

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 080006-WS

In the Matter of:

WATER AND WASTEWATER INDUSTRY ANNUAL
REESTABLISHMENT OF AUTHORIZED RANGE
OF RETURN ON COMMON EQUITY FOR WATER
AND WASTEWATER UTILITIES PURSUANT TO
SECTION 367.081(4)(F), F.S.



PROCEEDINGS: AGENDA CONFERENCE
ITEM NO. 14

BEFORE: CHAIRMAN MATTHEW M. CARTER, II
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER KATRINA J. McMURRIAN
COMMISSIONER NANCY ARGENZIANO
COMMISSIONER NATHAN A. SKOP

DATE: Tuesday, May 20, 2008

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

REPORTED BY: LINDA BOLES, RPR, CRR
Official FPSC Reporter
(850) 413-6734

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1 PARTICIPATING:

2 JOHN WILLIAMS, ESQUIRE, representing Utilities, Inc.

3 CHARLES J. BECK, ESQUIRE, representing the Citizens
4 of the State of Florida.

5 MICHAEL SPRINGER and JEAN HARTMAN, ESQUIRE
6 representing the Florida Public Service Commission staff.

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P R O C E E D I N G S

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2 CHAIRMAN CARTER: We are back on the record, and we
3 are moving now, Commissioners, to Item 14. Staff, you're
4 recognized.

5 MR. SPRINGER: Good morning, Commissioners. I'm
6 Michael Springer on behalf of technical staff, and this is Jean
7 Hartman over here on behalf of staff counsel.

8 CHAIRMAN CARTER: Hang on a second. Let's try that
9 again. We're getting some feedback on your microphone. Okay.
10 Let's start all over.

11 MR. SPRINGER: Okay. Good morning, Commissioners.

12 CHAIRMAN CARTER: That's better, much better.

13 MR. SPRINGER: I am Michael Springer on behalf of
14 technical staff, and this is Jean Hartman on behalf of staff
15 counsel.

16 By statute, the Commission has used the water and
17 wastewater leverage formula for determining a reasonable range
18 of returns on equity for water and wastewater utilities for
19 over 25 years. The last time the leverage formula went to
20 hearing was in 2001. Using the same methodology approved by
21 the Commission following the 2001 proceeding staff has updated
22 the leverage formula to reflect the most current financial
23 information.

24 We understand that Mr. Charlie Beck from the Office
25 of Public Counsel would like to address the Commission on this

1 matter. In addition, we have been notified this morning that
2 Mr. John Williams from Utilities, Inc. will also address the
3 Commission. Staff is prepared to answer your question.

4 CHAIRMAN CARTER: Thank you. Commissioners, is it
5 all right -- well, let's hear from OPC and Mr. Williams, and
6 then we'll proceed into our question phase.

7 Mr. Beck, good morning. You're recognized, sir.

8 MR. BECK: Thank you, Mr. Chairman, and good morning,
9 Commissioners. My name is Charlie Beck with the Office of
10 Public Counsel.

11 Commissioners, the staff recommendation before you
12 proposes to increase the high end of the allowed return on
13 equity for water and wastewater companies from 12.01 to
14 12.67 percent, and that's for companies with a 40 percent
15 equity ratio. And it also increases the low end from 9.06 to
16 9.48 for companies with 100 percent equity. To us these
17 numbers are, you know, extremely high, particularly given the
18 state of the economy. Over the past year interest rates have
19 generally declined, and yet the staff recommendation has a
20 substantial increase in the return on equity, which to us
21 didn't make sense. We think that the leverage graph formula
22 and the methodology it uses needs to be completely reviewed,
23 you know, ranging from its use of gas companies as surrogates
24 for water companies to the bond yield differential, the private
25 placement premium and the small utility risk premium. We're in

1 the process of obtaining an expert witness to address these
2 matters in an evidentiary hearing.

3 Commissioners, we're prepared to protest the proposed
4 agency action, but would submit to you that it would be more
5 efficient and make more sense to simply set the case strictly
6 for hearing. That's what we would request you to do, and we
7 will present a witness at the hearing.

8 CHAIRMAN CARTER: Thank you, Mr. Beck.

9 Mr. Williams.

10 MR. WILLIAMS: Good morning. My name is John
11 Williams on behalf of Utilities, Incorporated. We support the
12 staff recommendation. We believe a, the leverage formula is
13 currently a very effective tool in reducing rate case expense
14 and avoiding the cost of every utility having to hire cost of
15 capital witnesses. So we basically support the current
16 leverage formula, the concept, and we support staff's
17 recommendation.

