

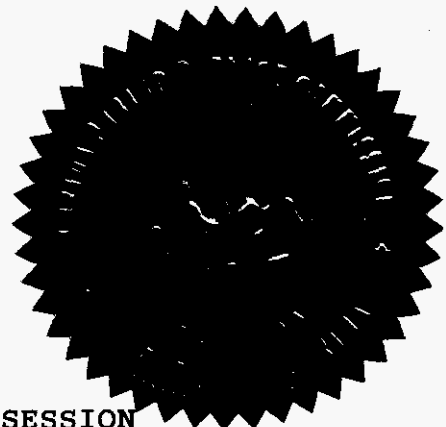
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

DOCKET NO. 950495-WS

Application for rate increase and
increase in service availability
charges by Southern States Utilities,
Inc. for Orange-Osceola Utilities,
Inc. in Osceola County, and in
Bradford, Brevard, Charlotte, Citrus,
Clay, Collier, Duval, Highlands,
Lake, Lee, Marion, Martin, Nassau,
Orange, Osceola, Pasco, Putnam,
Seminole, St. Johns, St. Lucie,
Volusia, and Washington Counties.



SEVENTH DAY - EVENING SESSION

VOLUME 29

Pages 3341 through 3392

PROCEEDINGS:

HEARING

BEFORE:

CHAIRMAN SUSAN F. CLARK
COMMISSIONER J. TERRY DEASON
COMMISSIONER JULIA L. JOHNSON
COMMISSIONER DIANE K. KIESLING
COMMISSIONER JOE GARCIA

DATE:

Tuesday, May 7, 1996

TIME:

Commenced at 9:00 a.m.

PLACE:

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

REPORTED BY:

JANE FAUROT, RPR

(Appearances as heretofore noted.)

I N D E X

WITNESSES

Name:	Page
GREGORY SHAFER	
Continued Cross Examination by Mr. Twomey	3343

P R O C E E D I N G S

(Transcript continues in sequence from Volume 28.)

GREGORY SHAFER

resumed the stand on behalf of the Florida Public Service Commission Staff, and having previously been duly sworn, testified as follows:

CONTINUED CROSS EXAMINATION

BY MR. TWOMEY:

Q Well, if we took that as the motivation, why would you -- why would the Commission want to implement conservation rates for plants that have low costs?

A Because typically low cost plants would equate to service areas with low rates. Low rates are -- or relatively low rates, that is relative in comparison to other similar systems, does not do anything to manage consumption.

Q Okay. Would you agree with me that it would be most logical to attempt to ascertain where water is scarce and concentrate your efforts on conservation in those areas first?

A I think those kinds of decisions depend on a variety of variables, and I'm not ready to just generically agree with that statement. Certainly you want to look at where the need to conserve is most critical, but you also want to look even in those areas where the need is not as

1 strong to conserve if you have exceedingly high consumption
2 levels, I think it's important to address those, as well.

3 Q Why is that? Why should one care, Mr. Shafer,
4 about consuming large amounts of water if there are large
5 amounts of water there to be consumed?

6 A I believe that we should care particularly in a
7 state like Florida, where although there may be pockets of
8 over abundance, if that's a characterization that you want
9 to make, I think it's important for a long-term outlook to
10 educate customers, and to educate utilities, and so forth to
11 conserve, because in the long-run, I believe that water is a
12 finite resource, or at least -- it is a renewable resource,
13 but it's one that we need to manage effectively as our
14 population continues to grow.

15 Q Would you agree with me that water as a problem is
16 primarily one of -- it's almost like the maxim of real
17 estate agents, it's location, location, location. Would you
18 agree with me that water as a problem in terms of its
19 availability should be addressed on a location specific
20 basis?

21 A Again, I can't make that leap. My personal belief
22 is that water resources in the State of Florida need to be
23 managed for the long-term.

24 Q Okay.

25 A And I don't believe that that should be a location

1 specific approach necessarily.

2 Q Let me try this question. If one were to attempt
3 to address conservation of water and had limited resources
4 with which to do it, where would you advise them to start
5 first, in areas where there is a water availability problem
6 or areas where there is a relative abundance of water? And
7 the question is this, if you have to make your election, do
8 you go to the areas where there is scarcity first or where
9 there is abundance?

10 A If you have to choose one, obviously I think you
11 have to choose where there is a scarcity first. But, again,
12 my view tends to be more global and more generic, and I
13 don't think that you can ignore excessive consumption even
14 in areas where availability is relatively high.

15 Q Let me ask you this, Mr. Shafer. Is it the
16 staff's plan as of right now to recommend to this Commission
17 at the conclusion of this case that the proper rate
18 structure for this utility is some type of inverted rate
19 charge that would be based upon the notion of conservation
20 and would charge a surcharge per thousand gallon consumption
21 over some cap level?

22 MS. CAPELESS: Objection, that calls for
23 speculation.

24 MR. TWOMEY: No, it doesn't necessarily. I'm
25 asking him if he knows of his own knowledge right now if

1 that is not the plan of this staff.

2 MR. FEIL: Commissioner, I have an objection, too.
3 I believe it's outside the scope of his direct testimony.
4 He doesn't testify about staff plans, he is only testifying
5 generally about rate structure.

6 MR. TWOMEY: Madam Chairman, the notion that this
7 is outside the scope of his testimony is absurd. His whole
8 testimony is of rate structure, and for me to ask him a
9 question about what he knows about what the plan -- he is a
10 staff witness, what the plan the staff proposes to do is
11 certainly within the scope of his testimony.

12 CHAIRMAN CLARK: Tell me again why it's within the
13 scope of his testimony.

14 MR. TWOMEY: Because he is testifying about rate
15 structure and what is appropriate here. I mean, this should
16 be -- Madam Chairman, this should be --

17 CHAIRMAN CLARK: Does he specifically talk about
18 what rate structure should be adopted or what reasonable
19 goals and objectives should be kept in mind in doing that
20 rate structure?

21 COMMISSIONER GARCIA: I just wanted to ask,
22 doesn't the heart of the objection talk about a formulation
23 of opinion which staff shouldn't have formulated yet?

24 MR. TWOMEY: I'm asking if they have. I don't
25 care if they have or not, Commissioner Garcia. I think it's

1 a reasonable question and we shouldn't be so defensive about
2 letting him answer.

3 COMMISSIONER GARCIA: I'm not. I'm not.

4 MR. TWOMEY: I don't mean you being defensive.

5 COMMISSIONER GARCIA: I'm curious if what you're
6 asking for would be impossible for him to provide anyway,
7 because it's something that staff should come up with that
8 position, I guess, a little bit further down the line.

9 MR. TWOMEY: It doesn't mean that it's impossible.

10 COMMISSIONER GARCIA: Is that why you're asking
11 it?

12 MR. TWOMEY: Yes. Madam Chairman, if the staff --
13 if the answer to the question is no, the Staff hasn't
14 decided what they are going to do and haven't planned it and
15 so forth, he can say so.

16 CHAIRMAN CLARK: Well, let me ask you, Mr. Twomey,
17 if you don't care what the answer is why are we asking the
18 question?

