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January 9, 2003

Ms. Blanca S. Bayo, Director
Division of the Commission Clerk and
Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Room 110
Tallahassee, Florida 32399-0850

030006-WS

Re: Docket No. ~~020006~~-WS
Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4)(f), F.S.

Dear Ms. Bayo:

Enclosed for filing under in the above docket is an original and fifteen copies of Florida Services Corporation's brief of the issues and evidence in the above-referenced docket. Also enclosed is a diskette with a copy of the brief in Word 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 in handling this matter.

Sincerely,

Marsha Rule

Marsha E. Rule

AUS ___
CAF ___
CMP ___
COM 5 cc: Adrienne Vining
CTR ___ Stephen Burgess
ECR ___
GCL ___
OPC ___
MMS ___
SEC 1
OTH ___

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Water and wastewater industry annual reestablishment of authorized range of return on common equity for water and wastewater utilities pursuant to Section 367.081(4) (f), F.S.	))))))	Docket No. 020006-WS Filed: 01/09/03

BRIEF
OF
FLORIDA WATER SERVICES CORPORATION

In Order No. PSC-02-0898-PAA-WS (the "PAA Order") the Commission proposed to reset the previously-authorized returns on equity ("ROEs") for all water and wastewater utilities in one fell swoop. The only authority cited for this broad, unprecedented action was the Commission's exclusive jurisdiction over water and wastewater rates and its ability to set rates under §367.081(2) (a), Florida Statutes. The Commission has for years properly limited the application of its ROE leverage formula to "calculate the last authorized rate of return on equity for any utility which otherwise would have no established rate of return on equity." Through the PAA Order the Commission has suddenly announced that a dramatic new policy of "utilizing the current leverage formula to reestablish the authorized ROE for all WAW utilities that currently have authorized ROEs." PAA Order at 3. There is no statutory support for the proposed action, which is beyond the Commission's delegated authority. The Florida Legislature has not authorized any short-cuts by which the Commission can reset ROEs on an industry-wide basis.

ISSUE 1: Does the Commission have legal authority under Section 367.081(4) (f), Florida Statutes, to reestablish a utility's rate of return on common equity by the leverage graph formula where the utility already has a rate of return on common equity established by the Commission?

** **Florida Water**: No. Section 367.081(4)(f) clearly limits application of the leverage formula to water and wastewater utilities "which otherwise would have no established rate of return on equity." Section 367.081(4)(f) does not provide authority for the Commission to apply the leverage graph formula to utilities that already have an established rate of return on equity. **

The PAA Order is an erroneous and unprecedented attempt to apply the leverage formula ROE in a manner not authorized by statute. Pursuant to §367.081(4) (f), Florida Statutes, the Commission is authorized to establish a leverage formula that reasonably reflects the range of returns on common equity for an average water or wastewater utility. While this subsection provides a short-cut method for determining an ROE in certain circumstances, the statute is

limited in its application to two specific situations, neither of which is applicable here.

Section 367.081(4) (f) provides as follows:

> The Commission may regularly, not less often than once each year, establish by order a leverage formula or formulae that reasonably reflect the range of returns on common equity for an average water or wastewater utility and which, for purposes of this section, shall be used to calculate the last authorized rate of return on equity for any utility *which otherwise would have no established rate of return on equity. In any other proceeding* in which an authorized rate of return on equity is to be established, *a utility, in lieu of presenting evidence on its rate of return on common equity, may move* the commission to adopt the range of rates of return on common equity that has been established under this paragraph.

Section 367.081(4) (f), Florida Statutes (emphasis added).

This subsection clearly specifies that there are *only two situations* in which the Commission may apply the leverage formula to determine a utility's ROE:

- the Commission can use the leverage formula to calculate an ROE for any utility "which otherwise would have no established rate of return on equity", or
- a utility may ask the Commission to adopt the leverage formula ROE "in lieu of presenting evidence" in a rate proceeding.

