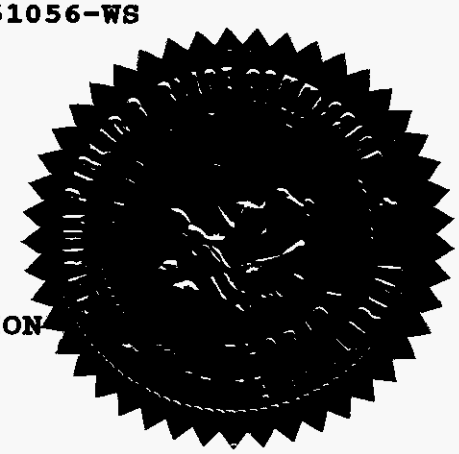
Case No. 97-01720

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of	:	**DOCKET NO. 951056-WS**
Application for rate increase in Flagler County by Palm Coast Utility Corporation.	:	



FIRST DAY - AFTERNOON SESSION

VOLUME 2

Pages 141 through 311

PROCEEDINGS:	**HEARING**
BEFORE:	COMMISSIONER J. TERRY DEASON COMMISSIONER JULIA L. JOHNSON COMMISSIONER DIANE K. KIESLING
DATE:	**Monday, July 1, 1996**
TIME:	Commenced at 10:00 a.m.
PLACE:	The Knights of Columbus Building 51 Old Kings Road Palm Coast, Florida
REPORTED BY:	JOY KELLY, CSR, RPR Chief, Bureau of Reporting ROWENA NASH HACKNEY Official Commission Reporters

APPEARANCES:

(As heretofore noted.)

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 1.)

COMMISSIONER DEASON: Ladies and gentlemen, if I could have your attention please. We'll go ahead and call the afternoon session to order.

Mr. Reilly, I understand that there's one individual from the public who signed up to testify and was temporarily out of the hearing room when his name was called, or her name -- I don't know which it is. Anyway, that individual wishes to make a brief statement at this time. If you'll call that person.

MR. REILLY: Carl Sugar.

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CARL SUGAR

was called as a witness on behalf of the Citizens of the State of Florida and, having been duly sworn, testified as follows:

DIRECT STATEMENT

WITNESS SUGAR: Good afternoon.

COMMISSIONER DEASON: Sir, if you could give us your name and address, please, for the record.

WITNESS SUGAR: My name is Carl Sugar. I live at 45 Fortune Lane in Palm Coast. We have been residents here five years. We come from California.

I'll give you a little credential, background. So you'll know where I'm coming from. I'm a registered engineer in California, professional engineer; law degrees. I have a diploma from University College, Oxford in political economics. I think I'm qualified to talk to you.

For the last 40 years in California I've represented large corporations in many aspects of their businesses; mainly as a consultant.

This program -- I'm unable to tell you about the relationship of ITT with Minnesota Utility, but it sounds very similar to a case that I handled in California that is almost identical, in my opinion, and I'm going to tell you about it.

I represented a major insurance company who was going to purchase a smaller automobile insurance company. They had an option, there was a two-tier operation. One tier as is; the second tier was if they were able to get from the insurance commissioner an increase in their substandard rates. The difference was about 15% of the purchase value.

And I have a feeling that that's the same situation here. ITT giving this option on a two-tier basis. If they get the increase from you, the price will be astronomically higher; if they don't get the

increase, it will be a smaller amount of purchase.

Now, ITT is seeking money to increase their gambling operations. They have just announced, I'm sure you've read in the paper, Wall Street Journal had it, they are going to build a billion dollar resort casino in Las Vegas and a billion dollar resort casino in Atlantic City. They are using these resources from selling off many of their other assets besides what they have here to increase their -- probably the cost -- the funds for building these operations.

I think that they want to sell, and Minnesota will buy, also on the basis of an increased amount of earnings protected by the laws of the state of Florida. Now, this is a situation that occurred in California. Once they increased the price of that insurance, the protection was there. There was nobody who could decrease it. It would be very difficult to decrease it. That's my opinion. That once they are granted this amount, the second tier purchase price will take effect. Minnesota will be protected by you and by the state of Florida in this increased amount of money that they are going to take out of this operation.

I think that these facts must be looked into. I've tried every way to find out something

about this sales contract agreement that is going on. I talked to the Chairman of our Board of Commissioners and he could not get any information, so I assumed that this was in -- within their own province of keeping it to themselves. But I think it's something that should be inquired into. And I thank you very much for your attention.

COMMISSIONER DEASON: Thank you. Any questions?

MR. REILLY: No questions. (Applause)

COMMISSIONER DEASON: I believe first order of business is to take up Staff's request for orders to be officially recognized. Has that been distributed to all parties?

MR. EDMONDS: Yes, it has. I don't think my microphone is on here.

The list has been distributed to all parties and we have copies of those orders available for anybody that may need them.

COMMISSIONER DEASON: As is customary practice, the Commission will take official recognition of its own orders. All of these are Florida Public Service Commission orders?

MR. EDMONDS: That's correct.

COMMISSIONER DEASON: Very well. I've also

been asked to raise a question at this point.

This hearing has been scheduled for two days, today and tomorrow. It is already obvious that we are behind schedule. We've not even begun the technical phase of the hearing and we have another customer meeting this evening. The question has been raised as to whether we can continue this hearing, if need be, on Wednesday here at this location. Then there's also -- when we would continue it, if that is not available, I'm not really sure. I guess that would have to be worked through the Chairman's office. The problem is due to prior commitments, and since this hearing was to the officially scheduled for Wednesday, there are two Commissioners who will not be available due to those prior commitments.

So I guess I'm raising the question at this point to the parties on notice that if you were planning on Wednesday, that may be in question. And if we are to go on Wednesday here, the only way that could be done is if all parties agreed to have one Commissioner sit to conduct that hearing and have the other two Commissioners, who are not available, to review the record and read the transcript. And the court reporters are curious as to what may take place for their planning at this stage.

So I'm asking the question and whatever feedback I can get from the parties at this point may be helpful for our future planning. And I'll begin with you, Mr. Gatlin, do you have any thoughts on this matter?

MR. GATLIN: I'm inclined to think it's something that can be done. I would certainly like to consult with my client before I give you the answer.

COMMISSIONER DEASON: Very well. County representatives.

MR. HADEED: Mr. Chairman, I think we would prefer to be heard before the full Commission, and would be willing to have the hearing adjourned if necessary, you know, to be continued on a date when all Commissioners could be present.

COMMISSIONER DEASON: I take it then there would be an objection that you would raise; is that correct?

MR. HADEED: I don't want to frame it in terms of an objection.

COMMISSIONER DEASON: It is your strong preference.

MR. HADEED: Yes.

COMMISSIONER KIESLING: May I just inquire for clarification, are we talking about continuing it

in Tallahassee or back down here?

COMMISSIONER DEASON: It would be my understanding it would be continued in Tallahassee. So you're talking travel to Tallahassee.

MR. HADEED: We understand that. But I think for the proper presentation of the case, if you're going to be hearing live testimony, you can learn much from it versus reading a stale transcript.

COMMISSIONER DEASON: I understand. Mr. Reilly, do you have any thoughts on the matter.

MR. REILLY: My sentiments would parallel Mr. Hadeed's.

COMMISSIONER DEASON: Mr. Melson.

MR. MELSON: We're amenable to whatever suits the Commission. We can do it either on Wednesday here in front of one Commissioner or at an adjourned time.

COMMISSIONER DEASON: Very well.

MR. GATLIN: Mr. Chairman, is there a date being reserved for Tallahassee if it comes to that?

COMMISSIONER DEASON: I'll have to refer that question to Staff.

MR. EDMONDS: The last information I had was that we were looking at the 9th. But I believe one of the Commissioners was not going to be available on the

9th.

COMMISSIONER KIESLING: I'm on vacation then.

MR. EDMONDS: And the next date that I had heard would be available would have been the 17th but we do not have that reserved as of yet.

COMMISSIONER DEASON: That would have to be done through the Chairman's office, that other day. And, of course, continuing it would then throw the other schedule off as far as briefing and having final transcripts and that sort of thing.

It's very possible we can conclude the hearing in two days, but it's going to mean we're going to have to move very rapidly through the remainder of the time that we have available. Of course, we have the customer hearing this evening. I assume that tomorrow evening that this building would be available for us to work late. Perhaps Staff can check on that and give us some more information and see if that is a possibility for tomorrow evening.

MR. EDMONDS: It's my understanding that it is available for tomorrow evening.

COMMISSIONER DEASON: Well, that's a possibility. I guess we can try to determine where we stand at that point, and if we think we can conclude

the hearing by working late, well then perhaps that's a possibility.

I wanted to raise the question and let the parties be thinking about it, put you on notice. It's a difficult situation. We'll just try to do what we can within the constraints we have to operate in.

And I think at this point I need to ask all of the technical witnesses who are here in the building at this time to please stand and to raise your right hand.

(Witnesses sworn collectively.)

COMMISSIONER DEASON: If you call a technical witness that was not here at the time that I swore witnesses in, please so state it so I can swear the witness in before he or she testifies.

MR. MELSON: Chairman Deason, I have one or two preliminary matters.

Dunes also had a list of orders for official recognition. That's been distributed. I believe it's on top of that big stack up at the edge of the desk.

We also -- and I'd move that the Commission take official recognition of those orders. Again, they are all orders of the Public Service Commission.

COMMISSIONER DEASON: As is our practice, we will take recognition of our own orders.

MR. MELSON: Chairman Deason, we, at the prehearing conference, had identified a number of the stipulated exhibits that are documents of Palm Coast Utility Corporation, mostly submitted in support of various permit applications. They are in that stack with a rubber band around them. We will have questions of a couple of Palm Coast witnesses about those and it would be helpful if we could identify those at the outset. There are five documents, and, frankly, I'd like to ask that they be given five separate numbers. That will vastly assist in the briefing process.

COMMISSIONER DEASON: Let's proceed through those exhibits then, Mr. Melson, if you could identify the first exhibit.

MR. MELSON: The first exhibit is Preliminary Design Report, dated January 1994.

COMMISSIONER DEASON: That will be identified as Exhibit No. 1.

(Exhibit No. 1 marked for identification.)

MR. MELSON: The second document is Abbreviated Reuse Feasibility Study, Dames and Moore, January 1994.

COMMISSIONER DEASON: Exhibit 2.

(Exhibit No. 2 marked for identification.)

MR. GATLIN: Just a moment, Chairman. Okay.

MR. MELSON: The third one is Updated Abbreviated Reuse Feasibility Report dated May 1995.

COMMISSIONER DEASON: Exhibit 3.

(Exhibit No. 3 marked for identification.)

MR. MELSON: The fourth one is a composite of DEP permits, letter to Thomas Trace dated February 16, 1995.

COMMISSIONER DEASON: Exhibit 4.

(Exhibit No. 4 marked for identification.)

MR. MELSON: And the final one is the transmittal letter accompanying Palm Coast's application DEP, a letter to Mr. Jeff Martin dated February 1, 1994.

COMMISSIONER DEASON: Exhibit 5.

Mr. Melson, I understand that it has been stipulated by all parties that these exhibits can be entered into the record.

(Exhibit No. 5 marked for identification.)

MR. MELSON: Yes, sir, that's my understanding.

COMMISSIONER DEASON: Is there any objection to 1 through 5 being admitted at this point?

MR. GATLIN: No objection.

MR. HADEED: No objection.

MR. REILLY: No objection.

COMMISSIONER DEASON: The County has no objection to these exhibits.

MR. HADEED: None.

COMMISSIONER DEASON: Very well. Show exhibits 1 through 5 as have been described by Mr. Melson are admitted into the record.

(Exhibit Nos. 1 through 5 received in evidence.)

COMMISSIONER DEASON: Any other preliminary matters?

MR. GATLIN: Yes, Mr. Chairman. There was an additional exhibit that Mr. Melson and I stipulated to that pertains to the Dunes question. It's entitled Palm Coast Utilities, Limited Wet Discharge Engineering Report, May 1, 1996, prepared for Palm Coast Utility. I passed that out to the Commissioners and the parties. I'd like to have that placed into the record also. That would be Exhibit 6 I believe.

COMMISSIONER DEASON: Yes. That will be identified as Exhibit No. 6. Have all of the parties had an opportunity to review this document? Mr. Reilly.

(Exhibit No. 6 marked for identification.)

MR. REILLY: I have not. Our engineer just

received a copy of it and he has been looking at it today.

COMMISSIONER DEASON: Let me ask, is there any objection to this exhibit?

MR. REILLY: I've gone to seek his attendance here in just one minute.

MR. GATLIN: The stipulation as I understood it related to Mr. Melson and I, and pertains to the Dunes question, is what it pertains to, the same as his five exhibits.

COMMISSIONER DEASON: I understand. I'm still going to give the other parties an opportunity to at least review it, and if they do have a objection then they can state it.

MR. REILLY: We do not have a objection.

COMMISSIONER DEASON: Does the County have a objection to Exhibit 6?

MR. HADEED: None.

COMMISSIONER DEASON: Staff.

MR. EDMONDS: No.

COMMISSIONER DEASON: Very well, then. Show that Exhibit 6 is likewise admitted into the record.

(Exhibit No. 6 received in evidence.)

MR. GATLIN: Mr. Chairman, pursuant to the prehearing conference we filed on behalf of Palm Coast

Utility Corporation, a list of the orders we wish the Commission to administratively notice. We filed 15 with the Commission, and I've served copies on the parties. I didn't have extra copies today but I'm certain filed it with the Commission earlier, on the 21st.

COMMISSIONER DEASON: Do all parties have that list of orders? Any objection to the Commission officially recognizing that list and the orders thereon?

MR. EDMONDS: No objection.

MR. REILLY: No objection.

MR. MELSON: No objection.

COMMISSIONER DEASON: Very well. Any other preliminary matters by any other parties?

Mr. Gatlin, I believe you can call your first witness.

MR. GATLIN: Call Mr. Seidman.

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FRANK SEIDMAN

was called as a witness on behalf of Palm Coast Utility Corporation and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. GATLIN:

Q Mr. Seidman, will you state your name and address?

A My name is Frank Seidman. My address, my business address is P. O. Box 13427, Tallahassee, Florida.

Q Have you been sworn?

A Yes, I have.

Q Did you prepare testimony for presentation in this proceeding?

A Yes, I have.

Q The one that's been served on the parties?

A Yes.

Q Do you have some changes you wish to make to that testimony?

A Yes. I had a couple of changes and I believe a sheet has been distributed showing those changes. These are changes to my direct testimony. Would you like me to read them?

Q Yes, please do.

A On Page 5 of my testimony, at Line 18.

Q Page 3?

A I'm sorry, Page 3. The correction has the wrong page. Correction to the correction sheet.

Page 3, Line 18, in exhibit FS-5 is identified as "Application to Change Service

Availability Charges" and should read "Response to Deficiency Letter."

Q And then there are some --

A On Page 25, all of the testimony to Page 25, that's Lines 1 through 25, Lines 1 through 4 on Page 26 are being deleted from my testimony because this was an issue that at the prehearing conference was dropped from the case.

Q Are there any other corrections or changes?

A No, sir.

Q If I were to ask you the questions set forth in that document, would your answers be the same today?

A Yes, they would.

MR. GATLIN: Mr. Chairman, we ask this be inserted into the record as though read.

COMMISSIONER DEASON: Without objection it will be so inserted.

Q (By Mr. Gatlin) Mr. Seidman, in your testimony do you refer to some exhibits?

A Yes, I do.

Q Are they FS-1, FS-2, FS-3, FS-4, and FS-5?

A Yes, sir.

Q Would you read the title of those exhibits and the number presently assigned to them?

A FS-1 is Volume 1, Financial Rate and Engineering Minimum Filing Requirements. FS-2 is Volume 2, Billing Analysis Schedule E-14 Minimum Filing Requirements. FS-3 is Volume 3, Additional Engineering Information, the latest offering statement and parent and related-party charges. FS-4 is the Analysis of Operating Departments Used and Useful. FS-5 is the Response to Deficiency Letter.

Q Response to the Deficiency Letter referring to the letter sent by the Commission to the Utility at the time of the filing of the application asking for additional information?

A That's correct. It's an integral part of the MFR.

MR. GATLIN: May we have that identified as one exhibit as far as I'm concerned, Mr. Chairman.

COMMISSIONER DEASON: Very well. FS-1 through FS-5 will be identified as Composite Exhibit No. 7.

