BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 20200139-WS

APPLICATION FOR INCREASE IN WATER AND WASTEWATER RATES IN CHARLOTTE, HIGHLANDS, LAKE, LEE, MARION, ORANGE, PASCO, PINELLAS, POLK, AND SEMINOLE COUNTIES, BY UTILITIES, INC. OF FLORIDA.
_____/

VOLUME 3
PAGES 434 - 575

PROCEEDINGS: HEARING

COMMISSIONERS PARTICIPATING: CHAIRMAN GARY F. CLARK
COMMISSIONER ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER ANDREW GILES FAY
COMMISSIONER MIKE LA ROSA

DATE: Tuesday, February 2, 2021

TIME: Commenced: 10:45 a.m.
Concluded: 4:58 p.m.

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

REPORTED BY: DEBRA R. KRICK
Court Reporter

APPEARANCES: (As heretofore noted.)

PREMIER REPORTING
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I N D E X

WITNESSES

NAME:	PAGE
FRANK W. RADIGAN	
Examination by Ms. Pirrello	436
Prefiled Direct Testimony inserted	438
Examination by Mr. Wharton	469
SARAH LEWIS	
Prefiled Direct Testimony inserted	482
DEBRA DOBIAC	
Prefiled Direct Testimony inserted	498
RHONDA L. HICKS	
Prefiled Direct Testimony inserted	502
DYLAN W. D'ASCENDIS	
Prefiled Rebuttal Testimony inserted	508
CHRIS SNOW	
Examination by Mr. Friedman	554
Prefiled Rebuttal Testimony inserted	556
Examination by Ms. Morse	562

P R O C E E D I N G S

(Transcript follows in sequence from Volume 2.)

CHAIRMAN CLARK: All right. I think that means we have everybody.

This will be our last witness today, the last witness we have scheduled on direct testimony is Mr. Radigan.

OPC, are you ready?

Mr. Radigan, would you raise your right hand?

Whereupon,

FRANK W. RADIGAN

was called as a witness, having been first duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

THE WITNESS: I do.

CHAIRMAN CLARK: Thank you.

EXAMINATION

BY MS. PIRRELLO:

Q Mr. Radigan, would you please state your name for the record?

A Frank Radigan.

Q Can you tell me on whose behalf you are testifying today?

A Florida Office of Public Counsel.

Q And they are representing the customers of Utilities, Inc. of Florida?

A Correct.

Q Mr. Radigan, did you cause to be prepared direct testimony on November 13th, 2020, consisting of 24 pages?

A I did.

Q Do you have any changes or corrections to make to that testimony?

A I do not.

Q Mr. Radigan, if I were to ask you the same questions today as contained in your November 13th, 2020, direct testimony, would your answers be the same as they were in that prefiled testimony?

A They would.

MS. PIRRELLO: Mr. Chairman, I move Mr. Radigan's November 13th testimony into the record.

CHARIMAN CLARK: So ordered.

(Whereupon, prefiled direct testimony of Frank W. Radigan was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in water and wastewater rates in Charlotte, Highlands, Lake, Lee, Marion, Orange, Pasco, Pinellas, Polk and Seminole Counties by Utilities, Inc. of Florida	Docket No. 20200139-WS

DIRECT TESTIMONY

Of

FRANK W. RADIGAN

ON BEHALF OF THE CITIZENS OF THE STATE OF FLORIDA

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TABLE OF CONTENTS

I.	INTRODUCTION/BACKGROUND/SUMMARY	2
II.	PRO FORMA ADDITIONS TO RATE BASE	6
III.	USED AND USEFUL	10
IV.	SEWER AND WATER IMPROVEMENT MECHANISM	17
V.	EXCESSIVE INFLOW AND INFILTRATION AND UNACCOUNTED WATER	21
VI.	SUMMARY	22
VII.	CONCLUSION	23

LIST OF EXHIBITS

Exhibit FWR-1	Curriculum Vitae
Exhibit FWR-2	Utilities Inc. of Florida List of Pro-Forma Projects that Lack Sufficient Support Information
Exhibit FWR-3	Utilities Inc. of Florida List of Pro-Forma Projects that are CWIP and Not Plant in Service
Exhibit FWR-4	Labrador Service Area
Exhibit FWR-5	ISO New England Inc. Open Access Transmission Tariff (OATT) Pool Transmission Owners Annual Transmission Revenue Requirement

I. INTRODUCTION/BACKGROUND/SUMMARY

Q. PLEASE STATE YOUR FULL NAME, ADDRESS, AND OCCUPATION.

A. My name is Frank W. Radigan. I am a principal in the Hudson River Energy Group, a consulting firm providing services in electric, gas, steam, and water utility industry matters, and specializing in the fields of rates, planning, depreciation, and utility economics. My office address is 235 Lark Street, Albany, New York 12210.

Q. PLEASE DESCRIBE THE HUDSON RIVER ENERGY GROUP.

A. The Hudson River Energy Group ("HREG") is an engineering consulting firm specializing in the fields of rates, planning, economics, and utility operations for the electric, natural gas, steam, and water utility industries. HREG was founded in 1998 and has served a wide variety of clients including municipal utilities, government agencies, state commissions, consumer advocates, law firms, industrial companies, power companies, and environmental organizations. HREG conducts rate design and cost of service studies, and designs performance-based rate plans. HREG also assists clients in handling the complexities of deregulation and restructuring, including Open Access Transmission Tariff pricing, unbundling of rates, depreciation, resource adequacy, transmission planning policies and power supply. During HREG's existence, we have proffered our expertise before the Federal Energy Regulatory Commission ("FERC") and a large number of state utility regulatory commissions across the country.

Q. PLEASE SUMMARIZE YOUR EDUCATION AND BUSINESS EXPERIENCE.

A. I received a Bachelor of Science degree in Chemical Engineering from Clarkson College of Technology in Potsdam, New York (now known as "Clarkson University") in 1981. I received a Certificate in Regulatory Economics from the State University of New York at Albany in 1990. From 1981 through February 1997, I served on the Staff of the New York State Department of Public Service (the "Department") in the Rates and System Planning Sections of the Power Division, as well as service in the Rates Section of the Gas and Water Division. My responsibilities included resource planning and the analysis of rates, depreciation rates, and tariffs of electric, gas, water, and steam utilities in the State. I also received specialized training in depreciation from Depreciation Programs, Inc. through a series of week-long intensive training programs and which predated the current depreciation society, Society of Depreciation Professionals. These duties also encompassed rate design, embedded and marginal cost of service studies, and depreciation studies. Before leaving the Department, I was responsible for directing all engineering staff during major proceedings, including those relating to rates, integrated resource planning ("IRP"), and environmental impact studies. In February 1997, I left the Department and joined the firm of Louis Berger & Associates as a Senior Energy Consultant. In December 1998, I formed my own consulting firm.

In my 39 years of experience, I have testified as an expert witness in utility rate proceedings on more than one hundred and forty occasions before various utility regulatory bodies, including: the Arizona Corporation Commission, the Connecticut Department of Public Utility Control (now the Connecticut Public Utilities Regulatory Authority), the Delaware Public Service Commission, the Kentucky Public Service Commission, the Illinois Commerce Commission, the Maryland Public Service Commission, the

Massachusetts Department of Telecommunications and Energy, the Michigan Public Service Commission, the Mississippi Public Service Commission, the New York State Public Service Commission, the New York State Department of Taxation and Finance, the Nevada Public Utilities Commission, the North Carolina Utilities Commission, the Pennsylvania Public Utility Commission, the Public Service Commission of the District of Columbia, the Public Utilities Commission of Ohio, the Rhode Island Public Utilities Commission, the Vermont Public Service Board, and FERC. Currently, I advise a variety of regulatory commissions, consumer advocates, municipal utilities, and industrial customers concerning rate matters, including wholesale electricity rates and electric transmission rates. A summary of my professional qualifications and experience, including a listing of cases in which I have proffered testimony, is attached (See Exhibit FWR-1).

Q. FOR WHOM ARE YOU APPEARING?

A. I am testifying on behalf of the Florida Office of Public Counsel ("OPC" or "Citizens").

Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT SUPERVISION AND CONTROL?

A. Yes.

Q. WHAT IS THE SCOPE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I have been asked to review several of the engineering issues of the rate application of Utilities Inc. of Florida ("UIF" or the "Company"). My testimony will address the proposed post-test year pro forma adjustments to rate base, the used and useful percentages

for the systems, and the Company's proposed Sewer and Water Improvement Mechanism ("SWIM") for its water and sewer systems. I will also address the excessive inflow and infiltration, and excessive unaccounted for water.

Q. WHAT INFORMATION DID YOU REVIEW IN CONDUCTING YOUR ANALYSIS?

A. I reviewed the Application and direct testimony and exhibits of UIF, responses to data requests, the Florida Statues applicable to UIF's rate request, and public information. I also toured several construction projects in the Company's Sanlando and Mid-County systems.

Q. PLEASE SUMMARIZE OPC's RECOMMENDATIONS.

A. With respect to the post test year plant additions, the Company proposes 45 separate projects over the 24-month period after the end of the test year (twelve months ending December 31, 2019). Approximately half of these projects are complete at the time of filing this testimony. The remaining half of the projects are either under construction or awaiting construction. I propose several adjustments to the second group of projects because the project documentation submitted to date is insufficient to allow me to verify that the projects will be in-service by the end of the 24-month period pursuant to Section 367.081(2)(a)2, F.S. I also propose a second adjustment to the post test year plant for six projects which are studies not related to a construction project and were erroneously included as plant in service.