The PAA Order seeks to establish a new application for the formula, an application that is not authorized by statute. The unprecedented attempt to use the leverage formula "to reestablish the authorized ROE for *all* WAW utilities that currently have authorized ROES" cannot be reconciled with the clear and specific terms of Section 367.081(4) (f), Florida Statutes. [1] Quite simply, the statute does not provide the Commission a shortcut for resetting an ROE that has

[1] Additionally, as a "statement of general applicability that implements, interprets, or prescribes law or policy" the Commission's order constitutes a rule under §120.52 and 120.54(1)(a), Florida Statutes, and therefore is subject to challenge under §120.56(4), Florida Statutes.

been established in a previously conducted rate proceeding.

Neither the plain language of §367.081(4) (f) nor any principal of statutory construction justifies use of the leverage formula to reset a utility's existing ROE in lieu of an individual rate proceeding. As noted above, the statute authorizes use of the leverage formula in two specific instances, neither of which is present in the instant case. The Commission's attempt to apply the leverage formula to set ROEs for all utilities, including those with previously established ROEs, would require a rewrite of §367.081(4)(f) as follows:

> The Commission may . . . establish by order a leverage formula or formulae that reasonably reflect the range of returns on common equity for an average water or wastewater utility and which ~~, for purposes of this section,~~ may ~~shall~~ be used to calculate the ~~last~~ authorized rate of return on equity for any utility in any proceeding. ~~which otherwise would have no established rate of return on equity. In any other proceeding in which an authorized rate of return on equity is to be established, a utility, in lieu of presenting evidence on its rate of return on common equity, may move the commission to adopt the range of rates of return on common equity that has been established under this paragraph.~~

The PAA Order's proposed broad extension of the use of the leverage formula is contrary to the concept of limited and specific application reflected by the statute. In view of the statutory delineation of the proposed use of the formula, the Commission cannot extend the reach of §367.081(4) (f). Where the language of a statute is clear and unambiguous, neither the courts nor the Commission may extend the statute beyond its terms. *See, State v. Rife,* 789 So.2d 288 (Fla. 2001) ("courts are without power to construe an unambiguous statute in a way which would extend, modify, or limit its express terms or its reasonable and obvious implications; to do so would be an abrogation of legislative power"; *Donato v. American Tel. & Tel. Co.,* 767 So.2d 1146, reh'g denied, ans. to certified question conformed to, 206 F.3d 1031 (11th Cir. 2000), ("When the language of a statute is clear and unambiguous and conveys a clear and definite

meaning . . . the statute must be given its plain and obvious meaning"); *M.W. v. Davis,* 756 So.2d 90 (Fla. 2000). Further, as an administrative agency created by the legislature, "the Commission's power, duties and authority are those and only those that are conferred expressly or impliedly by statute of the State." *Rolling Oaks Utilities v. Florida PSC,* 533 So.2d 770, 773 (Fla. 1st DCA 1988). "Any reasonable doubt as to the lawful existence of a particular power that is being exercised by the Commission must be resolved against the exercise thereof, and the further exercise of the power should be arrested." *City of Cape Coral v. GAC Utilities, Inc.,* 281 So. 2d, 493, (Fla. 1973), *Hernando County v. Florida Public Service Com'n,* 650 So. 2d 48 (Fla. 1st DCA 1996).

Section 367.081(4)(f) plainly and obviously limits application of the leverage formula to the two specific circumstances listed therein. The Commission is without power to extend the reach of the statute beyond those specific circumstances.

While the Commission need not resort to rules of construction because the statutory language is clear and unambiguous, the established principle of *expressio unius est exclusio alterius* (the mention of one thing implies exclusion of another) reinforces the conclusion that §367.081(4)(f) limits the Commission's use of the leverage formula to the two specific situations listed therein. Because the statute mentions only two applications for the leverage formula, the proper construction is that the Legislature intended to exclude all other possible applications for the formula. *See, Prewitt Management Corp. v. Nikolits,* 795 So.2d, 1001, (Fla. 4th DCA 2001) ("when a law expressly describes a particular situation where something should apply, an inference must be drawn that what is not included by specific reference was intended to be omitted or excluded.") Thus, a statute granting homestead exemption to certain types of corporate entities leads to the "inescapable conclusion" that the Legislature intended to deny the

exemption to other types of corporate entities. 795 So.2d at 1005. *See, also P.W. Ventures v. Nichols,* 533 So. 2d 281 (Fla. 1988) (statute provided that sale of natural gas at wholesale to direct industrial customer would not render the seller a "public utility" and Legislature's failure to provide a similar exemption for sale of electricity indicated that no such exemption was intended); *Young v. Progressive Southeastern Insurance Co.*, 753 So.2d 80, 85 (Fla. 2000), ("by failing to permit self-insured motorist policy exclusions in the list of authorized exclusions, the Legislature has further indicated its in tent . . . not to permit self-insured motorist policy exclusions".)

