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October 12, 2001

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
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Re: Docket No. 010006-WS


Dear Ms. Bayo:

Enclosed herewith for filing in the above-referenced docket on behalf of Florida Waterworks Association ("FWA") are the original and fifteen copies of Florida Waterworks' Prehearing Statement. Also enclosed is diskette containing the prehearing statement in a Word Perfect 6 format.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the copy to me.

Thank you for your assistance with this filing.

Sincerely,


J. Stephen Menton

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FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

Docket No. 010006-WS

Filed: October 12, 2001

FLORIDA WATERWORKS ASSOCIATION'S
PREHEARING STATEMENT

Florida Waterworks Association, ("FWA"), hereby files its Prehearing Statement in accordance with the Order Establishing Procedure, Order No. PSC-01-1447-PCO-WS issued on July 6, 2001, as revised by Order Granting Florida Waterworks' Agreed Motion for Extension of Time to File Prefiled Testimony and First Order Revising Controlling Dates, Order No. PSC-01-1767-PCO-WS issued August 29, 2001.

A. Witnesses.

FWA will offer the following witness in this proceeding:

Dr. Roger Morin testifying both on direct and in rebuttal addressing all issues in this docket.

B. Exhibits

FWA intends to present the following exhibits which are included with the prefiled testimony of FWA's witness:

<u>Exhibit:</u>	<u>Title:</u>
Appendix A to the prefiled testimony of Dr. Morin	Flotation cost allowance
RAM-1	Resume of Roger A. Morin

DOCUMENT NUMBER-DATE

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FPSC-COMMISSION CLERK

RAM-2	Annual long-term risk premium analysis-Moody's electric utility common stocks over long-term treasury bonds
RAM-3	Annual long-term risk premium analysis-Moody's natural gas distribution common stocks over long-term treasury bonds
RAM-4	DCF analysis: Value Line water utilities
RAM-5	DCF analysis: Moody's generation divestiture utilities
RAM-6	DCF analysis: natural gas distribution utilities
RAM-7	Composite analysis of allowed risk premium

FWA reserves the right to utilize demonstrative exhibits and to introduce exhibits for cross examination, impeachment or any other purpose authorized by the applicable Florida Rules of Evidence or the rules of the Commission.

C. Basic Position

This docket was opened as a result of FWA's petition challenging the Commission's Proposed Agency Action Order No. PSC-01-1226-PAA-WS (the "PAA Order") issued June 1, 2001. The PAA Order proposes a continuation (with only a minor correction and a minor modification) of the existing leverage formula methodology used for calculating a reasonable range of returns on equity for water and wastewater utilities. The current leverage formula methodology has essentially been followed by the Commission for several years without any significant modifications to reflect changes in the industry. FWA contends that the proposed regulatory treatment embodied in the existing leverage formula methodology does not appropriately reflect the risks and issues facing the industry. FWA also contends that the financial models utilized by the Commission in the PAA Order result in rates of return that are significantly lower than the rates of return on equity authorized for other Commission regulated utilities. The rates of return that result from the selected financial

models also result in rates of return that are significantly lower than returns authorized for water and wastewater utilities in other states.

The FWA contends that the Commission should not simply continue the current leverage formula methodology for water and wastewater utilities as proposed in the PAA. The range of returns on equity calculated under the PAA Order are not fair and reasonable. A more thorough and objective analysis results in a range of return between 10% to 13.4% with a mid point of 11.7% for a typical Florida water and wastewater utility.

D. Questions of Fact

At the time of the filing of this Prehearing Statement, there are no agreed upon questions of fact, law or policy for this docket. FWA suggests that the questions of fact in this docket include the following:

(1) Whether the water and wastewater industry is a rising cost industry - FWA contends that the current regulatory treatment embodied in the existing leverage formula does not appropriately reflect the risks and issues facing the water and wastewater industry. This industry is a rising cost industry facing uncertain and continually changing environmental regulations and conditions. Thus, water and wastewater utilities must assume greater business risks than in the past. The Commission's proposed continuation of the current formula fails to adequately recognize these risks and thereby jeopardizes the financial viability of the utilities and potentially compromises their ability to provide adequate, safe and reliable service.