The Company has changed several of the Used and Useful ("U&U") percentages for several systems which were adjudicated and set by the Commission in the Company's last

rate case. The Company presents no testimony or evidence to justify these proposed changes. In some cases, there are notes included in the F Schedules supplied with Minimum Filing Requirements ("MFRs"); however, a review of the MFR data shows it is insufficient to change what the Commission has already determined to be the proper U&U percentage.

The proposed SWIM is expected to result in rate increases at a rate above inflation for the foreseeable future. The Company proposes to include the SWIM with its annual index filings but that filing process has no provision for customer meetings or hearings. Thus, the proposed mechanism has practical problems associated with its implementation; namely, a lack of an adequate review process. Also, given that the rate case process already allows for 24 months of post-test year plant additions to be reflected in rates and that there has been no showing of the need for a special mechanism to fund capital projects, the necessity of the SWIM has not been established. For these reasons, I recommend that the SWIM not be adopted.

OPC has no recommended changes to the Company's proposed excessive inflow and infiltration and excessive unaccounted for water calculations.

II. PRO FORMA ADDITIONS TO RATE BASE

Q. PLEASE DISCUSS THE COMPANY'S PRESENTATION WITH RESPECT TO THE PRO FORMA ADDITIONS TO RATE BASE.

A. UIF proposes 45 separate projects over the 24-month period after the end of the test year (twelve months ending December 31, 2019). UIF does not perform any construction work itself but contracts for the construction of these projects, usually through the competitive

bid process.[1] The utility has submitted project price documentation and associated bid documentation for all projects (See UIF's response to Staff's Req. for Produc. 1). Approximately half of the pro-forma plant addition projects have been completed at the time of filing this testimony. For these projects, the Utility's cost estimating process was close, as it forecast the costs to be $3.1 million, and the actual costs came in at $3.5 million, with almost all of the cost variance related to one project where the construction contract was not bid or awarded until after the testimony was filed in this case (See UIF's responses to OPC's Interrogatories 63-120). I believe this is attributable to the Company's practice of seeking fixed price bids for their construction projects.

For the remaining half of the projects which are either under construction or awaiting construction, verification of construction timing and final price is much more difficult to verify due to the fact that the Company has not provided final construction contracts, a complete set of invoices, or project schedules. This is essential documentation that should have been previously provided, given that UIF has the burden of proof in seeking cost recovery for these projects. To allow UIF to submit this information at a later point in time in this docket is unfair and unreasonable to its captive customers who will bear the costs. For some projects where contracts have been awarded and construction time is short, we can assume that the projects will be completed before the end of the 24-month period pursuant to Section 367.081(2)(a)2, F.S. An example that fits into this category is the PCF - 27 - Sanlando I&I Corrections project which is intended to identify and correct sewer pipe deficiencies. The project has a four-month schedule to complete from the contract award in July 2020 (See UIF's response to OPC's Interrog. 101); thus, even if there is some delay

[1] UIF appears to bid out the construction work when a project is expected to exceed $75,000, and UIF's policy requires the solicitation of competitive bids (See UIF's response to OPC's Interrogs. 2-10).

in fixing the identified deficiencies, there should be no problem in getting this project done on time and in time to meet the statutory requirement.

For other projects I need more information, however, and cannot just recommend they be included in rate base at this time. For example, for PCF-13, the LUSI Barrington WWTP Improvements project is scheduled to be completed by March 31, 2021 and has an estimated cost of $380,000, including $47,000 of engineering costs and $333,000 of construction costs. This project calls for the installation of a plant lift station, emergency generator, automatic transfer switch, pumps and controls, a field office, and process control lab. The project components address items not included in the original plant design that are reportedly needed to meet operating permit requirements (See Ex. PCF-13). While UIF has provided the bid material for engineering and construction work, there is no project schedule, a project start date, or a signed construction contract (See UIF's response to Staff's Request for Production 1 re: Ex. PCF-13). For this project, and other similar projects, I have asked for the projects' scheduling documentation and the signed contracts with the contractors. Until the documentation is received and reviewed, there is no evidentiary basis upon which to approve these projects, and I cannot endorse the inclusion of these costs into the post test year plant.

Another example of the need for documentation relates to PCF-17, which is the Mid-County Headworks project. This project has a cost estimate of $2,424,782 and when UIF filed its petition, it had an expected completion date of March 31, 2021. This project, however, cannot be started until after the completion of PCF-14 which is the Mid-County Master Lift Station project that is designed to replace the master lift station after the decommissioning and demolition of the original lift station. This project was originally

expected to be completed by December 31, 2020 but has now slipped until March 31, 2021 (See UIFs response to OPC's Interrog. 82). Since one project is dependent upon the completion of another and the first project has slipped, there is a need for the project scheduling information to determine if the project can meet the 24-month post test year limitation for inclusion in UIF's rate base.

The projects for which I am still awaiting further documentation are PCF-13, PCF-14, PCF-16, PCF-17, PCF-18, PCF-20, PCF-23, PCF-28, PCf-29, PCF-31, and PCF-33. These projects total $ $9.875,036 in costs and are not reflected in the revenue requirement schedules presented by OPC witness Andrea Crane. Exhibit FWR-2 lists the projects, their costs, and a short description of why inclusion of them is not warranted without further information. Again, UIF has the burden of proof in this case to present its supporting documentation and evidence, which it has failed to do. To allow UIF to submit this documentation and information in an untimely manner is both unfair and unreasonable to UIF's ratepayers who must bear the costs of these projects.

Q. PLEASE CONTINUE.

A. Based on my review of the project documentation presented, I also propose a second adjustment to the post test year plant for six projects which the Company included as post test year plant additions but do not have actual plant addition associated with them. For example, PCF-26 is the Sanlando Engineering F5/C1/L2 FM Replacements project and is for the engineering, permitting, bidding and Construction, Engineering and Inspection ("CEI") services associated with the replacement of three critical force mains that have reached the end of their service life and have a high consequence of failure (See Ex. PCF-

26). However, there is no construction project associated with this project and UIF has indicated through the documentation it provided that the new force main will be constructed under a separate project (*Id.*). The six projects are construction work in progress and not plant in service. When the associated construction projects are complete, the expenditures to date will be added to the construction costs and the project could then be eligible for inclusion in the calculation of revenue requirement at some future time. The six projects in question are listed on Ex. FWR-3 and total $432,673. These projects are not reflected in the post test year plant addition in the revenue requirement schedules presented by OPC witness Andrea Crane.

III USED AND USEFUL

Q. DESCRIBE YOUR APPROACH TO USED AND USEFUL FOR THE UIF SYSTEMS IN THE RATE CASE.

A. My approach to determining U&U for wastewater treatment systems follows the provisions set forth in Rules 25-30.431 and 25-30.432, F.A.C., (U&U Rules) and Section 367.081(2) F.S. ("U&U Statute"). Under these provisions, U&U starts with the test year wastewater flow which is then adjusted to reflect growth for a five-year period beyond the test year and the removal of any excessive inflow and infiltration. This adjusted test year flow is divided by the capacity of the treatment facilities to determine the U&U percentage of the treatment facilities.

According to UIF, before the adjudication of Docket No. 20160101-WS, all but seven of the UIF wastewater systems had been found to be 100% U&U. [2] During the 2016

[2] Docket 20160101-WS, Testimony of Frank Seidman, Ex. FS-2.

Docket, UIF proposed that all but one of the remaining seven, the LUSI wastewater systems,[3] be determined to be 100% U&U. In that same Docket, OPC performed a U&U analysis for seven systems and the Commission found that five wastewater systems were less than 100% U&U. In this case, Company witness Seidman is proposing that only three wastewater systems have a U&U percentage less than 100%. My analytical approach to U&U was to concentrate on UIF's proposed changes to the findings made by the Commission in Docket No. 20160101-WS. Table 1 below summarizes the existing U&U designations for the five wastewater systems which were found to be less than 100% in Docket 20160101-WS and UIF's proposed UIF percentages to be applied in this case. My analysis for each system then follows.

Table FWR-1

Present and Proposed U&U Percentages for WW Plant that are currently not 100% U&U

WW System	Current U&U	UIF Proposed
Labrador	79.94%	100%
Lake Placid	29.79%	100%
LUSI	58.78%	72.00%
Golden Hills/Crownwood	93.67%	78.44%
Mid-County	68.65%	100%

[3] For LUSI, UIF proposed the U&U to be 69% due to the excess capacity at the wastewater treatment plant compared to test year flows (Docket 20160101-WS, Ex. FS-2).

Q. PLEASE DISCUSS YOUR FINDINGS WITH RESPECT TO THE MID-COUNTY SYSTEM.

A. The Company proposes the Mid-County U&U be set at 100% (See Ex. FS-2), compared to the current U&U of 93.67%. The permitted capacity at the plant is 900,000 gallons per day ("GPD"). This value compares to the actual test year flow of a daily average flow rate of 902,030 GPD and an allowance for future growth of 46,770 GPD, which results in an expected flow rate of 948,800 GPD and a U&U of 105%.

In its last rate case, UIF took the position that the U&U for these systems was 100% arguing that the systems were built out and there was no growth potential left. The Commission found otherwise and determined there was room for growth, and calculated the U&U according to the applicable rules, Section 367.081(2), F.S. In this case, UIF properly accounts for growth and the linear regression indicates a growth rate of 0.97% per year.

The Mid-County System is in Dunedin, Florida and the plant is less than three miles from the Gulf of Mexico. UIF states that the Mid-County WWTP average day flows can range from as low as 700,000 GPD in dry weather to more than 1,000,000 GPD in extended wet weather (See Ex. PCF-17, Revised). The test year flow data confirms this. In July 2019, the rainfall at the St. Petersburg Clearwater Airport was over 18 inches, compared to the normal 9 inches, and the flow at the WWTP was 1.26 million GPD, which is 40% above permitted capacity. For the year, the Tampa area received 60.8 inches of rain compared to the normal 45.4 inches, which is 34% higher than normal. A review of historic flows at the plant indicate that flows average 785,000 per year and the 2019 flows were the highest in the 2013-2020 time period (See UIF's response to OPC's Interrog. 122). If this flow rate were used, the U&U would calculate to be 91.74%.