Section 367.081(4)(f) does not provide the Commission with the authority to reset previously established ROEs. As discussed below, if the Commission wishes to review and perhaps reset a previously established ROE, it must do so in an individual rate proceeding for a specific utility, and the resulting ROE must be based on the evidentiary record developed in that proceeding.

ISSUE 2: Does the Commission have legal authority under §367.081(2)(a), Florida Statutes, to reestablish the range of returns on common equity for water and wastewater utilities that have previously established rates of return on common equity?

** Florida Water: No. Section 367.081(2)(a) authorizes the Commission to reset previously established ROEs only in the context of a rate proceeding for an individual utility. The statute does not provide the Commission with legal authority to bypass the rate case process or to apply the leverage formula to utilities with previously established ROEs. **

The PAA Order purports to rely on §367.081(2)(a) to reset previously established ROEs as follows:

> Pursuant to Section 367.011(2), Florida Statutes, the Commission has "exclusive jurisdiction over each utility with respect to its authority, service, and rates." Additionally, as set forth in Section 367.081(2)(a), Florida Statutes, the Commission can "either upon

> request or upon its own motion, fix rates." A utility's ROE is one factor that is used in determining rates. As a result, we have the authority to use the leverage formula set forth in this Order to reestablish the ROE for all WAW utilities that currently have an authorized ROE.

PAA Order at 4. The Commission's reasoning is fallacious. The Commission's exclusive jurisdiction over water and wastewater utilities and its authority to set rates pursuant to §367.081(2), Florida Statutes, do not authorize the Commission's attempt to utilize the leverage formula to reset the ROEs for an entire industry in a single proceeding.

Section 367.081(2), Florida Statutes, allows the Commission to set rates in the context of a full-blown rate proceeding, which may be held upon request of the utility or on motion of the Commission. Section 367.081(2) unmistakably anticipates and requires a separate rate proceeding for each individual utility. It sets forth in great detail the specific issues the Commission "shall consider" in a rate proceeding, and requires the Commission to perform a comprehensive review of the utility's financial and physical operations as a prerequisite to setting rates:

> (2)(a) 1. The commission shall, either upon request or upon its own motion, fix rates which are just, reasonable, compensatory, and not unfairly discriminatory. *In every such proceeding, the commission shall consider the value and quality of the service and the cost of providing the service, which shall include, but not be limited to*, debt interest; the requirements of the utility for working capital; maintenance, depreciation, tax, and operating expenses incurred in the operation of all property used and useful in the public service; and a fair return on the investment of the utility in property used and useful in the public service. However, the Commission shall not allow the inclusion of contributions-in-aid of construction in the rate base of any utility during a rate proceeding, nor shall the commission impute future prospective contributions-in-aid-of-construction against the utility's investment in property used and useful in the public service; and accumulated depreciation on such contributions-in-aid-of construction shall not be used to reduce the rate base, nor shall depreciation on such contributed

assets be considered a cost of providing utility service.

2. *For purposes of such proceedings, the commission shall consider* utility property, including land acquired or facilities constructed or to be constructed within a reasonable time in the future, not to exceed 24 months after the end of the historic base year used to set final rates unless a longer period is approved by the commission, to be used and useful in the public service, if:

a. Such property is needed to serve current customers;

b. Such property is needed to serve customers 5 years after the end of the test year used in the commission's final order on a rate request as provided in subsection (6) at a growth rate for equivalent residential connections not to exceed 5 percent per year; or

c. Such property is needed to serve customers more than 5 full years after the end of the test year used in the commission's final order on a rate request as provided in subsection (6) only to the extent that the utility presents clear and convincing evidence to justify such consideration.

