



Public Service Commission
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TO: DIRECTOR, DIVISION OF THE COMMISSION CLERK &
ADMINISTRATIVE SERVICES (BAYO)

FROM: DIVISION OF ECONOMIC REGULATION (LESTER) PL
OFFICE OF THE GENERAL COUNSEL (Vining) AEM/MLK JMS ALM JMS + M

RE: DOCKET NO. 030006-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.

AGENDA: 03/04/03 - REGULAR AGENDA - POST HEARING DECISION -
PARTICIPATION IS LIMITED TO COMMISSIONERS AND STAFF

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: RECOMMENDATION SHOULD BE ADDRESSED BY
COMMISSIONERS JABER, DEASON, BAEZ, AND
BRADLEY.

FILE NAME AND LOCATION: S:\PSC\GCL\WP\030006.RCM

CASE BACKGROUND

By Proposed Agency Action Order No. PSC-02-0898-PAA-WS, issued on July 5, 2002, the Commission proposed to establish the authorized range of returns on common equity for water and wastewater utilities for the year 2002, as required by Section 367.081(4)(f), Florida Statutes. For the first time, in this rollover docket, the Commission proposed to apply the leverage formula to water and wastewater utilities that currently have an authorized return on equity. Both Florida Water Services Corporation (Florida Water or FWSC) and the Office of Public Counsel (OPC) filed timely protests of the PAA Order. Florida Water protested the application of the leverage formula to all water and wastewater utilities that currently have an authorized return on equity, while OPC protested the leverage formula

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methodology. On August 26, 2002, OPC withdrew its protest, and the leverage formula methodology became final with the issuance of Consummating Order No. PSC-02-1252-CO-WS on September 11, 2002. In order to address the remaining protest of FWSC, an administrative hearing for this docket was scheduled for December 6, 2002, pursuant to Section 120.57(1), Florida Statutes.

As a result of discussions held prior to and at the November 18, 2002, Prehearing Conference, it was agreed that the testimony and exhibits filed to date would serve as the record evidence for the proceeding, cross-examination would be waived by both Florida Water and staff, and the hearing would be cancelled. Having considered the evidence and the arguments of Florida Water, staff submits its post-hearing recommendation. The Commission has jurisdiction pursuant to Sections 367.011, 367.081, and 367.121, Florida Statutes.

INTRODUCTION - THE EVIDENCE OF RECORD

Order No. PSC-02-0898-PAA-WS, issued July 5, 2002, established the current leverage formula. In that Order, the Commission stated that it would use the current leverage formula to reestablish the authorized ROE for all water and wastewater utilities that currently have authorized ROEs. Florida Water protested this issue of whether the Commission should reestablish authorized ROEs. FWSC witness Seidman and staff witness Willis both addressed this issue.

Witness Seidman notes that the fair return on investment is one of nine factors which the Commission shall consider for ratemaking. He believes resetting the authorized ROEs will result in "piecemeal" ratemaking in that utilities with new, lower ROEs may be subject to over-earning proceedings, whereas utilities with new, higher ROEs may request rate increases, without other factors being weighed. (Seidman Direct pp. 4 and 7) Mr. Seidman also notes that, for interim rate purposes, a utility's revenue deficiency is based on the difference between its achieved ROE and its last authorized ROE, as set in its most recent rate case. He believes resetting ROEs for utilities as contemplated in the Commission's PAA Order would supercede the ROE set for the utility in its last rate case and therefore conflict with the interim rate statute. (Seidman Direct pp. 7-8)

According to Mr. Seidman, if a utility's authorized ROE is reduced, then it may face a rate reduction and would have to defend its position in a rate proceeding. If the utility's authorized ROE is increased, then it may file a rate case. Either way, the utility would incur rate case expense it would not otherwise have incurred. (Seidman Direct p. 8)

Regarding a utility's planning and budgeting, witness Seidman notes that the Commission sets a utility's authorized ROE in rate cases and allows a range of reasonableness around the authorized ROE of plus or minus 1%. If a utility earns within this range, "it would not need to adjust rates, nor be subject to the adjustment of rates." Witness Seidman believes this stabilizes rates. He states that, in contrast, if the Commission reestablishes authorized ROEs, the utility will have to predict changes in the capital markets, and whether the Commission considers those changes significant enough to update authorized ROEs. He further notes that updating authorized ROEs will affect earnings surveillance and index and pass-through applications. He states that a utility's earnings