For this system, infiltration and inflow due to storm events is an obvious factor in daily flows at the wastewater treatment plant. In fact, one of the pro-forma plant addition projects is aimed at directly addressing this problem: PCF-16 - the Mid-County Curlew Creek I&I Remediation project. Rule 25-30.432, F.A.C., is the rule for wastewater treatment plant used and useful calculations, and allows the Commission to consider the impacts of I&I. I believe this rule should be applied specifically to this system where I&I has such a large and obvious impact. In dry years, simple application of the formula will unreasonably penalize the Utility with a low U&U, and in wet years will reward it. For example, if the 700,000 GPD were substituted into the Schedule F, the U&U would drop to 81.8% and if the 1,260,000 per day were used, it would be 147%. Thus, for this system a proper U&U analysis cannot be done by merely following the applicable regulatory provisions, rule's but requires more analysis which includes adjusting for the effects of I&I. Until such analysis is presented, it is prudent to retain the existing U&U of 93.67% which does not unduly penalize nor reward the Company for abnormal water flow. UIF has the burden of proof in this case and, if it believes this level of U&U is unreasonable, it must present a more sophisticated analysis for the Commission's consideration.

Q. PLEASE DISCUSS YOUR FINDINGS WITH RESPECT TO THE LABRADOR SYSTEM.

A. The Company proposes the Labrador U&U be set at 100% (See Ex. FS-2) compared to the current U&U of 79.94%. The permitted capacity at the plant is 216,000 GPD and the test year three-month maximum average daily flow was 84.447 Million Gallons Per Day ("MGD"). This results in a low U&U of 38.91% (See MFR Schedule F-6 for Labrador).

This system serves customers consisting of an 894-lot mobile home park and a 274-lot Recreational Vehicle Park, of which there are currently 891 Single Family Residential customers ("SFR customers") (*Id.*). In a previous case, Docket 140135-WS, the Commission rejected the use of 100% U&U for this system because an 11.6-acre parcel within the service area owned by the developer had remained vacant. Now, UIF states that the developer has indicated it has plans to finally develop the parcel for 36 manufactured homes (*Id.*).

However, there are several problems with UIF's analysis. First, even though UIF has produced evidence that the developer agreed when asked by the utility that a seven year build out of the vacant area would be a reasonable assumption, it is still an assumption and has not actually occurred yet. Second, even if the 36 additional homes were added to the ERC growth analysis, the U&U percentage would only increase from 39.91% to 40.19%. Third, in the last UIF rate case it was shown that there was an extensive amount of empty land adjacent to the service territory so the service area could expand and serve new customers. A review of satellite imagery of the service territory continues to show this to be true (Ex. FWR-4). For all three of these reasons, I believe that UIF has not met its burden to provide sufficient proof to overturn the Commission's finding of a 79.94% U&U, and the Company's proposed change should be rejected.

Q. PLEASE DISCUSS YOUR FINDINGS WITH RESPECT TO THE LAKE PLACID SYSTEM.

A. The Company proposes the Lake Placid U&U be set at 100% (See Ex. FS-2) compared to the current U&U of 29.79%. The permitted capacity at the plant is 90,000 GPD and the test

year three-month maximum average daily flow was 14,250 GPD. This results in a low U&U of 15.783% (See MFR Schedule F-6 for Lake Placid). In Docket 2016010-WS, the Commission rejected applying 100% U&U because (a) it recognized that there was some potential for growth, and (b) UIF did not present evidence that further growth was restricted (Order PSC-2017-0361-FOF-WS at 97).

UIF now argues that there has been negative growth, as shown in the ERC regression analysis (See MFR Schedule F-10 for Lake Placid), but gives no firm evidence that the system is actually built out to use the design capacity of the plant. In fact, in its responses to discovery, UIF indicates this system is currently serving 136 lots and there are still 63 vacant lots (See UIF's response to Staff's Interrog. 30). A review of the growth in the service territory shows that ERCs have risen and fallen over the past five years. Because of this, there is insufficient evidentiary basis to just blindly use the U&U calculations which would result in increasing the U&U determined in the last case. I propose retaining the existing U&U and revisiting the issue in the next UF rate case if UIF can present a sufficient evidentiary basis to do so.

Q. PLEASE DISCUSS YOUR FINDINGS WITH RESPECT TO THE LUSI SYSTEM.

A. The Company proposes the LUSI U&U be set at 72% (See Ex. FS-2) compared to the current U&U of 58.78%. The permitted capacity at the plant is 999,000 GPD and the Annual Average Daily Flow for the test year was 547,022 GPD. This alone results in a U&U of 55.00% (See MFR Schedule F-6 for Lake Placid). The statute provides for an allowance for the U&U of existing plant by allowing for growth in the number of customers, but no more than 5% per year. The system has benefited from very high growth in the past

five years with a 4.82% annual growth rate. Adding this to the historic test year flows brings the U&U to 65%. However, UIF goes one step further and proposes adding the usage for pre-paid connections that are still in development, resulting in an additional 561 lots to raise the U&U further to 72%.

In support of its analysis, UIF states that for this system at the end of 2019, there were 967 lots still to be developed (See MFR Schedule F-8 for LUSI). UIF also states that LUSI averaged 30 new taps per month in 2020, which is consistent with the growth of new ERCs in 2019 in the amount of 351 new taps (See MFR Schedule F-8 for LUSI).

UIF's analysis for this system is overly aggressive because it adds both historic growth and growth for pre-paid connections to lots that are still under development. At historic growth rates over the next five years, this system can expect to add 756 new ERCs (See MFR Schedule F-10 for LUSI). To add another 561 ERCs on top of this would not only exceed the number of undeveloped lots on the system (967), but it would also result in an annual growth rate of 5.7% which exceeds the statutory limit of 5% per year. For all these reasons, the Company's addition of prepaid connections on top of the historic growth rate is a double count of growth[4] and results on an overly optimistic U&U level for this system. Accordingly, I recommend that the pre-paid connections not be used and the U&U be calculated per the statute to be set at 65%.

Q. PLEASE DISCUSS YOUR FINDINGS WITH RESPECT TO THE MARION-GOLDEN HILLS/CROWNWOOD SYSTEM.

[4] It is my understanding a Florida court has addressed this issue and asserted there is a requirement to prevent double-counting of growth. *See Citizens of Fla. v. Fla. Pub. Serv. Comm'n*, 294 So. 3d 961, 967 (Fla. 1st DCA 2019).

A. The Company proposes the Golden Hills/Crownwood U&U be set at 78.44% (See Ex. FS-2) compared to the current U&U of 68.65%. The permitted capacity at the plant is 40,000 GPD. This value compares to the actual Three Month Average Daily Flow of 26,434 with an allowance for future growth of 4,942 GPD which results in an expected flow rate of 31,376 GPD and a Golden Hills/Crownwood U&U of 78.44%.

In its last rate case, UIF took the position that the U&U for these systems was 100%; the Company argued that the systems were built out and there was no growth potential left. The Commission found otherwise and determined there was room for growth and calculated the U&U according to the applicable regulatory provisions. In this case, UIF properly accounted for growth and the linear regression indicates a growth rate of 3.74% per year to develop the proposed 78.44% which is slightly higher than what was found in the last case. I have reviewed UIFs calculation and agree with their analysis.

IV. SEWER AND WATER IMPROVEMENT MECHANISM

Q. PLEASE DISCUSS THE COMPANY'S PROPOSED SEWER AND WATER IMPROVEMENT MECHANISM (SWIM).

A. UIF seeks approval of a scheme they have named a "SWIM "and claims that it is designed to allow the Company to recover its revenue requirement on the actual investment amounts (Application at 3). Company witness Jared Deason testifies that the revenue requirements for the SWIM would be filed yearly with the annual index filings (Deason at 3). The revenue requirements for the SWIM and index mechanism would be included together to calculate the annual percentage increase in rates (*Id.)*. As explained by Mr. Deason, the filing would detail the investments made, the revenue requirement associated with the

investments, and a projection of the next two years of scheduled investments with estimated revenue requirements (*Id.*). Mr. Deason takes the position that the annual filings would provide the opportunity for the Commission to review and audit the program, as well as conduct continuous oversight of the effectiveness and rate impacts to customers (*Id.*).

Q. PLEASE COMMENT ON THE CONCEPT OF THE PROPOSED SWIM.

A. Under the current regulatory process, water and wastewater utilities in Florida have been allowed to file annual index filings to adjust rates using a "Price Index" which reflects changes in operating costs. The Price Index is addressed in Section 367.081(4)(a), F.S. This statutory process allows water and wastewater utilities to adjust rates based on current specific expenses without applying for a rate increase. The Index is calculated by comparing the Gross Domestic Product Implicit Price Deflator Index of the current and previous fiscal years. The goal of annual index filing is that a utility can recover rising costs and lessen rate shock in subsequent rate cases. The annual index filing does not include reflection of capital investments, nor does it include increases in revenues, or savings that may be realized by a utility. To recover the carrying costs on capital investments, a full rate case must be filed and the Commission, intervenors and the public have an opportunity to review and match revenues, expenses and investments to determine if a change in rates is required.

In its responses to discovery, UIF estimates that its expected capital investment over the next five years will average $8 to $10 million per year (See UIF's response to Staff's Interrog. 5(b)). At this level of investment and at the Company's requested 7.889% rate of return, after taking into account taxes and depreciation, ratepayers can expect an automatic

4% increase in rates per year, plus the rate increase attributable to the annual index fling, which has been increasing at a rate of between 1%-3% per year.