Notwithstanding the provisions of this paragraph, *the commission shall approve rates for service which allow a utility to recover from customers the full amount of environmental compliance costs.* Such rates may not include charges for allowances for funds prudently invested or similar charges. For purposes of this requirement, the term "environmental compliance costs" includes all reasonable expenses and fair return on any prudent investment incurred by a utility in complying with the requirements or conditions contained in any permitting, enforcement, or similar decisions of the United States Environmental Protection Agency, the Department of Environmental Protection, a water management district, or any other governmental entity with similar regulatory jurisdiction.

The detailed roadmap for a comprehensive rate-making proceeding set forth in §367.081(2), Florida Statutes, cannot be interpreted as authority for a short-cut process not found therein.

Again, resort to principles of statutory construction is not necessary because Section 367.081(2), Florida Statutes, clearly and unambiguously contemplates a comprehensive review

as a prerequisite for setting rates. Nonetheless, the *expressio unius est exclusio alterius* principle reinforces the conclusion that §367.081(2) does not grant the Commission authority to reset previously established ROEs using the leverage formula. Because §367.081(2) specifies a comprehensive process for setting rates on a utility-by-utility basis, there is no acceptable interpretation of this provision that would allow the Commission to bypass this process by using the leverage formula to reset ROEs for the entire industry in a single proceeding.

ISSUE 3: Whether the Commission's proposed reestablishment of the range of returns on common equity for water and wastewater utilities that have previously established rates of return on common equity:

(a) violates or is inconsistent with Commission rules and/or policies for establishing rates and/or analyzing whether a utility is under-earning or over-earning;

** Florida Water: Yes. The Commission's long-standing rules, policies and practices for establishing rates and analyzing utility earnings require that rates be established and earnings analyzed on the basis of a utility's previously established ROE. **

Water and wastewater rates are established based on a test year reflecting historical and/or projected investments, expenses, revenues, debt and return on common equity. The isolation and updating of one factor in the ratemaking equation ignores all of the other factors historically utilized by the Commission and required to be utilized by the Commission under §367.081(2)(a)1, Florida Statutes.

Frank Seidman, Florida Water's witness, testified that for over 30 years, the Commission has determined an authorized rate of return on equity for a utility in an individual rate proceeding for that utility. [2] The proposed use of the leverage formula to reset previously established ROEs

[2] Direct Testimony of Frank Seidman at pg. 9, lines 7-25.

is not only contrary to Florida Statutes, but would also contravene established ratemaking principles and would be inconsistent with the Commission's long-standing rules, practices and policies.

The Commission's rules do not support use of the leverage formula to implement a wholesale revision to individually-established water and wastewater ROEs. To the contrary, the rules limit use of the leverage formula, consistent with §367.081(4)(f), Florida Statutes. [3]

The Commission cannot change its regulatory course without appropriate evidentiary support to justify the change. *Manisota-88 v. Gardinier, Inc.* 481 So. 2d 948 (Fla. 1st DCA 1986); *Southern States Utilities v. Florida Public Service Commission,* 714 So.2d 1056 (Fla. 1st DCA 1988). The testimony of staff's witness, Mr. Willis, fails to justify the Commission's change in the use of the leverage formula. The only justification he offers for the Commission's decision to reset water and wastewater utilities' ROEs *en masse* is administrative ease.

Mr. Willis explains the reason for the Commission's decision as follows:

> In Order No. PSC-01-2514-FOF-WS, issued December 24, 2001, the Commission significantly changed the equity leverage graph which materially raised the range of equity returns from prior years. Because of this significant change, the Commission decided to change the authorized ROE's to reflect the current market conditions. The Commission believed that it would be more cost effective and therefore appropriate to use this current proceeding to change the authorized ROEs in order to avoid a more costly and inefficient approach. [4]

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[3] Rule 25-30.415, Florida Administrative Code, states that the Commission shall establish "a leverage scale or scales" reflecting the range of returns on common equity "as required by section 367.081(4)(f), F.S." Rule 25-30.433 (11), F.A.C., further tracks the requirements of §367.081(4)(f) by specifying that a utility may elect to use the leverage formula in a rate case in lieu of presenting evidence.

[4] Direct Testimony of Marshall Willis at pg. 3, lines 11-19.