19 MR. TWOMEY: I do care what the answer is.

20 CHAIRMAN CLARK: Well, then I misunderstood you,
21 because I thought you said you didn't care what the answer
22 was.

23 MR. TWOMEY: I do care.

24 CHAIRMAN CLARK: All right. Let me hear your
25 question.

1 MR. TWOMEY: Let me be clear. What I meant to
2 tell Commissioner Garcia is I don't care if they have
3 already formulated a recommendation and figured out how they
4 are going to make a recommendation in this case. I don't
5 care about that, particularly. I do care what the
6 conclusion is if they have made one, and that's what I
7 wanted to ask him is, haven't they already decided what they
8 are going to do and isn't it --

9 CHAIRMAN CLARK: So you're asking him to his
10 knowledge?

11 MR. TWOMEY: Yes.

12 CHAIRMAN CLARK: I will allow the question

13 WITNESS SHAFER: Could you repeat the question,
14 please.

15 MR. TWOMEY: Yes, sir.

16 BY MR. TWOMEY:

17 Q To your knowledge, hasn't the staff concluded that
18 they will recommend as a rate structure in this case an
19 inverted block type rate structure that would involve a
20 conservation based surcharge per thousand gallons of
21 consumption over and above a certain cap level, let's say
22 10,000 gallons or whatever, and that the excess revenues
23 that would go from the conservation increase would go to
24 subsidize other areas?

25 A I don't have any idea what the staff intends to

1 recommend.

2 Q Okay. So you haven't discussed that with staff,
3 that being a possible solution, or have you?

4 A That's correct, I have not discussed it.

5 Q Okay. Now, let me ask you this, Mr. Shafer. If
6 your purpose -- would you agree with me that if your purpose
7 was to truly effect conservation of water, that you would
8 attempt to address rates that were aimed not just at low
9 cost plants, but wherever excessive consumption occurred,
10 would you agree with that?

11 A Yes.

12 Q Okay. And let me ask you this, why would you want
13 to take money that you obtained from charging a conservation
14 rate and use those monies or revenues, to offset high rates
15 in other service areas?

16 A The reason that would come to my mind would be to
17 attempt to mitigate excessively high rates in other areas.

18 Q And I take it that goes to the issue, the concern
19 you expressed of affordability, is that correct?

20 A Yes.

21 Q So you would take money from certain groups under
22 the guise of conservation, and you would use it to offset
23 higher rates in other service areas to achieve
24 affordability, is that correct?

25 A I believe that if the Commission chose to do that,

1 that would be one way to address affordability.

2 Q Let me ask you this, I think you indicate in your
3 experience that you have a Bachelor's Degree in Economics,
4 correct?

5 A I also have a Master's Degree in Economics.

6 Q Yes, sir, I was going to get to that. You have a
7 Master's Degree in Economics. Based upon your educational
8 background in economics, Mr. Shafer, would you agree with me
9 that if the Commission were to adopt this notion of taking
10 conservation revenues from extremely low cost plants and
11 using it to offset extremely high rates in other service
12 areas, that you would encourage consumption in the other
13 service areas with high rates by reducing their rate?

14 A That's not necessarily a certainty, but it might
15 happen.

16 Q And would you agree with me that whether or not it
17 occurred would depend upon in part the relative price
18 elasticities in the areas where the money was sent, would
19 you agree?

20 A That's correct.

21 Q Okay. Let me ask you this, you're not, are you,
22 taking any position on whether the Public Service Commission
23 has the statutory authority to impose conservation rates,
24 are you?

25 MS. CAPELESS: Objection, calls for a legal

1 response.

2 CHAIRMAN CLARK: I think he is just clarifying
3 that he is not providing testimony on that, is that correct?

4 MR. TWOMEY: Yes.

5 CHAIRMAN CLARK: I think he can answer that.

6 WITNESS SHAFER: I'm sorry, repeat the question
7 again.

8 MR. TWOMEY: Yes, sir.

9 BY MR. TWOMEY:

10 Q You're not suggesting by your statement in your
11 testimony here that the PSC does or does not have statutory
12 jurisdiction to set rates to effect conservation, isn't that
13 correct?

14 A That's correct. I'm not taking any legal position
15 on that.

16 Q Thank you. You say also at Page 5, Line 21, the
17 Commission has a role to play through pricing and education
18 in the protection and preservation of that resource, and the
19 resource being water, right?

20 A That's correct.

21 Q Where do you get the notion that the Commission
22 has a role to play through pricing to protect water
23 resources?

24 A In my experience with working with Class C water
25 and wastewater utilities in the staff assistance program, we

1 occasionally come upon situations where utilities having
2 their consumptive use permit renewed, contained in those
3 consumptive use permits is language that encourages or
4 requires that some type of conservation rate be implemented,
5 and since the Commission is responsible for setting rates,
6 that's where that comes into play.

7 Q Okay. Have you read the Brown and Caldwell
8 report?

9 A No, I have not.

10 Q The study. Did you read or listen to Doctor
11 Beecher's testimony?

12 A I was in the room for most of Doctor Beecher's
13 testimony.

14 Q Do you know enough about rate structure for water
15 and sewer utilities, Mr. Shafer, to have an opinion on
16 whether the base-facility rate structure and gallonage
17 structure is considered a water conserving rate structure?

18 A Well, I don't know if I have enough knowledge for
19 that, but I believe that to be true in some cases, yes.

20 Q Okay, sir. And isn't it true, if you know, that
21 the effectiveness of the base-facility gallonage rate
22 structure in effecting water conservation is based in great
23 deal on how much of the revenue assignment goes to the
24 gallonage charge versus the base-facility charge?

25 A There is a lot of things that impact whether or

1 not it encourages conservation, that would be one of the
2 things.

3 Q Right. And isn't it true, Mr. Shafer, that the
4 more revenue assignment that you take to the gallonage
5 charge, the greater the conservation effect?

6 A You would expect that, yes.

7 Q And isn't that because the customer more directly
8 feels through his or her consumption the actual cost of the
9 service?

10 A That's true.

11 Q And did you hear when I cross examined Doctor
12 Beecher that she agreed that conservation -- I recall her
13 saying, and you can correct me if I'm wrong -- that
14 conservation rates were most effective when rates sent the
15 price signal reflecting cost of service?

16 A I honestly don't recall whether she said that or
17 not. But, generally speaking, that's probably true.

18 Q Wouldn't you expect the greatest degree of
19 economic efficiency and, therefore, the ability of consumers
20 to make rational economic chooses when a rate is as close as
21 possible to cost?

22 A I'm assuming that when you say cost, you are
23 speaking of marginal cost, and in that case that would be
24 true.

25 Q Okay. On the same page, or Page 6, you say at

1 Line 12, "From time to time the Commission must deal with
2 troubled utilities that for whatever reason cannot seem to
3 provide safe, efficient, and reliable service, and cannot
4 afford to make the necessary improvements to do so." What
5 makes you take the position that the Commission must deal
6 with these type of troubled utilities?