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will be reviewed not based on an authorized ROE and range of reasonableness set in a rate proceeding, but based on updated ROEs. (Seidman Direct pp. 9-10)

Mr. Seidman believes reestablishing authorized ROEs will increase risk for the utility. He notes that authorized ROEs currently remain stable between rate proceedings, which allows for long term decisions. Finally, witness Seidman believes reestablishing authorized ROEs is beyond the scope of Section 367.081(4)(f), Florida Statutes. He believes the leverage formula has only two uses: (1) establishing an authorized ROE for utilities that do not have an authorized ROE; and, (2) allowing a utility to voluntarily accept the leverage formula ROE in lieu of presenting ROE testimony. (Seidman Direct pp. 10-12)

Staff witness Willis explains the Commission's proposal as follows: the Commission would use the current leverage formula to reestablish authorized ROEs for utilities that have authorized ROEs. This would not occur annually but only when capital markets had changed significantly. He points out that the Commission significantly changed the leverage formula in 2001, raising the range of ROEs. Due to this change, the Commission decided to change the authorized ROEs to reflect current market conditions. (Willis Direct pp. 3-4)

Mr. Willis notes that the Commission regulates a large number of water and wastewater utilities, and that many have authorized ROEs outside the range indicated by the current leverage formula. The Commission uses the authorized ROE and range for excess earnings reviews, index and pass-through applications, Allowance for Funds Used During Construction, and interim rates. Witness Willis believes the Commission's proposal to reestablish authorized ROEs will bring many outdated ROEs in line with the current economic returns expected by investors and will facilitate fair ratemaking. He also notes that changing authorized ROEs in separate limited proceedings would be administratively inefficient for the Commission. (Willis Direct pp. 3-4)

Witness Willis notes that the Commission has changed authorized ROEs outside individual rate cases for companies in all the industries it regulates. He provides an exhibit showing many cases where the Commission has changed the authorized ROE for a company outside a rate proceeding. (Willis Direct pp. 4-5; Exhibit MWW-1 pp. 1-4)

Responding to witness Seidman's assertion that reestablishing authorized ROEs would result in piecemeal ratemaking, Mr. Willis states that the Commission staff does not solely look at a utility's established ROE when evaluating potential overearnings. Instead, all factors enumerated in Section 367.081, Florida Statutes, are considered. Witness Willis believes most water and wastewater utilities are aware of annual changes in the leverage formula. He notes that a utility's established ROE has no bearing on final rates in an overearnings or rate case proceeding. The authorized ROE only affects interim rates. He concludes that utility management would not look at a rate increase on a piecemeal basis. Both the Commission and utility management consider many factors. Additionally, because neither the Commission staff nor utility management look at ROE in isolation, reestablishing authorized ROEs will not increase rate case expense. (Willis Direct pp. 5, 6, and 8)

Mr. Willis disagrees with witness Seidman's concern that reestablishing authorized ROEs would make the interim rate procedure unworkable. Witness Willis states that the Commission could reestablish authorized ROEs using the limited proceeding statute, Section 367.0822, Florida Statutes. He notes that reestablishing authorized ROEs is a proceeding for each individual utility. Because equity ratios vary among utilities, each utility will receive its own unique authorized ROE based on the current leverage formula. Therefore, reestablishing authorized ROEs for the approximately 94 utilities with authorized ROEs in one docket is done solely for administrative efficiency. (Willis Direct pp. 7-8)

Regarding Mr. Seidman's assertion that reestablishing ROEs would be detrimental for a utility's planning and budgeting, witness Willis agrees there could be some effect but he disagrees that it would be detrimental. Utilities have always been subject to the Commission initiating an overearnings proceeding. (Willis Direct pp. 8-9)

Mr. Willis concludes by proposing that the Commission consider reestablishing authorized ROEs when the high end of the leverage formula changes by 100 basis points or more from the 11.10% established by the current leverage formula in this docket. Witness Willis refers to this as the base year. He emphasizes that the Commission may consider reestablishing authorized ROEs if this trigger point is reached, but would not do so automatically since

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many factors should be considered. He believes this would reduce the regulatory risk of the Commission reestablishing authorized ROEs discussed by witness Seidman. (Willis Direct pp. 9-10)

DISCUSSION OF ISSUES

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?

