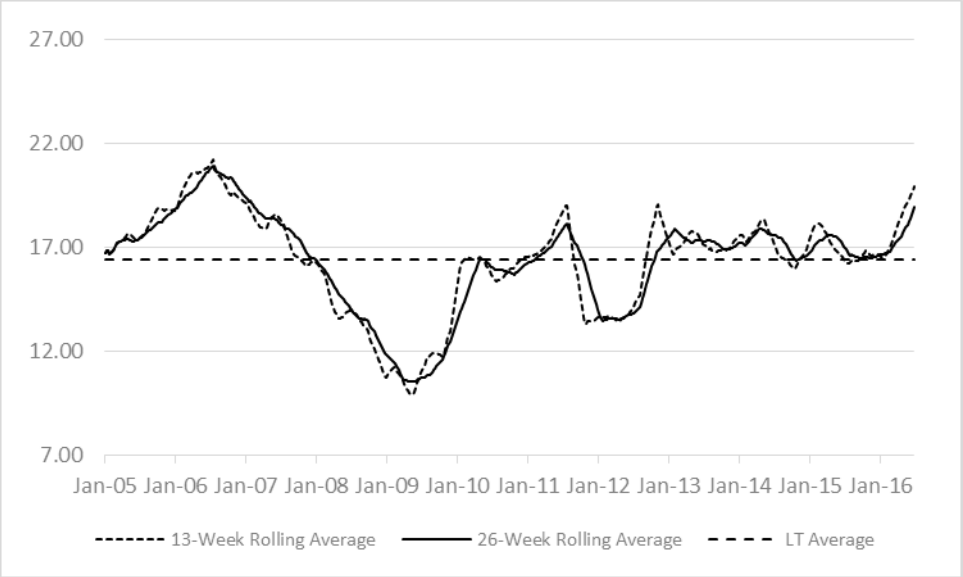
To arrive at his median DCF estimate, Mr. Gorman discards his Multi-Stage DCF results (8.01 percent), and his Constant Growth DCF model results based on the "sustainable growth" method (7.34 percent) in favor of his Constant Growth DCF results based on analysts' growth rate projections (8.89 percent).[142] Because Mr. Gorman does not rely on his Multi-Stage or sustainable growth DCF methods, I will not comment on his application of those approaches in my Rebuttal Testimony.

Q. Do you have any concerns with the Constant Growth DCF model in general, and the weight that Mr. Gorman applies to those results in particular?

A. Yes, I do. The Constant Growth DCF model is based on several underlying assumptions that combine to establish an inverse relationship between expected growth and the dividend yield. That is, as expected growth increases, the price would increase and the dividend yield would decrease. Conversely, as expected growth decreases, the price would decrease and the dividend yield would increase. Mr. Gorman's Constant Growth DCF analysis (as do Dr. Woolridge's and Mr. Baudino's), however, assumes P/E ratios that are high by historical standards, (*see* Chart 6, below), but growth rates that are relatively low.

140 *Ibid*., at 41, Table 4.
141 *Ibid*., at 47.
142 *Ibid*., at 41.

Chart 6: Proxy Group Rolling Average P/E Ratio[143]



Q. Are the growth rates assumed in Mr. Gorman's analysis consistent with historically high valuation levels?

A. No, they are not. Mr. Gorman's analysis assumes an average growth rate of 5.38 percent (*see* Exhibit MPG-5) which, he notes, is well below the long-term compound average growth rate for the economy as a whole (6.20 percent), and the long-term rate of stock market capital appreciation (on geometric average basis, 5.80 percent).[144] As discussed earlier, the Constant Growth DCF model assumes that low growth rates would be associated with low prices (and high dividend yields), yet the proxy group average P/E ratio is well above its long-term average. In the context of the Constant Growth DCF model, the two are not compatible.

[143] Sources: SNL Financial. Proxy Group P/E ratio calculated as an index.
[144] Direct Testimony of Michael P. Gorman at 37.

Mr. Gorman acknowledges that unsustainable expansions in P/E ratios create analytical concerns that should be addressed in determining the Cost of Equity. At page 52 of his direct testimony, Mr. Gorman discusses the Market Risk Premium component of his Capital Asset Pricing Model, and explains that Ibbotson & Chen found an "abnormal expansion" of P/E ratios relative to earnings and dividend growth. That is, Ibbotson & Chen found that because higher P/E ratios during the 1980 to 2001 period were not explained by higher growth in earnings or dividends, their analyses required adjustment.[145] Duff & Phelps, the source referenced by Mr. Gorman, calculates an adjustment using three-year average P/E ratios, rather than relying on the current year, because "the three-year average allows the adjustment to smooth out the volatility of extraordinary events and allows earnings to better reflect a normalized trend."[146] As did Ibbotson, Duff & Phelps recognized that abnormally high P/E ratios will produce questionable analytical results, and the long-term trend is important.

The same conditions hold here. The utility sector has undergone an "abnormal expansion" in P/E ratios; there is no dispute on that point. Whereas Duff & Phelps recognized and adjusted its analyses to reflect the abnormal expansion in P/E ratios, Mr. Gorman's DCF analyses, and his interpretation of their results, do not.

[145] *See* Direct Testimony of Michael P. Gorman at 52; Morningstar Inc., Ibbotson SBBI 2014 Classic Yearbook at 156 - 157. I also have addressed this issue in response to Dr. Woolridge's "Building Blocks" analysis.

[146] Duff & Phelps, 2016 Valuation Handbook: Guide to Cost of Capital, at 3-30.

Lastly, if Mr. Gorman's position is that the current P/E ratio will sustain itself over the long-run, as noted in my response to Dr. Woolridge, I have addressed that concern by calculating the terminal value portion of the Multi-Stage DCF model by reference to current P/E ratios.[147]

Q. Please summarize your concerns with Mr. Gorman's use of a sustainable long-term growth in his DCF analysis.

A. Although we agree that it is appropriate to rely on analyst earnings growth estimates in applying the Constant Growth DCF model, Mr. Gorman asserts that those estimates should be limited to what he considers to be a reasonable estimate of long-term "sustainable" growth. In that regard, because they are higher than the five- and ten-year nominal GDP growth estimates from Blue Chip *Financial Forecasts*, Mr. Gorman concludes that the mean analyst consensus earnings growth estimates in my Constant Growth DCF analysis produce elevated estimates of the Cost of Equity.[148]

As noted in my response to Dr. Woolridge, prior academic research (as well as the analyses presented in my response to Dr. Woolridge) indicates that investors rely on analysts' earnings growth projections. Those analyses demonstrate Value Line's "Retained to Common Equity", which is the product of the expected Return on Common Equity and the expected Retention Ratio (which are the two variables included in Mr. Gorman's assessment of what may constitute

147 *See* Exhibit RBH-14.
148 *See* Direct Testimony of Michael P. Gorman at 37-38.

"sustainable growth" on page 32 of his direct testimony) have no statistically significant ability to explain valuation levels (as measured by the P/E ratio, which Mr. Gorman presents in his Exhibit MPG-2).

Although Mr. Gorman may be of the view that analyst growth rates are not sustainable, the relevant issue is whether investors rely on those projections in making their investment decisions. That is, what matters is that analysts' projections reflect widely held expectations influencing investors at the time they make their pricing decisions, *i.e.*, the market prices investors are willing to pay. I am not aware of empirical evidence supporting the position that investors would disregard analysts' estimates of growth in Earnings Per Share for the companies in our respective proxy groups, nor has Mr. Gorman provided any such evidence. Rather, the empirical evidence discussed in my response to Dr. Woolridge supports the use of analysts' earnings growth projections. I therefore disagree with Mr. Gorman's conclusion that *his* view of sustainable growth, rather than analysts' projections, is the more relevant measure of investor expectations.

C. Application of Capital Asset Pricing Model

Q. Please briefly summarize Mr. Gorman's CAPM analysis and results.

A. Mr. Gorman's two CAPM estimates (9.25 and 7.90 percent) are based on two measures of principally historical Market Risk Premium estimates, Blue Chip's projected 30-year Treasury yield of 3.40 percent as the risk-free rate, and an

average Beta coefficient of 0.75, as reported by Value Line.[149] Based on his assessment of risk premiums in the current market, Mr. Gorman relies on the high-end 9.25 percent CAPM when estimating FPL's Cost of Equity.[150] Mr. Gorman's analyses assume Market Risk Premium estimates of 7.80 percent (based on the long-term historical arithmetic average real market return from 1926 through 2015 as reported by Duff & Phelps, adjusted for current inflation forecasts), and 6.00 percent (based on the historical difference between the average return on the S&P 500 and the average total return on long-term government bonds).[151] Combining those Market Risk Premium estimates with his projected long-term risk-free rate, Mr. Gorman develops expected market returns in the range of 9.40 to 11.20 percent.[152]

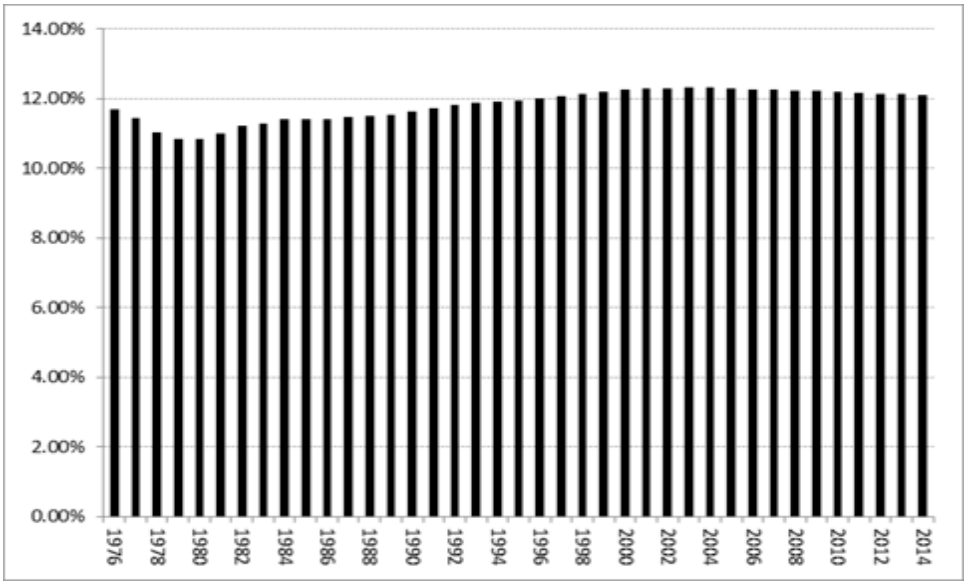
Q. Turning first to the expected total market return, do you agree with Mr. Gorman's 9.40 and 11.20 percent estimates?

A. No, I do not. As a practical matter, Mr. Gorman's 9.40 percent estimate, which is more than 250 basis points below the long-term average market return, falls in the bottom 10th percentile of the 90 annual returns reported by Morningstar.[153] His 11.20 percent estimate, which I believe is more reasonable, still falls in the bottom 24th percentile.

149 *Ibid.*, at 53 and Exhibit MPG-18.
150 *Ibid.*, at 53.
151 *Ibid*., at 51 and Exhibit MPG-18.
152 Mr. Gorman's low Market risk premium of 6.00 percent plus his projected risk-free rate of 3.40 percent equals an estimated market return of 9.40 percent. *See* Direct Testimony of Michael P. Gorman, 51; Exhibit MPG-18.
153 On a rolling average basis.

A helpful perspective on the historical market return is the rolling 50-year average annual market return. As Mr. Gorman points out, from 1926 through 2015 the arithmetic average market return was 12.00 percent.[154] Over the 50 years ended 2015, the average return was 12.10 percent, only ten basis points removed from the longer-term average that Mr. Gorman reports. Over time, the fifty-year average return has been quite consistent, in the range of approximately 12.00 percent (*see* Chart 7, below).

Chart 7: 50-Year Rolling Average Market Return (1976 – 2015)[155]



Taken from that perspective, Mr. Gorman's 9.40 percent expected market return is well below the long-term market experience, and, therefore, is not reasonable.

154 Direct Testimony of Michael P. Gorman, at 51.

155 Source: Morningstar, Inc., 2016 SBBI Appendix A Tables.

D. Application of the Risk Premium Model

Q. Please briefly describe Mr. Gorman's Risk Premium analyses.

A. Mr. Gorman defines the "Risk Premium" as the difference between average annual authorized equity returns for electric utilities, and a measure of long-term interest rates each year from 1986 through March 2016.[156] Mr. Gorman's first approach calculates the annual risk premium by reference to the 30-year Treasury yield, and his second approach considers the average A-rated utility bond yield.[157] In each case, Mr. Gorman establishes his risk premium estimate by reference to five-year and ten-year year rolling averages. The lower and upper bounds of Mr. Gorman's Risk Premium range are defined by the lowest and highest rolling average, respectively, regardless of the year in which those observations occurred.[158]

Regarding the period over which he gathers and analyzes his data, Mr. Gorman suggests that his 31-year horizon is a "generally accepted period to develop a risk premium study using 'expectational' data."[159] On page 44 of his direct testimony Mr. Gorman further states that "it is reasonable to assume that averages of annual achieved returns over long time periods will generally converge on the investors' expected returns," and concludes that his "risk premium study is based on expectational data, not actual investment returns, and, thus, need not encompass a

156 Direct Testimony of Michael P. Gorman, at 41-42.
157 *See* Direct Testimony of Michael P. Gorman, 42, Exhibit MPG-13 and MPG-14.
158 Direct Testimony of Michael P. Gorman at 41-42; Exhibit MPG-13 and MPG-14.
159 *Ibid.,* at 43.

very long historical time period."[160] Based on those assumptions, Mr. Gorman calculates a range of risk premium estimates of 4.25 percent to 6.71 percent using his Treasury bond analysis, and 2.88 percent to 5.53 percent using his A-rated utility bond analysis. Combined with a 3.40 percent projected Treasury yield and a 4.69 percent Baa-rated utility bond yield estimate, Mr. Gorman's Risk Premium analysis produces results ranging from 7.57 percent to 10.22 percent.[161] To calculate his Risk Premium-based ROE estimate, Mr. Gorman gives 75.00 percent weight to the high end of his risk premium estimates, and 25.00 percent to the low end, producing a range of 9.50 percent to 9.60 percent with a midpoint of 9.55 percent.[162]

Q. Do you have any general observations regarding Mr. Gorman's Risk Premium estimates and how they weigh in his overall ROE recommendation?

A. Yes, I do. In assessing his DCF analyses, Mr. Gorman decided to rely on his highest result and essentially discarded five of his six results, which ranged from 7.34 to 8.83 percent.[163] In his Risk Premium analysis, however, Mr. Gorman retained risk premiums that produced ROE estimates that were more than 100 basis points *below* the DCF estimates that he chose not to rely on. Despite their low levels, Mr. Gorman gave those risk premium estimates (producing ROE results of 7.57 and 7.65 percent) weights of 25.00 percent in aggregate. Mr.

160 *Ibid.,* at 44.
161 4.69% + 2.88% = 7.57%; 4.69% + 5.53% = 10.22%; 3.40% + 4.25% = 7.65%; 3.40% + 6.71% = 10.11%.
162 *Ibid.,* at 47.
163 *Ibid.,* at 41.

Gorman offers no explanation as to why he would exclude DCF results of 8.83 percent and lower, yet include Risk Premium results of 7.57 percent and 7.65 percent.

Q. What are your specific concerns with Mr. Gorman's Risk Premium analysis?

A. I have three concerns with his analysis: (1) Mr. Gorman's method understates the required risk premium in the current market because it ignores an important relationship confirmed by his own data, *i.e.*, that the risk premium is inversely related to the level of interest rates (whether measured by Treasury or utility bond yields); (2) the low end of Mr. Gorman's Risk Premium results is far lower than any ROE authorized since at least 1986 and as such, has no relevance in estimating the Company's Cost of Equity; and (3) Mr. Gorman suggests that a Market/Book of 1.00 is a relevant benchmark for assessing authorized ROEs.[164]

Q. Turning first to the issue of Market/Book ratios, as discussed on page 42 of his direct testimony, do you agree with Mr. Gorman that M/B ratios should be used to assess the reasonableness of ROE recommendations?

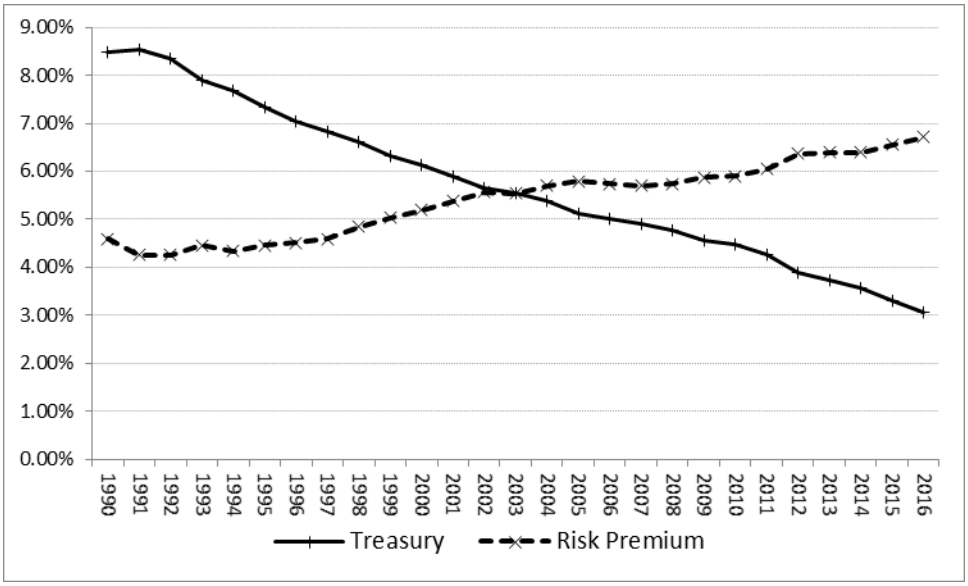
A. No, for the reasons discussed in my response to Dr. Woolridge, I do not.

Q. Have you reviewed Mr. Gorman's Risk Premium analyses?

A. Yes, I have. Considering first the Treasury yield-based analysis, I plotted the yields and Risk Premia over the 1986 to 2016 period included in Mr. Gorman's analysis. That graph, which is presented in Chart 8 (below), clearly indicates the inverse relationship between interest rates and the Equity Risk Premium.

[164] *Ibid.,* at 42.

Chart 8: Mr. Gorman's Treasury Yield-Based Risk Premium Data[165]



There are several other points made clear in Chart 8. First, the low end of Mr. Gorman's Risk Premium range, 4.25 percent, was observed in the five-year period ending 1991. There is little question that Risk Premium estimates associated with economic environments 25 years ago have little to do with current market conditions. A very visible measure of such differences is the fact that before 2002, Treasury yields exceeded the Risk Premium (on a five-year average basis). As Chart 8 (*see also* Exhibit RBH-28) demonstrates, however, since then the opposite has been true – the Risk Premium has consistently exceeded Treasury yields. By that measure alone, it is clear that the low end of Mr. Gorman's range has little, if any, relevance to the current market environment.

[165] Source: Direct Testimony of Michael P. Gorman, Exhibit MPG-13; based on five-year rolling average.

The high end of Mr. Gorman's range, 6.71 percent, occurred more recently (for the five year period ending March 2016). In fact, Exhibit MPG-13 indicates that his Equity Risk Premium averaged approximately 6.85 percent over the more recent period from 2015 through March 2016.[166] Adding that 6.85 percent Equity Risk Premium to Mr. Gorman's projected Treasury yield of 3.40 percent produces an ROE estimate of 10.25 percent.

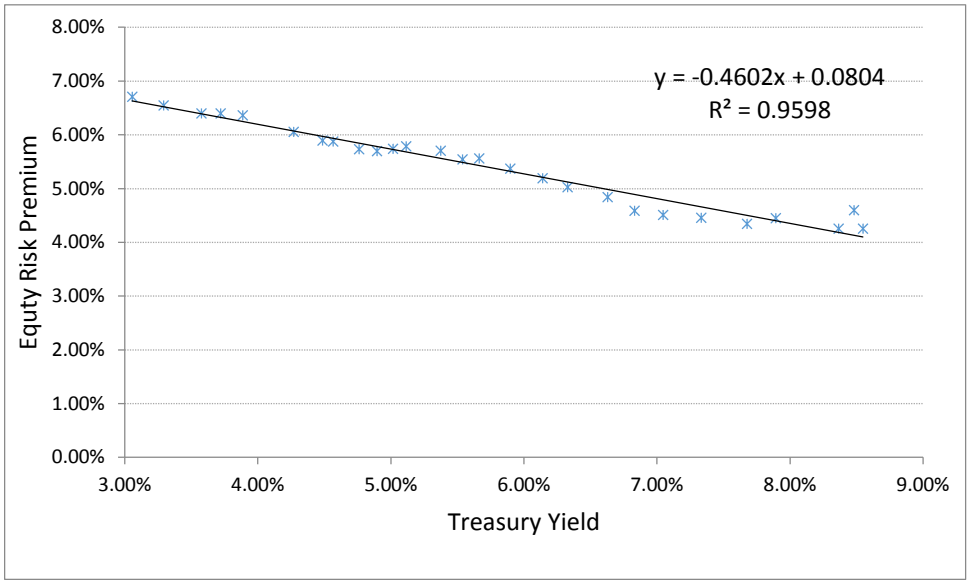
Q. Has the Risk Premium increased as Treasury yields have decreased?

A. Yes. The relationship between the five-year average Equity Risk Premium and Treasury yields is very clear. A simple linear regression demonstrates that the two are highly related, with a Coefficient of Determination (R-Square) of approximately 96.00 percent. That is, Mr. Gorman's data demonstrate that changes in Treasury yields account for 96.00 percent of the change in the Equity Risk Premium (*see* Chart 9, below).[167]

166 Based on Indicated Risk Premium.

167 Those findings are supported in academic studies. For example, Dr. Roger Morin notes that: "… [p]ublished studies by Brigham, Shome, and Vinson (1985), Harris (1986), Harris and Marston (1992, 1993), Carleton, Chambers, and Lakonishok (1983), Morin (2005), and McShane (2005), and others demonstrate that, beginning in 1980, risk premiums varied inversely with the level of interest rates - rising when rates fell and declining when interest rates rose." Roger A: Morin, New Regulatory Finance, Public Utilities Reports, Inc. 2006, at 128 [clarification added]

Chart 9: Treasury Yield vs. Equity Risk Premium (Five-Year Rolling Average)[168]



Turning back to Mr. Gorman's data, a simple linear regression analysis using annual (rather than the rolling average data) demonstrates that for every 100 basis point decrease in Treasury yields, the Equity Risk Premium increases by approximately 44 basis points (*see* Exhibit RBH-29).[169] Similarly, the Equity Risk Premium increases approximately 45 basis points for every 100 basis point decrease in utility bond yields. Those results are consistent with those reported by Maddox, Pippert, and Sullivan, who determined that the Risk Premium would increase by 37 basis points for every 100 basis point change in the 30-year Treasury yield.[170]

168 See Exhibit RBH-28. Source: Exhibit MPG-13.

169 Serial correlation is not present or is inconclusive.

170 *See* 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, Vol. 24, No. 3, Autumn 1995, at 93.

I also have found that accounting for additional factors by incorporating the credit spread (taken from Mr. Gorman's exhibits) does not change the sign, statistical significance, or the magnitude of the slope coefficient.[171] In short, including Mr. Gorman's credit spreads do not change the finding that interest rates and the Equity Risk Premium are inversely related.

Q. What are your conclusions regarding Mr. Gorman's Risk Premium analysis?

A. Although Mr. Gorman includes rolling average estimates in his Risk Premium analysis, doing so does not negate the finding that his approach relies on data from markets that are so disconnected in time and substance from the current environment that there is no reasonable basis for his conclusion that 9.60 percent represents a proper Risk Premium-based estimate of the Company's Cost of Equity. Consequently, it is appropriate to apply methods that have been accepted in published literature, and which reflect the finding that interest rates and the Equity Risk Premium move in opposite directions.

E. Risk Factors and Market Sentiment

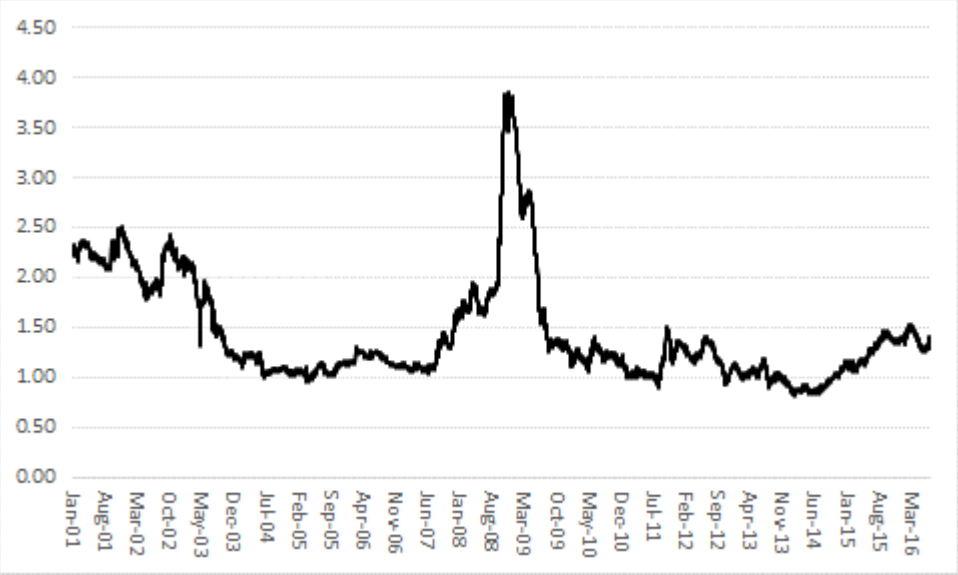
Q. Mr. Gorman suggests the market is placing a high value on utility stocks.[172] Have you considered the utility sector's recent equity market performance relative to the debt market?

A. Yes, I have. Because credit spreads, which represent the difference between the yields on debt and Treasury yields, can be directly observed, we can review the

[171] *See* Exhibit RBH-29.
[172] Direct Testimony of Michael P. Gorman, at 78.

change in spreads over time, and relative to other market sectors. Although credit spreads are not a full measure of equity risk, they reasonably can be seen to reflect, to some extent, investors' assessment of risk at a given point in time. As Chart 10 below indicates, but for the credit contraction that ended in 2003 and the financial crisis during 2008 and 2009, current credit spreads (for A-rated utilities) are near their highest level since the year 2000.

Chart 10: A-Rated Utility Credit Spreads[173]



Even considering the 2002 – 2003, and 2008 – 2009 market dislocations, the current utility credit spread (on a spot basis) is in the top 63rd percentile of spreads since January 2000; the thirty-day average is in the top 55th percentile. Looking to the period subsequent to the financial crisis (that is, since January 2010), the 30-day average credit spread is in the top 80th percentile (the spot spread is in the top 91st percentile). Taken from that perspective, it is apparent that investors

[173] Source: Bloomberg Professional

currently see the utility sector as relatively risky, and require higher returns as compensation for that risk.

As to the relationship between the level of Treasury yields and credit spreads, the level of explanatory value is rather low; Treasury yields explain only about 12.00 percent of the change in credit spreads.[174] Equity market volatility (as measured by the VIX), on the other hand, explains about 60.00 percent of the change in credit spreads.[175] That is, investors are concerned with market uncertainty, and require higher returns as uncertainty increases.

Q. Does any data presented by Mr. Gorman support the conclusion that credit spreads on A-rated utility debt are at historically elevated levels?

