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(LICENSED IN TEXAS ONLY)

June 28, 2003

BY FEDERAL EXPRESS

Ms. Blanca Bayo
Commission Clerk and Administrative Services Director
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399

Re: Docket No. 020071-WS; Application of Utilities, Inc. of Florida for a rate increase
Our File No.: 30057.40

Dear Ms. Bayo:

Enclosed please find for filing in the above-referenced docket an original and fifteen (15) copies of the Rebuttal Testimony of the following witnesses:

1. Rebuttal Testimony of Steven M. Lubertozzi 05764-03
2. Rebuttal Testimony of Patrick C. Flynn 05765-03
3. Rebuttal Testimony of David L. Orr 05766-03
4. Rebuttal Testimony of Frank Seidman 05767-03
5. Rebuttal Testimony of Hugh A. Gower 05768-03
6. Rebuttal Testimony of Pauline M. Ahern 05769-03

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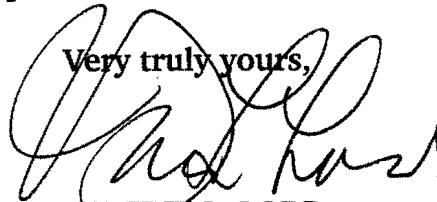
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Ms. Blanca Bayo
June 27, 2003
Page 2

Please contact me if you have any questions.

Very truly yours,



VALERIE L. LORD
Of Counsel

VLL/dlv
Enclosures

cc: Stephen Burgess, Esquire (w/enclosure)(by Federal Express)
Rosanne Gervasi, Esquire (w/enclosure) (by Federal Express)
Mr. Steven M. Lubertozi (w/enclosure) (by Federal Express)
Mr. Patrick Flynn (w/enclosure) (by hand delivery)
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Mr. Frank Seidman (w/enclosure) (by Federal Express)
Ms. Pauline M. Aherne (w/enclosure) (by U.S. Mail)

utilities, inc.\2002 rate case\psc clerk (bayo) 083 (Rebuttal testimony) ltr.wpd

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 020071-WS

UTILITIES, INC. OF FLORIDA

REBUTTAL TESTIMONY OF

HUGH A. GOWER

REGARDING THE APPLICATION FOR

INCREASE IN WATER AND WASTEWATER

RATES AND CHARGES

IN

MARION, ORANGE, PASCO, PINELLAS AND SEMINOLE COUNTIES

DOCUMENT NUMBER DATE

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1 REBUTTAL TESTIMONY OF

2 HUGH A. GOWER

3 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

4 A. My name is Hugh Gower and my address is 195 Edgemere Way, S., Naples,
5 Florida 34105. I am self employed as a consultant on public utility financial,
6 economic regulation and cost containment and control matters. I also provide
7 expert testimony on topics related to public utility economics and rate
8 regulation in cases before public service commissions and courts.

9 **Q. ARE YOU THE SAME HUGH GOWER WHO PROVIDED DIRECT**
10 **TESTIMONY IN THIS PROCEEDING?**

11 A. I am.

12 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

13 A. The purpose of my rebuttal testimony is to show that Office of Public
14 Counsel ("OPC") witnesses Ms. Kimberly Dismukes' and Mr. Mark
15 Cicchetti's recommendation to give the gain on sales of utility properties
16 realized in 1999 by Utilities, Inc. of Florida ("UIF" or "the Company") to the
17 Company's remaining customers should be rejected because-

- 18 (1) It is based on misinterpretations of prior regulatory decisions,
19 precedents or rules or, is simply unfounded;
- 20 (2) It is based on previously rejected regulatory precedents or
21 inappropriate comparison to unlike regulatory decisions;
- 22 (3) denies the importance of property rights;

- 1 (4) ignores the fact that “rate base” represents investors’ capital which is
2 entitled to protection against confiscation;
- 3 (5) proposes to pass the gains on sales of utility systems to customers who
4 were never served by and who never paid rates for service for service
5 from the properties in question; and
- 6 (6) would depart from the regulatory framework underlying historic
7 original cost based rate regulation which would be detrimental to the
8 best interests of customers and investors.

9 **Q. WHAT REGULATORY RULES OR PRECEDENTS HAVE BEEN**
10 **IGNORED, MISCONSTRUED OR MISINTERPRETED BY OPC**
11 **WITNESSES?**

12 A. They are numerous, but include their testimony about the Florida Public
13 Service Commission’s regulatory policies on gains(losses) on sales of
14 properties, abandonment losses, depreciation, CIAC, projected test periods,
15 allowed rates of return, the Uniform System of Accounts (“USOA”) and other
16 matters.

17 **Q. MS. DISMUKES ASSERTS (PAGE 6) THAT UNDER FLORIDA**
18 **PUBLIC SERVICE COMMISSION RATEMAKING PRACTICES,**
19 **CUSTOMERS HAVE CONSISTENTLY BORNE THE RISK OF LOSS**
20 **ON WATER AND WASTEWATER ASSETS. IS HER ASSERTION**
21 **CORRECT?**

22 A. No, it is not. Ms. Dismukes bases this position on misconstruction and

1 misinterpretation of Commission decisions and inappropriately mixes cases
2 involving sales of systems with those involving forced abandonments and
3 early retirements.

