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STATE OF FLORIDA
OFFICE OF THE PUBLIC COUNSEL

c/o The Florida Legislature
111 West Madison St.
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Tallahassee, Florida 32399-1400
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JACK SHREVE
PUBLIC COUNSEL

June 2, 2003

Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

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Re: Docket No. 020071-WS

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are original and 15 copies of the Testimonies of Mark A. Cicchetti; Kimberly H. Dismukes;Ted L. Biddy, P.E./P.L.S. and Donna DeRonne, C.P.A. on Behalf of the Office of Public Counsel.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

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Sincerely,

Stephen C. Burgess
Deputy Public Counsel

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cc: All parties of record

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Enclosures

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CERTIFICATE OF SERVICE
DOCKET NO. 020071-WS

I HEREBY CERTIFY that a true and correct copies of the Testimonies of Mark A. Cicchetti; Kimberly H. Dismukes; Ted L. Biddy, P.E./P.L.S. and Donna DeRonne, C.P.A. have been furnished by hand delivery and/or U.S. Mail to the following parties on this 2nd day of June, 2003.

By U.S. Mail:

Martin S. Friedman, Esquire
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650 S. North Lake Blvd.
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By Hand Delivery:

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Lorena Holley, Esquire
Division of Legal Services
Fla. Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Stephen C. Burgess
Deputy Public Counsel

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

IN RE: Application of
UTILITIES, INC. OF FLORIDA
for a rate increase in Marion,
Orange, Pasco, Pinellas
and Seminole Counties
_____/

Docket No. 020071-WS

Date Filed: June 2, 2003

TESTIMONY
OF
MARK A. CICCHETTI
ON BEHALF OF
THE OFFICE OF PUBLIC COUNSEL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

TESTIMONY AND EXHIBITS

OF MARK A. CICCHETTI

ON BEHALF OF

THE OFFICE OF PUBLIC COUNSEL

DOCKET NO. 020071-WS

BEFORE THE PUBLIC SERVICE COMMISSION

TESTIMONY

OF

MARK A. CICCHETTI

Q. Please state your name and address and on whose behalf you are testifying in this proceeding.

A. My name is Mark Anthony Cicchetti and my business address is 2931 Kerry Forest Parkway, Suite 202, Tallahassee, Florida 32309. I am testifying on behalf of the Office of Public Counsel.

Q. By whom are you employed and in what capacity?

A. I am a Project Manager and Manager of the Tallahassee Office for C.H. Guernsey & Co. Guernsey is an engineering, architectural and consulting firm that has been in business for 75 years. The services Guernsey provides include: cost-of-service and rate studies; regulatory and litigation support; economic and financial studies; valuation studies; power supply planning, solicitation, and procurement; fuel purchasing; transmission and distribution planning and facilities design; strategic planning; telecommunications and e-business applications; architectural design for headquarters and warehouse facilities; environmental assessments; security systems, and; web site development and internet applications.

For ten years prior to joining C.H. Guernsey & Co., I was President of Cicchetti & Co., a financial research and consulting firm specializing in public utility finance, economics, and regulation. I also have been employed by the Florida State Board of Administration as Manager of Arbitrage Compliance and the Florida Public Service Commission as Chief of Finance. A detailed narrative description of my experience and qualifications is contained in Exhibit No. ____ (MAC - 1).

Q. Have you previously testified before this Commission?

A. Yes, I have testified before this Commission numerous times.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address the leverage formula and the return on common equity the Commission should allow in this docket and to address the appropriate ratemaking treatment for the gains recognized by Utilities, Inc. of Florida on the sale of the Druid Isle water system and a portion of Oakland Shores water system and the Green Acres Campground water and wastewater systems.

The purpose of my rebuttal testimony is to rebut the testimonies of Hugh A. Gower and Steven M. Lubertozzi as they relate to gain on sale.

ALLOWED RETURN

Q. What is the leverage formula?

A. The leverage formula is a linear equation that, using a given set of assumptions, estimates changes in equity cost for given changes in financial leverage (i.e. the use of debt). The leverage formula has been in use in Florida since the late 1970's.