As presented in its testimony, the Company is seeking to replace the current regulatory process with a formula ratemaking mechanism that would allow it to recover the carrying costs on any capital investments made. This, together with the annual index filing, would allow UIF to recover all of its expenses and profit from its investments. At the same time, the Company would still be allowed to retain all of the revenue growth from increased sales and increases in the number of customers. In other words, UIF presents a win-win situation for itself. Of course, ratepayers would pay for this win-win situation with rate increases in the range of 5%-8% per year, with no ability to receive the benefits of increased revenues from increased sales. This is simply unfair and unreasonable to UIF's ratepayers.

Moreover, there are practical problems with the proposed SWIM as well. First is the fact that the Company simply states what and how much its investments will be without regard to rate impacts. Thus, if the Company seeks more profits from its operations and wants to grow rate base, it can simply invest more, regardless of the true need to invest. In New England, where wholesale electric transmission rates are set via a formula rate adjusted on an annual basis, rates between 2003-2020 investment in plant increased by a factor of 7 and rates have increased on average 14.1% per year (See Ex. FWR-5). Based on these results, there is little solace in the fact that UIF claims that the Commission will have the right to review and audit the resultant rate increases. Once the money has been spent, there is little chance of the costs not being allowed for recovery from ratepayers.

The second problem with the Company's proposal is the process itself. The annual index filing under Florida Statutes is automatically implemented 60 days after the utility

provides its notice of intention to the Commission. Customer meetings and hearings are not used in this process. Thus, by combining the SWIM with the annual index filing, contrary to the Company's claim, there is little if any ability to audit and review the need for the investments and the applicable costs. In its responses to discovery on the review process for the SWIM, UIF proposes that documentation for the SWIM would be provided on February 1st of each year and this would allow for an extra two months for the Commission and its Staff to review and approve the SWIM documentation (See UIF's response to Staff's Interrog.1-7). While this appears commendable, in reality there is no allowance for meetings and hearings under the current annual index filings; thus, "offering" more time for review does nothing on a practical basis. Instead, it would force the Commission to commence a proceeding for the sole purpose of reviewing, verifying, and receiving customer comments on the pro-forma plant additions. Thus, rather than less work, the Company's proposal could result in more work for Commission Staff, intervenors and the Commission.

Third, there has been no showing of a need for the mechanism. UIF merely states it wants a SWIM. It has not shown that its investments or operations have been hindered by the lack of one. Indeed, between 2015 and 2019, the Company's plant in service grew by over $100 million based on the rates set in Docket No. 20160101. The ability to fund these investments is due in large part to UIF's right, by statute, to ask for 24 months of pro-forma plant additions in a rate case. This is quite generous for a utility where the Commission uses a historic test year to set rates and the statute works as intended: it gives the utility the ability to receive carrying charges on plant placed in service for a reasonable period after the end of the test year, thereby allowing the utility to make additional investments in plant.

Given the expected increased rates resulting from the SWIM, the practical problems associated with its implementation, and the lack of any showing of need, the SWIM should not be adopted.

V. EXCESSIVE INFLOW AND INFILTRATION AND UNACCOUNTED WATER

Q. PLEASE DISCUSS THE COMPANY'S PRESENTATION FOR EXCESSIVE INFLOW AND INFILTRATION AND EXCESSIVE UNACCOUNTED FOR WATER FOR ITS WASTEWATER AND WATER SYSTEMS.

A. Company witness Frank Seidman presents the Company's calculations for Excessive Inflow and Infiltration ("I&I") and Excessive Unaccounted Water which he summarizes in Ex. FS-3.

Inflow and Infiltration result from separate causes. Inflow is storm water that enters into sanitary sewer systems at points of direct connection to the systems. Various sources contribute to the inflow, including footing/foundation drains, roof drains, downspouts, driveways, etc. These sources are typically improperly or illegally connected to sanitary sewer systems. Infiltration is groundwater that enters sanitary sewer systems through cracks and/or leaks in the sanitary sewer pipes. Cracks or leaks in sanitary sewer pipes or manholes may be caused by age related deterioration, loose joints, poor design installation or maintenance errors, damage or root infiltration. Groundwater can enter these cracks or leaks wherever sanitary sewer systems lie beneath water tables or the soil above the sewer systems becomes saturated. Excessive I&I is generally defined as an I&I level of above 10%. I&I should always be minimized because excessive I&I means more wastewater has to be treated, which results in more wastewater treatment costs (e.g., more water to be pumped in

lift stations resulting in more chemical costs and purchased power expense). According to UIF's calculations, only two systems, Orangewood and Ravenna Park, have excessive I&I. I have reviewed their Schedule F calculations for all systems, and agree with them and propose no change.

Water into the distribution system comes from surface water (e.g. rivers, reservoirs, etc.), groundwater, or water purchased from outside sources. Utilities measure all gallons purchased or pumped and how much water is sold. The difference between the amount going into the system and the amount sold is then identified and, if the utility is able, the amount of water for other uses (line breaks, flushing and water quality testing, etc.) can be isolated and identified. Any remaining difference is termed unaccounted for water. Due to errors in water metering or unidentified line breaks, there is always some unaccounted-for water. In Florida, excessive unaccounted for water is the level above 10%. Excessive unaccounted for water results in higher operating costs such as purchased water expense and/or chemical treatment expense and should be minimized. UIF has identified five systems with excessive unaccounted for water: Lake Placid, LUSI, Golden Hills/Crownwood, Sanlando and Little Wekiva. I have reviewed their Schedule F calculations for all systems, agree with them and propose no change.

VI. SUMMARY

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. I recommend several pro-forma projects be disallowed from rate base because the project documentation submitted to date is insufficient to allow verification that the projects will be in-service by the end of the 24-month period pursuant to Florida Statutes. I also

recommend a second adjustment to the post test year plant for six projects which are in fact simply studies that are not related to a construction project, and as such, were erroneously included in the revenue requirement calculations. These studies improperly labeled "projects" cannot be included in revenue requirement calculations until there is actual plant in service associated with them and customers can obtain benefits from their use.

The Company has changed several of the Used and Useful ("U&U") percentages for several systems which were adjudicated and set by the Commission in the Company's last rate case. Several of these changes are unreasonable because the Company presented no testimony or evidence to justify these proposed changes, and a review of the Company's Application data shows it is insufficient to change what the Commission has already determined to be the proper U&U percentages.

The proposed SWIM is expected to result in rate increases at a rate above inflation for the foreseeable future. The Company proposes to include the SWIM with its annual index filings; however, that filing process has no provision for customer meetings or hearings or other Commission review of the proposed changes. Thus, the proposed mechanism has practical problems associated with its implementation; namely, a lack of an adequate review process. Also, given that the rate case process already allows for 24 months of post-test year plant additions to be reflected in rates and that there has been no showing of the need for a special mechanism to fund capital projects, the necessity of the SWIM has not been established.

VII. CONCLUSION

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

BY MS. PIRRELLO:

Q Mr. Radigan, did you also cause to be prepared Exhibits FWR-1 through FWR-15?

A I did.

Q And do you have any corrections or changes to those exhibits?

A I do not.

MS. PIRRELLO: Mr. Chairman, please note that those exhibits are identified in the CEL as Exhibits 61 through 65.

CHAIRMAN CLARK: So noted.

BY MS. PIRRELLO:

Q Mr. Radigan, did you prepare a summary of your prefiled testimony?

A I did.

Q Would you give that summary at this time?

A Sure.

My name is Frank Radigan, as I said. I am an engineer with almost 40 years of experience in the utility industry. I started my career at the staff in the Public Service Commission in New York, and for the past 23 years, I have been -- I've owned my own consulting firm serving clients in the water, wastewater, gas, electric and steam utility businesses. I was assigned to review some of the engineering aspects

of the rate application.

I made a series of adjustments in my testimony. First was with respect to proforma plant additions. The company proposes 45 separate projects over the 24-month post test year period. Approximately half of these projects were completed at the filing of my direct testimony, and the remaining half were either under construction or awaiting construction.

During the course of the proceeding, I reviewed the company's bidding and contracting process, and became familiar with its internal process for taking a project from a concept to being in service. I also traveled to Florida and toured several of the projects so I could see for myself how the projects were progressing.

Based on my review and observation, I proposed numerous projects be disallowed because the project documentation presented was insufficient to allow me to verify that the projects would be in service by the end of the 24-month post test year period.

I also prepared a second adjustment to post test year plant for six projects that were actually studies and not related to construction projects actually under construction at this time. As such, under the Uniform System of Accounts, these costs cannot

be placed into service until an associated plant project is completed. Rather, these studies are going to rate base after the construction of the project, but that won't happen until after the end of the 24-month post test year period.

So the revenue requirement associated with these future construction projects will be part of some future rate case, when the construction projects are identified. Thus, the engineering and study costs were erroneously included in plant in service in this rate case. The value of these disallowances was $432,000 from rate base.

The company -- I also addressed the company's proposed changes to used and useful of several of the wastewater systems, which were adjudicated by the Commission in the company's last rate case. The company presented no testimony or evidence to justify these proposed changes. In some cases, there are notes included in the F schedules, however, review of that data showed it was insufficient in scope and explanation to change what the Commission has already determined to be the proper used and useful percentages.

The final area of my testimony is in response to UIF's proposed SWIM mechanism. The revenue requirement for the SWIM and the index mechanism would

be included together to calculate annual percentage increases in the rates. The filing would detail proposed projects, the revenue requirement associated with those projects, the projection of the next three years of scheduled expenditures and associated revenue requirements.