4 **Q. WHAT CASE INVOLVING SYSTEM SALES DOES SHE RELY**
5 **UPON?**

6 A. Ms. Dismukes cites Proposed Agency Action (“PAA”) Order No. 17168
7 issued February 10, 1987 relating to Florida Water Services’ (then Southern
8 States Utilities’) loss of \$5,643 on the sale of its Skyline Hills water system
9 to the Town of Lady Lake. This case has previously been urged by OPC as the
10 basis for assigning gains on sales to customers, and has previously been
11 rejected by the Commission as a basis for doing so. In its order on rehearing
12 of Southern States’ Docket No. 920199, the Commission stated in Order No.
13 PSC-93-1598-FOF-WS dated November 2, 1993:

14 “We have reviewed the 1987 rate case Order No. 17168 cited by OPC.
15 We find that it is the fact that SAS customers never contributed to the
16 recovery of any return on investment which distinguishes this case
17 from Order No. 17168. Because the facts of Order No. 17168 were
18 not fully explored at the hearing in Docket No. 920199, we find that
19 it is impossible to determine whether the facts in that case were the
20 same as presented in this docket. Even if the circumstances were the
21 same, we find that the order in that case was a proposed agency action,
22 which was not based on evidence adduced through the hearing
23 process.”

24
25 Thus, Ms. Dismukes’ reliance on the referenced decision was taken in spite
26 of the fact that the Commission had previously rejected it as probative
27 evidence.

1 **Q. MS. DISMUKES ALSO ASSERTS THAT “...THE COMMISSION HAS**
2 **CONSISTENTLY REQUIRED CUSTOMERS TO BEAR THE COST**
3 **AND RISK OF PLANT ABANDONMENTS” (PAGE 6) AS**
4 **JUSTIFICATION FOR ASSIGNING GAINS ON SALES TO**
5 **CUSTOMERS. IS HER ANALYSIS CORRECT?**

6 A. No, it is not. Ms. Dismukes treats “plant abandonment ” and “prudent
7 retirements” as if they were separate and totally independent from the
8 transactions and events to which they actually relate and ignores the benefits
9 which come from the replacements causing the retirements of existing plant.
10 Perhaps this error leads to her erroneous conclusion.

11 **Q. HOW ARE PLANT ABANDONMENTS AND PRUDENT**
12 **RETIREMENTS RELATED TO OTHER TRANSACTIONS AND**
13 **EVENTS?**

14 A. Plant abandonments and prudent retirements result from events unforeseen
15 when the plant in question was originally purchased or constructed and placed
16 into service, and result in the need to replace or retire the plant long before it
17 has provided service for the estimated service life on which its depreciation
18 (capital recovery) schedule directed by the Commission pursuant to rule was
19 based. Such unforeseen events might include the availability of more
20 technologically advanced equipment which can provide better service or lower
21 cost service or, more frequently, new environmental requirements with which
22 the existing plant cannot comply. When such circumstances occur, economic

1 and engineering analyses indicate the course of action which provides the best
2 service option at the lowest long-run cost, considering not only the cost of new
3 facilities and/or additional operating expenses, but also the unrecovered cost
4 of the property being evaluated for replacement. This situation is recognized
5 in the Commission's rules of practice which state:

6 "The amortization period for forced abandonment or the prudent
7 retirement, in accordance with the National Association of Regulatory
8 Utility Commissioners Uniform System of Accounts, of plant assets
9 prior to the end of their depreciable life shall be calculated . . ." Rule
10 25-30.433(9), Florida Administrative Code (emphasis added)

11
12 Clearly, this rule demonstrates that (1) "prudence" is a prerequisite to recovery
13 of a plant abandonment, and (2) the value of guidance provided by the
14 Uniform System of Accounts, belittled by both Ms. Dismukes and Mr.
15 Cicchetti, is, at the very least, acknowledged by the Commission's own rules.
16 With respect to the issue of prudence, in its order on rehearing in Docket No.
17 911188-WS, the Commission emphasized that "prudence" is a key issue to the
18 allowance of the recovery of a forced abandonment. The Commission stated
19 at Page 5 of its order:

20 "We also agree with the utility's argument that the Mad Hatter case
21 was based on evidence that reflected the utility's actions were prudent.
22 That finding was critical to the Commission's determination that the
23 loss should be borne by the ratepayers. In the alternative, had the
24 Commission found the utility's decision to be imprudent, the
25 shareholders would have borne the loss. Consequently, we find OPC's
26 argument that the Commission routinely allows the recovery of losses
27 on utility plant to be in error." Order No. PSC-93-1023-FOF-WS,
28 issued July 12, 1993 (emphasis added).

29
30 In each of the plant abandonment cases cited by Ms. Dismukes, the

1 Commission's allowance of recovery was based on a finding of prudence,
2 which she ignores along with the benefits of service improvements resulting
3 from the new facilities or service arrangements. Likewise, Ms. Dismukes has
4 ignored the subsequent developments in the Mad Hatter case.

