

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

FILED 6/13/2018
DOCUMENT NO. 04207-2018
FPSC - COMMISSION CLERK

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In the Matter of:

DOCKET NO. 20180006-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.

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PROCEEDINGS: COMMISSION CONFERENCE AGENDA
ITEM NO. 6

COMMISSIONERS
PARTICIPATING: CHAIRMAN ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER DONALD J. POLMANN
COMMISSIONER GARY F. CLARK
COMMISSIONER ANDREW G. FAY

DATE: Tuesday, June 5, 2018

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: ANDREA KOMARIDIS
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Notary Public in and for
the State of Florida at Large

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1 P R O C E E D I N G S

2 CHAIRMAN GRAHAM: Okay. We're going to skip
3 over five and we're going to go Item No. 6.

4 MR. RICHARDS: Good morning, Mr. Chairman and
5 Commissioners. I'm Chris Richards with Commission
6 staff.

7 Item No. 6 is staff's recommendation in Docket
8 No. 2018006-WS regarding the annual reestablishment
9 of the authorized range of returns on equity for
10 water and wastewater utilities, pursuant to
11 Section 367.081, Florida Statutes.

12 On November 8, 2017, staff held a workshop to
13 solicit input from interested persons regarding
14 potential changes to the current leverage-formula
15 methodology. The Office of Public Counsel and
16 Utilities, Inc. of Florida, participated in the
17 workshop, with both parties filing comments.

18 Staff refined the methodology to include water
19 and wastewater utilities in the proxy group. And
20 staff also utilized a weighted average based on
21 market capitalization, where appropriate, to
22 determine the range of returns on equity for water
23 and wastewater utilities.

24 Staff recommends the Commission approved
25 revised leverage formula with the range of returns

1 on equity from 8.18 percent for a utility with an
2 equity ratio of 100 percent, to 11.08 percent for
3 utility with an equity ratio of 40 percent.

4 Mr. Sayler from the Office of Public Counsel
5 is here, along with Mr. Friedman, and Mr. Deason
6 with Utilities, Inc. of Florida. And staff is also
7 available to answer any questions.

8 CHAIRMAN GRAHAM: Thank you, staff.

9 Mr. Sayler.

10 MR. SAYLER: Good morning, Chairman Graham,
11 Commissioners. Erik Sayler on behalf of the
12 citizens of the state of Florida for this docket.
13 You will be happy to hear that we believe that
14 staff has accurately summarized our comments that
15 we submitted to the Commission in November and in
16 February.

17 While we disagree with the outcome, we are
18 really not going to make any additional argument
19 because they're adequately summarized in staff's
20 recommendation; however, if you have any questions
21 regarding those comments that we made and were
22 submitted and summarized, I am here to answer those
23 questions.

24 And the only other comment I have is I'm sure
25 I will disagree with everything that Mr. Friedman

1 shares today.

2 (Laughter.)

3 CHAIRMAN GRAHAM: Okay. So, Mr. Friedman,
4 knowing that you're going into an oncoming wind --

5 MR. FRIEDMAN: Yes, I -- I spoke to Mr. Sayler
6 beforehand and -- and understood he was going to
7 disagree with whatever I would say. So, I was
8 going to say nice things about him, but I will --
9 I'll forego -- I'll forego that for the moment.

10 (Laughter.)

11 MR. FRIEDMAN: Again, Marty Friedman on behalf
12 of the Utilities, Inc. of Florida. Also with me is
13 Jared Deason, who is the regulatory manager for
14 Utilities, Inc. of Florida.

15 I'm going to address some of the technical
16 issues of the -- of the leverage-formula
17 recommendation. And then Mr. Deason is going to
18 address the simple sanity check that should be --
19 should have been done that would have shown the --
20 the fallacy of the result of the -- of the
21 particular methodology used.

22 There are really two errors that the -- that
23 the staff has made in the leverage formula. The
24 first one is that they use a company -- they did
25 expand from the gas companies to water and sewer,

1 but they used a company called Public Service
2 Enterprise Group that really doesn't meet the
3 criteria of a -- to be a member of proxy group.