As presented in its testimony, OPC believes the company is seeking to replace the current regulatory process with the formula rate-making process, that would allow it to recover carrying costs on any comparable projects that are undertaken. This, together with the annual index filing, would allow the utility to recover all of its expenses and profit from its capital spending. At the same time, the company would still be allowed to retain all of its revenue growth from increased sales and increased number of customers.

In other words, OPC believes that Utilities, Inc. presents a win-win situation for itself, but ratepayers would pay for this. Based on estimated increases in capital spending provided by the utility, OP -- OPC estimates the annual increases would be in the five to eight percent range if the SWIM was adopted. We believe this is simply unfair and unreasonable to UIF's ratepayers.

OPC also believes that there is practical

problems with the proposed SWIM. First is the fact that the company simply states what and how much its projects will be without regard to rate impacts. Thus, if the company seeks more profits on its operations, it can simply spend more regardless of the true need. The company also proposes to include its SWIM with the annual index filing but that --

MR. WHARTON: Mr. Chairman -- Mr. Chairman --

CHARIMAN CLARK: Yes.

MR. WHARTON: We are clearly exceeding three minutes here, Mr. Chairman.

CHARIMAN CLARK: You -- you --

THE WITNESS: I have said enough.

CHAIRMAN CLARK: -- I am sorry, who is this? Mr. Wharton?

MR. WHARTON: Yeah -- yes. We are well exceeding three minutes in the summary.

CHARIMAN CLARK: Repeat what you said, Mr. Wharton. I can't understand you.

MR. WHARTON: We -- we -- we are -- this summary well exceeds the three-minute limit.

CHARIMAN CLARK: Yes, sir, I am well aware of that. We were -- we were fixing to come to that.

Can you wrap this up, Mr. Radigan?

THE WITNESS: I think I have said enough, Mr.

Chairman.

CHARIMAN CLARK: Thank you, sir.

Ms. Morse.

BY MS. PIRRELLO:

Q Mr. Radigan, do you have anything else you would like to add based on late filed testimony or discovery?

A Yes. In my direct testimony, I proposed 11 of the 45 projects being proposed by the company be disallowed because the company did not provide sufficient evidence for me to verify that the projects would be in service by the end of the 24-month post test year time period.

In rebuttal testimony, company witness Flynn provided --

MR. WHARTON: I object --

THE WITNESS: -- to the construction projects being proposed by the company.

CHAIRMAN CLARK: Mr. Radigan, hold on, sir, we have -- Mr. Radigan, hold on one second, we have an objection. Hold on a second.

Mr. Wharton.

MR. WHARTON: I will -- I will withdraw the objection.

CHARIMAN CLARK: Proceed, Mr. Radigan.

THE WITNESS: Okay. Based on the updated information, I was able to verify that two more projects now have sufficient information in total to be allowed into rate base, and one project had enough information for -- because there was several subcontractors with the project, they provided enough information to -- for me to partially justify some of that information. So originally I had proposed a 9.8.7 million disallowance because of insufficient evidence for the 11 projects, but now I have reduced that number to 8.97 million based on the updated information provided in the rebuttal.

MS. PIRRELLO: Thank you, Mr. Radigan.

With that, Mr. Chairman, Mr. Radigan is available for process examination.

CHAIRMAN CLARK: Thank you is he much.

Mr. Wharton, your witness.

EXAMINATION

BY MR. WHARTON:

Q Can you hear me, Mr. Radigan?

A I can.

Q All right, good. So just -- just a few questions.

You are sole university degree is in chemical

engineering, right?

A That's correct.

Q So two of the issues that you have gotten into in your testimony, adjustments to test year plant in service and adjustments to proforma plant additions, are something that Ms. Crane also testified about, right?

A Well, she -- she adopted my testimonies to the plant in service.

Q All right. And -- and on the -- on the engineering issues in which you were to testify, there is a stipulation, so you -- you agreed with -- you do not disagree with Utilities, Inc.'s excessive unaccounted for water calculations, do you?

A I do not disagree, correct.

Q And you take no position against Utilities, Inc.'s calculation of whether there is any excessive I&I?

A That's correct.

Q And you take no position against the used and useful on the waterside that Utilities, Inc. has proposed?

A That's correct.

Q And on the wastewater side, everything has been stipulated except for four systems, is that correct?

A That's correct.

MS. PIRRELLO: Objection. We've stipulated to these issues.

CHARIMAN CLARK: Mr. Wharton?

MR. WHARTON: I'm sorry, what was that?

CHAIRMAN CLARK: She said that they had stipulated to those issues.

MR. WHARTON: I am not sure, what's the objection?

MS. PIRRELLO: To the extent that the issue has been stipulated, then Mr. Radigan should not be questioned about it. It's not a live issue.

CHAIRMAN CLARK: Do you have a question or are you making a statement, Mr. Wharton?

MR. WHARTON: No. I don't have any further questions on the issue.

CHAIRMAN CLARK: Okay. Thanks.

BY MR. WHARTON:

Q Okay. Now, of the four systems on used an useful wastewater, let me ask you about one of those. You are familiar with the wastewater facilities, the system referred to as Labrador?

A Yes.

Q And do I correctly characterize that in the 2016 rate case, Labrador was suggested by Utilities,

Inc. to be 100 percent used and useful, but the Commission determined it was not 100 percent used and useful because there was a plot of undeveloped land in the service area?

A Yes. The Commission adopted a lower number.

Q Okay. And now it is Utilities, Inc.'s position that that system is 100 percent used and useful because that undeveloped land is to be developed, correct?

A That's their position, but the wastewater treatment facility there is sized for customers using an average of 280 gallons per day, but customers are only using 75 gallons per day. And so the facility is oversized, but development is fully built out, and so that's the developer's idea to build a facility that size. Ratepayers shouldn't be saddled with the full cost.

Now, I didn't reduce it down as far as the mathematical numbers indicate down to the 40 percent range that we were talking about with Mr. Seidman earlier today, but rather, I just said there has to be more examination for this facility of why it's so oversized and, you know, the mathematical calculation shows that it's such a much, much lower number, so what I proposed is that the number adopted by the Commission

in the last case be retained.

Q But my question, sir, was whether I correctly characterized Utilities, Inc.'s position, that it is 100 percent used an useful because that lot is now set to be developed?

A That's correct.

Q Okay. Now, you actually suggested in your prefiled testimony that one of the reasons that you don't believe the Labrador system is 100 percent used and useful is because there are potential customers in land that is adjacent to the territory but not within the territory, is that correct?

A Yes. And that's a carryover issue from the last rate case as well, that a review of satellite image data shows that the area all around the Labrador system is empty, and it could be used in the future for more development. And that might be the reason why they built such a large wastewater treatment plant in the first place. The developer might have thought that that was going to occur in the last -- you know, in the future.

Q Now, you don't have any testimonial experience in Florida, do you?

A I do not.

Q And you don't have any used and useful

experience before this case in Florida, do you?

A No.

Q Are you aware of any case, rule, statute, Commission order where territory outside of a utility's certificated territory should be taken into account when calculating whether facilities are used and useful?

A Well, it's their current service territory. They could expand their services territory by a simple petition to the Commission.

Q But if would you answer my question, sir. Are you aware of any rule, case, order that supports your opinion in that regard?

A No.

Q Do you know what DEP requires for permitting purposes in terms of how many gallons per day when building a wastewater plant --

A No.

Q -- the Florida DEP? All right.

So you testified that you had looked at about 45 separate projects, and you divided them into two categories, those for which you believed there was sufficient documentation and those for which you felt there was not sufficient documentation; is that a fair statement?

A No. I divided them into three categories. I

divided them into projects that were completed at the time I was doing my review and preparing my testimony, projects that were under construction while was preparing my testimony, and projects that were going to be completed out into the future.

And so then I went down to Florida to do a due diligence to look at the projects firsthand. I toured some of the projects that were under construction, some of the projects that were recently completed, and some of the projects that had not been completed whatsoever.

And then in preparing my testimony, I reviewed the company's project documentation. Initially, the company's project documentation consisted mainly of its business case and bid documents from contractors. And then as the case went on, the -- that filled out to show the whole process the company has for getting a project from concept to in service, and that has several steps. It's the biggest business case form where the company proposes the project to itself, gets an estimated cost of the project and justifies its project, and then it goes out to bid to contractors.

It has a very good bid process, where it studies each of the bids, evaluates the contracts to just make sure that they are competent to do the work, and then selects the lowest qualified bidder to do the

work.

From there, then the company serves what's called an award form, notifying the contractor that the -- they have won the bidding process and the utility accepted their contract. And that award form is signed by the utility, and then the utility asks the contractor to execute it and send it back to the utility. So now the contractor and the utility understand that the contractor is going to do the work at a certain price.

The next step is a contract that has -- and we went -- we went through the --

(Multiple speakers.)

MR. WHARTON: Mr. Chair?

THE WITNESS: Can I --

MR. WHARTON: Mr. Chair?

CHAIRMAN CLARK: Yes, sir.

MR. WHARTON: If I may. This is literally an answer to a question as to whether he divided the projects into categories of insufficient documentation and documentation. It's not responsive, and I would ask that Mr. -- I would ask that Mr. Radigan be instructed to try to answer the question.

CHARIMAN CLARK: Mr. Radigan, our -- kind of our process is to answer the question with a yes or

no, and then if an explanation is necessary, that's certainly appropriate to give. So if you could directly answer the question and then provide an explanation.

Go ahead, repeat the question, Mr. Wharton.

THE WITNESS: I am sorry, Mr. Chairman, I thought I did, because he asked me what did I do.

MR. WHARTON: No, I --

CHARIMAN CLARK: Repeat the question, Mr. Wharton.

BY MR. WHARTON:

Q With regard to those projects for which you determined there was insufficient documentation, you formed no within with regard to the merits of those projects, right? The only opinion you have is that there was insufficient documentation?

