

**RUTLEDGE, ECENIA, PURNELL & HOFFMAN**

**ORIGINAL**

PROFESSIONAL ASSOCIATION  
ATTORNEYS AND COUNSELORS AT LAW

STEPHEN A ECENIA  
RICHARD M ELLIS  
KENNETH A HOFFMAN  
THOMAS W KONRAD  
MICHAEL G MAIDA  
MARTIN P McDONNELL  
J STEPHEN MENTON

POST OFFICE BOX 551, 32302-0551  
215 SOUTH MONROE STREET, SUITE 420  
TALLAHASSEE, FLORIDA 32301-1841

TELEPHONE (850) 681-6788  
TELECOPIER (850) 681-6515

R DAVID PRESCOTT  
HAROLD F X PURNELL  
MARSHA E. RULE  
GARY R RUTLEDGE  
GOVERNMENTAL CONSULTANTS  
MARGARET A. MENDUNI  
M. LANE STEPHENS

September 3, 2002

Ms. Blanca Bayo, Director  
Commission Clerk and Administrative Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

**HAND DELIVERY**

RECEIVED - FPSC  
02 SEP - 3 PM 12:05  
COMMISSION CLERK

Re: Docket No. 020006-WS

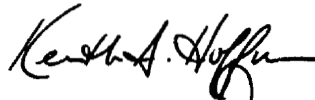
Dear Ms. Bayo:

Enclosed with this letter on behalf of Florida Services Corporation ("Florida Water") are the original and fifteen copies of the Prefiled Direct Testimony of Frank Seidman

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,



Kenneth A. Hoffman

- AUS \_\_\_\_\_
- CAF \_\_\_\_\_
- CMP \_\_\_\_\_
- COM 5 for original
- CTR \_\_\_\_\_
- ECR \_\_\_\_\_
- GCL \_\_\_\_\_
- OPC \_\_\_\_\_
- MMS \_\_\_\_\_
- SEC 1
- OTH \_\_\_\_\_

KAH/rl

Enclosures

RECEIVED & FILED  
*KLM*  
FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE  
09253 SEP-3 02  
FPSC-COMMISSION CLERK

Page 2  
September 3, 2002

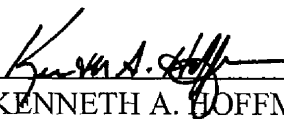
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Prefiled Direct Testimony of Frank Seidman was furnished to the following by U.S. Mail this 3<sup>rd</sup> day of September, 2002:

Adrienne Vining, Esq.  
Division of Legal Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Room 370  
Tallahassee, Florida 32399-0850

Mary Anne Helton, Esq.  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, Florida 32399-0850

Stephen C. Burgess, Esq.  
Office of Public Counsel  
111 West Madison Street  
Room 812  
Tallahassee, Florida 32399-1400

  
KENNETH A. HOFFMAN, ESQ.

1 DIRECT TESTIMONY OF FRANK SEIDMAN  
2 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION  
3 REGARDING THE PROPOSED REESTABLISHMENT OF AUTHORIZED  
4 RANGE OF RETURNS ON COMMON EQUITY  
5 FOR WATER AND WASTEWATER UTILITIES  
6 DOCKET NO. 020006-WS  
7

8 **Q. Please state your name, profession and address.**

9 A. My name is Frank Seidman. I am President of  
10 Management and Regulatory Consultants, Inc.,  
11 consultants in the utility regulatory field. My  
12 mailing address is P.O. Box 13427, Tallahassee, FL  
13 32317-3427.  
14

15 **Q. On whose behalf are you presenting testimony in  
16 this proceeding?**

17 A. I am presenting testimony on behalf of Florida  
18 Water Services Corporation (FWSC).  
19

20 **Q. State briefly your educational background and  
21 experience.**

22 A. I hold the degree of Bachelor of Science in  
23 Electrical Engineering from the University of  
24 Miami. I have also completed several graduate level  
25 courses in economics at Florida State University,