(Composite Exhibit No. 7 marked for identification.)

COMMISSIONER KIESLING: May I just get a clarification?

MR. GATLIN: Sure.

COMMISSIONER KIESLING: FS-5 that is

attached to his testimony is a different exhibit than the FS-5 that he just listed; is that correct?

MR. GATLIN: FS-5 that was attached was the Service Availability, and that's been deleted. So we've moved one into that place, which was the Deficiency Letter; is that correct, Mr. Seidman.

WITNESS SEIDMAN: That's correct.

TESTIMONY OF FRANK SEIDMAN
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
REGARDING THE APPLICATION FOR INCREASED RATES FOR
PALM COAST UTILITY CORPORATION
IN FLAGLER COUNTY
DOCKET NO. 951056-WS

Q. Please state your name, profession and address.

A. My name is Frank Seidman. I am President of Management and Regulatory Consultants, Inc., consultants in the utility regulatory field. My mailing address is P.O. Box 13427, Tallahassee, FL 32317-3427.

Q. What is the nature of your engagement with the Applicant, Palm Coast Utility Corporation (PCUC)?

A. I was engaged by PCUC to work with the staff of PCUC to prepare the financial and rate schedules of the Minimum Filing Requirements, to prepare an analysis of the operating departments for used and useful, and to assist with any facets of the rate case, as may be required, and to present testimony in support of the application.

Q. State briefly your educational background and experience.

A. I am a graduate of the University of Miami. I hold the degree of Bachelor of Science in Electrical Engineering. I have also completed several graduate level courses in economics, including public utility economics. I am a Professional Engineer, registered to practice in the state of Florida. I have over 30 years experience in utility regulation, management and consulting. This experience includes nine years as a staff member of the Florida Public Service Commission, two years as a planning engineer for a Florida telephone company, four years as Manager of Rates and Research for a water and sewer holding company with operations in six states, and three years as Director of Technical Affairs for a national association of industrial users of electricity. I have either supervised or prepared rate cases, rates studies, certificate applications and original cost studies or testified as an expert witness with regard to water and wastewater utilities in Florida, California, Indiana, Michigan, Missouri, North Carolina and Ohio.

Q. Would you please identify the exhibits you prepared and are sponsoring in support of this rate application?

A. With the assistance of the PCUC staff and its consulting engineer, I prepared or supervised the preparation of the minimum filing requirements of the application. This consists of the following:

Exhibit 1 (FS-1), Volume I, Financial, Rate and Engineering Minimum Filing Requirements

Exhibit 1 (FS-2), Volume II, Billing Analysis Schedule E-14 Minimum Filing Requirements

Exhibit 1 (FS-3), Volume III, Additional Engineering Information, the latest Developer Offering Statement and Parent and Related Party Charges.

I also prepared Exhibit 1 (FS-4), Analysis of Operating Departments Used & Useful and Exhibit 1 (FS-5) ~~Application to Change Service Availability Charges~~. Response to Deficiency Letter

Q. What is the source of the historical data utilized in preparing this filing?

A. The source is the books and records of the utility, kept in the normal course of business, and in accordance with the Uniform System of Accounts as

prescribed by this Commission. In preparing this filing, I reviewed this information and had numerous discussions with utility personnel with regard thereto.

Q. Please summarize the major conclusions of this filing.

A. PCUC is seeking an increase in its water and wastewater rates and charges. It is seeking approval of a new customer class for the sale of effluent reuse and for the elimination of the public fire hydrant charge. And it is requesting approval of an increase in its Service Availability Charges.

The request is based on the adjusted operating information for the partially projected test year ending December 31, 1995. The data for the first six months is actual. The data for the last six months is projected. The basis for the rate increase is a year end rate base, adjusted for known changes.

As shown in (Exhibit 7 (FS-1), the year end rate base for the adjusted test year ending December 31,

1995 is $ 21,328,433 for the water system and $ 16,031,209 for the wastewater system. (Exhibit 7 (FS-1), Schedules A-1 and A-2).

The adjusted operating income for the test year, without the requested increase, is $ 563,072 for the water system and $567,210 for the wastewater system (Exhibit 7 (FS-1), Schedules B-1 and B-2).

The adjusted operating income produces only a 2.64% rate of return on the water rate base and a 3.54% rate of return on the wastewater rate base. (Exhibit 7 (FS-1), Schedules B-1 and B-2). A fair rate of return on Applicant's rate base is 8.84%. (Exhibit 7 (FS-1), Schedule D-1).

This application indicates that an increase in test year annual water revenues of $ 1,479,626 and wastewater revenues of $1,575,817 is required to produce a fair rate of return. (Exhibit 7 (FS-1), Schedules B-1 and B-2).

THE TEST PERIOD

Q. I would now like you to take us through the major components of the rate case. First, what is the test period for this rate application?

A. This application is based on a partially projected test year ending December 31, 1995, with appropriate adjustments. This period was chosen because it is the period in which substantial plant additions necessary to serve current and near term customers were completed and placed in service. It is also the period which most accurately reflects the ongoing costs of providing service.

Q. What is the basis for projecting the last six months of the test year?

A. The projections in this filing were not done specifically for this case. PCUC prepares budgets and projections annually, each fall, for the coming year. Each month, as PCUC updates its general ledger, it tracks the actual "to date" amounts against the budgeted projections. The projections used in this case are the amounts budgeted for 1995, adjusted for known changes.

Q. Why has the company elected to use a year end rate base rather than an average rate base?

A. As I have stated, substantial plant additions were completed during 1995. Most of them were not booked until at least the middle of the year. Almost $7 million in additions were made during 1995, yet there is a $4.8 million dollar difference between the average and year end balances of total water and wastewater plant in service. Unless a year end rate base is utilized, the opportunity to earn a return on the portion of $4.8 million used to serve the public will be lost.

RATE BASE

Q. How was rate base developed?

A. The rate base consists of the adjusted year end balance for the period ending December 31, 1995 of the following components: plant in service, less accumulated depreciation, less contributions in aid of construction (CIAC) net of amortization, less advances for construction associated with used plant plus the net balance of deferred taxes and an allowance for working capital. Each of these components is adjusted to reflect ratemaking considerations. And, each of these components is

adjusted, where applicable, to reflect only the investment that is used and useful in the public interest.

Q. Did you make any adjustments to the book balances of these component accounts?

A. Yes, I did. First, with regard to Plant in Service, I allocated general plant between the water and wastewater systems. PCUC books all general plant under the NARUC water system accounts. I also transferred, or reclassified, some wastewater plant balances to reflect their current use. This includes transferring some 2.3 MGD oxidation basin trains from Plant in Service to Plant Held for Future Use and transferring advanced sewer mains from Plant Held for Future Use to Plant in Service. The oxidation basin trains are not currently in use but may be reactivated in the future. The advanced sewer mains that were being held for future use have been determined to be necessary, to some degree, to provide service to existing customers. Their used and usefulness has therefore been analyzed in the same manner as all other mains.

Q. Did you adjust any other rate base components besides Plant in Service?

A. Yes. Adjustments associated with the Plant in Service adjustments were made to Accumulated Depreciation. The balance of the Construction Work in Progress account was removed from rate base. In addition the balance of the Advances for Construction account was adjusted for used and useful considerations. This was done because the balance in water rate base is related to advanced property which has been eliminated from rate base as 100% non-used. The balance in the wastewater rate base is related to the advanced mains which I previously indicated has been transferred to Plant in Service for ratemaking purposes. It has been adjusted by the same percentage used and useful as the mains with which it is associated.

Q. Rate Base includes the line item "Net Debit Deferred Taxes (Used)." Please explain what that item represents.

A. Commission Rule 25-30.433(3), F.A.C. requires that the used and useful portions of debit and credit deferred taxes be offset against one another for ratemaking purposes. If the net balance is a

credit, it is to be included in the capital structure. If it is a debit, it is to be included in rate base. In this case, the net was a debit. Only the used and useful portion is shown in rate base Schedules A-1 and A-2 of Exhibit 7 (FS-1). The allocation of deferred taxes to the water and wastewater systems and the determination of the used and useful portion is shown in detail in Exhibit 7 (FS-1), Schedule A-3-DTAX. As that schedule indicates, the debit deferred taxes are associated with taxes on CIAC. Credit deferred taxes are primarily associated with timing differences between book and tax depreciation. Therefore, the used and useful adjustment for the debit deferred taxes is proportionate to that for CIAC, while the adjustment for credit deferred taxes is proportionate to used and useful plant.

Q. How did you calculate the Working Capital component of Rate Base?

A. In accordance with Commission Rule 25-30.433(2), F.A.C., working capital was calculated using the balance sheet approach. On that basis, the working capital calculation results in a numerically negative amount. I have therefore included zero

working capital in rate base. However, we take the position that the balance sheet method does not reflect the utility's need for working capital, but rather it reflects the level of net current assets and deferred non-tax debits that exists. On the surface, a negative working capital says the utility has no liquidity, that is, it does not have cash to cover current payables. The proper ratemaking treatment should be to provide the working capital that the utility needs. In this case, use of the balance sheet method ignores that need.

Q. Were adjustments made to Plant in Service for used and useful considerations?

A. Yes. The components of the system were analyzed by consulting engineer, Mr. John Guastella (see Exhibit 15 (JFG-1). I have adjusted Plant in Service, Accumulated Depreciation and Depreciation Expense by the used and useful percentages developed by Mr. Guastella. In addition, consistent with ratemaking treatment in previous cases, non-used adjustments were made to CIAC and Accumulated Amortization of CIAC. Basically, the only CIAC considered used is that paid by customers,

according to the utility's records, adjusted for year end amounts.

Q. Mr. Seidman, you have prepared used and useful analyses in several rate applications before this Commission, have you not?

A. That is correct.

Q. Do you agree that it is not proper to impute CIAC against the ERC's in margin reserve?

A. Yes I do. In its last case, PCUC voluntarily imputed CIAC to be consistent with the Commission's prior treatment and to eliminate one issue in an extremely complicated case. But in doing so, it was noted by Mr. Guastella that such treatment was improper if rates are to be set equal to cost. I agree that such treatment is improper and have consistently stated so in all testimony I have presented before this Commission in rate cases and in rulemaking. The costs of plant associated with providing a margin reserve is a necessary part of used plant, is an investment of the utility necessary to meet its statutory obligations and is properly recoverable from current ratepayers.

Q. What is the net result of the adjustments to Rate Base?

A. After all adjustments, the rate base for the test year ended December 31, 1995, on a year end basis, is $21,328,433 for the water system and $16,031,209 for the wastewater system.

OPERATING REVENUE

Q. What is included in operating revenue?

A. Operating revenue includes revenue received and projected for 1995 from the sale of utility services and from miscellaneous charges to the customer such as connection or reconnection charges.

Q. Were there any adjustments to the 1995 actual and projected operating revenues?

A. Yes. I allocated Miscellaneous Revenues between the water and wastewater systems; on its books, PCUC shows all Miscellaneous revenue under the NARUC water account. I adjusted revenues to annualize the effect of a pass-through and rate index adjustment that became effective for service rendered in November, 1995. I also adjusted revenue to reflect

year end customers, consistent with our use of a year end rate base. Included in this adjustment is the anticipated decrease in revenues from the Hammock Dunes development. Hammock Dunes purchases bulk water from PCUC and distributes to its residents. Hammock Dunes had engaged in a considerable amount of flushing over the past year. PCUC has been informed that flushing will decrease significantly. The revenue adjustment reflects the anticipated normal level of consumption by Hammock Dunes.

OPERATING REVENUE DEDUCTIONS

Q. What is included in operating revenue deductions?

A. Operating revenue deductions include operation and maintenance expenses, depreciation and amortization expenses and all tax expenses.

Q. Did you make any adjustments to test year operating and maintenance expenses?

A. Yes. I adjusted electric and chemical expenses to reflect consumption at year end customer levels. This adjustment includes the effect of the anticipated reduced consumption by Hammock Dunes.

Q. Did you make any adjustments to O&M expenses for excessive unaccounted-for water or infiltration and inflow?

A. No. No such adjustments were necessary. As shown in Exhibit 7 (FS-1), Schedule F-1, Unaccounted-for water for the test year is less than 5% of gallons pumped. This is well within the range considered reasonable for any water distribution system.

With regard to infiltration and inflow in the wastewater collection system, I measured the gallons treated but not billed-for against the specification allowance for infiltration set out in Water Pollution Control Federation Manual of Practice No. 9 and found it to be well within that specification allowance. Since the total amount not billed-for fell within the specification allowance for infiltration, I did not separately address the amount of inflow.

Q. Did you adjust O&M expenses for used and useful considerations?

A. Yes. Consistent with past filings, an analysis of the operating departments for used and useful was performed (see Exhibit 7 (FS-4)). It is quite

unusual for a utility to perform a used and useful analysis of its operating departments. The Commission has always recognized that O&M expenses are composed in general of variable, not sunk costs and that operating costs are typically geared to serve only current customers even though large amounts of plant may be non-used and useful for ratemaking purposes. However, several rate cases ago, PCUC recognized that because it was closely associated with the developer, in the early stages of development some of its employees would be devoting time for planning, record keeping and maintenance associated with developing the community in general and maintaining non-used plant. This is the third rate case in which an analysis has been performed and, judging from its results, it will probably be the last. As the summary of the analysis shows on Schedule B-3-O&M, the amount of "non-used" operating department expenses is now down to less than ten percent. Only the expenses related to maintaining the distribution and collection mains still show non-used amounts of any significance. The analysis methodology is consistent with that used in previous rate cases.

Q. Did you compare the adjusted operating expenses with those allowed in the last rate case?

A. Yes. That comparison, by departments, is set out, as required in Exhibit 7 (FS-1), Schedules B-7 and B-8. In those schedule, the adjusted test year expenses are compared to the expenses allowed in the last rate case after allowing for changes in customer growth and the consumer price index.

Q. How do adjusted test year expenses compare?

A. The adjusted test year expenses compare favorably when consideration is given to increases not directly affected by inflation or growth. One must remember that the expense comparison required in the MFR is a simplified guideline. Its underlying assumption is that, after adjusting for inflation, the unit cost of O&M remains the same. So if it costs $10.00 to serve one ERC, it will cost $20.00 to serve two ERC's. This is not necessarily the case. For example, the cost of health insurance have changed dramatically over the years. The cost per employee has risen far in excess of the rate of inflation, without even considering the changes in the services offered under a health care package. Another example of changes that cannot necessarily

be tied to growth or inflation is the change in the number of employees. At the time of the last rate case, PCUC operated its wastewater treatment plant with the equivalent of 1.5 operators. It now takes six people to operate that plant. The reason is a change in classification of the plant under Department of Environmental Protection rules resulting in a change in staffing requirements. A plant that once required operator attendance for six hours a day, five days a week, now must be staffed 16 hours a day, seven days a week, and the lead operator must have a higher rating. Another factor that results in cost changes not directly related to growth or inflation is when growth must be met by adding a treatment plant rather than expanding an existing one. This requires a second set of personnel, not just a proportional increase in staffing. All of these examples represent changes undergone by PCUC since its last rate case. These and other related changes are outlined in Exhibit 7 (FS-1), Schedules B-7 and B-8. When they are taken into consideration, the level of PCUC's O&M expenses are reasonable.

Q. Did you adjust operating expenses for the test year to recover the cost of this rate case application?

A. Yes. I have estimated the cost of this application to be $ 301,500 to complete it through the hearing and post hearing process. Exhibit 7 (FS-1), Schedule B-10 details the rate case expense components. Rate case expense is to be amortized over four years at the annual rate of $ 37,688 each for the water and wastewater systems.

Q. What adjustments were made to depreciation expenses?

A. Consistent with the allocation of general plant, I have allocated the associated depreciation expense. I have added or reduced the expense accordingly that is associated with plant reclassified between Plant in Service and Plant Held for Future Use. I have also adjusted depreciation expense to amounts consistent with year end plant balances. Finally, the used and useful factors developed for Plant in Service have been applied to depreciation expense.

Q. Did you adjust the CIAC amortization expense also?

A. Yes. CIAC amortization was adjusted to recognize year end plant balances.

Q. What are the adjustments shown on Exhibit 7 (FS-1), Schedules B-1 and B-2 for Amortization, CIAC Tax Gross-up?

A. Those adjustments make the amortization of the CIAC tax consistent with the year end balance of the CIAC tax gross-up account.