7 A Again, in my experience working with Class C
8 utilities through the staff assisted rate case program, we
9 frequently have to field calls, complaints, calls from
10 county health departments or what have you, DEP, relating to
11 utilities that aren't paying their bills, they are harassing
12 customers, or a wide variety of things basically that we
13 have to respond to by virtue of having jurisdiction over
14 those utilities.

15 Q Okay. Let me see if we can explore that a little
16 bit more thoroughly. Isn't the Commission's responsibility,
17 or don't you agree with me that the Commission has the
18 responsibility primarily to engage in economic regulation
19 for these jurisdictional utilities?

20 A Primarily that would be true, yes.

21 Q And that the primary responsibility for other
22 areas, for example health, is left either to the DEP, or to
23 the several -- HRS or the health departments, would you
24 agree?

25 A Generally, that's true, yes.

1 Q Okay. And would you agree with me, Mr. Shafer,
2 that the water resources of this state -- responsibility for
3 the water resources of this state have been charged to the
4 Department of Environmental Protection and/or the five water
5 districts, water management districts?

6 A Again, I believe that's a shared responsibility,
7 as I indicated earlier. The Commission is frequently asked
8 to respond to requirements and so forth placed on utilities
9 by these agencies, and by virtue of that the Commission
10 becomes a player in that particular arena.

11 Q Okay. Now, I don't intend this to be a legal
12 question which may signal an objection, but you don't mean
13 to suggest, do you, or are you aware of any statute that
14 requires the Public Service Commission to engage itself in
15 water conservation?

16 A I'm not aware of any statutory obligation in that
17 regard.

18 Q Would you consider that SSU is what you would
19 consider to be a troubled utility in the context of your
20 statement on Line 13 of Page 6?

21 A Not in the context of my testimony, no.

22 Q Would you consider that SSU is a utility that
23 consists in part of systems, if you want, or if you prefer,
24 service area facilities that are troubled?

25 A I can't say that I have a lot of firsthand

1 knowledge about the nature of the service areas under
2 Southern States' umbrella.

3 Q Okay, sir. On Line 15 of that same page, you say
4 that frequently these situations result in abandoned
5 utilities. Now, my question to you is, are you aware or not
6 whether there is a statute, a Florida statute that deals
7 with the primary responsibility for dealing with abandoned
8 water and wastewater utilities?

9 A I'm aware that there is a statute.

10 Q And do you know who the primary responsibility
11 goes to?

12 A I believe the primary responsibility for finding
13 receivers for abandoned utilities falls on the county.

14 Q On counties?

15 A Yes.

16 Q You say that -- and I think you must be talking
17 about abandoned utilities -- you say at Line 16, "Usually
18 these facilities require major capital improvements which
19 will result in extremely high rates. A' has that been your
20 experience?

21 A Yes, that has been our experience on more than one
22 occasion.

23 Q Okay. And you say that if the customer base is
24 not able to afford those rates, or to cut way back on
25 consumption, they may refuse to pay or cut way back on

1 consumption. If this happens, the utility will not be
2 afforded an opportunity to earn its return and may wind up
3 in an abandonment situation. And my question to you is, who
4 else is there to pay for such major capital improvements if
5 not the customer base of the utility?

6 A No one.

7 Q But you go on on the next page and suggest a
8 solution, don't you, Mr. Shafer, when you say in part that
9 larger utilities may play a role in addressing the problem
10 of nonviable smaller facilities?

11 A I'm sorry, can you tell me which line you are
12 referencing?

13 Q Yes, sir, I'm sorry. It's Page 7, beginning at
14 Line 10. You say, "In addition, larger utilities may play a
15 role in addressing the problem of nonviable smaller
16 facilities," correct?

17 A That's correct.

18 Q And then you suggest that regionalization and
19 consolidation may be a possible solution, correct?

20 A That's correct, in some cases.

21 Q Yes. And you say that at the bottom of the page,
22 as well, and you say that I believe regionalization and
23 consolidation are possible ways to address compliance and
24 affordability for small utilities. And my question to you
25 is, is that isn't it true that regionalization and

1 consolidation aren't necessarily the solution without
2 uniform rates?

3 A I don't know that I necessarily agree with that.
4 Certainly when you have a larger utility that has a greater
5 ability to secure financing, whether or not you have uniform
6 rates, it's easier for that utility to come into a situation
7 and make the necessary improvements. Time and again what we
8 see with smaller utilities is that they cannot secure the
9 financing to make the necessary improvements to even get to
10 the point of setting rates. And so the system sits there in
11 a state of limbo, because there is not any money, and the
12 utility owners or whoever happens to be running the utility
13 at the time doesn't have the wherewithal to attract the
14 financing to make the improvements. So whether or not you
15 have uniform rates, it may well be advantageous to have a
16 larger, stronger, financially stronger utility take over a
17 smaller utility. It doesn't secure the problem of high
18 rates, but it certainly addresses quality of service, and
19 that is a plus.

20 Q Okay, sir. So would you agree with me, then, that
21 the benefit of greater financing options of a larger perhaps
22 regional utility is something that is totally independent of
23 rate structure?

24 A I don't know that it's totally independent of rate
25 structure, but it's also not -- rate structure can impact

1 that, but it's not the sole determinant.

2 Q Okay. Would you cite me one reason why rate
3 structure should have an impact on the ability of a
4 regionalized consolidated utility to obtain financing?

5 A I'm sorry, can you say that one more time.

6 Q Yes, sir. Can you give me one reason why the type
7 of rate structure a utility has should affect its ability to
8 obtain financing?

9 A Well, in a general sense, and probably up some
10 level from any individual scenario that you might create, I
11 believe that rate structure can impact the revenue stability
12 of a utility, and to the extent that one rate structure is
13 more stable or provides a more stable revenue stream than
14 another, then it has an impact on that utility's ability to
15 attract financing, I would think.

16 Q Okay. So that's a different reason than
17 conservation. We are going into revenue stability as
18 another means for verifying the selection of a rate
19 structure, correct?

20 A Yes, those are two different reasons, sure.

21 Q You say on Page 8 that the point of my testimony
22 on this matter is not to recommend an acquisition policy,
23 but to inform the Commission that rate design has an impact
24 on the decision of one utility to acquire another utility,
25 right?

1 A Correct.

2 Q And so is it your suggestion that, first of all,
3 it's desirable for this utility -- I mean, this PSC, this
4 Commission to encourage one utility to acquire others?

5 A I think it's desirable for this Commission to be
6 cognizant that rate structure has an implication in terms of
7 that utility's approach towards acquisitions.

8 Q Okay, sir. Mr. Shafer, have you ever read the
9 staff management audit that the Public Service Commission
10 conducted on Southern States Utilities?

11 MS. CAPELESS: Objection, that's outside the scope
12 of the testimony.

13 MR. TWOMEY: Well, he's talking about decisions on
14 acquisitions, Madam Chairman, and I'm going to suggest to
15 you that if you allow me to ask the question, the
16 Commission, at least the staff in the staff management audit
17 of SSU, had as either its first or second highest priority
18 the goal of making SSU positioned to be better situated to
19 acquire other utilities. And I want to ask him if he is
20 aware of that or not.

