BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 120006-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. 15

COMMISSIONERS PARTICIPATING: CHAIRMAN RONALD A. BRISÉ
COMMISSIONER LISA POLAK EDGAR
COMMISSIONER ART GRAHAM
COMMISSIONER EDUARDO E. BALBIS
COMMISSIONER JULIE I. BROWN

DATE: Tuesday, June 19, 2012

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

REPORTED BY: LINDA BOLES, RPR, CRR
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P R O C E E D I N G S

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CHAIRMAN BRISÉ: Moving on to Item Number 15.

MR. CICCHETTI: Good morning, Mr. Chairman and Commissioners. Item 15 is the annual reestablishment of the leverage formula for the water and wastewater industries.

Staff's recommendation is that the current 2011 leverage formula be reauthorized until the leverage formula is addressed again in 2013. Staff's recommendation is largely influenced by the fact that the Federal Reserve has been intervening in the debt capital markets, which has pushed interest rates down to historically low levels. That in conjunction with certain simplifying assumptions of the leverage formula has resulted in some anomalous results, and so we recommend that the 2011 leverage formula be reauthorized until it is addressed again in 2013.

CHAIRMAN BRISÉ: All right. Mr. Friedman.

MR. FRIEDMAN: Thank you. Again, my name is Martin Friedman with the Law Firm of Sundstrom, Friedman & Fumero. We're here on behalf of the regulated subsidiaries of Utilities, Inc. We request that the Commission deny the staff's recommendation and to implement the outcome of the application of the leverage formula as it has been applied consistently with few exceptions since it was inceptioned many, many, many years ago.

What the staff has done is they, they, they plugged in the numbers to the leverage formula and said, oops, the spread is too much. We don't like the result. Let's just stick with the status quo. And they point out, well, you know, in '96 we got precedence for this recommendation because in '96 the same thing came and we asked you to do that and you agreed that, that since we didn't like the result, that you would, that you would maintain the status quo. What the staff didn't point out however is that there's precedence the other way as well.

In 1993 when the staff came to the Commission with the staff recommendation they didn't like the way the leverage formula fell out that year, and they came to the Commission and said let's, let's keep the status quo because we don't like what the result was. And that year, which was 1993, the Commission rejected that and decided that they would stay true to the leverage formula and in fact denied the staff recommendation and adopted the natural application of the results of the leverage formula.

And so, you know, there is precedence both ways. Don't just look at what the staff did and say, okay, yeah, we've done this before. Let's do it again. Let's look at the times when the Commission denied the staff's recommendation when they wanted to maintain the status quo.

And what we would ask that the, that the Commission do is to stay true to the leverage formula. It's a good formula, it's worked, and let's apply it as it was intended to be applied without any subjective determination that, oh, we just don't like the result this year. Let's maintain the status quo. Thank you.

CHAIRMAN BRISÉ: Thank you, Mr. Friedman.

Mr. Reilly.

MR. REILLY: The Office of Public Counsel does support staff's recommendation. Given the current condition of the state and national economy, the types of returns that Floridians are getting and receiving on their investments, we believe it's important for this Commission to not go beyond what your staff is recommending today on the, on the leverage formula.

We believe that because of the unusual increase on the upper end of 100 points and decrease of 38 points on the lower end that it really, as staff said in the recommendation, really creates an anomalous situation. It is not a situation that staff doesn't, doesn't like the result of. It's just an acknowledgment of the anomaly that it has created. And it's really the federal policies of lowering interest rates, thereby increasing the slope of the leverage formula relative to previous years that staff has come to the conclusion that the updated leverage formula does not, is not optimal really for setting these, these rates.

So I don't think it's a matter of don't like them. I think they really acknowledge that it's just a very unique, 30-year unique situation, not optimal, and in their recommendation that it would be more appropriate to set it as, as, as they have recommended. Again, particularly given the context of where we are and all of Floridians getting the kinds of returns that they are, from our view these returns are very commensurate, compensatory, you know, for the people to endure the risks of providing water and wastewater service to our state. So we support staff.

CHAIRMAN BRISÉ: Thank you, Mr. Reilly.

Commissioner Brown.

COMMISSIONER BROWN: Thank you, Mr. Chairman. And I, staff, I understand we do have precedent to go either way under these circumstances. So really the key question that I have is is the updated leverage formula indicative of the current market environment for 2012?

MR. CICCHETTI: Commissioner, if we were to testify, I think the result would be much more in line with the 2011 leverage formula than the 2012. Triple B interest rates right now are in the neighborhood of 4%, and I do not think I would be recommending over 12% for our water utilities at this time.

COMMISSIONER BROWN: Okay. And staff's suggestion seems to keep the range, the 2011 is still within the range of the 2012 updated leverage formula; is that right?

