

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

NOTICE OF WORKSHOP

TO

ALL INTERESTED PERSONS

RE: UNDOCKETED

WATER AND WASTEWATER RETURN ON EQUITY WORKSHOP

ISSUED: January 25, 1995

NOTICE is hereby given that the Florida Public Service Commission will conduct a workshop, in the above-referenced matter, to which all persons are invited, at the following time and place:

9:30 a.m., Thursday, February 23, 1995
Room 106, Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399-0870

PURPOSE

The purpose of this workshop is to discuss and evaluate the methodologies for determining the return on equity for the water and wastewater industry. A copy of relevant issues to be discussed is attached to this Notice. Workshop participants should review the issues and be prepared to comment on and/or discuss them.

Parties who wish to comment but cannot attend the workshop are encouraged to file comments with the Division of Records and Reporting, Fletcher Building, 101 East Gaines Street, Tallahassee, Florida, 32399-0870, on or before February 16, 1995, specifically referencing "Undocketed Water and Wastewater Return on Equity Workshop."

A copy of the agenda for this workshop may be obtained by writing to the Director, Division of Records and Reporting, at the address previously noted.

Any person requiring some accommodation at this workshop because of a physical impairment should call the Division of Records and Reporting at (904) 488-8371 at least five calendar days prior to the workshop. Persons who are hearing or speech impaired, should contact the Florida Public Service Commission using the Florida Relay Service, which can be reached at (800) 955-8771 (TDD).

JURISDICTION

Jurisdiction is vested in this Commission pursuant to Chapter 367, Florida Statutes. The workshop will be governed by the

DOCUMENT NUMBER-DATE

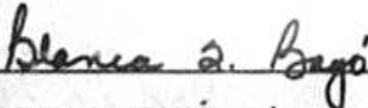
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provisions of that Chapter and Chapters 25-22 and 25-30, Florida Administrative Code.

By DIRECTION of the Florida Public Service Commission, this
25th day of January, 1995.



BLANCA S. BAYO, Director
Division of Records and Reporting

(S E A L)

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ATTACHMENT A

General Information

Pursuant to Section 367.081(4)(f), Florida Statutes, the Commission uses a leverage formula to calculate an authorized return on equity for Florida water and wastewater utilities. The leverage formula sets a range of returns on equity for an average water or wastewater utility. The Commission has used the leverage formula for setting the return on equity for the entire water and wastewater industry.

An authorized return on equity provides utility companies the opportunity to earn a fair return on its investment. The return on equity measures what the Commission considers to be that fair return of shareholder equity. The Commission has directed its Staff to review the methodology currently in use for determining the leverage formula. On December 1, 1994, Staff held a workshop in Orlando, Florida, in order to discuss issues related to the methodology.

The purpose of this workshop is to review the current leverage formula and determine if changes need to be made. Participants are encouraged to present alternatives to the current formula. Parties who wish to submit materials for the Commission's and participants' review and discussion should submit them to Ann Causseuax, Division of Auditing and Financial Analysis, by February 14, 1995, so that they may be copied and distributed.

Issues

1. The current leverage formula, established by Order No. PSC-94-1051-FOF-WS, issued August 29, 1994, is based on the financial theory that the lower the equity ratio (percentage of common equity to total debt and equity), the higher the demanded return on equity (ROE) and vice versa. However, to discourage imprudent financial risk, the Commission does not allow for returns greater than the level indicated at a 40% equity ratio. Should the Commission's use of a minimum equity ratio of 40% in the leverage formula be modified or changed? Please explain what changes would lead to a more reasonable approach.
2. The Commission employs an average of two financial models to estimate ROE for the water and wastewater industry, a discounted cash flow (DCF) model and a risk premium analysis. The present input into these models is readily available historical and prospective market information.
 - a. Are there other valuation models that would more reasonably reflect the average ROE for the industry? If

so, please described the methodology used by such models.

- b. Would other valuation models rely on historical market information or prospective information?
3. The current valuation models use quarterly compounding. Should ROE models use annual or quarterly compounding? Please explain.
4. The current DCF model employed in the derivation of the leverage formula is applied to an index of large, publicly traded water utilities. Most of these companies have no operating systems in Florida. Is this a reasonable approach? If not, provide details as to a more reasonable index of companies which reflect the ROE for an average water or wastewater utility and where to readily obtain such information.
5. The current risk premium analysis employed in the derivation of the leverage formula is applied to an index of natural gas distribution utilities. Is this a reasonable approach? If not, provide details as to a more reasonable index of companies and where to readily obtain such information.
6. In the development of the leverage formula, the Commission assumes a Moody's Baa bond rating for all Florida water and wastewater utilities. There is a bond yield differential adjustment to reflect the difference in size between the index companies and typically small Florida utilities.
 - a. Is an assumed bond rating of Baa reasonable for all Florida utilities?
 - b. If not, what bond rating should the Commission use?
 - c. Does the bond yield adjustment accurately reflect the difference in size between the index companies and Florida utilities?
 - d. Should the Commission recognize the differences in size of utilities within the Florida industry?
 - e. What alternatives to a bond yield differential should the Commission employ to recognize the difference in risk between Florida utilities and the companies in the indices?

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7. Florida water and wastewater utilities may be unique with respect to other utilities across the nation.
 - a. What risk factors are unique to the water and wastewater industry?
 - b. What risk factors are unique to the Florida water and wastewater utilities?
 - c. How should the Commission quantify this risk?
8. Other than higher ROE's, what regulatory policies would enhance the opportunities of water and wastewater utilities to earn a reasonable rate of return?

FLORIDA PUBLIC SERVICE COMMISSION - RECORDS AND REPORTING

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M E M O R A N D U M

JANUARY 23, 1995

RECEIVED
JAN 25 1995
12:45
FPC-RECORDS/REPORTING

TO: DIVISION OF RECORDS AND REPORTING
FROM: DIVISION OF LEGAL SERVICES (WAGNER) LW
RE: UNDOCKETED - RETURN ON EQUITY FOR NATURAL GAS

Attached is a NOTICE OF WORKSHOP with attachments, to be issued in the above-referenced docket. (Number of pages in Notice - 4)

LW/js
Attachment
cc: Division of Electric and Gas
~~I-NWGASROE.LW~~

Location
GAS ROE. NOT

OK
CP