5 **Q. WHAT WERE THE SUBSEQUENT DEVELOPMENTS IN THE MAD**
6 **HATTER CASE MS. DISMUKES IGNORED?**

7 A. The Mad Hatter Utility case cited by Ms. Dismukes approved the recovery of
8 an abandonment loss in the Commission's Order No. PSC-93-0295-FOF-WS
9 issued February 24, 1993. The abandonment loss recovery authorized by the
10 Commission included the unrecovered cost of two wastewater plants and
11 related land. The utility had represented that, for several reasons, the land
12 could not be sold and should be included in the abandonment loss.
13 Subsequently, the Commission learned that the utility had, in fact, disposed
14 of the land to an affiliated officer. Following the utility's response to the
15 Commission's show cause order, on October 13, 1997, the Commission
16 issued Order No. PSC-97-1233-AS-WS directing the utility to refund to its
17 customers both the amounts of "loss" on the land previously collected from
18 its customers and the "gain" on disposition of the land attributed to the utility
19 as a result of its disposition.

20 **Q. WHAT DO THE SUBSEQUENT DEVELOPMENTS ON THE MAD**
21 **HATTER CASE UPON WHICH MS. DISMUKES RELIED**
22 **DEMONSTRATE?**

1 A. These developments demonstrate that Ms. Dismukes claims that customers are
2 consistently required to bear the cost and risk of plant abandonments are not
3 well founded.

4 **Q. CAN YOU COMPARE THE ELECTRIC COMPANY CASES CITED**
5 **BY MS. DISMUKES IN HER TESTIMONY (PAGES 8-11) TO UIF'S**
6 **SALES OF SYSTEMS WHICH ARE THE SUBJECT OF**
7 **CONTENTION IN THIS PROCEEDING?**

8 A. Ms. Dismukes cites several cases, most of which occurred in the 1980s in
9 which the Commission did direct that gains on sale of electric utility plant be
10 assigned to customers. It is important to note that although on the surface the
11 Commission's disposition of gains in these electric company cases appears at
12 odds with its disposition of gains on sales in a number of water and
13 wastewater cases, the electric company cases involved gains on dispositions
14 of specific assets in the course of operating their ongoing business. By
15 contrast, the water and wastewater cases involved sales of utility facilities,
16 service territories and the associated customers. The water and wastewater
17 utilities ceased serving those territories and experienced reductions in their
18 future revenue and earnings streams as a consequence of those sales. By
19 contrast, sales of specific electric utility plant assets did not result in loss of
20 customers or future revenue streams.

21 The 1997 case involving Florida Public Utilities Company cited by Ms.
22 Dismukes was, like the more recent 2002 case involving the same company

1 (Order No. PSC-02-1159-PAA-GU, issued August 23, 2002), a Commission
2 ruling on the company's request to amortize gains on sales of specific plant
3 items over a period of years. As noted by the Commission in Order No. PSC-
4 93-1598-FOF-WS, issued November 2, 1993, as PAA orders, the evidentiary
5 value of these cases is somewhat questionable.

6 **Q. ON THE BASIS OF A REFERENCE TO "JURISDICTION" AND**
7 **"UNIFORM RATES" IN ORDER NO. PSC-96-1320-FOF-WS, ISSUED**
8 **OCTOBER 30, 1996, MS. DISMUKES CONCLUDES (PAGE 20)**
9 **THAT "JURISDICTION" AND "UNIFORM RATES" ARE MORE**
10 **IMPORTANT ISSUES WITH REGARD TO REGULATORY**
11 **DISPOSITION OF GAINS ON SALES THAN "LOST PROFITS" .**
12 **WHAT IS THE BASIS OF HER CONCLUSION?**

13 A. The basis of her conclusion is unclear. The Commission has indicated that a
14 number of factors are to be considered in deciding the disposition of gains on
15 sales, but has provided no weighting of relative importance. Obviously,
16 having jurisdiction would be key to the Commission's authority to direct the
17 assignment of gains on sales. The issue of "uniform rates" is less clear.

18 **Q. WHY IS THE ISSUE OF UNIFORM RATES LESS CLEAR?**

19 A. Rates, whether "uniform" or not, represent prices found by regulators to be
20 fair and reasonable on the basis of evidence presented in a rate case.
21 Rates—the actual prices—are set by relating the total cost of service and the
22 sales volumes found allowable for the test period. In addition, a number of

