BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc.	DOCKET NO. 080121-WS FILED: OCTOBER 27, 2008

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Direct Testimony of Paul W.

Stallcup, on behalf of the Florida Public Service Commission, has been furnished by electronic

mail and hand delivery, on this 27th day of October, 2008, to the following:

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DOCKET NO.: 080121-WS - 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.

WITNESS: Direct Testimony of Paul W. Stallcup,
Appearing on Behalf of the Staff of the Florida Public Service Commission.

DATE FILED: October 27, 2008

1   Q.   Would you please state your name and business address?

2   A.   My name is Paul W. Stallcup. My business address is 2540 Shumard Oak Boulevard,

3   Tallahassee, Florida, 32399.

4   Q.   By whom and in what capacity are you employed?

5   A.   I am employed by the Florida Public Service Commission as the Supervisor of the

6   Economics and Tariffs Section of the Division of Economic Regulation.

7   Q.   Would you please summarize your educational and professional experience?

8   A.   I graduated from Florida State University in 1977 with a Bachelor of Science degree in

9   Economics with minors in Mathematics and Statistics. I received my Masters of Science

10   Degree in Economics from Florida State University in 1979 and, as a Ph.D. candidate,

11   completed the course work and doctoral examinations required for that degree in 1980.

12   In 1981, I was employed by Florida Power & Light Company as a Load Forecast

13   Analyst. In this capacity, I prepared short and long term forecasts of company sales, peak

14   demand, and customer growth. In 1983, I was employed by the Florida Public Service

15   Commission as an Economic Analyst and in 1991 was promoted to my current position. In

16   this capacity, I have analyzed and made recommendations on a variety of issues in all of the

17   industries regulated by the Commission.

18   Q.   Have you previously testified before the Florida Public Service Commission?

19   A.   Yes. In 1983, I testified on behalf of the Commission staff in the Florida Power &

20   Light Company rate case (Docket No. 830465-EI). In 1997, I testified on behalf of the staff in

21   Florida Power Corporation's proposed buy-out of Orlando Cogen Limited's energy contract

22   (Docket 961184-EQ). In 2000, I provided testimony in Aloha Utilities' wastewater rate case

23   (Docket No. 991643-SU) and in BellSouth's Permanent Performance Measures case (Docket

24   No. 000121-TP). In 2001, I provided testimony in Aloha Utilities' water rate case (Docket

25   No. 010503-WU), and in 2007, I filed testimony in Aqua Utilities' water and wastewater

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1 | systems rate case (Docket No. 060368-WS).

2 | Q.   What is the purpose of your testimony?

3 | A.   The purpose of my testimony is to discuss four issues relevant to this case. First, I will

4 | discuss whether I believe it would be appropriate to adopt the repression methodology

5 | proposed by Aqua Utilities Florida, Inc. (AUF or company) or witnesses Franceski and

6 | Smeltzer. Second, I will discuss why I believe it would be appropriate to implement a three-

7 | tiered inclining block rate structure for the utility's residential class instead of the proposed

8 | two-tiered rate structure. Third, I will discuss two potential drawbacks to the utility's proposal

9 | to consolidate rates. Finally, I will discuss the utility's proposed methodologies to consolidate

10 | rates and offer two alternative rate consolidation methodologies.

11 | <div align="center">Repression</div>

12 | Q.   Please summarize the utility's proposed repression methodology.

13 | A.   According to the direct testimony of utility witnesses Franceski and Smeltzer, the

14 | utility's proposal consists of two key elements. The first element is that the customer response

15 | rate to increasing prices (i.e. the price elasticity of demand for discretionary usage) should be

16 | set at a two percent reduction in discretionary usage per ten percent increase in price. The

17 | second element is that the threshold defining where discretionary water usage begins should

18 | be set at 5,000 gallons per month.

19 | Q.   Do you believe using a customer response rate, or price elasticity of demand, of a two

20 | percent reduction in discretionary usage per ten percent increase in price is appropriate?

21 | A.   Ordinarily I would say that this proposed response rate is too low. Based on staff's

22 | analysis of the customer response rates in prior rate cases, we have found that the average

23 | customer response rate is approximately a four percent reduction in discretionary usage for

24 | every ten percent increase in price. I, therefore, believe that using a price elasticity of demand

25 | of -.40 would provide a better estimate of how AUF's customers will react to an increase in

1 rates. However, in this case, utility witness Smeltzer states that the company is willing to

2 accept a lower elasticity of -.20 in order to lessen affordability concerns that could adversely

3 affect its proposal to consolidate rates. I, therefore, see the utility's willingness to accept this

4 lower response rate as a business decision taken to help achieve the goal of rate consolidation.

5 Given this business decision willingly taken by the utility, I would recommend that, in this

6 case, the Commission adopt the utility's proposed value of -.20 for the price elasticity of

7 demand for discretionary usage.

8 Q.   What is the discretionary usage threshold and why is it important?

9 A.   The discretionary usage threshold is a level of monthly water usage that differentiates

10 between essential, or non-discretionary, water consumption (i.e. indoor uses such as cooking,

11 drinking, washing, etc.) and non-essential, or discretionary, usage (i.e. outdoor irrigation).