1 including public utility economics. I am a  
2 Professional Engineer, registered to practice in  
3 the state of Florida. I have over 35 years  
4 experience in utility regulation, management and  
5 consulting. This experience includes nine years as  
6 a staff member of the Florida Public Service  
7 Commission, two years as a planning engineer for a  
8 Florida telephone company, four years as Manager of  
9 Rates and Research for a water and sewer holding  
10 company with operations in six states, and three  
11 years as Director of Technical Affairs for a  
12 national association of industrial users of  
13 electricity. I have either supervised or prepared  
14 rate cases, rates studies, certificate applications  
15 and original cost studies or testified as an expert  
16 witness with regard to water and wastewater  
17 utilities in Florida, California, Indiana,  
18 Michigan, Missouri, North Carolina and Ohio. I  
19 have participated in, and appeared as a witness at,  
20 many of this Commission's rulemaking proceedings  
21 with regard to water, wastewater and electric  
22 rules, as well as proceedings before the Division  
23 of Administrative Hearings.  
24  
25

1       **Q.    What is the purpose of your testimony?**

2       A.    The purpose of my testimony is to address concerns

3           with language in Order No. PSC-02-0898-PAA-WS

4           wherein the Commission proposes to utilize the

5           current leverage formula to reestablish the

6           authorized return on equity (ROE) for all water and

7           wastewater utilities that currently have authorized

8           ROEs. Specifically, I will address concerns that

9           the proposal will result in a piecemeal approach to

10          ratemaking, will make the interim rate process

11          unworkable, will result in an increase in rate case

12          expense, will have detrimental effects on a

13          utility's planning and budgeting, and will increase

14          the risk to a utility because of regulatory

15          uncertainties. Although my testimony will address

16          these concerns on a factual basis, I will, from

17          time to time, refer to the sections of the statutes

18          by which the Commission should be guided.

19

20       **Q.    Before you address specific concerns, would you**

21           **please summarize your understanding, based on your**

22           **experience, of how the Commission's annual**

23           **reestablishment of the authorized rate of return**

24           **fits into the ratemaking procedure?**

1       A.    Yes. The general approach to ratemaking for water  
2            and wastewater utilities begins with Section  
3            367.081(2)(a)1, Florida Statutes, wherein the  
4            Commission is required, either upon request or upon  
5            its own motion, to fix rates which are just,  
6            reasonable, compensatory and not unfairly  
7            discriminatory. The section goes on to explain how  
8            that is to be done. The section specifies that  
9            there will be a proceeding in which the Commission  
10           shall consider, but not be limited to, nine  
11           factors, one of which is a fair return on the  
12           investment of the utility in property used and  
13           useful in the public service.

14  
15           A fair return is a return on all components of  
16           capital, including a return on equity. Section  
17           367.081(4)(f), Florida Statutes, provides a means  
18           by which the Commission can establish a reasonable  
19           range of return on equity for water and wastewater  
20           utilities. The section allows, but does not  
21           mandate, the Commission to regularly, not less than  
22           once a year, establish by order a leverage formula  
23           or formulae that reasonably reflect the range of  
24           returns on common equity for an average water or  
25           wastewater utility. The section goes on to specify

1 two potential uses of that range of returns. First,  
2 it shall be used to establish the last authorized  
3 rate of return on equity for any water or  
4 wastewater utility for which a return had not  
5 previously been established. Second, it allows a  
6 utility, in a proceeding in which an authorized  
7 rate of return is to be established, to request  
8 the Commission to adopt that range of returns in  
9 lieu of the utility presenting evidence on its rate  
10 of return on equity.

