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October 30, 2017

Carlotta S. Stauffer, Director
Office of Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 20170006; Office of Public Counsel's comments regarding the current leverage formula for water and wastewater utilities authorized by Section 367.081(4)(f), F.S.

Dear Ms. Stauffer:

The Office of Public Counsel (OPC) hereby submits its comments regarding suggested changes to the leverage formula methodology as requested in the Commission's Notice of Staff Workshop dated August 22, 2017, regarding the applicability of the leverage formula methodology used to establish the annual authorized range of returns for water and wastewater utilities.

1. Leverage Formula Rule. OPC submits that the Commission should adopt a rule setting forth the leverage formula. The Commission has applied a leverage formula methodology, with some modifications, for more than 30 years. OPC contends that the current formula methodology has flaws; however, the continued application of this policy constitutes an unadopted rule. Thus, OPC requests the Commission to initiate rulemaking procedures such that this formula is properly promulgated by rule.

2. Bond Yield Differential Adjustment. On pages 7 and 8 of Order No. PSC-08-0846, the Commission stated that it is appropriate to make a bond yield differential adjustment in the derivation of the water and wastewater (WAW) equity leverage formula. This adjustment recognizes the incremental difference in risk between the companies in the natural gas index and the average WAW utility in Florida. OPC submits the following issues should be considered regarding the bond yield differential adjustment:

a. If the Commission changes from an index of publically traded natural gas utilities to an index of publically traded water and/or wastewater utilities, what adjustment (if any) should be made to the bond yield differential adjustment?

b. Would the Commission change the following assumption used in the current formula: "the assumed bond rating for the average WAW utility in Florida is Baa3"? Does this assumption still hold true today?

c. Would there be a differential added for a large WAW utility that actually has a bond rating equal to the average index of WAW companies included in the proxy group?

3. Utility Size. OPC submits the leverage formula should differentiate between large Class A utilities as compared to smaller Class B and Class C utilities. Depending on the creditworthiness of their owners, all things kept the same, Class A utilities should have better access to capital (debt and equity) than Class B or Class C utilities; therefore, Class A utilities do not need the private placement or small-utility risk premiums.

4. Private Placement Premium. OPC submits the private placement premium of 50 basis points should be removed from the formula for Class A utilities. The Commission has previously included this to reflect the difference in yields on publicly traded debt and privately placed debt, which is illiquid. Investors allegedly require a premium for the lack of liquidity of privately placed debt. OPC does not believe this is true for large WAW utilities that are owned by substantially larger corporations. Further, OPC questions why this premium is fixed and why 50 basis points is reasonable.

5. Small-Utility Risk Premium Adjustment. OPC submits the small-utility risk premium adjustment should be removed from the formula. First, adding in a small-utility risk premium is duplicative of the bond yield differential as the risk due to size is already accounted for by the bond yield adjustment and the private placement premium included in the leverage formula. Second, the previously approved 50 basis point adjustment allowed for all WAW utilities ignores the fact that several utilities in Florida could be comparable to the water utilities included in the new index. Further, OPC questions why this premium is fixed and why 50 basis points is reasonable.

6. Flotation Costs. OPC submits flotation costs should not be considered in the Discounted Cash Flow (DCF) and Capital Asset Pricing Model (CAPM) analyses. "Flotation costs are incurred by a publicly traded company when it issues new securities, and includes expenses such as underwriting fees, legal fees and registration fees."[1] None of Florida's WAW utilities are publically traded; therefore, this cost should not be included in the leverage formula.

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[1] http://www.investopedia.com/terms/f/flotationcost.asp

7. <u>Leverage Formula Results Not Applied.</u> From 2012 through 2017, the Commission found that the range of returns on equity derived from the annual leverage formulas were not optimal for determining the appropriate authorized ROE for WAW utilities due to Federal Reserve monetary policies that resulted in historically low interest rates. In each of those years, this Commission approved continuing the use of the range of returns on equity from the 2011 leverage formula docket. OPC submits that the continued reliance on old data from 2011 is inconsistent with the purpose of adopting a leverage formula methodology. If the current formula produces "less than optimal results," then it should be updated. Until it is updated, the results of the current leverage formula should be used regardless of the outcome. Furthermore, if the Commission intends to continue applying exceptions to the formula, the exceptions should be codified in a rule.

Respectfully submitted,

<u>/s/ Erik L. Sayler</u>

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