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November 21, 2001

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COMMISSION
CLERK

Ms. Blanca S. Bayó, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0870

RE: Docket No. 010006-WS

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of Citizens' Post-Hearing Statement of Issues and Positions, With Supporting Brief for filing in the above-referenced docket.

Also enclosed is a 3.5 inch diskette containing Citizens' Post-Hearing Statement of Issues and Positions, With Supporting Brief in WordPerfect for Windows 6.1. Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

Stephen C. Burgess
Deputy Public Counsel

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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)
common equity of water and)
wastewater utilities pursuant to)
Section 367.081(4)(f), F.S.)
_____)

DOCKET NO. 010006-WS
DATED: November 21, 2001

**CITIZENS' POST-HEARING STATEMENT OF
ISSUES AND POSITIONS, WITH SUPPORTING BRIEF**

The Citizens of the State of Florida, pursuant to Rule 28-106.215, Florida Administrative Code, and Order No. PSC-01-2139-PHO-WS, hereby file this post-hearing statement of issues and positions, with supporting brief.

OPC BASIC POSITION:

The leverage formula described in Order No. PSC-01-1226-PAA-WS results in liberal equity returns that equal or exceed the "range of returns on common equity for an average water and wastewater utility," as required by Section 367.081(4)(f), Florida Statutes.

ISSUE 1: What is the most appropriate model or method to estimate a fair and reasonable return on a water and wastewater utility's common equity capital?

POSITION: *The most appropriate model is that which is used in the PAA. With occasional modifications, this model has been used for many years and clearly has proven to result in ROEs that attract capital investment to the industry.*

BRIEF:

On June 1, 2001, the Commission issued Order No. PSC-01-1226-PAA-WS. The Commission reached its decision after a highly deliberative process: the Commission had received a

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primary recommendation from its Staff, the Commission had received a secondary Staff Recommendation, with an in-depth analysis explaining the underlying methodology; the Commission entertained comments, testimony and arguments from all interested parties who appeared and chose to participate; the Commission engaged in extensive dialogue with the parties and its own Staff; the Commissioners discussed and debated the issues thoroughly among themselves; and finally the Commission voted out Order No. PSC No. PSC-01-1226-PAA-WS.

The leverage formula which the Commission approved in the PAA fully meets its statutory purpose. With a few adjustments (that have benefitted utilities), the leverage formula used in the PAA is the same formula that has been used in Florida since the late 1970s [T-131].

Testifying for the Citizens, Mr. Mark Cicchetti performed an analysis using two generally accepted market-based methodologies. Mr. Cicchetti used a discounted cash flow (DCF) model and a risk premium analysis. The results of Mr. Cicchetti's analysis support the reasonableness of the PAA [T-124].

Mr. Cicchetti's DCF analysis can be more specifically described as a two-stage, annually compounded discounted cash flow model applied to an index of publicly traded water companies [T-124]. The two-stage description refers to Mr. Cicchetti's estimate of dividend growth. For this first stage, Mr. Cicchetti relied on Value Line's forecast of dividends as a reasonable reflection of investor expectations. For the second stage of dividend growth, Mr. Cicchetti used the earnings retention method (b x r approach) and Value Line's expected return on equity and retention rate for 2005. Mr. Cicchetti added an estimate for issuance costs [T-126], and the method resulted in a required equity return of 9.00% (rounded) [T-127].

Mr. Cicchetti performed his risk premium analysis on Moody's Natural Gas Distribution Index for the ten-year period of January 1991 to December 2000 [T-128]. Mr. Cicchetti used the DCF to estimate the required equity returns during that period and compared those returns to the respective period's yield on long-term government bonds. The derived risk premium was 3.10%, resulting in a current cost of equity of 8.60% [T-129].

The average of Mr. Cicchetti's methods is 8.80%, to which Mr. Cicchetti added a bond yield differential to reflect the difference between the indices that he used and the average Florida WAW utility. In addition, Mr. Cicchetti added a second factor of 50 basis points as a private placement premium. The final result of Mr. Cicchetti's analysis was a cost of equity for the average Florida WAW company of 9.71%.

Based on his determination that the cost of equity is 9.71%, Mr. Cicchetti concluded that the leverage formula (range: 9.14% to 10.24%) adopted in Order No. PSC-01-1226-PAA-WS is reasonable [T-130].

ISSUE 2: Should the Commission, as a matter of law or policy, establish a leverage formula that systematically results in an allowed equity return that is either higher or lower than the actual measured cost of equity for an average water or wastewater utility at the corresponding equity ratio?

OPC: *No. Sound public policy as well as Section 367.081(4) (f), F.S., contemplates the establishment of authorized equity returns that equal -- not systematically exceed -- the actual cost of equity.*

BRIEF:

This proceeding is being conducted pursuant to the requirements established by Section 367.081(4)(f), Florida Statutes. That statutory provision requires the Commission to establish a formula that “reasonably reflect[s] the range of returns on equity for an average water or wastewater utility.” Id. It is the OPC position that the statute requires the Commission to establish a leverage formula that reflects the actual cost of equity for an average Florida water and wastewater utility, to the extent that cost can be measured.

