

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

NOTICE OF WORKSHOP

TO

ALL FLORIDA PUBLIC SERVICE COMMISSION REGULATED WATER
AND WASTEWATER UTILITIES

AND

ALL OTHER INTERESTED PERSONS

RE: UNDOCKETED - ALTERNATIVE RATE SETTING

ISSUED: June 12, 2001

NOTICE is hereby given that the Florida Public Service Commission will conduct a workshop, to which all persons are invited, at the following time and place:

9:30 a.m., Wednesday, August 8, 2001
Room 148, Betty Easley Conference Center
4075 Esplanade Way
Tallahassee, Florida

PURPOSE

The purpose of this workshop is to discuss the Commission's present alternative rate setting practices and policies to determine if current conditions warrant a modification of those practices and policies.

A copy of the questions to which the Commission requests written responses is attached. Please submit your responses in writing by July 25, 2001, to Troy Rendell, Division of Economic Regulation, Florida Public Service Commission, 2540 Shumard Oak Blvd., Tallahassee, Florida 32399-0850. A copy of the agenda for this workshop is also attached.

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

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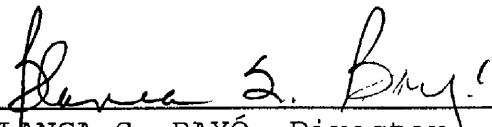
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the workshop. Any person who is hearing or speech impaired should contact the Florida Public Service Commission using the Florida Relay Service, which can be reached at 1 (800) 955-8771 (TDD).

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 120, 25-22 and 28-106, Florida Administrative Code.

By DIRECTION of the Florida Public Service Commission, this 12th day of June, 2001.



BLANCA S. BAYÓ, Director
Division of Records and Reporting

(S E A L)

SMC

Agenda for the Florida Public Service Commission Alternative Ratesetting Workshop



August 8, 2001, 9:30 a.m.
Room 148, Easley Building

- I. Introductions
- II. Staff presentations
 1. Purpose of the Workshop (Willis)
 2. History of Alternative Ratesetting (Rendell)
 3. Other States' activities in Alternative Ratesetting (Bethea)
- III. Oral comments/discussion on the questions attached to the workshop notice and the attached list of discussion questions.
(A question and discussion period will be provided after each person has provided comments.)
- IV. Discussion of participants on an Alternative Ratesetting policy
- V. Closing comments (Willis)

List of Handouts:

1. Other State Activity
2. History of FPSC Orders Addressing Alternative Ratesetting
3. Written Responses to the Questions Attached to the Notice of Workshop

ALTERNATIVE RATESETTING WORKSHOP

A. PURPOSE OF WORKSHOP

The Commission wishes to review its current alternative ratesetting practices and policies to determine if current conditions warrant a modification of the policy.

B. EXISTING ALTERNATIVE RATE SETTING POLICY

Section 367.0814(9), Florida Statutes, allows the Commission, by rule, to establish standards and procedures whereby rates and charges of small utilities may be set using criteria other than those set forth in Section 367.081, Florida Statutes. Therefore, the Commission promulgated Rule 25-30.456, Florida Administrative Code, addressing Staff Assistance in Alternative Rate Setting in 1993.

By Order No. PSC-96-0357-FOF-WU, issued March 13, 1996, in Docket No. 950641-WU, this Commission utilized, for the first time, the operating ratio methodology as an alternative means for setting rates. That order established the following criteria to determine the use of the operating ratio methodology:

- 1) Whether the utility's operation and maintenance expense exceeds rate base.
- 2) Whether the utility is expected to become a Class B in the foreseeable future.
- 3) Quality of service and condition of plant.
- 4) Whether the utility is developer owned.
- 5) Whether the utility operates treatment facilities or is simply a distribution and/or collection system.