MR. CICCHETTI: Yes. The 2011 formula falls within the range of the 2012. It's just on the extreme ends there is a, as Mr. Reilly has pointed out, the slope has increased due to the interest rates being so low, and that's producing the numbers that give us concern.

COMMISSIONER BROWN: Okay. I'd like to hear from other Commissioners as well.

CHAIRMAN BRISÉ: Commissioner Balbis.

COMMISSIONER BALBIS: Thank you, Mr. Chairman.

I just want to make a few comments that's kind of a result on a very detailed discussion I had with staff concerning the development of this formula. And, you know, it's my understanding that this formula was established to eliminate the need for a utility to come forward and provide expert testimony and have intervening parties provide expert testimony to determine what the appropriate return on equity would be. And I believe that there is no, regardless of which way we go on this, going with 2011, 2012, does not prevent any party to move forward and challenge this and go to the next process, which would be the hearing process.

So the question for staff is if we go back to the 2011 curve and it is challenged by the utility, what would be the process and how difficult would that be?

MR. CICCHETTI: The company could petition the Commission or in the process, in the -- while the rate case is filed they could file cost of equity testimony and that's what we would consider and what the Commission would vote on. They are not precluded from filing cost of equity testimony. This is only something that is a convenience particularly for the small water and wastewater companies. The cost, the cost of equity testimony would be substantial, so the Commission has made this formula available to them. But that does not preclude them from petitioning for a different rate.

COMMISSIONER BALBIS: Okay. And another question. The 2011 graph, does that match what we have determined for other utilities or industries recently?

MR. CICCHETTI: Yes, we did look at that. Surprisingly, for example, Florida Power & Light almost fits in there exactly, but I would caution this formula is a simplified process. And in other instances where you don't need the simplified process I would suggest we do look specifically at that. But it does fall generally within the range of what we have recommended in the past, what the Commission has allowed in certain instances.

COMMISSIONER BALBIS: Okay. And then I think this is my final question. But, you know, staff indicated that this was an anomaly with the financial situation that we're facing today. But do you feel that this warrants relooking at the leverage formula? Because obviously if the results -- you know, the goal was to come up with an appropriate ROE and we developed a formula based on the conditions at the time. Have the conditions changed enough to relook at that, and, if so, what is that process? Or do you feel that having this flexibility of seeing the results and then determining if it's appropriate or not would be the better avenue?

MR. CICCHETTI: The Commission has sort of, for lack of a better term, gone under the hood and looked at the mechanics on several occasions and it has worked well over the 30 years that it's been in effect.

There have been some times where things got a little out of line and the staff has brought that to your attention. But I think overall it's worked well for the purpose that it was intended.

COMMISSIONER BALBIS: Okay. And then I do have a question for Mr. Friedman.

Does the utility have a position that going back to the 2011 results will result in an inappropriate ROE that will affect your ability to obtain capital or otherwise affect your operations, or is it just that these are the results and we want the results?

MR. FRIEDMAN: Commissioner Balbis, I don't think that we could -- without looking at each of the individual companies that I represent, I couldn't say that the difference is significant enough that it would affect the ability of the respective utilities to continue to provide quality water and wastewater treatment to their customers. But that said, the wide range in the upper and lower range of ROE is the result of the current economy. The economy is where it is. The leverage formula came out to be what it is. Just because it's got a larger range between the high and low end doesn't mean that it's wrong, it doesn't mean that it should be better, and there's no reason that you shouldn't adopt the, the natural fallout from, from the leverage formula. Calling it an anomaly is just a nice way to say, you know, subjectively we don't agree with the results. And, and it's not practical for most utilities, I would say probably all but maybe Aqua, in a rate case to be able to afford to produce ROE testimony in a rate case.

The, I don't remember how many years ago it was, but the Public Counsel challenged the formula itself. Maybe '08 -- yeah. A long time ago. '08, that's not that long ago, is it? Geez.

Anyway, and, and so Utilities, Inc. was the only utility that really took the position of supporting the staff, and we, we brought in ROE cost of capital witnesses and it was not an inexpensive endeavor. So it's really -- although in theory, sure, we can always challenge cost of equity and bring in witnesses. As a practical sense we really can't. And if we did, probably the first thing you'd hear would be Mr. Reilly complaining about the cost of that type of witness.

So theoretically, sure, you can do it with the exception of, of, of a utility with a rate case the size of Aqua. It's not practical for any other water and sewer utility in Florida to present separate ROE testimony. This formula has worked, has worked very well for the 30 years it's been around, and I would, I would recommend and respectfully suggest that you leave the formula intact and the fallout as the numbers fall out.

COMMISSIONER BALBIS: Thank you, Mr. Chairman. And, you know, to be honest, you know, I'm kind of on the fence on, on this issue, and I'd like to hear from the other Commissioners.