18 CHAIRMAN CARTER: Thank you.

19 Commissioner Argenziano, you're recognized. We're
20 into our questioning phase, Commissioners. Commissioner
21 Argenziano, you're recognized.

22 COMMISSIONER ARGENZIANO: Well, just for staff to
23 make sure I'm correct, this formula has been used now for how
24 many years?

25 MR. SPRINGER: This particular methodology has been

1 used since 2001, but the actual formula has been used for 25
2 years, over 25 years, since 1982.

3 COMMISSIONER ARGENZIANO: With that question, at the
4 proper time I'd like to move to deny staff and go to hearing
5 because I think it's time to relook at things. I think OPC
6 brought up some very good points.

7 CHAIRMAN CARTER: Commissioner Skop and then
8 Commissioner McMurrian.

9 COMMISSIONER SKOP: Thank you, Mr. Chairman. And I
10 probably want to second that, but I do have some questions for
11 staff with respect to the staff recommendation and some of the
12 underlying issues associated with the recommendation as a
13 whole. I do think Mr. Beck raised some excellent points and I
14 think that those need to be further fleshed out.

15 But in response to Commissioner Argenziano's
16 question, I asked staff to prepare the handout which I think
17 everyone has, which is the water and wastewater leverage
18 formula return on equity at 40 percent equity ratio for the
19 period of '87 to 2007 just to get a flavor for what the ROEs
20 have been historically and how they've been trending.

21 But my question to staff would be on the existing ROE
22 leverage formula, that formula does not distinguish between the
23 size or the capitalization of a given utility, and to that
24 point you could be a closely held small company with a
25 40 percent equity ratio and on the flip side you could also be

1 a large publicly traded national utility and get the same ROE;
2 is that correct?

3 MR. SPRINGER: That is correct. It's a one size fits
4 all the way the leverage formula has been made so that, that
5 all wastewater and water companies don't have to put on that
6 expert witness. And so that's, that's the way it's designed.

7 COMMISSIONER SKOP: Okay. And then in that same
8 regard I think that, you know, that from what I've heard or
9 read in 2003 I think there was an argument raised as, in terms
10 of taking a look at whether that should be bifurcated in terms
11 of either market capitalization or some other criteria to
12 better reflect not having, you know, perhaps a large
13 well-capitalized company with less risk be rewarded in terms of
14 the same way a small mom-and-pop utility would be compensated.
15 Is that correct also?

16 MR. SPRINGER: That is correct. The way -- in 2003,
17 that was the 2003 UIF rate case. And the, the witness for the
18 companies had mentioned that they used the proxy companies.
19 They were comparing the capitalization of those with the actual
20 water and wastewater companies. So in that relation some of
21 the water companies were smaller and the Commission went with
22 that, and so we still have the one size fits all.

23 COMMISSIONER SKOP: Okay. And with respect to the
24 one size fits all, I mean, that's been tried and true and it's
25 worked effectively over the last, I believe you said, ten years

1 it's been used or what have you. I often have trouble hearing
2 down this far.

3 But I guess my concern is being able to properly
4 reconcile, and I think Mr. Beck again raised some excellent
5 concerns, but being able to properly reconcile the divergence
6 between the number that was calculated, and I agree with the
7 staff recommendation and the methodology and I'll get into that
8 in a second, but certainly the divergence between the new
9 revised leverage formula which I think has a 66-basis-point
10 increase at 12.67 percent at a 40 percent equity ratio versus,
11 you know, some of the other things that the Commission has
12 recently done in terms of setting an ROE that involved a
13 50-point basis point reduction. So the spread is widened
14 significantly.

15 But I guess the concern I have is that historically,
16 as shown by the other graphs that staff has provided, that
17 electrical utilities have inherently more risk than water and
18 wastewater in terms of the ROEs that are afforded that are a
19 measure of risk. And in the proposed staff recommendation I
20 could clearly envision a large publicly traded corporation that
21 receives a, the staff recommendation return on equity of
22 12.67 percent under the, at 40 percent equity ratio that would
23 have substantially less risk than a transmission and
24 distribution type company that is afforded a lower rate of
25 return.

1 So, I mean, again, that divergence -- I'm having
2 trouble rationalizing that to make sense in terms of a
3 regulatory policy. So I do think that certainly the
4 methodology is good, you know, and I support the staff
5 analysis. I think that the benchmarking that was done in terms
6 of benchmarking off the natural gas companies and some of the
7 other underlying assumptions, I mean, I think staff used its
8 best judgment to benchmark and come up with what the formula
9 would be.