12 This differentiation between essential and non-essential consumption is important because

13 customers will reduce their non-essential consumption in response to an increase in price,

14 while essential consumption is relatively unresponsive to changes in price. When a repression

15 adjustment is made to account for the reduction in consumption resulting from a price

16 increase, only those gallons sold that are above the discretionary threshold are adjusted

17 downwards.

18 Q.   Do you believe that the utility's proposal of using 5,000 gallons per month as a

19 threshold for defining discretionary usage is appropriate in this case?

20 A.   Yes, I believe that 5,000 gallons per month is appropriate, but for reasons other than

21 those presented in utility witness Smeltzer's testimony.

22 Q.   Why do you believe that 5,000 gallons per month is an appropriate value for

23 differentiating between non-discretionary and discretionary usage?

24 A.   The appropriate value for the discretionary usage threshold depends upon the

25 demographics of the service territory in question. For example, in a retirement community

1 with an average of only two people per household, I would recommend that the appropriate

2 threshold be set at 3,000 gallons per month (two people x 50 gallons per day per person x 30

3 days). In a suburban area populated by families with children, I would recommend that the

4 threshold be set at a higher level of usage of 7,000 gallons per month (4 people x 50 gallons

5 per day per person x 30 days plus an additional 1,000 gallons per month to account for the

6 extra cooking and washing required when children are in the home). In the case of AUF, the

7 individual systems served by AUF include both small retirement communities and suburban

8 systems. I believe that setting the discretionary usage threshold at 5,000 gallons per month

9 represents a reasonable 'middle ground' between the smaller retirement communities and the

10 larger suburban areas served by AUF. Furthermore, as I will discuss in the 'Rate Structure'

11 portion of my testimony, any adverse effects that may be felt by suburban customers with a

12 discretionary usage threshold greater than 5,000 gallons per month can be mitigated by an

13 appropriate selection of an inclining block rate structure. Therefore, I recommend that the

14 Commission adopt a discretionary usage threshold of 5,000 gallons per month.

15 Q. How does your support for the use of 5,000 gallons per month as the appropriate value

16 for the discretionary usage threshold differ from AUF's proposal.

17 A. According to the direct testimony of utility witness Smeltzer, the utility proposed using

18 5,000 gallons per month because the utility claims AUF's average statewide residential usage

19 is approximately 5,000 gallons per month. While I don't necessarily agree that this is a

20 sufficient rationale for selecting the discretionary usage threshold, I do not agree that 5,000

21 gallons per month is the correct value for average statewide residential usage.

22 To calculate average residential water consumption, all that is required is to simply add

23 up residential water usage for the 57 systems and divide by the total number of corresponding

24 residential bills. Using this methodology and the billing data contained in the utility's

25 Minimum Filing Requirements (MFRs), I calculate that the average statewide residential

1   water usage for the AUF systems is approximately 7,000 gallons per month. These

2   calculations, along with other system statistics, are shown in Exhibit PWS-1.

3   Q.   Why is it important to correctly calculate average statewide residential usage?

4   A.   Average statewide residential usage is used in the calculation of the subsidies that can

5   result from rate consolidation. In order to correctly measure these subsidies and determine the

6   extent to which rate consolidation is appropriate, it is necessary to utilize the correct level of

7   average statewide residential usage.

8   Rate Structure

9   Q.   Please summarize the utility's proposed water system rate structure.

10   A.   The utility has proposed a two-tiered inclining block rate structure that would be

11   applied to its consolidated water system's residential rate class. The rate in the first block

12   would apply to usage between 0 and 5,000 gallons per month and the rate in the second block

13   would apply to all usage above 5,000 gallons per month. The utility also proposes that the rate

14   factor for the second block be set at 1.25, meaning that the rate in the second block would be

15   only 25 percent higher than the rate in the first block.

16   Q.   Do you believe that the utility's proposed rate structure is appropriate?

17   A.   No. Based on the aggregated billing analysis data derived from the utility's MFRs, as

18   well as the testimony of the witnesses from the Water Management Districts, I would

19   recommend a three-tiered inclining block rate structure with usage blocks for monthly

20   consumption of 0 to 5,000 gallons, 5,001 to 10,000 gallons, and all usage above 10,000

21   gallons. I would also recommend more aggressive rate factors of 1.0, 1.25, and 3.0,

22   respectively.

23   Q.   Why do you believe that a three-tiered rate structure is more appropriate than the

24   utility's proposed two-tiered rate structure?

25   A.   I believe that a three-tiered rate structure is better suited to address the demographic

1   diversity of the individual systems served by AUF. As I mentioned earlier in my testimony,

2   the individual systems served by AUF include very small retirement communities with modest

3   levels of consumptions, as well as relatively large suburban areas with more extravagant levels

4   of consumption. When a rate structure is being designed, one goal is to insulate, to the extent

5   possible, those consumers who are already conserving from higher rates designed to promote

6   conservation. Another goal is to focus price-induced conservation only on those consumers

7   who have high levels of discretionary usage. If AUF's individual systems were all smaller

8   retirement communities, or all suburban areas, then it would be possible to design a two-tiered

9   rate structure capable of addressing these two goals. However, with the diversity of the

10 service areas discussed above, I believe that a three-tiered rate structure provides the needed

11 flexibility to design rates capable of achieving the two desired goals for both the small systems

12 serving the retirement communities as well as the larger suburban systems.