A. Yes. Mr. Gorman's Exhibit MPG-15 provides the spread between A-rated utility debt and Treasury bond yields. As shown in that exhibit, credit spreads on A-rated utility debt are higher than they have been in eight of the previous ten years. Credit spreads were only higher during the 2008-2009 financial crisis.

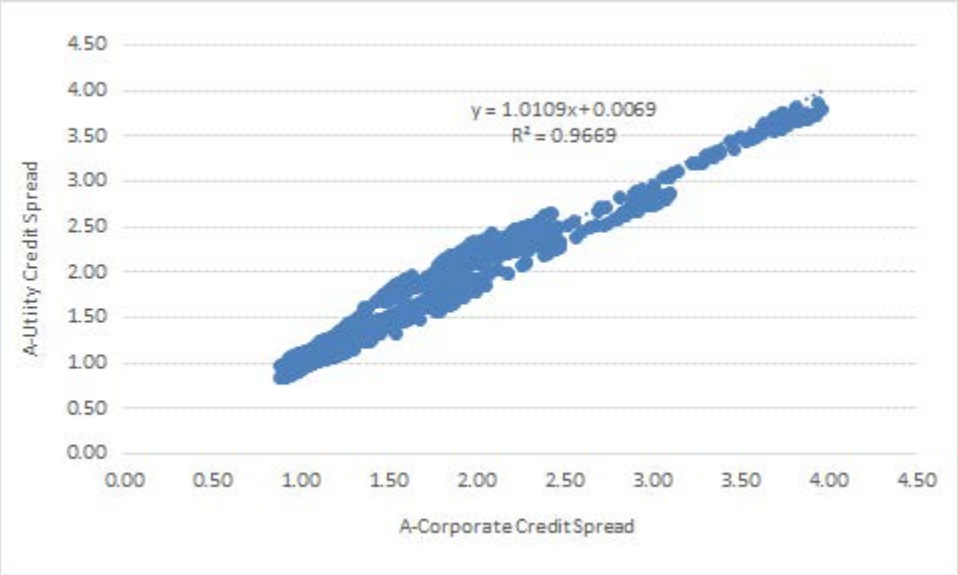
Q. Have you also reviewed the relationship between credit spreads for A-rated utility debt relative to A-rated corporate debt?

A. Yes, I have. Although Mr. Gorman suggests that utility debt is trading at a premium to corporate debt[176], I find the difference in yields to be only about two basis points. Given the historical volatility in the spread between corporate and

[174] Source: Bloomberg Professional.
[175] Source: Bloomberg Professional.
[176] Direct Testimony and Exhibits of Michael P. Gorman, at 78.

utility A-rated debt, there is no reason to conclude that utility yields are different than those of their corporate counterparts. That conclusion is consistent with the finding that over time, there has been a nearly one-to-one relationship between credit spreads on A-rated corporate and utility bonds. In fact, a regression analysis in which corporate credit spreads are the explanatory variable and utility credit spreads are the dependent variable shows that slope is approximately 1.00 and highly significant (*see* Chart 11, below). Because the intercept term is statistically insignificant, we can conclude that there has been no material difference between the two, and there certainly is no meaningful difference in the current market.

Chart 11: Corporate and Utility Credit Spreads (A-Rated)[177]



Q. What do you conclude from those analyses?

A. First, it is clear that A-rated utility credit spreads are at historically elevated levels. Second, the utility credit spreads are not measurably different than their corporate counterparts. Based on those two observations, we can conclude that investors do not consider utilities to be less risky than historical levels, nor are they requiring lower returns for utilities relative to similarly rated corporate bonds. Consequently, I do not believe we can conclude that the current level of utility equity valuation levels is due to lower levels of perceived risk. Rather, it is my view that the valuation levels are related to the "reach for yield" that sometimes occurs during periods of low Treasury yields.

[177] Source: Bloomberg Professional. Please note that for a univariate regression, the correlation coefficient equals the square root of the R-square. In this case, the square root of 0.9669 is approximately 0.98 (98.00 percent).

Q. Have there been other recent periods when utility equity valuation levels were high relative to both their long-term average and the market?

A. Yes. In early 2015, the utility sector (as measured by the S&P Electric Utility Index) traded at a Price/Earnings ratio of approximately 18.00. During the same period, the overall market (as measured by the S&P 500) traded at a P/E of approximately 18.00. Those levels were quite similar to the current market. In late January 2015, the utility sector began to lose value, and by the end of June 2015 it had lost approximately 15.50 percent of its value.[178] The point simply is that as investors see an increasing likelihood of higher interest rates, they will move out of sectors that provided relatively high current yields. As they do, valuations and P/E ratios fall. As discussed elsewhere in my Rebuttal Testimony, that degree of instability in P/E ratios is incompatible with the assumptions underlying the Constant Growth DCF model, rendering estimates from that model highly questionable.

Q. Have you also considered the effect of the United Kingdom's decision to exit the European Union (sometimes referred to as the "Brexit") on Treasury yields?

A. Yes, I have. What is clear is that in the one week following the Brexit vote (that is, from June 23 to June 30) Treasury yields fell by 25 basis points. As Treasury yields fell, utility valuations increased, as investors sought the relatively high dividend yields offered by the sector. Subsequent to June 30, the market appeared

[178] The Combined Proxy Group lost approximately 13.00 of its value between January 31, 2015 and the end of June 2015.

to have become more comfortable with the implications of the Brexit vote, interest rates began to increase, utility valuations fell, and the overall market increased to record levels.[179] The volatility observed during that two-week period demonstrates the importance of understanding the factors underlying market conditions, and how those factors and conditions comport, or not, with the methods used to estimate the Cost of Equity.

Q. What conclusions do you draw from those analyses?

A. In my view, we cannot conclude that the recent levels of utility valuations are due to a fundamental change in the risk perceptions of utility investors. Utility credit spreads are at historically elevated levels, and there is no measurable difference between credit spreads of A-rated utility debt, and A-rated corporate debt. That is, based on analyses of credit spreads, there is no reason to conclude that investors see utilities as less risky relative to either historical levels or to their corporate counterparts.

Q. Please briefly summarize Mr. Gorman's assessment of the Company's overall business risk.

A. Mr. Gorman summarizes certain rating agency reports and concludes that utilities in general are seen as a low-risk sector, which has provided utilities "strong access to capital."[180] Mr. Gorman also notes that 85.00 to 90.00 percent of regulated utilities have bond ratings in the range of A- to BBB, and FPL falls at

[179] Source: Bloomberg Professional

[180] Direct Testimony of Michael P. Gorman, at 11.

approximately the high-end of this range.[181] Lastly, Mr. Gorman suggests the implementation of a four year rate plan would not increase the Company's Cost of Equity.[182]

Q. Do the Company's current credit ratings distinguish it from other utilities?

A. No, they do not. As S&P notes, the vast majority of utility ratings fall within the BBB to A- range.[183] The Company's current credit rating falls within that range. In any event, as discussed in my response to Dr. Woolridge, credit ratings are not full measures of equity risk. And as discussed in my response to Mr. Chriss, investors' perceptions of regulatory supportiveness tend to be positively related to authorized equity returns.[184] Lastly, as Mr. Dewhurst explains, the Company's authorized capital structure and return have enabled it to access capital, maintain operating liquidity, and still have among the lowest retail rates in the region. In that important sense, Mr. Gorman's conclusion that the Company's credit rating somehow justifies an ROE that would be among the lowest authorized in the last 35 years for a vertically integrated electric utility is misplaced.

181 *Ibid.*, at 19.

182 *Ibid.*, at 61-62.

183 Standard & Poor's RatingsDirect, *Industry Report Card: The Outlook For U.S. Regulated Utilities Remains Stable On Increasing Capital Spending And Robust Financial Performance*, December 16, 2014, at 6.

184 As noted in my response to Mr. O'Donnell, both Standard & Poors and Moody's consider the assessment of the regulatory environment a significant factor in determination of credit ratings.

Q. Mr. Gorman suggests there is insufficient evidence that interest rates will rise to conclude that a four year rate plan will increase risks for shareholders.[185] What is your response?

A. The principal issue is uncertainty, which represents risk to investors. As discussed in my Direct Testimony, with a multi-year rate plan FPL forgoes the option to seek rate relief as capital costs increase.[186] Should interest rates rise over the course of the proposed four year rate period, the Company would be exposed to increases in the costs of both debt and equity.[187] As reported by Blue Chip, the average consensus forecast is for the 30-year Treasury yield to rise to 3.40 percent (approximately 100 basis points) in 2017 and 4.40 percent (approximately 200 basis point) by the end of proposed four year rate period.[188] In addition, market expectations for increased long-term Treasury yields are apparent in the market prices to buy or sell at-the-money options in long-term Government bond funds. That is, the value of the option to sell the TLT (an exchange-traded fund of long-term Government bonds) in January 2018 at today's price is approximately one and a half times the value of the option to buy that fund.[189] Because bond prices fall as interest rates increase, investors see a greater likelihood of increases in long-term interest rates than decreases. As such, investors may require a premium to the allowed ROE for compensation for the additional risk associated with

185 Direct Testimony of Michael P. Gorman, at 61-62.
186 Direct Testimony of Robert B. Hevert, at 50-51.
187 *See* Direct Testimony of Robert B. Hevert, at 20 and 63.
188 *See*, Blue Chip Financial Forecast, Vol. 35 No. 6, June 1, 2016, at 2, 14.
189 http://www.nasdaq.com/symbol/tlt/option-chain?dateindex=7

foregoing the opportunity to seek rate relief in the event of increasing capital costs.

Q. Do you agree with Mr. Gorman's position that relying on projected Treasury yields is "problematic"?[190]

A. No, I do not. Mr. Gorman asserts that relying on projected yields does not consider "the highly likely outcome that current observable interest rates will prevail during the period rates determined in this proceeding will be in effect." Mr. Gorman then goes on to suggest that relative to projected interest rates, "current observable rates are just as likely to accurately predict future interest rates as are economists' projections."[191] He concludes that the accuracy of those projections are "highly problematic."[192]

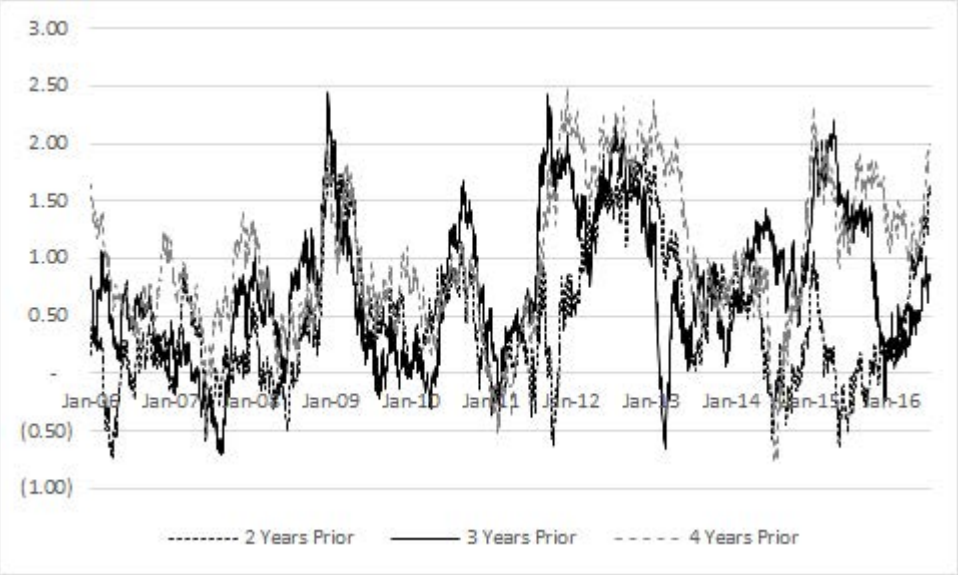
Q. What is your general response to Mr. Gorman's position?

A. First, the relevant question is whether investors view consensus forecasts as important information as they make their investment decisions. Mr. Gorman has provided no information to conclude that they do not. As to his position that it is highly likely that observable interest rates will prevail during the period in which rates will be in effect, that has not been the case historically; as Chart 12 below demonstrates, 30-year Treasury yields two, three and four yields lagged have not been very accurate predictors of spot yields. That is especially the case for the longer lag periods (three and four years), which would more closely reflect the

190 Direct Testimony of Michael P. Gorman, at 79 – 80.
191 *Ibid.*, at 79.
192 *Ibid.*, at 80.

term of the Company's proposed rate plan than does the roughly one-year lag reflected in Mr. Gorman's analysis (Exhibit MPG-21).

Chart 12: Difference in Spot vs. Lagged Treasury Yields[193]



In large measure, the inability of lagged yields to explain current yields relates to the decline in rates over time. As a practical matter, a simple trend variable has considerably greater explanatory value than do the lagged yields that Mr. Gorman favors. As shown in Exhibit RBH-30, the R-Square (which measures explanatory value of a given variable) increases from approximately 55.00 percent to approximately 82.00 percent. That is, a simple trend has a greater ability to explain current Treasury yields than do lagged observed Treasury yields.[194]

In my view, the relevant question becomes whether investors see that trend continuing over time. Simply extrapolating the trend, or even relying on prior

193 Source: Bloomberg Professional

194 It is interesting to note that including the Trend variable also changes the sign of the lagged Treasury yield variable from positive to negative.

Treasury yields as an estimate of future yields would assume that to be the case, even though central bank policy, which is a significant factor influencing interest rates, is changing. To that point, Mr. Gorman's observations include a highly unusual period in capital markets in which a number of central banks pursued a significant level of unconventional monetary stimulus (e.g., holding short-term rates near zero while also purchasing large quantities of long-term bonds), which led to long-term bond rates far below market estimates of normal rates. He has not explained, however, why such conditions will prevail two, three or four years in the future.

Regarding Mr. Gorman's observation that in the past, projected yields indicated interest rate increases even though actual yields did not increase, it is important to recognize that implied forward Treasury yields (which are based on observed interest rates) also indicated expectations of rate increases. Implied forward yields are based on the "Expectations" theory, which states that (for example) the current 30-year Treasury yield equals the combination of the current one-year Treasury yield, and the 29-year Treasury yield expected in one year. That is, an investor would be indifferent to (1) holding a 30-year Treasury to maturity, or (2) holding a one-year Treasury to maturity, then a 29-year Treasury bond, also to maturity.[195]

[195] In addition to the Expectations theory, there are other theories regarding the term structure of interest rates, including: the Liquidity Premium Theory, which asserts that investors require a premium for holding long term bonds; the Market Segmentation Theory, which states that securities of different terms are not substitutable and, as such, the supply of and demand for short-term and long-term instruments is developed independently; and the Preferred Habitat Theory,

As Chart 13 demonstrates, since 2006 the implied forward 29- and 28- year yields (one and two years hence, respectively) consistently exceeded the (interpolated) spot yields. That is, just as economists' projections implied increased interest rates, so did observable Treasury yields.

Chart 13: Forward vs. Interpolated Treasury Yields[196]

Q. What do you conclude from those analyses?

A. First, Mr. Gorman's assertion that spot yields are a reasonable measure of expected yields is inconsistent with observable data; there has been a considerable amount of dispersion between the two. Moreover, the ability of lagged yields to estimate current yields decreases as the lag period increases. In that regard, there

196 which states that in addition to interest rate expectations, certain investors have distinct investment horizons and will require a return premium for bonds with maturities outside of that preference. Source: Federal Reserve Schedule H.15

is no reason to conclude that current Treasury yields are a reasonable estimate of the yields that will prevail two, three or four years in the future.

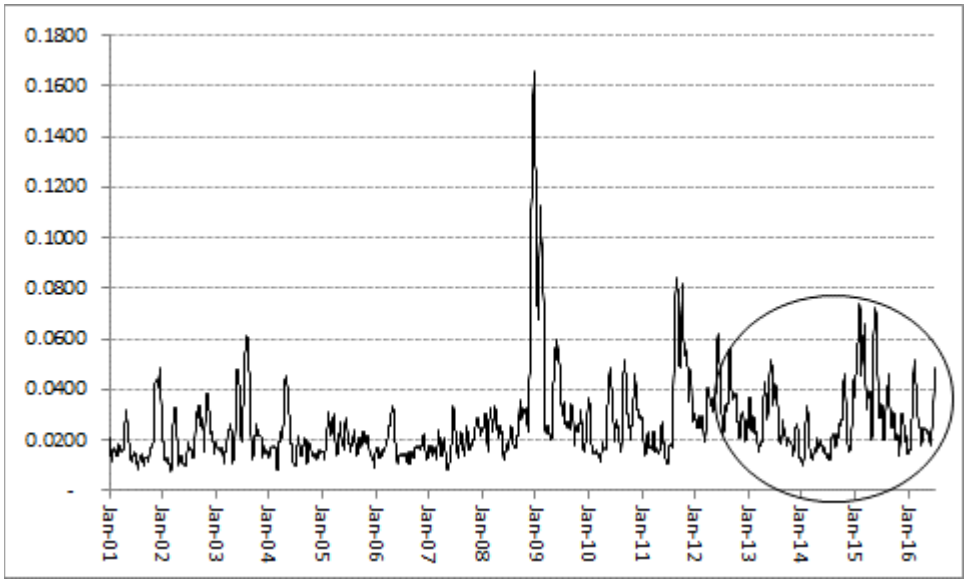
Second, a simple trend variable provides more explanatory value than do observed Treasury yields. But if we simply extrapolate that trend, by December 2018 the 30-year Treasury yield would be 0.58 percent (58 basis points; *see* Exhibit RBH-30). On the other hand, if we were to assume that the current 30-year Treasury yield will prevail for the next two to four years, we would have to assume no change in central bank policies, macroeconomic growth, or any of the other factors that recently have influenced Treasury yields.

Lastly, Mr. Gorman's conclusion that consensus projections exceeded observed yields does not seem to take into account the fact that implied forward yields also indicated interest rate increases. Because forward yields have been directionally consistent with economists' projections, and given that Mr. Gorman puts considerable weight on observed yields, there is no reason to believe that economists' projections are "highly problematic".

Q. Do you have any further observations regarding interest rates, and their effect on the Company's ROE?

A. Yes. Since 2012, the 30-year Treasury yield has been quite volatile, especially relative to its historical levels (*see* Chart 14, below).

Chart 14: 30-Year Treasury Yield Coefficient of Variation[197]



That variability represents an element of uncertainty for investors; uncertainty and risk increase investors' required returns. Further, as rates become more variable, the option to seek rate relief in future periods becomes more valuable. Foregoing that option, therefore, comes at a greater cost. Consequently, the increased variability of Treasury yields provides further support for my ROE range and recommendation.

F. Financial Integrity

Q. Please briefly summarize Mr. Gorman's assessment of his recommendation as it affects measures of the Company's financial integrity.

A. Mr. Gorman evaluates the reasonableness of his ROE recommendation by calculating the *pro forma* effect that his recommended ROE would have on two of

[197] Source: Bloomberg Professional. The Coefficient of Variation is calculated as the Standard Deviation divided by the Average. Calculations are based on 30-day moving periods.

the Company's key financial ratios with the goal of assessing whether those ratios would still fall within S&P's guideline ranges sufficient for an investment grade rating.[198] In that regard, Mr. Gorman develops the following *pro forma* ratios: (1) Debt to EBITDA; and (2) Funds From Operations ("FFO") to Total Debt. An important point is that Mr. Gorman's analysis assumes that the Company actually will earn the entirety of its authorized ROE on a going-forward basis.

In his Exhibit MPG-19, Mr. Gorman develops the *pro forma* financial ratios noted above based on the Company's retail cost of service, and his recommended ROE of 9.25 percent. Mr. Gorman notes that his *pro forma* financial analysis suggests that his recommended ROE of 9.25 percent would be sufficient to maintain "credit metrics at an investment grade utility level."[199]

Q. Do you agree with Mr. Gorman's analysis and conclusion?

A. No, I do not. First, simply maintaining an "investment grade" rating is an inappropriate standard. According to Standard & Poor's, only 6 of 221 utilities have had below investment grade ratings.[200] As Mr. Dewhurst explains, FPL must compete for capital within the utility sector in the first instance, and with companies beyond utilities, overall. If Mr. Gorman is of the view that simply maintaining an investment grade rating is sufficient for that purpose, I disagree. In my practical experience raising capital for a regulated utility, I can say

198 *See* Direct Testimony of Michael P. Gorman, at 56-57.
199 *Ibid.*, at 57.
200 See Standard & Poor's RatingsDirect, *The Outlook for U.S. Regulated Utilities Remains Stable on Increasing Capital Spending and Robust Financial Performance*, December 16, 2014, at 7-20.

firsthand that the competition for capital can be acute. Based on that practical experience, I also can say that Mr. Gorman's "investment grade" standard would frustrate the ability of FPL, or any other regulated utility, to raise capital under a variety of market conditions, and at reasonable costs and terms.

That fundamental concern aside, a wide range of ROE outcomes create *pro forma* coverage ratios that fall within S&P's guidelines for the Company's current rating. As shown in Exhibit RBH-31, using Mr. Gorman's analysis, an ROE of 6.55 percent creates coverage ratios that also fall within FPL's current range. There is little question that 6.55 percent is an unrealistic estimate of the Company's Cost of Equity.

Mr. Gorman concludes that his 9.25 percent recommendation produces *pro forma* ratios within S&P's "Intermediate" guideline and therefore supports an investment grade credit rating.[201] Again, using Mr. Gorman's analysis, an ROE of 6.55 percent produces coverage ratios that also fall within the "Intermediate" range. Again, I do not believe that 6.55 percent is a realistic estimate of the Company's Cost of Equity. My 11.00 percent ROE recommendation also produces coverage ratios that fall within the "Intermediate" range.[202]

In my view, the observation that that Mr. Gorman's 9.25 percent ROE produces *pro forma* ratios that fall within the same ratings band as the 6.55 percent ROE

[201] Direct Testimony of Michael P. Gorman, at 57.
[202] Exhibit RBH-31.

noted above does not support the conclusion that his recommendation would support the Company's financial integrity. As noted earlier, there are factors well beyond *pro forma* coverage ratios that weigh in rating determinations.

As noted above, Mr. Gorman's analysis also assumes that the Company actually will be able to earn its authorized return, and its Funds From Operations will not be diluted by regulatory lag, additional capital spending, or any of the other factors that may dilute earnings and cash flow.

Lastly, as Mr. Gorman recognizes, credit rating agencies consider a number of factors beyond coverage ratios. As noted in my response to Mr. O'Donnell, 50.00 percent of Moody's ratings factors relate to the regulatory environment. Mr. Gorman's ROE recommendation, which is far below the national average return for vertically integrated electric utilities, would introduce an element of regulatory risk that could put pressure on FPL's credit profile, potentially increasing its cost of capital. Because Mr. Gorman's analysis appears to be overly simplified, relying on its results may well lead to incorrect conclusions.

G. Flotation Costs

Q. What is Mr. Gorman's position with regard to flotation costs.

A. Mr. Gorman acknowledges that flotation costs are a legitimate cost of doing business, but suggests that the Commission only allow recovery if the actual costs

are demonstrated and proven to be reasonable. Mr. Gorman further asserts that because FPL does not issue common stock, it does not incur flotation costs.[203]

Q. What is your response to Mr. Gorman's position?

A. As explained in my direct testimony, 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 issuance costs of long-term debt, flotation costs are incurred over time, but remain part of the cost structure that exists during the test year and beyond.[204] Although FPL does not issue common stock, it still must compete for equity capital with other NextEra Energy affiliates and investment opportunities. The common stock that which has been issued by NextEra Energy, the parent holding company, includes flotation costs, which are passed through to FPL. As such, I continue to believe it is appropriate to consider flotation costs in the determination of where the Company's ROE falls within the range of results.

H. Response to Mr. Gorman's Criticisms

Q. Please summarize Mr. Gorman's criticisms of your Cost of Equity analyses.

A. Mr. Gorman asserts my estimated ROE is overstated and should be rejected because (1) my CAPM is based on inflated estimates of the Market Risk

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203 Direct Testimony of Michael P. Gorman, at 60-61.

204 Roger A. Morin, New Regulatory Finance, (Public Utilities Reports, Inc. 2006), at 321-322; Shannon P. Pratt, Cost of Capital Estimation and Applications, Second Edition, at 220-221; and Cleveland S. Patterson, Flotation Cost Allowance in Rate of Return Regulation: Comment, The Journal of Finance Vol. XXXVIII, No. 4. September 1983, at 1337.

Premiums; (2) my Bond Yield Plus Risk Premium is based on inflated utility Equity Risk Premium; (3) my Risk Premium analyses rely on "stale" Treasury yields; (4) my Constant Growth DCF results are based on excessive, unsustainable growth rates; and (5) my Multi-Stage DCF is based on an unrealistic GDP growth estimate and unsustainable payout ratio assumptions.[205] I respond to each of those criticisms in turn, below.

Q. Please summarize Mr. Gorman's criticisms of your CAPM analysis.

A. Mr. Gorman's concern with my CAPM analysis lies primarily with my Market Risk Premium estimates.[206] In particular, Mr. Gorman states that my 12.82 percent and 13.63 percent projected returns on the market are "inflated."[207] To determine the reasonableness of my derived expected market returns, it is instructive to understand how often various ranges of total returns actually have occurred over the 1926 to 2015 period. In fact, the 12.82 percent and 13.63 percent estimates presented in my Direct Testimony, which Mr. Gorman asserts are "inflated,"[208] represent the approximately 49th percentile of the actual returns observed from 1926 to 2015. In other words, of the 90 annual observations, 46 were 13.63 percent or higher. Moreover, given the historical volatility in market returns (as noted by Morningstar, the long-term standard deviation is 19.99 percent), my total return estimates of 12.82 percent and 13.63 percent are

205 Direct Testimony of Michael P. Gorman, at 58.
206 *Ibid*., at 63.
207 *Ibid*., at 64.
208 *Ibid*.

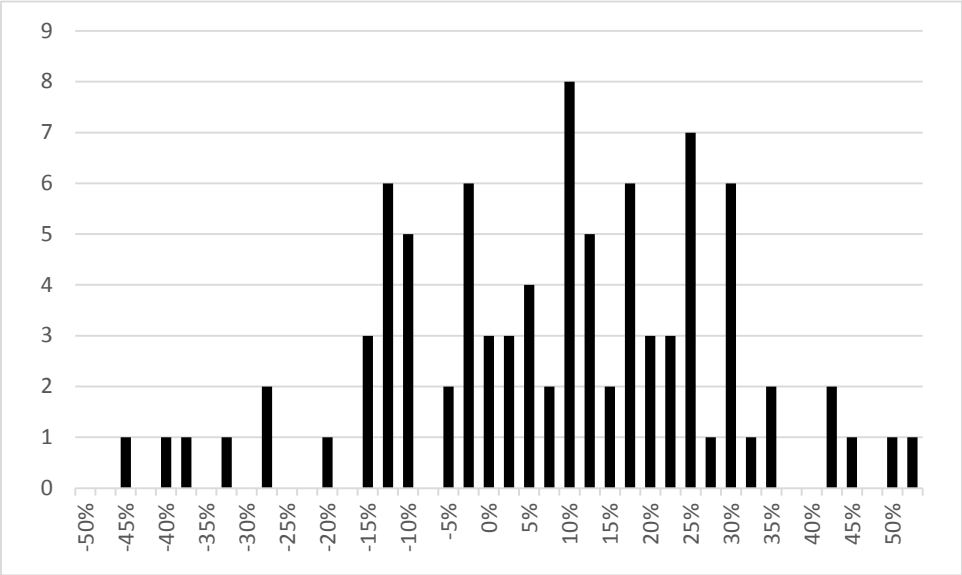
statistically indistinguishable from the long-term arithmetic average of 11.95 percent.[209]

Mr. Gorman further asserts that the Market Risk Premia estimated from my projected market returns are "inflated and not reliable."[210] I therefore performed a similar analysis using historical Market Risk Premia. I first gathered the annual Market Risk Premia reported by Morningstar, and produced a histogram of the observations (recall that Mr. Gorman includes historical data among the methods he uses to estimate the Market Risk Premium). The results of that analysis, which are presented in Chart 15 demonstrate that MRPs of at least 10.68 percent (the high end of the range of the MRP estimates in my Direct Testimony) will occur approximately half of the time.