I'm somewhat comforted by the fact that regardless of what decision we make either party can challenge it and provide the testimony that this is supposed to avoid. So I look forward to any discussions from the other Commissioners on this.

CHAIRMAN BRISÉ: Commissioner Brown.

COMMISSIONER BROWN: I just have another follow-up question for staff. Actual application of the updated formula and what affect that would have on all of the utilities, not just the smaller ones. Can you go through that with us so that we could get a little bit more insight as to why staff recommended to maintain the 2011?

MR. CICCHETTI: The theory behind the leverage formula is that the overall cost of capital is a function of risk and, therefore, you can vary the amounts of debt and equity. And although the cost of debt and equity might change, the overall cost of capital would remain the same. As the interest rates have come down so low, the weighted cost of the debt associated with that overall cost of capital is a much smaller piece now. So that means it's got to be made up as the equity ratio area gets smaller through the allowed return on equity.

And so for companies that have less equity there's a much bigger impact, and most of the small utilities have very little equity. And so because the slope has changed because of that lower interest rate, that being one of the major factors of it, you're going to get a very high, you know, 12%, a little over 12% for those smaller companies, and we just think that's anomalous.

For example, Aqua, if we plugged in Aqua's recent rate case, the difference would be 19 basis points because they had 61% equity. But with a smaller company that had 47% equity, the impact right there is 63%, 63 basis points. So as you get down to that lower amounts of equity, the impact is higher, and that's what we just think is anomalous and would prefer or would recommend that the Commission stick with the 2011 leverage formula.

CHAIRMAN BRISÉ: I'm about to hit the button so I can speak.

I too am on the fence on this. I generally like to see that if we have a formula in place and the numbers fall out where they fall out, that is what it's going to be. But understanding what our role is here and that there's not going to necessarily be a negative impact on the company's ability to go out to market and get funding and things of that nature, and the potential impact that could be passed on to consumers, that that then causes me a little bit of pause to, to weigh in as to whether an application of the formula has a, the desired impact on the ultimate consumer, and that's where my, my reservation is. And maybe one of you can help me with that.

Commissioner Balbis.

COMMISSIONER BALBIS: Thank you, Mr. Chairman. And I, I agree with all that you said. I think one of the things that we do need to point out, and again back to the discussion with staff, was that -- because I asked the question, well, why not have a 10% ratio, equity/debt ratio? And if you look at the curve, they can earn, you know, 16, 18, 20%. And staff indicated that there was a cap, you know, a limit on the 40%. So there was some arbitrary decision-making that was, that was done, recognizing that this formula is just an approximation of what an appropriate ROE should be.

You know, again back to the utility's indication that it would not limit their ability to attract capital or operate, you know, I would, I would support staff's recommendation in this. I would hope that if the utility does challenge this, there's some way to do it without going through the lengthy process you described. I'm not sure what that is, but I would be certainly open to, to hear that. But, but, again, based on all the discussions today, I move that we support staff's recommendation on this issue.

CHAIRMAN BRISÉ: Okay. Is -- before you move, let's see, we have Commissioner Edgar, let's see what she has to say first. But thank you.

COMMISSIONER EDGAR: Thank you, Mr. Chairman. And I'm glad to second the motion, but I did want to make a comment or two. And I was going to comment and then make the motion. So we're, we're thinking along the same lines, which is always nice.

I too agree, Mr. Chairman, with your comments and am of like mind. I do believe, you know, formulas are appropriate in certain circumstances; however, it is also within our jurisdiction to exercise discretion as we look at those formulas and the numbers that derive thereby and not just rubber stamp a number that comes out at the other end once the inputs are made.

I would slightly disagree with Commissioner Balbis' characterization of the 40% threshold as being arbitrary. I think a good deal of thought and analysis went into that decision at that point in time. And I recall the exercise and discussion that we had back, and I wouldn't have been able to say the year, but if you say 2008 when this Commission did take testimony and did take a very, very careful and fresh look again at the leverage formula and how it had worked in the past and if indeed it remained current as a tool for us to use. And I was part of that decision and believed that the correct decision was made.

So with all of that, again, I'm glad to either make or second the motion, whichever posture we are in, and that we approve the staff recommendation.

CHAIRMAN BRISÉ: So, Commissioner Balbis, you made a motion on all issues.

COMMISSIONER BALBIS: Yes.

CHAIRMAN BRISÉ: It was seconded by Commissioner Edgar. All in favor, say aye.

(Vote taken.)

All right. Seeing that, this item has been voted affirmatively, so therefore we are going to adjourn.

(Agenda item concluded.)

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, CRR, Official Commission Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 22nd day of June, 2012.

Linda Boles

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