13 Q.   Please explain why you believe that your particular recommended rate design of a

14 three-tiered rate structure with tiers from 0 to 5,000 gallons, 5,001 to 10,000 gallons, and all

15 gallons above 10,000, and with the associated rate factors of 1.0, 1.25, and 3.0, is appropriate

16 for AUF's combined service areas.

17 A.   I believe that my recommended rate structure satisfies the two goals of minimizing the

18 rate impact on all residential customers who are already conserving while focusing price

19 increases on those customers who are using greater quantities of water. As I discussed earlier

20 in my testimony, the individual systems served by AUF include both small retirement

21 communities and suburban systems. The first tier of my recommended rate structure (0 to

22 5,000 gallons) is designed to target the smaller retirement communities with essential usage of

23 around 3,000 gallons per month. The second tier of my recommended rate structure (5,001 to

24 10,000 gallons) is designed to target family oriented suburban systems with essential usage

25 around 7,000 gallons per month. The third tier (all usage above 10,000 gallons) is designed to

1   include only non-essential usage. The rate factors of 1.0 for the first tier, 1.25 for the second

2   tier, and 3.0 for the third tier were selected to help insulate customers with usage in the first

3   and second tiers from higher prices, while concentrating higher prices in the third tier. The

4   bill impact on customers at various levels of usage for both my recommended rate structure

5   and the utility's proposed rate structure are shown graphically in Exhibit PWS-2.

6   Q.   How does your recommended rate structure compare to AUF's proposed rate structure

7   given the two goals of lower rate impacts on customers who are already conserving while

8   focusing higher rates on customers who use greater quantities of water?

9   A.   As can be seen in Exhibit PWS-2, my recommended rate structure results in lower bills

10 for all customers in the first and second tiers. At the level of average residential usage of

11 7,000 gallons per month, the customer bill resulting from my recommended rate structure is

12 approximately 15 percent lower than the bill that would result from the utility's proposed rate

13 structure. At 10,000 gallons per month, the differential increases to nearly 18 percent. As

14 usage increases, the differential declines until at approximately 13,000 gallons per month the

15 two rate structures generate bills of equal size. Beyond 13,000 gallons, my recommended rate

16 structure results in bills that are progressively higher than the utility's proposal. At 20,000

17 gallons per month, my rate structure results in bills that are 26 percent greater than the bills

18 resulting from the utility's proposal.

19 Q.   What information did you use to calculate the bill amounts shown on Exhibit PWS-2?

20 A.   The information I used to calculate the bill amounts shown in Exhibit PWS-2 was

21 taken from the utility's MFRs. The total residential revenue the bills are designed to generate

22 was calculated by adding together the utility's requested revenues contained in MFR Schedule

23 E-2 for the 57 water systems. The billing determinants (i.e. bills and gallons) were generated

24 by summing the billing data contained in the MFR Schedule E-14 for the same 57 water

25 systems. Both rate structures use a Base Facility Charge (BFC) allocation factor of 40

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1 percent, which means that 40 percent of the total residential revenues are generated through

2 the BFC while the remaining 60 percent is generated through the gallonage charge. A

3 repression adjustment was made to both sets of rates using the utility's proposed repression

4 methodology.

5 Q. Do you believe that the bill differentials shown in Exhibit PWS-2 are good

6 approximations of what the final rates will generate?

7 A. Yes. I believe that these differentials, expressed as percentages, are a good

8 approximation of how final customer bills would differ under the two competing rate

9 structures. Even if the Commission approves a revenue requirement substantially less than the

10 utility's proposed revenue requirement, the customer bills under both rate structures would

11 decline by roughly the same proportion. This would result in the differentials, expressed as a

12 percentage, remaining essentially unchanged. Therefore, I believe that the differentials

13 presented in Exhibit PWS-2 are a good approximation of how the two competing rate

14 structures would ultimately affect customers' bills.

15 Q. Did you evaluate any other rate structures before selecting your recommended rate

16 structure?

17 A. Yes. In addition to my recommended rate structure, I evaluated two other alternative

18 three-tiered rate structures. Both alternative rate structures use the same 0 to 5,000 gallons,

19 5,001 to 10,000 gallons, and over 10,001 gallons usage blocks, but differ in the rate factor

20 used in the third block. The first rate structure uses a relatively "mild" rate factor of 2.00 for

21 the third tier (meaning the price in the third tier is twice as large as the price in the first tier).

22 The other rate structure uses a relatively "hot" rate factor of 4.00 for the third tier (meaning

23 that the price in the third tier is four times as large as the price in the first tier). This compares

24 to the relatively "medium" rate factor of 3.00 used in my recommended rate structure. The

25 effect of these three rate structures on customer bills is shown graphically in Exhibit PWS-3.

1   Q.   Please summarize AUF's proposed wastewater system rate structure.

2   A.   AUF has proposed consolidating the 25 stand-alone wastewater systems into a single

3   state-wide consolidated rate with a BFC/uniform gallonage rate structure.

4   Q.   Do you believe that AUF's proposal to consolidate rates for its wastewater systems is

5   appropriate?

6   A.   In general, I believe that rate consolidation for the wastewater systems will provide the

7   same customer benefits that I described earlier for the water systems. However, I would

8   recommend that the same caveats regarding cross-subsidies and affordability be applied to the

9   wastewater systems as well.

10   Q.   Please explain the methodology typically used by the Commission when designing

11   wastewater rates.

