

FLORIDA PUBLIC SERVICE COMMISSION

Docket No [REDACTED]

ORIGINAL
FILE COPY

Direct Testimony
of
John F. Guastella
Regarding Application of
Palm Coast Utility Corporation
for
Increased Water and Sewer Rates

DOCUMENT NO.
Replacement for
13065-98
12/27/95

1 Q. Please state your name and business address.

2 A. John F. Guastella, P.O. Box 371, Peapack, New Jersey.

3

4 Q. What is your occupation?

5 A. I am President of Guastella Associates, Inc. I am a licensed Professional Engineer,
6 and I have been actively engaged in matters involving utility valuations, management,
7 rates and service for thirty-three years. I formed Guastella Associates in 1978 to
8 provide consulting services, specializing in water and sewer utilities.

9

10 Q. Please state your educational background and professional experience.

11 A. I graduated from Stevens Institute of Technology in June of 1962, receiving a degree
12 in Mechanical Engineering. I have completed courses in utility regulation sponsored
13 by the National Association of Regulatory Utility Commissioners (NARUC) and
14 conducted by the University of South Florida, Florida Atlantic University, the
15 University of Utah and Florida State University.

16 I was employed by the New York State Public Service Commission for sixteen
17 years from 1962 to 1978. With the exception of two years in which I was involved
18 in the regulation of electric and gas utilities, my time with the New York Commission
19 was devoted to the regulation of water utilities. After a series of promotions during
20 the years 1962 to 1970, attained through competitive examinations, I was promoted
21 to Chief of Rates and Finance in the Commission's Water Division. In 1972 I was
22 made Assistant Director of the Water Division. In 1974 I was appointed by the
23 Chairman of the Commission as Director of the Water Division, a position I held until
24 my resignation from the Commission in August of 1978.

25 My duties with the Commission included the performance and supervision of

1 various engineering and economic studies concerning valuation of utility property,
2 financing rates and service of electric, gas and water utilities. While in the Water
3 Division, I either examined or supervised the examination of the books and records
4 of literally hundreds of water utilities.

5 As Director of the Water Division, I was responsible for the regulation of
6 more than 450 water companies in New York State, heading a professional staff
7 consisting of 32 engineers and three technicians. One of my primary duties was to
8 advise the Commission during its adjudication of formal proceedings, as well as other
9 matters. In the course of those deliberations, testimony, exhibits and briefs submitted
10 in formal proceedings were reviewed and analyzed. My duties and responsibilities
11 covered such subjects as the reasonableness of investments in utility plant, appropriate
12 depreciation, contributions in aid of construction, advances in aid of construction,
13 construction work in progress, working capital, amortizations, rate base, revenue
14 level, operation and maintenance expenses, taxes, cost of capital, fundable capital,
15 financing, capital structure, rate of return, rate design, rate structure, quality of
16 service, and in general, all aspects of utility valuation, rate setting and service.

17 Another major responsibility was the review of all proposed legislation
18 affecting water utilities in New York and the subsequent preparation of
19 recommendations for use by the governor or the legislature in considering such
20 legislation. I also made legislative proposals and participated directly in drafting bills
21 that were enacted: one expanded the New York Commission's jurisdiction with
22 respect to the regulation of the service provided by small water companies and
23 another dealt specifically with rate regulations and financing of developer-related
24 water systems. During my employment with the New York Commission, I handled
25 or supervised the handling of thousands of consumer complaints by individuals,

1 corporations and municipal, governmental and political officials.

2 Concurrently with my position as President of Guastella Associates, Inc., I
3 served as President of Country Knolls Water Works, Inc. from 1987 to 1991,
4 directing the management and operation of this utility which served some 5,000
5 customers.

6 I have prepared appraisals and valuations of utility property, depreciation
7 studies, rate analyses, cost allocation and rate design studies, and management and
8 financial analyses. I have provided consulting services for municipal and investor-
9 owned water and sewer utilities, as well as gas utilities and solid waste collection and
10 disposal companies.

11

12 Q. Before what regulatory agencies and municipal jurisdictions have you previously
13 presented expert testimony?

14 A. I have testified as an expert witness in the states of Connecticut, Florida, Illinois,
15 Massachusetts, Nevada, New Jersey, New York, North Dakota, Ohio, Pennsylvania,
16 Rhode Island, Texas and Virginia.