[209] *See* Morningstar, Inc., 2016 Ibbotson Stocks, Bonds, Bills and Inflation Classic Yearbook, Appendix A, at 3-5; Exhibit RBH-32. Even if we were to look at the standard error, my estimate is well within one standard error of the long-term average.

[210] Direct Testimony of Michael P. Gorman, at 63.

Chart 15: Frequency Distribution of Observed Market Risk Premia, 1926 - 2015[211]



Q. Please summarize Mr. Gorman's criticisms of your Bond Yield Plus Risk Premium analysis.

A. Mr. Gorman's concern with my Bond Yield Plus Risk Premium analysis is my "contention" of a "simplistic inverse relationship" between the Equity Risk Premium and interest rates is not supported by academic research.[212] Mr. Gorman further argues that the relevant factor explaining changes in the Equity Risk Premiums is the change to equity risk relative to debt risk, not changes in interest rates, alone. He concludes that my analysis ignores such investment risk differentials.

[211] Exhibit RBH-32.
[212] Direct Testimony of Michael P. Gorman, at 66.

Q. What is your response to Mr. Gorman's critiques?

A. First, regarding the inverse relationship between the Equity Risk Premium and interest rates, I cited several academic studies in my Direct Testimony that support my findings.[213] Moreover, as explained above, Mr. Gorman's own data clearly demonstrate that the Equity Risk Premium moves inversely to interest rates (both Treasury Yields and Utility Bond Yields). Mr. Gorman may disagree with the premise, but empirical results based on his data support my position (*see* Exhibit RBH-29).

Q. Did you perform any additional analyses to address Mr. Gorman's concern regarding the effect of expected market volatility and other interest rate environments on your results?

A. Yes, I did. Although for the reasons discussed above I continue to believe the model is properly specified, I performed an additional analysis to specifically include the effect of equity market volatility, and credit spreads (*see* Exhibit RBH-33). As with my original Bond Yield Plus Risk Premium analysis, I defined the Risk Premium as the dependent variable, and the prevailing 30-year Treasury yield as an independent variable. I then included two additional explanatory variables: (1) the VIX (the Chicago Board Options Exchange's one-month volatility index, which is a common measure of volatility); and (2) the credit spread between the 30-year Treasury yield and the Moody's Baa Utility Index (as

[213] Direct Testimony of Robert B. Hevert, at 24-25.

a measure of incremental risk).[214] In both instances, the statistically significant inverse relationship between Treasury yields and the Risk Premium remains, and the resulting ROE estimates are generally consistent with those of my original Bond Yield Plus Risk Premium analysis.[215]

Lastly, I note that applying Mr. Gorman's projected 3.40 percent 30-year Treasury yield to the alternative Bond Yield Plus Risk Premium Analysis produces a more reasonable (although still low) ROE estimate of 9.95 percent relative to Mr. Gorman's 9.25 percent recommendation (*see*, Exhibit RBH-33).[216]

Q. What is your response to Mr. Gorman's concern that your CAPM and Bond Yield Plus Risk Premium analyses rely on "stale" Treasury yields?

A. The Treasury yield estimates used in my Direct Testimony corresponded with the timing of the data used in my ROE analysis. Updated Treasury yield estimates as of June 30, 2016 have been used in the analyses accompanying my Rebuttal Testimony. Consequently, my analyses do not rely on "stale" Treasury yields, as Mr. Gorman suggests.

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214 Mr. Gorman notes on page 27 of his testimony that his proxy group has an average Moody's credit rating of Baa1.

215 *See* Exhibit RBH-3.

216 Mr. Gorman uses a 3.40 percent projected Treasury yield in his risk premium analysis. *See*, Direct Testimony of Michael P. Gorman, at 47.

Q. Turning to your DCF analysis, do you agree with Mr. Gorman's assertion that the growth rates used in your constant growth DCF analysis are "excessive" and "unsustainable"?

A. No, I do not. Although Mr. Gorman argues that the consensus growth rates in my constant growth DCF model (averaging 5.39 percent) are high relative to his estimate of projected GDP growth and retention growth, he also notes that my mean results are similar to his own. Even though Mr. Gorman believes that my mean high Constant Growth DCF results of 10.08 percent, which are based on an average growth rate of 6.22 percent, are "not reasonable" estimates of the Company's Cost of Equity, those estimates are well within the prevailing range of authorized returns, a benchmark that Mr. Gorman appears to believe is relevant given that his Risk Premium method is predicated on authorized ROEs.[217]

Q. Please respond to Mr. Gorman's assertion your long-term growth rate is inconsistent with other consensus estimates of long-term GDP growth.

A. As noted in my response to Dr. Woolridge, the long-term growth rate in my multi-stage DCF analysis reflects growth expectations beginning ten years in the future, whereas Mr. Gorman's consensus GDP projections are only five or ten year projections. Because there are no consensus forecasts that begin in ten years, it is reasonable to assume that real growth will revert to its long-term average over time. Moreover, the terminal growth rate is intended to reflect expected growth in perpetuity and as such, the term of even the longest GDP forecast considered by

[217] Direct Testimony of Michael P. Gorman, at 68-69.

Mr. Gorman does not reflect the expected, perpetual nature of the terminal growth assumed in the DCF model.

In his Multi-Stage DCF analysis, Mr. Gorman cites to projections from the Energy Information Administration ("EIA"), Congressional Budget Office ("CBO"), and other sources including the Social Security Administration ("SSA"), and suggests that the terminal growth rate in my Multi-Stage DCF analysis is too high.[218] I address the EIA and CBO forecasts in my response to Dr. Woolridge. In the case of the SSA forecast, my long-term growth estimate falls well within the range of the "cases" that the SSA considers. [219] Moreover, Mr. Gorman's 4.35 percent long-term sustainable growth rate conflicts with market measures cited elsewhere in his testimony. For example, Mr. Gorman does not consider the use of long-term historical data for the purpose of developing his terminal growth rate, yet he relies on long-term historical data for the purposes of his CAPM analyses. According to Duff & Phelps (which provides the data Mr. Gorman relies on to estimate the historical Market Risk Premia), the arithmetic average historical capital appreciation rate is 7.70 percent, which is substantially higher than Mr. Gorman's 4.35 percent estimate of long-term GDP growth.[220]

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218 *Ibid*., at 39, 69.

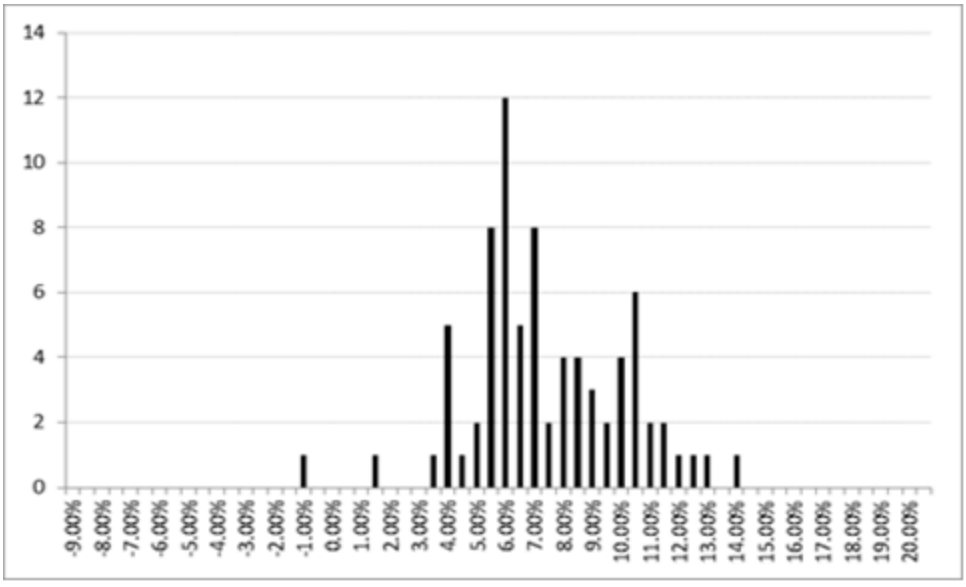
219 Tables V.B1 and V.B2 of the 2016 *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* includes "Low Cost" scenario assumptions of 2.90 percent and 2.70 percent for the GDP Price Index, and Real GDP Growth, respectively, over the period 2025 through 2085. Combined, those projections indicate nominal GDP growth of approximately 5.70 percent.

220 Duff & Phelps, 2016 Valuation Handbook: Guide to Cost of Capital at 2-4. Even if we were to consider the geometric mean, the historical capital appreciation rate exceeds Mr. Gorman's 4.35 percent estimate; Mr. Gorman notes on page 37 of his testimony that the long-term geometric average growth rate is 5.80 percent.

Aside from the inconsistency with his other analyses, Mr. Gorman's low growth rate has the effect of producing unduly low DCF estimates.

To assess whether my 5.35 percent nominal GDP growth estimate is reasonable within the context of historical observations, consistent with Mr. Gorman's approach to his risk premium study, I calculated the average five- and ten-year annual GDP growth rates from 1929 to 2015, an 87-year period. I then arranged that data in histograms to provide a perspective of how frequently various levels of growth have occurred. As Chart 16 demonstrates, average annual growth as low as 4.35 percent has been observed very infrequently. In fact, average annual growth *exceeded* 4.35 percent in 68 of 77 ten-year periods.

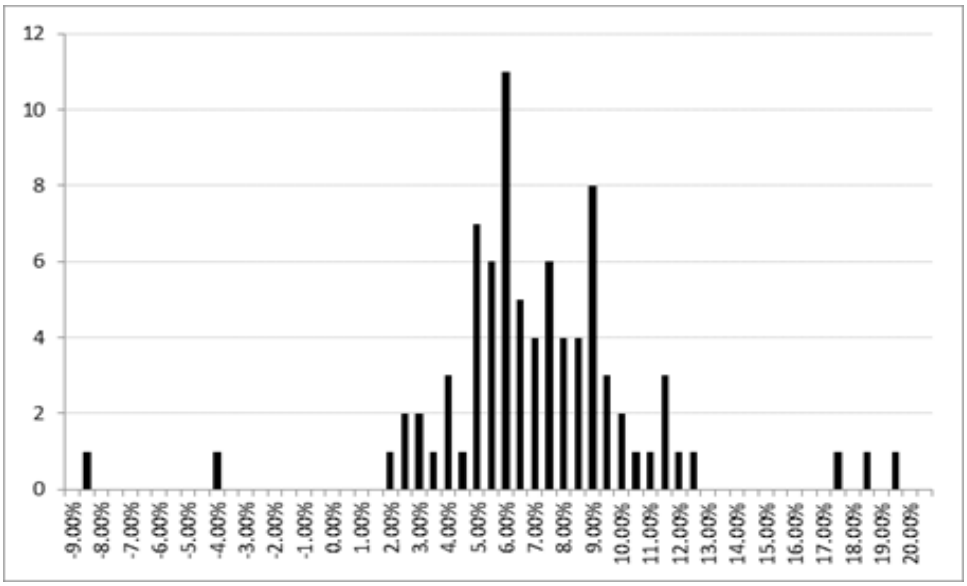
Chart 16: Average Annual GDP Growth Measured over Ten-Year Periods[221]



[221] Source: Bureau of Economic Analysis.

I also calculated average GDP growth over five year periods. In that case, average annual GDP growth rate was greater than 4.35 percent in 70 of 82 periods (*see* Chart 17).

Chart 17: Average Annual GDP Growth Measured over Five-Year Periods[222]



Q. What is your response to Mr. Gorman's assertion that your payout ratio assumption is "unreasonable"?

A. Mr. Gorman argues that there is "no reason" to expect the dividend payout ratio of the proxy group to increase or change between growth stages of the model.[223] However, as noted in my Direct Testimony there are several reasons why management may adjust dividend payments in the near term, such as increases or decreases in expected capital spending.[224] Over the long term, it is reasonable to assume that payout ratios will converge to the industry average; that is, the

222 *Ibid.*
223 Direct Testimony of Michael P. Gorman, at 72.
224 Direct Testimony of Robert B. Hevert, at 33.

analysis assumes that short-term trends in the payout ratio will not continue in perpetuity.

I also note that several of Mr. Gorman's proxy companies recently have discussed target payout ratios that are highly consistent with my 67.30 percent assumption. For example, in first and second quarter 2016 investor relations presentations, Alliant Energy, NorthWestern Corporation, and Xcel Energy all noted target payout ratios in the range of 60.00 percent to 70.00 percent.[225] Consequently, I disagree with Mr. Gorman's position that a long-term payout ratio of approximately 67.00 percent is unreasonable.

IV. RESPONSE TO SFHHA WITNESS BAUDINO

Q. Please summarize Mr. Baudino's ROE analyses and ROE recommendation in this proceeding.

A. Mr. Baudino recommends an ROE of 9.00 percent, which is based on the results of his Constant Growth DCF analyses.[226] Mr. Baudino also performs several CAPM analyses, but does not rely on them to set his recommended ROE.[227]

Mr. Baudino notes that interest rates declined from January 2008 through May 2016, and suggests that the required Return on Equity also is lower.[228] As to the Company's capital structure, Mr. Baudino proposes a hypothetical 55.00 percent

[225] In its June 2016 Investor Presentation at page 39, NextEra Energy noted its 2018 target payout ratio of 65.00 percent.
[226] Direct Testimony of Richard A. Baudino, at 2-3.
[227] *Ibid.*, at 41-42.
[228] *Ibid.*, at 6.

equity ratio.[229] Lastly, because he believes they are accounted for in the stock prices used in DCF analyses, Mr. Baudino suggests it is unnecessary to reflect flotation costs in his ROE estimate.[230]

Q. What are the principal areas in which you disagree with Mr. Baudino's ROE analyses?

A. The principal areas in which I disagree with Mr. Baudino include: (1) the composition and selection of the proxy group companies; (2) his reliance on the Constant Growth DCF model to determine the Company's Cost of Equity; (3) the growth rates applied in the Constant Growth DCF model; (4) the risk-free rate and Market Risk Premium used in the CAPM; (5) whether the Bond Yield Plus Risk Premium analysis provides reasonable estimates of the Company's Cost of Equity; (6) the recovery of flotation costs; (7) our respective assessments of the Company's level of business and financial risk; and (8) the reasonableness of the Company's capital structure.

A. Proxy Group Composition

Q. Please summarize the criteria by which Mr. Baudino selected his proxy group.

A. Mr. Baudino began with the electric utilities included in the June 2016 issue of AUS Utility Reports, and arrived at his proxy group by excluding companies that:

1. Were not rated at least "A" by Standard and Poor's or Moody's Investor Service;

229 *Ibid.*, at 50.
230 *Ibid.*, at 66-67.

2. Have less than 50.00 percent of their revenues from electric operations;
3. Do not have growth rates from Value Line and either Zacks or Thomson Financial;
4. Have recently cut or eliminated dividends; or
5. Were recently, or currently are involved in merger activities or significant restructuring.[231]

Based on those criteria, Mr. Baudino developed a group of twelve companies. Exhibit RBH-19 provides a comparison of the companies included in our respective proxy groups.

Q. Are the scope and definition of the screens applied by Mr. Baudino generally consistent with those used in your Direct Testimony?

A. Although certain of the screening criteria are common to our analyses, there are certain differences between our approaches.

Q. What are the primary differences between you and Mr. Baudino with respect to screening criteria?

A. The majority of the difference in our approaches relate to Mr. Baudino's use of proxy companies that: (1) receive less than 60.00 percent of their regulated net income from electric operations; (2) do not have meaningful amounts of regulated generating assets. In addition, seven companies included in my proxy group were excluded by Mr. Baudino because their bond credit ratings were below A from S&P or Moody's.

[231] *Ibid.*, at 28.

I also excluded Edison International ("EIX") from my proxy group based on recent financial information. EIX's merchant generation business unit was placed into Chapter 11 bankruptcy and subsequently sold to NRG Energy.[232] Although the sale of that segment was completed in April 2014,[233] there are continuing effects on the company's near-term financial outlook associated with a settlement agreement related to the business units' bankruptcy, including required payments of $204 million in 2015, and $214 million in 2016. Consequently, I excluded EIX from my proxy group.

Despite those differences, the composition of our respective proxy groups has little effect on the differences in our analytical results.[234] Consequently, the analyses accompanying my Rebuttal Testimony include results for a Combined Proxy Group that contains most of the proxy companies relied on by the ROE witnesses in this case.[235]

232 *See*, Edison International, SEC Form 10-K, for the Fiscal Year Ended December 31, 2013, at 35-36.

233 *See*, Edison International, SEC Form 10-K, for the Fiscal Year Ended December 31, 2014, at 104.

234 For example, Mr. Baudino reports an average Value Line Beta coefficient of 0.73 (*see* Exhibit No.___(RAB-9), while the average Value Line Beta coefficient for my proxy group, excluding recent mergers, is 0.75 as of June 30, 2016.

235 As discussed in my response to Dr. Woolridge, I continue to exclude companies that have been party to a merger or significant transaction, or that do not own generation assets.

B. Application of the Constant Growth DCF Analysis

Q. Please briefly describe Mr. Baudino's Constant Growth DCF analysis and results.

A. Mr. Baudino calculates an average dividend yield of 3.44 percent by dividing each proxy company's annualized dividend by its average monthly stock price for the six-month period ending May 2016.[236] For the expected growth rate, Mr. Baudino relies on Earnings Per Share growth rate projections from Value Line, Zacks, and Thomson Financial, as well as Dividend Per Share growth rate projections from Value Line.[237] Mr. Baudino then calculates DCF results based on the mean and median growth rate of the four sources noted above, producing eight ROE estimates, ranging from 8.15 percent to 9.54 percent.[238]

Mr. Baudino refers to the DCF results produced using mean growth rates as "Method 1", and DCF results produced using median growth rates as "Method 2". The mean DCF results of his Methods 1 and 2 were 8.64 percent and 8.87 percent, respectively.[239]

Lastly, Mr. Baudino considers a form of "sustainable growth", although he does not appear to include that estimate in his final DCF analyses.

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236 Direct Testimony of Richard A. Baudino, at 29.
237 *Ibid*., at 29.
238 *Ibid*., at 33, Exhibit No.___(RAB-7).
239 *Ibid*.

Q. What are your concerns with Mr. Baudino's selection of growth rates for the DCF models.

A. I disagree with Mr. Baudino's use of projected dividend growth rates in estimating the Cost of Equity and the form of "sustainable growth" described in Mr. Baudino's Direct Testimony. As discussed in my response to Dr. Woolridge, academic literature supports the use of earnings growth rates in the DCF model. As also discussed in my response to Dr. Woolridge, my analyses demonstrate that only earnings growth rates have a statistically significant ability to explain valuation levels.

Q. Please describe the sustainable growth rate estimate used by Mr. Baudino.

A. Mr. Baudino states that he "utilized the sustainable growth formula", which he appears to have taken from Value Line's projected "Retained to Common Equity" rate.[240] As Mr. Baudino explains, the estimate is calculated as the product of the expected earned return on common equity ("R"), and the retention ratio (i.e., the portion of earnings not paid out in dividends, or "B").

Q. Do you agree with Mr. Baudino's sustainable growth rate estimate?

A. No, I do not. As discussed in my response to Dr. Woolridge, the sustainable growth model assumes that growth is a function of expected earnings, and the extent to which those earnings are retained (that is, not paid out in dividends). Mr. Baudino relies on the simplest form of the sustainable growth model, which sometimes is referred to as the "B x R" approach (where "B" is the earnings

[240] *Ibid.*, at 31.

retention rate, and "R" is the expected Return on Common Equity). As Exhibit RBH-34 demonstrates, the B x R method is essentially equal to Value Line's "Retained to Common Equity" rate (differences are due to rounding).

If Mr. Baudino is going to consider a form of sustainable growth, he should use the "BR + SV" form of the model, which reflects growth from both internally generated funds (i.e., the "BR" term) and from issuances of equity (i.e., the "SV" term). As noted above, the first term is the product of the retention ratio (i.e., "B", or the portion of net income not paid in dividends) and the expected return on equity (i.e., "R"). The "SV" term can be represented as:

$$\left(\frac{m}{b} - 1\right) \times Growth\ Rate\ in\ Common\ Shares$$

Where:

$$\frac{m}{b} = The\ Market\ to\ Book\ Ratio$$

In this form, the "SV" term reflects an element of growth as the product of (1) the growth in shares outstanding and (2) that portion of the market-to-book ratio that exceeds unity.

In addition, it is important to realize that for the purpose of setting utility rates, sustainable growth requires an estimate of the expected earned Return on Common Equity. Since the "R" in the "B x R" approach refers to the equity return, Mr. Baudino effectively has pre-supposed the Return on Common Equity projected by Value Line for his proxy group companies. Notwithstanding that Mr. Baudino has assumed the reasonableness of Value Line's projections for the

purpose of his sustainable growth calculation, as demonstrated in Exhibit RBH-34, his recommended Cost of Equity of 9.00 percent is 108 basis points below the mean Return on Common Equity estimate (for his proxy group) of 10.08 percent.

Q. Putting aside those concerns, did Mr. Baudino use the sustainable growth estimate in arriving at his DCF estimate?

A. No, he did not. Exhibit No.___(RAB-7), page 2 provides the DCF calculations that support Mr. Baudino's ROE recommendation; that page does not reference the sustainable growth estimate. In addition, I have replicated Mr. Baudino's Exhibit No.___(RAB-7), page 2 (see Exhibit RBH-35), and confirmed that Mr. Baudino's DCF estimates do not include his sustainable growth estimate.

C. Multi-Stage DCF Analysis

Q. What are Mr. Baudino's concerns with your Multi-Stage DCF analysis?

A. Mr. Baudino considers it "highly unlikely" that investors consider Multi-Stage DCF analyses, and he is concerned I have provided no evidence that investors (1) use GDP growth in their evaluation, or (2) rely on payout ratio assumptions similar to those included in my Multi-Stage DCF analysis.[241]

Q. Do you agree with Mr. Baudino's suggestion that it is "highly unlikely" that investors use Multi-Stage DCF models?

A. No, I do not. As discussed in my Direct Testimony, the Constant Growth DCF Model requires a set of assumptions that can be quite limiting, and inconsistent

[241] Direct Testimony of Richard A. Baudino, at 68.

with prevailing and expected conditions. Mr. Baudino has provided no basis to assume that investors would prefer the limited structure of the Constant Growth DCF Model to the more flexible Multi-Stage form. As to the use of Multi-Stage models, D. Roger Morin notes that it is "consistent with current valuation practices of institutional investors and is a common estimation technique used by financial analysts."[242] For example, Morningstar describes a three-stage DCF approach (generally consistent with the model included in my Direct Testimony) in which the final stage assumes that long-run growth moves toward that of the overall economy.[243] In addition, while we disagree on certain aspects of the application of the Multi-Stage DCF model, I note both Dr. Woolridge and Mr. Gorman also consider Multi-Stage DCF analyses.

Q. Is GDP commonly used as a long-term growth rate assumption?

A. Yes, it is. As noted in my response to Dr. Woolridge, the use of expected long-term GDP growth in the terminal period is consistent with practice and financial literature. Morningstar's Multi-Stage DCF approach (noted above), for example, is similar to my methodology, including the use of GDP in the terminal growth period.[244] Nonetheless, if Mr. Baudino is of the view that (1) the Constant Growth DCF model is the better alternative, and (2) expected GDP growth is not a relevant measure of terminal growth, I have addressed those concerns by

242 Roger A. Morin, New Regulatory Finance, Public Utilities Reports, Inc., 2006, at 266.
243 *See*, Ibbotson SBBI 2013 Valuation Yearbook, Morningstar, Inc., at 50-52.
244 *Ibid*.

calculating the terminal value by reference to the proxy companies' recent P/E ratios.[245]

Q. What is your response to Mr. Baudino's concern with your assumption regarding payout ratios?[246]

A. I believe it is reasonable to assume that near-term payout ratios likely reflect downward pressure due to increased utility capital requirements, but will revert to the long-term industry average over the horizon of the DCF analysis. I note that assumption is consistent with the Value Line data presented in Mr. Baudino's Exhibit No.___(RAB-7), which indicates near-term dividend growth is expected to outpace earnings growth by approximately 130 basis points, on average, for Mr. Baudino's proxy group. In that regard, it is the Constant Growth DCF model relied on by Mr. Baudino (which assumes that payout ratios will remain unchanged in perpetuity) that is inconsistent with investor expectations.

Moreover, as discussed in more detail in my response to Mr. Gorman, a number of electric utility companies have indicated that their payout ratios likely will increase, and that they are targeting payout ratio ranges highly consistent with the long-term industry average used in my Multi-Stage DCF analysis.

[245] As noted earlier, the Constant Growth DCF model assumes a constant P/E ratio, in perpetuity.
[246] Direct Testimony of Richard A. Baudino, at 68.

D. Capital Asset Pricing Model

Q. Please summarize Mr. Baudino's CAPM analyses.

A. As noted earlier, Mr. Baudino performs two sets of CAPM analyses. His first set calculates two Market Risk Premium measures, which rely on the forecasted market total return as determined using Value Line projections, and five and 20-year Treasury security yields (i.e., 1.40 percent and 2.34 percent, respectively). Mr. Baudino calculates a total growth rate for the market of 10.44 percent, using the average of the book value and earnings growth forecasts (7.00 percent and 11.00 percent, respectively) for all companies covered by Value Line. Mr. Baudino combines that average growth rate with Value Line's average expected dividend yield of 0.84 percent for the same group of companies, and calculates an expected market return of 10.44 percent.[247]

Mr. Baudino's two Market Risk Premium measures represent the difference between (1) his calculated expected market total return, and (2) the current yield on five and 20-year Treasury securities. Mr. Baudino arrives at his CAPM results using the average Value Line Beta coefficient of 0.73 for his proxy companies.[248]

Mr. Baudino's second set of CAPM analyses calculate the geometric and arithmetic mean long-term annual returns on stocks, and long-term annual income returns on long-term government bonds, resulting in two historical measures of

[247] Exhibit No.___(RAB-8).
[248] Exhibit No.___(RAB-8).

the Market Risk Premium.[249] Mr. Baudino uses those two Market Risk Premium measures in combination with the current 20-year Treasury bond yield and the average Value Line Beta coefficient to calculate two additional CAPM results.

Although Mr. Baudino advises the Commission to consider only his DCF results in establishing the Company's ROE, he does report CAPM results ranging from 6.02 percent to 8.28 percent, reasoning that those results indicate that his 9.00 percent ROE recommendation is "generous".[250]

Q. Do you agree with Mr. Baudino's application of the CAPM and his interpretation of its results?

A. No, there are two areas in which I disagree with Mr. Baudino: (1) the term of the Treasury security used as the risk-free rate component of the model; and (2) the calculation of the Market Risk Premium. In addition, for the reasons discussed throughout my Rebuttal Testimony, I disagree that Mr. Baudino's 9.00 percent ROE recommendation is "generous".