4 Public Service Enterprise Group is shoehorned
5 into the criteria only because they're --
6 they're -- because of the regulated revenues as a
7 percentage of the total revenues were used. So,
8 they didn't use all of the revenues; they used a
9 percentage. They should have only used the natural
10 gas.

11 The problem is that -- that this company's
12 revenues include electric and gas. There,
13 unfortunately, is no way to differentiate the
14 revenues between those two separate utilities. And
15 as a result, it results in an inequal balance of --
16 of the proxy group.

17 The next issue with -- with using Public
18 Service Enterprise Group is that only 17.3 of the
19 assets are in the gas segment; whereas the
20 remaining utilities, gas utilities, in the proxy
21 group -- the amount of assets are anywhere between
22 85 and a hundred percent. And so, it really
23 doesn't accurately reflect an entity that should be
24 included in the proxy group.

25 The second issue is that the staff has market-

1 value-weighted the DCF results, betas, and equity
2 ratios. And that's inappropriate to do so. It
3 appears as if they're -- in the recommendation, if
4 they're -- they're saying that that was something
5 that UIF recommended. And it's not.

6 What UIF recommended was market-value-
7 weighting only for the market-index return,
8 consistent with the S&P 500 returned estimation
9 methodology. So, I -- either the staff
10 misunderstood it or -- or they ignored it.

11 The rate-of-return analysis in regulatory
12 rate-setting generally uses proxy groups to
13 estimate the typical or average cost of equity of a
14 group of utilities of a similar risk to the
15 regulated entity; however, the regulatory rate of
16 return is not estimated in the context of an
17 investment portfolio.

18 The -- the standard way that -- that this is
19 done is that the DCF results, betas, and equity
20 ratios are averaged on an equal weighting basis,
21 not on a market-value-weighting basis.

22 And -- and that -- and that makes a difference
23 in its -- its -- what we're asking is that the --
24 and that's typical. That's the typical methodology
25 used. And that's what we're asking, that -- that

1 the Commission use that typical methodology.

2 Mr. Deason is going to address the -- the
3 result of -- of the application of the leverage
4 formula, and then I'll -- I'll go back in for some
5 concluding statements.

6 MR. DEASON: Good morning, Commissioners.
7 Jared Deason with Utilities, Inc. of Florida. And
8 before I begin, I just want to follow up on
9 Mr. Saylor's comments. He did say he was going to
10 disagree with Mr. Friedman, but he didn't say he
11 was going to disagree with me. So, keep that in
12 mind.

13 I just want to bring up a couple of points in
14 staff's analysis. The first one was having to do
15 with small risk premium. As you may know, water
16 and wastewater util- -- utilities tend to be much,
17 much smaller utilities compared to others in the
18 natural-gas or electric industries.

19 And just kind of -- give you kind of a general
20 comparison, just looking at the proxy group that
21 staff is using, they said in staff recommendation,
22 the average calculation is \$5.45 billion.

23 If you were to compare the size of my company
24 with the average of the proxy group, the proxy
25 group, on average is 166 times larger. So,

1 although, we're the largest water and wastewater
2 utility in Florida, we're still a very, very small
3 company relative to the others. And if you take a
4 look at all the Class Bs and Cs utilities, then
5 you're talking about utilities that could be
6 several-thousand times smaller.

7 So, on top of that, being very small --
8 there's also a lot of risks that go along with
9 being very small. In fact, there's others risk
10 that even staff pointed out in the recommendation.
11 Water and wastewater utilities tend to be more
12 capital-intensive where we have lower depreciation
13 rates.

14 We're more likely to experience negative free
15 cash flow. Our credit metrics are -- tend to be
16 more inferior compared to electric and natural gas.
17 Our earnings are more volatile. And overall, we
18 experience more business failures compared to
19 electric or natural gas.

20 So, staff has always, in the past, included a
21 small-utility risk premium. In this case, they
22 decided to just keep that same risk premium. In
23 the staff recommendation, it said, without further
24 study, they determined not to change it; however
25 given the sheer size differential in our companies

1 between electric and natural gas and the proxy
2 group, I think it's important we do further study
3 on that.

4 I think it's needs to take a -- that it needs
5 further vetting at this point to determine what is
6 a small risk premium because, at this point, it
7 doesn't appear that staff has studied that in the
8 recommendation, and I think that's something that
9 should be looked at it further.