17

18 Q. Briefly state your activities in connection with professional organizations and
19 associations.

20 A. I served as Vice-Chairman of the Staff-Committee on Water of the National
21 Association of Regulatory Utility Commissioners (NARUC). While on that
22 committee, I prepared a 95 page instruction manual entitled, "Model Record-Keeping
23 Manual for Small Water Companies," which was published by the NARUC. The
24 manual describes in detail the kinds of operating and accounting records that should
25 be kept by small water utilities, with instructions on how to use those records in order

1 to properly operate a water system and properly keep account of the cost of providing
2 service.

3 Since 1974 I have prepared the rate case study material, assisted in the
4 coordination of the program and served as an instructor at the Annual Fall Seminar
5 on Water Rate Regulation sponsored by the NARUC and conducted by the University
6 of South Florida, Florida Atlantic University, University of Utah, and currently
7 Florida State University. This seminar is recognized as being one of the best in the
8 country for teaching rate-setting principles and methodology. It is attended by
9 representatives of regulatory agencies, utilities, engineering, accounting, economic
10 and law firms throughout the country. In 1980, as a special consultant to NARUC,
11 I assisted in the establishment of another similar seminar which has been held annually
12 in the spring in the western United States.

13 I served as an instructor and panelist in a seminar on water and sewer utility
14 regulation conducted by the Independent Water and Sewer Companies of Texas. As
15 a member of the National Association of Water Companies (NAWC), I serve on its
16 Rates and Revenue Committee and Small Company Committee. I am a member of
17 the American Water Works Association and served on its Water Rates Committee,
18 and assisted in the preparation of the AWWA Rates Manual, Third Edition. I have
19 also served on a joint committee on rate design composed of staff members of
20 NARUC and NAWC. In connection with my serving on these committees, and in
21 connection with cost allocation and rate design studies I have performed in the course
22 of my work, I have participated in decisional meetings to determine proper
23 engineering and construction criteria in relation to costs in the design of water and
24 sewer systems.

25 I have prepared and presented papers at a number of meetings of the National

1 Association of Water Companies, the National Association of Regulatory Utility
2 Commissioners, the New England Conference of Public Utilities Commissioners, and
3 at meetings of the Mid-America Regulatory Conference, the Public Utility Law
4 Section of the New Jersey Bar Association, the Pennsylvania Environmental Council,
5 the Southeastern Association of Regulatory Utility Commissioners, and the New
6 Jersey Chapter of the American Water Works Association.

7
8 Q. What is the nature of your involvement in this rate case?

9 A. My firm has been engaged by Palm Coast Utility Corporation ("PCUC" or
10 "Company") to prepare used and useful analyses of its water and sewer systems and
11 to perform a cost allocation study in order to establish a rate for the sale of effluent
12 reuse for irrigation purposes. We have also coordinated our efforts with those of Mr.
13 Frank Seidman, the Company's consultant who is responsible for other revenue
14 requirement and rate matters, and assisted in the preparation of the MFRs.

15
16 Q. What is the scope of work you performed in connection with these studies?

17 A. Together with Mr. Seidman and in cooperation with the Company's employees, I
18 have examined PCUC's books and records, financial and operating data, and I have
19 inspected the physical plant and facilities of both the water and sewer systems. I
20 would note that the Company is not subject to any consent order and, in my opinion,
21 is providing safe and adequate service.

22
23 Q. Have you prepared or supervised the preparation of any exhibits?

24 A. Yes. I prepared a used and useful analysis, Exhibit ____ (JFG-1) and a cost allocation
25 study to determine a rate for the sale of effluent reuse water, Exhibit ____ (JFG-2).

1 Q. Would you please describe the used and useful analysis?

2 A. The used and useful analysis contains a narrative section and a section setting forth
3 various tables and computations which determine the percentage of utility property
4 to be considered used and useful and includable in rate base and, conversely, the non-
5 used and useful percentage to be excluded from rate base for rate-setting purposes.
6 The narrative section explains the methodology used to determine the amount of used
7 and useful property, and also explains the basis for the calculations set forth in the
8 various tables.

9

10 Q. Would you please explain what you mean by “used and useful?”

11 A. The term “used and useful” is simply a regulatory rate-setting term which describes
12 the cost of property which is included in a utility’s rate base (net investment) upon
13 which the utility is entitled to earn a rate of return. The balance of the cost of
14 property which is excluded from rate base is referred to as “non-used” plant.

15 The reason for performing this type of allocation study is to have existing
16 customers pay rates based on the cost of plant necessary to provide safe and adequate
17 service to them on a reasonably continuous basis and, therefore, preclude any
18 subsidization of future customers by existing customers.