Q. What adjustments were made to Taxes Other than Income?

A. I adjusted the Regulatory Assessment Fee (RAF) to equal 4.5% of the adjusted operating revenue. I removed the RAF associated with the Community Development Corporation Revenue Agreement. I reallocated the payroll and other taxes associated with the administrative departments to be consistent with the allocation of those departmental expenses between the water and wastewater systems. And I adjusted the property taxes to reflect the current millage and valuation amounts.

Q. Have you included an allowance for income taxes?

A. Yes. The income tax provision treats PCUC on a stand alone basis, with the required recognition of a parent debt adjustment.

CAPITAL STRUCTURE

Q. What is the capital structure of the utility?

A. The capital structure, shown in Exhibit 7 (FS-1), Schedules D-1 and D-2, consists of equity, long and short term debt plus customer deposits and accumulated deferred investment tax credits. The capital of the utility has been reconciled to rate base on a prorata basis.

Q. Were any adjustments made to the capital structure?

A. No. However, consistent with a year end rate base, year end amounts were used to determine the weighting of the components. The cost used for each debt component is the interest expense for twelve months divided by the average balance of the component. That rate is applied to the year end amounts.

Q. What is the rate of return for the Equity component of capital?

A. The rate of return for the equity component is 11.10%. This is based on the most recent leverage formula adopted by the Commission in Order No. PSC-95-0982-FOF-WS, issued August 10, 1995, applied to PCUC's equity ratio.

Q. What is the rate of return which the utility should be allowed to earn on its rate base?

A. The rate of return which the utility should be allowed to earn for the test year is 8.84%, which is the weighted cost of debt and equity.

Q. Are you proposing any change in the rate for Allowance for Funds Used During Construction (AFUDC)?

A. Yes. We are requesting that the Commission authorize the AFUDC rate to be changed to the approved weighted cost of capital.

REVENUE REQUIREMENT

Q. What is the revenue requirement necessary to recover the utility's cost of service, including a 8.84% return on rate base?

A. The revenue requirement is $ 6,971,647 for the water system and $4,906,850 for the wastewater system, as shown in Exhibit 7 (FS-1), Schedules B-1 and B-2. The increase in revenue required to produce this level of return is $1,479,626 for the water system and $1,575,817 for the wastewater system.

RATES AND RATE STRUCTURE

Q. What rates are proposed to produce the revenues required?

A. The rates proposed are summarized in Exhibit 7 (FS-1), Schedule E-1.

Q. Is PCUC proposing to remove or add any rate classes?

A. Yes. PCUC is proposing to eliminate the Public Hydrant Charge. Public hydrants provide for the public welfare of all PCUC customers and the cost of maintaining hydrants can be absorbed by all customers without any discernible impact. Public fire hydrant revenues represent approximately 1.8% of the requested water revenues.

PCUC is also proposing to add a new rate class for effluent reuse customers, as developed in a cost study prepared by Mr. Guastella. The costs associated with providing reuse service have been used to reduce the costs to be recovered from other wastewater customer classes. The proposed charge for effluent reuse service is $0.67 per 1000 gallons and is projected to generate annual revenue of $195,640 on a proforma basis.

Q Have you proposed any change in rate structure?

A. The only structural change proposed is that for Private Fire Protection Service (PFPS) customers. Currently, these customers pay a monthly rate equal to one-third of the base facility charge for the equivalent meter size. In accordance with Commission Rule 25-30.465, that charge must be reduced to one-twelfth of the base facility charge. This 75% reduction in the PFPS charge will now be passed on to other water customers.

The present rate structure for metered services includes a base facilities charge and a gallonage charge as recommended by the Commission. The requested rates maintain that same rate structure, however, the relative portions of costs to be recovered through the base facility charge and the gallonage charge has been changed in accordance with the cost allocations in Exhibit 7 (FS-1), Schedule E-13A. These cost allocations are consistent with those developed as a guideline by the Commission staff.

SERVICE AVAILABILITY CHARGES

Q. Are you proposing any changes to the service availability charges?

A. Yes. Coincident with the filing of this rate case, PCUC filed Exhibit ____ (FS-5), an application to change service availability charges. An analysis was prepared of the range of service availability charges that meet the guidelines in Commission Rule 25-30.580, F.A.C. The method of determining plant and CIAC balances utilized in this analysis is consistent with that used by the PSC staff in its analysis of fees the last time they were considered for change. The analysis is based on the costs, ERC's and capacities developed for the projected 1995 test year. The analysis shows the water charge meets the guideline minimum, but the wastwater charge does not. It also shows that the present fees will result in net CIAC levels of 55% and 71%, for water and wastewater, respectively, at the next treatment buildout level. The proposed charges will bring the level of water and wastewater net CIAC close to the guideline maximum. It will also bring wastewater gross CIAC up to the minimum guideline level. In the case of wastewater, the minimum and maximum levels are nearly the same. The water

charge would increase from $766.00 to $1,500.00. The wastewater charge would increase from $1,466.00 to $1,600.00. We do not propose any changes in meter and service installation fees.

Q. Does that conclude your prefiled direct testimony?

A. Yes it does.

MR. GATLIN: Mr. Seidman is available for questions.

COMMISSIONER DEASON: Does the County have questions for Mr. Seidman?

MR. SIRKIN: Would you like us for us to go first?

COMMISSIONER DEASON: Normally we go from left to right. But if there is a preferred order, I will accept that.

CROSS EXAMINATION

BY MR. SIRKIN:

Q Good afternoon, Mr. Seidman. My name is Arthur Sirkin. I'm here representing the County in this proceeding.

I'd like for you to explain how the charge for each 100,000 gallons of capacity for Dunes was arrived at? Dunes, I understand, has an up-front charge, if you understand my question.

A Yes. The charge for reserving capacity for 100,000 gallons.

Q Yes, sir.

A I believe that was arrived at by a formula in a Commission Order.

Q Is that order in the record? Is that one of the documents that have been admitted into the record?

MR. MELSON: Chairman Deason, that is one of the orders that Dunes was just granted official recognition of, Order 21606.

BY MR. SIRKIN:

Q Does that include a margin reserve and a margin reserve gross-up as the Company is asking for from all the rest of the users of the system?

A I don't believe so. I think it includes only -- is a charge related only to the incremental cost of facilities to provide that capacity.

Q So Dunes has not paid for a margin reserve to the best of your knowledge?

A In that rate, that would be correct.

Q What about Mr. Guastella's suggested 20% economy of scale gross-up, does it include that?

A No, it would not.

Q Thank you.

In your testimony, Page 10, Line 3, in your rebuttal testimony, you talk about Palm Coast being plated for 46,000 lots, of which 12,000 have customers; is that correct?

COMMISSIONER DEASON: Excuse me, let me ask a question at this point. I understand that we're doing direct and then rebuttal is to follow. We're not going direct and rebuttal simultaneously; is that

correct?

MR. EDMONDS: That's correct.

COMMISSIONER DEASON: Your question pertained to --

MR. SIRKIN: Oh, I'm sorry. I didn't realize that was the rule. My apology. (Pause)

Q Mr. Seidman, can you refer to MFR F-1, Page 118. I'd like you to refer to the item called "other uses."

A Yes, sir.

Q Could you please explain what is in that category? Not with the exhibits, not what the Florida Public Service Commission requires, but what is actually in there as far as the Company is concerned. Did they include all of those various items in that category?

A In the "other uses" category there is primarily flushing water. There are some other things that we've broken down in response to a request for document or an interrogatory, but primarily it's flushing water.

Q What other things would be in there?

A Construction water. Maybe leaks.

Q Would leaks be unaccounted-for water or do you account for leaks?

A These would be accounted-for leaks. These would be some major leak that could be identified.

Q And how do you determine the volume of water that was flushed?

A The Company normally determines the amount of water for flushing by timing the amount of time the hydrant is running times the rate that it's running at. They do daily flushing reports.

Q Where is plant use water accounted for?

A Plant use water?

Q Uh-huh.

A I'm not sure.

MR. SIRKIN: That's all the questions I have on your direct testimony at this time.

COMMISSIONER DEASON: Mr. Reilly. Excuse me.

COMMISSIONER JOHNSON: Did it relate specifically to Dunes?

MR. SIRKIN: It related to Dunes' up-front charge for the 100,000 gallon units. The question was does it include the margin reserve and the gross -- economies of scale gross-up the Company is requesting of all other ratepayers.

CROSS EXAMINATION

BY MR. REILLY:

Q Mr. Seidman, how are you doing?

A Okay.

Q Am I correct that to estimate the reuse revenue from Hammock Dunes you assumed that Hammock Dunes would take 800,000 gallons per day times 365 days?

A I'd have to check on that.

Q Would you accept that figure, subject to check.

A Yes.

Q And in your calculation, am I correct you multiplied this total number of gallons, which is 292 million gallons, that would be 365 times 800,000, times your proposed rate of .67 per thousand gallons to arrived at the revenue to be generated of 195,640?

A I believe that's correct. The reason I hesitated before is this calculation was done by Mr. Guastella in his effluent disposal -- I'm sorry, is this water or wastewater?

Q This is effluent.

A Yes, that was calculated in his study.

Q Am I correct that Hammock Dunes has agreed to use its best efforts to take up 1.6 million gallons

a day of reuse on an average annual basis?

A You'd have to ask Mr. Guastella that. I didn't do anything on the effluent disposal except to transfer the revenue dollars into the rate calculation.

Q We're going to pass out an exhibit, FS-1D, and it is a response to OPC Document Request No. 62, it includes legal bills for the year ending 1995.

COMMISSIONER DEASON: Do you wish to have it identified?

MR. REILLY: I'd like to have it marked for identification purposes.

COMMISSIONER DEASON: Exhibit No. 8.

(Exhibit No. 8 marked for identification.)

Q (By Mr. Reilly) If you could turn to Page 3 of this exhibit, and the numbers are on the bottom left corner.

A Yes, sir.

Q It appears to be a bill from the Gatlin, Woods, Carlson & Cowdery for the month of January 1995, would you agree?

A Yes, sir.

Q There's an entry which I have marked which reads "Telephone conferenced regarding Governor's policies on agency budget and FAC reduction." Do you

know what this is related to?

A Not other than what it says, relating to the reduction in rules.

Q Excuse me?

A Reduction in rules, administrative code.

Q Do you know what agency that this is referring to?

A No.

Q Can you tell us why the costs should be recovered from ratepayers since it appears to be related to legislative matters?

A If they are legislative matters that have a effect on the Utility, I think they would be properly included as a legal expense.

Q Can I have you turn to Page 5 of this exhibit? This is another bill from the same law firm, would you agree?

A Yes, sir.

Q There's a similar entry that I've marked which states "Review agency budget reduction documents." Do you know what agency or budget reduction is referred to here?

A I would only have to guess because it's followed by PSC Annual Report Excerpts, but that would be a guess.

Q So you believe it relates to the agency as the PSC?

A I would believe so.

Q Could you turn to Page 6 of this exhibit. This is another legal bill from the same law firm; is that correct?

A That is correct.

Q I marked the first entry which states that it relates to CIAC payment by installment. Do you know what this relates to?

A This relates to an attempt by the Utility to see if they could get authority or permission to allow people on the beach side to pay their service availability charges over time. These are people that have access to the system now that lines are out on beach-side but were existing homes. And as an inducement to get them to hookup, they were trying to give them an option of paying the service availability charge over time.

Q So this does not refer to any monies to be received from Hammock Dunes?

A No.

Q What will happen if the service availability charges change over time and the person is making their payments on an installment basis? Do they have

any rights to -- what exactly is the nature of the agreement reached with the Utility on this installment payment?

A I don't know the exact terms of the agreement. My understanding is that if the agreement exists, that it's approved by the Commission, so whatever terms are in that would be applicable. I would assume -- well, I won't assume anything on it.

Q Has it, in fact, been approved by the Commission?

A I don't know.

Q Could I have you turn to Page 7. There's an entry which I've marked which is for the proposed rate case. Was this amount charged to rate case expense or test year expenses?

A I don't know. I would have to coordinate this exhibit with our rate case expense exhibit to see if it is included in that amount.

Q But to be included in this response to this discovery at least evidences that it is to be included in test year expenses?

A I don't know what the question was for the request.

Q If it is in test year expenses, should it be removed and put into rate case expense?

A It could go either way. Since it seems to precede the case, it looked like maybe at that time there was a conference to determine whether or not they were going to file a case; it could go either way.

Q Also on this same page there's an entry for privatization for the charge of $210. Do you know what this relates to?

A No, I don't.

Q Could you turn to Page 8. I want to address both entries on this page. The first relates to CIAC payment by installment. Would I be correct this relates to the same matter previously discussed?

A Yes, that's correct.

Q The next charge is for developer agreements. Can you tell me if this relates to a developer agreement that result in guaranteed revenue or CIAC?

A Yes. It relates to guaranteed revenue or CIAC.

Q Do you know which?

A I don't know.

Q If it relates to guaranteed revenues, should these costs be recorded below the line since the associated revenue is recorded below the line?

A You mean should the legal expense be below

the line?

Q Yes. If the expenses involved in developing a developer agreement that relates to generating guaranteed revenues, should the expense associated with that revenue also be put below the line?

A No. I think it's probably above the line because it's an effort by the Utility to determine financing. If they are able to work out something that provides either a guaranteed revenue or some type of a fee, then it relieves the other customers of cost.

Q Now, if it relates to CIAC, do you know if the CIAC is used and useful?

A Eventually it would be. It depends on what the agreement says when it comes in and what it is for.

Q And your view would be that current ratepayers should pay for these expenses whether the associated CIAC is associated with nonused and useful or used and useful --

A As far as, yes, legal expenses to do with utility business, yes. It's still utility business.

Q Could you turn to Page 9. The first entry which I have marked says "in reference to airport." Do you know what this matter is about?

A This relates to the agreement with the county airport to provide service.

Q Do you know what the status of this project is at this time?

A There is an agreement to provide service.

Q And as far as the work to run the lines, do you know where the Utility -- has any of the work begun?

A No. The agreement was just sent -- entered into in the past month, I believe. They just had a groundbreaking last month.

Q There are also three entries for developer agreements on this same page. Can you tell me for each if the legal services performed relate to developer agreements which produce guaranteed revenue CIAC, and if CIAC, whether the CIAC is used and useful or nonused and useful?

A I can't tell you.

Q Could you turn to Page 10. The first entry is for the airport. Is this the same matter discussed previously?

A Yes.

Q The second marked entry is developer agreements. Can you tell me if the legal services performed relate again to developer agreements that

relate to those same subjects I alluded to before?

A I don't know.

Q Will you turn to Page 11?

A Whatever it was it ended up as an agenda item before the Commission.

Q Okay. Page 11 under the section "General and Miscellaneous" there's an entry which states "Telephone conference regarding legislative matters." Do you know what legislative matters were addressed?

A No, I don't.

Q Would you turn to Page 14. Again there's an entry for developer agreements. Can you again shed any light on the subject of these agreements as to their relationship to --

A This would have been with regard to the application to increase the service availability charges.

Q Separately docketed.

A Separately docketed, yes.

Q There's also an entry which I have marked labeled "service availability."

A I'm sorry, that's what I was talking about.

Q Okay. Do you believe that the cost associated with developing the information to file your service availability charge is an expense that

should be collected from ratepayers?

A Yes.

Q Is the development of a service availability docket a recurring expense that the Utility could expect to undertake, or is it, in fact, an abnormal or nonrecurring expense that would only be expected to occur once in a number of years?

A Once in a number of years.

Q Has the Commission not in such instances more appropriately amortized that expense over a five-year period as opposed to expensing the full cost in the subject test year?

A I think in general that's correct. Because usually when I have done service availability charges they have been considered at the same time as the rate case and would have been part of the rate case expense.

Q And then --

A That would have been amortized with it.

Q Over a four-year period?

A Right.

Q Do you know what happens when they are done separately and not made a part of the rate case in terms of the expenses? Do they roll it into the calculation of the service availability charge or is

there any amortization?

A Neither. If it was just done as a separate docket outside of the scope of a rate case, there would be no way for the Utility to recover it because it would be just an expense in that year. Because the rate case expense is not part of what is recovered in the service availability charge.

Q Moving on to Page 15, we've highlighted several items. Now this is a bill from the law firm of Chiumento, Katz & Guntharp that were dated July 3, 1995?

A Yes, sir.

Q Could you please review the three entries that I've marked. These all appear to relate to a lease agreement with BellSouth Mobility for the lease of a water tower used by BellSouth Mobility. Would you agree?