Q. Turning first to the risk-free rate component, why do you disagree with Mr. Baudino's use of five and 20-year Treasury securities as the measure of the risk-free rate?

A. As discussed below, the tenor of the risk-free rate used in the CAPM should match the life (or duration) of the underlying investment. As noted by Morningstar:

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249 Direct Testimony of Richard A. Baudino, at 38 and Exhibit No.___(RAB-9).

250 *Ibid.*, at 41-42.

> The traditional thinking regarding the time horizon of the chosen Treasury security is that it should match the time horizon of whatever is being valued. When valuing a business that is being treated as a going concern, the appropriate Treasury yield should be that of a long-term Treasury bond. Note that the horizon is a function of the investment, not the investor. If an investor plans to hold stock in a company for only five years, the yield on a five-year Treasury note would not be appropriate since the company will continue to exist beyond those five years.[251]

Pratt and Grabowski recommend a similar approach to selecting the risk-free rate: "In theory, when determining the risk-free rate and the matching ERP you should be matching the risk-free security and the ERP with the period in which the investment cash flows are expected."[252] To that point, a 2004 paper titled *Applying The Capital Asset Pricing Model* by Robert Harris reviews current practices for application of the CAPM and, when summarizing best current practices, concludes "[t]he risk-free rate should match the tenor of the cash flows being valued."[253] As a practical matter, equity securities represent a perpetual claim on cash flows; 30-year Treasury bonds are the longest-maturity securities available to match that perpetual claim.

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251 Morningstar, Inc., 2013 Ibbotson Stocks, Bonds, Bills and Inflation Valuation Yearbook, at 44.

252 Shannon Pratt and Roger Gabrowski, Cost of Capital: Applications and Examples, 3rd Ed. (Hoboken, NJ: John Wiley & Sons, Inc., 2008), at 92. "ERP" is the Equity Risk Premium.

253 Paper cited with permission of author.

One measure of the term of expected cash flows is Equity Duration. In finance, "duration" (whether for bonds or equity) typically refers to the present value weighted time to receive the security's cash flows. In terms of its practical application, duration is a measure of the percentage change in the market price of a given stock in response to a change in the implied long-term return of that stock. A common investment strategy is to "immunize" the portfolio by matching the duration of investments with the term of the underlying asset in which the funds are invested, or the term of a liability being funded.

As demonstrated in Exhibit RBH-36, the average Equity Duration of the companies in Mr. Baudino's proxy group is approximately 30.47 years. Given that relatively long Equity Duration, and knowing that utility assets are comparatively long-lived, I continue to believe that it is appropriate to use the long-term Treasury yield as the measure of the risk-free rate.

Q. Is Mr. Baudino's assumption that five and 20-year Treasury yields are equally valid measures of the risk-free rate supported by his data?

A. No, it is not. As discussed above, the mean Equity Duration of the companies in Mr. Baudino's proxy group is 30.47 years. In comparison, the current duration of five-year, 20-year and 30-year Treasuries are 4.88, 16.57, and 21.46 years respectively.[254] Although the duration of even the longest-term Treasury security falls short of the average Equity Duration for Mr. Baudino's proxy group, the 30-

[254] *See* Exhibit RBH-37.

year Treasury yield provides the longest available duration and, therefore, is the best available security for that purpose. The principle of duration is relevant to the electric utility stocks that comprise Mr. Baudino's proxy group, given that institutional investors own (on average) 75.75 percent of those companies' shares.[255]

Q. Putting aside the issue of Equity Duration, does Mr. Baudino's DCF model recognize the perpetual nature of equity?

A. Yes, it does. As Mr. Baudino correctly observes, the Constant-Growth DCF model assumes growth in perpetuity: "the stream of income from the equity share is assumed to be perpetual; that is, there is no salvage or residual value at the end of some maturity date (as is the case with a bond)."[256]

Q. What would be the effect of assuming the companies in Mr. Baudino's proxy group only provided cash flows to equity investors over five or 20 years?

A. As shown in Exhibit RBH-38, assuming a 20-year holding period, the mean and median DCF would be 1.44 percent, and 1.69 percent, respectively. Interestingly, both of those ROE estimates are below Mr. Baudino's assumed 2.34 percent risk-free rate (*i.e.*, six month average of the 20-year Treasury yield). Assuming a holding period of five years produces mean and median ROE estimates of negative 36.93 percent and negative 36.50 percent, respectively. The only way Mr. Baudino's DCF results could be realized is if the shares were sold at the end of the five and 20-year holding periods, and the prices at which they are sold

[255] Source: SNL Financial.
[256] Direct Testimony of Richard A. Baudino, at 26.

reflect cash flows in perpetuity. Those results support the point made earlier in my testimony: The risk-free rate should reflect the perpetual nature of equity. Because the longest-dated Treasury security is 30 years, that is the appropriate term for this purpose.

Q. What is your response to Mr. Baudino's suggestion that "the risk-free rate should have no interest rate risk?"[257]

A. The process of duration matching mitigates interest rate risk. In any event, if Mr. Baudino is concerned with interest rate risk, he should focus exclusively on short-term Treasury Bills as the risk-free rate. Doing so, of course, would further decrease his already-low CAPM estimates. Consequently, I disagree with Mr. Baudino's position that interest rate risk disqualifies the 30-year Treasury yield as the appropriate measure of the risk-free rate.

Q. What concerns do you have with Mr. Baudino's *ex-ante* Market Risk Premium calculations?

A. In arriving at his *ex-ante* Market Risk Premium estimates, Mr. Baudino calculates the expected market return using an average of earnings growth projections (11.00 percent) and book value growth projections (7.00 percent). As noted above, academic research indicates investors rely on estimates of earnings growth in arriving at their investment decisions. The analysis presented in Exhibit RBH-22 (discussed in more detail in my response to Dr. Woolridge) also demonstrates book value growth rates are not a statistically significant indicator of electric

[257] *Ibid.*, at 62.

utility company valuations. In that regard, Mr. Baudino did not include book value growth projections in his proxy group-based DCF analysis. He has not explained, however, why it is reasonable to include those growth rates in his MRP analysis but exclude them from his proxy company DCF analyses. Excluding book value growth estimates from Mr. Baudino's market return calculation would increase his MRP estimate by 1.00 percentage points (100 basis points).

Q. Do you agree with Mr. Baudino's use of historical estimates of the MRP?

A. No, I do not. The MRP represents the additional return required by equity investors to assume the risks of owning the "market portfolio" of equity relative to long-term Treasury securities. As with other elements of Cost of Equity analyses, the MRP is meant to be a forward-looking parameter. As Morningstar observes:

> It is important to note that the expected equity risk premium, as it is used in discount rates and cost of capital analysis, is a forward looking concept. That is, the equity risk premium that is used in the discount rate should be reflective of what investors think the risk premium will be going forward.[258]

That is why the MRP estimates used in my CAPM analyses specifically rely on forward-looking, market-based estimates of the expected market return.

[258] Morningstar, Inc., 2013 Ibbotson Stocks, Bonds, Bills, and Inflation Valuation Yearbook, at 53.

Q. Please briefly summarize Mr. Baudino's comments regarding your *ex-ante* CAPM analyses.

A. Mr. Baudino disagrees with my *ex-ante* Market Risk Premium, noting that the underlying growth rates "are by no means long-run sustainable growth rates."[259] Mr. Baudino further suggests that the forecasted Treasury bond yields relied upon in my CAPM analyses are "speculative at best and may or may not come to pass."[260]

Q. Do you agree with Mr. Baudino's concerns in that regard?

A. No, I do not. As discussed in my response to Mr. Gorman, my estimates of the Market Risk Premium and the growth rates underlying them are consistent with historical measures.

Regarding the use of projected interest rates, it is important to remember that, as Mr. Baudino states, "[r]eturn on equity analysis is a forward-looking process."[261] In that regard, Mr. Gorman, Dr. Woolridge, and I consider forward-looking estimates of the risk-free rate. Even if Mr. Baudino is concerned that the projections may not come to pass, the increases in forward long-term Treasury yields demonstrate that investors believe interest rates are likely to rise.[262] Because our analyses are predicated on market expectations, the expected

259 Direct Testimony of Richard A. Baudino, at 63.
260 *Ibid*., at 62.
261 *Ibid*., at 30.
262 *See*, Chart 13.

increase in Treasury yields (as reflected in increasing forward rates) is a measurable and relevant data point.

E. Bond Yield Plus Risk Premium Approach

Q. What concerns does Mr. Baudino express regarding your Bond Yield Plus Risk Premium analyses?

A. Mr. Baudino suggests that the Bond Yield Plus Risk Premium method is "imprecise and can only provide very general guidance," and notes that "[r]isk premiums can change substantially over time."[263] In summary, Mr. Baudino likens the approach to a "blunt instrument".[264] As to its application, Mr. Baudino disagrees with the use of projected Treasury yields in calculating the range of Risk Premium-based results.

Q. What is your response to Mr. Baudino's observations?

A. As to Mr. Baudino's point that the Risk Premium can change over time, I agree. As noted in my Direct Testimony (and as discussed in my response to Mr. Gorman), there is a statistically significant negative relationship between long-term Treasury yields and the Equity Risk Premium. Given Mr. Baudino's observation that interest rates have declined since 2008, the Bond Yield Plus Risk Premium analysis provides an empirically and theoretically sound method of quantifying the relationship between the Cost of Equity and interest rates. That is, it provides a method to quantify the change that Mr. Baudino has observed.

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263 Direct Testimony of Richard A. Baudino, at 65.

264 *Ibid.*

As to Mr. Baudino's notion that the approach is a "blunt instrument," I disagree. As shown in Exhibit RBH-12, the R-squared of the Bond Yield Plus Risk Premium regression analysis is 0.71, indicating a rather high degree of explanatory value. In comparison, Beta coefficients calculated based on the Value Line methodology have a mean R-squared of only 0.19 (see Exhibit RBH-39).

As Exhibit RBH-40 demonstrates, using the 95.00 percent confidence interval of the Bond Yield Plus Risk Premium regression's equation coefficient estimates, the ROE results range from 9.47 percent to 10.89 percent. That 142 basis point range is approximately equal to the range of DCF model results reported by Mr. Baudino (8.15 percent to 9.54 percent, or 139 basis points).[265] It also is considerably less than the range of CAPM results reported by Mr. Baudino (6.02 percent to 8.28 percent, or 226 basis points). Consequently, the Bond Yield Plus Risk Premium approach provides empirically and theoretically sound results that can be used, at minimum, to assess the wide range of ROE results produced by Mr. Baudino's analyses in general, and his 9.00 percent recommendation in particular.

[265] *Ibid.*, at 41.

F. Flotation Costs

Q. Please now summarize Mr. Baudino's response to your proposed flotation cost adjustment.

A. Mr. Baudino believes it is "likely that flotation costs are already accounted for in current stock prices" and that an adjustment to the DCF result would amount to "double counting."[266]

Q. Do you agree with Mr. Baudino's concerns?

A. No, I do not. Mr. Baudino states that "[m]ultiplying the dividend yield by a 4% flotation cost adjustment, for example, essentially assumes that the current stock price is wrong and that it must be adjusted downward to increase the dividend yield and the resulting cost of equity."[267]

The flotation cost estimate used in my Direct Testimony, however, is well below 4.00 percent. Moreover, the adjustment is not calculated by "[m]ultiplying the dividend yield by a 4% flotation cost adjustment", as Mr. Baudino suggests. Rather, it is calculated by dividing the dividend yield by a factor of (1 – flotation costs).[268] Further, Mr. Baudino's suggestion that current prices "likely" account for flotation costs is misplaced. Because of direct issuance costs (such as those provided in Exhibit RBH-9 to my Direct Testimony), the net proceeds received by the Company were less than the market price of the offerings. Absent a direct

266 Direct Testimony of Richard A. Baudino, at 66.
267 *Ibid*., at 67.
268 *See*, Exhibit RBH-18.

recovery of those costs, the ROE should be adjusted to reflect that deficiency (which will persist in perpetuity).

I also note that although Mr. Baudino suggests that current prices "likely" account for flotation costs, he has provided no analyses as to what costs are reflected in prices, or how prices have adjusted in response to those costs. Conversely, my Direct Testimony provided a summary of direct costs incurred by the proxy companies to acquire the equity capital needed to fund the Company's rate base.

G. Relative Risk and Financial Integrity

Q. Has Mr. Baudino expressed any concerns with your consideration of the business risks associated with FPL?

A. Yes. Mr. Baudino suggests that the Company's credit rating already accounts for the risks discussed in my Direct Testimony.

Q. Do you believe that credit ratings are an appropriate measure to determine the relative risk of FPL relative to the proxy group?

A. Not entirely. As discussed in my response to Dr. Woolridge, credit ratings are directed toward the interests of debt investors. The view that differences in credit ratings "notches" among investment grade utilities can be used as a proxy for differences in the Cost of Equity fails to recognize the senior position that debt holders have relative to equity holders, and the investment horizon considered by equity holders. Moreover, Exhibit RBH-26 shows that there is not a quantifiable relationship between the proxy companies' credit ratings and Cost of Equity.

Q. Does the fact that Standard & Poor's ranks FPL as having an "Excellent" Business Risk Profile indicate they have less risk than other electric utilities?

A. No, it does not. A review of recent regulated electric utilities credit ratings from S&P Ratings Direct highlighted the prevalence of "Excellent" business risk profiles among electric utilities. Of 107 electric utility operating companies, S&P reported that 79 companies (i.e., approximately 75.00 percent) had "Excellent" business risk profiles (*see* Exhibit RBH-41). Among those with "Excellent" business risk profiles, S&P's credit ratings ranged from as high as AA- to as low as BB+ (i.e., below investment grade). As such, FPL's "Excellent" business risk profile from S&P does not distinguish the Company as being less risky than other electric utilities, nor does it insulate the Company from the detrimental effects of Mr. Baudino's ROE recommendation.

H. Capital Structure

Q. What is Mr. Baudino's position with regard to the Company's capital structure?

A. Mr. Baudino recommends an equity ratio of 55.00 percent if the Commission authorizes an ROE of 9.00 ROE, but an equity ratio of 53.00 percent if the allowed ROE is higher than 9.00 percent.[269] In support of his recommendation, Mr. Baudino notes the single highest equity ratio, at the holding company level, for his proxy group is approximately 55.00 percent and that the average equity

[269] Direct Testimony of Richard A. Baudino, at 4 and 53.

ratio for the proxy group used in my Direct Testimony was approximately 53.00 percent.

As discussed in my response to Dr. Woolridge, I believe the appropriate comparison is to the range of equity ratios in place at similar operating electric utilities. Reviewing the capital structures in place at the electric utility operating companies held within the Combined Proxy Group, it is apparent FPL's equity ratio is consistent with the proxy group's financing practices. I further discuss the Company's capital structure in response to Mr. O'Donnell.

V. RESPONSE TO WAL-MART WITNESS CHRISS

Q. Please summarize Mr. Chriss' testimony regarding the Company's ROE.

A. Mr. Chriss opposes my recommendation because it is higher than the average of authorized ROEs from regulatory commissions, both nationally and in Florida, since 2013.[270] Mr. Chriss also argues that the Commission should consider the Company's future test year and the percentage of revenues recovered through base rates versus cost recovery mechanisms.[271] Lastly, Mr. Chriss suggests that the Commission consider the effect of increases in rates on retailers. Chriss did not, however, undertake an independent, market-based analysis of the Company's Cost of Equity.

[270] *See*, Direct Testimony of Steve W. Chriss, at 10-11.
[271] *Ibid.*, at 9-10.

Q. Have you reviewed and updated the information contained in Mr. Chriss' Exhibit SWC-4?

A. Yes. As shown in Exhibit RBH-42, I have updated Mr. Chriss' Exhibit SWC-4 and added jurisdictional rankings from Regulatory Research Associates ("RRA"). RRA, which is the source of Mr. Chriss' rate case data, provides an assessment of the extent to which regulatory jurisdictions are constructive from investors' perspectives, or not. As RRA explains, less constructive environments are associated with higher levels of risk:

> RRA maintains three principal rating categories, Above Average, Average, and Below Average, with Above Average indicating a relatively more constructive, lower-risk regulatory environment from an investor viewpoint, and Below Average indicating a less constructive, higher-risk regulatory climate from an investor viewpoint. Within the three principal rating categories, the numbers 1, 2, and 3 indicate relative position. The designation 1 indicates a stronger (more constructive) rating; 2, a mid range rating; and, 3, a weaker (less constructive) rating. We endeavor to maintain an approximately equal number of ratings above the average and below the average.[272]

Sorting the data relating to Mr. Chriss' Exhibit SWC-4 by RRA's ranking, two points become apparent. First, looking at all cases there is an approximately 45

[272] Source: Regulatory Research Associates, accessed May 18, 2015.

basis point difference between the average return for "Above Average" and "Average" jurisdictions (the higher-ranked jurisdictions providing the higher authorized returns), and a 25 basis point difference between "Average" and "Below Average" jurisdictions (see Table 6, below). As Table 6 indicates, ROEs for Vertically Integrated electric utilities in "Above Average" jurisdictions range from 9.70 percent to 10.95 percent, with a median of 10.20 percent.

Table 6: Average Authorized ROE by RRA Ranking

	AUTHORIZED ROE: VERTICALLY INTEGRATED		
RRA Ranking	Above Avg.	Avg.	Below Avg.
Total Cases	18	46	7
Minimum	9.70	9.00	9.48
Mean	10.17	9.79	9.70
Median	10.20	9.80	9.70
Maximum	10.95	10.30	9.96

Those observations are important since (as discussed in my response to Mr. O'Donnell, below) the authorized ROE is a very visible measure of the regulatory environment in which utilities operate. The regulatory environment, in turn, is important to utility analysts and investors.

Q. Please now summarize Mr. Chriss' concerns regarding the effect of a rate increase on retailers.

A. Mr. Chriss states that "electricity is a significant operating cost for retailers", and that "[w]hen electric rates increase, that increased cost to retailers can put pressure on consumer prices and on the other expenses required by a business to

operate."[273] Mr. Chriss suggests that the Commission "should thoroughly and carefully consider the impact to customers in examining the requested revenue requirement and ROE, in addition to all other facets of this case, to ensure that any increase in the Company's rates is only the minimum amount necessary to provide adequate and reliable service, while also providing an opportunity to earn a reasonable return."[274]

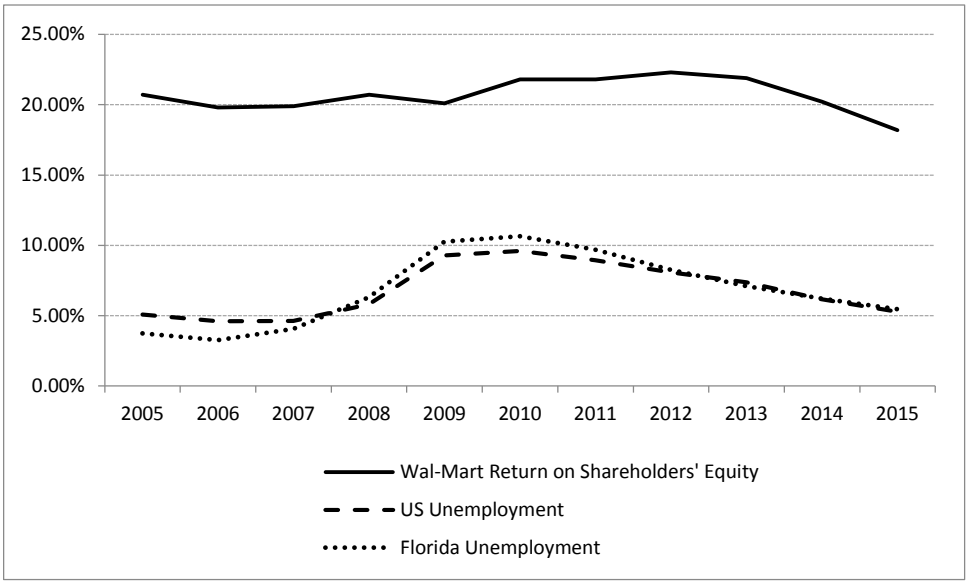
Although Mr. Chriss points out certain pressures that apply to retail businesses such as Wal-Mart, those companies have options not available to regulated utilities such as FPL. Wal-Mart has the option to choose whether, where, and when to open retail stores; what services or products will be offered; whether to invest in expansions, or whether to cease operations in a given location. Further, retail businesses may choose to increase their prices without gaining the approval of regulatory commissions. Quite simply, the options available to retailers such as Wal-Mart are not available to regulated utilities. Such options have value; forgoing those options comes at a cost.

Lastly, despite the pressures that Mr. Chriss discusses, since 200 Wal-Mart's Return on Shareholders' Equity has averaged over 20.00 percent.[275] Value Line currently estimates Wal-Mart's Beta coefficient to be 0.65, and assesses Wal-Mart's Financial Strength as A++. NextEra Energy, on the other hand, has a Beta

[273] Direct Testimony of Steve Chriss, at 7.
[274] Direct Testimony of Steve Chriss, at 7.
[275] Source: Value Line, as of April 29, 2016.

coefficient of 0.70, and a Financial Strength rating of A. By those measures, Wal-Mart is measurably less risky than NextEra Energy.[276]

Chart 18: Wal-Mart Return on Shareholders' Equity and Unemployment rates (2005-2015)[277]



Q. What is your response to Mr. Chriss' recommendation that the commission "examine" the proposed ROE in light of the company's future test year and cost recovery mechanisms?

A. Mr. Chriss asks the Commission to "examine" the proposed ROE in light of the company's future test year and percentage of revenue derived from cost recovery mechanisms, however he does not provide any explanation or analysis to support how these factors would affect FPL's ROE.[278]

[276] Source: Value Line, as of May 20, 2016. Please note that Value Line does not separately rate FPL.

[277] Sources: Value Line; Bureau of Labor Statistic (www.bls.gov).

[278] Direct Testimony of Steve Chriss, at 13-14.

In that regard, the position that a reduction in revenue volatility necessarily requires a reduction in the Cost of Equity runs counter to Modern Portfolio Theory, which is the fundamental basis of the Capital Asset Pricing Model. Under Modern Portfolio Theory, total risk is separated into two distinct components: non-diversifiable risk, which is that portion of risk that can be attributed to the market as a whole; and non-systematic (or diversifiable) risk, which is attributable to the idiosyncratic nature of the subject company itself and, therefore, can be diversified away. Any reduction in the Cost of Equity depends on the type of risk that is reduced. If the risk assumed to be mitigated by rate mechanisms is diversifiable, there would be no reduction in the Cost of Equity because investors could otherwise mitigate the risk through portfolio diversification. If, on the other hand, the risk is non-diversifiable (that is, systematic), it may be that the factors that drove the need to implement the mechanisms also are systematic. That is, if the factors that drove the implementation of rate structures reflected increased systematic risk, those structures would offset that incremental risk and there would be no reduction in the Cost of Equity. Either way, Mr. Chriss has not addressed that crucial issue.

Q. How common are revenue stabilization and cost recovery mechanisms?

A. There is little question that revenue stabilization and cost recovery structures are becoming increasingly common. The increased use of such mechanisms has generally resulted from the growing cost of maintaining system reliability, coupled with the flat or declining sales volume. Adjustment mechanisms to recover fuel costs, purchased power expenses, energy efficiency and demand-side

program costs, new plant investment, and other expenses are common.[279] In addition, decoupling has been implemented by electric utilities in 27 jurisdictions.[280] Consequently, the implementation of alternative regulation mechanisms has become an increasingly visible issue to investors.

Q. Are revenue stabilization mechanisms common among the proxy companies?

A. Yes, they are. Exhibit RBH-43 provides a summary of revenue stabilization mechanisms and cost trackers currently in effect at each electric utility subsidiary of the Combined Proxy Group companies. As Exhibit RBH-43 demonstrates, there are a substantial number of cost recovery mechanisms in place at the proxy companies. Although those mechanisms are diverse, they each address issues related to the timing or certainty of cost recovery. Exhibit RBH-43 also includes a summary of the alternative regulation and incentive plans currently in effect at the proxy companies. Those regulatory constructs include formula-based rate plans, which provide comprehensive adjustment mechanisms that automatically adjust rates in the event that the earned return is above or below an authorized range. Since revenue stabilization and cost recovery mechanisms are common among the proxy companies, I do not believe FPL is materially less risky than its peers by virtue of its recovery mechanisms.

279 See Exhibit RBH-43.

280 *See*, for example, *Alternative Regulation for Emerging Utility Challenges: 2015 Update*, Edison Electric Institute, November 2015, at 4-5. Includes true-up plans, lost revenue adjustment mechanisms, and fixed/variable pricing.

Q. Has Mr. Chriss considered the effect of his recommendation on the Company's financial profile?

A. No, he has not. As discussed in my response to Mr. O'Donnell (below), it is important to recognize that both Moody's and Standard & Poor's put considerable weight on the nature of regulation. Here, Mr. Chriss suggests that the Commission should reduce the Company's ROE by some unspecified amount without the benefit of market-based, comparative analyses to support that recommendation. The consequence of such an action likely would indicate an increased degree of regulatory risk. In my view, therefore, Mr. Chriss has not reasonably considered the effect of his recommendation on the Company's financial profile and, therefore, its ability to attract capital on reasonable terms.

VI. RESPONSE TO OTHER ROE WITNESSES

Q. Please summarize Messrs. Brosch's and Pollock's testimony as they relate to the Company's Cost of Capital.

A. While they review recently authorized ROEs, neither Messrs. Brosch nor Pollock perform an independent analysis of the Company's cost of capital.

Based on his review of average authorized ROEs as well as changes in long-term Treasury yields, Mr. Brosch concludes capital market conditions are "very favorable" and recommends that the Commission therefore allow an ROE "that is significantly lower than the authorized ROE levels approved in recent FPL rate

orders."[281] With regard to capital structure, Mr. Brosch recommends an equity ratio of no more than 47.00 percent based on his review of the average equity ratio used by large electric utility holding companies, as reported by AUS, EEI and Y Charts.[282]

Mr. Pollock performs a similar review of authorized ROEs for vertically integrated electric utilities and concludes that average authorized ROEs have declined and notes that the most recent authorized ROEs in Florida ranged from 10.25 percent to 10.50 percent.[283] Based on that analysis Mr. Pollock concludes an 11.00 percent ROE is "excessive," and recommends the Commission authorize FPL an ROE below the average ROE allowed by other state regulatory commissions to reflect the lower risk associated with a 60.00 percent equity ratio.[284] With regard to capital structure, Mr. Pollock recommends an equity ratio of 51.10 percent based on the average authorized electric utility equity ratio since 2012.[285]

Q. What is your response to Messrs. Brosch and Pollock regarding the appropriate ROE for FPL in relation to recently authorized ROEs?

A. First, although both witnesses argue the average authorized ROE has recently been below 10.00 percent, as discussed in my response to Mr. Chriss, the median authorized ROE for vertically integrated utilities in credit supportive jurisdictions

281 *See*, Direct Testimony of Michael L. Brosch, at 38-39.
282 *See*, Direct Testimony of Michael L. Brosch, at 48, 50-51.
283 Direct Testimony of Jeffry Pollock, at 30.
284 *Ibid*., at 30-31.
285 *Ibid*., at 32.

has been 10.20 percent since January 2013. Of the 18 ROEs authorized for vertically integrated electric utilities by credit supportive jurisdictions since the beginning of 2013, 16 have been 10.00 percent or higher.[286]

Second, neither Mr. Brosch nor Mr. Pollock took in to consideration the Company's specific business risks when determining their ROE recommendations. As discussed in my Direct Testimony and discussed above, I believe the estimation of the Cost of Equity should take into consideration FPL's risk factors, including: (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; and (4) the potential for an increase in the Cost of Equity over the Company's proposed four year rate period. Messrs. Brosch and Pollock's simple review of average authorized ROEs does not take into account those considerations.

