

VOTE SHEET

DECEMBER 17, 2001

RE: Docket No. 010006-WS - 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.

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?

RECOMMENDATION: With the adjustments set forth in Issue 4, the existing methodology for determining the ROE leverage formula is appropriate. Based on the record in this proceeding the most appropriate models to estimate a fair and reasonable ROE for a water and wastewater utility for inclusion in the leverage formula is the Discounted Cash Flow model (DCF) and the Capital Asset Pricing Model (CAPM).

**APPROVED**

COMMISSIONERS ASSIGNED: Full Commission

COMMISSIONERS' SIGNATURES

MAJORITY

DISSENTING

*Michael A. Palesi*  
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REMARKS/DISSENTING COMMENTS:

DOCUMENT NUMBER - DATE

15692 DEC 17 2001

FPSC-COMMISSION CLERK

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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 and wastewater utility at the corresponding equity?

RECOMMENDATION: No. Staff believes it is appropriate for the Commission to base its decision on the evidence contained in the record.

**APPROVED**

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?

RECOMMENDATION: Pursuant to Section 367.081(4)(f), Florida Statutes, the Commission must establish a leverage formula which reasonably reflects the "range of returns on common equity for an average water or wastewater utility." Staff believes that using the methodologies in Issue 1, and allowing for placement costs and a risk premium to account for the small size and the additional risk of the average water and wastewater utility, results in a leverage formula appropriate for an average water and wastewater utility.

**APPROVED**

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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?

RECOMMENDATION: Staff recommends the following return on equity:

Return on Common Equity = 9.10% + 0.896/Equity Ratio

Where the Equity Ratio = Common Equity / (Common Equity + Preferred Equity + Long-Term and Short-Term Debt)

Range: 10.00% @ 100% equity to 11.34% @ 40% equity

Based on its analysis of this issue and a review of the witnesses' testimonies and exhibits, staff recommends the following:

1. The Commission should use a two-stage annual DCF model applied to an index of natural gas distribution utilities, using forecasted expected dividend growth rates for the first stage and the retention earnings method for the second stage.
2. The Commission should use the CAPM for an index of natural gas distribution utilities, using an average beta, derived from Value Line, and a market risk premium calculated by a simple DCF model using an average of forecasted dividend and earnings growth rate.
3. The Commission should make a 20-basis point adjustment to each model to adjust for flotation cost allowance. In addition, a 10-basis point adjustment made to the CAPM to adjust for quarterly compounded results.
4. The Commission should make the following adjustments to the average of the two models: a bond yield differential adjustment, a private placement premium of 50-basis points and a small-utility risk premium of 50-basis points.

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5. The Commission should allow the indicated range of ROE in the leverage formula for a WAW utility to range from 40% equity to 100% equity. In addition, it has been Commission practice to include an adjustment to reflect the required equity return at a 40% equity ratio.

**APPROVED**

ISSUE 5: Should this docket be closed?

RECOMMENDATION: No. Pursuant to Stipulation No. 1, this docket should remain open to allow staff to monitor the movement in capital costs and to readdress the reasonableness of the leverage formula as conditions warrant.

**APPROVED**