The theories underlying the leverage formula, as used in Florida, are based on the works of Modigliani and Miller (1958) and Miller (1977). According to Modigliani and Miller, the overall cost of capital remains constant despite changes in financial leverage. Therefore, the major premise underlying the leverage formula is that firms with different equity ratios will have different costs of equity even though they have the same business risk and the same overall cost of capital. This means that the increase in the required return on equity resulting from the use of leverage completely offsets the advantage of the increased use of lower cost debt. (See Modigliani and Miller, "The Cost of Capital, Corporation Finance and the Theory of

Investment," *American Economic Review*, June 1958, pp. 261-297 and Miller, "Debt and Taxes," *Journal of Finance*, May 1977, pp. 261-275.)

Q. Why is the leverage formula used to determine the allowed return on common equity for water and wastewater utilities in Florida?

A. There are over 200 certificated water and wastewater utilities under the jurisdiction of the Florida Public Service Commission ("FPSC"). Without a workable methodology such as the leverage formula, the costs and administrative burdens associated with cost of equity testimony, in potentially 200 rate cases, could become quite onerous. Additionally, many water and wastewater utilities are small operations that find it beneficial to avoid the costs associated with presenting cost of equity testimony. Consequently, applying a workable methodology such as the leverage formula lowers costs to all parties and serves the public interest.

Q. What are the assumptions underlying the leverage formula?

A. As stated in Public Service Commission Order No. PSC-02-0898-PAA-WS, the four basic assumptions are: 1.) Business risk is similar for all water and wastewater utilities; 2) The cost of equity is a function of the equity ratio; 3) The marginal weighted average cost of investor capital is constant over the equity range of 40% to 100%; and 4) The cost rate at an assumed Moody's bond rating of baa3 plus a 50 basis point private-placement premium and a 50 basis point small-utility premium represents the average marginal cost of debt to a Florida water and wastewater utility over an equity ratio range of 40% to 100%.

Q. Are these assumptions reasonable?

A. In general, yes. However, in this docket, the 50 basis point premium for small utilities should not be applied because Utilities, Inc. of Florida is one of the largest

water and wastewater utilities in Florida. The 50 basis point premium for small utilities was incorporated in Order No. PSC-01-2514-FOF-WS because two-thirds of Florida's water and wastewater utilities range from small to very small. Consequently, the premium for small utilities should not be applied to Utilities, Inc., one of the few large water and wastewater utilities in the state.

Q Please explain.

A. In Order No. PSC-02-0898-PAA-WS, the Commission allowed three adjustments to the leverage formula to compensate for risks associated with the small size of the typical Florida water and wastewater utility. The three adjustments increased the leverage formula cost of equity by 140 basis points. The three adjustments are: 1) A bond yield differential of 40 basis points to compensate for the fact that Florida water and wastewater utilities are smaller than the companies used in the indexes to calculate the cost of equity; 2) A private-placement premium of 50 basis points to recognize that investors require a premium for holding privately placed bonds that small firms issue as opposed to publicly issuing debt, and; 3) A small-utility risk premium of 50 basis points to recognize the financial stress, and hence risk, that small water and wastewater systems can experience. However, Utilities, Inc. of Florida is much larger than the average Florida water and wastewater utility.

Historically, Florida water and wastewater utilities have been characterized as small (Class C), medium (Class B), and large (Class A) based on revenues. Typically, small firms have under $200,000 in revenue, medium sized firms have between $200,000 and $1,000,000 in revenue and large firms have over $1,000,000 in revenue. As of 2000, only nine water or wastewater systems had revenues over

$1,000,000. As shown in the Company's 2001 annual Report, Utilities, Inc. of Florida had revenues of over $2,050,000, more than four times the median revenue of the 78 intermediate sized Florida water and wastewater firms and more than 35 times the median revenue of the 170 small Florida water and wastewater utilities cited in Order No. PSC-01-2514-FOF-WS.

Q. Was the fact that the adjusted leverage formula would be applied to large Florida firms as well as small Florida firms -- absent a protest by an interested party -- addressed at the hearing where the three adjustments for small size were proposed?