A Yes. At least one of the entries does mention the water tower, and the others don't but I'll assume they are associated with it.

Q And the others mention BellSouth?

A Yes, they do.

Q Do you know what all this relates to?

A No, I do not.

Q Would it be reasonable to conclude that

BellSouth Mobility wants to lease the water tower to install an antenna?

A I don't know.

Q If this assumption is correct, would you expect that the lease agreement would generate revenue for the Utility?

A If they lease it for a price, yes.

Q Since it relates to a water tower that is partly or wholly included in rate base, shouldn't the lease revenue also be included in test year regulated revenue, or at least for that portion of the water tower which is included in rate base as used and useful?

A I wouldn't have any problem with that.

Q You would not. Could you provide that as a late-filed exhibit of the lease agreement between PCUC and BellSouth Mobility, assuming that there is such a final agreement, and if not, a draft of the document.

COMMISSIONER DEASON: Mr. Seidman, can you provide that?

WITNESS SEIDMAN: I don't know. I'd have to find out. I don't know if it's been executed.

MR. REILLY: I missed that.

COMMISSIONER DEASON: He's not sure that such a document has been executed.

MR. REILLY: What our request would be is if we could get a copy of the document, if it's executed, if it's -- excuse me a second -- we would request a draft, the latest draft if there's not an executed --

MR. GATLIN: Mr. Chairman, we would object to furnishing a draft of a document that's in negotiations. We would not be able to do that.

COMMISSIONER DEASON: There's been an objection to such an exhibit, Mr. Reilly. Would you care to respond?

MR. REILLY: I would say that with the direction that we're headed, to try to input the income with the associated expense, that we would restrict our request to an executed agreement. If such an agreement does exist, we would continue to request a copy of it. If no agreement has yet been reached, then we will be satisfied not to receive it.

COMMISSIONER DEASON: If such an executed agreement exists, is there any objection to providing that?

MR. GATLIN: If it's executed we will provide it.

COMMISSIONER DEASON: We will identify it is Late-filed Exhibit No. 8 -- I'm sorry, Late-filed Exhibit 9, the executed agreement, if one exists

between, Palm Coast Utility Corporation and BellSouth Mobility.

MR. REILLY: Okay, thank you.

(Late-Filed Exhibit No. 9 identified.)

MR. REILLY: I'm having another exhibit handed out labeled FS-2D, top left-hand corner. This is the Company's response to OPC Interrogatory No. 47 which asks for the amount of guaranteed revenue received by the Company.

COMMISSIONER DEASON: Do you want this identified?

MR. REILLY: I'd like to have this identified.

COMMISSIONER DEASON: Exhibit 10.

MR. REILLY: Thank you.

(Exhibit No. 10 marked for identification.)

Q (By Mr. Reilly) Mr. Seidman are you familiar with how the Company determines the amount of guaranteed revenue that it collects from various developers?

A I'm somewhat familiar with the development of the one for ICDC; not particularly with the others.

Q Now, excluding -- well, excluding ICDC, does the amount of guaranteed revenue change depending on how much the plant -- how much the Commission

determines is used and useful, or do you have even not that level of understanding.

A No. I haven't looked at those agreements.

Q Could you look at the last page of this exhibit, and it's my understanding that all of these are monies received from these various entities to compensate the Utility for nonused and useful plant; is that correct?

A Well, it looks like the Hammock 1 has to do with expenses and taxes to do with some portion of plant. And the others, all we have is a cost of capital gross-up involved in there.

Q With respect to Hammock Dunes Phase 1 and 2, what nonused and useful O&M is Hammock Dunes reimbursing the company for?

A I don't know what the agreement says. I'd have to look at the agreement.

Q Does Mr. Guastella know anything, or do you have any idea about whether he could answer that question?

A No, but it's something I can find out for later.

Q Perhaps at the time of rebuttal testimony we could have that clarified?

A That would be fine.

Q Again, the same answer; you would not know what nonused and useful property and other taxes is Hammock Dunes reimbursing the company for?

A I don't know what is being reimbursed in there.

Q Have any of the customers of Hammock Dunes Phase 1 and 2 connected to the utility system; do you know that?

A No.

Q And do you know if the Company's proposed '95 rate base includes any plant that will serve Hammock Dunes Phase 1 and 2?

A I don't know anything about these agreements.

MR. GATLIN: Mr. Chairman, you talk about finishing tomorrow. I'm not sure we'll finish in three weeks. It looks to me -- and I object to these kinds of questions -- it looks like we're just -- we're conducting discovery now; and the time for discovery is over, to bring these exhibits out and then ask each little column and each where it came from. That's not cross examination. It's not his exhibit.

COMMISSIONER DEASON: Mr. Reilly?

MR. REILLY: I believe this is a response to

our interrogatory request. I believe that this is a legitimate issue in this proceeding, and we're trying to quantify and understand this whole guaranteed revenue arrangement. And I would hope that we'd be given latitude to pursue that.

Now, this witness does not appear to be able to answer any questions on this exhibit, and I had decided I was going to move on to my next set of questions.

COMMISSIONER DEASON: Very well.

MR. REILLY: But I wouldn't want to have to endure these kinds of objections every time we ask questions about a highly relevant issue.

COMMISSIONER DEASON: Well, let's proceed, and if there's another objection, we'll deal with it --

MR. REILLY: We'll deal with that. Okay.

Q (By Mr. Reilly) Let me ask you a few questions about CIAC. PCUC has some CIAC which is held in trust; is that correct?

A Yes, sir.

Q Why is the CIAC held in trust?

A To preserve it for the use of future customers who have prepaid towards it.

Q Now, PCUC also has a substantial amount of

CIAC that is not held in trust; is that correct?

A That's correct.

Q Am I correct that developer Palm Coast, ITT Community Development Corporation, collected water and sewer connection charges from customers and then turned this money over to PCUC?

A Would you repeat the question?

Q Is it not correct that ICDC collected water and sewer connection charges from lot purchasers and then turned that money over to PCUC?

A ICDC collects some type of a charge from people buying property on a time basis and turns that money over to Palm Coast; that's correct.

COMMISSIONER KIESLING: Could you answer his question specifically? You said "some kind of charge." That's not what you asked. Could you ask your question again as to --

MR. REILLY: It's the various CIAC connection charges.

WITNESS SEIDMAN: ICDC collects several charges. I'm not familiar with all of them. Part of it is partial payments, prepayments, that will be available towards the service availability charge when they finally hook up to become customers. And that money is collected, is turned over to Palm Coast.

Q (By Mr. Reilly) Now, is it not true that this money is turned over prior to the customers actually connecting?

A That's correct. It's prepaid. It's a prepaid arrangement between the customer and ICDC.

Q Well, it's, of course, prepaid by the customer and ICDC collects it, but it's also immediately handed over as it's collected to the Utility.

A That's correct.

Q What happens when a connection charge is financed by ICDC? Is the money turn over as collected and only when -- or only when 100% of the connections -- collections have been made?

COMMISSIONER KIESLING: Could you repeat that one?

MR. REILLY: Well, the question relates to the finance charges.

WITNESS SEIDMAN: Whose finance charges?

Q (By Mr. Reilly) Does ICDC retain a finance charge?

A I don't know.

Q Can you explain why Palm Coast has so much prepaid CIAC?

A Because between the contracts between ICDC

and lot purchases, they've collected a lot of money towards their service availability charges for when they become customers.

Q From your experience in the water and wastewater industry, is this normal?

A It's kind of unique. I don't think there's a lot of companies that have done that.

Q Do you know if the developer, ICDC, offered any incentives for customers to prepay their CIAC charges?

A I have no idea about any relationship between ICDC and lot purchasers.

Q So you would not know about any guarantees that ICDC might have made to customers to give them an incentive to prepay?

MR. GATLIN: Mr. Chairman, I object to that question because it's answered in the last rate order that was a three-year investigation. That was an issue in that case and it's spelled out, and Mr. Reilly was there and heard all the testimony.

MR. REILLY: I just wanted to know what this witness knows, if he knows anything --

COMMISSIONER DEASON: I believe the witness says he doesn't know, so we can proceed.

Q (By Mr. Reilly) How long does it take,

approximately, to hire a plant operator; do you know? Do you have any experience or knowledge about the time period that a company could expect?

A I have been associated with utilities, and it varies. If you're lucky -- and it depends on what the market is, you may be able to get a plant operator in a short period of time.

Q And that would be within a month or so?

A I'd say 30 to 60 days.

Q You've included a margin reserve in the used and useful calculations for O&M expenses; is that correct?

A For just certain portions, portions related to lines, maintenance of lines.

Q Have you not included a margin reserve associated with those O&M expenses relating to salaries and -- salaries that maintain the lines?

A Yes; the water distribution and wastewater collection departments. Yes.

Q And is it not true that you've requested a five-year margin reserve for wastewater and three years for water?

A I believe that's correct.

Q If it only takes the kind of time that we were discussing earlier to hire an operator, would you

feel it's still appropriate to include a margin reserve of such long periods in the O&M expenses?

A I don't think the margin reserve was meant to cover the length of time it takes to hire an operator.

Q What do you believe that it should be designed to cover?

A It relates to the time to cover the plant that's covered -- the plant that's included in margin reserve is used and useful plant.

COMMISSIONER DEASON: Mr. Seidman, those operating expenses would not already be reflected in the operating statements of the Company?

WITNESS SEIDMAN: Yes; but we've done a used and useful analysis of the operating expenses and have taken some of them out, specifically with regard to the expenses related to operating and maintaining a water distribution and collection system, since they are of a sizeable amount that's nonused.

And so in doing that, when we determined what portion of the actual expenses for maintaining those portions of the system, what they were, we included a factor for maintaining the portion of the lines that would be included as margin reserve.

Q (By Mr. Reilly) The Company is, of course,

separately asking for a margin reserve on plant, as I understand it, and that plant is covered by that margin reserve.

I understood this margin reserve associated with O&M would apply more to the personnel and the expenses associated with those personnel in operating that plant, and that was the nature of my question. And you said, "well, it's really designed to cover the cost of the plant, and --

A No, I'm sorry --

Q -- if I misunderstood your answer --

A -- if you misunderstood.

Q Okay.

A It's designed to cover the expenses associated with maintaining the plant that's in used and useful margin reserve.

Q Okay.

MR. REILLY: No further questions.

CROSS EXAMINATION

BY MR. MELSON:

Q Mr. Seidman, I'm Rick Melson, representing the Dunes Community Development District. I've got just a couple of questions about the proposed bulk water rate increase.

Is it correct that you determine the new

bulk water rate by applying the same across-the-board percentage increase to the current bulk water rate that you applied to the other current water rates?

A Yes, that's correct.

Q Is Dunes the only customer who pays the bulk water rate?

A Yes.

Q And that bulk water rate today is lower than the general service rate for a comparable meter size; is that correct?

A That's correct.

Q And is the reason that the bulk rate is lower because Dunes has paid up-front advance capacity charges which essentially refund 100% of Palm Coast's investment of the water treatment plant that's necessary to provide that capacity to the Dunes?

A That's correct. A determination was made on a cost per gallon for the capacity, and it's applied to whatever they purchase. And I think it has an indexing formula in it for any additional capacity they may want to purchase.

Q And Dunes also paid a tax gross-up in connection with those advance capacity charges, did they not?

A That would be correct.

Q And is it, therefore, correct that the current rate to Dunes is set to take into account the fact that Palm Coast does not have any remaining water treatment plant investment related to the service of Dunes and, therefore, it doesn't need to recover a return on or return of that investment in the bulk water rate?

A Could you repeat that? That was kind of a long --

Q I'll try.

A -- involved question.

Q Is it correct that the current bulk water rate to Dunes takes into account the fact that Palm Coast doesn't have any remaining investment in the plant necessary to serve Dunes, because that's been paid by the advance capacity charge and, therefore, that rate contains no component for depreciation, return of investment and no component for return on investment or rate of return or related income taxes?

A That's kind of a long way around it. But basically it's lower because they have paid up front for the capacity that they've required, and the return and the different depreciation expenses associated with it is not included in that rate.

Q And is all of the basis for that detailed in

Commission Order No. 21606 in which the bulk water rate to the Dunes was initially approved?

A Yes.

MR. MELSON: I've got no further questions. Thank you, Mr. Seidman.

COMMISSIONER DEASON: Staff?

CROSS EXAMINATION

BY MS. REYES:

Q Good afternoon, Mr. Seidman.

A Good afternoon.

Q Staff is passing out three exhibits that I'll be using in my cross examination. Did everyone get a copy?

Mr. Seidman, I'll refer you to them at the appropriate time.

A That's fine.

Q You're sponsoring the MFRs through Exhibit FS-1; is that correct?

A That is correct.

Q If I could refer you to the exhibit consisting of Staff's Interrogatory No. 50 and 51. That's probably the first one on the stack?

A Yes, I have it.

Q Would you agree that this is the Utility's response to these interrogatories?

A Yes. It looks familiar.

MS. REYES: Commissioner Deason, may we have that identified as Exhibit No. 11, I believe? Short title is Utility's answer to Staff Interrogatory No. 50 and 51.

COMMISSIONER DEASON: Yes. Exhibit 11.

(Exhibit No. 11 marked for identification.)

Q (By Ms. Reyes) Would you agree that according to MFR, Page 31, and the Prehearing Order, that Palm Coast is requesting a 26.94% increase in water rates?

A I'll take your word for that. There's no calculation on Page 31.

Q Subject to check, you would agree with that?

A Yes.

Q Would you also agree, subject to check, that for Hammock Dunes' bulk rate Palm Coast is requesting a 45.89% increase from its current indexed rates?

A If that's what the dollars come out to, yes. I haven't done a percentage.

Q Could you explain why this differs from the Utility's response to Staff Interrogatory No. 50?

A On Page 31 of the MFR where it has operating revenues, where you made the determination of the 26% that is a total percentage increase for all charges

for metered service, and miscellaneous charges are included in there, fire protection service charges are included in there.

Miscellaneous charges were not requested to be increased; therefore, the average increase that would be tied to Page 31 is less than what would be -- show up for any particular line item with regard to specific rates.

Another reason why there would be a difference is that the design of the rate -- there was a split in cost to be recovered between base facility charges and gallons charges; and, therefore, when the percentage is applied, that weighting will affect what the total dollar increase will be for any particular customer.

Q Did Palm Coast do an updated cost study similar to the one conducted in Order No. 21606 to determine the appropriate bulk service rate for Hammock Dunes?

A No. It just, as we indicated, did an across-the-board increase, which is in keeping with the way, I believe, that price indexes have been applied, when they have gone in for that.

Q If I could get you to refer to the second exhibit in the stack. It's the letter dated May 21st,

1996, to Mr. Al Washington.

A I have it.

Q Would you agree these are the Utility's responses to questions raised during the billing audit?

A Yes.

Q Would you agree these are corrections to the rate schedules of the MFRs which you are sponsoring? (Pause)

A I don't see them as changes to the MFR. They refer to the location of where charges are listed in the MFR, not to any changes in the charges themselves.

Q Would it be more correct to ask if these are clarifications to the MFRs?

A Yes, that would be true.

Q And do you agree with these clarifications?

A Yes.

MS. REYES: Commissioner Deason, may we have that identified as Exhibit No. 12, short title, letter dated May 21st, 1996 to Mr. Al Washington?

COMMISSIONER DEASON: Yes. Exhibit 12. Identified.

(Exhibit No. 12 marked for identification.)

Q (By Ms. Reyes) Mr. Seidman, isn't it true

that the Utility is requesting a year-end rate base for both water and wastewater?

A Yes, it is.

Q And would you agree that whether a 13-month average or a year-end test year is used, it should consistently be applied to the both the water and wastewater systems in a rate proceeding?

A Yes, I do.

Q Isn't it also true that Rule 25-30.433 requires a Class A utility to use a 13-month average to calculate rate base unless the Utility demonstrates unreasonable burden?

A I'm going from recollection, but I don't believe that's how I interpreted that to read. I know that the rule required the calculation of rate base on a 13-month average, and I know that there is a provision in the rate rule for deviating from anything in the rule. But I don't know that there was any specific tie between that general request for deviation and the provision of -- in the presentation of a rate case on a 13 month versus a year-end basis.

In other words, put another way, it requires that we present the MFR on a 13-month average. It doesn't require that we ask permission to also do it on a year end basis. We can do that.