12   A.   The Commission typically attempts to achieve two rate design goals when designing

13   wastewater rates. One goal, in recognition of the capital intensive nature of wastewater plants,

14   is to set the BFC cost recovery percentage to 50 percent or greater. The other goal is to set the

15   residential wastewater gallonage cap at a consumption level equal to 80 percent of the total

16   number of residential gallons sold. This latter goal is based upon the presumption that 80

17   percent of all water sold to customers is returned to the wastewater system, with the remaining

18   20 percent being used for outdoor purposes like irrigation.

19   Q.   Do you believe that using the 80 percent criteria for setting the wastewater gallonage

20   cap is appropriate in this case?

21   A.   No. Using the 80 percent criteria in this case would result in a wastewater gallonage

22   cap of 12,000 gallons per month. This would imply that, on average, AUF's customers would

23   use 12,000 gallons per month just for indoor purposes such as cooking, washing, etc., and only

24   those gallons sold above 12,000 gallons per month would be used for outdoor purposes. As I

25   described earlier in my testimony, I believe that the appropriate threshold for distinguishing

1 between indoor and outdoor uses ranges from 3,000 gallons per month for retirement

2 communities up to 7,000 gallons per month for suburban communities. Averaging these

3 together led to my recommended discretionary usage threshold for the water systems of 5,000

4 gallons per month. Ordinarily, given this 5,000 gallon per month threshold, I would

5 recommend that the wastewater gallonage cap be set at 5,000 gallons as well (implying that

6 roughly 60 percent of all water sold is used for indoor purposes and 40 percent used for

7 outdoor purposes). However, given the extraordinarily high stand-alone wastewater rates that

8 customers may face, I recommend that the wastewater gallonage cap be set at 6,000 gallons

9 per month. This will allow the gallonage portion of the wastewater cost-recovery to be spread

10 over more gallons thereby reducing the gallonage rate. In turn, the lower gallonage rate will

11 help address affordability concerns by reducing wastewater bills for those customers

12 consuming less than 6,000 gallons per month.

13   Potential Drawbacks to Rate Consolidation

14 Q.   Have you read the direct testimony of utility witness Smeltzer and his representation of

15 the benefits of rate consolidation?

16 A.   Yes.

17 Q.   Do you agree with Witness Smeltzer's assessment that consolidating the stand-alone

18 system rates into a single tariff applicable to all systems is beneficial to customers?

19 A.   As a general proposition, I agree with Witness Smeltzer that combining smaller stand-

20 alone systems into a larger single entity can be beneficial to customers. The most important

21 benefit that I see in this case is that the cost of system upgrades can be spread over a larger

22 number of customers thereby mitigating the dramatic increases in rates that can impact

23 customers of smaller stand-alone systems.

24 Q.   Are there any potential drawbacks for customers resulting from rate consolidation?

25 A.   Yes, there are two potential drawbacks. The first drawback concerns the

1 Commission's ability to target conservation initiatives on an individual system after rate

2 consolidation has occurred, and the second involves the possible creation of excessive cross-

3 subsidies between customer groups.

4 Q. Please explain how rate consolidation could inhibit the Commission's ability to target

5 conservation initiatives on individual systems.

6 A. The Commission's Memorandum of Understanding (MOU) with the state's five water

7 management districts pledges that the Commission will cooperate with the districts in

8 implementing water conservation programs. In the MOU, the districts are recognized as

9 having the necessary expertise to identify systems for which water conservation programs are

10 appropriate, and the Commission is recognized as having the expertise to ensure cost recovery

11 of any mandated programs and/or to implement water conserving rate structures. Under a

12 strict interpretation of rate consolidation, it could be possible to argue that the imposition of

13 additional conservation expenses and/or more aggressive rate structures intended to impact a

14 particular system should be spread over all systems whose rates have been consolidated. If

15 this argument were to hold, then the impact of the conservation efforts intended for a

16 particular system would be diluted across multiple systems and not have the intended impact.

17 Q. How can this potential drawback to rate consolidation be avoided?

18 A. I believe that if the Commission decides to implement a rate consolidation plan for

19 AUF's individual systems, it should include as part of the final order an acknowledgement that

20 the Commission may, at its discretion, impose a water conservation program or rate structure

21 on an individual system basis as the Commission deems appropriate. This will insure that the

22 Commission can continue to work effectively with the water management districts in

23 protecting the state's water resources.

24 Q. Please explain how rate consolidation can result in excessive cross-subsidies between

25 customer groups.

A.   Cross-subsidies are created when systems with low average costs are combined with systems with high average costs. For the customers of the lower cost systems, the rates of the combined systems will be necessarily higher than their original stand-alone rates. When the differential between the stand-alone rates for the low cost systems and the combined rates becomes sufficiently large, customers of these low cost systems will be paying an excessive premium, or subsidy, resulting solely from the imposition of rate consolidation.

For example, consider two stand-alone systems that are identical in all respects except that the first system has half the revenue requirement of the second system. The stand-alone rates for the first system would therefore be half the rates of the second system with typical monthly bills of, say, $20 and $40, respectively. On a stand-alone basis, the bills that the customers of each system would pay would cover the costs of providing service to its respective service territories. If the two systems were to be combined under a single rate structure, however, the typical bill that customers of both systems would pay would be $30 per month. For the customers of the lower cost system, the combined rates would include a $10 per month subsidy that they must pay over and above its actual cost of service, while customers of the higher cost system would receive a $10 per month subsidy.

