

NOTICE OF WORKSHOP
DOCKET NO. 990006-WS
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before March 8, 1999, specifically referencing "Docket No. 990006-WS, Water and Wastewater Rate of Return Workshop."

A copy of the agenda for this workshop may be obtained by writing to the Director, Division of Records and Reporting, at the address previously noted.

Any person requiring some accommodation at this workshop because of a physical impairment should call the Division of Records and Reporting at (850) 413-6770 at least 48 hours prior to the workshop. Any person who is hearing or speech impaired, should contact the Florida Public Service Commission by using the Florida Relay Service, which can be reached at 1-800-955-8771 (TDD).

JURISDICTION

Jurisdiction is vested in this Commission pursuant to Chapter 367, Florida Statutes. The workshop will be governed by the provisions of that Chapter and Chapters 25-22, 25-30 and 28-102, Florida Administrative Code.

By DIRECTION of the Florida Public Service Commission, this 2nd day of February, 1999.

• BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
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(S E A L)

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General Information

Pursuant to Section 367.081(4)(f), Florida Statutes, the Commission uses a leverage formula to calculate an authorized return on equity for Florida water and wastewater utilities. The leverage formula sets a range of returns on equity for an average water and wastewater utility. The Commission has used the leverage formula for setting the return on equity for the entire water and wastewater industry.

An authorized return on equity provides utility companies the opportunity to earn a fair return on their investment. The return on equity measures what the Commission considers to be that fair return of shareholder equity.

Staff is looking for input and comments from the industry and other interested parties to review the current leverage formula methodology and determine if changes need to be made. Participants are encouraged to present alternatives to the current formula.

Issues

1. Florida water and wastewater utilities may be unique with respect to other utilities across the nation.
 - a. What business and financial risk factors are unique to the water and wastewater industry?
 - b. What business and financial risk factors are unique to the Florida water and wastewater utilities?
 - c. How should the Commission quantify this risk?
2. The return on equity (ROE) and cost of borrowing are related. ROE should exceed the cost of borrowing in order to remain in business.
 - a. What are the sources of loans for water and wastewater companies - banks, individuals, etc.?
 - b. What are the qualitative factors that determine the price and availability of debt?

- c. Can water and wastewater companies borrow independently or do they need backing from parent companies or individuals?
 - d. What are the typical terms of a loan to water and wastewater utilities, such as time to maturity and type of collateral?
 - e. What interest rates are typical for loans to water and wastewater utilities?
3. The current leverage formula, established by Order No. PSC-98-0903-FOF-WS, issued July 6, 1998, and made final and effective on October 6, 1998, by Order No. 98-1434-FOF-WS, issued October 23, 1998, is based on the financial theory that the lower the equity ratio (percentage of common equity to total debt and equity), the higher the demanded return on equity (ROE) and vice versa. However, to discourage imprudent financial risk, the Commission does not allow for returns greater than the level indicated at a 40% equity ratio. Should the Commission's use of a minimum equity ratio of 40% in the leverage formula be modified or changed? Please explain what changes would lead to a more reasonable approach.
4. The Commission employs an average of three financial models to estimate ROE for the water and wastewater industry, a discounted cash flow (DCF) model, capital asset pricing model (CAPM) and a risk premium analysis. The present input into these models is readily available historical and prospective market information.
 - a. Are there other financial models that would more reasonably reflect the average ROE for the Florida water and wastewater industry? Please explain.
 - b. Would other financial models rely on historical market information or prospective information?
5. The current financial models use quarterly compounding. Should ROE models use annual or quarterly compounding? Please explain.
6. The current DCF model employed in the derivation of the leverage formula is applied to an index of large, publicly traded water utilities. Most of these companies have no

operating systems in Florida. Is this a reasonable approach? If not, provide details as to a more reasonable index of companies which reflect the ROE for an average water or wastewater utility in Florida and where to readily obtain such information.

7. The current risk premium analysis employed in the derivation of the leverage formula is applied to an index of natural gas distribution utilities. Is this a reasonable approach? If not, provide details as to a more reasonable index of companies and where to readily obtain such information.
8. In the development of the leverage formula, the Commission assumes a Moody's Baa bond rating for all Florida water and wastewater utilities. There is a bond yield differential adjustment to reflect the difference in size between the index companies and typically small Florida utilities.
 - a. Is an assumed bond rating of Baa3 reasonable for all Florida utilities? Please explain.
 - b. If not, what bond rating should the Commission use? Please explain.
 - c. Does the bond yield adjustment accurately reflect the difference in size between the index companies and Florida utilities? Why or why not?
 - d. Should the Commission recognize the differences in size of utilities within the Florida industry? Why or why not?
 - e. What alternatives to a bond yield differential should the Commission employ to recognize the difference in risk between Florida utilities and the companies in the indices? Please explain.
9. Other than higher ROE's, what regulatory policies would enhance the opportunities of water and wastewater utilities to earn a reasonable rate of return?
10. What regulatory policies would improve the financial viability of Florida water and wastewater utilities?