A. Yes. Commissioner Deason questioned staff witness Lester concerning such application. Page 235 line 15 through Page 237 line 2 of the hearing transcript, which follows, is the dialogue between Commissioner Deason and staff witness Lester:

> COMMISSIONER DEASON: I have a question concerning your adjustment for small companies.
>
> THE WITNESS: Yes, sir.
>
> COMMISSIONER DEASON: Fifty basis points. And I understand in your analysis you chose to compare bond yields for triple B and BB plus. I don't know what the terminology is.
>
> THE WITNESS: That's BB+.
>
> COMMISSIONER DEASON: BB+ and BBB. And you came out with an average of 83 basis points and then a range. And then you tempered that calculation somewhat, and correct me if I'm wrong, but I think you tempered that calculation somewhat for the fact that we really shouldn't consider regulated utility companies as speculative

grade, and so you chose 50 basis points –

THE WITNESS: That's correct.

COMMISSIONER DEASON: –as some type of quantification of the risk factor of a small company; correct?

THE WITNESS: That's correct, yes, sir.

COMMISSIONER DEASON: Okay. First of all, let me ask you this. Do you consider all of the companies that we regulate in Florida to be small companies?

THE WITNESS: No. I consider the average to be.

COMMISSIONER DEASON: The average to be.

THE WITNESS: Yeah.

COMMISSIONER DEASON: Okay. But any company in Florida can come in and choose the leverage formula, and if that is not protested by Public Counsel or someone else, then that's what's used regardless of the size of that company; correct?

THE WITNESS: Yes, sir.

COMMISSIONER DEASON: But since the statute uses the term "average," you think it's appropriate then to allow any company to come in and choose that if they think it's appropriate.

THE WITNESS: Yes, sir. I based my analysis on the statutory language, which I think is an average water and wastewater utility.

Q. What rate of return on common equity should be allowed in this docket?

A. Because Utilities, Inc. of Florida is significantly larger than the average water and wastewater utility in Florida, I recommend the Commission apply the leverage

formula without the third adjustment of 50 basis points for small size. Two adjustments for small size will remain, the 40 basis point bond-yield-differential adjustment to recognize the difference in size between the companies in the indexes used to calculate the cost of equity and Utilities, Inc. of Florida and the 50 basis point private-placement premium to recognize that investors require a liquidity premium to hold privately placed debt. It should be noted, the adjustments for small size are in addition to the recovery of the actual cost of debt. Although many Florida water and wastewater utilities are small, they are still regulated entities and have lower risk than similar non-regulated entities. It is not reasonable to assume, for the purposes of the leverage formula, that a well-managed, prudently-operated Florida water or wastewater utility would not meet the financial criteria necessary for an investment grade rating. Furthermore, bonds below investment grade are characterized, at best, as "uncertain as to position" by Moody's. The ability of Utilities, Inc. of Florida to pay its debts should not be considered "uncertain." It is reasonable to assume the average marginal cost of debt to Utilities, Inc. of Florida WAW is equal to Moody's bond rating of baa3 plus 50 basis points as a private-placement premium. A bond rating below baa3 is not investment grade. The additional third adjustment for size of 50 basis points for financial stress for small size is based on a bond yield below baa3.

In defining its baa rating, Moody's states, "Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well." It would be unreasonable to assume that the debt of a Florida-regulated water or wastewater utility is below that described by Moody's baa rating and therefore below investment grade. Furthermore, it would be unreasonable to assume it is uncertain that a

prudently operated Florida water or wastewater utility can pay its debts, particularly one of the largest water and wastewater utilities in Florida. Consequently, the allowed return on common equity in this docket should be 10.41% as opposed to 10.91%. The derivation of the leverage formula to arrive at the 10.41% is shown on Exhibit No. ____(MAC-2). A return of 10.41% will allow Utilities, Inc. of Florida to maintain its' financial integrity and attract capital.

GAIN ON SALE

Q. What gains did Utilities, Inc. of Florida recognize on the sale of its Druid Isle water system, the sale of a portion of its Oakland Shores water system and the sale of its Green Acres Campground water and wastewater systems?

A. Utilities, Inc. of Florida recognized a gain on sale of $61,699 for its Druid Isle water system and the portion of its Oakland Shores water system and a gain on sale of $269,661 for its Green Acres Campground water and wastewater systems.

Q. What is the appropriate ratemaking treatment of the gains on sale of these water and wastewater systems?

A. The appropriate ratemaking treatment of the gains on sale of the water and wastewater systems sold by Utilities, Inc. of Florida is to attribute the gains to ratepayers. Cost of service regulation as it is practiced in Florida, as well as most of the rest of the country, is a balancing of the interests of shareholders (i.e., the owners) and ratepayers and is based on the premise that shareholders are given the opportunity to recover their costs, including a fair return on their investment, and that ratepayers pay the reasonable and prudent costs associated with the provision of utility service.