1 other factors are usually considered in devising the actual tariff prices. These
2 might include value, customer usage characteristics, conservation, consistency
3 with prior charges, ease of administration and customer understanding.
4 Consequently, actual tariff rates may not be equal to the exact amount of cost
5 of service for each class of customer or each volume category within classes.
6 In the case of UIF, the test period for the rate case preceding the current case
7 was 1993. It would be unreasonable to expect that the relationship between
8 the key variables used in the calculation of rates, such as number of customers,
9 weather, demand and sales volumes, as well as operations expense and capital
10 investment levels would remain the same as they were during the test period.
11 Prices set on any basis cannot provide a lasting link to or preserve the relative
12 values between the key variables which was the basis for their calculation.
13 Subsequent to any test period it simply isn't possible to ascertain with any
14 degree of reliability the amount of any particular cost of service element (such
15 as depreciation, operations expense or income taxes) such rates produce. As
16 such, "rates" are "just and reasonable" prices, no more and no less, until the
17 regulatory authority having jurisdiction finds otherwise. Whether rates were
18 set on a "stand alone" or "uniform" basis has little to do with whether such
19 rates were compensatory or not, or whether the cost of service elements (e.g.,
20 depreciation) can be "traced" for years. In my view "uniform" or "stand
21 alone" rates isn't a particularly significant or relevant factor in deciding the
22 regulatory disposition of gains on property sales, much less, "more important"

1 than some other factors which might be relevant. In fact, the notion that there
2 is any “attachment” created by the rates customers pay for service and any
3 particular element of cost of service was rejected by the courts many years
4 ago.

5 **Q. WHERE DID THE COURTS REJECT THE NOTION THAT TARIFF**
6 **RATES PAID BY CUSTOMERS FOR SERVICE CREATE AN**
7 **“ATTACHMENT” BETWEEN THE PAYMENT AND ANY ELEMENT**
8 **OF COST OF SERVICE?**

9 A. This was made clear by the Supreme Court of the United States in its decision
10 in a 1926 case involving New York Telephone Company when the Court said:

11 “Customers pay for service, not the property used to render it. Their
12 payments are not contributions to depreciation or other operating
13 expenses, or to the capital of the company. By paying bills they do not
14 acquire any interest, legal or equitable, in the property used for their
15 convenience or in the funds of the company. Property paid for out of
16 moneys received for service belongs to the company, just as does that
17 purchased out of proceeds of its bonds and stock. Board of Public
18 Utility Commissioners v. New York Telephone Company, 271 U.S.
19 23, 31-32 (1926) (emphasis added).

20
21 **Q. MS. DISMUKES CONCLUDES HER ANALYSIS OF PREVIOUS FPSC**
22 **DECISIONS ON DISPOSITION OF GAINS ON SALES WITH THE**
23 **STATEMENT “CONSISTENCY DICTATES THAT RATEPAYERS BE**
24 **GIVEN THE GAIN WHICH IS A DIRECT RESULT OF PAYING FOR**
25 **THE ASSETS THROUGH DEPRECIATION AND CIAC”. (PAGE 24)**
26 **IS HER CONCLUSION CONSISTENT WITH ECONOMIC FACTS?**

27 A. No, it is not.

1 **Q. PLEASE EXPLAIN.**

2 A. First, it would appear that Ms. Dismukes confuses the balance sheet credit
3 represented by accumulated depreciation on assets sold (or not sold, for that
4 matter) as being a cause of a “gain” on the sale of such assets. This would
5 only be logical if the depreciation booked by the utility were in excess of the
6 amount needed to reflect the expiration of the assets’ useful lives. In Florida,
7 depreciable lives are specified by Rule 25-30.140, Florida Administrative
8 Code, so utilities have little flexibility in this regard. More importantly, it
9 suggests that Ms. Dismukes doesn’t understand what accumulated
10 depreciation represents.

11 **Q. WHAT DOES THE AMOUNT OF ACCUMULATED DEPRECIATION**
12 **RECORDED BY A UTILITY REPRESENT?**

13 A. The Commission’s own rules spell this out at 25-30.140(1)(i), Florida
14 Administrative Code:

15 “Depreciation - As applied to depreciable utility plant, the loss in
16 service value not restored by current maintenance incurred in
17 connection with the consumption or prospective retirement of utility
18 plant in the course of service from causes that are known to be in
19 current operation and against which the utility is not protected by
20 insurance. Among the causes to be given consideration are wear and
21 tear, decay, action of the elements, inadequacy, obsolescence, changes
22 in the art, changes in demand and requirements of public authorities.
23 The intent of depreciation per this rule is to provide for recovery of
24 invested capital and to match this recovery as nearly as possible to the
25 useful life of the depreciable investment.”

26
27 Amounts recorded in the accumulated depreciation accounts represent that
28 portion of the original cost of the plant sold which has been “consumed” in the

1 course of providing service. Such amounts don't have values which may, in
2 the ordinary course of business, be sold since such amounts equal the amount
3 by which the original cost has "lost service value". Contrary to Ms.
4 Dismukes' reasoning, potential purchasers don't pay for values already
5 consumed or expired. What buyers of utility assets or systems pay for is
6 physical or economic usefulness which remain; in other words, any value paid
7 for by a purchaser is the assets' remaining useful life for which no
8 accumulated depreciation has yet been recorded, no customer has yet been
9 "charged" and no amount of investors' capital yet recovered.