RECOMMENDATION: Yes. Together Sections 367.081(4)(f), 367.081(2)(a), and 367.0822, Florida Statutes, provide the Commission with the authority to adjust the rates of return on common equity for all water and wastewater utilities in one generic proceeding using the leverage formula. (Vining)

POSITION OF THE PARTIES

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.

STAFF ANALYSIS:

Staff disagrees with Florida Water's contention that the Commission does not have the authority to reset the rate of return on common equity of a utility with a previously established ROE. (FWSC BR p. 3) Sections 367.081(4)(f), 367.081(2)(a), and 367.0822, Florida Statutes, provide the Commission with ample authority and discretion to do so. The proceeding the Commission conducted in this case is compatible with its authorizing statutes. It is akin to the consolidation of several limited proceedings to adjust the rate of return on common equity for all water and wastewater utilities. Such an action is consistent with the Commission's general rate-setting authority, consistent with the intent of Chapter 367, Florida Statutes, and consistent with the public interest.

Section 367.081(4)(f), Florida Statutes, 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 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(2)(a), Florida Statutes, provides that "the commission shall, either upon request or upon its own motion, fix rates" Finally, Section 367.0822, Florida Statutes, provides that "the commission may conduct limited proceedings to consider, and act upon, any matter within its jurisdiction, including any matter the resolution of which requires a utility to adjust its rates."

The Commission has been given very broad authority by the Legislature in determining rates. Southern States Utilities v. Florida Public Service Com'n, 714 So. 2d 1046, 1051 (Fla. 1st DCA 1998); Citizens of the State of Florida v. Public Service Com'n, 425 So. 2d 534, 540 (Fla. 1982) ("This Court has consistently recognized the broad legislative grant of authority which these statutes confer and the considerable license the Commission enjoys as a result of this delegation."). In addition, the Commission has "considerable discretion and latitude in the rate-fixing process." Gulf Power Co. v. Bevis, 296 So. 2d 482, 487 (Fla. 1974).

A water and wastewater utility's rate of return on common equity is within the Commission's general rate-setting jurisdiction, pursuant to Section 367.081(2)(a), Florida Statutes, and the Commission can conduct a limited proceeding to adjust any water and wastewater utility's ROE based upon Section 367.0822, Florida Statutes. Therefore, when Section 367.081(4)(f), Florida Statutes, is construed together with these two statutory provisions, it is clear that the Commission has the discretion and the authority to use the leverage formula to reestablish the rate of return on common equity for all water and wastewater utilities with a previously authorized ROE.

Construing Section 367.081(4)(f), Florida Statutes, together with Sections 367.081(2)(a) and 367.0822, Florida Statutes, gives effect to the purpose of the statutory scheme contained in Chapter 367 of the Florida Statutes, as summarized in Section 367.011(3), Florida Statutes. Section 367.011(3), Florida Statutes, states: "[t]he regulation of utilities is declared to be in the public interest, and . . . for the protection of the public health, safety, and welfare. The provisions of this chapter shall be liberally construed for the accomplishment of this purpose."

"It is axiomatic that all parts of a statute must be read together in order to achieve a consistent whole . . . [and] [w]here possible, courts must give full effect to all statutory provisions and construe related statutory provisions in harmony with one another." Forsythe v. Longboat Key Beach Erosion Control Dist., 604 So. 2d 452, 455 (Fla. 1992); Rollins v. Pizzarelli, 761 So. 2d 294 (Fla. 2000); See also Louisiana Public Service Com'n v. Federal Communications Com'n, 476 U.S. 355, 370 (1986) ("provisions of a statute should be read so as not to create a conflict"). Statutory construction is a "holistic endeavor" wherein a statutory provision that may appear "ambiguous in isolation is often clarified by the remainder of the statutory scheme." United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., 484 U.S. 365, 371 (1988).

Florida Water argues that the Legislature would have to amend and rewrite Section 367.081(4)(f), Florida Statutes, to give it the scope the Commission has given it in this case. (FWSC BR p. 4) Staff believes there is no need to rewrite Section 367.081(4)(f), Florida Statutes. Chapter 367, Florida Statutes, as a whole, clearly provides the Commission the discretion and the authority to use the leverage formula to reestablish the rate of return on common equity for all water and wastewater utilities with a previously authorized ROE.