11

12 **Q. Does the Commission's annual reestablishment of the**  
13 **authorized rate of return fit into the interim**  
14 **ratemaking procedure?**

15 A. Only indirectly. The procedure for setting interim  
16 rates is set out in Section 367.082, Florida  
17 Statutes. The section states that the Commission  
18 shall determine the revenue deficiency by  
19 calculating the difference between achieved and  
20 required rate of return. The section states that in  
21 calculating the "required rate of return" the  
22 Commission shall use the "last authorized rate of  
23 return on equity." It then defines "last authorized  
24 rate of return on equity" as that established in

1 the most recent individual rate proceeding of the  
2 utility.

3  
4 The annual reestablishment of the authorized rate  
5 of return fits in indirectly because the section  
6 indicates that the Commission is not prohibited  
7 from authorizing interim rates for a utility which  
8 does not have a previously established authorized  
9 rate of return. Since Section 367.081(4)(f),  
10 Florida Statutes, requires the Commission to  
11 utilize the results of the annual reestablishment  
12 procedure to calculate the last authorized rate of  
13 return for such utilities, it follows the result  
14 would be utilized in setting interim rates for  
15 utilities for which an authorized rate of return  
16 had not been previously established.

17

18 **Q. Why do you believe that the Commission's proposal**  
19 **will result in a piecemeal approach to ratemaking?**

20 A. If the Commission's proposal were to be placed in  
21 effect, it is my understanding that the authorized  
22 rate of return will automatically, without a  
23 proceeding, be reestablished for every water and  
24 wastewater utility that currently has an authorized  
25 rate of return that was determined in an individual



1 proceeding. By fiat, the Commission will have  
2 changed one of the at least nine factors which it  
3 must consider in fixing rates, without weighing the  
4 impact of the other factors. If the new, mandated  
5 authorized rate of return is lower than the  
6 authorized rate of return last determined at an  
7 individual proceeding, the utility may be judged to  
8 be over-earning and subject to a rate reduction  
9 without any other factors being weighed.  
10 Conversely, if the new, mandated authorized rate of  
11 return is higher than the authorized rate of return  
12 last determined at an individual proceeding, the  
13 utility may well be in a position to request a rate  
14 increase without any other factors being weighed.  
15 That is piecemeal ratemaking.

16

17 **Q. You expressed concern that the interim rate**  
18 **procedure would be unworkable. Why is that?**

19 A. As previously discussed, the interim rate procedure  
20 is set by statute. The revenue deficiency, for  
21 interim rate purposes, is based on the difference  
22 between achieved rate of return and required rate  
23 of return. By statute, the required rate of return  
24 is based on the last authorized rate of return on  
25 equity established in the most recent individual

1 rate proceeding. If I understand the Commission's  
2 proposal correctly, the annual reestablished return  
3 on equity range would supercede the range  
4 authorized in the most recent individual  
5 proceeding. The Commission's proposal and the  
6 statutory procedure are in conflict.

7

8 **Q. Why do you believe there will be an increase in**  
9 **rate case expense?**

10 A. If the authorized rate of return for a utility is  
11 reduced through implementation of the Commission's  
12 proposal, and the utility faces a reduction in  
13 rates that it would not otherwise have been exposed  
14 to, it is going to defend its position in a rate  
15 proceeding and incur rate case expense that it  
16 would not otherwise have incurred. Conversely, if  
17 the authorized rate of return for a utility is  
18 increased through implementation of the  
19 Commission's proposal, and the utility finds it is  
20 entitled to rates higher than it would otherwise  
21 have been, it may well move forward with a rate  
22 proceeding and incur rate case expense that it  
23 would not otherwise have incurred. In addition,  
24 since there is no certainty in the proposal as to  
25 how often the Commission will reset the authorized

1 rate of return, rate cases may occur more  
2 frequently than in the past.