(2) Whether the financial models utilized by the Commission result in a dependable, reasonable range of returns on equity - The Commission's current leverage formula calculates a range of returns on equity based on certain financial models. The PAA Order is based upon a sample

of utilities that is not reflective of Commission regulated water and wastewater utilities. The sample is too small in size and utilizes a disproportionate number of utilities located out-of-state who operate in markets and circumstances which do not reflect water and wastewater industry in Florida. Furthermore, the current leverage formula utilizes an index of out-of-state water utilities that have publically traded stock. This sample does not accurately reflect a typical Florida water and wastewater company. FWA contends a more diversified and focused use of financial models results in a significantly higher range of returns than contained in the PAA Order.

(3) Whether the results of the current leverage formula methodology produces a range of returns on equity that are comparable to Commission regulated electric and gas utilities - The current leverage formula methodology for water and wastewater utilities produces returns on equity that are significantly less than the composite authorized rate of return for Commission regulated electric and gas utilities. FWA contends there is no reasonable or justified basis for this difference.

(4) What is the most appropriate method to estimate a fair and reasonable return on a water and wastewater utility's common equity capital - No individual method provides the necessary level of accuracy. Several different approaches should be utilized to cross-check results. An independent, diversified analysis of the fair and reasonable rate of return on equity upon which the Commission should base its leverage formula methodologies for water and wastewater utilities in the State of Florida results in a range of returns significantly higher than contained in the PAA Order.

(5) Whether Florida water and wastewater utilities will be able to attract the capital funds needed to meet their service demands and to maintain financial integrity with the range of returns calculated using the current methodology and the proposed minor modifications - Strict adherence

to the Commission's models has resulted in rates or return that are significantly lower than the returns on equity authorized for water and wastewater utilities in other states. Consequently, investment in Florida water and wastewater utilities is comparatively becoming less and less attractive.

(6) Whether adoption of the PAA Order will offer returns to capital suppliers that are comparable to those achieved on alternate competing investments of similar risks - The current leverage formula methodology for water and wastewater utilities produces returns on equity that are significantly less than the composite authorized rate of return for competing investments of similar risks. FWA contends there is no reasonable or justified basis for this difference. The range of returns calculated in accordance with the PAA Order would place Florida water and wastewater utilities at a competitive disadvantage in the capital markets.

E. Questions of Law

FWA suggests that the questions of law in this docket include:

(1) Whether the proposed continuation of the current leverage formula methodology with only minor corrections and modifications will result in a reasonable range of returns on equity for water and wastewater utilities as directed by Section 367.01(4)(f), Florida Statutes - The range of return set forth in the PAA Order is too low. A just and reasonable range of return on common equity to be used as part of the leverage formula methodology for ratemaking purposes on a company's common equity capital should be 10% to 13.4% with the mid-point of 11.7% for a typical Florida water and wastewater utility with an average capital structure. Individual rates of return on equity can be determined within that range in accordance with the leverage adjustment based upon the common equity ratio of each company. A formal comprehensive review of the leverage formula

should be completed so that individual rates of return on equity can be more fairly calculated with a formula that replicates.

F. Policy Questions

FWA suggests that the Policy Questions in this docket include:

(1) Whether there is justification or basis for utilizing a leverage formula methodology that yields a lower return on equity for water and wastewater utilities as compared to other rate-based industries in Florida and elsewhere;

(2) Whether the leverage formula methodology should incorporate the use of an electric and gas composite authorized return on equity to yield a more reasonable and reliable return;

(3) Whether the proposed continuation of the current leverage formula methodology with minor modifications should assume that water and wastewater utilities are less risky than other rate-based regulated industry;

(4) Whether the range of return set forth in the PAA Order is fair and reasonable for the water and wastewater industry in Florida.

G. Stipulated Issues:

No issues have been stipulated at this point.

H. Pending Motions:

There are no pending motions at this time.

I. Confidentiality

There are no pending requests or claims for confidentiality.

G. Other Requirements:

FWA believes that this Prehearing Statement is fully responsive to the requirements of the above-stated procedural Orders.

Respectfully submitted,




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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing testimony has been furnished by U.S. Mail this 12th day of October, 2001 to:

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c/o The Florida Legislature
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J. Stephen Menton