Florida Water maintains that the Commission's Order is a statement of general applicability that must be promulgated as a rule, pursuant to Sections 120.52 and 120.54(1)(a), Florida Statutes. Staff disagrees. Section 120.54(1)(a)(1), Florida Statutes, states that "[r]ulemaking shall be presumed feasible unless the agency proves that: [t]he agency has not had sufficient time to acquire the knowledge and experience reasonably necessary to address a statement by rulemaking" Since this is the first instance in which the Commission has used the leverage

formula to reestablish the ROEs for those water and wastewater utilities with an already authorized ROE, the Commission has not had sufficient time to secure the knowledge and experience required to propose a rule. Due to this lack of knowledge and experience, the Commission has not yet solidified its position on the use of the leverage formula to reestablish ROEs for water and wastewater utilities.

Florida Water contends that the language of the leverage formula provision is clear and unambiguous, and the Commission cannot extend the statute beyond its terms. (FWSC BR p. 5) Staff does not dispute that the language of Section 367.081(4)(f), Florida Statutes, is clear and unambiguous. The Commission is not extending the statute beyond its terms. Rather, the Commission is construing together the terms of Sections 367.081(4)(f), 367.081(2)(a), and 367.0822, Florida Statutes, which grant the authority to reset the rate of return on common equity of a utility with a previously established ROE in a generic proceeding using the leverage formula.

Finally, while FWSC contends that the Commission need not resort to rules of construction because the language is clear and unambiguous, Florida Water argues that if the Commission were to resort to using the principle of *expressio unius est exclusio alterius* (the meaning of one thing implies exclusion of another), it would be constrained to the two situations listed in the leverage formula provision. (FWSC BR p. 6) As stated above, the staff agrees that the language of Section 367.081(4)(f), Florida Statutes, is clear and unambiguous. Therefore, the Commission need not resort to using the principle of *expressio unius est exclusio alterius*.

The Commission has often reset ROEs for individual water and wastewater utilities when they are out of line with current market conditions. This proceeding simply streamlines that process by consolidating in effect the individual proceedings that the Commission could conduct for each utility. This streamlined proceeding does not deny any utility due process or a point of entry. If a utility wanted to protest the uniform application of the leverage formula, it is free to do so as Florida Water has done here. In this instance, it is necessary to conduct a generic proceeding because the Commission significantly changed the leverage formula in 2001, raising the range of ROEs. As a result,

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the Commission decided to change the authorized ROEs to reflect current market conditions. (Willis Direct pp. 3-4)

In conclusion, staff believes that when Section 367.081(4)(f), Florida Statutes, is read together with Sections 367.081(2)(a) and 367.0822, Florida Statutes, the Commission has the authority to adjust the rates of return on common equity for all water and wastewater utilities in one generic proceeding using the leverage formula. The current proceeding is akin to the consolidation of several limited proceedings to adjust the rate of return on common equity for all water and wastewater utilities. Such an action is consistent with the Commission's general rate-setting authority, consistent with the intent of Chapter 367, Florida Statutes, and consistent with the public interest.

ISSUE 2: Does the Commission have legal authority under Section 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?

RECOMMENDATION: Yes. Together Sections 367.081(4)(f), 367.081(2)(a), and 367.0822, Florida Statutes, provide the Commission with the authority to adjust the rates of return on common equity for all water and wastewater utilities in one generic proceeding using the leverage formula. (Vining)

POSITION OF THE PARTIES

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.

STAFF ANALYSIS:

Staff reiterates the analysis from Issue 1.

ISSUE 3: Whether the Commission's proposed re-establishment 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;

(b) is arbitrary, capricious or speculative?