10 But I guess what's troubling to me and maybe also to
11 my colleagues is that in the instant case, you know, we just,
12 the proposed update to the ROE reflected a 66-basis-point
13 increase for, you know, utilities that are traditionally less
14 risky than their electrical counterparts, yet we went the other
15 way recently. So I just -- I'm trying to reconcile those two
16 so we have cohesive good policy. And I do think that Mr. Beck
17 has raised an excellent point in terms of moving towards
18 hearing. And also, too, it may be worthwhile, given where
19 we're at in terms of trying to come up with a comprehensive
20 policy of looking at the disparity in terms of -- you know,
21 maybe one size does not fit all anymore. I mean, I'm certainly
22 open-minded and not predisposed to anything, but one size fits
23 all doesn't seem to fit in light of the divergence of
24 inconsistent outcomes.

25 And, you know, at least the ROE data that I, that I

1 see reflects the underlying, I guess the underlying rationale
2 that utilities traditionally, I mean, electric utilities
3 traditionally have more risks than their water and wastewater
4 counterparts. And I'm seeing divergence in results, and I just
5 want to make sure that we have appropriate policy in place to
6 not only have sound regulatory policy to protect the consumers,
7 but also to make sure that, you know, there's not a flight of
8 capital from one industry utility segment to another by virtue
9 of some of the decisions that we're making. So that's the only
10 questions I had. Thank you.

11 CHAIRMAN CARTER: Commissioner McMurrian.

12 COMMISSIONER McMURRIAN: Thank you. And I'm, I too
13 am absolutely comfortable with going straight to, straight to
14 hearing. I don't really see a need to set ourselves up to go
15 through the motions of a protest if we're going to end up in a
16 hearing anyway. So I absolutely support that.

17 My questions are more related to what happens in the
18 meantime. And I think the answer to my first question is yes,
19 but I'm going to ask it anyway just to make sure I'm clear.

20 If we go to hearing sometime this year and issue a
21 final order prior to December 31st, will that satisfy the
22 requirements of the statute that we establish, establish a rate
23 not less than once a year?

24 MS. HARTMAN: Yes. The statute requires the
25 Commission to establish it once a year.

1 COMMISSIONER McMURRIAN: So we just have to make sure
2 that we get that done sometime by the end, and issue an order
3 sometime by the end of this calendar year?

4 MS. HARTMAN: That's the direction from the statute.
5 And were that not to happen, the last formula that you
6 established would stay in place. And that -- it's my
7 understanding that's what happened in 2000 when the 2001 rate
8 was protested or leverage formula was protested.

9 COMMISSIONER McMURRIAN: Okay. And that -- actually,
10 Chairman, that anticipates somewhat my next question, which for
11 now would the 2007 rate that we put in place stay in place for
12 any company that comes in until we get through a hearing
13 process?

14 MS. HARTMAN: Yes.

15 COMMISSIONER McMURRIAN: Okay. Thank you.

16 CHAIRMAN CARTER: Commissioners, any further
17 questions?

18 Commissioner Edgar, you're recognized.

19 COMMISSIONER EDGAR: Thank you. And I too am
20 comfortable with going forward, going into hearing and having
21 the opportunity to hear further testimony and then further
22 discussion on some of the fine points. In fact, I look forward
23 to it and expect to learn a lot.

24 But I did -- some of the comments just a few moments
25 ago did raise a question in my mind. And so I would ask staff,

1 the issue of comparative risk between water/wastewater
2 companies in this state versus electric utilities, I guess in
3 my mind when I look at the, when I think through the history in
4 this state, I'm not sure that I understand that water and
5 wastewater companies have less risk. And I know that's
6 something we'll discuss more, and it's probably depending on
7 the subjective definitions of risk. But if you just could
8 speak to that since it's been raised a couple of times.

9 MR. SPRINGER: Well -- I'm sorry. Well, I guess a
10 lot of the water and wastewater utilities in the State of
11 Florida are, a lot of them are small. And so normally when you
12 have a smaller water and wastewater utility, you have higher
13 risk. But there are different risk factors relative to the
14 electric utilities that, that might mitigate risk in the sense
15 of, well, when you look at just recently we had the FPUC rate
16 case. They were just a transmission and distribution company
17 so that they had less risk than, say, a generation utility. I
18 think you really have to look at it as a case-by-case situation
19 in that situation because of how small they are. I would, I
20 would venture to say that the water and wastewater, these small
21 ones which predominate, excluding, say, Utilities, Inc. and
22 Aqua America, those are large, they're publicly traded, or at
23 least Aqua Utilities, Aqua America is, they don't have, they
24 have access to financing and some of these risk, small utility
25 risk premiums wouldn't apply to them. So, but we've always had

1 a one size fits all for this water and wastewater utility
2 leverage formula.