Q. What is your response to Mr. Brosch's suggestion that the Company's ROE should be lowered to reflect the general decline in 30-year Treasury yields?

A. While the current 30-day average of the 30-year Treasury yield (2.50 percent as of June 30, 2016) is somewhat below the level seen at the time of the order in the Company's last rate case (2.81 percent as of December 13, 2012), Treasury yields have been rather volatile over the intervening period and spent much of the past few years at higher levels.

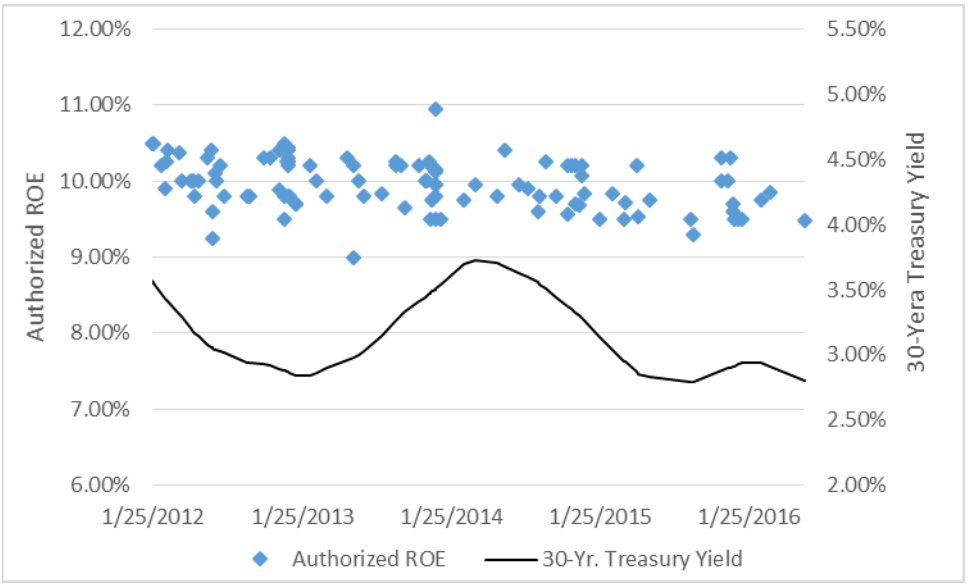
[286] *See* Exhibit RBH-42.

As discussed above, the recent lows in Treasury yields have been associated with a capital flight to safety associated with the "Brexit" and have recently begun to rise off the lows seen during that period. As discussed in my response to Mr. Gorman, consensus forecasts reported by Blue Chip continue to suggest investors expect rates to rise. Similarly, recent prices for options on the TLT index continue to show that investors are willing to pay a significant premium for protection against rising interest rates relative to declining interest rates. Importantly, the potential for rising rates represents risk for utility investors. For example, (as discussed above) the S&P Electric Utility Index lost approximately 15.00 percent of its value in the first half of 2015 as Treasury yields rose 86 basis points to 3.11 percent (from the end of January to the end of June).

Q. Have authorized ROEs changed in tandem with recent fluctuations in Treasury yields?

A. No, they have not. As shown in Chart 19 below, since January 2012 there has been no discernible relationship between the level of authorized ROEs for electric utilities and changes in long-term interest rates. The fact that authorized returns remained relatively stable over that period reflects the inverse relationship between interest rates and the Equity Risk Premium; it also may reflect the observation that utility commissions recognize that Federal policy – including "Quantitative Easing" – created unusual market conditions.

Chart 19: Authorized ROEs for Vertically Integrated Electric Utilities (January 2012 - June 2016) and 30-Year Treasury Yields[287]



Q. What is your response to Messrs. Brosch's and Pollock's recommendations regarding the Company's capital structure?

A. Mr. Brosch suggests higher debt leverage would be beneficial to ratepayers and recommends an equity ratio of 47.00 percent (or lower) based on his estimate of the industry average equity ratio.[288] To support his conclusion, Mr. Brosch compares the Company's existing capital structure to the reported investor owned holding company equity ratios reported by AUS, Edison Electric Institute and Y Charts.[289] As discussed in my response to Dr. Woolridge (above), my review of the actual capital structures in place at the operating companies held within my proxy group reflects the nature of assets financed by vertically integrated utilities

287 Source: Regulatory Research Associates and Federal Reserve Schedule H.15. Average 30-year Treasury over average lag period (200 days). Limited-issue riders are excluded.

288 *See*, Direct Testimony of Michael L. Brosch, at 51.

289 *Ibid.*

such as FPL. Based on that review, it is apparent that the Company's current capital structure is generally consistent with the capital structures of the proxy companies. As discussed in my response to Mr. O'Donnell (below), my updated capital structure analysis continues to support the reasonableness of the Company's capital structure.

Mr. Pollock recommends an equity ratio of 51.10 percent based on the average authorized equity ratio since 2012.[290] A review of the authorized equity ratios reported in Mr. Pollock's Exhibit___(JP-4), however, shows that the Company's 59.60 percent equity ratio is within the range of equity ratios authorized to other vertically integrated electric utilities and is consistent with the Company's most recently authorized equity ratio. Given FPL's specific operating risks and capital needs, I believe the Company's current capital structure is reasonable and Mr. Pollock's suggestion to rely on the average authorized equity ratio is misplaced.

VII. RESPONSE TO OPC WITNESS O'DONNELL

Q. Please summarize Mr. O'Donnell's recommendation regarding the Company's capital structure

A. Mr. O'Donnell recommends a capital structure of 46.93 percent long-term debt, 3.07 percent short-term debt, and 50.00 percent common equity. Mr. O'Donnell's recommendation is based on his review of other electric utility capital structures,

[290] Direct Testimony of Jeffry Pollock, at 32 and Exhibit___(JP-4).

authorized equity ratios reported by RRA, and the capital structure of NextEra Energy and its unregulated subsidiaries.[291]

Q. Do you agree with Mr. O'Donnell's recommended capital structure?

A. No I do not. As noted in my Direct Testimony, FPL is a separate corporate entity with its own capital structure and the Company's current capital structure is consistent with the range of capital structures in place at the operating utilities held by the proxy companies.[292] As discussed by Company witness Dewhurst, FPL has maintained a stable equity ratio over time, which has provided the financial support necessary to maintain FPL's credit rating and access to capital following severe storm damage and during turbulent economic conditions. As discussed below, adding debt to the capital structure (as Mr. O'Donnell recommends) increases financial risk and, therefore, the Cost of Equity.

Q. How does the capital structure affect the Cost of Equity?

A. In the practice of finance, we often speak of two general categories of risk: business risk and financial risk. Business risk generally includes operating, market, regulatory, and competitive uncertainties, whereas financial risk is associated with additional levels of debt in the capital structure (often referred to as "financial leverage"). As the degree of financial leverage increases, the risk of financial distress (*i.e.,* the risk of not meeting financial obligations as they become due) also increases. In essence, even if two firms face the same business risks, the

[291] Direct Testimony of Kevin W. O'Donnell, at 15, 21.
[292] Direct Testimony of Robert B. Hevert, at 67.

company with higher levels of debt in its capital structure is likely to have higher total risk and, therefore, higher costs of both debt and equity.

Business and financial risk are related in that financial leverage has the effect of concentrating business risk on equity investors. By way of example, if a firm were capitalized with 100.00 percent common equity, there would be no financial risk and individual equity holders would hold *pro rata* shares of business risk. If the firm were capitalized with 60.00 percent equity and 40.00 percent debt, the equity investors would continue to bear residual business risk, even though they represent only 60.00 percent of the capital structure. As Brigham and Gapenski point out, "…the use of debt, or financial leverage, concentrates the firm's business risk on its stockholders."[293]

It is also important to recognize both the complexity and the dynamic nature of the relationship between capital structure, financial integrity, cost of capital and maintaining ongoing access to capital at reasonable costs. In particular, financing costs go beyond coupon rates, and any measure of an "optimal" capital structure must consider the numerous objectives and constraints associated with financing decisions. In my practical experience raising capital for a publicly traded utility, I can say firsthand that capital structure "optimization" is an extremely complex notion. Simply reviewing holding company or authorized equity ratios without

[293] Eugene F. Brigham, Louis C. Gapenski, Financial Management, Theory and Practice, 1994, The Dryden Press, at 528.

considering differences in situations, constraints, or objectives is an overly simplistic approach that is likely to lead to flawed conclusions.

Q. Please describe your review of FPL's capital structure relative to industry practice.

A. In Exhibit RBH-10, I calculated the average capital structure for each of the utility operating companies held by the proxy companies over the most recent eight fiscal quarters (ending in the third calendar quarter of 2015). I have updated that analysis in Exhibit RBH-17 using the Combined Proxy Group. As that Exhibit demonstrates, for the period ending in the first quarter of 2016 the proxy group companies' average common equity ratios ranged from 45.95 percent to 61.00 percent. Based on that updated review, FPL's equity ratio remains within the range of those in place at the operating utilities of the proxy companies. Although this comparison is not specific to FPL, it does recognize that utility operating companies must finance long-lived assets, and must access capital regardless of market conditions. It also indicates that the Company's equity ratio is within the range of those in place at other vertically integrated electric utilities.

Q. Are there implications of increasing the debt component and reducing the common equity component of FPL's capital structure?

A. Yes, there are. Based on criteria established by Standard and Poor's ("S&P"), a credit rating reflects the combination of the company's "Business Risk" rating and its "Financial Risk" rating. With regard to business risk, Standard & Poor's ("S&P") has noted that:

> The assessment of regulatory risk is perhaps the most important factor in Standard & Poor's Ratings Services' analysis of a U.S. regulated, investor-owned utility's business risk. Each of the other four factors we examine--markets, operations, competitiveness, and management--can affect the quality of the regulation a utility experiences, but we believe the fundamental regulatory environment in the jurisdictions in which a utility operates often influences credit quality the most.[294]

Similarly, Moody's considers the regulatory structure to be so important that 50.00 percent of the factors that weigh in a ratings determination are related to the nature of regulation.[295] Among the factors considered by Moody's in assessing the regulatory framework are the predictability and consistency of regulatory actions:

> As the revenues set by the regulator are a primary component of a utility's cash flow, the utility's ability to obtain predictable and supportive treatment within its regulatory framework is one of the most significant factors in assessing a utility's credit quality. The regulatory framework generally provides more certainty around a utility's cash flow and typically allows the company to operate

[294] Standard & Poor's, *Utilities: Assessing U.S. Utility Regulatory Environments*, updated November 15, 2011.

[295] Moody's Investors Service, Rating Methodology; Regulated Gas and Electric Utilities, at 6 (Dec. 23, 2013).

> with significantly less cushion in its cash flow metrics than comparably rated companies in other industrial sectors.
>
> ***
>
> In situations where the regulatory framework is less supportive, or is more contentious, a utility's credit quality can deteriorate rapidly.[296]

A decision by the Commission to increase FPL's debt ratio (*i.e.*, increase FPL's financial leverage) therefore could adversely affect investors' perception of the regulatory environment in Florida.

Q. Please explain your concern with Mr. O'Donnell's recommendation relative to the financial community's view of Florida regulation.

A. As discussed in my response to Mr. Chriss, Florida is considered to be a credit-supportive jurisdiction. Any decrease in the perception of regulatory supportiveness in Florida may increase investors' assessment of FPL's regulatory risk (and therefore its business risk and Business Risk rating), increasing FPL's cost of capital. As noted earlier, Moody's considers the regulatory structure to be so important that 50.00 percent of the factors that weigh in a ratings determination are related to the nature of regulation.

As also discussed in Mr. Dewhurt's rebuttal testimony, if the Commission were to adopt Mr. O'Donnell's recommendation, it would represent a departure from

[296] Moody's Investors Service, Regulatory Frameworks – Ratings and Credit Quality for Investor-Owned Utilities, at 2 (June 18, 2010).

recent precedent. In light of Moody's focus on "predictable and supportive treatment," I strongly disagree with Mr. O'Donnell that his recommendation somehow would not have any impact on how credit rating agencies view FPL.[297] Such a dramatic change by the Commission from previous decisions would create an immediate and lasting concern for investors of the supportiveness of the regulation in Florida.

Q. What is your conclusion regarding the appropriate capital structure for FPL?

A. It is important for FPL's capital structure to reflect the Company's risks, and to provide sufficient financial support to maintain liquidity and access to capital. Considering that the proxy company average equity ratios range from 45.95 percent to 61.00 percent, I believe that FPL's 59.60 percent common equity ratio is reasonable. Increasing FPL's debt leverage would increase its Cost of Equity, and potentially reduce investor confidence in the regulatory support for its operations and increase its financial risk. I believe it is likely the increased financial and regulatory risk would increase investors' required returns.

[297] *See*, Direct Testimony of Kevin W. O'Donnell, at 25-26.

VIII. RESPONSE TO OPC WITNESS LAWTON

Q. Please summarize Mr. Lawton's testimony regarding the supportiveness of Dr. Woolridge's ROE recommendation and Mr. O'Donnell's capital structure recommendation for FPL's financial integrity.

A. Mr. Lawton suggests that Dr. Woolridge's 8.75 percent ROE recommendation and Mr. O'Donnell's 50.00 equity / 50.00 percent debt capitalization recommendation are sufficient to maintain FPL's financial integrity.[298] To support his position, Mr. Lawton notes that he reviewed credit rating agency commentary, and determined that FPL's credit quality is considered "strong," and "not threatened or under significant pressure of a downgrade."[299] Mr. Lawton also performs a *pro forma* analysis of certain financial metrics (including Cash From Operations to Interest, Cash From Operations to Debt, and Debt to Capital) to support his position and concludes that the results "indicate strong financial metrics, supporting FPL's current bond rating."[300]

Q. How do ratings agencies' view the use of credit metrics in ratings determinations?

A. Ratings agencies provide benchmark guidelines that associate credit metric ranges with different credit ratings, but credit ratings are not determined by mechanical application of financial ratios to a rating matrix. For example, On November 30, 2007, S&P released a statement announcing that electric, gas, and water utility

298 Direct Testimony of Daniel J. Lawton, at 30.
299 *Ibid.*, at 24.
300 *Ibid.*, at 26.

ratings would be "categorized under the business risk/financial risk matrix used by the Corporate Ratings group." [301] S&P also provided matrices of business and financial risk, based on "Financial Risk Indicative Ratios": FFO/Debt; FFO/Interest; and Total Debt/Capital. In that announcement, S&P noted that:

> …even after we assign a company business risk and financial risk, the committee does not arrive by rote at a rating based on the matrix. The matrix is a guide - - it is not intended to convey precision in the ratings process or reduce the decision to plotting intersections on a graph. Many small positives and negatives that affect credit quality can lead a committee to a different conclusion than what is indicated in the matrix.[302]

On May 27, 2009, S&P expanded its matrix, and noted the relative significance of credit metrics to the rating process:

> The rating matrix indicative outcomes are what we typically observe – but are not meant to be precise indications of guarantees of future rating opinions. Positive and negative nuances in our analysis may lead to a notch higher or lower than the outcomes indicated in the various cells of the matrix.

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[301] Standard & Poor's Ratings Services, *U.S. Utilities Ratings Analysis Now Portrayed In The S&P Corporate Ratings Matrix*, Nov. 30, 2007, at 2 – 3.

[302] *Ibid.*, at 3.

> Moreover, our assessment of financial risk is not as simplistic as looking at a few ratios. [303]

Later, on September 18, 2012, S&P further expanded its matrix, confirming that "[s]till, it is essential to realize that the financial benchmarks are guidelines, neither gospel nor guarantees."[304]

It is clear, therefore, that credit metrics are not relied on in a rote fashion, nor are individual metrics viewed in isolation, to the exclusion of other information. Rather, those reviews encompass broad assessments of business and financial risk, including factors that are extraneous to the standalone, mathematically derived financial metrics of the regulated utility, and which are often based on qualitative, not entirely quantitative, discussions with management.

It also should be remembered that metrics used by Mr. Lawton, (*i.e.*, Cash Flow to Interest, Cash Flow to Debt, and Debt to Capital ratios) are derived from financial statements, including the Income Statement, Balance Sheet and Cash Flow Statement. For regulated utilities, all three are influenced by the overall rate of return allowed by regulatory commissions, which is reflected in the revenue requirement. The metrics therefore are a result of the regulatory process, *i.e.*, the overall rate of return, which in turn is a function of the capital structure (debt and

[303] Standard & Poor's Ratings Services, *Criteria Methodology: Business Risk/Financial Risk Matrix Expanded*, May 27, 2009, at 4-5.

[304] Standard & Poor's Ratings Services, *Methodology: Business Risk/Financial Risk Matrix Expanded*, September 18, 2012, at 4.

equity ratios), debt cost rate and the allowed ROE. It is not the other way around. To set a component of the overall rate of return, such as the ROE and equity ratio, based on *pro forma* credit metrics therefore is a circular exercise, and one that in my experience is atypical of the regulatory process.

Assessing recommended equity ratios and ROEs on the basis of *pro forma* credit metrics therefore should be done with the explicit understanding that other, often qualitative factors weigh heavily in ratings determinations. Like so many other aspects of corporate finance, ratings determinations are an empirical, but not an entirely mathematical exercise. Because so many other factors are considered, a focused review of *pro forma* metrics is the type of partial analysis that practitioners avoid.

Q. Please describe Mr. Lawton's *pro forma* financial metric analysis.

A. Alternately assuming FPL and OPC's proposed ROE and capital structures, Mr. Lawton calculates the following ratios: Cash From Operation to Debt (CFO/Debt), Cash From Operations to Interest (CFO/Interest), and Debt to Total Capital (Debt/Capital).[305] Mr. Lawton then compares the results of those ratios to Moody's benchmark guidelines for "A" and "Baa" rated bonds.

[305] Direct Testimony of Daniel J. Lawton, Exhibit___(DJL-5). Mr. Lawton also varied certain revenue requirement assumptions based on the Company's and OPC's position, including rate base and depreciation & amortization.

Q. Does Mr. Lawton's analysis support his position that OPC's recommended 8.75 percent ROE and 50.00 equity / 50.00 percent debt capital structure would continue to support the Company's current bond rating?

A. No, I do not believe so. As Mr. Lawton notes, Mr. O'Donnell's proposed 50.00 percent equity ratio falls below Moody's benchmark for an A rating (55.00 percent to 65.00 percent equity).[306] In addition, Mr. Lawton's *pro forma* financial metric analysis shows OPC's ROE and capital structure recommendations would result in a 22.52 percent CFO/Debt ratio, which is at the bottom end of the 22.00 percent to 30.00 percent benchmark guideline for an "A" rating.[307] As noted above, although a given financial metric may be within a given benchmark range, other factors may affect the rating agency's actual rating assessment.

With regard to the CFO/Interest financial metric, I believe relying on Mr. Lawton's *pro forma* results to assess the credit supportiveness of any specific ROE or equity ratio is misplaced. In particular, I examined the robustness of using that measure as a threshold benchmark by recreating the analysis provided in Schedule (DJL-5) and testing variations in the assumed ROE. As shown in Table 7 (below) relying on the assumptions in the scenario in column "A" of Mr. Lawton's Schedule (DJL-5), including the Company's existing equity ratio of 59.60 percent, but adjusting the ROE to 0.00 percent (i.e., no return on equity) still produces a CFO/Interest in the "A" rating category. The assumption that the

306 Direct Testimony of Daniel J. Lawton, at 30. A 35.00 percent to 45.00 percent Debt/Capital ratio implies a 55.00 percent to 65.00 percent equity ratio.

307 *Ibid.*, Exhibit___(DJL-5).

Company could maintain an A-rating with a 0.00 percent allowed return on equity is clearly misplaced, and certainly does not provide a reasonable benchmark for determining an equity ratio that satisfies the *Hope* & *Bluefield* standards acknowledged by Mr. Lawton.[308] Assuming the scenario in column "B" of Mr. Lawton's schedule, including a 50.00 percent equity ratio, but adjusting the ROE to 6.25 percent also produces a CFO/Interest ratio in the A-rating category. Consequently, the CFO/Interest metric does not appear to be a good measure for assessing the reasonableness of ROE or capital structure proposals.

Table 7: CFO/Interest – Variations in Mr. Lawton's Analysis[309]

	Assumptions		Moody's Guideline (4.5x – 6.0x = A rating)	
Scenario	**ROE**	**Equity Ratio**	**CFO/ Interest**	**Implied Rating**
Scenario A – Original	11.50%	59.60%	8.6x	Aaa
Scenario A – with 0.00% ROE	**0.00%**	59.60%	4.8x	A
Scenario B – Original	8.75%	50.00%	5.1x	A
Scenario B – with 6.25% ROE	**6.25%**	50.00%	4.5x	A

I also note a similar test of the robustness of Mr. Lawton's CFO/Debt analysis produces similarly unlikely results. For example, assuming OPC's recommendations as provided in Schedule (DJL-5), but adjusting the ROE to negative 0.76 percent would still achieve a CFO/Debt ratio sufficient for a Baa rating (13.00 percent).

308 *Ibid.*, at 24.
309 See also, Exhibit RBH-44.

Lastly, I note that Moody's April 2015 Credit Opinion of FPL stated that a downgrade of the Company's rating would be considered "if there are significant cost disallowances or other changes to Florida's credit-supportive regulatory and cost recovery framework, or if there is a sustained decline in cash flow coverage metrics, including CFO Pre-WC-to-debt below 25%, or an increase in debt-to-capitalization above the 40% range." Mr. Lawton's *pro forma* analysis indicates OPC's recommendations result in financial metrics below the thresholds Moody's notes would trigger consideration of a downgrade.

Q. Are there other considerations that should be taken in to account when determining the credit supportiveness of OPC's ROE and capital structure recommendations?

A. Yes. As noted above, financial metrics are only one factor rating agencies take into consideration when assessing a company's credit rating. The assessment of the regulatory environment is another important factor. In that regard, Moody's notes that the regulatory "framework in which a regulated utility operates is typically one of its most significant credit considerations. The regulatory structure and its general framework is a primary consideration that differentiates the industry from most other corporate sectors."[310] Moody's further explains:

> As the revenues set by the regulator are a primary component of a utility's cash flow, the utility's ability to obtain predictable and supportive treatment within its

[310] *See* Moody's Investors Service, *Special Comment: Regulatory Frameworks – Ratings and Credit Quality for Investor-Owned Utilities*, June 18, 2010, at 1.

> regulatory framework is one of the most significant factors in assessing a utility's credit quality. The regulatory framework generally provides more certainty around a utility's cash flow and typically allows the company to operate with significantly less cushion in its cash flow metrics than comparably rated companies in other industrial sectors. In situations where the regulatory framework is less supportive, or is more contentious, a utility's credit quality can deteriorate rapidly.[311]

I believe the effect of (1) authorizing an equity ratio significantly below the ratio long used by FPL to successfully finance its operations (through a range of market and operating conditions); and (2) authorizing an ROE that is not only 175 basis points below the Company's currently authorized ROE, but is also below the lowest ROE authorized for a vertically integrated electric utility in at least the last 30-years, would be to reduce investors' assessment of the regulatory supportiveness for FPL. A perception of unsupportiveness, or regulatory inconsistency, could linger long into the future and affect FPL's ability to access the capital markets on favorable terms, especially during times of market unrest or operational strain from extensive weather related damage.

[311] *Ibid.*, at 2.

IX. UPDATED AND REVISED ANALYSES

Q. Have you updated the analyses presented in your Direct Testimony?

A. Yes. I have updated the Constant Growth DCF, Multi-Stage DCF, CAPM, and Risk Premium analyses presented in my Direct Testimony with data as of June 30, 2016. As noted in my response to Dr. Woolridge, I performed the analyses for a Combined Proxy Group comprised of the companies included by the opposing ROE witnesses and me in our respective proxy groups.

Q. Please summarize your updated CAPM analysis.

A. I have continued to use the same inputs used in my Direct Testimony, updated through June 30, 2016. For the risk-free rate, I continue to refer alternately to (1) the 30-day average of the 30-year Treasury yield; and (2) a consensus forecast of the average 30-year Treasury yield for 2017 and 2020. Likewise, I continue to rely on published Beta coefficients from Bloomberg and Value Line, and the *ex-ante* market risk premia described in my Direct Testimony (*i.e.*, the expected return on the S&P 500 Index less the current 30-year Treasury yield).

Q. What are your updated CAPM results?

A. As shown in Table 8 (below; see also, Exhibit RBH-11), based upon updated market information, my CAPM analyses produce a range of ROE estimates from 8.97 percent to 12.64 percent.

Table 8: CAPM Results

	Bloomberg Derived Market Risk Premium	Value Line Derived Market Risk Premium
Bloomberg Beta Coefficient		
Current 30-Year Treasury (2.50%)	8.97%	9.29%
Blue Chip Forecast 2017 (3.40%)	9.86%	10.19%
Blue Chip Forecast 2020 (4.40%)	10.86%	11.19%
Value Line Beta Coefficient		
Current 30-Year Treasury (2.50%)	10.35%	10.75%
Blue Chip Forecast 2017 (3.40%)	11.25%	11.64%
Blue Chip Forecast 2020 (4.40%)	12.25%	12.64%

Q. Please summarize your updated Risk Premium analysis.

A. My updated Risk Premium analysis includes authorized ROEs as reported by Regulatory Research Associates through June 30, 2016. For the purpose of calculating the expected risk premium and ROE, I have used the current and projected 30-year Treasury yield. As shown in Table 9 (below; see also, Exhibit RBH-12), my updated results range from 10.04 percent to 10.37 percent.

Table 9: Bond Yield Plus Risk Premium Results

Assumed Treasury Yield	Implied ROE
Current 30-Year Treasury (2.50%)	10.04%
Blue Chip Forecast 2017 (3.40%)	10.08%
Blue Chip Forecast 2020 (4.40%)	10.37%

Q. Please summarize your updated Constant Growth DCF and Multi-Stage DCF analyses.

A. I have continued to use projected earnings growth rates from Zacks, First Call, and Value Line in developing my Constant Growth and Multi-Stage DCF models. The results are shown in Table 10 (below); *see also*, Exhibit RBH-13 to Exhibit RBH-14.

Table 10: Discounted Cash Flow Model Results

	Low Growth Rate	**Mean Growth Rate**	**High Growth Rate**
Mean Constant Growth DCF Results			
30-Day Average	8.32%	8.91%	9.41%
90-Day Average	8.41%	8.99%	9.49%
180-Day Average	8.60%	9.19%	9.69%
Mean Multi-Stage DCF Results			
	Low Growth Rate	**Mean Growth Rate**	**High Growth Rate**
30-Day Average	9.03%	9.16%	9.28%
90-Day Average	9.12%	9.26%	9.38%
180-Day Average	9.33%	9.48%	9.61%
Mean Multi-Stage DCF Results – Terminal P/E at 20.86			
	Low Growth Rate	**Mean Growth Rate**	**High Growth Rate**
30-Day Average	9.44%	9.79%	10.09%
90-Day Average	9.67%	10.03%	10.32%
180-Day Average	10.18%	10.54%	10.84%

X. SUMMARY AND CONCLUSION

Q. What are your overall conclusions and recommendations?

A. Based on the analyses discussed throughout my Rebuttal Testimony, I conclude that my recommended range of 10.50 percent to 11.50 percent, and within that range, 11.00 percent, remains a reasonable and appropriate estimate of FPL's Cost of Equity. The results of the updated DCF, CAPM, and Bond Yield Plus Risk Premium analyses, along with my analyses of capital market data, authorized returns in other regulatory jurisdictions, and assessment of rating agency concerns and criteria support the reasonableness of my range of ROE estimates and my recommendation. Furthermore, I do not support certain intervenors' recommendation to authorize a hypothetical capital structure below the Company's actual capital structure.