RECOMMENDATION:

(a) No. The reestablishment of ROEs for all water and wastewater utilities with an authorized ROE is consistent with Commission rules, policies, and prior action, and is within the Commission's discretion to implement its statutory obligations in an administratively efficient manner. (Vining, Lester)

(b) No. The reestablishment of authorized ROEs is reasonable and appropriate, and not arbitrary, capricious, or speculative, given that the Commission updates its leverage formula annually resulting in ROEs that reflect current economic conditions. Further, the responsibility of the Commission to monitor the earnings of water and wastewater utilities can be managed only in the context of current ROEs and current economic conditions. Finally, updating the authorized ROEs of water and wastewater utilities in one generic proceeding rather than in many individual proceedings is administratively efficient and cost effective. (Lester, Vining)

POSITION OF THE PARTIES

FLORIDA WATER:

(a) 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.

(b) 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 §367.082, and would hinder utilities' planning efforts.

STAFF ANALYSIS:

In light of the record evidence and our review of the relevant Commission rules and policies, staff recommends that the reestablishment of ROEs for all water and wastewater utilities with an authorized ROE is consistent with Commission rules and policies, reasonable and appropriate, and not arbitrary, capricious, or speculative.

Issue 3 (a)

Staff believes that the reestablishment of ROEs for all water and wastewater utilities with an authorized ROE is consistent with Commission rules and policies. On numerous occasions, the Commission has reestablished the ROE of regulated utilities outside of a full rate proceeding. The Commission adjusted the ROE of all regulated gas utilities in the state in 1993. (Exhibit MWW-1 pp. 1-4) By reestablishing authorized ROEs, the Commission will be able to review utilities' earnings in light of current market conditions. (Willis Direct p. 4) Changing the authorized ROEs of this many utilities in separate limited proceeding dockets would have been expensive, administratively inefficient, and not in the public interest.

Florida Water argues that Commission Rules 25-30.415 and 25-30.433(11), Florida Administrative Code, limit the use of the leverage formula. (FWSC BR p. 10) Staff disagrees. Rule 25-30.415, Florida Administrative Code, just repeats the requirement in Section 367.081(4)(f), Florida Statutes, that the Commission establish the leverage formula at least once each year. Rule 25-30.433(11), Florida Administrative Code, states that "[i]n establishing an authorized rate of return on common equity, a utility, in lieu of presenting evidence, may use the current leverage formula adopted by Commission order." This rule does not specify whether or not the authorized rate of return is one that has already been established. Rather, the rule allows all water and wastewater utilities, regardless of whether or not they already have an authorized ROE, to elect to use the leverage formula in any proceeding before the Commission. In staff's view, neither of these rules limit the use of the leverage formula. It is the

Commission's discretion to use the leverage formula where it deems it appropriate.

Florida Water contends that the Commission cannot change its regulatory course without appropriate evidentiary support to justify the change; and, it argues that witness Willis' testimony fails to justify this change in the use of the leverage formula, because the only explanation offered is administrative ease. According to Florida Water, Mr. Willis' assertion that the change in the leverage graph in 2001 made it necessary to revise authorized ROEs to reflect market conditions is not sufficient to support the change in policy. (Willis Direct p. 4; FWSC BR pp. 10-11)

There is sufficient evidentiary support to justify the Commission's action in this case. Mr. Willis testified that the Commission has the authority to reset an individual utility's ROE in a limited proceeding, pursuant to Section 367.0822, Florida Statutes. He also testified that resetting the authorized ROEs for all the water and wastewater utilities in this proceeding is akin to having individual proceedings for each of the water and wastewater utilities; and, to change the authorized ROEs of this many utilities in separate limited proceeding dockets would have been administratively inefficient. The record supports Mr. Willis' position that the action taken by the Commission is consistent with Commission rules, policies, and prior action. (Willis Direct pp. 4-6; EX MWW-1 pp. 1-4)

In the Permian Basin Area Rate Cases, 390 U.S. 747 (1968), the Federal Power Commission determined just and reasonable rates for natural gas companies in proceedings for each major producing area rather than in individual proceedings. The U.S. Supreme Court approved the procedure stating that "the ultimate achievement of . . . regulatory purposes may easily depend upon the contrivance of more expeditious administrative methods." Permian at p. 777. Additionally, the "width of administrative authority must be measured in part by the purposes for which it was conferred . . . [and] broad responsibilities therefore demand a generous construction of its statutory authority." Id. at 776. The Court's discussion in Permian Basin demonstrates that administrative efficiency is an important administrative goal, and one that meets the legislative purpose of the Commission's enabling statutes and the Florida Administrative Procedures Act. See also Florida Gas Company v. Hawkins, 372 So. 2d 1118, 1120 (Fla. 1979) (an action

that furthers administrative efficiency and avoids unnecessary hearings is consonant with the "admonition of the Supreme Court that unnecessary litigation and associated expenses should be avoided whenever possible); State Road Department of Florida v. Cone Brothers Contracting Co., 207 So. 2d 489, 491 (Fla. 1st DCA 1968) ("the general purpose of the administrative procedures act is to provide a means by which state agencies charged with regulatory duties . . . may efficiently, economically and expeditiously adjudicate").