21 CHAIRMAN CLARK: You're going to ask him questions
22 about -- what was the document, again?

23 MR. TWOMEY: The staff management audit that the
24 Commission conducted on this utility. It was a major
25 discussion of Mr. Ludsen's testimony in the 199 docket, and

1 I wanted to ask him if he is familiar with that audit
2 report.

3 CHAIRMAN CLARK: Okay.

4 WITNESS SHAFER: No, I'm not.

5 MR. TWOMEY: Okay.

6 BY MR. TWOMEY:

7 Q You suggest that in the near future the Commission
8 will perform or may perform analyses on troubled utilities
9 in an attempt to assess whether they are viable over the
10 long-term. Is that something that is an ongoing project?

11 A I'm not sure it's a project at all. I believe
12 that at some point the Commission will be required to do
13 that, but -- I mean, I'm aware that some of our staff is
14 investigating methodologies to do that, but to my knowledge
15 we haven't conducted --

16 Q Would you agree with me, Mr. Shafer, that it would
17 be a lot more desirable to determine whether utilities will
18 be viable or not on the front end of their certification
19 instead of attempting to look at them after they are in
20 existence?

21 A Obviously, that's true, yes.

22 Q Okay. Do you believe that it's the proper goal or
23 option of the Commission to include incentives to larger
24 utilities for acquiring smaller utilities?

25 A I'm sorry, repeat that again, please.

1 Q Yes, sir. Do you believe it's a proper strategy
2 for the Public Service Commission to include incentives to
3 large utilities for acquiring smaller utilities?

4 A That depends entirely on whether the Commission
5 believes they have a role to play in addressing problems of
6 smaller utilities that may not be viable for the long-run.

7 Q Okay.

8 A If the answer is yes, then that's something they
9 need to consider. If it's no, then probably not.

10 Q Do you know, Mr. Shafer, whether the Florida
11 Public Service Commission still -- and this is in relation
12 to your testimony on Page 8 about independent utilities
13 versus those that are not -- do you know whether the Florida
14 Public Service Commission still approves for developer
15 related utilities, or any utility for that matter, water or
16 sewer rates that are noncompensatory?

17 A To my knowledge, the cases I have personally been
18 involved with we have not approved noncompensatory rates.

19 Q Okay. You are aware, are you not, Mr. Shafer,
20 that SSU has affiliated companies that are landowner or
21 developers in Florida, right?

22 A That SSU has affiliated --

23 Q Companies that are developers in Florida?

24 A I was not aware of that.

25 Q Okay. On Page 9 of your testimony, when you speak

1 of regulatory efficiency, you suggest that the agency itself
2 strives to operate in an efficient manner, and you go on and
3 discuss the notion that efficiency is fair for the utility,
4 as well, is that correct?

5 A I'm sorry, could you cite the lines that you're
6 looking at, please.

7 Q You say at Line 7, "First, it suggests that the
8 agency itself strives to operate in an efficient manner to
9 process cases without undue delay and without imposing
10 burdensome and costly requests on the utilities. This lag
11 imposes a cost on the utility by deferring needed
12 increases." And my question is, aren't you saying that
13 regulatory efficiency involves, one, the agency acting in a
14 more efficient manner and, two, in a manner that avoids
15 undue cost to the utility?

16 A Yes, that's true.

17 Q Do you have any concern about the effects of
18 regulatory efficiency on a utility's customers?

19 A Sure. I think that to the extent that you impose
20 additional costs on utilities, you are imposing additional
21 costs on customers in many respects.

22 Q Okay. I take it that you are not suggesting in
23 your testimony, Mr. Shafer, that any given rate structure,
24 including uniform rates, of necessity involves lower per
25 customer rate case expense, are you?

1 A No. I believe at some point in my testimony I
2 indicate that the Commission should be cognizant of the
3 decisions it makes and what impact those decisions may have
4 on future rate case expense.

5 Q Okay. But you're not testifying in this case that
6 uniform rates result in lower rate case expense per customer
7 than any other rate structure, are you?

8 A No.

9 Q Okay. Now, on Page 10, starting at Line 14, you
10 recognize that the Commission is not the agency of primacy
11 for environmental matters, right?

12 A That's correct.

13 Q As well as health and safety matters, conservation
14 matters, and reuse matters. And you go on to say that the
15 Commission shares with and sometimes defers jurisdiction to
16 the DEP, HRS, and the water management districts, right?

17 A That's correct.

18 Q Do you have any statutory reference when you make
19 that statement, Mr. Shafer, that the Florida Public Service
20 Commission, in fact, has any jurisdiction over environmental
21 matters, health and safety matters, and conservation
22 matters?

23 A No, I have no statutory basis for that, as I
24 indicated earlier. Implicit in the process through the
25 consumptive use permits and so forth, we wind up with some

1 obligation.

2 Q Okay. I apologize, maybe it's just my ears, but
3 it seems like you're fading out again. Could you talk just
4 a little louder?

5 A Sure.

6 Q On Page 10, currently the Commission regulates
7 facilities in 39 counties out of 67. Is there a change due
8 in that number, does that reflect the --

9 A I made a change at the beginning of my testimony.

10 COMMISSIONER KIESLING: Yes. He changed it while
11 you were having Mr. Jacobs run interference for you.

12 MR. TWOMEY: Okay. I was trying to avoid the
13 breaking point syndrome.

14 BY MR. TWOMEY:

15 Q On Page 12 of your testimony at the top, you say
16 at Line 3, "The goals of reasonable rates can be
17 jeopardized," and I guess you're talking about when a
18 utility has to make significant financial investments to
19 comply with environmental and other factors, right, is that
20 what you're saying?

21 A I'm sorry, could you repeat the question, please.

22 Q Yes, sir. You say starting on the previous Page
23 11, you say, "The Commission rarely intercedes on behalf of
24 customers or utilities when matters of environmental
25 protection are involved. When these matters result in

1 significant financial investments on the part of the
2 utility, the Commission has little or no recourse but to
3 pass those costs on to consumers. Thus, the goal of
4 reasonable rates can be jeopardized." Now, I was under the
5 understanding, and I want to ask you if you agree with me,
6 that the reasonable rates meant that they contained
7 reasonable costs, necessary costs, prudent costs, return on
8 used and useful investment, is that your understanding?

9 A Yes. What I would say is that while they may be
10 reasonable in terms of the fact that they reflect reasonable
11 costs, they may not be affordable.

12 Q Affordable?

13 A Affordable would be a better choice of words.

14 Q Would you agree with me that the issue of
15 affordability is dependent in large matter upon the income
16 of the person that is being faced with the rate?

17 A Income is one of a number of factors, yes.

18 Q Would you agree that it's a primary factor?

19 A Again, my experience in working with these small
20 utilities is that sometimes even in what appear to be
21 reasonably affluent service territories, customers have some
22 very strong opinions about what affordable rates are. I can
23 only surmise that income is not the strongest factor in some
24 of those cases but, yes, typically it would be among the
25 primary factors.

