

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity of water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

DOCKET NO. 010006-WS
DATED: OCTOBER 12, 2001

COMMISSION STAFF'S PREHEARING STATEMENT

Pursuant to Order No. PSC-01-1447-PCO-WS, Order Establishing Procedure, issued July 6, 2001, and Order No. PSC-01-1767-PCO-WS, Order Granting Florida Waterworks Association's Agreed Motion for Extension of Time to File Prefiled Testimony and First Order Revising Controlling Dates, issued August 29, 2001, the Commission Staff (Staff), by and through its undersigned Counsel, files its Prehearing Statement as follows:

A. All Known Witnesses

Staff intends to call Pete Lester of the Division of the Economic Regulation as its only witness. He will testify as to the appropriate calculation of the 2001 leverage formula that reflects the appropriate range of returns on common equity for an average water and wastewater (WAW) utility pursuant to Section 367.081(4)(f), Florida Statutes.

B. Exhibits

Staff has identified and intends to sponsor the following exhibits:

- PL-1: Index of Exhibits
- PL-2: Water and Wastewater Leverage Formula Equation
- PL-3: Calculation of Recommended Leverage Formula
- PL-4: Comparison of Allowed Returns of Equity (ROEs)
- PL-5: Breakdown of Water and Wastewater Systems by Revenue

DOCUMENT NUMBER-DATE

12982 OCT 12 5

FPSC-COMMISSION CLERK

COMMISSION STAFF'S PREHEARING STATEMENT
DOCKET NO. 010006-WS

- PL-6: Florida Electric Utilities Revenue & Earnings for 2000
- PL-7: Florida Gas Utilities Revenue & Earnings
- PL-8: Comparison of 2000 Revenue for Gas Companies and WAW Systems
- PL-9: Distribution by Revenue of the Nine Water Systems with Revenue Over \$1 Million
- PL-10: Distribution by Revenue of the Nine Wastewater Systems with Revenue Over \$1 Million
- PL-11: Comparison of Achieved ROEs for Water Systems
- PL-12: Comparison of Achieved ROEs for Wastewater Systems
- PL-13: Water Index Statistics for the Four Water Utilities followed by Value Line
- PL-14: Gas Index Statistics of Eleven Gas Utilities Followed by Value Line
- PL-15: Basic DCF Equation
- PL-16: Two Stage Annually Compounded DCF Model
- PL-17: Inputs and Results of DCF Analysis
- PL-18: Equation for CAPM Model
- PL-19: Bond Yield Differentials
- PL-20: Spread Between BBB and BB+ Bond Yields
- PL-21: Leverage Formula Calculation and Comparison
- PL-22: Status Quo Leverage Formula

COMMISSION STAFF'S PREHEARING STATEMENT
DOCKET NO. 010006-WS

Staff reserves the right to identify additional exhibits at the Prehearing Conference and at hearing for purposes of cross-examination.

C. Basic Position

The following 2001 Leverage Formula should be approved:

$$\text{Return on Common Equity} = 8.95\% + 0.738/\text{Equity Ratio}$$

Where the Equity Ratio = Common Equity / (Common Equity + Preferred Equity + Long-Term and Short-Term Debt)

Range: 9.69% @ 100% equity to 10.80% @ 40% equity

D. Issues of Fact, Law and Policy

The following are issues identified by Staff and its positions on these issues. Staff's positions are preliminary, and are intended to inform the parties of Staff's preliminary positions. Staff's final positions will be based upon an analysis of the evidence presented at the hearing.

ISSUE 1: What is the appropriate range of returns on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), Florida Statutes?

POSITION: The Commission should make four modifications to the existing leverage formula methodology, updated with current financial data. The four modifications or adjustments are: (1) add 10 basis points to the CAPM results to allow for flotation costs; (2) add 10 basis points to the market return in the CAPM model to allow for quarterly compounding of dividends; (3) use an index of natural gas distribution companies along with an index of water companies with both the DCF and CAPM models; and (4) add 50 basis

COMMISSION STAFF'S PREHEARING STATEMENT
DOCKET NO. 010006-WS

points as the appropriate small-utility risk premium. Based on these four modifications, staff recommends the following leverage formula:

$$\text{Return on Common Equity} = 8.95\% + 0.738/\text{Equity Ratio}$$

Where the Equity Ratio = Common Equity / (Common Equity + Preferred Equity + Long-Term and Short-Term Debt)

Range: 9.69% @ 100% equity to 10.80% @ 40% equity

(Lester)

ISSUE 2: Should this docket be closed?

POSITION: No, upon expiration of the protest period, if a timely protest is not received from a substantially affected person, the decision should become final and effective upon the issuance of a Consummating Order. However, this docket should remain open to allow staff to monitor the movement in capital costs and to readdress the reasonableness of the leverage formula as conditions warrant. (Lester)

E. Stipulated Issues

There are no issues that have been stipulated at this time.

F. Pending Matters

There are no matters pending at this time.

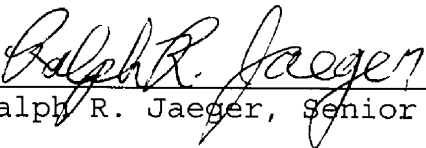
G. Pending Confidentiality Claims or Requests

There are no pending confidentiality claims or requests at this time.

COMMISSION STAFF'S PREHEARING STATEMENT
DOCKET NO. 010006-WS

H. Requirements That Cannot Be Complied With

There are no requirements of Orders Nos. PSC-01-1447-PCO-WS and PSC-01-1767-PCO-WS that cannot be complied with at this time.



Ralph R. Jaeger, Senior Attorney

FLORIDA PUBLIC SERVICE COMMISSION
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850
(850) 413-6199