As discussed above, the period over which my analyses were performed included market data that were highly unusual and inconsistent with the DCF model's fundamental assumptions. In my view, therefore, Risk Premium-based methods should be given more weight than the DCF-based approaches. Doing so supports my recommended range of 10.50 percent to 11.50 percent, and my ROE recommendation of 11.00 percent.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BY MR. LITCHFIELD:

Q Mr. Hevert, you have exhibits that were identified in your prefiled testimony as RBH-11 through RBH-44, correct?

A Yes, that's correct.

Q And I would note that these exhibits have been pre-identified in staff's exhibit list as numbers 352 through 385.

CHAIRMAN BROWN: So noted. Staff.

EXAMINATION

BY MS. BROWNLESS:

Q Mr. Hevert, did you review what's been identified on the comprehensive exhibit list as Exhibit 522 which are work papers associated with your rebuttal testimony?

A Yes, I did.

Q Are those true and correct, to the best of your knowledge and belief?

A Yes, they are.

Q If I were to ask you to provide work papers today, would you provide the same work papers?

A I would.

Q Are there any portions of your work papers that are confidential?

A Not to my knowledge, no.

MS. BROWNLESS: Thank you, sir.

CHAIRMAN BROWN: FPL.

FURTHER DIRECT EXAMINATION

BY MR. LITCHFIELD:

Q Mr. Hevert, would you please provide a summary of your rebuttal testimony for the Commission this evening.

A Yes, thank you. Madam Chairman, Commissioners, good evening and thank you for the opportunity speak with you again this evening. My rebuttal testimony responds to opposing witnesses as their recommendations relate to the company's return on equity and capital structure.

Turning first to the return on equity, I have discussed the fact that the cost of equity is unobservable and, therefore, must be estimated based on the application of financial models. I've also discussed the fact that those models are based on simplifying assumptions that may be become more or less applicable as market conditions change.

No one financial model is more reliable than all others under all market conditions. And when a given model's underlying assumptions are incompatible with prevailing and expected market conditions, its results are not likely to be reasonable estimates of

the return that equity investors require.

The opposing ROE witnesses in this case have given considerable weight to the constant growth discounted cash flow method, and my concern with that approach is that many of the models underlying the assumptions are incompatible with the current market.

In the recent market, utility stock prices have been driven by Central Bank policy and the resulting reach for yield on the part of investors. The model assumes that a return calculated today under those conditions will be the same return that investors will require every year in perpetuity.

And that is if the model calculates a return of 8.75 percent today, it assumes that investors will require that same 8.75 percent in Year 5, Year 10, Year 20, Year 100 even though it's highly likely that market conditions will change, even though it's highly likely that Central Bank policy will have evolved.

There are other more technical concerns that I have with the opposing witnesses application of the discounted cash flow model, the capital asset pricing model and other methods. Those concerns are discussed throughout the balance of my rebuttal testimony, but putting aside methodological issues, I disagree that equity investors return or require as low as

9.25 percent.

I also disagree with certain of the opposing witnesses that simply proforma analyses of a limited number of credit metrics support their ROE recommendations. The credit rating process is complex and like estimating the cost of equity, it's not solely based on quantitative analyses.

In my view, an ROE of 9.25 percent or lower is not likely to be considered constructive by the financial community. Rather, it would put downward pressure on the financial community's view of the company's financial profile ultimately to the long-term detriment of its customers.

As to the company's capital structure, I continue to believe that if we were to look at other companies as a point of reference, the proper perspective is the operating company level, not the holding company level.

Although no one utility is a perfect substitute for another, operating utilities must finance long-lived, irreversible assets regardless of market conditions. They have limited options to defer and delay capital acquisition. They have similar financing objectives and face similar constraints.

From that perspective, I continue to believe

that the company's proposed 59.6 percent equity ratio on an investor-supplied basis is reasonable.

Thank you for your time and for your consideration.

MR. LITCHFIELD: Mr. Hevert is now available for cross examination.

CHAIRMAN BROWN: Thank you, Mr. Hevert. Good evening. Thank you and welcome back.

MR. HEVERT: Thank you.

CHAIRMAN BROWN: A reminder to all of the parties who are cross examining this witness that although his rebuttal testimony is voluminous, please be cognizant of keeping your questions to the rebuttal testimony and not trying to ask questions as if he was a direct witness to his direct testimony.

I'll be paying attention very closely to this process. So, we will be starting with Mr. Moyle.

EXAMINATION

BY MR. MOYLE:

Q Thank you. Good evening, sir.

A Good evening.

Q The documents that you were asked to review by staff -- how many pages did those documents

represent?

A I would say several thousand.

Q And that was in your rebuttal just a minute ago; is that right?

A I'm sorry, is your question were those work papers related to my rebuttal testimony?

Q Yes.

A Yes, they were related to my rebuttal testimony.

Q And so, the several thousand that you're saying that you reviewed just a minute ago -- that was just a minute ago with Ms. Brown. So, it was in addition to what you reviewed in your direct testimony, right?

A Yes. The work papers that we spoke to just now were with respect to my rebuttal testimony.

Q And it was several thousand pages?

A That's my recollection. To the extent that it included many pages of analyses, many pages of cited documents, it was at least well into the several hundreds, and it's not uncommon for it to be far more than that.

Q Have there been any Commission decisions addressing return on equity since you last visited with us?

A Since last week?
Q Yes, sir.
A Not that I'm aware of.
MR. MOYLE: Thank you. That's all I have.
CHAIRMAN BROWN: Thank you, Mr. Moyle.
MR. LITCHFIELD: Not even one objection I was able to make.
CHAIRMAN BROWN: I mean, really. You had your finger on the button.
Retail Federation.
MR. LaVIA: No questions. Thank you.
CHAIRMAN BROWN: Thank you. FEA.
MR. JERNIGAN: No questions. Thank you.
CHAIRMAN BROWN: Thank you, Mr. Jernigan. Ms. Czank.
MS. CSANK: No questions, ma'am.
CHAIRMAN BROWN: Thank you. Wal-Mart.
MR. WILLIAMSON: I do have a few.
CHAIRMAN BROWN: That's okay.
MR. WILLIAMSON: We'll see. We'll see if my questions are as muddled as my mind.

EXAMINATION

BY MR. WILLIAMSON:
Q Good evening, Mr. Hevert. How are you doing?

A I'm doing well. How are you?

Q My questions are going to focus on your rebuttal with respect to Mr. Chriss' exhibit, SWC-4. You address that in your direct testimony essentially at Pages 134 and 135.

MR. LITCHFIELD: I'm sorry. I'm sure counsel meant his rebuttal testimony at 134 and 135?

CHAIRMAN BROWN: You did mean rebuttal, right?

MR. WILLIAMSON: Yes, ma'am.

CHAIRMAN BROWN: You were right about muddled.

MR. WILLIAMSON: Muddled is the right word.

BY MR. WILLIAMSON:

Q Rebuttal testimony, 134-135 and Exhibit 42.

A Yes, I'm there.

Q And I think without reading testimony that's already in the record, you have taken the data that Mr. Chriss used from Regulatory Research Associates or RRA. You've analyzed it to some extent, and then you reframed it with respect to Exhibit 42, correct?

A Yes, that's correct.

Q And with respect to your analysis at Page 134, you've identified how RRA creates essentially

rankings or categories of risk associated with jurisdictions. There are above average, average and below average, correct?

A Yes, that's correct.

Q Those categories of ranking are a reflection of risk. So, an above average ranking means there's less risk; is that correct?

A I think the way Regulatory Research Associates discusses it is it has to do with the extent to which they believe the jurisdictions are constructive.

Q So, if we look at your testimony there at Page 134, Line 10, this is a quotation from RRA. It says, "With above average indicating a relatively more constructive lower risk regulatory environment," correct?

A Correct.

Q And as we go down to Line 16, it goes on to say designation one indicates a stronger, parenthetically, more constructive rating.

A That's right.

Q Right. And with respect to below average at Lines 12 and 13, that indicates a higher risk regulatory climate or a less-constructive climate, to use your terminology.

A That's not my terminology. It's Regulatory Research Associates' terminology.

Q Okay. That's fair. But do you agree with that analysis?

A I agree. I think there's no question that circumstances that are considered to be more constructive are considered so because of the predictability of the outcomes because investors have certainty, at least, relatively more certainty as to the outcome of rate case proceedings.

Those outcomes are figured into their return requirements and expectations.

Q And do you agree with RRA's assessment that more constructive means less risky?

A I agree that more constructive means more predictable. And again, from an investor's perspective, we have two sides. We have risk, and we have expectations. Expectations are based in this context on the extent to which the Commission is considered to be constructive.

Q And just to close that out -- you had started to reference it -- there are one, two and three categories that they also ascribe. So, if a jurisdiction is above average one, then that's the strongest, most constructive ranking, correct?

A Yes, that's right.

Q And if there was an above average three, then that's the weakest of the above-average category, correct?

A Correct.

Q And your Exhibit 42 essentially identifies the above average, below average and average rankings as they apply to the ROEs for vertically integrated utilities from 2013 essentially to the present?

A Yes, with the only clarification being that the first step was to look at all cases. The second step, as you suggested, was to look at vertically integrated companies.

Q And Exhibit 42 just shows the vertically integrated utilities or no? I can't recall.

A Exhibit 42 begins with all cases which include distribution companies.

Q And then you segment those out in the far right-hand column for vertically integrated, correct?

A Right. And again, just to be clear, the designation "distribution vertically integrated" is given by RRA. It's not my designation.

Q Sure. You've recast that data, however, to reflect the ratings that they also ascribe to the ROEs by jurisdiction.

A Agreed, yes.

Q With respect to Table 6 on Page 135, would you agree that this is a handy-dandy -- that's a technical term -- summary of what you have done with respect to the RRA rankings?

A I have to say I've never heard that term in this context before.

Q ROE is difficult.

A Yes, but I think it applies, so yes.

Q And so, what we see here -- if we were to look at the columns identified -- and these are just vertically integrated as it's labeled. If we were just to look at the columns above average, average and below average, meaning above average, more constructive would be your term. My term would be less risky.

Average would be medium, moderately constructive average risk. Below average would be less constructive high risk.

Those correspond with the ROEs. If we look for example at the median row of ROEs that decrease, the highest being in the above-average category to the lowest being in the below-average category, correct?

A That's correct.

Q And those decreasing ROEs correspond to more constructive down to less constructive environments or

less risky down to more risky environments, correct?

A Let me just restate it and see if I got it correctly.

Q Sure.

A The higher median result, 10.2 percent, is associated with the more constructive regulatory jurisdictions. The median result of 9.7 percent is associated with the less constructive regulatory jurisdictions.

Q Sounded a lot better when you said it, but yes, you have it correct. Okay. And you've recast the data, but do you agree -- is that a correlation that you agree with? That higher ROEs should be ascribed with jurisdictions that are more constructive or less risky?

A I think the data points out that higher ROEs have been authorized by more constructive jurisdictions.

Q The data points that out, but do you agree with that?

A Do I agree that that's what the data points out? Yes.

Q Do you agree that if you were to make a recommendation, the ROE would be higher in a more constructive environment?

A I'm sorry, I see your question now. Yes, as I said a minute ago, there are two aspects to this. One has to do with investor expectations. Investor expectations are based, in large measure, on the constructiveness of the jurisdiction.

Those expectations, of course, are related not only to the returns here that equity investors expect, they are also layered into the credit ratings and, therefore, the overall cost of capital. So, yes, I agree that this relationship makes sense from that perspective.

Q So, knowing the jurisdiction in which you are seeking to invest or in which, in your case, you're analyzing is important to assessing what an appropriate ROE should be, correct?

A I would agree with that.

Q In fact -- well, I might as well quit while I'm ahead.

At Table 6, you note that for above-average jurisdictions, the median is 10.2 percent, correct?

A That's right.

Q And if we were to look at the mean, the actual mathematical average, it's 10.17 percent, correct?

A That's right.

Q And for average companies, if we were to look at the actual mean or mathematical average, it's 9.79 percent, correct?

A That's right.

Q Do you accept that Mr. Chriss' testimony indicated that the average ROE for the timeframe that's addressed by this table for vertically integrated utilities was 9.88 percent?

A Yes.

Q And that falls somewhere between the averages for the above average and average -- the means for the above average and average categories, correct?

A It does. And as you suggested, that includes all jurisdictions of all natures.

Q Do you know what Florida's ranking is by the RRA folks?

A I knew you were going to ask me that trick question.

Q It's reflected in your Exhibit 42, so it's not a trick question. It's your exhibit.

A Yeah, that's what I was about to go through. Florida is rated as -- excuse me one second.

Q It's on Page 1 in three different locations.

A It would be helpful if I looked at the right exhibit. Give me a hint here.

Q If you go down about a third of the way on that first page, you'll see the first Florida reference.

A Above average two.

Q Hmm --

A No?

Q I'm not seeing that. I think it's above average three. It's on the first page.

A Above average three. You're correct. I was looking at the wrong row. Above average three.

Q And if we turn to the second page of your exhibit, as reflected on your exhibit, the two most recent above average three ROEs that are referenced on Page 2, the first is three down. It's Mississippi for Entergy. That ROE is 10.07 percent, correct? It's above average three?

A Yes, I see that.

Q And the only other above average three on this page is for Indiana. It's about six up from the bottom, and that's 9.85 percent, correct?

A Indiana, yes, correct.

Q And just to compare the difference in regulatory environment, immediately above that is an ROE for Arkansas Entergy.

A Yes, that's right.

Q In February, they are average two, so right dead in the middle. So, that ROE is 9.75 percent, correct?

A Right.

Q In that differential, that essentially ten-basis-point differential, in your view does it reflect the differences in whether the environment is more or less constructive?

A Out of two cases -- I'm not sure you can draw many conclusions out of two cases. The reason we look at this broader average is to, in fact, take into account the fact that there are a number of cases. I would be reluctant to draw conclusions of a comparison of two.

Q Okay. You testified that you do consider regulatory environment as an analyst when you make recommendations, correct?

A That's right.

Q Have you recently testified in Arkansas, submitted prefiled testimony in Arkansas?

A I have.

Q And what was your recommendation in that case?

A My recommendation in that case was the gas case with 10.4 percent.

Q Was there an electric case that you filed?

A Electric case, 10.25 percent.

MR. WILLIAMSON: Thank you. I have no further questions.

CHAIRMAN BROWN: Thank you, Mr. Williamson. Larsons.

MR. SKOP: Thank you, Madam Chairman. I have a few questions.

EXAMINATION

BY MR. SKOP:

Q Good evening, Mr. Hevert.

A Good evening.

Q I just have a few follow-up questions. Your testimony gives more emphasis to the Capital Asset Pricing Model, correct?

A I think that's fair to say for all of the reasons that I discussed in my summary. I think discounted cash flow methods should be given less weight, so yes, that approach is given more weight.

Q And you would agree that in the Capital Asset Pricing Model that the term "beta" is a measure of volatility, correct?

A It measures two things. It measures relative volatility, and it measures correlations.

Q In general, a beta less than one indicates

that the investment is less volatile than the market, correct?

MR. LITCHFIELD: Madam Chairman, may I interpose an objection. We appear to be talking about betas and CAPM models which were obviously the subject of his direct testimony. So, if counsel could refer us to his rebuttal testimony as to where those questions would be relevant.

CHAIRMAN BROWN: Thank you.

MR. SKOP: May I speak to the objection?

CHAIRMAN BROWN: Yes.

MR. SKOP: Thank you. So, on Page 5 of the prefiled rebuttal testimony, Lines 18 through 20, it's important to review and consider a variety of data points in the context of a quantitative analysis and associated recommendations in continuing on Exhibit RBH-11 where analysis is performed using the Capital Asset Pricing Model results which use risk-free rates, average beta and market risk premiums.

So, I have a line of questioning regarding that, and I'm laying a predicate foundation.

CHAIRMAN BROWN: Okay. I'll allow a limited scope.

MR. SKOP: Thank you. May I proceed?

CHAIRMAN BROWN: Yes.

BY MR. SKOP:

Q So, again, the question: In general, a beta of less than one indicates that the investment is less than volatile in the market, correct?

A Generally, that's correct.

Q And less volatility means less perceived investor risk?

A I don't want to quibble with your words, but if a beta is less than one, two things happen. It's got less relative risk. It may also have a lower correlation. It's, therefore, viewed as a measure of risk, so that security would be viewed as less risky than the overall market, if that's your question.

Q Yes, thank you. So, investors expect a lower return on investments that have lower risks, correct?

A I think we would all agree that there's a risk-return tradeoff.

Q Great. Let's turn to Page 5 of your prefiled rebuttal testimony, please, on Lines 18 through 20. I'll give you a moment to get there.

MR. LITCHFIELD: I'm sorry, Counsel. Could you give me the page number again?

MR. SKOP: Yes, sir, Page 5, Lines 18

through 20.

A Yes, I'm there.

Q And you state that you believe it's important to review and consider a variety of data points. Doing so enables us to put in context both quantitative analysis and associated recommendations, correct?

A That's right.

Q So, with respect to your choice of proxy groups that you also mentioned in your summary and recently in response to questions that had just been asked, you indicated that you did not look at the parent company, correct?

A I don't recall getting a question about the proxy group, but --

Q The holding company? You looked at the operating company and not the holding company, correct?

A I don't know that that's what I said for the purpose of estimating the cost of equity. What I said in my summary was that for the purpose of looking at capital structure, it's important to look at the operating company.

Q Okay. Great. To the extent that the operating company receives a benefit in terms of capital funding from the holding company, would it not

also be important to look at the holding company?

A For what purpose?

Q To the extent that it is benefiting from being able to attract and raise capital to meet its capital funding requirements.

A I'm sorry. I'm still confused. Are you talking about capital structure or the cost of equity right now?

Q No, I'm talking about the fact that for Florida Power & Light, which is not publicly traded and is a stand-alone stock, it's traded at its holding company level, proxy groups that you used for the Cap M analysis did not include its personal holding company.

MR. LITCHFIELD: So, I'll object here again. The discussion of proxy groups is clearly the subject of his direct testimony. And if Mr. Skop is going to refer us to Line 18 on Page 5 where Mr. Hevert says consider a variety of data points as essentially the door through which Mr. Skop intends to ask him any number of questions regarding any number of data, I think that would be improper.

MR. SKOP: Madam Chairman, I'll get to my point and ask the question, if I may.

CHAIRMAN BROWN: I've given you a little bit

of leeway here based on your reference to that particular exhibit sponsored by this witness, but I do believe you're going outside the scope of his prefiled rebuttal.

MR. SKOP: Thank you. I do have one question.

BY MR. SKOP:

Q Mr. Hevert, would you happen to have your calculator with you?

A (Indicating.)

Q Excellent. So, if I can ask you to turn to Exhibit RBH-11. And let me know when you're there, please.

A Yes, I'm there.

Q And also on Page 5 of your prefiled rebuttal testimony, again, you recite your direct testimony where you recommended an ROE of 11 percent with a range of 10.5 to 11.5 percent on Lines 8 through 9.

Do you see that?

A Just one second, please. Yes, I see that.

Q So, let's turn back to an exhibit that's been marked. It's RBH-11. Can you generally speak to what that represents?

A Yes, this is a summary of my Capital Asset Pricing Model results.

Q And that changed from your prior exhibit which I believe, subject to check in your direct prefiled testimony -- give me one second, Madam Chairman, if I can get there going through screens here -- of RBH-2, correct? Those numbers are slightly different?

A If you'll bear with me one minute here. Yes.

Q And, in fact, those numbers identified, subject to check, on RBH-11 are lower than the numbers you presented in your direct testimony under Exhibit RBH-2, correct?

A I don't know if I can agree with that.

Q Let's look at Exhibit RBH-11. And on the CAPM result for Bloomberg Market DCF derived, you see a mean of 9.9 percent, correct?

A Yes, I see that.

Q Would you agree, subject to check, on Exhibit RBH-2 that that same number in the same column for the mean is 10.41 percent?

A I would agree with that, and I would also say that in Column 6, we're now 10.23 percent relative to 9.92 percent.

Q Okay, fair enough. So, with respect to your calculator, do you see the line that says proxy group

Bloomberg beta coefficient and you have the line right underneath the bold text on RBH-11? It's titled "Current 30-year Treasury, 30-day Average." You see that?

A I do.

Q And do you see the risk-free rate that you used on RBH-11 of 2.5 percent?

A I do.

Q And you see the average beta coefficient that you selected which is .610, correct?

A The beta coefficient, yes.

Q With respect to the choice of the 30-year Treasury, you would agree, would you not, that in the CAPM, it's also appropriate to use a 10-year Treasury yield as a risk-free rate?

A Not for utilities. I disagree with that.

Q Has it been done in other instances outside of utilities?

A It may, but the --

Q And the yield on that would be lower than a 30-year Treasury, correct? On a ten year.

A It would, but let me finish your first question, if I could. The reason I use the 30-year Treasury yield is because utilities are long-term assets. They are what we refer to as long-duration

assets.

The 30-year Treasury yield is the longest possible risk-free rate that we have. If you think of buying equity, what you're buying is something that that is perpetual. It never goes away. You own it, and you own it as long as the company is in business.

So, using the 30-year Treasury is the best approximation that we have to the life of equity. So, in my view, the 30-year is appropriate.

Q Are you familiar with the term "prudency" or "prudent" in terms of rate --

A I am, yes.

Q So, to the extent that the Commission renders a prudency determination on an asset placed in service, you can't look back. It's basically in rate base at that point, correct?

A If your question is if an investment has been considered prudent and it goes into the rate base can it never subsequently be written down, I'm not sure about that. But if it's deemed prudent and it goes into the rate base, then it's been deemed prudent and it goes into the rate base.

MR. SKOP: Madam Chair, just one final question in the interest of time. Hopefully, we can avoid an objection to the extent that his

prefiled rebuttal testimony stated it was important to review and consider a variety of data points. So, I have one to suggest --

MR. SUNDBACK: Well, I'm intrigued.

MR. SKOP: -- that's not considered.

BY MR. SKOP:

Q So, Mr. Hevert, for the proxy group Bloomberg beta coefficient, assuming the 30-year Treasury with a risk-free rate of 2.5 percent and assuming the ex-antimarket risk premium Bloomberg market DCF derived at 10.59 percent and substituting the beta coefficient for the .61 with that of Nexterra which, subject to check, I would assert is .28, can you please tell me what CAPM result you would get?

MR. LITCHFIELD: I'll object to the question. I don't think counsel has established a predicate for this witness substituting in his calculations Mr. Skop's assumptions.

CHAIRMAN BROWN: Mr. Skop, what is this hypothetical?

MR. SKOP: So, I'm changing the beta coefficient. The beta coefficient that's chosen there does not represent the beta coefficient of Nexterra Energy which is, subject to check, .28, substantially lower, which if you change the beta

coefficient based on the Capital Asset Pricing Model formula, I believe, if Mr. Hevert would do some simple math, that the ROE result or the required return on equity would be substantially lower than that presented in RBH-11 and also in RBH-2.

MR. LITCHFIELD: Well, Mr. Skop's testimony is not sufficient predicate for Mr. Hevert to adopt it in his calculation.

MR. SKOP: It's not a hypothetical on my part. It's readily verifiable on any financial means. I'm sure that Mr. Hevert, given his financial knowledge, would know or should know what the beta coefficient is for Nexterra Energy.

CHAIRMAN BROWN: Mr. Skop, you are talking a totally different language than my legal mind even processes. So, if you could just a moment allow me to ask our staff to process your hypothetical as it relates to the rebuttal testimony.

MS. BROWNLESS: Okay. I think the rebuttal testimony has an exhibit, RBH-11, and I think as that is a revision of Exhibit RBH-2. And if I understand what Mr. Skop wants to do, he wants to change some of the parameters in the revised RBH-11. Is that correct, Mr. Skop?

MR. SKOP: Yes and no, Madam Chair. May I address that?

CHAIRMAN BROWN: Yes.

MR. SKOP: The only parameter I'm changing is the beta coefficient, changing it from .61 to .28, and asking for what the result would be. Everything else in that column remains the same for the Bloomberg DCF derived.

And that is consistent with his prefiled rebuttal testimony where he states himself it's important to review and consider a variety of data points. Unfortunately, he's not considering a data point that's highly relevant and perhaps fatal to his CAPM analysis.

MR. LITCHFIELD: Well, Madam Chair, that is per Mr. Skop's testimony. There's been no predicate established by Mr. Skop through this expert witness as to the appropriateness of using a 2.8 beta coefficient for purposes of this analysis.

CHAIRMAN BROWN: Or the relevance. The broad language of the data points really, if you go down the path that you're going, would open up an incredible can of worms of substituting all sorts of variables.

MR. SKOP: Madam Chair, if I may, I know staff had some questions on the prefiled direct for Mr. Hevert on beta. They had generally the same question I did or some of the same questions other intervenors did. I'm not trying to open a --

CHAIRMAN BROWN: We are on the rebuttal.

MR. SKOP: Yes, and I'm on the rebuttal also. And again, on RBH-11, he has presented his analysis. He's also stated that it's important to consider a variety of data points. Unfortunately, he's not used the beta coefficient for the very company we're talking about, the parent holding company, Nexterra Energy.

I'm just merely asking what the result would be if he plugged in and changed the beta coefficient. It's very simple.

MS. BROWNLESS: With all due respect, the problem I'm having is that the validity of that beta for the holding company being inserted into this calculation has not been verified by Mr. Hevert. Mr. Hevert hasn't said, yeah, I think that's fine; yes, I think that's appropriate.

So, that's my issue that I don't think that the witness has substantiated that or agreed to

that.

MR. SKOP: Madam Chair, may I reframe the question, then?

CHAIRMAN BROWN: Try.

MR. SKOP: Thank you.

BY MR. SKOP:

Q Mr. Hevert, in your analysis and your testimony in this rate case, did you review the beta coefficient of Nexterra Energy?

A For the purpose of estimating the cost of equity, as I've consistently said, I do not include the parent company of the subject in my analyses, so I would not have included Nexterra Energy.

Q Are you aware of the beta coefficient for Nexterra Energy?

CHAIRMAN BROWN: Mr. Skop, you're crossing that line.

MR. SKOP: All right, Madam Chair. I mean, I have no questions. It feels highly relevant to the extent -- and I would prefer to the extent that FPL receives the benefit of capital funding at times from its parent that this is highly relevant.

And the fact that we, as a Commission, can't consider the variation of the beta coefficient

which changes the analysis substantially, I think, it is somewhat concerning.

No further questions. Thank you, Madam Chair.

MR. LITCHFIELD: That was not a proffer. That was testimony, but we can move on.

CHAIRMAN BROWN: We can move on. Staff -- actually, no. Pardon me. OPC.

MR. SAYLER: Thank you, Madam Chairman.

EXAMINATION

BY MR. SAYLER:

Q Good evening, Mr. Hevert. It's almost ten minutes -- or it's 10:00. It's late. Mr. Hevert, would you please turn to RBH-12 of your rebuttal testimony, Page 101.

A I'm sorry, which page?

Q RBH-12, Page 1.

A Page 1 of 19?

Q Yes.

A Yes, I'm there.

Q And this is your updated bond yield plus risk premium; is that correct?

A Yes, that's right.