A Yes, and as I was explaining, under their process, then they have a contract, and then they tell the contractor there is a notice to proceed, which is, again, executed by the utility and by the contractor that the project will be done by -- that you will start the project within a certain period of time, and it will be done by a certain period of time. And that's -- that's how I know that the project -- that's how I am able to verify if the project is going to be done in the

24-month proforma test period -- post test year period. That is the company's contract process, and that is the -- those are the documents that I needed to look at to verify the due diligence that the project will be in service.

Q But for those projects for which you were not able to get sufficient documentation, in your opinion, that is the limit of your opinion with regard to those projects, correct?

A Well, I -- those -- those documents tell you how much the project is going to cost and when it's going to be in service. If you -- if you don't have some kind of due diligence process, you know, someone could write down any number and tell you any -- you know, write down any time period that it's going to be in service.

Q So you would agree with my statement then, it's correct? I am just trying to get an answer from you.

A Yes.

MS. PIRRELLO: Objection, asked and answered. He said yes.

MR. WHARTON: I could ask for it to be read back, he did not. I will move on.

CHARIMAN CLARK: Thank you.

BY MR. WHARTON:

Q So do you contest the prudency of any of the projects on any basis other than that some had insufficient documentation in your opinion?

A Well, I went and toured the facilities. For instance, the Mid-County project, where they are going to build a new lift station and a new headworks facilities, I stood there on October 19th and nothing was done. There was no work being performed whatsoever.

So after that -- after that physical tour, I came back, issued more discovery asking the utility for more documentation to show that the project was going to be completed on time.

Q It appears to me that, from your testimony, that in every case in which you believed you had sufficient documentation, you agreed with Utilities, Inc.?

A Yes.

Q You didn't question their conclusions, is that correct?

A Could you repeat the question?

Q Yes.

It appears from your testimony that in every case in which you determined there was sufficient documentation, you agreed with the position of

Utilities, Inc.?

A Yes.

MR. WHARTON: Hold on a second. I am looking at my notes real quick, Mr. Chairman.

BY MR. WHARTON:

Q You -- you talked about the project involving the lift station a few minutes ago, is that correct?

A Yes.

Q Did -- did you make any determination that that project was not a prudent project for Utilities, Inc. to undertake?

A No. I believe they are going to do it eventually, but the question is when.

Q So you do believe it was a prudent project for Utilities, Inc. to undertake?

A Yes, it will be done at some point in time.

MR. WHARTON: That's all I have, Mr. Chairman.

CHARIMAN CLARK: Thank you very much.

Staff?

MR. TRIERWEILER: Staff has no questions for this witness.

CHAIRMAN CLARK: Commissioners?

No questions from Commissioners.

All right. Ms. Morse?

MS. PIRRELLO: We have no further questions,

Mr. Chairman.

I would move Mr. Radigan's exhibits identified as CEL 61 through 65 into the record.

CHARIMAN CLARK: All right. Mr. Radigan's exhibits are moved into the record.

All right, Mr. Radigan, thank you very much for your testimony today. I think we have you back up again tomorrow.

All right. That concludes all of our direct testimony. I am inclined to at least get into a little bit of the next -- of the rebuttal testimony this afternoon. Let's move a little bit further along.

I would just like to get kind of some idea for witness Snow, let's begin with that one. UIF, I believe that is your witness, correct? OPC, can you give me any idea on how long you are going to have for Mr. Snow?

MS. MORSE: Maybe a half hour or so with Mr. Snow.

CHARIMAN CLARK: Okay. I am not holding you to anything. I promise. I just want to try to get a little bit of a ballpark idea to know how far we are going to be proceeding along. Well, that's great, if you have got about a half hour, then

maybe we can get this witness out. We will conclude there today and pick up with the rest tomorrow morning.

So is everyone ready to proceed?

MR. REHWINKEL: Mr. Chairman?

CHAIRMAN CLARK: Mr. Rehwinkel.

MR. REHWINKEL: Just for the record, I think you may have indicated that we would see Mr. Radigan again tomorrow, but he -- he was only on direct, and I think he should be excused --

CHARIMAN CLARK: Yes.

MR. REHWINKEL: -- if I am not mistaken.

CHAIRMAN CLARK: Yes, without objection, Mr. Radigan is excused. Thank you very much, Mr. Rehwinkel.

(Witness excused.)

(Whereupon, prefiled direct testimony of Sarah Lewis was inserted.)

SECOND ERRATA SHEET

WITNESS: Sarah Lewis

The following table contains the corrected errata in her direct testimony.

Page	Line	Original	Revision
4-5	23-2	I created a summary of the list, which includes five categories of water and wastewater issues. My summary is attached to my testimony as SML-2. These five categories pertain to six of UIF's systems, some of which have more than one quality of service issue. All six systems listed are subject to consent orders between the Utility and DEP related to violations by the Utility. Most notable is the raw sewage spill that occurred at facility ID #WU413,	I created a summary of the six consent orders related to water and wastewater issues. My summary is attached to my testimony as SL-2. These consent orders pertain to three of UIF's systems, some of which have more than one quality of service issue. All three systems listed are subject to consent orders between the Utility and DEP related to violations by the Utility. Most notable is the raw sewage spill that occurred at PSC facility ID #WU413 (Wekiva Hunt Club),
5	21-22	Q. DID YOU REVIEW THE CUSTOMER COMPLAINTS FILED AS PART OF THE UTILITY'S MFRs?	Q. DID YOU REVIEW THE CUSTOMER COMPLAINTS FILED AS PART OF THE INSTANT DOCKET AND IN THE PSC's COMPLAINT ACTIVITY TRACKING SYSTEM?
5	26	Duplicative complaints were submitted to OPC	Duplicative complaints were provided to OPC by the PSC
6	5	Generally, my review	Generally, in my opinion based on my review, it
6	11	The majority of complaints relate to billing	There are numerous complaints related to billing
8	9	201 complaints.	197 complaints.
8	10-11	But more importantly, most of these customers never received a response from the Utility until they reached out to the PSC and	But more importantly, some of these customers never received a resolution from the Utility until they reached out to the PSC and
8	22	The majority of the	There are numerous

9	19	Utility multiple times to get a response from the Utility.	Utility multiple times to get a response or resolution from the Utility.
9-10	25-3	o Lake Utility o Wekiva Hunt Club o Sanlando Utilities o Mid-County o Pinellas-County owned by Utilities Inc.	o Lake Utility Services, Inc. (LUSI) o Wekiva Hunt Club/Sanlando Utilities o Mid-County Services, Inc.
10	18-19	for the following systems: Lake Utility, Wekiva Hunt Club, Sanlando Utilities, Mid-County, and Pinellas-County owned by Utilities Inc.	for the following systems: LUSI, Wekiva Hunt Club/Sanlando Utilities, and Mid-County Services, Inc.

ERRATA SHEET

WITNESS: Sarah Lewis

The following table contains the corrected errata in her direct testimony.

Page	**Line**	**Original**	**Revision**
Passim			Throughout the testimony, references to exhibits "**SML**-x" should be referred to as "**SL**-x" instead.
Exhibit SL-3		Title: PSC's Complaint Activity Tracking System	Title: PSC's Complaint Activity Tracking System Data

DIRECT TESTIMONY

Of

Sarah Lewis

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 20200139-WS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Sarah Lewis. My business address is 111 West Madison Street, Room 812, Tallahassee, FL 32399-1400.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am an accountant and employed as a Legislative Analyst with the Office of Public Counsel (OPC). I began my employment with OPC in July 2018.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I received a Bachelor of Arts degree from Flagler College in accounting as well as a Bachelor of Arts degree from Flagler College in business administration in 2005. Prior to my work at OPC, I worked at the Florida Department of Education in the Office of Funding and Financial Reporting as a Policy Analyst from 2016-2018 compiling fiscal analyses for Florida House and Senate bills as well as compliance with Generally Accepted Accounting Principles ("GAAP"), bond accounting, and various other accounting-related analysis and reporting projects. This also included auditing of

district and school financial information. I worked at the Novey Law Firm as a Legal Administrator from 2012-2016; my duties included accounting functions as well as business management. Additionally, from 2011-2012, I performed various accounting functions as a Staff Accountant with Goodwill Big Bend, where my duties included budget modifications, grant procurement and other non-profit accounting functions, including compiling and submitting sales tax calculations for 25 retail locations. From 2006 to 2011, I was an accountant for Applied Fiber Manufacturing, LLC where my duties included, but were not limited to, in-house auditing of financial data for budgeting and reporting purposes, as well as audits of contracts and data compilation for break-even statistics and return on equity.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony provides a summary of the various letters, exhibits, and other documentation contained in the instant docket file and in other files of the Public Service Commission ("PSC" or "Commission") as relates to the quality of service provided by Utilities, Inc. of Florida ("UIF" or "the Utility") during or after the test year. Sections 367.081(2)(a)1 and 367.0812, Florida Statutes (F.S.), provide the Commission shall consider the quality of the service when setting rates. Commission Rule 25-30.433(1), Florida Administrative Code (F.A.C.), further details the Commission's requirements as follows:

> The Commission in every rate case shall make a determination of the quality of service provided by the utility by evaluating the

> quality of utility's product (water) and the utility's attempt to address customer satisfaction (water and wastewater). In making this determination, the Commission shall consider:
> (a) The most recent chemical analyses for each water system as described in rule 25-30.440(3), F.A.C.;
> (b) Any Department of Environmental Protection (DEP) and county health department citations, violations and provisions of consent orders that relate to quality of service;
> (c) Any DEP and county health department officials' testimony concerning quality of service;
> (d) Any testimony, complaints and comments of the utility's customers and others with knowledge of the utility's quality of service; and
> (e) Any utility testimony and responses to the information provided in paragraphs (1)(a)-(d), above.