Florida Water's witness Seidman testified that for over thirty years the Commission has determined an authorized ROE for a utility in an individual rate proceeding, and that to do otherwise would be inconsistent with the Commission's policies and practices. (Seidman Direct p. 9) Staff believes that this characterization of the Commission's policies and practices is incorrect. Across all regulated industries, the Commission has changed authorized ROEs outside of rate cases on numerous occasions, as identified in witness Willis' Exhibit MWW-1. Further, the Commission can change authorized ROEs for water and wastewater utilities in separate limited proceeding dockets, pursuant to Section 367.0822, Florida Statutes. Given the large number of water and wastewater utilities regulated by the Commission, staff believes one proceeding in which the Commission reestablishes authorized ROEs is administratively efficient and in the public interest, rather than opening nearly 100 individual limited proceeding dockets to address the ROE for those utilities that currently have an authorized ROE. (Willis Direct pp. 4-5; EX MWW-1; FWSC BR pp. 9-10)

By reestablishing authorized ROEs, the Commission will be able to review utilities' earnings in light of current market conditions. (Willis Direct p. 4) Contrary to what is alleged in FWSC's brief, the Commission considers many factors in addition to ROE in evaluating a utility's current earnings, including those laid out in Section 367.081(2)(a)(1), Florida Statutes. (Willis Direct p. 6; FWSC BR pp. 8-10)

Florida Water claims that the cases listed on witness Willis' Exhibit MWW-1 do not show an attempt by the Commission to reset the ROE of an entire industry. In staff's opinion, this is not correct. The Commission reestablished the authorized ROEs for all natural gas utilities in the state in 1993. As shown in witness Willis' exhibit, the orders resetting the authorized ROEs for six of the gas utilities were issued on the same day in consecutively-

numbered orders. For five of the six utilities, the ROE was reestablished at 11.00%. Order No. PSC-93-1773-FOF-GU, issued December 10, 1993, reestablished Peoples Gas System's ROE at 11.25%. (Willis Direct p. 5; EX MWW-1 p. 2) Therefore, contrary to FWSC's statement, the Commission has previously treated regulated utilities as a group in reestablishing authorized ROEs.

In addition, Florida Water argues that comparing reestablished ROEs for gas companies to water and wastewater utilities is not persuasive since Chapter 366 of the Florida Statutes, pursuant to which the Commission regulates gas utilities, does not have a statutory provision analogous to the leverage formula. FWSC also states that the factual scenarios in the cited orders are not similar since the gas companies voluntarily offered to reduce their ROEs in order to avoid a hearing. Staff does not believe that FWSC's arguments are persuasive because whether or not the utility volunteered to lower its ROE, the Commission took the action to lower the ROEs of all the regulated gas utilities in a concerted fashion.

Florida Water contends that the Commission is reducing the determination of a utility's ROE to a math problem, with no consideration of a specific utility's circumstances. Staff believes that FWSC mischaracterizes the proposed results of this proceeding. The reestablished ROEs would vary because each water and wastewater utility has its own individual equity ratio, which would then be applied to the current equity leverage formula, resulting in a unique authorized ROE for each utility. (Willis Direct p. 8)

The reestablishment of ROEs for all water and wastewater utilities with an authorized ROE is consistent with Commission rules, policies, and prior action. The Commission has on numerous occasions reestablished the ROE of regulated utilities in isolation outside of a rate proceeding, and the Commission adjusted the ROE of all regulated gas utilities in the state in 1993. By reestablishing authorized ROEs, the Commission will be able to review utilities' earnings in light of current market conditions. Changing the authorized ROEs of this many utilities in separate limited proceeding dockets would have been expensive, administratively inefficient, and not in the public interest.