1 Q Right. But wouldn't you agree with me, Mr.
2 Shafer, that if you had irrespective of reactions and
3 opinions as to rate levels, that if you had a family with
4 disposable income of \$10,000 per year and you had a family
5 with a disposable income of \$50,000 per year, that the same
6 rate would be less affordable for the lower income family
7 than the higher income family irrespective of what their
8 views and opinions were on the rate?

9 A Only to the extent that you associate affordable
10 with a percentage of their income allotted to their water
11 and wastewater bills.

12 Q Okay. Now, on Page 12, beginning at Line 20, you
13 say that rate structure can influence the utility's revenue
14 stream by making it more or less subject to variation. And
15 my question to you is, is it your understanding that
16 affecting the variability of revenue stream is a legitimate
17 topic of concern when going about establishing a rate
18 structure?

19 A It's a legitimate topic of concern for the
20 utility, I'm sure.

21 Q Is it a legitimate topic of concern for the Public
22 Service Commission, if you know?

23 A It may be of some minor consequence to the Public
24 Service Commission to the extent, again, that the
25 variability in the revenue stream impacts the utility's

1 ability to secure certain types of financing and, therefore,
2 may have some impact in terms of the Commission's decision.

3 COMMISSIONER KIESLING: I'm sorry, you faded out
4 at the end. In terms of --

5 WITNESS SHAFER: In terms of the Commission's
6 decision is what I said. I guess what I'm trying to say is
7 that rate structure -- or, again, the variability in the
8 revenue stream can impact the utility's ability to secure
9 certain types of financing, just like variability in my
10 income stream can impact my ability to borrow or secure
11 financing.

12 BY MR. TWOMEY:

13 Q Sure. Now, Mr. Shafer, I thought that rate
14 structure involved a method of a regulatory body assigning
15 revenue responsibilities to different classes of customers
16 based on their respective cost of service. Am I correct, is
17 that a major factor in what rate structure determination is?

18 A Basically, cost of service, in my mind, is the
19 determination of the revenue requirement. Rate structure
20 for an individual -- let's assume for a moment that the
21 utility only had residential customers rate structure, it is
22 still an important issue in determining and trying to
23 achieve certain goals and objectives.

24 Q Why?

25 A Why?

1 Q Why, yes.

2 A Well, I believe that the Commission, you know, as
3 I have indicated earlier, has a role to play in issues like
4 conservation and that may play into their determination in a
5 rate structure.

6 Q Okay. On Page 13 of your testimony, still on the
7 topic of efficiency, at Line 7, you say, "Efficiencies can
8 also be affected by rate design in terms of investment
9 incentives faced by the utility." You go on to say that
10 what may be an immaterial investment when spread over all
11 customers of Southern States may have significant impact if
12 costs can only be spread and recovered over a particular
13 service area. That spreading methodology you're talking
14 about is uniform rates, isn't it, Mr. Shafer?

15 A That would be one way to do it. That doesn't
16 necessarily have to be uniform rates to achieve the same
17 objective.

18 Q How else can you do it?

19 A I believe one of the rate proposal contained in my
20 testimony that has benchmark levels would provide some
21 certain amount of subsidy between service areas and that
22 would achieve basically the same thing without being a
23 uniform rate.

24 Q Okay. But you recognize you did use the word
25 subsidy between service areas, didn't you?

1 A That's correct.

2 Q Okay. And by subsidies, irrespective of what
3 benefits you or anybody else may want to ascribe to that
4 transfer of money, you do recognize, don't you, Mr. Shafer,
5 that the subsidy is just a plain transfer of revenue from
6 one service area to another, right?

7 A Sure.

8 Q Okay.

9 A It could be viewed in that way.

10 Q Sir?

11 A I said it could be viewed in that way.

12 Q Didn't you say sure first?

13 A Uh-huh. I'm sorry, yes.

14 Q Now, again, I don't understand why the Commission
15 should be concerning itself with giving utilities investment
16 incentives. Do you believe that the Commission should be
17 giving any utility, including SSU, investment incentives?

18 A Again, it depends on the objectives that the
19 Commission has.

20 Q Can you give me --

21 A You certainly wouldn't want to give the utility
22 investment disincentives if that investment was critical to
23 quality service being provided.

24 Q Shouldn't we consider, Mr. Shafer, letting utility
25 management make investment decisions and then in rate cases

1 make determinations of whether they were prudent or not?

2 A I believe that that is what we currently do.

3 Q Okay. And that offering them incentives to invest
4 one way or the other is not necessary?

5 A Again, it depends on whether they are objectives
6 that the Commission is attempting to meet in its regulation
7 and oversight of this industry. And if they have objectives
8 that are not being met, that they believe can be better
9 achieved by providing incentives to the utility, then
10 perhaps that's a decision they would choose to make.

11 Q Okay. Would you agree with me that when a
12 regulatory body gives a regulated utility an incentive to do
13 something, that it essentially makes itself a partner in
14 those decisions, and somewhat ties its hands in terms of the
15 regulation that it can accomplish thereafter?

16 A I'm sorry, I guess I don't follow your question
17 exactly.

18 Q Well, if the Commission were to give a
19 hypothetical utility an incentive for picking up a troubled
20 utility, one that you used in your definition in the
21 beginning of high capital cost and high rates, if the
22 Commission were to give a larger utility an incentive in
23 terms of an acquisition adjustment, let's say, isn't the
24 Commission somewhat constrained in subsequently reviewing
25 the prudence of that decision?

1 A It seems to me that the Commission makes a
2 determination on the prudence of that decision at the time
3 it makes the decision on the acquisition adjustment
4 typically. I don't see there is a separation there.

5 Q Sure, but what if we extend that, Mr. Shafer, and
6 we find that the Commission hasn't done any due diligence
7 examination of the system, and its lines, and its state of
8 maintenance and so forth, and perhaps the utility hasn't
9 either when they go ahead and make that acquisition
10 adjustment. Doesn't that present problems later when there
11 are increased costs to be recovered?

12 A Again, I guess I'm having a hard time following
13 you. As far as I am aware, the Commission doesn't make
14 decisions regarding acquisition adjustments prior to making
15 determinations as to whether the acquisition was prudent. I
16 could be wrong, but --

17 Q Sure. But my question to you is, in your
18 experience at the Commission in the water and wastewater
19 division, do you know of any case in which the Commission
20 determines at the time it makes an acquisition adjustment
21 whether it evaluates what the status of the facility's state
22 of maintenance of the facility's capital assets are.

23 MR. FEIL: Objection.

24 MS. CAPELESS: Objection. It's beyond the scope
25 of the direct testimony.

1 MR. TWOMEY: Okay. I will withdraw that.

2 BY MR. TWOMEY:

3 Q On Page 13 at the bottom, you say that
4 affordability of rates from the Commission's perspective is
5 oftentimes a byproduct of the reasonableness of the revenue
6 requirements for an individual utility. And you say the
7 Commission strives to make the revenue requirement
8 reasonable recognizing the limitations and its ability to
9 act directly on rates. What do you mean by that?