Q And down below the bottom half of the page where it says bond yield plus risk premium, you have a

bunch of data inputs; is that correct?

A There is data there, correct.

Q And you'd agree the first column is the date; the second column, return on equity; the third column, 30-year Treasury yield. The last column, the risk premium, correct?

A Yes, that's right.

Q And these return on equities -- are they for electric companies?

A Yes.

Q And are these vertically integrated and/or distribution or both?

A These include both because that's the way we had done it. So, it does include both vertically integrated and distribution of the companies.

Q Thank you. Now, if you will turn to Page 19 --

A Okay.

Q -- of that exhibit.

A Yes, I'm there.

Q And you would agree that it covers the years 2015 through 2016?

A Yes, I would agree with that. Well, I would say it includes those years.

Q Yes, it covers those years and includes.

And in that column for ROE, do you see any approved ROEs at or above 11.0?

A No, we don't. We see 10.3, 20 basis points from my range; 10.2, 30 from my range. But there's no 11, so I agree with that.

Q And going back one page to Page 18 in that same ROE column, you would agree that it starts December of 2012 and goes through January of 2015, correct?

A I agree with that, yes.

Q And would you look down that column. Do you see any 11 percent or greater ROEs there?

A I see a 10.95, and that's as close.

Q If you will please turn to Page 17. That covers the year January 2011 through December 2012, correct?

A Yes, it does.

Q And the same question: Do you see any ROEs at or about 11 percent?

A No, although I do see several within my recommended range.

Q If you will scroll down, please, to September 2, 2011. What is that ROE there?

A I'm sorry. Which date? 2011?

Q September 2nd.

A September 2nd, 12.88 percent.

Q And was that for an electric company in Alaska?

A Yes, it was, but again, we've got 9 percent. That would have been distribution companies in New York.

Q Fair enough. Now, you would agree that that 12.88 percent is about 200 basis points higher than any of the other ROEs for those two years?

A Sure. I would agree with that. And again, we've got over a thousand observations here and recall the purpose of this exhibit is not to look at average authorized ROEs. The purpose of this exhibit is to look at the relationship between interest rates and the equity risk premium.

Q Certainly. And if you go back to Page 16, when was the next time prior to that where an ROE above 11 was authorized or approved? On Page 16 of 19.

A I'm sorry, Page 16?

Q If you'd look at the bottom of the page.

A So, you're looking ing for an 11 percent, so 2000. So, it would be December 29, 2010, at 11.15 percent.

Q That is correct. And in the last five years, you would agree that going back to looking at

Page 17 to today's date, which is August 31st, you would agree that there's only been one time any U.S. regulatory agency has authorized an ROE above 11.

A I agree with that. I'd also say there was a time when it within five basis points. And as we've said, there have been several instances in which the returns were within my recommended range.

Q And for that Alaskan Commission-approved ROE on December 2, 2011, subject to check, was the long-term Treasury rate right about 4.32 percent?

A I was going to take a look real quick.

Q It should be in the column --

A 4.32. Is that what you said?

Q Yes.

A Yes. So, that 4.32 is about a 200-day average, but yes, that's about right.

Q All right. And if you'd flip back to Page 19 as of the time you prepared this exhibit on June 15th, I guess, the long-term Treasury was about a 2.9 percent?

A That's right.

Q And where is the long-term Treasury rate currently?

A It's about 2.3.

Q 2.3 or 2.25, somewhere in that neighborhood?

A Yes. And, of course, the market conditions are somewhat different than -- of course, the point of this exhibit, I think, goes to your question which is as interest rates fall, the market risk premium expands. So, if your question is --

Q No, that's not my question, and you have answered my question which was --

MR. LITCHFIELD: I'm sorry. The witness actually got cut off before he was able to express his understanding of the question, at which point Mr. Sayler said, no, that's not my question. I think we ought to let the witness finish what he's saying.

CHAIRMAN BROWN: Mr. Sayler, I'm going to let the witness continue to answer --

MR. SAYLER: Would he rephrase my question so I can understand that we're on the same page?

MR. SUNDBACK: Sure. I'd be happy to. My understanding from your question is you asked about changes in Treasury yields between 2011 and 2013. They've fallen. I agree with that.

As I said earlier, the purpose of this exhibit is to measure the relationship between interest rates and the equity risk premium. So, we cannot conclude that because --

MR. SAYLER: Madam Chair, I apologize for interrupting, but I did not ask for the purpose of the exhibit. I was asking about the authorized ROEs.

CHAIRMAN BROWN: Mr. Sayler, I really don't like it when counsel interrupts a witness trying to explain his answer. It cuts off the record to the benefit of that counselor.

MR. SAYLER: Yes, ma'am, but it's a nonresponsive answer. He can continue on answering it. I just wanted to point that out for the record. That was not my question.

CHAIRMAN BROWN: You can finish your sentence, sir.

MR. SUNDBACK: I'll be very quick. The point of the exhibit is not to look at average returns over some discrete period of time. It's to look at the relationship between interest rates and the equity risk premium. As those interest rates fall, the equity risk premium increases.

CHAIRMAN BROWN: Thank you.

BY MR. SAYLER:

Q Continuing on with questions about ROEs, Mr. Hevert, when was the last time you recommended that a State regulatory commission approve an authorized ROE

of 11 percent or greater for an electric utility?

A I couldn't answer offhand, but I also don't recall recently a situation in which we've had the company propose a four-year essentially stay-out period either.

Q Subject to check, did you recommend above 11 percent for the TECO rate case?

A I believe I did.

Q What about prior to the Tampa Electric? Prior to 2013.

A I can't recall offhand.

Q And you would agree that in FPL's last rate case, they requested an 11.25 percent ROE; is that correct?

MR. LITCHFIELD: Object to relevance and scope as to his rebuttal testimony.

MR. SAYLER: Madam Chair, just a little bit of latitude. My comparison will be done, and I'll move on to the next line of questions.

CHAIRMAN BROWN: If you're setting a predicate, you can continue.

MR. SAYLER: Yes, ma'am.

BY MR. SAYLER:

Q Were you aware in the last rate case that the Office of Public Counsel recommended a 9 percent

return on equity?

A That's my understanding.

Q And in this rate case, FPL is seeking an 11 percent and OPC is recommending an 8.75 percent, correct?

A That's correct.

Q You would agree that the difference between the last rate case and this rate case for both OPC and FPL is about 25 basis points, correct?

MR. LITCHFIELD: Object to the form of the question. I'm not even sure I understand the question.

BY MR. SAYLER:

Q You have your calculator, sir?

A I do, but I want to be sure I understand.

MR. LITCHFIELD: If counsel is simply asking for the arithmetic difference, that question I understand. It was phrased differently.

MR. SUNDBACK: Let me try.

CHAIRMAN BROWN: Mr. Sayler, clarification. Are you asking for the --

MR. SAYLER: Yes, I was asking for the mathematical difference between the ROEs in the last rate case and this rate case.

CHAIRMAN BROWN: Mr. Hevert, go ahead.

MR. SUNDBACK: So, if you're asking what is the difference between 11.25 and 11, that's 25 basis points. If you're asking the difference between 9 and 8.75, that, too, is 25 basis points.

BY MR. SAYLER:

Q Yes. So, you would agree that the required cost of equity for Florida Power & Light has decreased since the last rate case?

A I was not a witness in the last rate case, so I can't speak to the company's recommendation in that case. What I can tell you is, in my view, the cost of equity in this case is 11 percent.

Q Okay. Would you please turn to your RBH-17, Page 1 of 2.

A Yes, I'm there.

Q And this exhibit contains proxy group capital structures; is that correct?

A Yes, that's right.

Q And you include them for both the holding company and for the operating company; is that correct?

A With one modification. The holding company numbers represent a roll-up of the operating companies beneath them.

Q What you explain roll-up.

A Sure. So, as opposed to looking at a

balance sheet at the holding company level and getting the capital structure there, what we do is we take the operating companies held within the holding company and we add them up together. We get the average that way.

It's a subtle distinction, but just wanted to clarify.

Q Thank you. And this was a proxy group schedule that you updated after reviewing the proxy groups of Dr. Woolridge and the other witnesses in this case, correct?

A Yes, that's right.

Q And did Dr. Woolridge include Southern Company in his proxy group?

A I believe he did. If you'll just hold on one second.

Q Absolutely.

A Thank you.

Q We want to be precise, for the record.

A We do. Yes, he did.

Q But you did not include Southern Company, correct?

A Right. When I talked about the combined proxy group, I noted that I did exclude companies that were party to transactions, and Southern was party to a transaction.

Q What transaction was that?

A The AGL transaction. AGL, the acquisition of AGL.

Q Thank you. And you would agree that Georgia Power is its subsidiary, correct?

A Yes, I would agree with that.

Q And that Georgia Power is currently building a nuclear power plant?

A I would agree with that.

Q Now, looking at the back to your exhibit for the holding companies, we have a company on there called SCANA; is that correct?

A Yes, that's right.

Q What does SCANA stand for?

A That's a great question, but it's South Carolina Electric and Gas, generally.

Q And if you look down under your operating companies, you also have South Carolina Electric and Gas Co. Is that correct?

A That's right.

Q And what is the common equity for both of those companies?

A Which --

Q For SCANA Corp and the holding --

A Right.

MR. LITCHFIELD: I'm sorry, is counsel asking for total outstanding shares? If he could clarify his question.

MR. SAYLER: Sorry. That's a good question.

BY MR. SAYLER:

Q Would you tell me the average common equity for SCANA Corporation? It's in the far right column.

A Oh, you're looking at the average?

Q Yes. I apologize for not being clear.

A That's fine. 52.93 percent.

Q And if you slide down the same column down to South Carolina Electric and Gas.

A 52.93 percent. And that goes to the clarification I made a couple of minutes ago.

Q Certainly. And you would agree that South Carolina Electric and Gas is currently constructing a nuclear power plant?

A Yes, that's right.

Q And I believe one of the risk factors you testified about for your recommended ROE and equity structure is building a nuclear power plant?

A Building a plant?

Q If you have nuclear operations and things of that nature.

A I would agree that I identified nuclear

operations.

Q Certainly. And you would include constructing a nuclear power plant within that, correct?

A Generally, although I think the regulatory treatment of some construction expenditures is something to consider, but generally, yes, I'd agree with you.

Q All right. And you would agree that SCANA's -- the operating companies, 52.93 percent is --

MR. LITCHFIELD: Madam Chair, may I interrupt for just a minute. We've been going for some time on Exhibit RBH-17.

As a matter of course in preparing his rebuttal, I'm confident that Mr. Hevert has replicated a number of these exhibits from his direct testimony because it's necessary for purposes of demonstrating his results in the context of the rebuttal, but I would be interested if in Mr. Sayler could explain how this relates to points made in Mr. Hevert's rebuttal because it does seem like we're traversing risk factors and what should be in the proxy group and out of the proxy group, clearly, that were all addressed and primarily addressed in the direct.

CHAIRMAN BROWN: And Mr. Sayler, I'm giving you as much leeway as you have until an objection is raised on this issue. I'm assuming you're getting to a question that addresses his rebuttal.

MR. SAYLER: Two questions, Madam Chair.

CHAIRMAN BROWN: Okay.

MR. SAYLER: Thank you.

BY MR. SAYLER:

Q You would agree that both Florida Power & Light and South Carolina Electric are both constructing nuclear power plants?

MR. LITCHFIELD: Asked and answered.

Q And that the difference that South Carolina Power and Light's common equity percentage is about 600 basis points lower than South Carolina Electric and Gas; is that correct?

A I would agree with that, but I would also --

MR. SAYLER: Thank you.

CHAIRMAN BROWN: Mr. Sayler, allow the witness an opportunity to explain his answer.

MR. SUNDBACK: The purpose of my exhibit, the purpose of this analysis, is to generally look at the range of capital structures in place at utility operating companies. It's not to be definitive.

I was not asked to provide anything more than a general assessment, and this is the way to provide a general assessment. My conclusion is that the company's capital structure on a investor-supplied basis is within the range of those in place at other operating companies.

Mr. Dewhurst can speak in much more detail about the propriety of the company's 59.6 percent equity ratio. My analysis simply is to identify that it is within the range of other vertically integrated electric utilities.

BY MR. SAYLER:

Q Yes, sir, thank you. And you would agree that the mean for your operating companies -- the mean average for all of your operating companies in your proxy group is about 52.17 percent?

A Yes, subject to the same answer I gave just a minute ago.

Q Please turn to Page 148 of your testimony, Lines 3 through 16. If you'll take a moment to review that, please.

A Yes, I've read that.

Q And you would agree that here you've review FPL's capital structure relative to industry, correct?

A Relative to those --

Q Industry practice, sorry.

A Relative to those in Exhibit 17.

Q Yes, sir. And if you look at Lines 11 through 12, you testify that FPL's equity ratio remains within the range of those in place at the operating utilities for the proxy companies, correct?

A That's right.

Q And then on 15 and 16 --

CHAIRMAN BROWN: Mr. Sayler, I certainly don't want to cut you off, but I want to streamline this a little bit more efficiently at this hour. Instead of repeating some of the sentences that are in his rebuttal, if you could get to the question, that would be helpful.

MR. SAYLER: Yes, ma'am. Certainly.

CHAIRMAN BROWN: Thank you.

BY MR. SAYLER:

Q My question is: For Florida Power & Light, you looked at the range of equity ratios for the proxy companies, both the holding and the operating companies, and determined that FPL's 59.6 percent is appropriate for ratemaking purposes here; is that correct?

A It's almost correct. Again, it's not the holding company level. It's the roll-up of the

operating company levels. But the purpose of my analysis -- and again, I won't repeat my point, but the purpose is to see whether the company's capital structure is within the range. And that's what I found.

Q Certainly. And you would agree that in other jurisdictions, you testified that you rely upon both the range of equity ratios as well as the median common equity ratio of your proxy companies?

A Yes.

Q Would you please turn to Page 17 of your testimony starting with Line 7 and going on to the next page.

A Page 17?

Q Page 17, Line 7.

A Line 7. Yes, I'm there.

Q And this begins a line of your testimony where you say that there are reasons to doubt the results of the DCF analysis; is that correct?

A The full question reads: Are there reasons to doubt the results of a DCF analysis that uses the sustainable growth rate for electric utilities in particular.

Q In your opinion, in this case is the DCF constant growth results unreliable or doubtful?

A I think the constant growth model should be given little weight in this case, yes.

Q And that is your opinion for this case; is that correct?

A It's my opinion in this case because of the market conditions that we're encountering in this case because of, again, the effect of Central Bank intervention, the effect on Treasury yields, the effect on investors reaching for yield.

Under these market conditions, I think we have to be very, very cautious about putting too much weight on that model.

Q Certainly. And does your doubt in the DCF constant growth results -- is that true for all jurisdictions where you provide testimony?

A The use of the constant growth model, I think, again, in this market we have to look at with great caution.

Q But you have testified that at times in the past you have relied upon DCF results?

A I have under different market conditions, correct.

Q Turning to the next page, Page 18.

A Yes, I'm there.

Q There's a Q and A about Dr. Woolridge's

analysis accounting for abnormally elevated PE ratios?

A Yes, I see that.

Q And PE is price to earnings, correct?

A That's right.

Q And the price would be the stock price?

A Correct.

Q And the "E" for earnings -- that would be the revenues less expenses or how would you define earnings in the PE ratio?

A It's the price per share divided by the earnings per share.

Q Thank you. And you would agree that the DCF Constant Growth Model relies upon recent stock prices, correct?

A I do.

Q And that is one of your issues with the DCF Constant Growth Model, that it relies on current stock prices?

A I'm sorry. Can you re-ask that question?

Q Certainly. Is one of the issues that you have or concerns with the DCF Constant Growth Model the fact that it relies on recent stock prices?

A No, it's the nature of the recent stock prices.

Q Okay. Thank you. And you would agree that

you testified that these unusually high price-to-earning ratios are unlikely to persist; is that correct?

A Yes. Correct.

Q But you also would agree that the S & P utility index is currently outperforming the rest of the S & P 500 index?

A Over what time period?

Q For the last year.

A Perhaps for the last year. For the last month, it's underperformed by 8 percent.

Q And in your opinion, do you believe that utility stocks are currently overpriced to the rest of the market?

A It doesn't matter what I think. What I look at is what the market is seeing. What the market is seeing is that utility evaluations were stretched. They were very high. We've seen periods before when those valuations were high, and then they began to revert back to a mean level.

I said a minute ago, the utility sector has lost about -- I guess, depending on when you calculate it, let's call it between 6 and 8 percent it's underperformed the market over the past month. So, I think any time you see a utility sector trading in

excess of the market PE for a period of time, in all likelihood, it's going to revert back to its normal relationship. And again, that's simply what we see from market data.

Q So, in your opinion, the current prices for stock flies are unsustainable?

A Let me repeat it one more time. What we've seen is that when valuations get this high, you expect to see those valuation levels contract. That's what we've seen before. That's what we're seeing right now.

MR. SAYLER: Thank you, Madam Chair. No further questions.

CHAIRMAN BROWN: Thank you, Mr. Sayler. I'm trying to still determine whether this is streamlined by having you go towards the end, but all right.

MR. SAYLER: Just think of all the questions others could have freelanced off of.

CHAIRMAN BROWN: Okay. Hospitals.

EXAMINATION

BY MR. SUNDBACK:

Q Mr. Hevert, it's good to see you again. Mr. Sayler did a very good job on his questions, so we've gotten rid of some of the obvious, but we can probably start on a couple of the exhibits that you

were looking at with Mr. Hevert just to explore two aspects perhaps that weren't covered.

So, you looked at what's been marked as RBH-12; is that right? You recall that?

A I do. I'm there.

Q Okay. Notes 6 and 7 indicate the source is S & L Financial, right?

A That's right.

Q And your Exhibit RBH-17 is also based on data from S & L Financial, correct?

A RBH-17, you said?

Q Yes, sir.

A Let me just take a quick look. Yes, that's correct.

Q And, in fact, throughout your testimony at various points you rely on that source, right?

A I do.

Q And S & L financial is harvesting data from public sources such as SEC Forms 10K, 8K, FERC Form 1s and the like; is that right?

A Yes, that's generally correct.

Q And you've used those sources yourself from time to time, right?

A When you say "those sources," do you mean the 10Ks, 8Ks, FERC forms?

Q Yes.

A Yes, I would agree with that.

Q And those forms -- and I'll walk you through your footnotes, if you want, to illustrate your use of those forms -- generally carry penalties for misstatements of information if a knowing piece of misinformation is included in them.

Is that your understanding?

A I'm sorry, can you --

Q That was a poorly-phrased question, and I apologize.

To the extent that one of the filings that we just talked about with the regulatory agencies contains a piece of information that isn't accurate there's potentially liability for violation of Federal reporting regulations. Is that not correct?

MR. LITCHFIELD: Let me ask a clarifying from counsel. Is your question as to whether those who have SEC reporting obligations earn a penalty or S & L is under penalty.

MR. SUNDBACK: As to SEC reporting, and I appreciate that.

MR. LITCHFIELD: Those who have the obligations to. Fair enough.

MR. SUNDBACK: That is correct.

CHAIRMAN BROWN: You understand?

MR. HEVERT: I understand. I would say I'm not an attorney so I could not speak to penalties, but I have no reason to doubt that.

BY MR. SUNDBACK:

Q Okay, very good. Thank you. Let's look at your rebuttal Page 147, Lines 11 through 12.

CHAIRMAN BROWN: 147 Lines 11 through 12.

MR. SUNDBACK: Yes, Madam Chair.

A I'm there, yes.

Q And you're quoting a book there that indicates the use of debt or financial leverage concentrates business risk on shareholders effectively, right?

A Correct.

Q Do you understand that quote to distinguish between a debt and financial leverage or are those being used synonymously in your understanding of this passage?

A My understanding of this passage is financial leverage could be financial obligations/fixed obligations that could be beyond the general term debt used here.

Q So, for instance, leases or long-term contracts?

A Possibly.

Q And similarly, the use of the term "debt" here -- that could include short-term and long-term debt, right?

A It could, yes.

Q Let's look at Page 148, Lines 1 through 2, of your testimony, please. There you are talking about differences between entities whose capital structure is being compared. You see that?

A I just wanted to read the prior page, if that's okay.

MR. LITCHFIELD: Counsel, if you are referring to Lines 148, I'm not following the question.

MR. SUNDBACK: I'll wait for the witness to review that section, and then I'd be happy to --

THE WITNESS:

MR. SUNDBACK: I've read the full sentence which begins on 147; is that right?

BY MR. SUNDBACK:

Q Yes. And there you're discussing the need to consider differences in the respective entity's circumstances that you're comparing. Is that a fair summation?

A Let me just back up. This section is in the

context of discussing what some people may consider to be how you develop an optimal capital structure. Capital structure optimization, as I say here, is complex. Therefor, we have to consider differences in situations and constraints across companies when we think about what may be optimal for one company versus another.

Q Fair enough. Now, let's keep going on Page 148. Just below what we were talking about is a question and answer on Lines 3 through 16. Let me know when you've read that.

A All right. Okay, I'll read it; not okay, I've read it yet.

Q Yes. In that, you're describing RBH-17, right?

A That's right.

Q And you're stating, for instance, at Lines 12 and 15 that utilities need to access capital regardless of market conditions, right?

A Correct.

MR. SUNDBACK: Madame Chair, we'd ask to have distributed at this time a series of collated exhibits, emulating Mr. Wiseman's good example. We'd ask that they, in accordance with our treatment of the exhibits with regard to, for

instance, Mr. Barrett, we'll just roll them one at a time and mark them, if that would be acceptable.

CHAIRMAN BROWN: Yes, that is acceptable. The witness is advised of that as well.

MR. LITCHFIELD: I'm sorry, what are we doing?

MR. SUNDBACK: If I might, Madam Chairman, what we'd asked the witness to do is take the package and not to leaf through them until we've called the particular --

MR. HEVERT: I understand.

MR. SUNDBACK: Hopefully, they're in sequence.

CHAIRMAN BROWN: So, whenever you are prepared to mark them, we will be starting at 788.

MR. SUNDBACK: Thank you, Madam Chair. We'd ask to have 788 assigned to an excerpt of Wheeling Power Company's FERC Form 1 for December 31, 2015.

CHAIRMAN BROWN: We will mark that, as you just described, as 788 for this witness.

(Exhibit 788 marked.)

BY MR. SUNDBACK:

Q Mr. Hevert, do you have that before you?

A I do.

Q Now, you'll recall we looked at Exhibit

RBH-17 because, as I understand it from that passage in your rebuttal testimony we just looked at, you supplemented RBH-17 with additional information compared to your direct; is that right?

A When you say "additional information," can you be more clear about that?

Q Well, it's your exhibit, but it was my understanding that you added additional chronological periods to the table to provide, arguably, a broader array of data. Is that fair?

A Yes, we added -- we extended the time period and added the companies in the combined proxy group.

Q Fair enough. Let's look at Wheeling Power on RBH-17, Page 1. It's just above halfway on the page.

A Yes, I'm there.

Q Would you accept, looking at calendar year 2015, quarters one through four, subject to check, that your average equity component for Wheeling is 62 percent?

A For which years?

Q Calendar 2015.

A For Wheeling Power?

Q Yes, sir.

A You said it's 62 percent?

Q Yes. Your ophthalmologist wants to scrutinize that carefully.

A If you can hold on one second, please.

Q Sure.

A Yes, I'm with you.

Q And that includes one data point of 86 percent equity, right?

A It does.

Q Let's look at the excerpt now of the Wheeling Power Form 1. You'll see on Line 16 -- first of all, is this a familiar format to you of Form 1?

A It is.

Q Let's look at Line 16. That shows total propriety capital of 406 million, right? I'm sorry. Under Column C, current year.

A Thank you. Yes, I'm with you.

Q On Line 24, that shows 350 million for long-term debt, right?

A It does.

Q And that would approximate 53.7 percent equity component if you just used those components, right?

A Okay.

MR. LITCHFIELD: I'll object to the form of the question. He's asking the witness to assume

that, in fact, the capital structure would be computed by using simply these two elements on this page.

MR. SUNDBACK: Can I rephrase?

MR. LITCHFIELD: Please.

BY MR. SUNDBACK:

Q If one were simply to determine the capital structure based on the numbers shown on Lines 16 and 24, wouldn't that produce a 53.7 percent equity component in the capital structure?

MR. LITCHFIELD: Well, I'm not sure -- I'm okay with the rephrasing of the question. I think it assumes an inapplicable and inappropriate computation of capital structure. And to that extent, I object to the question to the extent that it's misleading.

CHAIRMAN BROWN: Mr. Sundback.

MR. SUNDBACK: Madam Chairman, I'm just asking for a computation of -- let me ask it this way. Can I try one more time?

CHAIRMAN BROWN: Try one more time.

BY MR. SUNDBACK:

Q Would you agree, Mr. Hevert, that 406 million is 53.7 percent of the total of Lines 16 and 24 which approximate $756 million.

A You said approximately 53.67 percent? Is that what you said?

Q Yes.

A Yes.

Q Now, let's look at Line 39, if we could, notes payable to associated companies. Let me know when you've looked at that.

A I see that, yes.

Q You'll see that in 2014 in Column D, it was 66 -- almost $67 million. In Column C, it's only about seven or $8 million in 2015, right?

A Yes, I see that.

Q So, could that have influenced the equity proportions that you have computed on RBH-17, Page 1?

A Could be.

Q Could be. You didn't --

MR. LITCHFIELD: I'm sorry. Could the witness finish his answer?

MR. SUNDBACK: I'm sorry, I didn't realize he wasn't done.

A No, I'm just not sure if I understand your question. Is your question could the 7.8 million in Column C affect the $350 million? Was that your question?

Q And similarly, the 66 million on Line 39,

Column K -- could that be interrelated to the $25 million amount shown on Line 24, Column D. In other words, one is going down. One is going up, aren't they?

A One is going down and one is going up. It could be, but I can't say one way or the other what drove those numbers either way.

Q You didn't, for instance, review this data and try to analyze what was causing those changes?

A No, that's part of the reason we look at a broad group and a group over time is to the extent there are anomalies like this, they get averaged away.

Q Now, you had described in your conversation with OPC the difference between the first table on Page 1 of RBH-17 and the second table which, as I understood it, on the lower two-thirds was the operating company data. The upper table is the roll-up. Is that fair?

A That's fair, yes.

Q And just for a lawyer to understand it, to compute the roll-up, you added up the capital structures for each of the component operating companies within the holding company family; is that right?

A That's right.

Q So, if there is an error in the computation of the operating company equity component, for instance, that would ultimately be carried into the calculation of the holding company that owned the operating company when you did the roll-up, right?

A Let me see if I can say it a little bit more quickly. Any data that's contained in the lower table would get rolled up to the upper table.

Q Fair enough. Very good. Okay. And when you do the roll-up -- let's look at Wheeling Power again. That's an AEP sub, right?

A It is, yes.

Q And you take, for instance, the average of 68.13 that you computed there in the far right-hand column, and you'd give that the same weight as any other AEP sub in doing the roll-up. Is that how you developed the roll-up?

A Let me check on that. To be honest Mr. Sundback, I don't recall whether we take the average of the averages or whether we take the combined balances beneath each of the companies and calculate the average that way.

Q Well, if you could tell us that and if you want to tell us that after a break, I'm happy to do that. This isn't a game of --

CHAIRMAN BROWN: That's assuming we're going to take a break.

MR. SUNDBACK: Yes, fair enough.

CHAIRMAN BROWN: Just joking.

(Laughter.)

BY MR. SUNDBACK:

Q Okay. Now, you had mentioned in the answer to one of my earlier questions the scope of financial commitments beyond debt including, for instance, long-term contracts. Do you recall that?