Q. How does appropriate application of cost-of-service regulation achieve the goal

of balancing the interests of shareholders and ratepayers?

A. Cost-of-service regulation evolved as a way to deal with the natural monopoly characteristics associated with the provision of utility service. To understand how cost-of-service regulation benefits society one must understand market structure and its effect on a firm's return on common equity. Market structure is the range of conditions (such as the number of firms, the economies of scale or scope, the type of product sold, and the demand for a product) that affects a firm's behavior and performance. Market structure is best thought of as a continuum stretching between purely competitive markets and natural monopoly. Purely competitive markets are characterized by minimal economies of scale or scope - - that is, no single supplier has a natural cost advantage over other suppliers. In the short run, a firm can earn economic profits, (that is a return above its cost of capital) only if it is efficient or innovative. In the long run, a firm cannot earn above its cost of capital due to the ease of entry into, and exit from, the market. If a firm in an effectively competitive environment is earning above its cost of equity, new firms will try to share those profits.

Another way to look at it is to recall that in economics, long-term is defined as the period of time necessary to change production processes. In the long-term, in an effectively competitive environment, a firm's competitors will match its efficiency by changing their production processes.

Natural monopoly markets, by contrast, are marked by substantial economies of scale or scope and decreasing average costs. This means one supplier can always serve the market at lower unit cost than two or more suppliers. Entry barriers are severe because the single most efficient provider will always be able to price below

any potential entrant. Left unregulated, a natural monopoly market will not produce competitive results. Assuming an industry is a natural monopoly (as are the water and wastewater industries), cost of service regulation benefits society by increasing output while reducing price and economic profits. Regulators achieve this by backing away from the objectives of allocative efficiency and marginal cost pricing, and establishing a "fair-return" price. The "fair-return" price includes the reasonable and prudent costs associated with the provision of utility service including a fair return on invested capital. Although this does not produce a socially optimum price and output, it is an improvement over an unregulated natural monopoly.

Because utilities must meet the peak demand for their products or services, they generally have significant excess capacity during periods of normal demand. This requires a high level of facilities investment, which means that the unit cost of production likely will decrease over a wide range of output. The result is a socially optimum price that is below average cost. Pricing here would likely result in bankruptcy. Therefore again, regulators set a "fair return" price that allows a utility to recover the reasonable and prudent costs associated with providing utility service, including an appropriate return on common equity.

Q. What are the implications, under cost-of-service regulation, if the gains associated with the sale of utility plant are not attributed to ratepayers?

A. Cost-of-service regulation contemplates ratepayers paying the net cost of providing utility service including a fair return on capital. All other things being equal, if the gain on sale of property is not attributed to ratepayers then the utility will be allowed to recover more then the cost of providing service. This is equivalent to consciously allowing a utility a return on common equity above the

required return. Through depreciation, a utility realizes a return *of* capital and through a fair allowed rate of return a utility earns a return *on* capital. Shareholders are rewarded for the risks they take through the allowed return on common equity. The return is not guaranteed which provides an incentive for the firm to be efficient. The allowed return on common equity includes a premium to recognize the risks associated with providing utility service. To contend, all other things being equal, that a utility deserves to be allowed to recover more than the net cost of providing service plus a fair return on common equity is inconsistent with cost-of-service principles.

Furthermore, it is unfair to ratepayers to allocate gains on the sale of regulated assets to shareholders when it is generally accepted that ratepayers should incur the cost of reasonably incurred losses on sales of regulated assets.

Q. When are ratepayers required to incur the cost of losses on sales of utility assets under cost-of-service regulation?

A. In recent years, when electric utilities were required to divest generation or transmission assets under "deregulation" it was generally accepted that ratepayers should bear any stranded costs (loss of value as compared to original cost) associated with the sale of regulated assets. The basic idea was that the utilities had made the investment to provide service under a regulatory compact, i.e. cost-of-service regulation, and that it was only fair that the ratepayers, not the new customers, bear the stranded costs. In fact, to the best of my knowledge, in all states where it was contemplated there would be stranded costs under a plan of deregulation, whether actually implemented or just proposed, stranded costs were to be recovered from ratepayers. Consequently, under cost-of-service principles, the knife should cut both

ways. Gains on sale and reasonable, prudently incurred losses on sale of utility assets (such as through forced divestiture) should be treated above the line for ratemaking purposes. Such treatment is consistent with sound cost-of-service regulation.

