ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 060368-WS
AQUA UTILITIES FLORIDA, INC.

IN RE: APPLICATION FOR INCREASE IN WATER AND WASTEWATER RATES IN ALACHUA, BREVARD, HIGHLANDS, LAKE, LEE, MARION, ORANGE, PALM BEACH, PASCO, POLK, PUTNAM, SEMINOLE, SUMTER, VOLUSIA, AND WASHINGTON COUNTIES BY AQUA UTILITIES FLORIDA, INC.

DECEMBER 1, 2006

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DIRECT TESTIMONY OF:

JOHN F. GUASTELLA

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

AQUA UTILITIES FLORIDA, INC.

DIRECT TESTIMONY OF JOHN F. GUASTELLA

DOCKET NO. 060368-WS

December 1, 2006

Q. Please state your name and business address.

A. John F. Guastella, Guastella Associates, Inc., 6 Beacon Street, Suite 410, Boston, MA 02108.

Q. Please describe Guastella Associates, Inc.

A. Guastella Associates, Inc. provides utility management; valuation and rate consulting services to both regulated and unregulated utilities.

Q. Please describe your educational, professional and business background and experience.

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

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 regulation 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.

In 1978, I formed Guastella Associates, Inc. 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 wastewater utilities, as well as gas utilities and solid waste collection and disposal companies.

Q. Have you previously presented expert testimony in proceedings involving regulatory agencies, municipal jurisdictions and court cases with respect to utility matters?

A. Yes.

Q. In what states were the utilities located?

A. My testimony was presented on behalf of utilities or regulatory agencies in the states of Alaska, California, Connecticut, Delaware, Florida, Georgia, Illinois, Indiana, Maryland, Massachusetts, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, 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 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, Florida State University, the University of Florida, and currently Michigan 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, and 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. In 1998, I prepared and conducted a rate regulation seminar in Maine on behalf of the New England Chapter of the National Association of Water Company's ("NAWC"). In 2000 and 2001, I prepared and conducted a seminar for developer related and small water and sewer utilities in conjunction with Florida State University, and again in 2003 in conjunction with the University of Florida. This seminar provided instruction as to the financial structuring of utilities, rate setting, financing and valuation for market value determinations in preparation for negotiated sales or condemnations. It also identified the various problems faced by small utilities, the impact on their operations and potential solutions. In 2005, I prepared and conducted a special seminar on rate regulation for the newly formed Office of Regulatory Staff in South Carolina. In 2006, I prepared and conducted a seminar on rate regulation and valuation on behalf of the New York Chapter of NAWC.

As a member of the NAWC, I served on its Rates and Revenue Committee and Small Company Committee. I am a life-time member of the American Water Works Association ("AWWA") and served on its Water Rates Committee, assisting in the preparation of the AWWA Rates Manual, Third Edition. I am a life-time member of the New England Water Works Association. 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, the Mid-America Regulatory Conference, and at meetings of the Public Utility Law Section of the New Jersey Bar Association, the Pennsylvania Environmental Council, the Southeastern Association of Regulatory Utility Commissioners, the New Jersey Chapter of the American Water Works Association, and the Florida, New England, New Jersey and New York chapters of NAWC. I also participated in a special workshop conducted by the U.S. Environmental Protection Agency, State Revolving Fund Section, with respect to its Full Cost Pricing Initiative.

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

A. Guastella Associates, Inc. has been retained by Aqua Utilities, Florida ("AUF" or "Company") to provide consulting services with respect to the preparation of its rate filing. In addition to general assistance in the preparation of the MFRs, our specific assignments included the performance of used and useful analyses, and the calculation of rates and single tariff pricing on a county-wide basis. We also provided assistance for the Company's proposed service availability and AFPI changes.

Q. What is the scope of work performed by Guastella Associates in connection with this assignment?

A. Mr. Gary C. White and I have examined the Company's financial and operating data, and I directed an analysis of the maps of each system. Our work was also coordinated with that of the Company's staff as well as other consultants.

Q. Have you prepared or supervised the preparation of any schedules that comprise the Minimum Filing Requirements?

A. Yes, the following schedules of the Minimum Filing Requirements ("MFR") were prepared by me or under my direction: Schedules F-5, F-6, F-7, F-8, F-9 and F-10. The results of my used and useful analysis are also reflected in Schedules A-1, A-2, A-3, A-5, A-6, A-7, A-9, A-10, A-12 and A-14.

Q. Are schedules F-5 through F-10 all related to used and useful calculations?

A. Yes.

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 that describes the cost of property that 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 that is excluded from rate base is referred to as "non used and useful" or "future use" 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 judgment as to 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 general parameters must be considered in performing used and useful analyses?

A. It must be recognized that water and wastewater systems are designed to meet maximum demands that are intentionally quantified at higher levels than are actually expected to be realized. In other words, well-designed water and wastewater systems should always have additional capacity over and above the maximum demands that would actually occur when the systems are built out. It is important to understand that the engineering design of a water and wastewater systems are not based on a rate setting term called used and useful. Water and wastewater systems are designed to assure the provision of safe and adequate service to the customers on a continuous basis. Water and wastewater utilities must incur costs to meet that standard; and rate setting used and useful determinations should not deny the full cost of doing so. Accordingly, if there are systems in which ratios of demands to capacities are less than 100%, it cannot necessarily be concluded that the used and useful percentage is also less than 100%.