10 Another thing I looked at, just kind of doing
11 a -- as Mr. Friedman said, a sanity check, I wanted
12 to compare what the results of this formula are
13 giving as you apply the equ- -- equity ratios of
14 water and wastewater utilities.

15 And what I did is compared it to other recent
16 decisions that the Commission has made. Looking at
17 some of the electric and gas cases that have
18 recently made in ROEs -- now, these are utilities
19 that are much larger and experience a lot less risk
20 than my company does.

21 Recently, in Docket 160021, Florida Power &
22 Light was allowed a 10.55 ROE. In 20160186, Gulf
23 Power was allowed a 10.25 ROE.

24 Now, if you were to take my company's equity
25 ratio, which is approximately 50 percent, and apply

1 it to staff's recommended leverage formula, that
2 would give us an ROE of 10.12, a lower- -- lower
3 ROE.

4 Now, to me, that seems a bit counterintuitive.
5 Typically, in any marketplace -- not just
6 utilities, but any market -- generally, with higher
7 risk goes higher return, not the opposite. So,
8 even though, you know, we're a natural monopoly, we
9 still have to compete in the marketplace. We still
10 have to attract capital. We still have to borrow
11 money.

12 And just put your shoe -- you in the place of
13 an investor, if you had one option on one side,
14 where you have a large company with lower risk and
15 a higher ROE versus a company with higher risk and
16 a lower ROE, where you want -- where are you going
17 to want to put your money. Not with the water and
18 wastewater utilities.

19 So, I think that -- that the overall results
20 of the utility -- of the leverage formula need to
21 read -- need to show that water and wastewater
22 utilities deserve a higher ROE compared to the
23 less-risky counterparts in electric and natural
24 gas.

25 Just looking at staff's recommendation, as --

1 as Mr. Friedman mentioned, there -- there's a few
2 things we disagree with, technically, but I think,
3 at this time, that it's premature to make a
4 decision -- given the outputs of the leverage
5 formula, it's premature to make a decision at this
6 time. I think there's more effort that needs to go
7 into -- to looking at some of these issues.

8 And I'll let Mr. Friedman summarize further.

9 MR. FRIEDMAN: And just, in conclusion, you
10 know, the leverage formula is used a whole lot and
11 it's -- it's been very beneficial in the years
12 since it was first adopted. And it's really
13 important that we get it right.

14 The points that we have -- have raised involve
15 technical discussions that aren't necessarily
16 conducive to resolution in this agenda-conference-
17 type format. And as a result, I would ask that you
18 direct the staff to reevaluate its recommendation
19 and even hold another workshop, if necessary.

20 And we would love for the Commissioners to
21 attend a workshop like that as well and -- and just
22 give it another try because it is a -- it is a very
23 important issue to the water and wastewater
24 industry since it is used so frequently. And I'd
25 respectfully request that you do that.

1 Thank you.

2 CHAIRMAN GRAHAM: Thank you, sir.

3 Commissioners, any questions of staff or OPC
4 or Mr. Friedman or Mr. Deason?

5 Commissioner Brown.

6 COMMISSIONER BROWN: Thank you, Mr. Chairman.

7 Mr. Buys, could you follow up on some of the
8 arguments that were raised by UIF here today?

9 MR. BUYS: Yes, I can, Commissioner. In
10 regards to Mr. Friedman's comments, the one company
11 that he pointed out, the Public Service Enterprise
12 Group -- we agree with their assessment of the
13 company. That was in -- our screening criteria did
14 not catch that company. It does provide gas
15 distribution service in New Jersey and does have
16 gas revenues.

17 Should we choose a proxy group tomorrow, we
18 would probably not include those. And we don't
19 have any objection to removing that company from
20 the existing proxy group.

21 As far as the -- using the market-value-
22 weighted index, that is an accepted methodology
23 used to level out the -- the -- if you would, the
24 influence on the proxy group so that not one -- to
25 take into account the difference in the -- in the

1 size differences -- I think we've explained that in
2 the recommendation. I think we went from the
3 simple average to the -- the market-value-weighted.