19

20 Q. Is there a prescribed method for performing used and useful analyses?

21 A. No. Such analyses require many allocations as to different kinds of utility property
22 and facilities. Those allocations must be based on judgement of such factors as
23 equipment design and utilization, system demands and characteristics, and the
24 interrelationship of each kind of equipment or facility within a system. No two utility
25 systems are alike in design, utilization and system characteristics. Moreover, utility

1 systems are constantly changing with respect to plant and function as customer
2 demand and system characteristics change, as new equipment becomes available and
3 as regulatory requirements and standards change.

4

5 Q. What procedures did you undertake to understand the Company's operations in
6 connection with the preparation of the used and useful analysis?

7 A. I made a physical inspection of the system with Company operators and engineers in
8 order to identify the plant and equipment which is being utilized to provide service.
9 I examined operational data as to system capacities, system demands, customer
10 growth and various other statistical data. Books and records were examined in order
11 to establish the cost of plant as categorized by primary plant account. Meetings were
12 held with Company accountants, engineers and operators in order to establish
13 appropriate allocation factors and to review each phase of the used and useful
14 analysis.

15

16 Q. Did you summarize the results of your used and useful analysis?

17 A. Yes. Table A-1 of the used and useful exhibit is a summary showing the primary plant
18 accounts for the water system and respective non-used and useful percentages. Table
19 I-1 is a summary of the used and useful percentages for the sewer system. These
20 percentages were then applied to the pro forma plant balances which include projected
21 1995 year-end figures.

22

23 Q. Did you prepare the used and useful analysis in the Company's last two cases?

24 A. Yes.

25

1 Q. Is the study you prepared for this case similar?

2 A. Yes. As I indicate in the narrative of the used and useful study, this study
3 incorporates most of the findings of the FPSC in the last rate case as set forth in Order
4 No. 22843. I have repeated the methodology for those used and useful allocations
5 accepted by the FPSC, and made adjustments to my previous methodology in some
6 instances to conform to the FPSC findings in order to avoid unnecessary controversy.
7 I have also incorporated calculations to recognize prudence and economies of scale
8 considerations under discussion in the FPSC workshop on the establishment of rules
9 as to used and useful.

10

11 Q. Would you briefly summarize those items in the used and useful study, which were
12 accepted by the FPSC in the last case?

13 A. In the last case, the FPSC accepted the Company's overall methodology of calculating
14 used and useful adjustments. For both water and sewer systems, the FPSC adopted
15 the allowance of margin reserve, recognizing that utilities cannot reasonably assume
16 safe and adequate service if they do not have margin reserve capacity beyond the
17 capacity needed for immediate demands. In order to provide such service, they must
18 construct systems with margin reserve capacity, and they must pay for that capacity.
19 The FPSC also recognized that the need for margin reserve capacity is current -- to
20 meet changing demands of existing customers as well as growth -- and the cost of that
21 capacity is current. Accordingly, the FPSC found that the allowance for margin
22 reserve is essential.

23 The water treatment plant and storage facilities are separately treated,
24 consistent with the FPSC decision, with the used and useful percentage for the
25 treatment plant based on the maximum day plus fire demands, and the used and useful

1 percentage for the storage facilities based on equalization plus fire demands. The fire
2 demands are based on 2,000 GPM for five hours, as accepted by the FPSC in the last
3 case. The treatment capacity is also adjusted by 13.3% of rated capacity to allow for
4 plant uses. Although this level is less than the actual level of plant uses for chemical
5 processing and filter backwashing (14.2% of average filtered water), it is more than
6 the 10% allowed by the FPSC in the last case, because the actual data consistently
7 supports a level greater than 10%.

8 The FPSC accepted the Company's allocation of transmission and distribution
9 mains to used and useful on the basis of the ratio of ERCs, adjusted for margin
10 reserve, to total lots capable of being served, recognizing that the transmission mains
11 are not installed to serve the entire service area. The water mains are also adjusted
12 to recognize that, in addition to the size and distance necessary to meet the demands
13 of customer usage, mains must have sufficient capacity for fire flows.

14 With respect to the gravity and PEP portions of the sewer collection system,
15 the FPSC accepted the density analysis based on the ratio of ERCs to total lots, as
16 well as the detailed analysis of the force mains. The lift stations were analyzed
17 individually as to flows and capacity; the method was accepted by the FPSC.

18 The used and useful percentage of services for both water and sewer are based
19 on the ratio of ERCs to total services. The used and useful percentage for hydrants
20 is based on the ratio of used hydrants to total hydrants.

21
22 Q. With respect to the margin reserve and the issue of imputation of CIAC, does it make
23 a difference if one source of funding of utility plant is from "pre-paid" CIAC?