And it's been my understanding, and my experience with the Commission, that if we ask for a rate case to be evaluated on a year-end basis, that it's up to us to prove that that's the proper way to go.

Q Mr. Seidman, do you believe that it would be an unreasonable burden on the Utility to implement a 13-month average?

A I'm not sure what you mean by "an unreasonable burden." You mean is it going to cost the Utility money in loss of revenues?

Q Hold on just a second. (Pause)

Isn't it true it would not have been necessary to file for a year end rate base if the Utility had filed a projected test year ended June 30th, 1996?

MR. GATLIN: Would you mind repeating that question?

MS. REYES: Sure.

Q (By Ms. Reyes) The question is: Isn't it true that it would not have been necessary to file for a year end rate base if the Utility had filed a projected test year ended June 30th, 1996?

A If we had filed for a test year ended June 30th, 1996 on an average basis? Is that what you

mean?

Q Yes.

A That would have incorporated the plant that we're concerned about in this case, but it would have required projecting another six months of expenses and revenues and balance sheet items. We would have had a 100% projection at that point, because we were working on it in mid-1995.

We felt it was better and the data would be more reliable to use six months actual and six months projected, rather than 12 months projected.

Q Could I get you to please refer to MFR schedule D-1 and D-2.

A B, as in boy?

Q I'm sorry. I couldn't hear you.

A B, as in boy?

Q D, as in dog.

A Okay. Yes.

Q When reconciling a utility's capital structure to its rate base, do you agree that it is acceptable to make specific adjustments to the capital structure components where possible, and then to spread the remaining difference pro rata over all sources?

A My understanding is that this Commission

uses a reconciled capital structure across the board except for customer deposits, which can be specifically identified with the utility customers.

Q Would you agree that it is acceptable to include in the capital structure, then, the customer deposits, ITCs and deferred taxes that are specifically related to the requested rate base and reconcile any remaining difference pro rata over the investor sources of capital only after specific adjustments?

A If they can be so identified.

COMMISSIONER KIESLING: I'm sorry. Was that a yes?

WITNESS SEIDMAN: Yes, if they can be so identified.

Q (By Ms. Reyes) I'm now going to be referring to Order 22843 from Palm Coast's last rate case, and in that case the Commission imputed ITCs because Palm Coast failed to claim the ITCs on its tax return related to certain additions that were transferred from CWIP to plant in service.

As of December 31st, 1988, the Commission imputed $264,356 of ITCs, and $83,272 of accumulated amortization on those ITCs. Are you familiar with this imputed ITC adjustment?

A Yes. I think I may have even addressed it in either my testimony or the deposition.

Q Amortizing that imputed ITC adjustment forward at 3%, as was done in that order, do you agree that the December 31st, 1995, year end amount of that imputation results in a net $125,569?

A I believe that's covered in my rebuttal testimony.

Q I'm sorry?

A That does sound like the number I had, but I'd have to verify it.

Q If that's in your rebuttal, I can ask you in rebuttal.

A That would be better.

Q I'd like now to talk about the parent debt adjustment and income tax expense.

Is it true that ITT was reorganized in November 30th, 1995?

A Yes.

Q And is it also true that the resulting three companies were ITT, ITT Hartford, and ITT Industries?

A Yes.

Q Do you also agree that Palm Coast parent is now ITT Industries?

A That's correct.

Q Do you also agree that Palm Coast has one parent level only?

A That's correct.

Q And is it true that Palm Coast MFRs reflect the use of ITT's capital structure for the calculation of the parent debt adjustment for Palm Coast?

A Yes.

Q And do you believe that the use of ITT Industries' capital structure for calculating the parent debt adjustment of Palm Coast would be more appropriate?

A Yes. That is the parent now.

Q If I could now get you to refer to the last exhibit that was passed out. That consists of ITT Industries, Incorporated Form 10-Q.

A Yes, I have it.

Q Would you agree that this is ITT Industries, Incorporated's Form 10-Q?

A Yes, it is.

MS. REYES: Commissioner Deason, if we could have that identified as Exhibit No. 13 and titled ITT Industry, Incorporated's Form 10-Q.

COMMISSIONER DEASON: Yes, Exhibit 13.

(Exhibit No. 13 marked for identification.)

Q (By Ms. Reyes) Could we get as a late-filed

exhibit, using Exhibit 13 that was just identified and Rule 25-14.004, the calculation of the parent debt adjustment? We would like it if you could show your calculations so they could be traced to the ITT Industries' Form 10-Q.

A The 10-Q is for the first quarter of 1996, and all it shows is three months ended March 31st, 1995 and 1996. I don't know that there's enough information in this to do the calculation of the debt expense that's going to be necessary to determine the parent debt adjustment without also referring to the 1995 ITT Industries' report that was furnished as a response to request for documents.

If that's all right with you, if it's necessary, I'll refer to that and I'll reference it and trace it.

Q Yeah. That would be fine.

COMMISSIONER DEASON: That will be Late-filed Exhibit No. 14. Could I have a short title please?

MS. REYES: Calculation of parent debt adjustment.

(Exhibit No. 14 marked for identification.)

MS. REYES: Thank you, Mr. Seidman. I have no further questions.

COMMISSIONER DEASON: Redirect?

REDIRECT EXAMINATION

BY MR. GATLIN:

Q Mr. Seidman, look at the MFRs on Page 12, which is a schedule of plant in service by primary account, test year, average balance. What is Column 2 that's numbered 2 up on the top?

A The 13-month average balance for the test year.

Q And that was furnished in the MFRs?

A Yes, sir.

Q And what's the next column?

A The test year, year end.

Q All right. Year end balances?

A Yes, sir.

Q All right. Let me show you a copy. (Hands document to witness). Is a that copy of the application filed by Palm Coast Utility Corporation in this case?

A Yes, it is.

Q What is the nature of Paragraph 12 of that application, and are you familiar with it?

A Yes. It's a paragraph that gives our basis for using a year end rate base.

Q And what was the basis for using year-end?

A That there were substantial and extraordinary plant additions completed during 1995, that there were $7 million in addition --

Q I'm having trouble hearing you.

A That there was $7 million in additions, but there was a $4.5 million difference between average and year end balances of plant.

Q Is it still Palm Coast's position that the year end test year should be used?

A Yes. We think it should be used not only because of the large difference between the average and the year-end plant additions, but also because we've matched it up with year-end revenues and expenses, and it give a much better basis for rates going on into the future.

Q At the time the rates will be in effect?

A Yes, sir.

Q Thank you.

MR. GATLIN: I move exhibit -- excuse me.

COMMISSIONER DEASON: Yes. Exhibits?

MR. GATLIN: 6 and 7.

COMMISSIONER DEASON: Without objection -- I believe 6 is already admitted.

MR. GATLIN: Okay.

COMMISSIONER DEASON: Without objection,

Exhibit 7 is admitted.

(Exhibit No. 7 received in evidence.)

MR. REILLY: Citizens would move Exhibits 8, 9 and 10, and I'm not sure we gave a short title to Late-filed Exhibit 9. I would do so at this time by just identifying as BellSouth lease agreement-executed.

COMMISSIONER DEASON: First of all, is there any objection to Exhibits 8 and 10?

MR. GATLIN: No objection.

(Exhibit Nos. 8 and 10 received in evidence.)

COMMISSIONER DEASON: Exhibit 9 is a late-filed, so we won't move it at this time. Further exhibits?

MS. REYES: Staff moves 11, 12, 13 and 14.

COMMISSIONER DEASON: Likewise 14 is late-filed 14. We won't move it at this time. Without objection, Exhibits 11, 12 and 13 are admitted.

(Exhibit Nos. 11, 12 and 13 received in evidence.)

Thank you, Mr. Seidman. We'll take a ten-minute recess at this point.

(Witness excused.)

(Brief recess taken.)

COMMISSIONER DEASON: Call the hearing back to order. Mr. Gatlin, you can call your next witness.

MR. GATLIN: Call Mr. Guastella.

- - - - -

JOHN F. GUASTELLA

was called as a witness on behalf of Palm Coast Utility and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. GATLIN:

Q Would you please state your name and address?

A John F. Guastella. Business address is 371, Peapack, New Jersey.

Q And have you been sworn?

A Yes, I have.

Q Have you prepared testimony for presentation today in the form of questions and answers?

A Yes.

Q If I were to ask you questions -- the questions set forth therein, would your answers be the same today?

A Yes.

MR. GATLIN: Mr. Chairman, we ask that this

testimony be inserted into the record as though read.

COMMISSIONER DEASON: Without objection, it will be so inserted.

Q (By Mr. Gatlin) Mr. Guastella, you have two exhibits, do you not?

A Yes, I do.

Q And they are described on Page 7 of your testimony?

A Yes.

Q And the exhibits are Used and Useful Analysis, Utility Plant in Service, JFG-1, and Effluent Rate Study Cost Allocation, JFG-2. Is that correct?

A Yes, it is.

MR. GATLIN: Mr. Chairman, may we have those marked as Exhibit 15, maybe?

COMMISSIONER DEASON: Yes. They will be identified as Composite Exhibit 15.

(Exhibit No. 15 marked for identification.)

Q. Please state your name and business address.

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

Q. What is your occupation?

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

Q. Please state your educational background and professional experience.

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

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

My duties with the Commission included the performance and supervision of

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

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

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

corporations and municipal, governmental and political officials.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Q. Would you please explain what you mean by "used and useful?"

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

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

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

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

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

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

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

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

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

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

A. Yes.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Q. Does this complete your testimony at this time?

A. Yes.

MR. GATLIN: The witness is available for questions.

COMMISSIONER DEASON: County?

CROSS EXAMINATION

BY MR. SIRKIN:

Q Good afternoon, Mr. Guastella. If no one minds, I will call you John. Because I'm so used to using that name, I may forget. Good afternoon, John.

A Good afternoon.

Q Is the Dunes 600,000-gallon-a-day effluent requirement a take-or-pay requirement?

A No.

Q Is there a penalty for not taking?

A No.

Q Your 800,000 gallons per day of Dunes effluent that you used in your testimony is based on PCUC's forecast?

A That's correct.

Q When was that forecast made?

A During 1995, when we were preparing the case.

Q So roughly you have what; six months of forecast, six months of actual deliveries?

A I believe that's approximately correct, yes.

Q And I believe the actual amount delivered in

the test year was a million roughly, a million gallons?

A I believe that's correct.

Q Is this degree of accuracy of forecasting normal; you're off by 25% in six months?

A I don't believe there is any normal for -- that I'm aware of for effluent reuse. I could probably give you normals if we were dealing with water consumption and studies, but the effluent reuse seems to fluctuate.

Q You mention that the salaries associated with effluent reuse were determined by reports provided by the company; is that correct?

A The salaries related to certain effluent reuse facilities were provided by the company based on employee reports; that's correct.

Q Do you know what the reports are, what they contain?

A I believe the reports contain time records of certain employees.

Q They're actual time sheets where specific tasks are listed?

A I believe that's correct.

Q You estimated that roughly 85% of residential water sold is returned as wastewater.

Where did that estimate come from?

A That was based on judgment and figures that have been used in the industry based on my experience.

Q Is that based on your experience here in Florida, or general experience?

A Both.

Q Because we had some residential witnesses earlier this morning who were talking about a much, much larger percentage which would not show up in the wastewater that was used for irrigation. Did you take that into account?

A The figures which I used are related strictly to sewer -- water consumption figures, which has a limit on it of 8,000 gallons per month. I believe the irrigation water that customers were talking about may have related to their water consumption for which there is no limit.

Q I don't understand the answer, so let me ask another series of questions. What does the 85% residential sewage use of water sold mean? Can you take me through that?

A Yes. The 85% is a percentage applied to the gallons of water for which sewer customers were billed. Sewer customers are billed on the basis of their water consumption up to 8,000 gallons; not in

excess of 8,000 gallons.

Q Thank you. It is your belief, I believe, that elevated tanks should never be drained down to less than 10% of their capacity; is that right?

A That's correct, under normal operations.

Q Is this based on some analysis of elevated storage tanks?

A No. I didn't perform any special analysis of the tanks.

Q So what is it based on?

A It's based on my discussion with operators here and in other utilities. They simply don't drain their tanks down to the ground, and they certainly don't design them to be utilized for that purpose.

Q Can they be designed to be utilized that way?

A If they can be designed to be operated improperly, they can. I don't think -- I'm not aware of anyone who would design an elevated tank so that during the normal course of operation the tank would empty completely.

Q But don't you need the maximum capacity only during some abnormal conditions, such as a fire where the demand is very high?

A When you refer to maximum capacity, you -- a

utility incurs maximum demands on the system without fire demands. Your storage facilities are going to be dealing with maximum capacity and equalization during maximum days, and then also be able to handle fire flow requirements. And it's true that a fire may occur infrequently, but you need to be prepared to meet that fire demand if and when it occurs.

Q So isn't it likely on a maximum day that you might bring the level below 10%? I assume the maximum day is an unusual day?

A I don't think you would design your facilities for that purpose. I think you would design your facilities so that you at least retain at least 10% in your storage tanks while you experience a maximum day plus a fire demand.

Q And that's based on your belief?

A Yes, of course.

Q You talk about the elasticity of water, water use, and you say, I believe, that water isn't price elastic. Is that your belief?

A Yes. I might -- yes. I believe I do say that in my rebuttal testimony.

Q As a matter of fact, you say it in your deposition. I'm not sure if the deposition covers the direct or the rebuttal. I'll leave it up to your

attorneys to object if I'm asking the question at the wrong time.

Do you still believe that water is not price elastic?

A In the strict definition of the term "price elastic," water is not price elastic.

Q What's the strict definition?

A If the percentage change in consumption -- the relationship of the percentage change in consumption with the percentage change in rate. If it's greater than one, then it's considered price elastic. If it's less than one, it's not considered price elastic.

Q So you don't believe a 30, 40% increase in rates will cause a decrease in consumption in water use?

A No, I didn't say that. There may be some adjustment to water use based on change in price, but it's not because water is considered price elastic. There is some adjustment for reduction in consumption due to price, I believe, but the change is much smaller than what would be considered price elastic.

Q So it's mini price elastic?

A I'm sorry?

Q I say it's mini price elastic.

A I suppose you just coined a phrase.

Q So your used and useful analysis does not take into account when you gross it up for reserve, margin reserve and for your 20% economy of scale factor, does not take into account any elasticity, or any adjustment in the usage?

A No, it would not, even if we were dealing with price elasticity. My used and useful analyses are primarily based on maximum demands, and I believe during periods when customers use larger quantities of water causing maximum demands, I don't think those are the times when they're conserving water. I think it's during the rest of the time they're able to conserve water on an average basis.

So if we're dealing with price elasticity, water is not price elastic in terms of the definition of price elasticity, and even though there is some reduction in consumption, or there may be some reduction in consumption due to changes in price, that's going to happen over an average period.

I don't believe it's going to happen over the maximum day period to any significant extent to warrant an adjustment to the used and useful calculations.

Q John, that's based just on your belief?

Have you seen any studies you could cite where this has been looked at and some reasonable analysis made based on hard data?

A I believe there has been some information as to reductions in consumption based on my experience with different utilities I've worked for, but not necessarily reductions in maximum day demands. I've seen conservation take place without changes in maximum day demands or the utilities.

Q Have you also seen reductions in maximum day demand resulting from alternate -- or adjustments in use?

A It's difficult to attribute the differences in maximum day demand to identify what portion of the maximum day has changed in relation to rates, what portion is changing in relation to weather and customer growth. So I don't recall a study where I can give you a specific answer that the change in the maximum day was due to the change in rates.

In my opinion, any impact on the maximum day because of change in rates would be minimum. The other factors would more impact the maximum day.

Q So it's your belief; right?

A Yes. You realize my belief is based on my experience.

Q We'll talk about that. Let's look at flushing for a minute. What is your experience with flushing? Line flushing that is. (Laughter) I'm sure you have all sorts of flushing experience.

A I'll try to tell you everything I know about flushing.

Q Please.

A All water utilities I've been involved with do perform some type of flushing eventually, and it's going to change depending on the system. And I don't really know if any one system -- I don't know of any system that's alike in that respect.

It's going to depend on the age of the system, the type of pipe, the characteristics, the geographic characteristics of the system. And I haven't done any studies, and I'm not aware of any studies that have converted to a formula, a level of flushing that's appropriate for any utility, or even try to attempt to establish an average utility.