For my testimony, I have reviewed the testimony and exhibits of the Utility's witnesses for quality of service issues. I have gathered data from the Florida Department of Environmental Protection ("DEP") filed with the Commission in response to Commission Staffs' requests, consent orders obtained from DEP's OCULUS database, and UIF's Minimum Filing Requirements (MFRs) addressing quality issues. I have also assembled letters filed by UIF's customers in the PSC's docket. My testimony provides all of this information in a summary format for the Commission to consider in its determination of UIF's quality of service.

Q. WHY DID YOU INCLUDE QUALITY OF SERVICE ISSUES THAT OCCURRED AFTER THE TEST YEAR?

A. The Commission should make its determination of quality of service based upon the most up-to-date information available. Quality of service issues, such as

water quality, affect the customers' quality of life and their pocketbooks. If a situation that arose after the test year affects the quality of service determination, then it could be an indication of an issue which the Commission should consider when making its determination.

II. DEP QUALITY OF SERVICE ISSUES

Q. WHAT DID YOU REVIEW REGARDING QUALITY OF SERVICE ISSUES IDENTIFIED BY DEP?

A. DEP's information about UIF's quality of service issues was obtained from a number of sources. I reviewed the documentation submitted by the Utility with its MFRs as well as its responses to the deficiency letters issued by the DEP. I also reviewed the documentation available to the public on DEP's Oculus database. While Oculus contains information related to UIF's systems going back many years, I have only included items from 2015 (from UIF's last base rate case) through January 2020. While these dates range outside of the test year in the current docket, it is important to review the more recent violations to show ongoing issues with the different facilities owned by the Utility. This Consent Order data is attached to my testimony as SML-2, and the Consent Orders issued by DEP to UIF are attached to my testimony as SML-4.

Q. CAN YOU SUMMARIZE THE HIGHLIGHTS OF THE LIST OF DEP QUALITY OF SERVICE ISSUES?

A. Yes, I can. I created a summary of the list, which includes five categories of water and wastewater issues. My summary is attached to my testimony as SML-2. These five categories pertain to six of UIF's systems, some of which have more than one quality of service issue. All six systems listed are subject to

consent orders between the Utility and DEP related to violations by the Utility. Most notable is the raw sewage spill that occurred at facility ID #WU413, which was also the subject of customer correspondence to the PSC, and is listed in my customer complaint summary attached to my testimony as SML-1.

Q. DO YOU HAVE ANY COMMENTS REGARDING YOUR FINDINGS REGARDING THE QUALITY OF SERVICE ISSUES IDENTIFIED BY DEP?

A. Yes, I do. These issues should be included for consideration by the Commission in this rate proceeding and should be evaluated as a part of the overall quality of service issues in this docket. The Commission's evaluation should include consideration of these issues, even if the Utility has since corrected any deficiencies. The customers who have experienced these quality of service issues have continuously paid rates even when UIF was not in compliance with primary or secondary water standards. No utility, including UIF, should be allowed to operate in non-compliance during its test year, later resolve its deficiencies for its rate case, and then expect to receive a clean bill of health from the Commission with respect to setting new rates.

III. CUSTOMER COMPLAINTS TO THE UTILITY

Q. DID YOU REVIEW THE CUSTOMER COMPLAINTS FILED AS PART OF THE UTILITY'S MFRs?

A. Yes, I reviewed these customer complaints and tabulated all the quality of service complaints. This tabulation is included with my testimony as SML-1 and the complaints received through the PSC's Complaint Activity Tracking System are attached as exhibit SML-3. Duplicative complaints were submitted to OPC and

I attempted to exclude these duplicates. The years 2017-2020 were requested from the Commission for all complaints.

Q. WHAT HIGHLIGHTS DID YOU FIND WHEN YOU REVIEWED THE BILLING COMPLAINTS?

A. Generally, my review shows that most of the billing complaints occurred after a customer received a high bill and UIF conducted a follow-up investigation to determine whether there was either a leak that was the responsibility of the Utility, or a meter malfunction, as determined by a meter test and re-reading of the meter for accuracy. I would also note that several of the billing complaints also included complaints relating to the quality of service provided by the Utility.

The majority of complaints relate to billing - either due to the 2016 rate increase, subsequent pass-through increases, and interim rate increases - or to protesting upcoming rate increases.

Several complaints relate to quality of customer service, water/wastewater quality and problems with receiving refunds from the Utility. These issues appear to have been resolved only after the customers subsequently made formal complaints to the PSC, which was after the customers first attempted to resolve their disputes with UIF.

A number of miscellaneous complaints that did not identify the specific UIF system are included in the customer complaints list.

I also spoke personally to three customers from different UIF systems about the quality of the water and issues related with the quality.

Dana Elliott, who resides at 625 Grand Vista Tri, Leesburg FL 34748, had to purchase a water softener filtration system that cost approximately $5,000. She also stated she spends approximately $20 a month for bottled water for drinking, as the water that comes directly from the facility is undrinkable. Ms.

Elliot stated that the unfiltered water emits a black substance as well as a rust color substance that stain the streets and sidewalks. Her toilets are stained orange from the water.

Gail Russakov, who resides at 306 Cambridge Dr., Longwood FL 32779, stated that she has lived in her house for 30 years. She did not have water quality issues until UIF took over her utility. She stated that one of the more notable issues was that a strong chemical smell has emitted from the unfiltered water. This occurred sporadically for a while although she has not noticed it during the past year. She also has to filter her water for drinking. She was told that the reason for past rate increases is that UIF needed to replace the pipes on her street; however, she has not witnessed activity on this project.

Barry Saylor, who resides at 33125 Meadow Green Ct., Leesburg FL 34748, stated that he has had to purchase two water filtration systems so that the water can be usable and drinkable. The first system was a water softener system that cost approximately $4,000. The second system cost approximately $1,600 and was a three filtered treatment system utilizing a paper filter, a charcoal filter and a Nuvo filter. Mr. Saylor stated that he has had to replace his toilets due to staining and etching from a black substance that builds up as well as a rust colored stain. He also stated the sprinkler systems stain the houses, sidewalks and driveways. He further stated his yearly water bill is nearly what he is paying for his property taxes on his home and is as much as his yearly homeowners' association fees, and that this seemed exorbitant.

Numerous customers have submitted letter complaints against the Utility for poor quality of water, poor customer service, and the high rates they are forced to pay for water and wastewater. Notably I read numerous complaints that stated the cost of the water and wastewater from UIF exceeded the

customers' electricity bills. This was a widespread complaint.

Q. DO YOU HAVE ANY CONCERNS REGARDING THE COMPLAINTS THAT YOU REVIEWED?

A. Yes, I do. It appears that customers in many cases never received responses to their complaints until and unless they contacted the Commission, which was after first contacting UIF. This is further borne out by the customer complaints that were also obtained from the PSC, which included approximately 1,000 pages of documentation related to 201 complaints. Some of these complaints involved multiple issues per incident. But more importantly, most of these customers never received a response from the Utility until they reached out to the PSC and filed a formal complaint.

IV. CUSTOMER LETTERS

Q. DID YOU REVIEW THE CUSTOMER LETTERS FILED IN THIS DOCKET?

A. Yes, I did. I reviewed and logged each of the customer letters and customer comments filed at the Commission in this docket. I have included these complaints in my customer complaint compilation, Exhibit SML-1.

Q. WHAT ELSE DO YOU INCLUDE IN EXHIBIT SML-1?

A. Each letter and comment is categorized in the exhibit. The majority of the customer letters and comments express concerns relating to the Utility's request for another rate increase. Many of these systems have seen repeated increases requested by UIF every 3 years or so. These increases are in many cases substantial and are in addition to the annual price index and pass-through

increases obtained by the Utility. In addition, there are numerous customers who have commented that the quality of the water is so bad, it is insulting to continue to pay more for it.

Q. ARE THERE ANY TYPES OF LETTERS THAT ARE NOT INCLUDED IN YOUR SCHEDULE?

A. No. I am not in possession or aware of any other types of customer letters.

V. CONCLUSION

Q. PLEASE SUMMARIZE THE MAJOR CONCERNS YOU IDENTIFIED DURING YOUR REVIEW OF THE COMPLAINT-RELATED DOCUMENTATION IN THIS CASE.

A. The utility has entered into several Consent Orders with DEP due to deficiencies and problems with its operations. Additionally, the documents indicate the Utility does not respond to customer complaints until and unless the customers subsequently contact the PSC, and the PSC forces the Utility's hand. Even with the complaints filed at the PSC, customers sometimes have to reach out to the Utility multiple times to get a response from the Utility. This is particularly concerning when it relates to a necessary repair, refund request, or water quality or safety complaints.

The following UIF systems are either currently subject to active Consent Orders or have been subject to Consent Orders during a time period relevant to this case:

- Lake Utility
- Wekiva Hunt Club

- Sanlando Utilities
- Mid-County
- Pinellas-County owned by Utilities Inc.

Q. DO YOU HAVE ANY RECOMMENDATIONS REGARDING QUALITY OF SERVICE?

A. Yes, I do. I recommend that the Commission consider the large number and severity of the quality of service issues experienced by UIF's customers, the length of time those issues have existed, whether UIF has attempted to resolve those known issues, and the existence of DEP violations or consent orders during or after the test year. My recommendation is based upon the available quality of service information provided by UIF, received through discovery, obtained from DEP's Oculus database, and contained in the Commission's files, much of which I have attempted to summarize in my testimony. Based upon the quality of service information currently known from the test year and thereafter relating to specific UIF systems, and summarized in my testimony, I recommend the Commission consider a finding of marginal or unsatisfactory quality of service for the following systems: Lake Utility, Wekiva Hunt Club, Sanlando Utilities, Mid-County, and Pinellas-County owned by Utilities Inc.