A I do.

Q And that's one of the differences you want us to take into account when we're thinking about, in your phrase, optimizing capital structure, right?

A I think one of the things I want to take into account are -- excuse me, let me back up. One of the things that I took into account when I was managing capital structure were all of those things that we talked about, all of the obligations that companies have, all of the constraints that they face.

Q And that would include long-term PPAs, right?

A It could.

Q If they're material.

A It could, yes.

Q Once again, on behalf of the American Optician Association, let's look at RBH-17. In this instance, let's look the entry for Kingsport Power which is four lines above Wheeling Power we were just looking at.

A I'm there.

CHAIRMAN BROWN: And Mr. Sundback, I mean, I have the privilege of seeing the exhibits in advance, so I'm assuming you are going to go through the same exercise for the remaining --

MR. SUNDBACK: Madam Chair, if you'd like to expedite it, we have one somewhat different point on a part of this one. And if it's acceptable from your perspective and we don't get objections from FPL, we're happy, in light of the hour, to move them in after we cover this one.

CHAIRMAN BROWN: Yes.

MR. SUNDBACK: Would that be --

CHAIRMAN BROWN: I'm a big fan of streamlining. So, if you can point something different in the scope of your cross on this exhibit, that would be acceptable. As long as that's acceptable to counsel.

MR. LITCHFIELD: Yes, thank you, Madam Chairman.

CHAIRMAN BROWN: All right. So, we're going to label this one as 789. This is an excerpt for Kingsport Power Company FERC Form 1.

MR. SUNDBACK: Yes, that's correct.

(Exhibit 789 marked.)

CHAIRMAN BROWN: Mr. Hevert, you have a copy in front of you?

MR. HEVERT: Yes, ma'am, I do.

CHAIRMAN BROWN: All right. Lovely, you may begin.

MR. SUNDBACK: Thank you, Madam Chair. Madam Chairman, in the interests of streamlining maybe our best bet is to go ahead and mark the two other Form 1 excerpts, so that would get us to 790 for the excerpt from Superior Water & Light and then 791 for the excerpt from Alaska Light & Power Company.

CHAIRMAN BROWN: We will label those, again, 790 for the Alaska Electric Light as you've just laid out titled, and then 791 for the excerpt for Superior Water Light & Power Company. We're labeling them in the spirit of expediting the cross here.

(Exhibits 790 and 791 marked.)

CHAIRMAN BROWN: You may proceed whenever

you're ready.

MR. SUNDBACK: Thank you, Madam Chairman. I gave you and the witness a bum steer. To best illustrate the alternative point, we'd like to go to what's been marked as 791, the Alaska Electric Form 1. I apologize for that.

CHAIRMAN BROWN: 790? Alaska is 790.

MR. SUNDBACK: 790. Thank you.

BY MR. SUNDBACK:

Q Let us know when you have that before you, Mr. Hevert.

A 790, yes, I do.

Q Okay. And to streamline things again, if we look at Lines 16 and 24, would you agree, subject to check, that 104 million shown on Line 17 is approximately 58 percent of the total of Lines 16 and 24 to start off with?

A Yes.

Q And that ties pretty closely to your data in RBH-1, Page 1, right, for 2015?

A It does, yes.

Q Let's look at Line 26 on this Form 1. You'll see $62 million of capital leases. Do you see that?

A I do.

Q Would you accept, subject to check, that if we combined the values on Line, 16, Line 24 and Line 26, which would produce something in the neighborhood of 241 and $242 million, that the value on Line 16 is approximately 43.2 percent of that?

A I'm sorry, Mr. Sundback. What was the number you had?

Q I'm sure you'll do a better job than I did. The question I believe -- the percentage number?

A Yes.

Q Approximately 43.2 percent?

A Approximately?

Q Good enough for lawyer math. Madam Chairman, we'd be happy to go through the notes that are appended to this Form 1 that explain the capital lease. Alternatively, if it's your preference and we don't have objections from FPL given the hour, we'd be happy to move forward and move on to other topics.

CHAIRMAN BROWN: Yes, the latter is my preference.

MR. LITCHFIELD: And we're supportive of that, again, subject to the entire document going in.

CHAIRMAN BROWN: Of course. All right. Mr. Sundback, can you please move along.

MR. SUNDBACK: We're trying mightily. Thank you, Madam Chair. We just covered off a lot of questions.

BY MR. SUNDBACK:

Q Okay. Let's look at your rebuttal testimony, Page 83. Let's start with Line 9. It's good to be back in the big print, isn't it?

A I'm there.

Q There you reference 2002-2003 and 2008-2009 market dislocations. You see that?

A I do.

Q Since you've mentioned them in the same breath, should we presume that you believe that they are about comparable in terms of severity and duration?

A No.

Q Is it your belief that the 2008-2009 market dislocation was worse?

A I think the 2008-2009 dislocation has commonly been referred to as the Great Recession, so I think given that name and given the Federal response subsequent to that dislocation, I think most people would say that it had a more lasting effect than 2002-2003.

Q I'm asking you your opinion, sir.

A That's my opinion as well.

Q Okay. Thank you. Let's look at Page 98, Lines 3 through 4. There you were criticizing Mr. Gorman, in part, because you believe it would frustrate FPL's ability to raise capital under a variety of market conditions at reasonable cost and terms. In fact, you suggest that his approach would impair other regulated utilities' ability to do that.

You see that?

A Let's read it.

Q I don't think we have to read it.

A I didn't use the word "impair."

Q Okay. But when you refer to a variety of market conditions, you mean good and bad, both, right?

A Yes, I think that's fair.

Q And just stepping back and looking at your rebuttal testimony overall, you repeatedly criticized witnesses, for instance, Baudino for the hospitals, O'Donnell and others for their approach to capital structure, right?

A You say I criticized. I certainly disagree with them on points.

Q Fair enough. Is a sentence that starts at the bottom of 146 and carries over to Page 147, Line 2. There you say that higher levels of debt and capital structure are likely to have companies with higher

levels of the debt and their capital structure are likely to have higher total risk and, therefore, high cost of debt and equity.

You see that?

A Right. It begins, in essence, even if two firms face the same business risk.

Q Yes. Fair enough. Fair enough. So, is it your position that any increase in the amount of debt in a capital structure would lead to higher costs of both debt and equity?

A I have said, I think, fairly consistently that the credit ratings process is very complex and an increase in the amount of debt would be viewed not only from the perspective of financial metrics but also the perspective of what it means in terms of regulatory risk.

I cannot tell you what specific levels or increments or decrements would have that effect, but when a company has a target capital structure that's been successful with that target capital structure and there's a movement from that target capital structure, I think that is something that the financial community would view and could well put pressure on the company's credit metrics.

Q Well, in the past you've reviewed and

presented to commissions data concerning the impact of different credit ratings on the ability to access financial markets and the cost of accessing financial markets; isn't that correct?

A I wonder if you could be more specific. In this case, for example, we looked at credit spreads.

Q Let's look at some of your other testimony on this topic. You should have in your packet excerpts from your testimony in the Nevada PUC, Docket No. 11-06006.

CHAIRMAN BROWN: We've not had that -- we do not have that.

MR. SUNDBACK: I'm sorry. Hopefully, you will shortly.

CHAIRMAN BROWN: Mr. Sundback, I'm trying to get an understanding of how many more questions you have for this witness. We've been going a substantial amount of time.

MR. SUNDBACK: By volume, we are over 90 percent done. And with the cooperation of the witness, we could be 95 percent of the way down.

CHAIRMAN BROWN: I'm going to encourage Mr. Hevert to try to be succinct in your responses as well.

MR. HEVERT: Yes, ma'am, I will.

MR. SUNDBACK: Certainly, Madam Chairman, the good news is that this piece of evidence does not have a lot of small type face.

CHAIRMAN BROWN: So, we're going to label this as 792. It's an excerpt from FPL Witness Hevert's direct testimony before Nevada PUC. Okay?

(Exhibit 792 marked.)

MR. SUNDBACK: May we proceed, Madam Chairman?

CHAIRMAN BROWN: Please.

BY MR. SUNDBACK:

Q Let's look at Page 87, what's marked as Page 87. It has something called Chart 7. The pagination we'll be referring to is the pagination in the center of the bottom of the page.

A I'm there.

Q And if we look at the chart, is it fair to conclude that we have about a 40- or 50-basis point change in moving from an A- to BBB+ credit rating?

MR. LITCHFIELD: May I object to this question on the grounds of relevance? I'm looking at this as testimony filed by Mr. Hevert in 2011. I think there's abundant testimony in this record already as to the importance of current market

conditions, so if Mr. Sundback could establish relevancy before we provide down this line, that might be constructive.

MR. SUNDBACK: Madam Chairman, we've just spent maybe ten minutes with the witness outlining the fact that it's his position that the company -- a company, utility company, needs in both good and bad circumstances to be able to raise capital --

CHAIRMAN BROWN: Objection overruled. You may proceed.

MR. SUNDBACK: Thank you.

BY MR. SUNDBACK:

Q So, would you agree that we see a difference of about 40- or 50-basis point in the yield percentage as between A- and BBB+ rated securities on this chart?

A Yes, it's about that.

Q And the same would be true moving from BBB+ to BBB, right?

A It would probably be about that, sure.

Q And is it fair to conclude Chart 7 is based on data from 2008 and 2009?

A It's been a while since I've looked at this, so you'll have to bear with me.

Q If it would help, the top of Page 87, the

first full sentence -- does that help refresh your recollection?

A It says Chart 7 indicates non-investment utility. That market was closed 2008-2009. Of the 82 issuances, only three were below BBB-. So, that's what it says.

Q Okay. Let's look at what had been paginated as Page 89 in the middle of the page in this package. It's another couple of pages on. You'll see something labeled Table 13. You see that?

A I do.

Q Do we understand Table 13 to show us the incremental change in financing spreads between the two credit ratings that are shown in the left-hand margin. So, for instance, change from an A rated to a BBB+ would produce in 2011 a .16 percent increment in the spread; is that right?

MR. LITCHFIELD: Madam Chair, I'm sure Mr. Hevert can have a lengthy conversation with regard to his prior testimony here tonight with Mr. Sundback, but again, I would simply ask if counsel could articulate the relevance of discussing credit spreads in the periods that are reflected on this chart dating back to 2007 as they may relate to rating agency standards at that

time.

CHAIRMAN BROWN: Mr. Sundback. Succinctly.

MR. SUNDBACK: Certainly. Mr. Hevert emphasizes the need to be able to access capital markets on reasonable terms in good one at time and bad one at time. 2008-2009, which is surveyed in his testimony, by his own characterization was a very severe financial cross. It wasn't a garden variety recession. It was the Great Recession.

So, it's a great test of what it costs to add debt to a capital structure. It's a test drive in the real world, not a visit to a theoretical construct.

CHAIRMAN BROWN: I'll allow it.

MR. SUNDBACK: Thank you.

BY MR. SUNDBACK:

Q All right. Mr. Hevert, do we understand Table 13 to quantify the change in financing cost of moving from an A rating to a BBB+ rating over the surveyed chronological period?

A We do, but one thing that I think we should look at is what begins at Line 24. While the maximum term was 30 years for a BBB+ and BBB, it was only 15 years for BBB- and ten years for non-investment grade.

So, the point is there may be different

terms and maturities included in there. So, yes, that's what the difference in that chart shows, but it may also reflect different maturities. I just can't recall at this point.

MR. SUNDBACK: Fair enough. Madam Chairman to the extent that we're not going to face objections from FPL for not having spent more time with this testimony, we would be happy to move from here. Otherwise, there are other grounds for asserting that it's relevant to the rebuttal testimony, and I'd be happy to go through those if we feel the need to.

CHAIRMAN BROWN: I don't feel a need. FPL?

MR. LITCHFIELD: Nor do I.

(Laughter.)

MR. SUNDBACK: Then at that point, our cross examination of the witness is concluded. We thank Mr. Hevert, and we thank the panel.

CHAIRMAN BROWN: *Muy bueno*. Staff.

MS. BROWNLESS: Yes, ma'am.

CHAIRMAN BROWN: Remember, there were a lot of questions asked so --

MS. BROWNLESS: We've cut a serious amount of our questions. Trust me.

CHAIRMAN BROWN: Thank you. We've spent a

lot of time on this witness.

MS. BROWNLESS: Yes, ma'am.

EXAMINATION

BY MS. BROWNLESS:

Q Can you please turn to your rebuttal testimony to your Exhibit No. RBH-11.

A I'm sorry. RBH --

Q 11.

A 11, yes.

Q And let me get my book, Madam Chair.

A Yes, I'm there.

Q Am I correct that your RBH-11 is the equivalent chart to your Exhibit RBH-2 in your direct testimony?

A Yes, that's correct.

Q Did you use the same methodology to calculate your CAPM results in your rebuttal testimony as you did in your direct testimony?

A Yes. The only difference would be the difference in the proxy group, this being dependent upon the combined group.

Q The results of your CAPM analysis provide a range of estimated ROE of 8.97 percent to 12.64 percent; is that correct?

A Yes, that's right.

Q Would you agree that the median of that range is 10.8 percent?

A I've no reason to doubt that.

Q The results from your CAPM analysis in your direct testimony range from 9.45 percent to 13.09 percent; is that correct?

A I'm sorry. Yes, that's correct.

Q Would you agree that the median or mid point of that range is 11.3 percent?

A I get 11.27 but close enough.

Q Thank you. Would you agree that since the time of your direct testimony, the median of the CAPM results have decreased by 50 basis points?

A Well, I'm sorry, you keep using the term "median."

Q Mid point.

A What we're looking at is the mid point of those two data points.

Q Yes.

A So, the mid point of those two data points, I would agree, has fallen. I would also say that even the revised 10.8 percent is within 20 basis point of my continuing recommendation.

Q And I just want to make sure I get an answer to my question. So, you would agree that the mid point

of the CAPM results have decreased by 50 basis points?

A The mid point of the two points that you've defined, yes, I would agree with that.

MS. BROWNLESS: And that's all the questions we have, Madam Chairman.

CHAIRMAN BROWN: Thank you. Commissioners. Redirect.

MR. LITCHFIELD: Thank you, Madam Chair. I just have a hand full.

REDIRECT EXAMINATION

BY MR. LITCHFIELD:

Q I think I will start with what has been marked as Exhibits 788 to 791. Do you still have those in front of you?

A I do.

Q These are excerpts from FERC Forms 1 for four specific companies that were included in -- I think it was RBH-17. Am I remembering that correctly?

A That's correct.

Q Could you please provide the overall context for this list specifically as it may relate to the four companies that Mr. Sundback singled out?

A The list in RBH-17?

Q Yes, thank you.

A The list in RBH-17 includes the electric

utility operating companies held within each of the holding companies in the combined proxy group. So, to the extent I took companies that other witnesses used as proxies that I had not included in my original group but included them in my rebuttal testimony, this represents the capital structures of those holding companies -- excuse me -- those operating companies.

Q And you may have answered this question, but since the exhibit was discussed extensively by more than one counsel, what was the overall purpose of your including RBH-17 in your rebuttal testimony?

A Simply to provide a broad perspective. As I said earlier, the way a company capitalizes itself is very specific to that company. And how it optimizes its capital structure is very specific to that company.

All this exhibit is intended to do is to give a broad range and to look at the company's investor-provided capital structure within the context of that broad range.

Q Mr. Sundback also asked you about how S & L -- I think you used the term "harvests" data from different sources. Do you recall that discussion?

A I do.

Q When you rely upon S & L data, how do you approach the data that S & L compiles or aggregates or

presents for the purposes of your analysis?

A We use some of the functionality that S & L provides to us. We tell it what we're looking for, and S & L essentially goes, and it has grabbed that data for each of the companies.

They will give definitions of FERC Form lines that are used, but we specify what it is we're looking for for each of the companies.

Q And particularly, when you're looking occasionally at S & L data that includes equity ratios, what can you discern from those numbers on their face?

A What we can discern is there is a range and what we can discern is what the relative proportions of debt -- excuse me -- long-term debt and equity are for those companies so we can get a sense of the average and the range.

Q Are those numbers in all cases/some cases/no cases the numbers that are used for purposes of setting rates?

A For the purposes of setting rates, they are not always the same numbers.

Q Why would that be?

A Because we're looking at simply the investor-applied capital here. And to the extent that the jurisdiction makes adjustments to the capital

structure for ratemaking purposes, it would not show up in this analysis.

MR. SUNDBACK: Madam Chairman.

MR. LITCHFIELD: If it helps, I'm finished with my redirect on Mr. Sundback's line.

MR. SUNDBACK: We didn't want to object in the middle of the witness' response in respect to the prior rulings from the chair, but the witness previously answered that he didn't know, wasn't able to look at or hadn't looked at the Form 1 data.

CHAIRMAN BROWN: Mr. Sundback, I'm sorry, the answer has already been recorded by the court reporter. You did not object timely.

MR. SUNDBACK: Okay. Just so I understand the rules of the road, not that we have much road left, mercifully, but to the extent we have an objection --

CHAIRMAN BROWN: You must object when the question is being asked or right after before the witness answers.

MR. SUNDBACK: Thank you.

MR. LITCHFIELD: Thank you, Madam Chair.

BY MR. LITCHFIELD:

Q Mr. Hevert, you were also asked a few

questions by Mr. Sayler representing the Office of Public Counsel. He asked you with regard to a portion of your rebuttal testimony in which you indicated that that you were -- to the extent that you were relying upon recent stock prices.

Do you recall those questions?

A I do.

Q And I think in answer to one of his questions you inserted the word "nature." You had concerns about the nature of the recent stock prices. Do you recall that answer?

A I do.

Q What do you mean by that specifically, the nature of the current stock prices?

A I understood the question to be do I object to a model that relies on recent prices. No, I don't. The issue to me is whether the recent prices are consistent with the model and whether recent prices are likely to be affected by things such as Federal policy.

So, it's not the fact that a model may use recent prices. It's the nature of those prices and how they comport with the model that matters to me.

Q Mr. Sayler also focused you on RH-12 and particularly asked you a few questions relative to long-term Treasury rates reflected in that exhibit. Do

you recall that?

A I do.

Q In one of your answers to his questions you indicated or you referenced changed market conditions. Do you remember that?

A I do.

Q Have there been any recent market developments or changes with regard to market expectations as to the Federal funds rate?

A Yes, we had as recently as this past Friday the Chair of the Federal Reserve speak and discuss her view that we're getting to the point where it's likely that the Federal funds rate would increase.

We can look at the --

MR. MOYLE: I'm going to object. This is bringing in stuff, just like the other witness did. He's talking about stuff he heard last week from the head of the Federal Reserve. That wasn't in his rebuttal testimony. It's objectionable.

MR. LITCHFIELD: Madam Chair, Mr. Sayler spent a great deal of time on long-term interest rates, long-term Treasury rates. This is perfectly appropriate redirect in light of the fact that Mr. Sayler opened that entire line through this discussion.

CHAIRMAN BROWN: I think I've given a lot of the intervenors here a great deal of latitude in asking their questions, so I'm going to allow the witness to continue his answer.

MR. HEVERT: We've seen the Chair of the Federal Reserve say that conditions are getting ripe --

CHAIRMAN BROWN: Succinctly.

MR. HEVERT: -- for increases. We see implied probabilities increasing and, as a consequence, we've seen the utility sector fall off in valuation.

BY MR. LITCHFIELD:

Q Thank you. Mr. Sayler also asked you questions about RH-12 relative to the REO figures included on that exhibit. Do you recall that questions?

A I do.

Q What does the list of ROE figures in RH-12 represent for purposes of your rebuttal testimony?

A Simply the authorized return on a given date.

Q What should the commission discern from that list as far as an appropriate ROE for FPL in this case?

A I don't think there should be a lot taken

from that. Again, the purpose of this exhibit is to look at the relationship between those and interest rates, not in looking a discrete observation or one or two observations.

Q Does this list in any way --

MR. MOYLE: Objection. Leading.

Q Are risk factors identified anywhere on this list?

A No.

Q You were asked a few questions about Mr. Williamson on behalf of the Wal-Mart. He led out this evening. Do you recall that?

A I do.

Q And he focused you on Table 6 at Page 135 of your rebuttal. Do you remember that?

A I do.

Q He also referenced Exhibit 42, Page 2 of 2.

A Yes.

Q And he focused you on the ROE set forth in in that table in that exhibit. You recall that?

A Yes.

Q What do the ROE figures or values in that exhibit reflect -- let me ask it this way. What factors drive the determination of ROE?

A It would be the issues facing the specific

subject company. The market conditions at the time.

MR. LITCHFIELD: Thank you. Those are all the questions that I have.

MR. SUNDBACK: Madam Chairman, I have one housekeeping item, if I could, before the witness is excused.

CHAIRMAN BROWN: Is it about the exhibits?

MR. SUNDBACK: No, we had posed a question to Mr. Hevert about whether in his roll-up calculation it was weighted or not, essentially. Mr. Hevert understandably said he wasn't sure and would have to check his data.

We'd appreciate getting an answer to that question one way or the other. We don't mind having him excused, but of course, you're in charge.

CHAIRMAN BROWN: Just one second. Counsel. Do you recall that.

MR. LITCHFIELD: I do recall that. I'm just wondering whether Mr. Sundback had properly established a predicate as to the relevance of that data point.

CHAIRMAN BROWN: And I must be honest, I don't recall the exact line of questions and how it -- can you refresh our memories?

MR. SUNDBACK: May I? We had walked through the calculation of Wheeling Power Company's calculation. It's a sub of ADP. The question was if there is an error in the calculation of the capital structure of one of the subs, the operating utilities shown in the lower table of Page 1 of RBH-17 when you do the roll-up, how is that going to be reflected.

So, if you just do an equal weighting, a small company, capitalization of 100 bucks, and the same weighting for the capitalization --

CHAIRMAN BROWN: What was the actual question, though, to the witness?

MR. SUNDBACK: The actual question was do you do a weighted average or do you give equal weight to each of the operating companies in the lower table.

MR. LITCHFIELD: So, now Mr. Sundback has refreshed my recollection. He just indicated that his assertion is that there is an error in the calculation or could be an error in the calculation. He did not establish that as a predicate, so we would object to a late-filed exhibit.

CHAIRMAN BROWN: Objection sustained. We

are going to move along right now into exhibits. Okay. This witness has Exhibits 352 to 385.

MR. LITCHFIELD: Correct. We would so move.

CHAIRMAN BROWN: Any objections to moving in 352 through 385. Seeing none, we will go ahead and move those into the record.

(Exhibits 352 through 385 were admitted.)

CHAIRMAN BROWN: As to Exhibits 788 through 792, I will note all of them are excerpts. And for the record, FPL did say that they would be okay with entering them in as long as they were in their complete form; is that correct?

MR. LITCHFIELD: Correct.

MR. SUNDBACK: And we would move the admission of 788 and 792 in that expanded form consistent with the understanding.

CHAIRMAN BROWN: Thank you. And please provide that to the clerk. Okay. Seeing no other objections, we will move 788 through 792 into the record.

(Exhibits 788-792 were admitted.)

CHAIRMAN BROWN: Mr. Sayler.

MR. SAYLER: Madam Chairman, from last week, OPC had Exhibit 711. You asked me to remind you about that at the appropriate time.

CHAIRMAN BROWN: And you know, I remember that because of 7/11.

MR. SAYLER: Absolutely. Everyone loves a Big Gulp.

CHAIRMAN BROWN: Everyone from Fort Myers. We love it.

MR. SAYLER: Absolutely. I conferred with counsel for FPL earlier today, but they didn't object to the admission of that, but I would have like to have that --

MR. LITCHFIELD: We won't change our minds.

CHAIRMAN BROWN: You won't change your minds. Any other objections? Okay, 711 is coming in.

(Exhibit 711 admitted.)

MR. SAYLER: Thank you.

CHAIRMAN BROWN: You're welcome. And I'm keeping track of all of them that are in very carefully. I know we have a couple of staffers that are doing it as well. We will get into that a little bit more tomorrow.

MR. LITCHFIELD: May Mr. Hevert be excused?

CHAIRMAN BROWN: Yes. Lucky. Have a good night. After the ROE witness, I think we all deserve about a five-minute break. What do you

think?

MR. REHWINKEL: Madam Chair, before we take a break --

CHAIRMAN BROWN: Mr. Rehwinkel, I can't hear you.

MR. REHWINKEL: Is it your intention to take up Mr. Deason tonight?

CHAIRMAN BROWN: I was hoping with the assumption that we had the discussion earlier that everyone was willing to put in the hours tonight.

MR. REHWINKEL: Well, I would just like to ask the Chair to consider this. It will be 11:30 probably before Mr. Deason gets here for cross. I have a significant amount of cross.

When the day started today, I did not think I would have three major cross examination tasks today. I'm up to the task. I'm kind of bleary-eyed right now. I would ask you to consider this. I have a series of exhibits that will take some time to go through.

I'm not trying to do this for the sake of taking the time. I would be happy to give these exhibits to Mr. Deason, his counsel and spend some time between now and tomorrow trying to cut down cross examination.

I probably have 45 minutes to an hour for this witness. I believe I could trim it down significantly if I was given that latitude. I just put it out there for your consideration.

CHAIRMAN BROWN: I am very flexible about this, but again, given the pending storm coming, we have so many hours tomorrow that we can utilize. It's really up to the parties here to consider that. FPL.

MR. LITCHFIELD: Madam Chairman, listen empathies greatly with Mr. Rehwinkel's situation because we find ourselves in the same situation.

On the other hand with the pending storm, I think there are a number of us, including probably other counsel at this table, that would like to get out of Dodge before the storm hits, including witnesses and so --

CHAIRMAN BROWN: I've repeatedly heard that from the parties.

MR. LITCHFIELD: We would prefer to press on. And again, at the break we're happy to spend a little bit of time with Mr. Rehwinkel and see what exhibits, if any, we might be willing to stipulate in and short-circuit cross. We're amenable to that, for sure.

MR. REHWINKEL: Madam Chairman, we started off today -- and I agreed --

CHAIRMAN BROWN: I'm going to let everybody talk, and then we'll make a decision.

MR. REHWINKEL: I agreed to do this, but I said specifically I did not want the time of day to impinge upon my opportunity to go through this witness. He rebuts a significant amount of issues.

CHAIRMAN BROWN: I understand. I understand. Mr. Moyle.

MR. MOYLE: And I, likewise, have told you that I have some significant questions and Lines of questioning of Mr. Deason. If Mr. Rehwinkel has 45 minutes and then I'm going, I mean, it's 11:20. And then we're going to be back here at nine, and I'm going to be trying to handle this issue about the errata that -- you know, respectfully, we've been going really-really hard.

So, I would appreciate the chance to pick -- we only have two witnesses left, I think.

CHAIRMAN BROWN: You're correct. Your objection is noted. Any other parties have an objection? Ms. Csank.

MS. CSANK: I will just note for the record

that my preference would be to not continue and to take this up tomorrow morning.

CHAIRMAN BROWN: I don't need to hear any more. We will take up Mr. Deason tomorrow morning at 9:00 a.m. Okay. And Mr. Rehwinkel, at this time if you could get with FPL to go over those exhibits.

MR. REHWINKEL: I will do that. Thank you very much.

CHAIRMAN BROWN: Have a wonderful evening. We will see you all tomorrow at 9:00 a.m.

(Proceedings adjourned for the day at 11:30 p.m.)

(Transcript continues in sequence in Volume 37.)

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CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, LISA GAINEY, 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 5th day of September 2016.

LISA GAINEY
NOTARY PUBLIC
COMMISSION #EE198942
EXPIRES MAY 23, 2020