3

4 **Q. Would you please discuss why you believe that the**  
5 **Commission's proposal will have a detrimental**  
6 **effects on a utility's planning and budgeting?**

7 A. For the more than 30 years that this Commission has  
8 regulated the rates of water and wastewater  
9 utilities, this Commission has determined an  
10 authorized rate of return on equity in the  
11 individual rate proceeding of each utility. In each  
12 case, the Commission has also set a range of  
13 reasonableness for the return on equity, of plus or  
14 minus 1% of the authorized return. Utilities have  
15 always been able to plan and budget with the  
16 knowledge that as long as the utility earnings  
17 remained within the range of reasonableness of the  
18 last authorized rate of return on equity, as  
19 determined in its last individual rate proceeding,  
20 it would not need to adjust rates, nor be subject  
21 to the adjustment of rates. Under that policy,  
22 utilities have been able to stabilize rates for  
23 many years, and limit rate changes to small, annual  
24 index or pass-through adjustments. This Commission  
25 proposal will change that. Planning and budgeting

1 would now have to include a year to year prediction  
2 of (1) when, whether and by how much, capital  
3 markets might change, and (2) if and when the  
4 Commission might consider those market changes  
5 significant enough to "update" the authorized rate  
6 of return of water and wastewater utilities as a  
7 group.

8  
9 In addition, as the Order points out, the  
10 "updating" of the authorized rate of return will  
11 effect earnings surveillance and index and pass-  
12 through applications. So a utility's earning will  
13 be reviewed, not based on a range of reasonableness  
14 as determined in a rate proceeding in which all  
15 factors were considered, but on a shifting  
16 "updated" range of reasonableness in which one  
17 factor was considered.

18

19 **Q. Will the proposed change increase the risk to a**  
20 **utility?**

21 A. Yes. The proposed change substantially increases  
22 regulatory uncertainties. Under current policy, the  
23 authorized rate of return on equity remains stable  
24 between rate proceedings. Everyone knows that. It  
25 is predictable and dependable. Long term decisions

1 can be safely based on that knowledge. Under the  
2 Commission's proposal, the authorized rate of  
3 return on equity is subject to annual fluctuations.  
4 An earnings level that is acceptable one year, may  
5 not be the next year. A price index adjustment that  
6 might be acceptable one year, may not be the next  
7 year, even though operating expenses may  
8 justifiably be increasing. Long term financing  
9 decisions that depended on the predictability of an  
10 authorized earnings stream may now be at risk.

11

12 **Q. Do you have any additional concerns with the**  
13 **Commission's proposal?**

14 A. Yes. The concerns I have raised thus far are with  
15 problems that I believe will be the result of the  
16 implementation of the Commission's proposal. But,  
17 resulting problems aside, I believe the proposal to  
18 mandate an updated rate of return on equity is in  
19 conflict with Section 367.081(4)(f), Florida  
20 Statutes. As I have previously discussed, this  
21 section of the statute has only two specified uses:  
22 (1) for the Commission to establish a last  
23 authorized rate of return on equity for any water  
24 or wastewater utility for which a return had not  
25 previously been established, and (2) to allow a

1 utility to voluntarily accept the range of returns  
2 on common equity calculated under the section in  
3 lieu of presenting evidence in which an authorized  
4 rate of return on common equity is established.  
5 Using the range of returns calculated under the  
6 section to mandate a range of returns on common  
7 equity for a water or wastewater utility goes  
8 beyond the authority of the section and places the  
9 Commission proposal in conflict with the statute.

10  
11 **Q. Do you have any summary comments?**

12 A. Yes. The Commission's longstanding policy of  
13 implementing the statute regarding reestablishment  
14 of the authorized range of return on common equity  
15 has worked well for several decades, even in the  
16 face of vast shifts in capital markets. It has  
17 introduced stability and predictability into the  
18 ratemaking process. It has reduced the cost of  
19 conducting a rate case. In conjunction with the  
20 index and pass-through procedure it has reduced the  
21 frequency of rate applications. It has provided a  
22 stable environment in which utilities can plan and  
23 budget. The policy should not be expanded as  
24 proposed. The current policy should be maintained.

25

1 Q. Does that conclude your direct testimony?

2 A. Yes it does.