* * *

> [T]he Commission took this action to bring the large number of water and wastewater utilities with authorized ROE's more in line with current market conditions. The Commission's proposal would have the effect of raising 36 and lowering 32 utilities' authorized ROEs. The remaining 26 would remain relatively unchanged since they fall within the current range of equity returns produced by the equity leverage formula. For the Commission to change the authorized ROE's of this many utilities in separate limited proceeding dockets would have been administratively inefficient. [5]

His testimony fails to provide the reasonable explanation and record evidence necessary to support the Commission's dramatic departure from its long-standing policy and practice. *Manisota-88, Inc.; Southern States Utilities; Florida Cities Water Company v. State, Public Service Commission,* 705 So.2d 620 (Fla. 1st DCA). Mr. Willis fails to explain why an administrative efficiency has suddenly become *sine qua non* justifying blanket application of the leverage formula as opposed to individual rate proceedings. He does not even discuss whether the leverage formula would produce the same or more accurate ROE than that which would be established in an evidentiary hearing. The conclusory assertion that change in the leverage graph in 2001 suddenly made it necessary to revise previously-authorized utility ROEs to reflect market conditions is not sufficient to support this radical policy change.

Mr. Willis attempted to downplay the magnitude of the Commission's change in policy by providing Exhibit MWW-1, purportedly a list of "some of the cases where the Commission has changed a utility's ROE outside of a rate proceeding." However, none of those 27 proceedings involved blanket application of the leverage formula to an entire industry. Further,

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[5] *Id.* at pg. 4, lines 9-17.

only one of the orders concerns a water or wastewater utility, and it is not on point. In the one water case, the utility agreed that its ROE was "too high", and the Commission initiated a limited proceeding to consider the appropriate ROE for that utility. Noting that the utility had provided no evidence supporting an ROE different from that established by the leverage formula, the Commission issued a PAA order establishing a new ROE for the utility based on the leverage formula.[6]

A close examination of Mr. Willis's list confirms the Commission's long-standing practice that rates are established and earnings analyzed on the basis of a utility's previously established ROE. In each of the 27 cases listed in Mr. Willis's exhibit, the Commission initiated an individual proceeding to examine aspects of a single utility's operations. In no case did the Commission attempt to reset the ROE of an entire industry using a one-size-fits-all formula. Far from justifying the Commission's decision to reset the ROEs of the water and wastewater industry as a group, without regard to the individual facts and circumstances of each utility, Mr. Willis's exhibit instead clearly demonstrates that the PAA Order constitutes an unprecedented departure from the Commission's well-settled policy.

The PAA Order's attempt to support the proposed reestablishment of rates of return on common equity by reference to orders where the Commission reestablished returns on common equity for natural gas utilities is not persuasive. Privately owned natural gas distribution utilities are regulated by the Commission pursuant to Chapter 366, Florida Statutes. Chapter 366 does not include an analogous provision to §367.081(4)(f), Florida Statutes, which provides for a

[6] Order No. PSC-95-1328-FOF-WS at 3, issued November 1, 1995 in Docket No. 950371-WS, In re: Investigation into the Authorized Return on Equity (ROE) of Indiantown Company, Inc. in Martin County.

default leverage graph return on common equity available at the option of the utility and only where the utility does not have a previously authorized return on common equity. Nor are the factual situations in the cited cases similar to the instant circumstances. For example, in Order No. PSC-94-0249-GU cited in the PAA Order, the natural gas utility simply made a voluntary offer to reduce its return on equity to avoid a hearing on the issue. That situation cannot be equated to the present case, where the Commission proposes to mandate an industry-wide revision in return on common equity based upon application of the leverage formula.

Mr. Willis also argued that the instant docket fulfills the Commission's obligation to conduct individual proceedings, stating that he believed this docket to be "a proceeding for each individual utility":

> Q. How do you consider the Commission's proposal as a proceeding for each individual utility?
>
> A. Because each utility may not end up having the same ROE established. Each ROE established for the approximately 94 utilities with established ROEs will be based on each individual utility's debt equity ratio as applied to the current equity leverage formula. Therefore, each utility will end up with its own unique authorized ROE based on the current equity leverage formula. [7]

Mr. Willis's logic is not persuasive. By adopting a mathematical formula,[8] and requiring its standardized application on an industry-wide basis, the Commission would reduce the determination of a utility's ROE to a math problem. The fact that the *result* of the required calculation may differ among utilities is a function of the formula itself, not a function of the

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[7] Direct testimony of Marshall Willis, pg. 7, line 24 – pg. 8, line 10. As discussed in Issue 3(b), §367.0822, Florida Statutes, requires the Commission to base interim rates on the last authorized ROE established in the utility's most recent individual rate proceeding. Mr. Seidman testified that using the leverage formula to reset previously established ROEs renders the interim rate procedure unworkable. In response, Mr. Willis represented that the PAA Order in the instant docket qualifies as an individual rate proceeding that meets the requirements of §367.0822, Florida Statutes.