Further, by Order No. PSC-96-0357-FOF-WS and Order No. PSC-97-0130-FOF-WU, issued February 10, 1997, in Docket No. 960561-SU, the Commission determined that a margin of 10% shall be used unless unique circumstances justify the use of a greater or lesser margin. The Commission settled on the 10% margin due to lack of economic guidance on developing an operating ratio method rate of return. The Commission believed that it would be a futile and unwarranted exercise to try to establish a precise return applicable to all small utilities. The important question was not what the return percentage should be, but what level of operating margin will allow the utility to provide safe and reliable service and remain a viable entity. The answer to this question requires a great deal of judgment based upon the particular circumstances of the utility.

Several factors must be considered in determining the reasonableness of a margin. First, the margin must provide sufficient revenues for the utility to cover its interest expense. Second, use of the operating ratio methodology rests on the contention that the principal risk to the utility resides in operating cost rather than in capital cost of the plant. The fair return on a small rate base may not adequately compensate the utility owner for incurring the risk associated with covering the much larger operating cost. Therefore, the margin should adequately compensate the utility owner for that risk. Third, if the return on rate base method were applied, a normal return would generate such a small level of revenues that in the event revenues or expenses are estimated incorrectly, the utility

could be left with insufficient funds to cover operating expenses. Therefore, the margin should provide adequate revenues to protect against potential variability in revenues and expenses. If the utility's operating expenses increase, the utility would not have the funds required for day to day operations.

C. IN ORDER FOR THE COMMISSION TO FULLY REVIEW THE CURRENT POLICY, THE COMMISSION IS REQUESTING THAT ANY INTERESTED PERSON ADDRESS THE FOLLOWING QUESTIONS:

1. What goals, if any, should the Commission be trying to achieve through its alternative ratemaking policy?
2. What is the appropriate operating margin for small water and wastewater utilities?
3. Should the existing operating margin of 10% be increased/decreased? Why?
4. What is the appropriate operating margin ratio formula?
5. Since the pass-through of increases in purchased water and/or wastewater services are allowed by Section 367.081(4)(a), Florida Statutes, should these expenses be removed from the calculation of the operating margin?
6. Should the Commission be looking at different criteria when approving or disapproving alternative ratemaking?
7. How should utilities with approved operating margins be treated in future earnings reviews?
8. Should the Commission monitor utilities with approved operating margins, and if so, how?
9. Should the Commission's policy on alternative ratemaking be revised?
10. Should the current rule on alternative ratemaking be revised?
11. Other than the operating ratio methodology, what ratesetting alternatives could be used for Class C utilities?
12. In setting rates using the operating ratio methodology, should the Commission require some of the margin to be escrowed for future needs (i.e., capital improvements, unexpected expenses, future testing, etc.)
13. Under certain conditions, is it appropriate to switch from an operating ratio methodology back to the rate base methodology? If so, what are those conditions?
14. If a negative acquisition adjustment reduces a utility's rate base below the level of O&M, making the utility a candidate for the operating margin method, should the acquisition adjustment be revisited?

15. Should a utility have the option of electing the operating margin method when such treatment would result in a greater margin to the utility than the rate base method?
16. Does the Commission's current leverage formula account for the risk of not covering operating cost? If so, how? Can the current leverage formula be modified to reflect the increased risk of not covering operating cost for utilities with little or no rate base?
17. For utilities with high levels of non used and useful plant, which causes rate base to be less than O&M, should used and useful calculations be reconsidered especially for utilities with high growth?
18. Should utilities with high growth qualify for the operating ratio? If not, what level of growth should be considered high?
19. If an averaging adjustment causes a utility's rate base to be less than O&M, should a year end rate base be selected?
20. Currently, Section 367.0814(9), Florida Statutes, allows the Commission to implement alternative ratemaking procedures only for small utilities. Rule 25-30.456, Florida Administrative Code, sets forth the methodology for Class C utilities to request staff assistance in alternative rate setting. Should alternative ratemaking be extended to Class A and B utilities, and if so, what limitations, if any, should be imposed?