4 If we go with the simple val- -- simple
5 average, I think it raises the results from the
6 leverage formula. And also, if we -- I think --

7 COMMISSIONER BROWN: The risk premium -- the
8 risk premium that they -- that Mr. Deason talked
9 about?

10 MR. BUYS: Oh, the -- yes, now, I'm getting to
11 Mr. Deason, the small risk premium. The 50 basis
12 points has been used since at least 2001. It was
13 approved in two hearings without -- an evaluation,
14 a thorough evaluation, and probably vetting of that
15 issue through discovery and testimony -- that would
16 probably be the best way to ascertain what the
17 appropriate small risk premium should be. That's a
18 very hard number to actually calculate. It would
19 just take a lot more discovery than what we can do
20 in the PAA.

21 And on the electric -- when he mentioned the
22 electric and the nat- -- natural-gas comparison to
23 the water companies, our proxy group is based on
24 mostly the water and the -- and the gas companies.

25 UIF -- we are comparing UIF and the other

1 small SARC-type water companies to the larger water
2 and natural-gas companies. The proxy group does
3 not take into account the electric and the natural-
4 gas companies. So, you're comparing kind of apples
5 and oranges there, as opposed to maybe an orange
6 and a tangerine, let's say.

7 So, I think that addressed most of their
8 comments.

9 MR. CICCHETTI: Commissioners, we did find out
10 about the Public Service Enterprise company
11 yesterday. We were able to revise the
12 calculations. It provides a small downward
13 adjustment. With regard to --

14 COMMISSIONER BROWN: A downward adjustment in
15 the result.

16 MR. CICCHETTI: In the result in the range.

17 And with regard to the risk premium, that was
18 vetted thoroughly in the other two dockets. We
19 just didn't see a need -- a reason to change it or
20 had any information why it should be changed. So,
21 it has been thoroughly vetted in the past.

22 COMMISSIONER BROWN: Thank you.

23 CHAIRMAN GRAHAM: I'm not sure I can tell a
24 difference between an orange and a tangerine.

25 (Laughter.)

1 Commissioner Polmann.

2 COMMISSIONER POLMANN: Thank you,
3 Mr. Chairman.

4 To staff, can you please elaborate on the
5 workshop process? Did we have multiple workshops
6 and -- and what was the participation in that?

7 MR. BUYS: Yes, Commissioner. In November,
8 staff conducted a workshop in which representatives
9 from UIF participated, and representatives from the
10 OPC participated.

11 The representative from the UIF pres- -- made
12 a presentation and went through several changes
13 that they would like to make to the leverage
14 formula. Most of those resulted in increasing the
15 results of the leverage formula.

16 OPC, if I recall, did not make sev- -- did not
17 make many comments. They were there in
18 observation. And they did file their -- their
19 comments where most of their suggestions would
20 lower the results of the leverage formula.

21 And after that, staff reviewed the comments.
22 We addressed the comments in the recommendation.
23 And we've, thus, used some of those suggestions and
24 tried to revise the leverage formula to be more
25 reflective of the -- of the market.

1 COMMISSIONER POLMANN: With regard to the
2 leverage formula, was there a -- a change in the
3 type of formula, the -- the parameters, the
4 variables actually within the formula or the -- the
5 numeric -- the numbers that are assigned to the
6 parameter?

7 MR. BUYS: No, sir, the -- the formula is
8 basically the same.

9 COMMISSIONER POLMANN: Okay.

10 MR. BUYS: We revised it to use market-
11 weighted-average beta, a market-weighted-average
12 result from the DCF, and include the water and
13 wastewater companies in the proxy group as opposed
14 to the gas -- using solely gas companies in the
15 proxy group.

16 The problem we were having with using only the
17 gas companies in the proxy group was we were simply
18 running out of companies to use that were basically
19 a hundred percent gas.

20 So, we wanted to expand the proxy group and,
21 hopefully, make it more reflective of Florida --
22 the average Florida water and wastewater company.

23 COMMISSIONER POLMANN: Thank you.

24 Mr. Friedman or Mr. Deason, did you feel that
25 the -- the workshop process was fair and

1 reasonable? I --

2 MR. FRIEDMAN: Yeah, no, absolutely. It
3 was -- everybody was given a fair opportunity to --
4 to present their -- their positions. What I am
5 suggesting is that -- you know, the one thing they
6 didn't do was a sanity check, which -- which
7 Mr. Deason talked about; and that is, look at what
8 the result is.