24 A. No. The real estate arrangements between a developer and potential utility customers
25 to prepay service availability charges should not impact used and useful calculations.

1 While CIAC is deducted from rate base in full when a potential customer actually
2 connects to the system, it should not be deducted before there is a connected
3 customer who is paying rates for service. The level of prepaid CIAC related to future
4 customers is not related to margin reserve. Instead, it is simply a provision which
5 enabled the affiliated developer to offset part of the carrying costs associated with the
6 formation of a new utility. Indeed, the FPSC has recognized that carrying costs
7 associated with the cost of utility plant for future customers (beyond the “margin
8 reserve” plant) should be borne by future customers. Thus, the FPSC established the
9 AFPI charge (allowance for funds prudently invested) which recovers the carrying
10 costs of future use (“non-used and useful”) plant. While prepaid CIAC should
11 properly be considered as an offset in calculating AFPI charges, it is not proper to use
12 prepaid CIAC as an offset to margin reserve or any other component in a used and
13 useful calculation.

14 As discussed in the FPSC workshop on used and useful rules, water and sewer
15 utilities should be encouraged to construct prudently-sized systems capable of
16 providing safe and adequate service on a continuous basis to all customers and
17 whenever those customers connect. The imputation of CIAC, whether or not prepaid
18 CIAC exists, would reduce used and useful plant related to margin reserve, and give
19 utilities an improper signal. Utilities would be in better financial condition to install
20 more costly, smaller facilities that will be 100% used and useful without margin
21 reserve allowances, thereby avoiding the imputation of CIAC. Ultimately, however,
22 the rates for all customers would be higher.

23
24 Q. Would you please describe Exhibit ____ (JFG-2) which sets forth the cost allocation
25 and effluent reuse rate study?

1 A. This exhibit contains an allocation of PCUC's proposed revenue requirement
2 components. It includes various tables, as well as a narrative, which describe the
3 allocations and the resultant effluent reuse rate.

4

5 Q. What effluent reuse rate was produced by your study?

6 A. My study produced an effluent reuse rate of \$0.67 per 1,000 gallons, reflecting costs
7 associated with the Company's 1.0 MGD RIB and 6 million gallons effluent storage
8 tank. These facilities are necessary to meet wet weather effluent flow and furnish
9 effluent reuse water for irrigation of public access areas.

10

11 Q. What amount of revenues would be generated under the application of the effluent
12 reuse rate?

13 A. At this time the Company anticipates that DCDD will take an average of 800,000
14 gallons per day of effluent reuse water, which would produce \$195,640 of additional
15 annual revenues.

16

17 Q. Does this complete your testimony at this time?

18 A. Yes.

19

20

21

LIST OF EXHIBITS

		<u>Short Title</u>
Exhibit ____	(FS-1)	Minimum Filing Requirements, Vol. I, Financial, Rate & Engineering Schedules, Including Interim Rate Schedules
Exhibit ____	(FS-2)	Minimum Filing Requirements, Vol. II, Billing Analysis Schedule E-14
Exhibit ____	(FS-3)	Minimum Filing Requirement, Vol. III Additional Information Required by Rules
Exhibit ____	(FS-4)	Analysis of Operating Departments for Used and Useful
Exhibit ____	(FS-5)	Application for Approval of Revised Service Availability Charges
Exhibit ____	(JFG-1)	Used and Useful Analysis, Utility Plant in Service
Exhibit ____	(JFG-2)	Effluent Rate Study, Cost Allocation

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application by PALM COAST
UTILITY CORPORATION for rate)
increase in Flagler County)

Docket No. 951056-WS

A F F I D A V I T

STATE OF: FLORIDA

COUNTY OF: FLAGLER

BEFORE ME, personally appeared James A. Perry, who, after being duly sworn on oath, deposes and says that pursuant to the requirements of Rule 25-30.436(1)f, F.A.C., Palm Coast Utility Corporation will comply with Rule 25-22.0407, F.A.C.

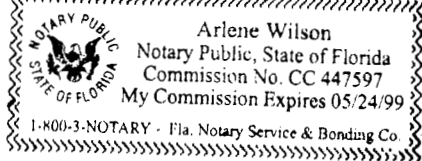
FURTHER AFFIANT SAYETH NOT.

James A. Perry
JAMES A. PERRY
Vice President of Finance
Palm Coast Utility Corporation

SWORN TO and SUBSCRIBED BEFORE me on this 27th day of December, 1995. (PERSONALLY KNOWN TO ME)

Arlene Wilson
NOTARY PUBLIC
State of Florida at Large

My Commission Expires:



APPENDIX "A"