Q.   Why do you believe that it is important that the Commission consider cross-subsidies between customer groups in this case?

A.   Section 367.081(2)(a)1., Florida Statutes (F.S.), states that in setting rates for water and wastewater systems, "the commission shall, either upon request or upon its own motion, fix rates which are just, reasonable, compensatory, and not unfairly discriminatory." In order to be sure that rates are not unfairly discriminatory across customer groups, I believe that the Commission must evaluate the subsidies resulting from rate consolidation and determine whether or not the rates resulting from rate consolidation satisfy the requirements of the statute.

1   Q.   Has the Commission considered cross-subsidies between customers resulting from rate

2   consolidation in prior cases?

3   A.   Yes.   In the Southern States rate case (Docket 950495-WS), the utility proposed

4   consolidating the rates of over 150 separate water and wastewater systems in 25 counties.

5   Although the Commission reaffirmed consolidated state-wide rates as an appropriate long

6   term goal, it instead adopted a capband rate structure that emphasized affordability and the

7   avoidance of excessive cross-subsidies.   Under the capband rate structure, systems with very

8   high stand-alone rates were capped at a level deemed to be affordable ($52 per month for 10

9   kgal for water and $65 per month for 6 kgal for wastewater).   The revenue shortfall created by

10   the cap was then allocated to the remaining systems with lower stand-alone rates.   The

11   remaining water systems were separated into eight groups and the wastewater systems into six

12   groups, each of which were given its own consolidated rate structure.   Each group contained

13   systems with similar cost characteristics so that the resulting stand-alone and combined rates

14   were also similar.   This scheme minimized the cross-subsidies between customers of the

15   systems contained within each group.   Of the customers who paid a subsidy under the capband

16   rate structure, only 5 percent of those customers paid a subsidy greater than $2.00, with a

17   maximum subsidy of $3.64 per month.

18   In the Utilities, Inc. of Florida rate case (Docket 020071-WS), the utility proposed

19   consolidating the water rates for its systems in Pasco and Seminole counties.   In evaluating the

20   subsidies resulting from consolidation in Seminole County, the Commission noted in order

21   PSC-03-1440-FOF-WS, issued on December 22, 2003 In Re: Application for rate increase in

22   Marion, Orange, Pasco, Pinellas, and Seminole Counties by Utilities, Inc. of Florida, that the

23   $2.00 per month subsidy "benchmark" employed in the Southern States case, when adjusted

24   for the effects of inflation from 1996 to 2003, would equal $2.35.   Given this inflation

25   adjusted benchmark, the Commission found that consolidating rates in Seminole County,

1   which resulted in customers of the Oakland Shores subdivision paying a subsidy of $2.35 per

2   month, was consistent with prior Commission decisions. The Commission also found that the

3   subsidies resulting from the combined rates were not excessive or unduly discriminatory and

4   therefore approved a consolidated rate structure.

5   In this same Utilities, Inc. rate case, the Commission considered whether it was

6   appropriate to consolidate the rates for the two wastewater systems in Pasco County. The

7   Commission found that a subsidy of $4.89 per month in 2003 was not consistent with the

8   requirements of Section 367.081(2)(a)1. F.S., requiring that rates not be unduly

9   discriminatory. Given the magnitude of this subsidy, the Commission found it appropriate to

10   reject consolidated rates for the wastewater systems and to calculate rates on a stand-alone

11   basis.

12   Q.   Given the Commission's prior decisions regarding subsidies and affordability, do you

13   have any recommendations on how to evaluate subsidies and affordability in this case?

14   A.   Yes. Based upon the Commission's decisions in the Southern States and Utilities Inc.

15   of Florida cases cited above, and adjusting the dollar amounts in these cases for inflation

16   through 2009 (the first year the new rates will be in effect), I would recommend:

17   1. Subsidies paid by customers equal to or less than $2.83 per month are not

18   excessive and are therefore not unduly discriminatory. This amount is derived by

19   adjusting the $2.35 used in the Utilities, Inc. of Florida case for the effects of

20   inflation from 2003 to 2009.

21   2. Subsidies paid by customers greater than or equal to $5.90 per month are excessive

22   and are not consistent with the requirements of Section 367.081(2)(a)1, F.S.. This

23   amount is derived by adjusting the $4.89 used in the Utilities, Inc. of Florida case

24   for the effects of inflation from 2003 to 2009.

25   3. Subsidies paid by customers greater than $2.35 per month and less than $5.90 per

1   month have not been previously decided upon by the Commission. The

2   Commission could select any dollar amount within this range as a threshold for

3   determining when subsidies become excessively large and therefore inconsistent

4   with Florida Statutes.

5   4. Water bills of $73.52 per month and wastewater bills of $91.90 per month can be

6   considered as appropriate maximum amounts for the purposes of defining

7   affordability. These amounts are derived by adjusting the $52.00 per month for

8   water and $65.00 per month for wastewater bill amounts used in the Southern

9   States rate case for the effects of inflation from 1996 to 2009.

10 The calculations used to derive these amounts are shown in Exhibit PWS–3.

11 Q.   Do you have any additional thoughts on setting the subsidy and affordability criteria?

12 A.   Yes. Clearly, there is no single right or wrong answer for determining what an

13 appropriate value is for limiting cross-subsides or for defining what is affordable. My

14 recommendations are based solely on prior Commission decisions and how those decisions,

15 when carried forward to 2009, could be used to resolve issues in this case.