9 And when the result turns out to be less than
10 what this Commission has given electric and gas
11 companies that the staff is, at the same time,
12 saying, are less risky than water and sewer, then
13 something is wrong with the formula.

14 And so, what I'm suggesting is that we just --
15 you know, it's a very important issue and that we
16 give an opportunity to -- to maybe vet it
17 through -- through -- you know, through another
18 workshop and have the Commissioners attend some of
19 these and have their input as well. We would
20 certainly welcome that.

21 COMMISSIONER POLMANN: Well, I understand
22 your -- your position on the outcome, but what
23 we're trying to address here is the methodology and
24 the -- the formula, itself, if I may focus on -- on
25 that.

1 There are differences in -- in the industries,
2 water, wastewater, gas, and electric. And we try
3 to address them separately, and we end up with
4 different -- you know, different numeric values
5 for -- for each.

6 In the water and wastewater, we -- we work
7 with the formula and the -- there are parameters
8 and there are proxies, and it's a difficult
9 process. And I know you appreciate that.

10 So, across the water/wastewater industry,
11 as -- as you know, there's reason to try to use the
12 formula. When we get an answer that -- that is
13 difficult to -- to get warm and fuzzy about, I'm
14 trying to understand how we go back into the
15 formula and look for a place to make an adjustment.

16 MR. FRIEDMAN: There are certainly places to
17 make adjustments in -- in the formula to
18 accommodate the -- like Mr. Deason pointed out, the
19 difference in the rates of return that you're
20 giving electric and gas as in -- and then versus
21 what -- what this formula comes out for water and
22 sewer.

23 You know, they're -- they're relative -- you
24 know, adding to the risk premium is a very easy --
25 easy way to -- to try to true that up, to -- you

1 know, after you use the sanity test, to true it up
2 to a reasonable thing would be to use something
3 like the -- the small risk premium, to add
4 something -- another half a point or so to the risk
5 premium to get it to something where at least it
6 passes the sanity check and at least you're giving
7 the water and sewer utilities the same rate of
8 return you're giving electric and gas that are less
9 risky.

10 COMMISSIONER POLMANN: And -- and I don't know
11 that we're going to resolve that here today.

12 MR. FRIEDMAN: No.

13 COMMISSIONER POLMANN: But I -- I think if I
14 understand the intent, we're trying to look for a
15 water/wastewater industry formula that would apply
16 across all of the utilities that we deal with. And
17 that may not be possible.

18 I understand that UIF is the regulated utility
19 that's the largest one that we deal with, now
20 that -- if the formula is going to apply to all of
21 our regulated entities, is there one single formula
22 that we look at all the parameters and say, there's
23 a value that applies -- a particular parameter that
24 applies for all, and there may not be.

25 So, where -- I'm having some difficulty

1 saying, is there one formula and, you know, for
2 each parameter, there's one value and so forth.

3 I'm just trying to express --

4 MR. FRIEDMAN: I think that --

5 COMMISSIONER POLMANN: And I hear what you're
6 saying.

7 MR. FRIEDMAN: I think that's a good point.
8 You know --

9 COMMISSIONER POLMANN: Yeah.

10 MR. FRIEDMAN: I'm just representing the
11 Utilities, Inc. of Florida here, but you know,
12 there are -- most of these utilities are a lot -- I
13 mean, which is small in relation to the proxy
14 group.

15 COMMISSIONER POLMANN: Of course.

16 MR. FRIEDMAN: But the -- a lot of the water
17 and sewer companies, you know, are really small.

18 COMMISSIONER POLMANN: Yes, sir.

19 MR. FRIEDMAN: And it might be appropriate
20 to -- to have a separate -- you know, to -- a
21 formula or add to the small risk premium for those
22 very-small water and sewer utilities.

23 COMMISSIONER POLMANN: And that may be
24 something --

25 MR. FRIEDMAN: They can't borrow without

1 having their -- their owners sign --

2 COMMISSIONER POLMANN: Sure.

3 MR. FRIEDMAN: Co-sign notes.

4 COMMISSIONER POLMANN: That -- that may be
5 something that -- that the Commission could
6 consider. I -- I -- I'm just trying to understand
7 your point. And I appreciate your -- you being
8 here and expressing that input. Thank you, sir.

