

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Annual Reestablishment of)	DOCKET NO. 890006-WS
Authorized Rate of Return on Common)	ORDER NO.: 21775
Equity of Water and Sewer Utilities,)	ISSUED: 8-23-89
per Section 367.081(4)(f), F.S.)	
)	

The following Commissioners participated in the disposition of this matter:

- MICHAEL MCK. WILSON, Chairman
- THOMAS M. BEARD
- BETTY EASLEY
- GERALD L. GUNTER
- JOHN T. HERNDON

NOTICE OF PROPOSED AGENCY ACTION

ORDER ESTABLISHING AUTHORIZED RANGE OF RETURNS ON COMMON EQUITY

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature and will become final unless a person whose interests are substantially affected files a petition for a formal proceeding pursuant to Rule 25-22.029, Florida Administrative Code.

Section 367.081(4)(f), Florida Statutes, requires us to establish annually, by order, a leverage formula to develop an authorized range of returns on common equity for water and sewer utilities.

In calculating this authorized range of returns on common equity, we have used certain basic assumptions. These assumptions are: 1) similar business risk exists for all water and sewer utilities; 2) the cost of equity is an exponential function of the equity ratio; 3) the marginal weighted average cost of investor capital is constant over the 40% to 100% equity ratio range; and 4) given adequate management, a Moody's Baa bond rating would be representative of the average marginal equity ratio range. The above assumptions have been used in the previous establishment of an authorized range of returns on common equity.

In accordance with these assumptions and based upon the analysis described below, we find that the authorized range of

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returns on water and sewer common equity should be based on the following formula:

$$\text{Return on Common Equity} = 10.30 + 1.46/\text{Equity Ratio}$$

where:

Equity Ratio =

Common Equity

 Common Equity + Preferred Equity + Long and Short-Term Debt

We believe the authorized return on common equity should be limited to a maximum of 13.95% for all equity ratios less than 40% in order to discourage imprudent financial risk.

The leverage formula was previously revised in July of last year (Order No. 19718, July 26, 1988). In developing the instant leverage formula, we updated the current formula, relying on the same methods used in last year's docket, to reflect current market conditions, such as changes in bond yields and required rates of return. The range of common equity returns using the updated leverage formula range from 11.76% to a maximum of 13.95%. Last year's leverage formula, 10.65 plus 1.48/Equity Ratio, produced a range of returns of 12.13% to 14.35%. The net change in the average return on equity over the 40% to 100% equity ratio range is a decrease of 38 basis points, from 13.24% to 12.86%. The decrease in the average common equity return reflects the lowered bond yield.

The 13.95% return on common equity, the maximum return allowed under the revised leverage formula, was arrived at through the application of a Discounted Cash Flow model to an index of publicly traded water and sewer utilities, application of a Risk Premium model to an index of natural gas utilities, and the use of a bond yield differential adjustment to reflect the difference in risk between the indices and an average water and sewer utility in Florida. Using the most recently available capital structure for the index of publicly traded water and sewer companies as a proxy for the capital structure of an average water and sewer utility in Florida, we calculated the marginal cost of investor capital for an average water and sewer utility in Florida to be 13.95% at a 40% equity ratio.

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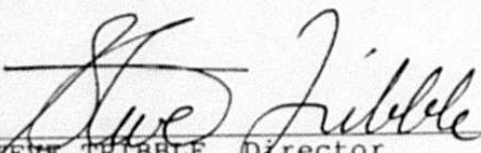
Based upon the foregoing, it is

ORDERED by the Florida Public Service Commission that the authorized range of returns on common equity for an average water and sewer utility is hereby established as set forth in the body of this Order. It is further

ORDERED that the provisions of this Order are issued as proposed agency action and will become final unless an appropriate petition is received by the Director of the Division of Records and Reporting, 101 East Gaines Street, Tallahassee, Florida 32399-0850, by the close of business on September 13, 1989. It is further

ORDERED that, after September 13, 1989, this Commission will issue either a notice of further proceedings, or an order indicating that the provisions of this Order have become final and effective.

By ORDER of the Florida Public Service Commission
this 23rd day of AUGUST, 1989.



STEVE TRIBBLE, Director
Division of Records and Reporting

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NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.59(4), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

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The action proposed herein is preliminary in nature and will not become effective or final, except as provided by Rule 25-22.029, Florida Administrative Code. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, as provided by Rule 25-22.029(4), Florida Administrative Code, in the form provided by Rule 25-22.036(7)(a) and (f), Florida Administrative Code. This petition must be received by the Director, Division of Records and Reporting at his office at 101 East Gaines Street, Tallahassee, Florida 32399-0870, by the close of business on September 13, 1989. In the absence of such a petition, this order shall become effective September 14, 1989 as provided by Rule 25-22.029(6), Florida Administrative Code, and as reflected in a subsequent order.

Any objection or protest filed in this docket before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.

If this order becomes final and effective on September 14, 1989, any party adversely affected may request judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or by the First District Court of Appeal in the case of a water or sewer utility by filing a notice of appeal with the Director, Division of Records and Reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days of the effective date of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.