3 COMMISSIONER EDGAR: And thank you for your comments.
4 And that, the response to my question, you know, may lead us
5 to, as Commissioner Skop has suggested, to different thresholds
6 rather than that one size fits all as we look at it. I don't
7 know and I'm not presupposing, but those various levels of risk
8 and other factors dependent upon size and other things may, may
9 have us look at that. I don't know. Thank you, Mr. Chairman.

10 CHAIRMAN CARTER: Thank you.

11 Commissioner Argenziano.

12 COMMISSIONER ARGENZIANO: I guess size does matter.

13 (Laughter.)

14 CHAIRMAN CARTER: You're recognized for a motion,
15 Commissioner Argenziano.

16 Oh, one second. Commissioner Skop.

17 COMMISSIONER SKOP: Thank you. I have to stop
18 laughing. That was quite funny.

19 Just, just as a follow-up to Commissioner Edgar's
20 point, which I thought was a good one, I think that's the very
21 point I'm trying to distinguish here in terms of reconciling
22 the outcomes and the divergence of the results. It's not for
23 the small mom-and-pop utilities or the mid-sized -- and I have
24 nothing against the large utilities. I think that, you know,
25 one size fits all and it's worked well for quite some time.

1 But in light of some of our decisions that the Commission has
2 made lately, which, which I respect, I think the point that I
3 was trying to articulate was the fact that on a large,
4 nationwide, publicly traded utility, that, you know,
5 essentially it has for all practical purposes less risk under a
6 one-size-fits-all type of approach.

7 You have an instance where you have a company -- a
8 water and wastewater company arguably has less risk than a
9 smaller transmission and distribution type company, yet the
10 company with less risk that's largely capitalized, publicly
11 traded is getting a higher return on equity than the T&D. And
12 I guess that's, that's just the inconsistency I'm struggling
13 with in my mind in terms of fairness across the industry. It's
14 not just picking on water and wastewater because, again, I
15 think one size fits all well. But just distinguishing that
16 inconsistency troubles me because I can't, in terms of, you
17 know, the financial analysis, distinguish and reconcile and
18 make that work in my mind.

19 So, again, I think that going to hearing is a good
20 thing, will develop a full record and go from there. But I
21 just want to make sure that we have good, consistent, cohesive
22 policy and do what's right not only in the interest of
23 consumers, which we certainly need to look out for, but to
24 ensure the financial health and integrity of the regulated
25 entities. Thank you.

1 CHAIRMAN CARTER: Thank you, Commissioner. I also
2 want to thank Mr. Beck from the Office of Public Counsel. Mr.
3 Williams, thank you for participating with us.

4 Commissioner Argenziano, you're recognized for a
5 motion.

6 COMMISSIONER ARGENZIANO: Thank you, Mr. Chair.

7 I'd like to thank staff for the good work that they
8 do; however, I would deny staff's recommendation, given the
9 information that OPC has spoken of, and move to go to hearing.

10 CHAIRMAN CARTER: Go to hearing.

11 COMMISSIONER SKOP: Second.

12 CHAIRMAN CARTER: It's been moved and properly
13 seconded. Commissioners, all those in favor, let it be known
14 by the sign of aye.

15 (Unanimous affirmative vote.)

16 All those opposed, like sign. Show it done.

17 (Agenda Item 14 concluded.)

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1 STATE OF FLORIDA)
 :
2 COUNTY OF LEON) CERTIFICATE OF REPORTER

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4 I, LINDA BOLES, RPR, CRR, Official Commission
Reporter, do hereby certify that the foregoing proceeding was
5 heard at the time and place herein stated.


6 IT IS FURTHER CERTIFIED that I stenographically
reported the said proceedings; that the same has been
7 transcribed under my direct supervision; and that this
transcript constitutes a true transcription of my notes of
8 said proceedings.

9 I FURTHER CERTIFY that I am not a relative, employee,
attorney or counsel of any of the parties, nor am I a relative
10 or employee of any of the parties' attorneys or counsel
connected with the action, nor am I financially interested in
11 the action.

12 DATED THIS 27th day of May, 2008.

13

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LINDA BOLES, RPR, CRR
FPSC Official Commission Reporter
(850) 413-6734

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