9 MR. FRIEDMAN: Thank you.

10 CHAIRMAN GRAHAM: Just remember, at the end of
11 the day, they can always file a cost-of-equity
12 testimony and not even use the leverage --

13 COMMISSIONER POLMANN: Yeah, I'm just trying
14 to explore their -- their particular circumstance
15 compared to the industry as a whole.

16 Thank you, Mr. Chair.

17 CHAIRMAN GRAHAM: Mr. Saylor?

18 MR. SAYLER: Yes, sir, some brief responses to
19 the comments I'm hearing from Utilities, Inc.
20 First, the ROEs they're discussing between the
21 electric and the gas and what the leverage formula
22 produces -- those were negotiated ROEs that came as
23 a result of settlements agreed to by the
24 intervenors. And then those cases and the ROE,
25 itself, was a negotiated ROE. So, that is why, in

1 my opinion, it is higher than what the leverage
2 formula produces, for that.

3 Secondly, I know Mr. Deason said Utilities,
4 Inc. of Florida is relatively small compared to the
5 proxy group, but remember, Utilities, Inc. is a
6 larger nationwide company with operations in many
7 jurisdictions. And it's also owned by Corix, which
8 is a much larger company that also has water/
9 wastewater operations. So, for Utilities, Inc. to
10 say that they're a really, really small utility is
11 a bit of a red herring.

12 Now, when it comes to Florida, yes, they are
13 the -- the 800-pound gorilla when it comes to the
14 water and wastewater industry in Florida. And
15 that's why we have advocated that this Commission
16 consider not doing the small-utility risk premium
17 for Utilities-Inc.-sized companies, but those are
18 my briefer comments.

19 Thank you.

20 CHAIRMAN GRAHAM: Thank you, sir.

21 Commissioners -- Mr. Deason --

22 MR. DEASON: I just want to respond to
23 Mr. Saylor. That's basically a two-way street,
24 looking at -- talking about our parent company. A
25 lot of the companies in the proxy group or even

1 FP&L -- they have parent companies. FP&L's parent
2 is a subsidiary of NextEra Energy.

3 So, you if want to keep going up the ladder,
4 you can keep going up to the ladder on that side as
5 well. So, just want to throw that out there.

6 CHAIRMAN GRAHAM: Commissioners, any further
7 comment?

8 Commissioner Fay.

9 COMMISSIONER FAY: I just had one quick
10 comment, Mr. Chairman. As a fellow ACC alumni,
11 there's a -- there's a UF cup sitting on the table
12 there, and I didn't know what the process for --

13 COMMISSIONER BROWN: There's two Gators up
14 here, though.

15 COMMISSIONER FAY: Yes, I know.

16 COMMISSIONER POLMANN: I -- I don't have any
17 problem with that at all.

18 (Laughter.)

19 CHAIRMAN GRAHAM: Okay. Well, then, I'll
20 entertain a motion.

21 (Brief pause.)

22 CHAIRMAN GRAHAM: Or if somebody wants to take
23 the gavel.

24 (Laughter.)

25 COMMISSIONER FAY: I'll move staff's

1 recommendation.

2 CHAIRMAN GRAHAM: It's been moved and second,
3 staff recommendation on Item No. 6. Any further
4 discussion?

5 Seeing none, all in favor, say aye.

6 (Chorus of ayes.)

7 CHAIRMAN GRAHAM: Any opposed?

8 By your action, you have approved staff
9 recommendation Item No. 6.

10 MR. CICCHETTI: Mr. Chairman, does the staff
11 have administrative authority to make the
12 correction of removing Public Service Enterprise
13 Group from the proxy?

14 CHAIRMAN GRAHAM: Yeah, that was in
15 Commissioner Fay's motion.

16 MR. CICCHETTI: Okay. Thank you.

17 CHAIRMAN GRAHAM: All right. I think as we're
18 switching everyone around, let's take a five-minute
19 break.

20 (Brief recess.)

21 (Agenda item concluded.)

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CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

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