10 A I mean that the Commission determines the revenue
11 requirement after a thorough review of, you know, all the
12 financial matters and investment decisions and so forth for
13 their reasonableness, and the revenue requirement is what
14 the revenue requirement is. And the rates that fallout
15 based on customers consumption and so forth are really just
16 an end result for a single service area utility.

17 Q Yes, sir. But, again, at the bottom of 13, you
18 say, "The Commission strives to make the revenue requirement
19 reasonable." Now, wouldn't you agree with me that the
20 revenue requirement is what the revenue requirement is going
21 to be under any given state of facts, right? I mean, the
22 Commission can't strive to make a revenue requirement go up
23 and down to make it reasonable, would you agree with that?

24 A I would agree that they review a number of
25 decisions in determining that revenue requirement, and

1 hopefully that that end product is the best possible
2 decision and the closest to actual cost that it should be.

3 Q I mean, the Commission should give the utility a
4 chance to recover its reasonable, necessary, and prudent
5 costs and give it an opportunity to earn a fair rate of
6 return on its used and useful investment, correct?

7 A Correct.

8 Q And that basically the same is true, isn't it,
9 with the fallout rates? It can't make the rates go up and
10 down from a revenue requirement just because it wants to
11 make them higher or lower, right?

12 A That's correct.

13 CHAIRMAN CLARK: Mr. Twomey, how much more do you
14 have?

15 MR. TWOMEY: I've got quite a bit, Madam Chairman.
16 This witness is the single most --

17 CHAIRMAN CLARK: How much is quite a bit?

18 MR. TWOMEY: Probably hour and a half at least.

19 CHAIRMAN CLARK: We are going to take a break
20 until 20 after 6:00, and we will reconvene and start with
21 that cross examination again.

22 MR. TWOMEY: Thank you.

23 (Brief recess.)

24 CHAIRMAN CLARK: Let's go back on the record. Go
25 ahead, Mr. Twomey.

1 MR. FEIL: Madam Chairman, if I could just for the
2 record, I have passed out a copy of what has been identified
3 as Exhibit 82. Mr. Twomey has indicated that he wanted to
4 ask Mr. Terrero some questions about that, and we won't move
5 it into evidence until Mr. Twomey completes that
6 opportunity.

7 CHAIRMAN CLARK: Okay.

8 MR. FEIL: Thank you.

9 CHAIRMAN CLARK: Thank you.

10 BY MR. TWOMEY:

11 Q Okay. Let's go again here, Mr. Shafer. On Page
12 14 of your testimony, I take it that you recognize that by
13 your statement beginning at Line 5 that uniform rates are,
14 in fact, rate averaging, right?

15 A That's correct.

16 Q In fact, isn't true that as last adopted by the
17 Commission in the 199 docket, that it was just a straight
18 mathematical averaging?

19 A I believe that's true. I was not involved in that
20 process.

21 COMMISSIONER KIESLING: I'm sorry, I can't hear
22 you. You weren't involved in --

23 WITNESS SHAFER: I was not involved in that
24 process in the last case.

25 BY MR. TWOMEY:

1 Q Okay. At Page 14, Line 15, you say -- or 14, you
2 say, "Pricing is a fundamental element in resource
3 allocations, and in this case resource protection. Through
4 pricing signals, the utility can influence water
5 consumption." And, again, that is consistent with the
6 notion that you must send -- that you send the best price
7 signal when you have price equal cost, or incremental cost,
8 correct?

9 A I don't think those statements say anything about
10 what the best pricing signal is.

11 Q I'm sorry. You don't think that that statement is
12 consistent with the -- first of all, you have already
13 agreed, have you not, that when rates equal incremental cost
14 they send the most efficient price signal?

15 A When price equals marginal cost.

16 Q Marginal cost, yes, it sends the most efficient
17 price signal?

18 A That's correct.

19 Q Okay. So, isn't it true -- don't you agree with
20 the statement that for pricing signals to influence water
21 consumption most effectively the prices should equal
22 marginal costs?

23 A That would be an economically efficient solution
24 that does not necessarily achieve whatever goals that you
25 may have apart from economic efficiency.

1 Q Okay. But, again, it would achieve economic
2 efficiency, right?

3 MS. CAPELESS: Objection, that's asked and
4 answered.

5 BY MR. TWOMEY:

6 Q On the next page you discuss inverted block
7 pricing, and you say, for example, the price of \$1.50 per
8 thousand gallons may apply to the first 10,000 gallons
9 consumed and a price of \$3.00 per thousand gallons for any
10 consumption beyond 10,000 gallons, correct?

11 A Yes, that's what it says.

12 Q Okay. And you recognize, you go on to recognize
13 that success or failure of such a rate structure will vary
14 based on a variety of factors, not the least of which is the
15 income of the customer, right?

16 A That's correct.

17 Q And that would be each individual customer, right?

18 A It could mean the aggregate customer base, as well
19 as an individual customer.

20 Q Well, did you listen to Mr. Hansen's testimony
21 today?

22 A I had it on in my office, I was not listening that
23 carefully, no.

24 Q Did you hear Mr. Hansen talk about the neighbor
25 that he had whose husband had to move to a medical care

1 facility?

2 A Yes.

3 Q Would you agree with me that the effect of a
4 system that is proposed there or suggested there would vary
5 even within one community or one service area depending upon
6 what the individual customer's income was?

7 A I'm sorry, I missed the first part of your
8 question.

9 Q Yes, sir. Would you agree with me that the
10 effectiveness, the success or failure of this rate structure
11 even within one service area would be dependent upon what
12 the income was for each individual customer?

13 A The outcome for each individual customer can vary
14 within a service area, sure.

15 Q Okay. Are you supporting SSU's weather
16 normalization factor?

17 A No.

18 Q Is the staff, to your knowledge?

19 MS. CAPELESS: Objection, this is beyond the scope
20 of the testimony.

21 MR. TWOMEY: Well, he speaks -- Madam Chair, he
22 speaks at Page 15 to the impact of rate design and how it
23 relates to weather normalization factor.

24 CHAIRMAN CLARK: I think he indicated he is not
25 supporting the weather normalization.

1 MR. TWOMEY: Right. And the question that was
2 objected to was, I asked him whether the staff did.

3 CHAIRMAN CLARK: I think that's beyond the scope
4 of his testimony.

5 MR. TWOMEY: Okay. He is a staff witness.

6 BY MR. TWOMEY:

7 Q On Page 16, Mr. Shafer, you say, "The extreme
8 example of predictable revenues would be to make all rates
9 flat rates with no consumption components at all." Isn't it
10 true that by moving -- proposing to move its revenue
11 assigned to the -- to increase the revenue assignment to the
12 past facility charge from the gallonage charge, that SSU is
13 moving in that direction of the scale? Do you understand my
14 question?

15 A I have no knowledge of Southern States' intention
16 to move to a flat rate structure. But if they are proposing
17 a shift from consumption charges to base-facility, that may
18 have an impact on conservation.