Q. Please summarize your direct testimony.

A Regarding the leverage formula and an appropriate allowed return, in Order No. PSC-02-0898-PAA-WS, the Commission allowed three adjustments to the leverage formula to compensate for risks associated with the small size of the typical Florida water and wastewater utility. The three adjustments increased the leverage formula cost of equity by 140 basis points. The three adjustments are: 1) A bond-yield differential of 40 basis points to compensate for the fact that Florida water and wastewater utilities are smaller than the companies in the indexes used to calculate the cost of equity; 2) A private-placement premium of 50 basis points to recognize that investors require a premium for holding privately placed bonds that small firms issue as opposed to publicly issuing debt, and; 3) A small-utility risk premium of 50 basis points to recognize the financial stress, and hence risk, that small water and wastewater systems can experience. However, Utilities, Inc. of Florida is much larger than the average Florida water and wastewater utility. Because Utilities, Inc. of Florida is significantly larger than the average water and wastewater utility in Florida, I recommend the Commission apply the leverage formula without the third adjustment of 50 basis points for small size. Two adjustments for small size will remain, the 40 basis point bond-yield differential adjustment to recognize the difference in size between the companies in the indexes used to calculate the cost of equity and Utilities, Inc. of Florida and the 50 basis point private-placement

premium to recognize that investors require a liquidity premium to hold privately placed debt. It should be noted, the adjustments for small size are in addition to the recovery of the actual cost of debt.

Regarding gains on sale, cost-of-service regulation contemplates that ratepayers pay the net cost of providing utility service including a fair return on capital. All other things being equal, if the gain on sale of property is not attributed to ratepayers than the utility will have been allowed to recover more than the cost of providing service. This would be equivalent to consciously allowing a utility a return on common equity above the required return. Through depreciation, a utility realizes a return *of* capital and through a fair allowed rate of return a utility earns a return *on* capital. Shareholders are rewarded for the risks they take through the allowed return on common equity. The return is not guaranteed which provides an incentive for the firm to be efficient. The allowed return on common equity includes a premium to recognize the risks associated with providing utility service. To contend, all other things being equal, that a utility deserves to be allowed to recover above the net cost of providing service plus a fair return on common equity is inconsistent with cost-of-service principles.

REBUTTAL OF GOWER

Q. On page 4 line 2 Mr. Gower states "Neither gains nor losses on sales of utility systems should be included in cost of service used for rate setting purposes." Do you agree?

A. No. Ratepayers should pay only the net cost of service under cost-of-service regulation. Furthermore, it is generally accepted that utilities that incur stranded costs when forced to sell assets should be kept whole through the ratemaking

process.

Q. On page 12 line 7, Mr. Gower states, "It is the investors whose capital is exposed to the risks of ownership and to whom gains or losses--including those from property sales--should accrue." Do you agree?

A. No. As stated above, ratepayers should only bear the net cost-of-service under cost of service regulation and it is generally accepted that utilities should be allowed to recover stranded costs, i.e. losses, when reasonably incurred. Furthermore, owners are compensated for the risks associated with the provision of utility service through the allowed return on common equity which includes a premium specifically for taking on the risks of ownership. Regarding gains on sale of property under cost-of-service regulation, ownership is not a relevant consideration. What is relevant is determination of the appropriate costs to be borne by ratepayers. For example, salvage value is netted against original cost to determine the amount of capital plant and equipment that is to be recovered through depreciation. I have never heard anyone argue that because shareholders are the owners of the plant and equipment used to provide utility service, salvage value should not be used to reduce the net cost of depreciation to ratepayers but instead should accrue to the owners. Likewise, gains on the sale of regulated property should be netted against the cost of service and accrue to the benefit of ratepayers.

Q. On page 14, line 11 Mr. Gower states, "Failure to assign to investors gains or losses on sales of this type is not only confiscatory, unfair and improper, but also has adverse implications to the utilities ability to raise capital at reasonable costs." Do you agree?