Q John, you've had lots of experience testifying before commissions, working as staff in New York and even running your own water company. Have you ever run into a water company that's well run and well managed and well designed that flushes in the 20% to 25% area?

A I've never measured the flushing in relation to total water sales in all the years that I have been involved in water utilities. Just -- if flushing is needed to maintain quality of service, then that's indeed what takes place. Flushing is essential.

Q Why does this utility flush at that rate?

A I believe the flushing at Palm Coast is for two basic reasons. One is the configuration of the system. A large part of the flushing that you see at Palm Coast has to do with a beach-side community. That is across east of the intercoastal waterway. And in order to maintain quality of service, significant amounts of flushing are necessary for that portion of the system.

The other part of the system is it's an extensive system which requires flushing. It's a growing system, and you'd expect with a growing system that has the extent of mains that this utility has that you're going to have flushing involved with it.

I don't view the flushing to be excessive for this utility in relation to the overall cost of providing service, if that's where this -- the intent of your question is heading; because the system has been installed at historical costs which are much less than they otherwise would have been if it was

installed gradually over time.

And I think the relatively insignificant costs associated with flushing still provide the customers with the benefit of the overall lower embedded cost of the distribution system for this company.

Q Is the distribution system 100% used at this point in time?

A No. I've made adjustments for used and useful with respect to the transmission distribution system.

Q But you've made no calculation to see what it cost this company to flush the nonused and useful portions? It's based on your belief?

A I have made no calculations to determine the costs. It's relatively small costs we're dealing with. There may be some power and chemicals. But I have made rough estimates of what this system would have cost.

I think the system, distribution system, probably would have cost at least three times more than it did cost. So I think given the choice, the customers were better off with the Utility's transmission distribution system having been installed and having some flushing costs, which are really not

that significant in relation -- in overall dollar amounts when you consider that a large portion of the flushing is necessary for the beach side, which is not part of the Palm Coast system.

Q If a quarter of the water treated and produced is flushed, you don't think that creates a significant charge?

A No; in relation to what the costs would otherwise have been.

Q That's not the question. The question is does it create a significant charge?

A I don't believe so, no.

Q But you've done no studies to indicate that?

A Well, we know that we're dealing with power and chemicals, and we know that of the -- and I don't know if we're dealing with a quarter, I thought the figure was more like 18% or so, in that area -- but if we're dealing with a portion of the flushing that's on the beach side, it takes up, I would think, about a third or more of that amount. So the balance is -- I don't think it's out of line for a system of this configuration at all.

Q As I understand it, we have a system that was designed to service approximately 225,000 people, and it's only serving 25,000; is that correct?

A I never looked at the system in terms of population. I've looked at it in terms of customers.

Q What is it in terms of customers?

A Approximately 46,000 customers, the water system; and serving approximately 12,000 customers, I believe.

Q So it's serving about one-quarter of the capacity of the system?

A I don't know. It may vary off of that, because some of the customers are not residential customers; and I was talking about strictly numbers of customers, not commercial, multifamily and residential differences.

Q Do you know what criteria the company uses for flushing? When does it flush?

A I couldn't tell you the specific criteria. I believe they have a routine flushing program where they undertake periodic flushing of different sections of the system. I couldn't give you any more detail than that.

Q Why doesn't PCUC have a need for AFPI?

A I haven't done any calculations as to what level of AFPI would be appropriate, if any, for Palm Coast.

Q What does AFPI do?

A AFPI is an allowance for funds prudently invested. It's a service availability charge that charges future customers the carrying costs associated with nonused and useful plant.

Q Why wouldn't that be appropriate for this utility?

A I didn't say it wouldn't be appropriate. I haven't done any calculations with respect to AFPI. I do know the company has prepaid CIAC, which would be an offset to the carrying costs that would be charged through AFPI, but I haven't done any calculations to see whether, despite the offset, there would still be a feed for an AFPI charge. I just haven't done any calculations regarding that.

Q In your deposition testimony -- and I'm not sure if this relates to your direct or your rebuttal, so we'll depend upon your attorneys to keep it straight here -- you talk about a peaking factor. And you say in the last rate case it was two, and now you believe it's three and a half to four times at the lift stations and you used a factor of 3; is that right?

A Yes.

Q Why do you use a factor of 3?

A Information provided to me by the company in

this case demonstrated that the peaking factor of 2 used in the last case was not adequate and not representative of what the actual peaking factors are. And there are tables which indicate at different flows what peaking factors would be expected. And we've submitted copies of those charts identifying the range of flows of the lift stations at PCUC showing that the peaking factor would exceed 3.

We also, as a late-filed exhibit resulting from the deposition, provided an analysis of two of the largest lift stations showing that the peaking factor is, in fact, 3.

And since those are the largest lift stations, the smaller lift stations are expected to have an even greater peaking factor.

Q As one of the hazards of being a late entry is we've missed a few of the documents.

Are the current ratepayers of PCUC benefiting from the economies of scale?

A Yes; and I believe they will continue to benefit from --

Q How are they benefiting?

A The cost of facilities are installed in larger increments, so that the overall cost of the facilities are cheaper than they would be if they were

installed at, say, 10% of their capacity more often.

Q Well, the current ratepayers now are paying for plant that they are not -- that is not needed now; is that correct?

A No, it's not --

Q They're paying -- sorry.

A It's not correct.

Q If you have your 20% economy of scale factor, they are not paying more now for plant than they would if you didn't include the 20% economy of scale factor?

A They are -- the used and useful calculation that we're including now includes an adjustment for economies of scale, so that in the long run the customers will be paying for plants which cost less than if smaller plants were constructed.

The Utility has already constructed plants that were economically sized for which the customers are getting the benefit; for example, Wastewater Treatment Plant 1 and the original wastewater treatment plant.

Those plants were not constructed in increments at one-sixth or one-tenth the size that it was constructed. So there now exists facilities at the system that these customers have been paying for

all along that reflect economies of scale, and there will be in the future; and that's what the adjustment for economies of scale includes now.

Q But right now ratepayers are paying more -- will pay more if the Commission allows your 20% economies of scale than if it wasn't allowed. It costs current ratepayers more.

A The used and useful adjustments I'm proposing will include more dollars of investment in rate base than without the adjustment, and that will result in rates that are higher than what they would otherwise be.

However, your question was, are the current customers benefiting from economies of scale. They're already benefiting from economies of scale because of the facilities that have been installed by the Utility over the years.

Q But from this point out, you are suggesting that 20% more be added to rate base, to the plant in service and rate base, and that results in a current charge that is more than if it were not included.

A That's correct. And by doing that, the rates to the customers in the long run will be lower than they would otherwise be.

Q But isn't it the future ratepayers who are

benefiting from those economies of scale, starting at this instance in time forward?

A Well, I look at future customers being people who are here now will still be here in the future. So as a utility is designed to serve future customers, I'm anticipating that existing customers will be here in the future along with new customers who are added. And all customers will benefit with a more economically sized and constructed utility system.

Q Don't you say in your testimony that used and useful is to prevent subsidization of future customers by present customers?

A Yes.

Q And now you have future customers paying more to make it less expensive -- current customers paying more to have future customers pay less?

A In a sense that's correct, but future customers include existing customers. The alternative is to have all customers pay more in the future with uneconomically sized and constructed utility facilities.

Q Are all present customers going to be future customers?

A I don't believe they all will. We hope they

all will, but I don't believe they all will.

Q Now, you talked about the CIAC, the CIAC used and useful workshop where the 80% economy of scale -- what do you call this factor? The 80% economy of scale? 20% economy of scale? What shall we call this device you're using?

A Economy of scale?

Q Yeah.

A You could call it an economy of scale factor.

Q Okay. The economy of scale factor --

A And it's a used and useful workshop. That also addressed CIAC in it.

Q And you said you mentioned this at the workshop and that there wasn't any -- the fact that it costs about the same to build a plant that's only at 80% of capacity versus one at 100%?

A That's correct.

Q And you don't recall anybody saying it wasn't correct?

A That's correct.

Q Who was there?

A A number of members from Staff, a number of members from the industry. The Florida Waterworks Association was represented. I believe there was

someone from Public Counsel in attendance. I believe there were people from the Department of Environmental Protection in attendance, and I don't recall whether or not there were people from water management districts or not. There were quite a few people there.

Q So you're saying there were people at that meeting representing the public other than Staff?

A In terms of regulatory agencies, that's correct.

Q I'm sorry. Could you read that back? I was not paying attention.

A In terms of regulatory agencies, that's correct.

Q Well, was there any general members of the public there, let alone regulatory agencies?

A I don't know of any individual customers who were there.

Q Or engineering supply companies or water consultants?

A There were water consultants there.

Q Representing industry, or in a nonindustry capacity?

A I don't -- I was there.

Q Representing industry. (Laughter)

Was there any notes taken? Are there any minutes or is there any documentation of this conference?

A Yes. I believe there was some follow-up correspondence that Mr. Schiefelbein submitted. There were notes taken. And as a matter of fact, there was a revised set of proposed rules put together as a result of that meeting that was submitted to the Public Service Commission.

Q Does it have your economy of scale factor in it?

A Yes, it does.

Q And I believe what you said -- and I'm not sure this is -- I believe this is an exact quote, that it's usually true that it probably wouldn't be significantly different. There are three qualifiers in there. Is that what you said?

A Are you reading from my deposition?

Q Yes.

A If you're reading from it, I agree that's what I said.

Q Page 109, Lines 11 through 23. Quite often my depositions don't have what I thought I said. Is that what you mean?

A Yes.

Q Okay. There are three qualifiers in there. Have you ever seen any engineering studies. Are you aware of any engineering services which would allow you to calculate the cost of an 80% versus 100% capacity plant?

A Yes. I've seen studies for various components of utility facilities, such as wells, pumps storage facilities, all of which showed that the difference constructing a facility at one level of capacity compared to 80% of its capacity was relatively minor, particularly when compared to the increase in capacity that you could get for a relatively minor difference in cost.

Q But you didn't present any of that evidence, any of those studies; this is just based our belief it's usually true it probably wouldn't be significant?

A I didn't present it where; at the workshop?

Q Yes.

A I think everyone knew what I was saying was exactly correct. I think that's why we had a consensus that it was correct. I think they've probably seen, on their own, similar examples.

Q And you knew they were all paying attention and knew what you were saying? You know that?

A Well, I don't know if they were all paying

attention and they all knew, but they certainly seemed to be have been paying attention, and they certainly were involved in the discussion; and they certainly seemed to express an interest in conducting a workshop. So my assumption is they were all paying attention.

Q But it's based all on the belief there were no engineering studies presented there?

A As I indicated before, I think some things don't require the presentation of engineering studies; and I think this is obvious enough to many of them where you didn't have to give them an engineering study for them to understand what you were saying, and for them, based on simply their own experience, to know that that's correct.

Q How much is likely not much lower? How much lower is likely? You said it's likely not much lower. What's --

A I gave it a range of 10 to 20%.

Q Okay. What do you call this factor? Is it -- you figure it's a provable number? Is it a guesstimate? What do you consider this 80/20 -- this 80% versus the 100%, rather? What would you call it? Is it a provable number? Is it a guesstimate?

A It's a provable number for many components,

and I suppose you could take different components of a utility system -- (Power outage in hearing room.)

In fact, I've done that. It ranges between 10 and 20%.

COMMISSIONER DEASON: Okay. We're going to go back onto the record. We'll proceed with the cross examination.

Q (By Mr. Sirkin) John, does the up-front charges to Dunes for their 100,000 gallon increments include your economy of scale or your reserve capacity that all the other companies are being asked by the company to pay?

A I'm not familiar with how the charge to Dunes for the capacity payments were calculated. I haven't looked at that at all.

My calculations are part of a used and useful calculation, which is part of -- which becomes, then, base rates for service.

I don't think the same calculations would be applicable to calculating capacity connection fees in terms of service availability charges as for the base rates and service. I think they are different calculations. But not having looked at the specific calculation for the capacity payments paid by Dunes, I couldn't tell you how they were calculated.

Q So you don't know?

A I don't know.

Q But they are -- well, if you don't know, you still don't know.

You looked at the growth of the utility in your used and useful calculation; is that correct?

A In calculating a margin reserve, yes.

Q What did you conclude as a result of your examination of customer growth? How is this utility growing?

A My margin reserve calculations are set forth in JFG-1, Table H for water.

MR. GATLIN: What was the page number?

COMMISSIONER DEASON: There's been a request for the page number.

WITNESS GUASTELLA: I don't have a page number on my copy. Excuse me. I'll find it for you. Page 26, JFG-1; Page 26, which is Table H.

Q (By Mr. Sirkin) How fast is this utility growing?

A I've got a margin reserve under two calculations. One is a year and a half at close to 11%, 10.77% in terms of ERC growth. So approximately 8%; 7, 8% in that area, per year with respect to the water system.

Q Are you familiar with the PCUC ITT service agreement, the June of 1990 agreement, I believe? I'm sorry. Let me get you the exact -- the June 27th, 1980 agreement between PCUC and ITT Community Development Corporation?

A No.

Q Okay. So much for those questions. Was there a witness who knows something about that agreement? Can the company supply witness who knows something about that agreement?

A I don't know.

Q Okay. You used six years of historic data, 1990 to 1995, to determine your expected ERCs?

A Yes.

Q Why did you pick that period of time?

A I believe that was a period of time since the last rate increase.

Q And the projected growth only depends upon those five years, those six years?

A The way I use it, that's correct.

Q So if they said, then, if we had been three years since the last rate case, you would have used three years?

A I probably would have used five. I would have gone back to have at least five years. I believe

the Commission looks for at least five years' worth of data. At least the Staff does.

Q That's all I have at this time, John. Thank you.

COMMISSIONER DEASON: Mr. Reilly?

CROSS EXAMINATION

BY MR. REILLY:

Q Good afternoon, Mr. Seidman -- Mr. Guastella.

A Good afternoon.

Q A question for you. Seidman was on my mind because we asked him some questions that he wasn't able to answer and he referred them to you, and this had to do with the amount of reuse being sent to the Hammock Dunes.

I believe in response to Mr. Sirkin's question you said that the Dunes received approximately 1 million gallons a day of effluent during 1995; is that correct?

A I believe that's the number that comes out of the latest information; that's correct.

Q And yet in the MFRs, did not PCUC use the figure of 800,000 gallons per day times 365 days, times the .67 per 1,000 gallons to arrive at the estimated revenue impact of 195,000 --

A That's correct.

Q -- 640? Am I correct that Hammock Dunes has agreed to use it's best efforts to take up to 1.6 million gallons a day of reuse on an average annual basis?

A No, I don't believe that's correct. I believe they're going to -- I don't know what they committed to take. I think the average is about 600,000 gallons a day is what they targeted taking. I think the 1.6 is a maximum number level, and I don't believe their facilities at this point in time can take an average of 1.6 throughout the year.

Q But in the agreements with PCUC are they not obligated to exercise their best efforts to take up to that amount?

A I don't recall that in the agreement. I believe PCUC will try to give Dunes up to 1.6 MGD if it can, but I don't recall seeing a commitment by Dunes to take 1.6; certainly not on average. They can't do that on an average.

Q Have you reviewed Mr. Moyer's testimony?

A I have.

Q And could I have you refer to Page 11 of his prefiled direct testimony, and refer you particularly to Lines 11 and 12. Would that clarify your

understanding of at least their commitment?

A Yes, but I don't -- I don't -- I mean, despite his testimony, they can't take 1.6 million gallons a day on average. There are days when they don't take any because of wet weather conditions, and there are times during the day where they can take at a greater rate than 1.6. They have to take at less than the rate of 1.6, so it's -- I think during dry periods they will attempt to take as much as 1.6 for that day, but I don't think they can take that on an average annual basis. I mean, I know they can't.

As a matter of fact, if you read Line 9 it says, "The district has committed to take an annual average of 600,000 gallons per day. They will take no less than 3,000 gallons per day and they'll make their best effort to take 1.6 MGD. When they can, I believe, should be implied by that.

Q And that's on an annual average basis that they will exercise their best efforts?

A No. As I just stated, on Line 9, the annual average basis is at 600,000 gallons per day.

Q Right.

A I believe they'll make their best effort to take 1.6 MGD. And although Mr. Moyer says "on an average annual basis," I don't believe he's correct.

Q So you disagree with his testimony?

A In that regard if that's what he means, that the Dunes is going to take 1.6 MGD every day for 365 days a year, I don't think that's what should be expected.