16   If the Commission decides to adopt different values for the cross-subsidy and

17 affordability criteria, I would note that:

18   • Decreasing the excessive cross-subsidy threshold will reduce the number of

19   systems that can be grouped together for rate consolidation purposes resulting

20   in more rate groups. Increasing the excessive cross-subsidy threshold will

21   allow more systems to be grouped together and result in fewer rate groups.

22   • Decreasing the definition of what is affordable will result in more systems

23   having their rates capped. This causes more cost recovery dollars to be

24   reallocated to the lower cost systems thereby increasing the subsidies paid by

25   customers of the lower cost systems. Increasing the definition of affordability

1   reduces the number of systems whose rates would be capped. This causes

2   fewer cost recovery dollars to be reallocated to the lower cost systems thereby

3   decreasing the subsidies paid by customers of the lower cost systems.

4   •   With respect to the affordability criteria and the 25 wastewater systems, I

5   would note that the consolidated requested revenue requirement per customer is

6      $88.27. This means that if the Commission approves an affordability definition

7   less than $88.27, then the utility would not be able to recover its revenue

8   requirement.

9 <div align="center">Rate Consolidation Methodologies</div>

10 Q.   Has the company proposed any methodologies to implement consolidated rates?

11 A.   Yes, the company has included two rate consolidation methodologies in its filing. One

12 methodology is described in Mr. Smeltzer's testimony and the other is described in Mr.

13 Franceski's testimony.

14 Q.   Please describe the rate consolidation methodology described by Mr. Smeltzer.

15 A.   Mr. Smeltzer describes the rate consolidation methodology used to calculate the

16 proposed rates contained in the company's MFRs. This methodology is a simple state-wide

17 rate consolidation plan in which all the individual water systems (and wastewater systems) are

18 combined without regard to potential cross-subsidy issues. The result of this methodology is a

19 state-wide uniform rate structure in which the customers of all the individual water (and

20 wastewater) systems pay the same rates.

21 Q.   Do you believe that the state-wide uniform rate structure methodology proposed by

22 Mr. Smeltzer is appropriate?

23 A.   No. While Mr. Smeltzer's methodology does appear to adequately address the issue of

24 affordability for the utility's water systems, it ignores any consideration of the adverse effects

25 of excessive cross-subsidies. Using the data contained in the utility's MFRs, I estimate that

1   Mr. Smeltzer's proposed rate consolidation methodology would result in customer bills at

2   7,000 gallons per month of $43.20 (based on my recommended 3-tiered rate structure).

3   However, it would also result in the customers of 9 systems paying excessive subsidies. This

4   would include the 2,000 customers of the King's Cove and Silver Lakes Estates systems

5   paying subsidies of over twenty dollars per month, the 1,500 customers of the Jasmine Lakes

6   and Picciola Island systems paying subsidies between ten and twenty dollars per month, and

7   the roughly 3,000 customers of the Fern Terrace, Lake Gibson Estates, Ocala Oaks,

8   Tangerine, and Valencia Terrace systems paying subsidies greater than my recommended

9   amount of $5.90 but less than $10.00 per month. Taken together, these 6,500 customers,

10   representing over 40 percent of AUF's residential customer base, would be paying monthly

11   subsidies that I believe to be an excessive. Given the statutory requirement that the rates set

12   by the Commission not be unfairly discriminatory, I cannot recommend the rate consolidation

13   methodology described by Mr. Smeltzer.

14   Q.   Please describe the rate consolidation methodology described by Mr. Franceski.

15   A.   Mr. Franceski's methodology begins by calculating stand-alone rates on a system-by-

16   system basis, then compares the resulting customer bills to the customer bills that would result

17   from Mr. Smeltzer's state-wide uniform rates. For those systems with subsidies exceeding the

18   maximum amount of $5.90 (i.e. the 9 systems I identified above), Mr. Franceski's

19   methodology would cap their rates so that the resulting customer bills would be equal to the

20   bill produced by the stand-alone rates plus the maximum subsidy amount. For example, in the

21   case of the King's Cove system, the capped bill at 7,000 gallons per month would be

22   calculated by adding $5.90 to the stand-alone bill of $20.02 per month, resulting in a capped

23   bill of $25.92. This results in the bills for the customers of the 9 systems no longer exceeding

24   the maximum subsidy criteria. However, it also results in these 9 systems under-recovering

25   their revenue requirements because their rates have been artificially capped. To address this

1 under-recovery, Mr. Franceski spreads the under-recovery over the bills of the remaining

2 systems. But because the amount of the under-recovery is so large, adding these dollars to

3 bills of the remaining systems causes many of these systems to exceed the subsidy cap as well.

4 It appears that Mr. Franceski would again cap many of these remaining bills, thereby causing

5 additional under-recovery, and in turn causing more systems to exceed the subsidy cap.

6 Q. Do you believe that the capped rate consolidation methodology proposed by Mr.

7 Franceski is appropriate?

8 A. No. I have attempted follow the methodology of Mr. Franceski but have been unable

9 to derive a set of consolidated capped rates that satisfy the subsidy and affordability criteria I

10 described previously. Therefore, I can not recommend that the Commission adopt Mr.