A. No. It is hard to see how *not* assigning losses to investors is confiscatory to

investors and would have adverse implications to raising capital at a reasonable cost. Second, allowing a fair return on common equity, by definition, meets the capital attraction standard for raising capital at a fair price. All other things being equal, allowing gains on sales to be attributed 100% to shareholders allows shareholders to earn more than a fair return--directly the opposite of hampering the utility's ability to attract capital at a reasonable cost.

REBUTTAL OF LUBERTOZZI

Q. On the fourth page, line 29 of Mr. Lubertozzi's direct testimony, he states, "since the investors provide the capital and bear the risks, they are entitled to receive the return. Gains and losses on the sale of utility property are properly assigned to the owners of the facilities, just as in any other business enterprise. Utility investments are not risk free and may bear additional risks beyond the normal, predictable risks borne by other business enterprises." Do you agree?

A. No. As outlined in my rebuttal testimony to Mr. Gower's direct testimony, under cost-of-service regulation, ownership is not a relevant consideration. What is relevant is determination of the appropriate costs to be borne by ratepayers. Furthermore, regulated utilities are not the same as any other business enterprise due to the natural monopoly nature of the utility business and the potential for undue discrimination as outlined in my direct testimony. As shown on page nine of the February 7, 2002, staff recommendation in Docket No. 991890-WS, of the eight states that responded to the staff's survey that had an established policy or practice concerning gains on sale, only one had an established policy or practice of allocating 100% of the gain to shareholders. Six had the established policy or practice of allocating 100% of the gain to ratepayers. Investors in utility stocks are compensated

for the risks incurred through the allowed return on common equity. Finally, it is generally accepted that regulated utilities are less risky than non-regulated companies. For example, rating agencies have recognized this fact in their publications and their financial benchmark criteria.

Q. Please summarize your rebuttal testimony.

A. Both Mr. Gower and Mr. Lubertozzi claim that because investors bear the risks associated with investment in utility assets, the utility should receive the gains on sale of utility property. However, investors are compensated for the risks they bear through the fair return allowed on common equity capital. Furthermore, under cost-of-service regulation, ownership is not a relevant consideration. What is relevant is determination of the appropriate costs to be borne by ratepayers. For example, salvage value is netted against original cost to determine the amount of capital plant and equipment that is to be recovered through depreciation. I have never heard anyone argue that because shareholders are the owners of the plant and equipment used to provide utility service, salvage value should not be used to reduce the net cost of depreciation to ratepayers but instead should accrue to the owners. Likewise, gains on the sale of regulated property should be netted against the cost of service and accrue to the benefit of ratepayers.

Finally, Mr. Gower states, "Failure to assign to investors gains or losses on sales of this type is not only confiscatory, unfair and improper, but also has adverse implications to the utilities ability to raise capital at reasonable costs." However, it is hard to see how *not* assigning losses to investors is confiscatory to investors and would have adverse implications to raising capital at a reasonable cost. Second, allowing a fair return on common equity, by definition, meets the capital attraction

standard for raising capital at a fair price. All other things being equal, allowing gains on sales to be attributed 100% to shareholders allows shareholders to earn more than a fair return--directly the opposite of hampering the utility's ability to attract capital at a reasonable cost.

Q. Does this conclude your testimony?

A. Yes.

Experience and Qualifications

I received a Bachelor of Science degree in Business Administration in 1980 and a Master of Business Administration degree in Finance in 1981, both from Florida State University. Upon graduation I accepted a planning analyst position with Flagship Banks, Inc., a bank holding company. As a planning analyst, my duties included merger and acquisition analysis, lease-buy analysis, branch feasibility analysis, and special projects.

In 1983, I accepted a regulatory analyst position with the Florida Public Service Commission. As a regulatory analyst, I provided in-depth analysis of the cost of equity and required overall rate of return in numerous major and minor rate cases. I reviewed and analyzed the current and forecasted economic conditions surrounding those rate cases and applied financial integrity tests to determine the impacts of various regulatory treatments. I also co-developed an integrated spreadsheet model which links all elements of a rate case and calculates revenue requirements. I received a meritorious service award from the Florida Public Service Commission for my contributions to the development of that model.