Q When Counselor Sirkin was asking you some questions about flushing and whether you considered it to be an excessive cost to have to devote 20 to 25% of finished water to flushing, you really didn't feel that was a particularly serious cost when you consider all this lower embedded cost of plant that's out there, nonused and useful, that's helping to contribute to the flushing problem; is that correct? That the value of all of this plant having been built so long ago more than offsets the cost of excess flushing? And did I understand your answer correctly?

A Well, there was more discussion than that. There was discussion that part of the flushing was necessary to serve east of the intercoastal, about a third, I believe. I don't know whether or not the number on average was the 20 to 25%, I thought it was more in the range of 18%, but I -- I mean, I haven't analyzed the specific percentage myself.

But then, yes; the answer to the rest of your question is yes, there's -- I think there's a

benefit to the customers of having the system installed as it was installed in terms of the overall cost of providing service.

And I think if the option is install the system for all the lots it was installed for and have flushing in order to maintain quality, then I think that would be the preference; to install the system as it was installed and have some costs for flushing. And I don't think the costs for flushing are excessive in any event. We're dealing with some power and chemicals, I believe.

Q Will the current and future ratepayers receive the benefits of these lower embedded cost?

A They have been, they are, and they will.

Q But they will only for a certain finite period of time into the future; isn't that true? I mean, the plant which is constructed in the early '70s will become obsolete at what point in time? 2010? 2020? And is that not true?

A That's probably not true.

Q And what would you expect to be the life -- the useful life of transmission lines, distribution lines, plant -- placed into the ground in the early '70s?

A I think the lives are going to be

significantly greater than what the PSC's average service lives used for depreciation purposes are. I think in real physical, terms as opposed to economic terms, the fiscal property is probably going to last 75 to 100 years for mains. The economic life is going to be different, because costs of mains keep increasing.

Q Are you familiar with the substantial money already being paid by Palm Coast to try to rehabilitate these lines that are going to last for 100 years?

A Well, I don't know what you define as substantial. I believe the allowance for depreciation far exceeds what the cost of maintaining the lines are. So I don't think the company is at all at the point where it's spending more money than the Commission anticipates it's spending through depreciation allowance.

Q Is it not true that there are several troubled sections that were controversial in terms of their construction in the first place, that the company has had to devote approximately $1 million worth of rehabilitation just since the last rate case?

A Mr. Reilly, I'm not familiar with the specific numbers, but even if you're talking about --

based on my discussions with the company regarding this issue -- and it wasn't specifically because I was going to be testifying regarding this issue -- but I observed, myself, that the allowances for depreciation where you expect the company to be spending certain levels for routine costs of replacing mains when compared with what the actual cost is, the actual cost is much lower.

So by the standards of loss-of-service value of utility facilities, there's nothing beyond what was expected. It's lower than what was expected. I believe.

Q I was a little surprised to hear you say that the flushing, that was substantial flushing on the beach side. I had always understood that there were large tracts of underutilized transmission distribution system on the mainland that also had the added problem of deadend lines, cul de sacs. We had a number of people testify as to the number of cul de sacs on the mainland.

Would not the low used and useful and the large number of cul de sacs contribute to an increased amount of -- increased requirement for flushing?

A It's difficult for me to characterize large and small when I haven't analyzed the system. I mean,

most systems have cul de sacs and most systems that I'm aware of have deadends. There may be more deadends here than, say, your typical average system.

But as I testified before in response to Mr. Sirkin, the costs of flushing, I think, are relatively minor, and certainly minor in relation to the benefits of the system having been installed, for which customers aren't paying for any capital costs at a current level. They're paying on the basis of historic embedded cost for the system, and only for a portion of those, which through the rate setting process, only allows them to pay for used and useful portions.

So all of the unused and useful portions are not being paid for by the customers at all. It just so happens that the system's method of doing used and useful adjustments for new and growing utilities has protected the customers as the system is growing. The connected customers as the system is growing has resulted in a significant benefit for the customers.

Q Now, the dollar impact on purchased power and chemicals might be relatively small compared to this total revenue requirement.

However, would it not have a serious impact on impairing the capacity of the plant to meet the

water demands of the community, if in fact 20 to 25% of the plant's total output has to be devoted to this purpose? And wouldn't that cause the need for millions of dollars more to be spent for more plant when it's needed for growth?

A No.

Q And why not?

A Because the capacities on the system have not been adversely impacted by the flushing. The company has been meeting its demands. The capacity has been based a maximum day, and we've excluded any extraordinary flushing on those -- on the days that we did use. So I just don't understand what calculations you're referring to that would show it as an adverse impact.

Q Well, if flushing is not brought down, and growth continues in a orderly fashion, will not the need to build new plant occur more quickly than otherwise, if 20 to 20% of the plan is devoted to flushing that could have been devoted to growth.

A You're relating a percentage to existing flows. As the system builds out, the percentage is going to decrease and decrease and decrease, and I think the percentage of flushing has decreased over the years.

So as the system grows out, your observation of a percentage is going to be to observe a smaller percentage. The percentage looks higher now because of the number of customers you have now in relation to the size of the system that you have.

Q But the growth rate is relatively small here, is it not?

A No. I think it's relatively large. I mean you're growing at a rate of 8 to 10% a year. I believe that's a pretty significant growth for a water and sewer utility.

Q Last question on flushing. Can you relate to us the percentage of flushing on beach side versus mainland, or do you have the knowledge about that?

A I haven't -- as I indicated, I didn't prepare direct testimony on the issue or rebuttal on the issue. It's just based on my discussions once the issue is raised. And I believe it's about a third. A third of the flushing is related to beach side. That seems to be a number I recall.

Q Let me have you refer to MFR's Volume 1.

A I need to get a copy of that.

Q And we're going to be looking at Page 137-N, titled "Calculation of ERCs, Sewer." Okay. I'll tell you what. I'm not even going to take you through this

quite extensively, because I think Mr. Sirkin did cover the fact that you were assuming the 85% residential water sold to return as wastewater; correct?

A Yes.

Q And on the same table, however, you also indicate that hundred percent of water sold, in your estimation, is expected to go back to the plant as wastewater; is that correct?

A I don't understand.

Q That's for general service and multifamily.

A No. This calculation wasn't made to determine for general service how much wastewater was going back to the plant. This calculation was made to come up with an equivalent ERC basis. And the ERC basis that I'm looking at was based on the residential consumption and a return factor. I'm applying that same return factor to general service. I don't make a similar adjustment for general service.

Q So you do, for the purpose of this calculation, assume the 100%; is that not correct?

A As I indicated, this calculation wasn't made for the purposes of determining how much of the general service billed consumption for sewer was returning for a plant that was made to come up with an

equivalent residential connection for growth purposes.

Q That is how you calculated your ERC?

A That's how I calculated the ERC. And the ERC calculation is used to come up with a percentage of growth. So the issue of whether or not the general service water returns at 85%, 100% doesn't come into play in any of my calculations.

Q Could I have you refer to MFRs, Volume 3, (5), Section (5).

MR. GATLIN: If you don't have it, John, I'll get it. (Hands document to witness.)

Q (By Mr. Reilly) I'll tell you what, I'm going to spare you. We're going to try to move on and get to a subject that relates to that.

Do you know how much of the reject concentrate from the membrane water treatment plant has been discharged into the wastewater treatment plant during 1995?

A I don't know off the top of my head. I believe there was a response --

Q Late-filed Deposition Exhibit No. 6?

A I'll take that, subject to check. I believe it was a response to a late-filed deposition which gives that figure.

Q Does the figure $139,747 gallons per day

strike a familiar chord?

A No; but I'll accept it, subject to check.

Q Okay.

A And per day are you assuming over a 365-day period, just so I understand what you're asking me to check?

Q That's correct; yes.

A And was that for 1995? I'm sorry.

Q That's correct.

A And may I ask your figure again?

Q Okay. Yes. 139,747 gallons per day. Is that correct?

A I'll check it. I didn't add up the numbers and do the arithmetic. I just wanted to know what I was going to check.

Q Is it correct that the pretreatment effluent pumping, the PEP main system, eventually connects with gravity main system through lift stations?

A I believe that's correct. It may connect to a force main as well.

Q But not all PEP mains currently connect with gravity main system; is that correct?

A I don't know. Not all PEP mains -- I know it's my understanding that all of the mains connect to lift stations, and I just couldn't tell you whether or

not there are some that don't.

Q I understood that there were a number of PEP customers whose PEP flows to certain manholes that are not connected to gravity mains, and that the only way that effluent can get transported to the treatment plant is by some truck coming out and pumping that pump station out? Is that correct? Or is that your understanding of underutilized PEP areas?

A I believe there's some trucking that takes place. I believe the trucking may be from certain lift stations to others. But I'm not aware of the details of that.

Q Would it not seem that that would be a much more expensive means of transporting effluent than through the gravity system?

A More expensive in relation to what?

Q Than having an integrated system and having the flows go through gravity mains?

A I haven't done that calculation, but I recall from previous cases that the installation of the PEP system was the least costly for providing service under the conditions of the system. I mean, I haven't reexamined that for this case.

Q Have you done any examination of the man hours required to address problems that occur as a

result of the PEP system versus the main?

MR. GATLIN: Mr. Chairman, I object to the question. There's not a proper predicate laid to the question. It assumes the problems, and there's no testimony that there is a problem, from this witness.

COMMISSIONER DEASON: Mr. Reilly?

MR. REILLY: I'll rephrase the question.

Q **(By Mr. Reilly)** Do you have any information about the man hours required to service the PEP system and problems that arise as a result of the PEP system?

MR. GATLIN: Mr. Chairman, I still object. There's no testimony that there's a problem with the PEP system as far as expenses are concerned.

MR. REILLY: I believe there's substantial customer testimony earlier about that issue.

MR. GATLIN: Not as to expenses.

COMMISSIONER DEASON: I'm going to allow the question to the extent that if there are any problems, and this witness has knowledge of those problems, he can describe those in spoken to the question.

WITNESS GUASTELLA: As I indicated in response to your previous question, I have not done any separate analyses for this case, so I don't know the man hours.

I do recall in previous cases, however, an issue regarding the PEP system being addressed, and there were studies which showed that it was a cost-effective means for providing wastewater collection. I haven't done any separate analyses for this case.

MR. REILLY: With counsel's permission, I do have late-filed Deposition Exhibit 6 to refresh his memory on his deposition.

MR. GATLIN: I think he has it. We'll get it to him. (Hands document to witness.)

Q (By Mr. Reilly) There's just a couple of quick follow-up questions. To quantify the amount of concentrate flow to the wastewater treatment plant in the year 1995, this particular late-filed exhibit, it just provides the monthly flows; is that correct?

A Yes; for 1994 and 1995.

Q And so it would just be a mathematical computation to add that up and multiply times 1,000 gallons to give us our annual daily flow; is that correct?

A No. You're going to have to divide by the number of days in the year as well.

Q Well -- yeah, and divide by the -- could you confirm for me, please, what this late-filed exhibit

shows in terms of the average daily flow for the year 1995 for concentrate flowed to the wastewater treatment plan?

A Do you want me to do the arithmetic instead of accepting your number subject to check?

Q No. That would be all right.

A I believe you gave me a number of 139,747, and asked me to --

Q That's fine?

A -- take that number, subject to check.

Q Let's move on to Exhibit JFG-1, Table C, Pages -- looking at Table C.

A I have it.

Q We'll be talking about the 10% plant use adjustment. In Table C of this exhibit you made a 10% plant capacity adjustment, so that total plant capacity is reduced to 7.2 million gallons a day from 8 million gallons a day; isn't that correct?

A No.

Q All right. Would you clarify it for me?

A I adjusted water treatment plant No. 1 to 5.2 million gallons. I did not make any adjustment to water treatment plant No. 2, which is the membrane plant. So the $800,000 is not a 10% figure. It happens to be 10% of the combined --

Q I see.

A -- 8 million capacity, but it is not a 10% adjustment that was made to the 8 million gallons. It's a fallout number.

MR. GATLIN: Mr. Chairman, just so the record is correct, are you referring to Table C, Page 5 of the --

MR. REILLY: I think it's on Page 20 of this JFG-1, and it's Table C found on Page 20 of his used and useful analysis, JFG-1.

Now, on Page 5 and 6 he refers to this subject in his testimony.

MR. GATLIN: Page 20 of that exhibit is what you're looking at?

MR. REILLY: That's correct.

Q (By Mr. Reilly) So then what sort of a plant use adjustment does this reflect, then? It's to the lime softening plant? What does that work out on a percentage basis?

A I believe it's 13%.

Q Okay. And what is your basis for using that percent again?

A If you refer to Page 6 of exhibit JFG-1 --

Q Okay.

A -- I calculated -- or I had provided to me

the actual average 1994 plant uses, which amounted to 14.2%. The company had outside consultants looking at the plant, and the percentage used for backwashing was approximately 13.3% based on backwashing of filters. And I used the 13.3% instead of the actual, which was greater than the 13.3%.

I had also put in substantial testimony in previous cases which showed that the percentage was actually about 18.5% for plant uses.

Q All right. In this same exhibit -- thank you -- this same exhibit on Page 7, just over from where you were referring -- I think we're looking at the last two sentences -- okay. In this exhibit -- I guess next thing after -- I'd also like you to turn to Table D of this same exhibit. Okay. Now on --

A Is that JFG-1, Table D, page 21?

Q Correct. Now, on this -- at this location are you not using the 1,200,000-gallon storage for fire demand because a fire may occur at any location; is that correct?

A That's correct. I'm using 600,000 gallons per day, but because of the two major facilities, I'm adjusting by a million, two.

Q Does this mean you assume two fires happening at the same time?

A Not necessarily, although that could happen. I'm assuming a fire can happen at any location within the system, and when it does, it will be -- the water for fighting that fire would be available from the facility, either of the major facilities.

Q Isn't the PCUC water system one integrated system with the water supply being provided to the entire system by the two separate water plants?

A Yes, that's correct. However, integrated systems all have storage -- distribution storage facilities that would provide for fire protection purposes at each facility.

Q Why should the fire flow requirement be doubled because the company built two plants at different locations, instead of just increasing the capacity of the first plant?

A Well, you want to build your system so that it's the most reliable, and if you could build your system so that your sources of supply are extended over a broader area of the system, you're going to have a more reliable system. And you can't expect all the pipes to deliver water to any extreme of the system without some assistance from distribution storage or different locations. It improves the ability to meet demands throughout your system.

Q Instead of expanding the two existing plants, if the company had -- elects to build a third plant, would it be your recommendation that the fire flow requirement be tripled?

A I'll analyze that when we get to the location of the third plant.

For example, what you're suggesting is just keep building all your plants and all your storage at one location. If we can put in our mind one system with one mile of main or with ten miles of main, you wouldn't want to be the customer at the end of the 10th mile of main with all of your source supply being at one end.

And I'm not using that in strict engineering terms, but it just makes sense that you'd want to have points of source that are scattered throughout a system and --

Q But you would --

A -- I haven't done an engineering study as to where the third treatment plant expansion should take place.

Q In your deposition you said that you did not make any analysis to find out whether PCUC's wastewater system has excess inflow and infiltration; isn't that correct?

A I did not -- but I believe I had also testified that I had seen some figures to show that it was well within a recommended infiltration, even for new systems.

Q Are you talking about the smoke testing physical survey provided in OPC document request No. 60?

A I don't know.

Q This is the only survey we've been able to identify up to this point that the company has offered as its attempt to quantify any I&I problem.

A No, I don't believe I personally looked through this system. What I was looking at was some flow information that was related per inch miles of main, and the level of I&I per inch mile of main was well within what is considered reasonable for wastewater facilities.

Q So you don't know too much about this particular study?

A No. I don't recall reviewing this.

Q Well, I won't ask you any questions about it. Let me move you to Exhibit JFG-1, Table N-2, and we're talking about your maximum month factor of 1.3 and maximum three-month factor of 1.2. (Pause)

Okay. On this table, is it correct that --

isn't it correct that the factors of maximum month and maximum three-month used in this table are ratios of peak flows to annual average daily flow?

A Well, they are what they show on the table. They are the maximum three months in relation to average.

Q So the effect of this calculation is you're projecting growth of flows from '94 to '95. Is that what you're doing there?

A No.

Q All right. Would you help me understand what this calculation is --

A Yes. I'm estimating a maximum three-month flow for the number of customers during 1995. The plant flows are receiving -- I'm sorry -- the plant is receiving flows through a system that is built larger than just to serve the number of customers at year end.