11 Franceski's methodology.

12 Q. Are there alternative rate consolidation plans that could achieve the desirable outcomes

13 of rate consolidation while addressing the issues of excessive subsidies and affordability?

14 A. Yes, I believe there are two possible alternatives. The first alternative plan is the

15 capband rate structure used in the Southern States rate case. As discussed previously, this rate

16 consolidation plan is capable of promoting the long run positive affects of rate consolidation

17 while simultaneously addressing the issues of affordability and excessive cross-subsidies.

18 The second alternative rate consolidation plan involves grouping smaller systems with

19 high stand-alone rates with larger systems that have lower stand-alone rates. By carefully

20 selecting the systems to be combined, the resulting consolidated rates for each group can be

21 much lower for customers of the smaller systems and only slightly greater for the customers of

22 the larger systems. The idea is similar to the premise behind financial portfolio management

23 in which securities with high risk are combined with securities with low risk to yield a

24 moderate level of risk for the portfolio.

25 Q. Can you provide an example of how the second alternative rate consolidation plan

1　works?

2　A.　Yes. Suppose there are two systems that can be consolidated. The first system is a

3　small high cost system with 50 customers and a revenue requirement of $60,000. The second

4　system is a larger low cost system with 750 customers and a revenue requirement of $180,000.

5　The customers of both systems use 5 kgals per month. If we calculate stand-alone rates for

6　each system using a BFC allocation of 40 percent and a uniform gallonage charge rate

7　structure, the resulting customer bill at 5 kgal per month would be $100 for the small system

8　and $20 for the large system. If we combine the two systems, there will be a total of 800

9　customers with a combined revenue requirement of $240,000, and the resulting customer bill

10　for 5 kgal usage would be $25.

11　　In this example, the issue of affordability is addressed by significantly reducing the bill

12　for customers of the smaller system from $100 to $25. This positive outcome is offset,

13　however, by a relatively small increase in the bill for customers of the larger system from $20

14　to $25. This increase of $5 per month for customers of the larger system is the cross-subsidy

15　that they pay to subsidize the reduction in the bills for the customers of the smaller system.

16　Q.　Is it possible at this point to determine which rate consolidation methodology, if any, is

17　appropriate for use in this case?

18　A.　No. At this point there are too many unknowns to be able to know which of the rate

19　consolidation methodologies will work best. The most significant set of unknowns is the final

20　revenue requirements for each of the individual systems. Also, the Commission may wish to

21　modify my recommended values for the subsidy cap and affordability threshold, thereby

22　changing the parameters used to determine which systems should be grouped together under

23　either the capband rate structure of the second alternative rate structure.

24　Q.　Do you have any recommendations on how the Commission should evaluate the

25　utility's proposal to consolidate rates?

1   A.   Yes. I recommend that, once the Commission has voted on the revenue requirements,

2   subsidy cap, affordability threshold, and rate structure issues at the first 'Revenue

3   Requirements Agenda' on February 11, 2009, that the Commission's rate staff calculate

4   consolidated rates based on each of the methodologies discussed above. Then at the second

5   'Rates Agenda' on March 3, 2009 staff can present the results from each methodology for the

6   Commission's consideration.

7   Q.   Does this conclude your testimony?

8   A.   Yes.

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Residential Customer System Statistics - Continued

System Name	Water Systems				Wastewater Systems	
	Residential Customers	Residential Kgals	Residential Kgals/Cust.	Standalone Bill @ 7 Kgals	Residential Customers	Standalone Bill @ 6 Kgals
South Seas						
St Johns Highlands	93	3,075	2.8	$42.60		
Stone Mountain	10	568	4.7	$168.62		
Summit Chase	203	7,105	2.9	$74.01	202	$63.46
Sunny Hills	505	40,945	6.8	$37.36	158	$108.00
Tangerine	236	27,146	9.6	$35.21		
The Woods	54	3,729	5.8	$142.05	50	$135.73
Tomoka	258	21,728	7.0	$65.12		
Valencia Terrace	308	17,982	4.9	$35.84	306	$52.86
Venetian Village	151	9,610	5.3	$49.16	93	$86.54
Village Water	113	9,909	7.3	$60.11		
Welaka/Saratoga	139	5,945	3.6	$79.88		
Wooten	28	814	2.4	$225.01		
Zephyr Shores	389	7,795	1.7	$118.38	387	$83.28
Total Company	16,044	1,354,150	7.0	$43.33	5,822	$91.34

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Comparison of Customer Bills Using Alternative Rate Factors