10 **Q. WHAT ABOUT THE CIAC MS. DISMUKES ASSERTS CUSTOMERS**
11 **HAVE PAID?**

12 A. First, it is usually true that at least some customers are required to pay
13 contributions-in-aid of construction ("CIAC"), or service availability fees,
14 pursuant to approved tariffs. It is also usually true that a large portion of the
15 CIAC reflected on utilities' books represent amounts contributed by property
16 developers. Regardless of the source, customers benefit from CIAC because
17 of the lower rates for service which result from CIAC being a negative item
18 in rate base and depreciation. More importantly, when customers pay CIAC,
19 it does not result in any proprietary rights with respect to the utility's property.
20 This question was decided quite emphatically by the Supreme Court of Florida
21 in its 1972 decision in the General Waterworks Corporation case. In that case,
22 the Court cited the United States Supreme Court opinion in Board of Public

1 Utility Commissioners v. New York Telephone Company, supra, which said:

2 “The manner in which defendants came to own this property does not
3 operate to exclude it from the otherwise applicable constitutional
4 requirements.

5
6 “ ‘Constitutional protection against confiscation does not depend on
7 the source of the money used to purchase the property. It is enough
8 that it is used to render service.’ Board of Public Utility
9 Commissioners v. New York Telephone Company, 271 U.S. 23, 46;
10 Dade County v. General Waterworks Corporation, 267 So.2d 633, 640
11 (Fla. 1972)

12
13 **Q. THE NATURE OF DEPRECIATION AND CIAC ASIDE, IS THERE**
14 **ANYTHING ELSE WRONG WITH MS. DISMUKES’ CONCLUSION**
15 **THAT CUSTOMERS SHOULD BE ASSIGNED THE GAINS ON**
16 **SALES BECAUSE OF HAVING PAID DEPRECIATION AND CIAC?**

17 A. Yes, she proposes to give the gains to customers who did not pay the
18 depreciation and CIAC on the properties sold. If any customers paid
19 depreciation and CIAC, it would have been those customers served by the
20 properties and who paid the rates for such service. The remaining customers
21 paid nothing for depreciation and CIAC applicable to the property sold.
22 Consequently, Ms. Dismukes proposes to give the gain to the “wrong parties”.

23 **Q. MS. DISMUKES CRITICIZES YOUR POSITION THAT CAPITAL**
24 **TRANSACTIONS SHOULD BE ASSIGNED TO INVESTORS AND**
25 **NOT CUSTOMERS AS HAVING “...NO LOGIC AND IS NOT BASED**
26 **UPON TRADITIONAL RATEMAKING PRACTICES AND**
27 **PRINCIPLES.” IS HER CRITICISM VALID?**

1 A. No, it is not. As early as 1926, the Supreme Court of the United States
2 enunciated this very logic in Board of Public Utility Commissioners v. New
3 York Telephone Company, stating in its order:

4 Customers pay for service, not the property used to render it. Their
5 payments are not contributions to depreciation or other operating
6 expenses, or to the capital of the company. By paying bills they do not
7 acquire any interest, legal or equitable, in the property used for their
8 convenience or in the funds of the company. Property paid for out of
9 moneys received for service belongs to the company, just as does that
10 purchased out of proceeds of its bonds and stock. Board of Public
11 Utility Commissioners v. New York Telephone Company, 271 U.S.
12 at page 32.

13
14 For most who understand economic cost based rate regulation, not only is the
15 “logic” contained in the Court’s statement perfectly clear, but also the date of
16 the decision is sufficiently early to constitute “traditional” .

17 **Q. AT PAGES 28 AND 32 OF HER TESTIMONY MS. DISMUKES**
18 **DISMISSES YOUR SUGGESTION THAT THE USOA PROVIDES**
19 **STRONG GUIDANCE AS TO THE PROPER RATEMAKING**
20 **TREATMENT OF VARIOUS TRANSACTIONS. IS HER**
21 **DISAGREEMENT WITH YOUR POSITION AND HER DISREGARD**
22 **FOR THE USOA WELL FOUNDED?**

23 A. No, it is not. First, Ms. Dismukes badly misinterprets my testimony to mean
24 that the USOA absolutely controls what constitutes proper ratemaking and that
25 regulators are “bound” to follow it completely without latitude. That is not
26 and never has been my position. A more careful reading of my testimony will
27 show that I recognize that regulatory authorities have wide latitude, subject to

1 statute, as to their regulatory treatment of transactions. On the other hand,
2 regulators place a great deal of emphasis on utilities' compliance with the
3 USOA with good reason. The importance of the USOA is recognized both by
4 regulators and in authoritative literature.

5 **Q. PLEASE PROVIDE AN EXAMPLE OF WHERE IS THE**
6 **IMPORTANCE OF THE USOA RECOGNIZED IN AUTHORITATIVE**
7 **LITERATURE.**

8 A. A good example is in The Economics of Regulation by Charles F. Phillips, Jr.
9 where he wrote about the historical development of the USOA as well as its
10 importance. Regarding the importance of the USOA, Dr. Phillips stated:

11 "Several basic objectives of accounting regulation can be realized
12 under uniform systems of accounts. In the first place, rate regulation
13 requires accurate records of operating costs, depreciation expenses and
14 investment in plant and equipment, among others. ..."