Commission's consideration of any specific utility's circumstances. A mathematical calculation cannot substitute for the individual utility-specific evidentiary proceeding that is required for the Commission to change a change utility's previously established ROE.

The Commission's decision to reset an entire industry's ROE by the application of a mathematical formula constitutes a dramatic departure from its long-standing policies and practices. No reasonable explanation has been provided to support the Commission's action.

ISSUE 3: Whether the Commission's proposed reestablishment of the range of returns on common equity for water and wastewater utilities that have previously established rates of return on common equity:

(b) is arbitrary, capricious and speculative.

** Florida Water: Yes. The Commission has not fully considered the implications of its proposed decision nor has it set standards for implementing future ROE changes. The record establishes that the decision will result in piecemeal ratemaking, increase rate case expense, would conflict with §367.0822, and would hinder utilities' planning efforts. **

The Commission's proposal to reset previously established water and wastewater ROEs via the leverage formula is arbitrary, capricious and speculative because the Commission failed to consider how this significant change in the ratemaking process will affect utilities. Further, the Commission announced its intent to make future ROE revisions "when there have been significant changes in the capital markets" but failed to set any standards whatsoever for that process. The record evidence in this docket establishes that the Commission's decision, if implemented, will result in piecemeal ratemaking, would conflict with the interim rate requirements of §367.0822, Florida Statutes, and would harm utilities by increasing increased rate case expense and adversely affecting utility planning, thereby increasing regulatory risk.

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[8] Return on Common Equity = 9.65% + 0.582/Equity Ratio

Although the PAA Order noted that the Commission wished to update all previously established ROEs "to avoid a piecemeal approach," Florida Water's witness, Mr. Seidman, demonstrated that the Commission's proposal would cause, rather than eliminate, piecemeal ratemaking:

> By fiat, the Commission will have changed one of the at least nine factors which it must consider in fixing rates, without weighing the impact of the other factors. If the new, mandated authorized rate of return is lower than the authorized rate of return last determined at an individual proceeding, the utility may be judged to be over-earning and subject to a rate reduction without any other factors being weighed. Conversely, if the new, mandated authorized rate of return is higher than the authorized rate of return last determined at an individual proceeding, the utility may well be in a position to request a rate increase without any other factors being weighed. That is piecemeal ratemaking. [9]

There is no evidence in the record that refutes this testimony. The Commission's proposal arbitrarily places 32 utilities in a potential overearning position and 36 utilities in a potential underearning position. [10] Mr. Willis did not dispute the Commission's ability to initiate a rate reduction for any of the 32 utilities whose earnings exceeds its newly-mandated ROE. Nor did he dispute the ability of any of the 36 utilities placed in a potential underearning position to request a rate increase on the basis of its newly-increased ROE. In fact, Mr. Willis confirmed that staff would compare the utility's current earnings (which could be well within its authorized range of returns) to the newly reset ROE when determining whether to recommend rate reductions. [11] Although Mr. Willis attempted to downplay the likelihood that staff would

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[9] Direct testimony of Frank Seidman, pg. 7, lines 1 – 15.

[10] *See,* direct testimony of Marshall Willis at pg. 4, lines 11-13: "The Commission's proposal would have the effect of raising 36 and lowering 32 utilities' authorized ROEs."

[11] Direct testimony of Marshall Willis, pg. 6, lines 6-9.

recommend rate reduction actions, he could not dispel the prospect of piecemeal ratemaking. [12] The Commission's discretion to refrain from initiating overearnings proceedings does not alleviate the increased prospects of such proceedings that many utilities would face if the PAA Order was adopted.