OPC raised this “Issue 2” and asked the Commission to rule on the issue in its deliberation. OPC seeks the Commission’s agreement that it will not consider any factors that are extraneous to the actual risk factors applicable to the Florida water and wastewater industry.

To illustrate OPC’s concern, consider the following scenario: Suppose the Commission finds as a fact that actual measured cost of equity for an average water and wastewater company is reflected in the formula recommended by Mr. Lester. Suppose, further, that the Commission takes note of the fact that, because of various happenstances, several electric utilities (Florida or otherwise) currently enjoy higher authorized ROEs than would result from Mr. Lester’s formula. Under those two suppositions, would it be legal or proper for the Commission to adjust the formula upward for no other reason than to bring the authorized water and wastewater ROE more in line with the Florida electrics?

The Citizens believe that an upward adjustment for that reason would be illegal and improper. The Citizens urge the Commission likewise to find, as a matter of law and policy, that it will consider only those factors which bear on an accurate measure of the actual cost of equity for water and wastewater utilities in Florida.

It is the Citizens position that there is no legitimate reason -- policy, legal or otherwise -- for the Commission to base its ultimate decision on any factor that is extraneous to the actual cost of equity for an average Florida water or wastewater company.

ISSUE 3: Is there justification for utilizing a leverage formula methodology that yields a lower return on equity for water and wastewater utilities as compared to other rate based regulated industries in Florida and elsewhere?

OPC: *The formula should reflect the actual cost of equity for an average water/wastewater utility, not ROEs stipulated in some other industry. If risk factors associated with another industry are different (e.g., threat of restructuring, absence of indexing), the ROEs should reflect that difference.*

BRIEF:

Since this was presented by FWA as an issue of policy, rather than of fact, the Citizens will approach it in that context. Accordingly, the Citizens will not approach this issue as the factual question of how other industries' risk compares with the risk of water and wastewater utilities. Rather, the Citizens will discuss whether, as a matter of regulatory policy, there is any justification for a leverage formula that yields ROEs that may be lower than previously set ROEs for some other regulated industries. In that context, the answer is unequivocally yes.

The Commission cannot increase the leverage graph results merely because certain companies in other regulated industries may currently enjoy higher authorized rates those resulting from the leverage graph. The leverage graph method is authorized by Section 367.081(4)(f), Florida Statutes, which clearly applies only to water and wastewater companies. The law specifies that the leverage formula must "reasonably reflect the range of returns on common equity for an average water or

wastewater utility” Id. Nowhere does the section even mention electric utilities. Thus, as a matter of legal policy, the statute restricts the Commission’s consideration to the cost of equity for water or wastewater companies.

Approved returns for other industries are not identified as a consideration in the statute. Had the legislature desired to require the same ROE to be authorized for all regulated industries, it would have mandated that result in the statute. Instead, the Legislature separated this statutory provision from the other industries. The legislature never intended any policy to equate ROEs for all industries.

As a result, the establishment of ROEs for the respective industries are entirely independent considerations. If, as a matter strictly of coincidence, the risk and timing for one industry is the same as that for another industry, then the ROEs should be the same. If, on the other hand (and far more likely), the risk and timing varies from one industry to another, the authorized ROEs should likewise vary. This is the policy established by the statutory context.

There is another consideration that makes this policy all the more justified under the existing circumstances. Since FWA seeks the Commission to consider electric utilities as a benchmark for the water and wastewater ROEs, it is worth noting the process through which the current ROEs were authorized for the Florida electric utilities. The ROE currently authorized for each electric utility was the result of either a settlement or a hearing that transpired years ago. A multitude of variables affect the results of an ROE settlement, and many of these variables are simply pragmatic and have absolutely nothing to do with the actual measured risk of that particular utility. The results of these electric stipulations or years-old hearings have absolutely no relevance to the risk considerations facing the water and wastewater industry in the years 2001-2002.

There is clear policy justification for using a leverage formula methodology based strictly on the risk associated with the Florida water and wastewater industry. Stipulated returns from other industries are not relevant.

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

OPC: *9.14% ROE @ 100% equity ratio to the 10.24% ROE @ 40% (or lower) Equity ratio, based on the formula: Return on Common Equity = 8.41% + 0.731/Equity Ratio.*

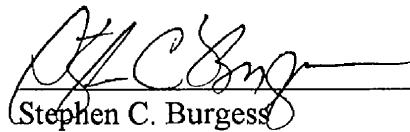
BRIEF:

The OPC rationale for this position is presented in response to Issue 1.

ISSUE 5: Should this docket be closed?

OPC: *The Citizens do not take issue with the prehearing position articulated by PSC Staff on this issue.*

Respectfully submitted,



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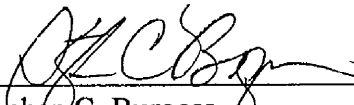
**CERTIFICATE OF SERVICE
DOCKET NO. 010006-WS**

I HEREBY CERTIFY that a true and exact copy of the above and foregoing Citizens' Post-Hearing Statement of Issues and Positions, With Supporting Brief has been furnished by hand-delivery* or U.S. Mail to the following parties of record this 21st day of November, 2001.

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