In February 1987, I was promoted to Chief of the Bureau of Finance. In that capacity I provided expert testimony on the cost of common equity, risk and return,

corporate structure, capital structure, and industry structure. I provided technical guidance to the Office of General Counsel regarding the development of financial rules and regulations. In addition, I authored the Commission's rules regarding diversification and affiliated transactions, chaired the Commission's Committee on Leveraged Buyouts, supervised the finance bureau's regulatory analysts, co-developed and presented a seminar on public utility regulation to help educate the Florida Public Service Commission attorneys, and provided technical expertise to the Commission in all areas of public utility finance for all industries.

In February 1990, I accepted the position of Chief of Arbitrage Compliance in the Division of Bond Finance, Department of General Services. As Manager of the Arbitrage Compliance Section, I was responsible for assuring that over $16 billion of State of Florida tax-exempt securities remained in compliance with the federal arbitrage requirements enacted by the Tax Reform Act of 1986. I provided investment advice to trust and managers on how to maximize yields while remaining in compliance with the federal arbitrage regulations. I designed and implemented the first statewide arbitrage compliance system which included data gathering, financial reporting, and computation and analysis subsystems.

In July 1990, I founded Cicchetti & Company. Through Cicchetti & Company I provided financial research and consulting services, including the provision of expert testimony, in the areas of public utility finance, economics, and regulation. Topics I have testified on include cost of equity, capital structure, corporate structure, regulatory theory, cross-subsidization, industry structure, the overall cost of capital, incentive regulation, the establishment of the leverage formula for the water and wastewater industry, reconciling rate base and capital structure, risk and return, and the appropriate regulatory treatment of construction work in progress, used and useful property, construction cost recovery charges, and the tax gross-up associated with contributions-in-aid-of-construction.

In January, 2001, I joined C.H. Guernsey & Co. as a Project Manager and Manager of the Tallahassee, Florida Office.

In 1985, I was certified by the Florida Public Service Commission as a Class B Practitioner in the areas of finance and accounting.

In June, 1985, I published an article in Public Utilities Fortnightly titled "Reconciling Rate Base and Capital Structure: The Balance Sheet Method." In September, 1986, I was awarded third place in the annual, national, Competitive Papers Session sponsored by Public Utilities Reports, Inc., in conjunction with the

University of Georgia and Georgia State University, for my paper titled "The Quarterly Discounted Cash Flow Model, the Ratemaking Rate of Return, and the Determination of Revenue Requirements for Regulated Public Utilities." An updated version of that paper was published in the June, 1989 edition of the National Regulatory Research Institute Quarterly Bulletin. I subsequently served twice as a referee for the Competitive Papers Sessions. On June 15, 1993, I published an article on incentive regulation in *Public Utilities Fortnightly* titled "Irregular Incentives." On September 1, 2002, I published an article in *Public Utilities Fortnightly* titled "Gas Distribution: A Higher Risk Business. I am a past President and past member of the Board of Directors of the Society of Utility and Regulatory Financial Analysts ("SURFA"). I was awarded the designation Certified Rate of Return Analyst by SURFA in 1992. I am a member of the Financial Management Association International and have been listed in Who's Who in the World and Who's Who in America.

I have made public utility and finance related presentations to various groups such as the Southeastern Public Utilities Conference, the National Society of Rate of Return Analysts, the National Association of State Treasurers, and the Government Finance Officers Association.

Exhibit No. ____ (MAC-2)
Docket No. 020071-WS
Attachment No. 1
Page 1 of 1

LEVERAGE FORMULA
Excluding 50 basis Point Financial Stress for Small Firms Premium

Capital Component	Ratio	Marginal Cost Rate		Weighted Marginal Cost Rate
Common Equity	45.46%	10.43%		4.74%
Total Debt	54.54%	9.15%*		4.99%
	100.00		9.73%	

A 40% equity ratio is the floor for calculating the required return on common equity. The return on equity at a 40% equity ratio is 9.15 + .58/.40 = 10.60% as shown below:

Capital Component	Ratio	Marginal Cost Rate		Weighted Marginal Cost Rate
Common Equity	40.00%	10.60%		4.24%
Total Debt	60.00%	9.15%*		5.49%
	100.00		9.73%	

Where the equity ratio = Common Equity/(Common Equity + Preferred Equity + Long-Term Debt + Short-Term debt)

* Assumed Baa3 rate for April 2002 plus a 50 basis point private placement premium.