15
16 In the second place, accounting regulation is needed so as to
17 distinguish between expenditures that should be charged to capital and
18 those that should be charged to income. ...Expenditures that represent
19 investment in capital assets (plant and equipment) should be charged
20 to fixed asset accounts rather than operating expense accounts.
21 Similarly, expenditures that represent costs of doing business should
22 be charged to operating expense accounts rather than capital. ...

23
24 In the third place, as regulated companies are entitled to a fair rate of
25 return on the fair value of their property, an accurate statement of a
26 company's property account is one of the most important objectives of
27 accounting regulation and the uniform system of accounts. ...

28
29 In the fourth place, carrier and utility business must be separated from
30 noncarrier and nonutility business....The commissions can permit a
31 company to earn neither more than a fair return to make up for other
32 unprofitable undertakings nor less when a company has additional
33 sources of income that are profitable. ...

1 In the fifth place, accounting regulation is of aid to the commissions
2 and companies in establishing rate structures. ...

3
4 Finally, accounting regulation is beneficial to investors. (emphasis
5 added)
6

7 While the USOA does not determine ratemaking practices, it does provide
8 fundamental guidance because it is based on widely accepted ratemaking
9 practices. As such its guidance should be given considerable weight. Its
10 guidance is sufficiently important that Rule 25-30-115, Florida Administrative
11 Code, requires water and wastewater utilities to maintain their accounts in
12 conformity with the USOA.

13 **Q. IS IT YOUR TESTIMONY, AS MS. DISMUKES SUGGESTS, THAT**
14 **USOAs WERE DEVELOPED TO DICTATE RATEMAKING**
15 **PRACTICES?**

16 A. No. USOAs were developed so that the accounting practices and reports
17 would be consistent with and conform to the regulatory practices of the
18 commission having jurisdiction. Only in this way would the reports be useful
19 to regulators as they monitored the adequacy of a utility's earnings or rates.
20 Regulators are always free to change regulatory practices, but, until they do,
21 the USOA provides important guidance as to what the proper regulatory
22 treatment of a given transaction is.

23 **Q. DO YOU AGREE WITH MS. DISMUKES' POSITION THAT THE**
24 **RATES CUSTOMERS PAY FOR SERVICE SHOULD NOT**
25 **DETERMINE THE DISTRIBUTION OF GAINS BETWEEN**

1 **CUSTOMERS AND STOCKHOLDERS (PAGE 27)?**

2 A. No, I do not. Her position is illogical.

3 **Q. WHY IS HER POSITION ILLOGICAL?**

4 A. Aside from the fact that the utility property is not owned by customers but
5 rather the investors who are entitled to the income it produces, as explained
6 in my direct testimony and above, even conceding the arguable assumption
7 that rates customers pay are equal to cost of service, what customers pay for
8 is “service” which they receive. Gains on sales are attributable to what
9 customers haven’t (yet) paid for, and wouldn’t pay for until the future if the
10 assets were to continue to provide service, rather than being sold.

11 **Q. MS. DISMUKES CLAIMS THAT CUSTOMERS’ RATES AREN’T**
12 **LIMITED TO ORIGINAL COST SINCE THE COMMISSION HAS**
13 **PERMITTED UIF AS WELL AS OTHER UTILITIES TO SET RATES**
14 **USING PROJECTED TEST YEARS (PAGE 28). IS HER ASSERTION**
15 **CORRECT?**

16 A. No, it is not. While it is true that the Commission has allowed utilities to base
17 their rate case data on projected test periods, it is not correct that this practice
18 represents a departure from original cost rate regulation. The cost data for
19 projected periods is projected cost, not fair value, reproduction cost or any of
20 the other methods of valuation which might be employed.

21 Perhaps more importantly, Ms. Dismukes has overlooked the fact that the only
22 rate cases filed by UIF for more than 20 years have been based on historical

1 test periods.

2 **Q. MS. DISMUKES CLAIMS THAT INVESTORS BEAR NO RISK OF**
3 **LOSS, ABSENT IMPRUDENT ACTIONS (PAGE 29). DO YOU**
4 **AGREE?**

5 A. No, I do not. The primary risk of loss faced by shareholders is inadequate
6 earnings, the very reason UIF is before the Commission in this case.
7 Shareholders also face the risk of regulatory disallowances of various kinds
8 which preclude the recovery of all costs of service. In addition, there are
9 general business risks (eg., weather, customer usage, ability to control costs,
10 market risks, product risks, etc.). Should a utility suffer a loss on sale of
11 assets, this clearly is their problem also. These investor risks are widely
12 acknowledged.