Issue 3 (b)

Witness Willis provides extensive evidence of the Commission changing authorized ROEs outside rate cases. He provides examples from each industry regulated by the Commission. Staff believes this refutes witness Seidman's suggestion that the Commission cannot change the ROE outside of a rate case. Staff believes the Commission is well within its statutory authority to monitor and change authorized ROEs in rate cases and in other proceedings. (Willis Direct p. 4; Exhibit MWW-1 pp. 1-4)

FWSC has not questioned the Commission's authority to open individual dockets to update authorized ROEs for each of the 94 water and wastewater utilities that have authorized ROEs. Noting the large number of water and wastewater utilities, staff agrees with witness Willis and believes that one proceeding to update authorized ROEs, instead of many individual proceedings, is administratively efficient and in the public interest. (Willis Direct pp. 3, 4, and 8)

As to the issue of whether the Commission's reestablishment of authorized ROEs would increase rate case expense, staff believes the reestablished ROE would give the Commission and the utilities a new perspective on a utility's earnings, but would not automatically result in an overearnings review or a rate case. Witness Willis notes that, of the 94 water and wastewater utilities with authorized ROEs, approximately a third would have higher ROEs given the current leverage formula, a third would have lower ROEs, and a third would have little change to their authorized ROE. Even with significant changes to the authorized ROE, a rate proceeding would not necessarily result since many factors besides ROE would have to be considered. (Willis Direct pp. 4, 6, and 8)

For similar reasons, staff does not believe that reestablishing authorized ROEs would be piecemeal ratemaking. The Commission does not look solely at the authorized ROE when evaluating potential overearnings; instead, the Commission staff considers many factors, as enumerated in Section 367.081, Florida Statutes. Additionally, utilities do not use their authorized ROEs as a gauge of when to file a rate case. Utilities would instead consider their current earnings compared with the ROE allowed by the current leverage formula. Staff does not believe reestablishing authorized ROEs would result in piecemeal ratemaking. (Seidman Direct pp. 6-7; Willis Direct p. 6)

Staff believes reestablishing authorized ROEs could affect a utility's planning and budgeting, but this would not necessarily have a detrimental effect because utilities are always subject to the possibility of the Commission initiating an overearnings proceeding. Any possible detrimental effect should be eliminated by applying Mr. Willis' proposal, i.e. that the Commission consider reestablishing authorized ROEs when the high end of the new leverage formula range changes more than 100 basis points from the base year as defined by witness Willis. Most water and wastewater utilities are aware of the annual changes in the leverage formula and can plan and budget accordingly. (Willis Direct pp. 6, 8, and 10; Seidman Direct pp. 9-10)

Staff does not believe reestablishing authorized ROEs conflicts with the interim rate procedure, as alleged by witness Seidman. Witness Seidman believes only the last authorized ROE from an individual rate case can be used for interim rates. Staff believes four points raised by witness Willis refute this contention. First, Section 367.082(5)(b)(3), Florida Statutes, states that "the last authorized return on equity for purposes of this subsection shall be established only: in the most recent rate case of the utility; in a limited scope proceeding for the individual utility; by voluntary stipulation of the utility approved by the Commission; or pursuant to Section 367.081(4)(f)." The Commission has the authority to use a ROE established in a limited proceeding as well as with the leverage formula for the purpose of setting interim rates. Second, the Commission can change authorized ROEs outside of a rate case, e.g. in a limited proceeding pursuant to Section 367.0822, Florida Statutes. Third, reestablishing authorized ROEs in one docket is administratively efficient and in the public interest. The Commission could open an individual docket for each of the many water and wastewater utilities, but this would not change the result from that proposed in the current proceeding. Last, the reestablished ROEs will vary because each water and wastewater utility has its own individual equity ratio, the only input to the leverage formula, resulting in a unique authorized ROE for each utility. (Seidman Direct pp. 7-8; Willis Direct pp. 4, 7, and 8)

Florida Water states that the Commission did not initiate this proceeding pursuant to Section 367.0822, Florida Statutes, and it is FWSC's position that the Commission cannot arbitrarily and retroactively turn one type of proceeding into another, in an attempt to "cure" the problems with the requirements of Section

367.082, Florida Statutes. However, staff notes that FWSC's protest rendered the PAA Order a nullity; thus, the Order is of no precedential value. As a result, the Commission is not bound to the reasoning contained within the PAA Order, and can utilize Section 367.0822, Florida Statutes, as a basis for decision.