Q. Are there any other general parameters with respect to used and useful determinations?

A. Yes. Utility systems are also designed to be economically sized. For example, it is typically less costly to construct one facility to meet the longer-term demands of the customers than to construct two or more facilities. Even if the ratio of demand to capacity is less than 100%, a downward used and useful adjustment should not be made if it would be no less costly to install facilities with less capacity or to meet the lower demands of the existing customers.

Q. Have you applied those parameters with respect to your used and useful determinations in this rate filing?

A. Yes.

Q. Are you able to summarize your used and useful determinations without discussing the individual calculations for each of the 56 water systems and 24 wastewater systems?

A. Yes. These water and wastewater systems are relatively small - - some very small - - and most have characteristics that have enabled an easy determination of used and useful, as described in the respective "F" schedules. Those few systems that required more detailed calculations, involving ratios of demands and capacities, were consistently treated.

Q. Before summarizing your used and useful determinations, would you describe the source of the data you used?

A. The data were obtained from the Company, as reflected in the various "F" schedules showing demands and capacity and, if necessary, from operating reports.

Q. Did you use a margin of reserve in your calculations?

A. Yes, but only when necessary.

Q. Would you briefly describe margin reserve?

A. Margin reserve is an allowance for growth in customers for a five-year period after the test year. For interim rates, the 2005 historical test year was used and, therefore, the growth was projected to 2010; for the 2007 projected test year the growth was projected to 2012. A margin reserve allowance recognizes that utilities must have capacity available to provide service to new customers so that both new and existing customers will in the future receive adequate service. Obviously, facilities must be installed and operational in order to provide service to customers in the future, and the utility must incur costs for those facilities that must be recognized in setting rates.

Q. Would you please describe your determination of the used and useful percentages of the water transmission and distributions systems and the wastewater collection systems?

A. There are 56 water systems and 24 wastewater systems. On the basis of our take-offs of the individual systems' maps, and review of the number of connected customers and related ERCs, I found that 40 water systems are built out and, therefore, 100% used and useful. Another water system was considered 100% used and useful with respect to permanent rates when the ratio of ERCs to total lots (lots with mains fronting the

property) was found to be over 80%, after an allowance for margin reserve. The remaining 15 water systems had various used and useful percentages, calculated on the basis of the ratio of ERCs to total lots, after an allowance for margin reserve.

With respect to the wastewater systems, 21 were built out and, therefore, 100% used and useful. The used and useful percentages for the remaining 3 systems were calculated on the basis of the ratio of ERCs to total lots.

Q. Why do you use ERCs as the numerator?

A. Mains are not designed only to cover distance, but also to meet varying demands. Ratios of connected lots to total lots only consider distance; ratios of ERCs to total lots take into account both distance and demands, because ERCs reflect the higher demands of customers with larger meters.

Q. How did you determine the used and useful percentages for water plants?

A. For these small systems, the water plants essentially consist of wells. The wells of the water systems that are built out are considered 100% used and useful. Some systems do not have their own sources of water supply, accordingly related assets are of course 100% used and useful. Systems with only two wells must also be considered used and useful because two wells are necessary for reliability so that demands could be met with the largest well out of service, and the cost of the remaining well would be no less costly if designed only to meet the demands of existing customers. All of the water well systems fall into one or more of the above categories and all are 100% used and useful.

The wastewater treatment plants for systems that are built out are considered 100% used and useful. Some systems do not have their own treatment plants and of

course any related assets are 100% used and useful. There are four wastewater treatment plants (Chuluota, Leisure Lakes, Sunny Hills and Village Water) that are not in those categories, and for which the used and useful percentages are based on the ratio of the maximum month demands, projected for margin reserve growth, to the capacity of the plants.

Q. Have brief discussions or, where appropriate calculations, been included in the respective F schedules related to used and useful?

A. Yes.

Q. Do you support the Company's proposal to establish single tariff pricing, or uniform rate structures, by county?

A. Yes.

Q. Would you briefly outline the benefits of single tariff pricing?

A. Yes. The first benefit is that all customers pay the same rates for the same service, a benefit that was recognized in the early days of setting rural electric and telephone rates. Because single tariff rates spread the cost of plant additions and replacements over a wider customer base, no one system will be faced with very high rate increases, which sooner or later would otherwise be faced by every individual system. Single tariff pricing recognizes the economies of scale that would otherwise not be available if the individual systems were not part of one company. Single tariff rates recognizes that if truly stand-alone, individual systems would find it difficult if not impossible to obtain capital when needed, or if they can it would be at a higher cost than when part of a large company.

Once single tariff pricing is established, the cost of rate case expenses will be less in terms of preparing rate filings and MFRs as well as adjudicating issues. Single tariff pricing recognizes that a greater level of experienced administrative, accounting, engineering, legal and other staffing resources are available to all individual systems, which would likely not be the case if they were truly stand-alone systems.

Q. Has single tariff pricing been accepted by regulatory agencies around the country?

A. Yes. On the basis of my involvement in other states with respect to this issue, I have found that most states that regulate companies with multiple water and/or wastewater systems have accepted single tariff pricing. The Department of Public Utility Control in Connecticut has required its regulated water utilities to movement toward single tariff pricing. NARUC and individual states have also recognized single tariff pricing as an incentive to encourage larger water utilities to acquire smaller systems.

Q. Does Mr. White cover the specific determination of single tariff pricing, by county?

A. Yes. I would note that Mr. White also addresses the Company's proposals for uniform Service Availability charges, and AFPI charges.

Q. Does that conclude your testimony at this time?

A. Yes.