Mr. Seidman also pointed out the inconsistency between the Commission's proposal and the process for setting interim rates pursuant to §367.082, Florida Statutes. [13] Section 367.082 directs the Commission to determine interim revenue deficiency by calculating the difference between achieved and required rate of return, and states that in calculating the "required rate of return" the Commission shall use the "last authorized rate of return on equity." The "last authorized rate of return on equity" is specifically defined as that "established in most recent individual rate proceeding of the utility". The Commission's attempt to reset the ROE outside of an "individual rate proceeding" clearly conflicts with this requirement. Further, pursuant to §367.082(6), the Commission may only use the leverage formula as a basis for determining interim rates for utilities that do not have an individually-established ROE.

Mr. Willis did not disagree with Mr. Seidman's testimony regarding the requirements of §367.082, Florida Statutes. Instead, he proposed that the Commission could "cure" the problems identified by Mr. Seidman and meet the requirements of §367.082 by "issuing the final order in this case using section 367.0822, Florida Statutes". [14] Mr. Willis's makeshift response to the inconsistencies pointed out by Mr. Seidman illustrates the arbitrary and capricious nature of the

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[12] *Id.* at lines 3 – 11. According to Mr. Willis, "any decision to seek rate relief should be based on the current equity leverage formula compared to the utility's current financial situation." *Id.* at pg.6, lines 14-16.

[13] Direct Testimony of Frank Seidman, pg. 7, line 17 – pg. 8, line 6.

[14] Direct Testimony of Marshall Willis at pg. 7, lines 17-21.

Commission's proposal. The Commission did not initiate this proceeding pursuant to §367.0822, Florida Statutes, and cannot arbitrarily and retroactively turn one type of statutory proceeding into another by relabeling it in midstream.

Finally, Mr. Seidman testified that the Commission's proposal would harm utilities by increasing rate case expense and adversely affecting utility planning, with the overall effect of increasing regulatory risk. Rate case expense would increase for utilities forced to defend against rate reductions to which the utility otherwise would not have been exposed, and also would increase for utilities that were entitled to request higher rates. In either case, the utility would "incur rate case expense that it would not otherwise have incurred." [15] Mr. Seidman also points out that "since there is no certainty in the proposal as to how often the Commission will reset the authorized rate of return, rate cases may occur more frequently than in the past." [16] Mr. Willis's response does nothing to alleviate Mr. Seidman's concerns. He states only that "the Commission staff does not look at ROE in isolation in deciding future rates nor do I believe that utility management would do so either." [17]

The Commission's proposal will detrimentally and arbitrarily affect utility planning and budgeting, substantially increasing each utility's regulatory risk. Mr. Seidman pointed out that the Commission's proposal would arbitrarily end the stable regulatory environment experienced by water and wastewater utilities for more than 30 years:

> Utilities have always been able to plan and budget with the knowledge that as long as the utility earnings remained within the range of reasonableness of the last authorized rate of return on

[15] Direct Testimony of Frank Seidman at pg. 8, lines 10 – 23.

[16] *Id.* at pg. 9, line 14 – pg. 10, line 7.

[17] Direct Testimony of Marshall Willis at 8, lines 11 -15.

> equity, as determined in its last individual rate proceeding, it would not need to adjust rates, nor be subject to the adjustment of rates. Under that policy, utilities have been able to stabilize rates for many years, and limit rate changes to small, annual index or pass-through adjustments. This Commission proposal will change that. Planning and budgeting would now have to include a year to year prediction of (1) when, whether and by how much, capital markets might change, and (2) if and when the Commission might consider those market changes significant enough to "update" the authorized rate of return of water and wastewater utilities as a group. [18]

Because each newly-reset ROE will affect earnings surveillance and index and pass-through applications, "a utility's earning will be reviewed, not based on a range of reasonableness as determined in a rate proceeding in which all factors were considered, but on a shifting 'updated' range of reasonableness in which one factor [the leverage formula] was considered." [19] Mr. Seidman concluded that in this less-predictable regulatory environment "[l]ong term financing decisions that depended on the predictability of an authorized earnings stream may now be at risk." [20]

In response, Mr. Willis acknowledged that the Commission's proposal "may have some effect on utility planning and budgeting", but disagreed that it would be "detrimental" because "utility management should normally be considering the annual impact of the change in the current ROE leverage formula" and "utilities have always been subject to the Commission initiating an overearnings proceeding if the facts before the Commission warrant that action." Mr. Willis's contention that "the Commission staff's determination of when to request an overearnings proceeding will not change because of this proposal to change the established

[18] Direct testimony of Frank Seidman at pg. 9, line 14 – pg. 10, line 7.