13 **Q. WHO HAS ACKNOWLEDGED THAT INVESTORS FACE THE**
14 **RISKS OF OWNERSHIP?**

15 A. Those who understand and acknowledge this fact are numerous and include
16 the Commission who wrote in Order No. PSC-93-0301-FOF-WS, issued
17 February 25, 1993:

18 "We also agree that it is the shareholders who bear the risk of loss on
19 their investments, not the Lehigh ratepayers."
20

21 **Q. MS. DISMUKES CITES SEVERAL RISKS (PAGE 29) SHE BELIEVES**
22 **RATEPAYERS FACE. DO YOU AGREE?**

23 A. The specific risks cited by Ms. Dismukes are increased costs due to

1 environmental compliance and compliance testing, repairing plant and
2 equipment (reason not specified) and inflation. While utility prices clearly are
3 driven upward by the factors she cites, customers have the Commission to
4 stand between them and the utility and rigorously examine the utility's
5 application prior to permitting rates to be increased. In addition, Ms.
6 Dismukes suggests that customers are exposed to higher rates as older plant
7 retired is replaced with higher cost new equipment and depreciation and
8 capital costs rise. Before utilities can charge higher rates to cover such costs,
9 they must undertake financing the new investments and then seek regulatory
10 approval for new rates. In the meantime, such increased costs are absorbed
11 by the utility. All things considered, customers' risks are considerably less
12 than utilities' risks in this regard.

13 **Q. MS. DISMUKES ASSERTS (PAGE 39) THAT "THERE IS NOTHING**
14 **IMPROPER, UNFAIR, OR CONFISCATORY ABOUT ASSIGNING**
15 **GAINS TO RATEPAYERS." DOES THIS ASSERTION REFLECT A**
16 **GOOD UNDERSTANDING OF ECONOMIC AND FINANCIAL**
17 **FACTS?**

18 A. No, it does not. It's bad enough from a financial and economic point of view
19 when utilities are unable, for whatever reason, to earn a reasonable return.
20 Most rate of return analysts refer to the Bluefield Water Works (262 U.S. 679
21 [1923]) and the Hope Natural Gas (320 U.S. 591-660[1944]) cases as the
22 legal standards for setting appropriate rates of return. Both cases indicate that

1 rates which fail to include adequate returns are confiscatory. By comparison,
2 an outright taking of investors' property which results from assigning gains on
3 sales to customers, is blatant confiscation from a financial and economic point
4 of view, not to mention the legal implications. The Commission, in fact,
5 expressed the same conclusion in Order No. PSC-93-1821-FOF-WS, dated
6 December 22, 1993, deciding the North Fort Myers Utility case:

7 "We find that a refund to the customers or off-set of connection fees
8 is not appropriate because customers of utilities do not have any
9 proprietary claim to utility assets. Although customers pay a return on
10 utility investments through rates for service, they do not have any
11 ownership rights to the assets, whether contributed or paid for by
12 utility investment."

13
14 And further,

15
16 "The property rights that rest in the ownership of the utility land and
17 facilities are constitutionally protected. To deny this property interest
18 would constitute an unconstitutional taking by this Commission. Any
19 contribution to the system by the customers would have no value
20 without the risk and investment of the utility owner(s) in the land and
21 facilities that are now being removed from utility service."

22
23 **Q. MS. DISMUKES ALSO STATES (PAGE 29) THAT THERE WOULD**
24 **BE NO ADVERSE IMPLICATIONS TO UIF IN THE CAPITAL**
25 **MARKETS SINCE UIF COMPETES WITH OTHER UTILITIES**
26 **WHICH ARE SUBJECT TO THE SAME REGULATION. IS THIS A**
27 **SOUND CONCLUSION?**

28 **A.** No, it is not. Ms. Dismukes seems to forget that it is not only utilities with
29 which UIF must compete for funds in the capital markets, but other kinds of
30 businesses as well. In addition, investors are risk averse and tend to invest in

1 companies they perceive as having lower inherent risks. This applies to both
2 utilities and nonutilities. Clearly, confiscation of capital is a risk about which
3 investors would be concerned and attempt to avoid.

4 **Q. TURNING NOW TO MR. CICHETTI, HE ASSERTS THAT “ALL**
5 **OTHER THINGS BEING EQUAL, IF THE GAIN ON SALE OF**
6 **PROPERTY IS NOT ATTRIBUTED TO RATEPAYERS THEN THE**
7 **UTILITY WILL BE ALLOWED TO RECOVER MORE THEN (SIC)**
8 **THE COST OF PROVIDING SERVICE. THIS IS EQUIVALENT TO**
9 **CONSCIOUSLY ALLOWING A UTILITY A RETURN ON COMMON**
10 **EQUITY ABOVE THE REQUIRED RETURN.” (PAGE 10) IS THIS**
11 **CLAIM CORRECT?**

12 A. No, it is not. What Mr. Cicchetti overlooks is that “all other things” are not
13 equal because the sale of the property is outside the scope of providing rate
14 regulated service. It is, in fact, at least a partial withdrawal of that much of the
15 investors’ capital from the business of providing utility service. The purchase
16 price paid by the buyers of the utility property is not regulated as are the rates
17 customers pay for the service they receive. More importantly, it is not the
18 customers who pay the purchase price to the seller of the utility property, but
19 rather an independent third party. The gain (or loss) realized by the utility on
20 the sale of its utility plant is no more relevant to whether the utility earns
21 above its authorized rate of return than earnings it might realize from mowing
22 lawns for customers in its service territory because neither is a rate regulated

1 utility service. And as noted earlier, Dr. Charles F. Phillips, Jr. wrote:

2 “The commissions can permit a company to earn neither more than a
3 fair rate of return to make up for other unprofitable undertakings nor
4 less when a company has additional sources of income that are
5 profitable. The Economics of Regulation (page 147) (emphasis
6 added.)
7

8 **Q. WHAT WOULD BE THE EFFECT ON CUSTOMERS IF, AS MR.**
9 **CICCHETTI SUGGESTS, THE GAIN ON SALE IS ASSIGNED TO**
10 **UTILITY CUSTOMERS?**

11 A. They would receive a windfall and their rates would be set at less than the
12 actual cost of providing utility service.