I'm taking the ratio of the maximum three months to average and, in effect, calculating what the maximum three months would be to serve only the customers at year-end 1995.

Q But if I understand the 1.3 and the 1.2 -- and you're establishing a 20 and 30% growth factor, are you not?

A No.

Q By multiplying by those amounts?

A No.

Q Okay. Well, help me again, then.

A If you take a look at Table N-2, there's a line in the middle chart that shows maximum three months, October to December, 1994.

Q Yes.

A It shows the maximum three-month flow on an average day basis as 2.65 million gallons. That was what the plant received. Turn to Table N-1 on the previous page.

Q Okay.

A I'm using a maximum three-month demand, the second number on the page, of 2.89 million.

So I've calculated a maximum three months only for the 1995 customers to eliminate the question as to whether or not the plant flows are receiving wastewater and -- flows through the system due to wet weather periods greater than what should be applied to just the 1995 level of customers.

So I'm reducing the actual three months maximum demand on the system to relate it to only the 1995 level of customers, eliminating, I assume, any question about whether or not the used and useful

study is including flows for a system that's not fully developed.

Q If I were to use the actual population growth to do this flow projection, would my projected flow be less than what you are projecting here?

A I don't have any idea of how you would do the calculation. I can't answer your question.

MR. REILLY: That concludes our --

COMMISSIONER DEASON: Mr. Melson?

MR. MELSON: I can't finish in seven minutes.

COMMISSIONER DEASON: Well you just go right ahead. When we get to the point where we have to break, I'll just interrupt you.

MR. MELSON: All righty. Thank you.

CROSS EXAMINATION

BY MR. MELSON:

Q Mr. Guastella, I'd like to start by following up on a couple of questions that you've been asked by Mr. Sirkin and Mr. Reilly.

There was talk about flushing on beach side. Just so there's no confusion, does beach-side -- when you use the term "beach side," you don't mean the Hammock Dunes and the Dunes Community Development District, do you?

A In response to those questions, I don't include that, but in a generic sense I usually do.

Q All right. Would you agree that any flushing that Dunes does of its own system is of water that comes to Dunes through the meter and for which Dunes pays Palm Coast the tariffed rate?

A Yes, I agree with that.

Q You were asked a question by Mr. Sirkin about your 20% economy of scale factor that applied to used and useful, and I've got a couple of follow-ups as it relates to the bulk water rate that Dunes pays.

If the application of that factor results in a higher used and useful, that translates to a higher revenue requirement; is that correct?

A I need to have it repeated.

Q Okay. If the application of that 20% economies of scale factor has the result of increasing the dollar amount of plant that is used and useful, that translates to an increase in revenue requirement; is that correct?

A Overall that's correct. You previously related that to Dunes and I'm assuming that the Dunes rate is simply a proportionate increase in relation to the overall rate. So it would impact Dunes proportionately.

Q Good. You cut out about three of my questions. That's where I was going.

I believe you indicated in one answer to Mr. Reilly that there are days that Dunes does not take any effluent. Are you aware of when the most recent effluent agreement between Dunes and Palm Coast was entered into?

A I couldn't give you the date off the top of my head. I could look for it in part of the testimony or accept --

Q Okay. Would you accept, subject to check -- and it's Exhibit 4 to Mr. Moyer's testimony -- that it was September of 1995?

A Yes, I will except that, subject to check.

Q And that agreement, I believe, provided for Dunes to take a minimum of 300,000 gallons a day each and every day; is that correct?

A Yes.

Q And is it your understanding that Dunes has met that obligation and has, in fact, taken at least 300,000 gallons a day since that agreement went into effect?

A I've made that assumption. I haven't specifically checked that.

Q So when you said there were days when they

take nothing, that was not based on any personal knowledge of the amounts that Dunes has taken on a day by day basis?

A That's correct. And I may have -- be mistaken where it would be at least 300,000 gallons per day.

Q All right. Let me sort of leave the follow-up questions.

You propose an effluent rate of 67 cents per 1,000 gallons; is that correct?

A Yes.

Q And today Dunes is Palm Coast's only effluent customer; is that correct?

A That's my understanding, yes.

Q And today there is no charge to Dunes for the effluent; is that right?

A Yes, I believe that's correct.

Q And the effluent that Dunes -- excuse me -- that Palm Coast provides to Dunes is treated to secondary wastewater treatment standards; is that right?

A Yes.

Q And is that the level to which Dunes is required to treat all of its effluent regardless of the method of disposal?

A I believe Dunes is required to provide additional treatment.

Q All right. But Palm Coast, by its permit conditions, is required to treat all of its effluent to secondary standards?

A That's my understanding, yes.

Q And can we use the term "unfiltered effluent" to refer to effluent that is treated to secondary standards?

A For the purposes of discussion, yes.

Q Okay. Now, Palm Coast disposes of its unfiltered effluent either in its own spray field, its own RIBs, or rapid infiltration basins, or by providing it to Dunes; is that correct?

A Yes.

Q And from your point of view, is that all essentially one integrated effluent disposal system for Palm Coast?

A Yes.

Q The unfiltered effluent that Palm Coast produces is suitable for reuse at public access sites -- excuse me -- nonpublic access sites, such as sprayfields and RIBs; is that right?

A Yes.

Q And would you agree that the unfiltered

effluent requires further treatment in the form of filtration and high level disinfection in order to be suitable for application to public areas, such as golf courses, road rights-of-way, residential lawns?

A I believe that's the degree of treatment that Dunes is required to provide.

Q Could Palm Coast apply unfiltered effluent that leaves it's plant to public access areas without further treatment?

A I haven't -- I don't know. I don't know what they would have to go through to get approval from DEP in order to do that.

Q The additional treatment that Dunes is required to perform before application to public access areas is done with Dunes' facility at Dunes' sole cost and expense; is that correct?

A That's my understanding, yes.

Q Now, your proposed 67-cent rate was developed based on a cost allocation study that I believe is JFG-2, part of Exhibit 15; is that right?

A Yes.

Q And that study allocates the total cost of Palm Coast's new million-gallon-a-day RIB and the total cost of its new 6 million gallon effluent storage tank to the effluent reuse rate; is that

right?

A Yes; for total effluent, not just for Dunes' portion.

Q And you basically allocate the total cost of those two facilities to effluent and divide by the total effluent that Palm Coast produces to develop the 67-cent rate?

A That's correct.

Q And although it's not broken down that way in your exhibit, would you agree that the cost of the RIB included in your study is about $1,970,000, and the cost of the storage tank is about $879,000?

A I believe that's correct.

Q Would it help you if I showed you a work paper that supports your table?

A I'll accept it, subject to check.

Q Well, I don't know exactly how we're going to check it. Will you accept it, or would you like to check it?

A I'll check it.

Q Mr. Guastella, let me show you Exhibit 3 to your deposition, which I believe is one of the work papers that supports your table, and ask if by reference to that work table you can agree that the cost of the RIB is 1.970 million, and the cost of the

effluent -- of the storage tank is 879,000? (Pause)

A Okay. $1,970,000, and the storage tank is approximately 879,000."

The RIB is approximately $1,970, 000. And the -- (Pause) -- and the storage tank is approximately 879,000.

Q All right. Let's talk a minute about the RIB. The RIB is basically an all-weather effluent disposal site; is that correct?

A Yes.

Q And effluent that goes to Dunes never goes through the RIB; is that correct?

A That's correct.

Q And isn't it true that Palm Coast would have constructed the RIB whether or not Dunes was an effluent customer of Palm Coast?

A I believe that's correct.

Q And given that, is it fair, then, to say that the cost of the RIB is not an incremental cost of providing service to Dunes?

A That's correct. It's not an incremental cost. It's Dunes -- Dunes shares in that cost through my cost allocation study, as do all of Palm Coast's other customers.

Q Palm Coast doesn't have any other effluent

customers, though?

A I was referring to the sewer customers.

Q All right. Let's talk a minute about the 6 million gallon storage tank. That tank was designed and permitted in order to provide wet weather storage capacity for Palm Coast's own spray field site; is that correct?

A I don't know the timing of the design. I know the tank was constructed to serve both Palm Coast's needs as well as the Dunes' needs; in particular the Dunes' needs. If it was just Palm Coast customers, sewer customers, they would not have needed the tank.

Q Let me give you a document that's previously been marked as Exhibit 5. It's a letter from Palm Coast Utility Corporation to Mr. Jeff Martin of DEP transmitting the application for the wastewater treatment plant capacity increase. And ask if you would read the middle paragraphs on Page 2.

A Beginning with the word "included"?

Q Yes.

A Do you want me to read that into the record, Mr. Melson?

Q Let me ask you, Mr. Guastella, if you would agree that it says: "Included in the project is the

construction of a 6 million gallon ground storage tank. This reservoir will provide for storage of the 0.8 million-gallon per day of effluent flow to the existing spray irrigation site."

A That is what it reads, yes.

Q And does it also say PCU -- Palm Coast Utilities -- will not be providing any additional wet weather storage for the 1.6 million-gallon-a-day flow associated with Hammock Dunes' reuse system, and that's because the wet weather storage requirement for that system is already met at the Dunes?

A That's what it reads, yes. It doesn't say that that storage has been met at the Dunes. It says "has been permitted by the Florida Department of Environmental Protection and constructed by Hammock Dunes." So I don't believe they are referring to the same storage facility in that paragraph.

Q Well, let me just be clear. That letter says, in essence, that Hammock Dunes has a 1.6 million-gallon-a-day facility and the associated wet weather storage necessary to support the permitting of its facility; is that correct?

A That's correct.

Q And the -- it says that Palm Coast intends to construct a 6 million gallon tank in order to

provide wet weather storage not for the Dunes, but for Palm Coast's own 800,000-gallon-a-day spray field; is that correct?

A Well, it doesn't say "not for the Dunes." This is one piece of correspondence out of many, and when I reviewed the many pieces of correspondence, it was fairly clear that the storage facility was needed to provide service to the Dunes.

Q Okay. Let me show you another document, then. It's previously been identified as Exhibit 1, titled "Preliminary Design Report." And ask if you would turn to Pages 16 and 17 of that report. John, it's probably the one with the yellow sticky on it. It's between the two sets of maps.

A I have it.

Q And if you look toward the bottom of that page, doesn't that preliminary design study tell DEP essentially the same thing, that Palm Coast is not adding any wet weather storage capacity related to the reuse that goes to Hammock Dunes?

A Well, this is indicating that the wet weather requirement for 1.6 MGD flow from PCUC to Hammock Dunes has been met at Hammock Dunes' reuse facilities, referring to Hammock Dunes' own 11.6 million gallon of storage facility.

Q So it's not just in the transmittal -- doesn't that document also say that the 6 million gallon storage tank is, therefore, designed to provide wet weather flow to Palm Coast's own spray field site and not to Hammock Dunes?

A It doesn't say "not to Hammock Dunes," and it says "and would also provide some flexibility for the operation of the effluent reuse system."

As I indicated, there's been a lot of discussion and correspondence back and forth which indicates that the storage facility was needed in order to serve Dunes.

Q You say there's been a lot of discussion and correspondence back and forth. In your view, how is it that the 6 million-gallon-a-day storage facility is required to support the Dunes?

A The 6 million gallon storage facility is required for two primary reasons. One is to provide equalization to Dunes, and the other is to maintain the quality of the effluent going to Dunes, to assist Dunes in its use of the spray field, and generally as a wet weather storage participate for Palm Coast.

I believe Dunes shares in that cost as well through my cost allocation study, or should share in it.

Q Well, I know they do share in it. I guess I'm questioning if they provide all of their own wet weather storage at their site why they should share in the cost of more wet weather storage at your site.

A I believe you're trying to simplify what's probably you very complex story. There was a time when Palm Coast was anticipating that the storage facilities at the Dunes would be available to Palm Coast for storage. That turned out not to be the case.

The reasons why Dunes should be sharing in the cost is part of the reason that we discussed before, and that is that it's an integrated system, and that the cost of providing effluent to Dunes -- or there is a cost of providing effluent to Dunes by a cost allocation process, regardless of what facilities the Dunes may have on its own.

I believe the existing sewer ratepayers are paying for the cost of Palm Coast's treatment and disposal of wastewater, and the Dunes should be picking up a piece of its cost, a part of that cost as well, as part of a reasonable effluent rate, which is spelled out in the testimony.

Q Let me ask you this: If there was not an effluent agreement with the Dunes, wouldn't Palm Coast

be required to provide other effluent disposal sites, other effluent disposal capacity?

A No question Palm Coast needs to dispose of its effluent. I think for the purposes of my study, Dunes also has to receive effluent and use effluent for irrigation purposes.

The cost of doing both is something which I believe should involve a sharing of the cost. I have not, as I indicated, not performed a fully allocated cost of service study to have Dunes share in all of the costs, but I also don't believe it's appropriate to use an incremental cost study.

I've used part of the cost related to just effluent disposal facilities to establish a rate for effluent that recognizes both a sharing of the cost and the value of the service.

Q Let's talk a minute about that. You regard it as an integrated system. How did the costs that Dunes incurs in pumping the effluent across the intracoastal waterway in treating the effluent to the level that's required to put in a public access areas, how is that cost accounted for in your cost allocation study?

A That cost is not included in my cost allocation study. I have never performed a cost

allocation study that assigns to customers their costs once the water or the wastewater is collected from a specific site; and there may be many situations where customers on site have to provide their own facilities for improving quality of -- for example, in water. You don't include in utility rate setting the costs someone else incurs as part of the rate you would charge that customer.

Q But in determining whether Dunes is paying a fair share of the cost of the effluent it uses, you did not take into account -- it's correct you did not take into account any of the costs that Dunes incurs to make that effluent suitable for application to public access areas?

A No, of course not. I'm not going to charge Dunes for its own facilities. I'm only going to have Dunes share in the cost of Palm Coast's facilities in the rate that Palm Coast charges the Dunes.

Q Well, if you're looking at the incremental cost of the -- strike that.

You mentioned that one of the reasons that you allocated a portion of the cost to the storage tank to Dunes is that it improved the quality of effluent going to Dunes. Did I understand that correctly?

A Yes, that's correct.

Q Hasn't Palm Coast been required from the outset to provide Dunes with effluent that meets secondary standards?

A Yes, I believe that's correct.

Q And when there were quality problems, was that the result of Palm Coast providing Dunes with effluent that did not meet secondary standards in that it had excessive concentration of total suspended solids?

A No. I believe Palm Coast was meeting its permit requirements for its effluent. As it turns out, there were problems at Dunes with respect to its filtration, I understand, where they were unable to handle the quality of the effluent if taken from the ponds that then existed.

And that's part and parcel as well of the -- I believe, of this story is more involved than the letters that you were referring to.

In order to solve that problem -- and I believe part of that is reflected in one of the agreements where they -- Dunes was seeking a closed system -- instead of taking effluent from the then existing ponds, the storage facility was constructed, which eliminates the problem of algae associated with

what was being experienced from the ponds.

Q Mr. Guastella, let me ask you, if you are providing Dunes with effluent that has algae in it, you're not providing them with effluent that meets secondary standards, are you?

A I believe Palm Coast's effluent is --

Q That wasn't --

A -- meeting its requirement. And I understand that Palm Coast's requirement to provide effluent to the Dunes was the requirement that DEP requires of Palm Coast for its treatment process. So it's my understanding that whatever Palm Coast's requirement is in accordance with DEP permits, that's what was available to the Dunes.

Q And that DEP permit requirement on Palm Coast specifies a maximum level of total suspended solids; is that correct?

A I believe so.

Q And isn't it true that effluent, after it has sat in a pond and algae has grown in it, at that point that effluent does not meet that total suspended solids requirement?

A It may not meet that requirement. However, it's in compliance with DEP regulations.

Q It was in compliance with DEP when it left

the plant. Is it in the compliance -- is it wastewater that meets secondary standards at the point that it exists in that pond with algae in it?

A I believe it does.

Q Let me pass out a simplified drawing here, and I want to talk a little bit more about this quality issue that you've raised.

COMMISSIONER DEASON: Before we proceed further, let me ask how much more do you have for this witness?

MR. MELSON: More than I thought when I started. Realistically, at least another half hour.

COMMISSIONER DEASON: I think now would be appropriate time to take the recess before we begin the evening customer hearing. So we will stand in recess until 6:30.

(Recess.)

(Transcript continues in sequence in Volume 3.)

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