19 Q Right. Well, in addition to perhaps having --

20 A Or revenue stability, I'm sorry. Ask the question
21 again, I'm sorry.

22 Q Okay. You seem to suggest, did you not, that if
23 they transfer revenue responsibility from the consumption
24 charge to the base-facility charge, that it might have an
25 effect on conservation, correct?

1 A It may, yes.

2 Q And isn't it true, Mr. Shafer, that if they do
3 that such a resulting rate would be less conservation
4 oriented than one that had a greater assignment of revenue
5 to the gallonage charge?

6 A That would be the expectation. But, again,
7 without knowledge of the end result, it's hard to say.

8 Q But all other things being held equal, shifting
9 revenue responsibility from the gallonage charge to the
10 base-facility charge makes the rate less conservation
11 oriented, doesn't it?

12 A Again, that's what you would expect, but without
13 knowledge of the price elasticities, it's difficult to say
14 for sure.

15 Q Right. And isn't it true that the other thing
16 that it does, or one of the other things that it does that
17 you cite on this page is that it makes the revenue stream of
18 company more predictable, that is increasing revenue
19 assignment -- transferring revenue assignment from the
20 gallonage charge to the base-facility charge makes the
21 revenue stream of the utility more predictable and stable,
22 correct?

23 A You would expect that, it would be a matter of
24 degree, and small changes in that shift may not have any
25 impact at all in the predictability.

1 Q Okay.

2 COMMISSIONER KIESLING: Greg, could you try
3 talking to closer to the mike.

4 WITNESS SHAFER: I'm sorry. I just made a note to
5 myself to try.

6 COMMISSIONER KIESLING: Okay.

7 BY MR. TWOMEY:

8 Q On Page 18 you are asked the question do you
9 believe that Southern States is concerned about
10 affordability and acceptability, and you say yes, right?

11 A That's correct.

12 Q Do you believe that? Do you think that there is
13 any lack of controversy over SSU's proposed rate structure?

14 A Do I believe there is any lack of controversy?

15 Q Yes, sir.

16 A I mean, I guess it's controversial.

17 Q Sure. You say at Line 14 on Page 18, "Yes, any
18 business should be concerned about the affordability of its
19 products," and I ask you is that true even for a monopoly?

20 A I believe so, yes.

21 Q Even for a monopoly with an exclusive territory?

22 A I believe that if that monopoly is subject to some
23 type of regulation by a regulatory body that, yes, they
24 should be concerned about that.

25 Q Okay. On Page 19 you go into a discussion of

1 fairness and rate continuity, and you say beginning at Line
2 4, that fairness relates in my mind to the degree to which
3 the cost causer pays a fair share of the cost he or she is
4 responsible for and the degree to which the rates are in
5 line with those of customers in similar situations. And I
6 ask you first, what relevance at all does the rates of other
7 customers in similar situations have to do with fairness?

8 A I believe that it has a lot to do with fairness.
9 In my experience working with smaller utilities, a very
10 common complaint that we receive is that customers in nearby
11 locations that the customers perceive to be similarly
12 situated are paying less, and it is a very common complaint
13 and something that, you know, we are forced to address.

14 Q But might not be a possible answer, Mr. Shafer,
15 that you would tell such a customer or complainer that maybe
16 the person paying lower rates in the adjacent system paid
17 more CIAC or has a different water treatment type, things of
18 that sort?

19 MS. CAPELESS: Objection, that's speculative.

20 MR. TWOMEY: I don't think there is anything
21 speculative about it at all, Madam Chairman. It's common
22 knowledge that that -- and it should be common knowledge to
23 Mr. Shafer with his six years or so in the water and
24 wastewater division that differences in rates amongst
25 different utilities may be based on a myriad of factors,

1 including CIAC and --

2 CHAIRMAN CLARK: If you want to ask that question,
3 you may. That is a different question than what you asked.

4 MR. TWOMEY: Okay.

5 BY MR. TWOMEY:

6 Q Isn't it common knowledge, Mr. Shafer, that based
7 upon your experience that rate level can be based on a
8 myriad of factors, including level of CIAC?

9 A I would say that rate levels can be based on a
10 myriad of factors, including CIAC. My experience would tell
11 me that it's not common knowledge.

12 Q No, isn't it common knowledge to regulators, or
13 shouldn't it be common knowledge to regulators?

14 A I think that it should be.

15 Q Okay. What does fair share have to do with --
16 what do you mean by fair share of cost to the cost causer?
17 Do you have a percentage that you would ascribe to that?

18 A No.

19 Q Do you think that paying 50 percent of the cost
20 that one causes is fair?

21 A That depends entirely on surrounding
22 circumstances.

23 Q What surrounding circumstance would have an impact
24 on whether such a situation would be fair or not?

25 A Well, if a developer, for example, was willing to

1 provide utility service at half of its actual cost, for
2 whatever reason, the customers might view that as being very
3 fair.

4 Q I see. Let me ask you this. At what percentage
5 -- you recognize that customers can be forced to pay more
6 through rates than their actual cost of service, right?

7 A That can happen, yes.

8 Q At what percentage above their cost would you
9 consider a customer to be required to pay unfair rates? Do
10 you follow my question?

11 A I don't think so, no. You lost me at some point.

12 Q If parity means 100 percent, and a customer is
13 required to pay rates that causes him to pay or her to pay
14 125 percent of cost, is that necessarily unfair?

15 A Necessarily, no.

16 Q How about 200 percent of cost?

17 A It's difficult to draw a line in terms of percent
18 anywhere and determine based on any particular set of
19 circumstances whether that's fair or not.

20 Q Okay. Are you familiar with the term undue
21 discrimination?

22 MS. CAPELESS: Objection, again he is seeking a
23 legal conclusion.

24 MR. TWOMEY: I'm not seeking a legal conclusion.
25 I asked him if he understood the term or was familiar with

1 the term undue discrimination?

2 CHAIRMAN CLARK: I will allow him to answer that
3 question.

4 WITNESS SHAFER: I have heard the term before.

5 BY MR. TWOMEY:

6 Q Do you know what it means, Mr. Shafer?

7 MS. CAPELESS: Objection, it calls for a legal
8 conclusion.

9 CHAIRMAN CLARK: I think it does, Mr. Twomey.

10 MR. TWOMEY: Okay.

11 BY MR. TWOMEY:

12 Q You say on the next page, Page 20, that you don't
13 believe that subsidies and fairness in pricing are mutually
14 exclusive, correct? You say that at Page 20, Line 4.

15 A That's correct.

16 Q You say that the real issue is the degree to which
17 subsidies occur, right?

18 A In my mind that is the real issue, yes.

19 Q And my question to you is at what degree can
20 subsidies start becoming unfair, if you have an answer to
21 that?

22 A Again, it's very difficult to draw a line in terms
23 of percentages or anything else. I think the circumstances
24 in each situation have to be examined and the decision
25 makers have to make the best possible decision they can

1 under the circumstance.

2 Q You say that to the extent that any time the cost
3 to serve an individual customer is different, but the price
4 to each customer is the same, a subsidy exists, and I ask
5 you is that in line with the commonly stated notion that it
6 is cheaper to serve the person that's closer to the water
7 tank in terms of subsidies within a system?