13 **Q. IS IT THE POLICY OF THE COMMISSION TO ASSIGN LOSSES ON**
14 **SALES OF UTILITY PLANT TO CUSTOMERS AS MR. CICCHETTI**
15 **SUGGESTS (PAGE 11)?**

16 A. Not to my knowledge, nor have I ever encountered any regulatory authority
17 which had such a policy.

18 **Q. DOES MR. CICCHETTI’S CLAIM THAT THE ALLOWANCE OF**
19 **RECOVERY OF “STRANDED COSTS” INCURRED BY UTILITIES**
20 **IN CONNECTION WITH DEREGULATION (PAGE 11) LOGICALLY**
21 **SUPPORT HIS POSITION THAT CUSTOMERS ARE REQUIRED TO**
22 **ABSORB LOSSES ON SALES OF UTILITY ASSETS UNDER COST-**
23 **OF-SERVICE REGULATION ?**

24 A. No. “Deregulation” is the abandonment of cost-of-service regulation for at
25 least a part of a utility’s business, and insofar as it is applied, represents the

1 termination of the “social contract” implicit in cost based rate regulation.
2 When this occurs, the allowance of recovery of “stranded costs” is deemed to
3 be a “transition cost” to the new (at least partial) free market system and is
4 made in anticipation of net savings to be realized by customers even after
5 absorbing the transition cost of “stranded assets”. Since deregulation is the
6 polar opposite of cost-of-service regulation, Mr. Cicchetti’s claim is invalid
7 and inappropriate.

8 **Q. MR. CICHETTI TAKES THE POSITION (PAGE 14) THAT**
9 **“REGARDING GAINS ON SALE OF PROPERTY UNDER COST-OF-**
10 **SERVICE REGULATION, OWNERSHIP IS NOT A RELEVANT**
11 **CONSIDERATION.” DO YOU AGREE?**

12 A. No, absolutely not. The issue of property rights was addressed in the
13 previously referenced Commission Order No. PSC-93-1821-FOF-WS, supra,
14 where the Commission wrote:

15 “The property rights that rest in the ownership of the utility land and
16 facilities are constitutionally protected. To deny this property interest
17 would constitute an unconstitutional taking by this Commission.”
18

19 **Q. MR. CICHETTI ALSO SUGGESTS THAT THE RETURNS**
20 **ALLOWED ON EQUITY CAPITAL BY THE COMMISSION ARE**
21 **SUFFICIENT COMPENSATION TO COVER THE RISK OF LOSS OF**
22 **CAPITAL WHICH OCCURS IF GAINS ON PROPERTY SALES ARE**
23 **ASSIGNED TO CUSTOMERS. IS THIS CORRECT?**

24 A. No, it is not. The returns on equity capital allowed by regulators, including the

1 Commission, are intended to be compensation for the risks equity investors
2 face. These would include general business risks (customer growth, customer
3 usage and demand, weather, service area economics, etc.), but, under cost
4 based ratemaking, not the risk of loss of capital. Mr. Cicchetti himself
5 recommends 10.41% equity return in this case (Page 8), or only 126 basis
6 points more than the cost of debt (Exhibit No. __ (MAC-2)). This level of risk
7 premium, in my experience, would be woefully inadequate to attract capital
8 to investments whose risks included loss of capital.

9 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

10 A. Careful analysis of the assertions and recommendations in the testimony of
11 OPC witnesses Dismukes and Cicchetti show:

- 12 (1) They erroneously contend that there should be no difference in how
13 capital and operating transactions should affect rate setting;
- 14 (2) They fail to recognize that utility assets in rate base represent the
15 amount of capital investors have provided for utility service;
- 16 (3) They ignore equity investors' property rights in the face of earlier
17 contrary rulings by not only the Florida Public Service Commission,
18 but also the Supreme Court of the United States;
- 19 (4) They propose to confiscate investors' capital by giving gains on sales
20 of utility systems to customers who were never served by and who
21 never paid rates for service from the properties in question.

22 Adoption of the recommendations of OPC witnesses Dismukes and Cicchetti

1 would be a major departure from the regulatory framework which underlies
2 cost based rate regulation which has provided major benefits to customers and
3 utilities alike for many years. These recommendations should be rejected
4 because they will not serve the best interests of customers or utilities.

5 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

6 A. Yes.

7