Therefore, staff believes that the reestablishment of authorized ROEs is appropriate, and not arbitrary, capricious, or speculative, given that the Commission updates its leverage formula annually resulting in ROEs that reflect current economic conditions. Further, the responsibility of the Commission to monitor the earnings of water and wastewater utilities can be managed only in the context of current ROEs and current economic conditions. Finally, updating the authorized ROEs of water and wastewater utilities in one generic proceeding rather than in many individual proceedings is administratively efficient and cost effective.

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?

RECOMMENDATION: Yes. Consideration of a utility's ROE, whether it is previously established or not, is within the Commission's jurisdiction, pursuant to Chapter 367, Florida Statutes. Given that many water and wastewater utilities have authorized ROEs outside the range set by the current leverage formula, and that the Commission can effectively monitor utility earnings only in the context of current ROEs, the Commission should utilize the current leverage formula to update the authorized ROEs for utilities that have authorized ROEs. One proceeding, rather than 94, for reestablishing these authorized ROEs is administratively efficient and cost effective, which is in the public interest. (Vining, Lester)

POSITION OF THE PARTIES

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.

STAFF ANALYSIS:

Florida Water argues that Chapter 367, Florida Statutes, sets forth a comprehensive plan for economic regulation of water and wastewater utilities, and provides the Commission with procedural opportunities to review financial aspects of a utility's operation. FWSC contends that Chapter 367 of the Florida Statutes does not provide the Commission with a method for resetting the entire industry's previously established ROEs, 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 requests that action. The leverage formula, in Florida Water's view, is a surrogate for the testimony normally provided during a ratemaking proceeding, and it is intended to produce an average ROE that can be used as a surrogate when the utility has no established ROE. When the Commission has previously established a utility's ROE, no surrogate is necessary or appropriate, according to FWSC, and the surrogate ROE provided by the leverage formula may not be imposed upon the utility in the absence of a request by the affected utility. (FWSC BR pp. 19-20)

Florida Water is correct that Chapter 367 of the Florida Statutes sets forth a comprehensive plan for the economic regulation of water and wastewater utilities; however, FWSC is incorrect that Chapter 367 does not provide the Commission with a mechanism for resetting authorized ROEs for all water and wastewater utilities. Section 367.0822, Florida Statutes, authorizes the Commission to "conduct limited proceedings to consider, and act upon, any matter within its jurisdiction." Consideration of a utility's ROE, whether it is previously established or not, is within the Commission's jurisdiction, pursuant to Chapter 367, Florida Statutes. The Commission is considering the ROE of all water and wastewater utilities in this proceeding rather than opening numerous individual dockets because it conserves the resources of both the Commission and the water and wastewater utilities, which is in the public interest. Because the Commission has the authority to reset an individual utility's ROE in a limited proceeding, staff believes that the Commission has the authority to reset the ROE, using the leverage formula, for all the water and wastewater utilities in the instant proceeding.

To adequately serve the public interest, it is imperative that the Commission review the earnings of water and wastewater utilities based on current capital market and economic conditions. In addition, the Commission has materially changed the leverage formula methodology, causing an increase in ROEs and rendering many authorized ROEs obsolete. The current leverage formula provides the Commission with the appropriate ROE benchmark with which the Commission can evaluate, in an accurate and reasonable manner, the current earnings of water and wastewater utilities. (Willis Direct pp. 3-5)

The public interest is also served by efficient, cost-effective regulation. The Commission could open many separate dockets, one for each utility with an authorized ROE, and reestablish the utility's authorized ROE. This method would be cumbersome and inefficient. The record in this case clearly shows that the Commission can change the authorized ROE of a utility outside of a make whole proceeding. One proceeding, rather than 94, for reestablishing authorized ROEs will provide due process for all participants in an administratively efficient and cost effective manner. (Willis Direct pp. 3-5)

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ISSUE 5: Should this docket be closed?

RECOMMENDATION: The docket should be closed after the time for filing an appeal has run. (Vining)

STAFF ANALYSIS: The docket should be closed after the time for filing an appeal has run.