[19] *Id.* at pg. 10, lines 9-17.

[20] *Id.* at pg. 11, lines 8-10.

returns on equity" [21] provides no comfort to the utilities who are facing reviews based on new standards with no clearly-defined guidelines. Rather than rebutting Mr. Seidman's concerns, Mr. Willis instead demonstrates the arbitrary and speculative nature of the Commission's proposal.

Mr. Willis sought to downplay concerns by relying upon an "internal guideline" which he believed "would ameliorate the regulatory uncertainties and unpredictability discussed in Mr. Seidman's testimony." [22] This unpromulgated, after-the-fact proposal, which is not found in any Commission statute or rule, is well beyond the scope of this proceeding and cannot justify the Commission's unauthorized attempt to use the leverage formula to reset previously established ROEs. To the contrary, Mr. Willis's "guideline" demonstrates that the Commission's proposal lacks sufficient standards and vests the Commission with unbridled discretion regarding the timing of any future updates.

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[21] Direct Testimony of Marshall Willis at pg. 8, lines 11-21; pg. 9, lines 2-4.

[22] *See,* Direct Testimony of Marshall Willis at pg. 9, line 12 – pg. 10, line 10:

> I would propose, as an internal guideline, that the Commission staff would not start considering recommending a change in the established returns on equity until there has been a minimum 100 basis point change in the high end of the Commission's equity leverage formula from the base ROE. The high end of the equity leverage formula is the resulting ROE using a forty percent equity ratio. I believe that you need to use a single equity ratio as the base ROE, because the actual range of equity returns produced by the equity leverage formula can vary with each year. I chose to use the forty percent equity ratio as the base ROE because the majority of the water and wastewater utilities are at the high end of the range. The base ROE would be 11.10 percent using the new equity leverage formula established in this docket at a forty percent equity ratio. What this means under this proposal is that the Commission staff would not consider the need to change the established ROEs unless the equity leverage formula adopted by the Commission in future years, using a forty percent equity ratio, was above 12.10 percent or below 10.10 percent. I use the term "consider" because it would not be an automatic action by staff. Staff naturally must weigh many factors when deciding to make this kind of recommendation. In other words, just because a trigger point is reached does not mean that an action will follow. I believe that this proposal would ameliorate the regulatory uncertainties and unpredictability discussed in Mr. Seidman's testimony.

ISSUE 4: Should the Commission use the current leverage formula to reestablish the authorized ROE for all water and wastewater utilities that currently have an authorized ROE?

** Florida Water: No. The Commission lacks authority to reestablish authorized ROEs across-the-board or to use the formula to reset any previously authorized ROE unless the utility so moves.

Chapter 367, Florida Statutes, sets forth a comprehensive plan for economic regulation of water and wastewater utilities and provides the Commission with a number of procedural opportunities to review financial aspects of each utility's operation. It does not, however, provide the Commission with a method for resetting the entire industry's previously established ROEs on an across-the-board basis, nor does it offer the Commission the authority to apply the leverage formula to reset any individual utility's previously authorized ROE unless the utility so moves.

The leverage formula is designed as surrogate for the testimony normally provided during a ratemaking proceeding. [23]It clearly is intended to produce an average ROE that can be used *as a surrogate when a utility has no established ROE.* When the Commission previously has established a utility's ROE, however, no such surrogate is necessary or appropriate. The Commission may not impose the surrogate ROE provided by the leverage formula in the absence of a request by the affected utility.

[23] As noted in the PAA Order, the leverage formula depends upon and incorporates several "basic assumptions". For example, the formula relies upon the assumption that "business risk is similar for all WAW utilities", as well as assumptions about bond ratings, private placement premiums and small utility premiums. Further, the Commission noted that the formula incorporates two ROE models and several adjustments thereto "in order to conform the results of the models to the average Florida WAW utility."

RESPECTFULLY SUBMITTED this 9th day of January, 2003.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing brief has been furnished by hand delivery (*) or U.S. Mail (**) this 9th day of January, 2003 to the following:

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