"Mild" Rate Design

Recommended "Medium" Rate Design

"Hot" Rate Design
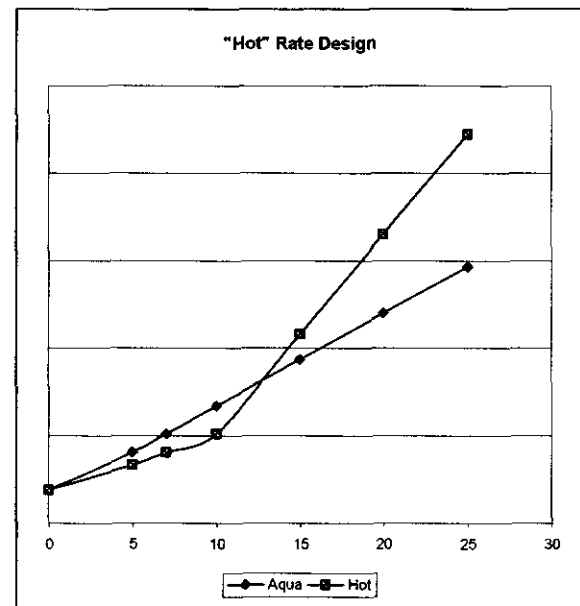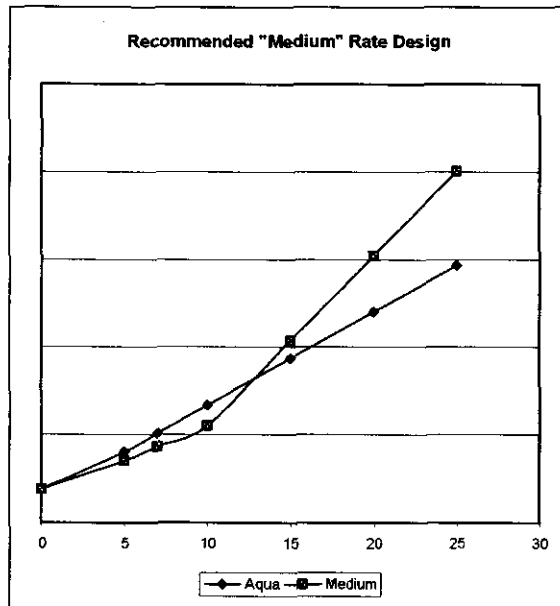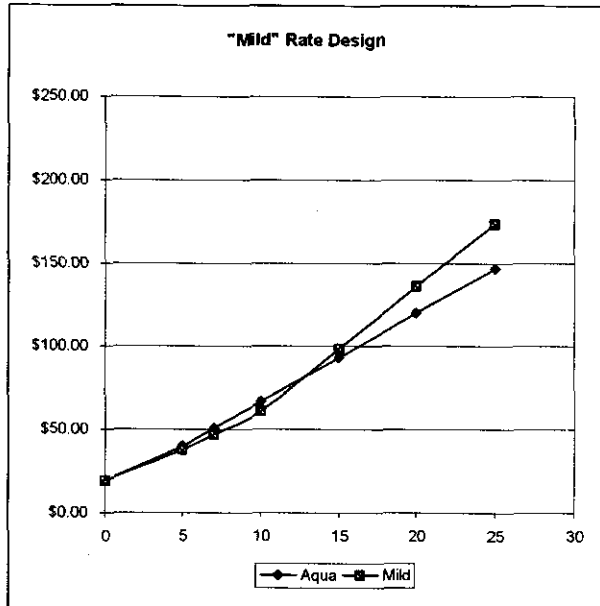
"Mild"
Customer Bills with
Rate Factors of 1.00, 1.25, 2.00

Kgals	Aqua	Mild
0	$19.02	$19.03
5	$40.28	$37.74
7	$50.92	$47.10
10	$66.86	$61.13
15	$93.44	$98.56
20	$120.02	$135.99
25	$146.60	$173.41

"Medium"
Customer Bills with
Rate Factors of 1.00, 1.25, 3.00

Kgals	Aqua	Medium
0	$19.02	$19.03
5	$40.28	$35.14
7	$50.92	$43.20
10	$66.86	$55.28
15	$93.44	$103.62
20	$120.02	$151.96
25	$146.60	$200.30

"Hot"
Customer Bills with
Rate Factors of 1.00, 1.25, 4.00

Kgals	Aqua	Hot
0	$19.02	$19.02
5	$40.28	$33.29
7	$50.92	$40.42
10	$66.86	$51.12
15	$93.44	$108.18
20	$120.02	$165.24
25	$146.60	$222.31

Calculation of Inflation Adjusted Subsidy and Affordability Amounts

Year	CPI	Growth Factor	SSU Subsidy Benchmark	UIF Subsidy Benchmark	Water Affordability Threshold	Wastewater Affordability Threshold
1996	156.9	1.00	$2.00	-	$52.00	$65.00
1997	160.5	1.02	$2.05	-	$53.19	$66.49
1998	163.0	1.04	$2.08	-	$54.02	$67.53
1999	166.6	1.06	$2.12	-	$55.21	$69.02
2000	172.2	1.10	$2.20	-	$57.07	$71.34
2001	177.1	1.13	$2.26	-	$58.69	$73.37
2002	179.9	1.15	$2.29	-	$59.62	$74.53
2003	184.0	1.17	$2.35	$4.89	$60.98	$76.23
2004	188.9	1.20	$2.41	$5.02	$62.61	$78.26
2005	195.3	1.24	$2.49	$5.19	$64.73	$80.91
2006	201.6	1.28	$2.57	$5.36	$66.81	$83.52
2007	207.3	1.32	$2.64	$5.51	$68.70	$85.88
2008	216.4	1.38	$2.76	$5.75	$71.73	$89.66
2009	221.8	1.41	$2.83	$5.90	$73.52	$91.90

Notes: 2008 and 2009 CPI projections taken from October issue of Blue Chip Economic Forecasts.