8 A To the extent that that would be true, that would
9 be an example of that, yes.

10 Q Have you ever gone to a movie matinee during
11 daylight hours?

12 A Yes, I have.

13 Q Okay. Would you agree with me that there are some
14 retailers that charge higher prices at night than during the
15 day?

16 A Yes.

17 Q On Page 21 you begin a discussion of telephone
18 service pricing, right?

19 A That's correct.

20 Q Would you agree with me that historically in
21 Florida that telephone service rates have been established
22 primarily on a value of service basis?

23 A For local service that would be correct,
24 historically. I'm not so sure that that's the continuing
25 practice.

1 Q Okay. Would you agree with me that for the most
2 part water and wastewater service has been priced on a cost
3 of service basis?

4 A I guess I will have to give some context to my
5 response on that, to the extent that establishing an overall
6 revenue requirement is cost of service basis, then, yes.

7 Q Okay. On Page 22, you state that beginning at
8 Line 13, "Should the Commission consider a pricing scheme
9 for water and wastewater that includes some cost and/or
10 price averaging and some degree of subsidization, it would
11 not, in my judgment, be without regulatory precedent." And
12 my question to you is, aside from any previous SSU uniform
13 rate orders, what would you point to as precedent?

14 A I believe the residual pricing of local telephone
15 service is an example of that.

16 Q Do you have any other examples?

17 A Offhand, no.

18 Q So you don't have any -- I take it that means you
19 don't have any other examples in water and wastewater
20 service, necessarily, right?

21 A Not that I can think of offhand, no.

22 Q Okay. On Page 22 at Line 20, you say, "The most
23 important factor for the utility to consider regarding
24 acquisition is whether it believes it can earn a return on
25 its investment," correct?

1 A That's what I believe that the utility should
2 consider, yes.

3 Q On Line 25 of Page 22, you say, "Rate structure
4 can impact the decision to acquire a small utility." You go
5 on to say at Line 4 of the next page, "That is the acquiring
6 utility will be concerned with the ability of any particular
7 facility to provide a reasonable return on its own." Now, I
8 want to ask you, don't you think that that acquiring utility
9 should always be concerned with the ability of a particular
10 facility to provide a reasonable return on its own?

11 A I think the requiring utility is always concerned
12 about the payback on an individual customer basis for the
13 investment they have to make. It may not necessarily be
14 restricted to or isolated to that particular service area.

15 Q Wouldn't you agree with me, Mr. Shafer, that if an
16 acquiring utility failed to be concerned with the ability of
17 any particular facility to provide a reasonable return on
18 its own, that it would be imprudent on its face?

19 A No, I don't believe that, necessarily.

20 Q You think it's acceptable for a utility to acquire
21 a system someplace, irrespective or knowing that it cannot
22 provide a reasonable return on its own?

23 A I do not believe the utility would make an
24 investment that they did not believe they were going to gain
25 a return on. Whether or not that return is a result of a

1 particular isolated service territory in this case being
2 able to generate that return, I don't believe that to be
3 necessarily true or necessarily required.

4 Q Okay. So a utility -- doesn't it follow, then,
5 that a utility which bought a particular facility that it
6 knew could not provide a reasonable return on its own would
7 have to expect the payment of subsidies from some other
8 systems to support the return, to support a reasonable
9 return?

10 A What I'm saying is that if -- or as an example, if
11 the acquiring utility has the ability to spread that
12 investment over its entire customer base, and it looks at
13 the return on a per customer basis and there exists a return
14 on a per customer basis, per additional customer basis, then
15 I don't think it's unreasonable or imprudent on its face for
16 that utility to make that investment. But, again, it
17 depends on the circumstances facing that particular
18 acquiring utility.

19 Q Okay. Let me ask you this. Would you agree with
20 me that if a utility regulated by this Commission can expect
21 that it does not have to be concerned with the ability of an
22 acquired facility to provide a reasonable return on its own,
23 that it will have no incentive to make those determinations
24 before acquiring additional systems?

25 A I believe that the utility is going to look at the

1 number of additional customers it is going to get by
2 acquiring a particular service area, and how they are going
3 to be able to recover those costs that it may take
4 investment-wise or improvement-wise to bring that system
5 into compliance. So it does not necessarily have to be on
6 that isolated service area basis.

7 Q Okay. I would like to try and ask you the
8 question again, and see if I can get a yes or no answer, and
9 you can explain all you would like as is necessary. Isn't
10 it true, Mr. Shafer, that if a utility believes that it will
11 get a return from a Commission irrespective of the ability
12 of a particular acquired utility to earn a reasonable return
13 on its own, that it will have no incentive to determine
14 beforehand whether that particular facility can earn a
15 reasonable return on its own?

16 A If the utility believes that, then I would agree
17 with that.

18 Q Okay. Now, you continue at Line 5, "It will look
19 at the compliance --" and you mean by it, "The utility will
20 look at the compliance record of the facility and what
21 investments might be required to achieve compliance and make
22 it profitable." Now, I take your testimony, Mr. Shafer, to
23 suggest that looking at the compliance record and
24 determining what investments might be required to achieve
25 compliance and make it profitable is bad.

1 A Is that a question?

2 Q Well, it seems to me that you are suggesting that
3 looking at compliance records and determining what
4 investments have to be made is an undesirable characteristic
5 of a rate structure that isolates each service area as a
6 separate rate center, i.e., stand-alone rates. Aren't you
7 saying that?

8 A Aren't I saying what, I'm sorry?

9 Q You say at the top of Page 23, "Under a rate
10 structure that isolates each service area as a separate rate
11 center, i.e., stand-alone rates, or some version of
12 stand-alone rates, the acquiring utility will always view
13 acquisitions on a microeconomic level." And I take it from
14 that statement that you're saying that viewing acquisitions
15 on a microeconomic level is bad or is undesirable. Aren't
16 you saying that?

17 A Not at all.

18 Q You're not? Okay. You go on and you say, "That
19 is the requiring utility --" and we have already discussed
20 about the ability of the particular facility to provide a
21 reasonable return on its own. And then you go on and say it
22 will look at the compliance record of the facility and what
23 investments might be required to achieve compliance and make
24 it profitable. And I'm asking you shouldn't a utility
25 always look at the compliance record of the facility, and

1 shouldn't it always determine what investments might be
2 required to achieve compliance and make it profitable before
3 it makes the acquisition?

4 A I believe it will always look at what costs there
5 will be in order to make the system compliant and able to
6 provide quality service, sure.

7 Q Let me try again. And I would like you to -- and
8 I don't blame you for this, but would you try and answer my
9 questions yes or no and then offer your explanation.

10 Don't you agree that a utility should always look
11 at the compliance record of a facility and determine what
12 investments might be required to achieve compliance and make
13 it profitable before it makes such an acquisition?

14 A Yes, I believe it always will.

15 (Transcript continues in sequence with Volume 30.)

16

17

18

19

20

21

22

23

24

25