If the Commission makes a finding of unsatisfactory quality of service, for all or some of the systems, I recommend the Commission reduce the return on equity for the Utility by at least 50 basis points. If a specific system or systems have a history of repeated or unresolved issues, the return on equity should be reduced by 100 basis points. "History of issues" includes past Commission decisions, as well as the history of past customer complaints against a particular

system. In addition, the quality of service determination should include systems where the quality of service may have been found satisfactory in the past, yet there are strong indications that the customers are dissatisfied with the secondary standards, pressure, or other water/wastewater issues, and the Utility has failed or refused to address those issues when it received customer complaints. If UIF ignored evidence presented in prior rate case proceedings that its customers are dissatisfied with the quality of service, and no action was taken to address or improve that service, then that supports a reduction in the return on equity. A well-run utility should not wait until the Commission imposes a penalty before it decides to (a) respond to its customers, and (b) provide the satisfactory quality of service that its customers are paying for and deserve.

Q. WHAT ABOUT THE QUALITY OF SERVICE FINDINGS FOR THE REMAINING UIF SYSTEMS?

A. Although I do not have any specific recommendation at this time for the systems not listed in my testimony, this does not mean the remainder should be considered satisfactory by default. Customers are still sending complaints to the PSC's docket file in this case, and the customer service hearings have not yet been held. Additionally, the discovery period in this case has not closed. Therefore, it is possible additional information will be provided by customers and others before the hearing in this matter. I based my recommendations above on available public information about the systems I discussed, as well as information received from discovery to date.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

(Whereupon, prefiled direct testimony of Debra Dobiac was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

COMMISSION STAFF

DIRECT TESTIMONY OF DEBRA DOBIAC

DOCKET NO. 20200139-WS

NOVEMBER 20, 2020

Q. Please state your name and business address.

A. My name is Debra M. Dobiac. My business address is 2540 Shumard Oak Boulevard, Tallahassee, Florida, 32399.

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

A. I am employed by the Florida Public Service Commission (FPSC or Commission) as a Public Utility Analyst in the Office of Auditing and Performance Analysis. I have been employed by the Commission since January 2008.

Q. Briefly review your educational and professional background.

A. I graduated with honors from Lakeland College in 1993 and have a Bachelor of Arts degree in accounting. Prior to my work at the Commission, I worked for six years in internal auditing at the Kohler Company and First American Title Insurance Company. I also have approximately 12 years of experience as an accounting manager and controller.

Q. Please describe your current responsibilities.

A. My responsibilities consist of planning and conducting utility audits of manual and automated accounting systems for historical and forecasted data.

Q. Have you previously presented testimony before this Commission?

A. Yes. I testified in the Aqua Utilities Florida, Inc. Rate Case, Docket No. 20080121-WS, the Water Management Services, Inc. Rate Case, Docket No. 20110200-WU, and the Utilities, Inc. of Florida Rate Case, Docket No. 20160101-WS. I also prefiled testimony for

the Water Management Services, Inc. Rate Case, Docket No. 20100104-WU, the Gulf Power Company Rate Cases, Docket Nos. 20110138-EI and 20130140-EI, the Fuel and Purchased Power Recovery Clause (Hedging Activities) for Gulf Power Company, Docket Nos. 20130001-EI, 20140001-EI, 20190001-EI, and 20200001-EI, the Fuel and Purchased Power Recovery Clause (Hedging Activities) for Florida Power & Light Company, Docket No. 20180001-EI, Florida Public Utilities Company's Limited Proceeding to recover incremental Storm Restoration Costs, Docket No. 20180061-EI, the Gulf Power Company Limited Proceeding to recover incremental Storm Restoration Costs, Docket No. 20190038-EI, and the Florida Public Utilities Company's Petition for a Limited Proceeding to recover incremental Storm Restoration Costs, Capital Costs, Revenue Reduction for Permanently Lost Customers, and Regulatory Assets Related to Hurricane Michael in Docket No. 20190156-EI.

Q. What is the purpose of your testimony today?

A. The purpose of my testimony is to sponsor the staff auditor's report of Utilities, Inc. of Florida (UIF or Utility) which addresses the Utility's filing in Docket No. 20200139-WS. We issued an auditor's report in this docket on October 26, 2020. This report is filed with my testimony and is identified as Exhibit DMD-1.

Q. Was this audit prepared by you or under your direction?

A. Yes, it was prepared under my direction.

Q. Please describe the work you performed in this audit.

A. The procedures that we performed in this audit are listed in the Objectives and Procedures section of the attached Exhibit DMD-1, pages 4 through 9.

Q. Were there any audit findings in the auditor's report, Exhibit DMD-1, which address the historical 2019 amounts in the schedules prepared by the Utility in support of its filing in the current docket?

A. Yes. There was one audit finding reported in this audit and is found in the

attached Exhibit DMD-1, page10. This is summarized below:

Finding 1 – Revenue

Revenues for the test year and the annualized revenues should be increased by $14,585 and $14,923, respectively. Taxes other than income taxes (TOTI) should be increased by $656. In the MFR Schedule E-2, the number of water residential customer bills are 373,481. Audit staff traced the number of bills to the Utility's supporting schedules and determined that the water residential customer bills should be 374,804. The variance of 1,323 bills result in test year revenues to be understated by $14,585 and annualized revenues to be understated by $14,923. Based on the adjustment to revenues, we calculated an increase of $656 to TOTI for the regulatory assessment fees.

Q. Does that conclude your testimony?

A. Yes.

(Whereupon, prefiled direct testimony of Rhonda L. Hicks was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 20200139-WS - Application for increase in water and wastewater rates in Charlotte, Highlands, Lake, Lee, Marion, Orange, Pasco, Pinellas, Polk, and Seminole Counties, by Utilities, Inc. of Florida.

WITNESS: Direct Testimony of RHONDA L. HICKS appearing on behalf of the Staff of the Florida Public Service Commission

DATE FILED: November 20, 2020

DIRECT TESTIMONY OF RHONDA L. HICKS

Q. Please state your name and address.

A. My name is Rhonda L. Hicks. My address is 2540 Shumard Oak Boulevard; Tallahassee, Florida; 32399-0850.

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

A. I am employed by the Florida Public Service Commission (FPSC or Commission) as Chief of the Bureau of Consumer Assistance in the Office of Consumer Assistance & Outreach.

Q. Please give a brief description of your educational background and professional experience.

A. I graduated from Florida A&M University in 1986 with a Bachelor of Science degree in Accounting. I have worked for the Commission for more than 34 years, and I have varied experience in the electric, gas, telephone, and water and wastewater industries. My work experience includes rate cases, cost recovery clauses, depreciation studies, tax, audit, consumer outreach, and consumer complaints. During the course of my career at the Commission, I have testified in numerous dockets involving varied industries regulated by the Commission. I currently work in the Bureau of Consumer Assistance within the Office of Consumer Assistance & Outreach where I manage consumer complaints and inquiries.

Q. What is the function of the Bureau of Consumer Assistance?

A. The Bureau's function is to resolve disputes between regulated companies and their customers as quickly, effectively, and inexpensively as possible.

Q. Do all consumers that have a dispute with their regulated company contact the Bureau of Consumer Assistance?

A. No. Consumers may initially file their complaint with the regulated company and

reach a resolution without the Bureau's intervention. In fact, consumers are encouraged to allow the regulated company the opportunity to resolve the dispute prior to any Commission involvement.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to outline the number of consumer complaints logged with the Commission against Utilities, Inc. of Florida (UIF) under Rule 25-22.032, Florida Administrative Code, Consumer Complaints, from October 5, 2015, through October 5, 2020. My testimony will also provide information on the type of complaints logged and those complaints that appear to be rule violations.

Q. What do your records indicate concerning the number of complaints logged against UIF?

A. From October 5, 2015, through October 5, 2020, the Commission logged 194 complaints against UIF.

Q. What have been the most common types of complaints logged against UIF during the period October 5, 2015, through October 5, 2020?

A. During the specified time period, approximately sixty-nine (69%) percent of the complaints logged with the Commission concerned billing issues, while approximately thirty-one (31%) percent of the complaints involved quality of service issues.

Q. Do you have any exhibits attached to your testimony?

A. Yes. I am sponsoring Exhibits RLH-1 and RLH-2

Q. Can you summarize Exhibit RLH-1?

A. Yes. Exhibit RLH-1 is a listing of customer complaints logged with the Commission against UIF under Rule 25-22.032, Florida Administrative Code. The complaints listed were received between October 5, 2015, through October 5, 2020, and were captured in the Commission's Consumer Activity Tracking System (CATS). The complaints are

sorted and grouped by county.

Q. What counties received the most complaints during October 5, 2015, through October 5, 2020?

A. Exhibit RLH-1 indicates that UIF in Seminole County, followed by UIF in Lake County, received the most complaints during the specified time period. UIF in Seminole County received 133 complaints while UIF in Lake County received 31 complaints. Included within their total complaints, both counties each received 6 complaints regarding water quality/pressure. Consequently, the twelve complaints received by Seminole and Lake Counties constituted the great majority of the fifteen water quality/pressure complaints that the Commission sent to Florida's Department of Environmental Protection (DEP).

Q. Why are water quality/pressure complaints sent to DEP?

A. The DEP establishes secondary water quality standards, and consumer complaints about water quality issues may assist DEP in determining whether or not a utility has met its secondary water quality standards.

Q. Can you summarize Exhibit RLH-2?

A. Yes. Exhibit RLH-2 is the same information contained in the listing of customer complaints presented as Exhibit RLH-1. However, the information is sorted and grouped by Close-Out Code.

Q. What is a Close-Out Code?

A. A Close-Out Code is an internal categorization code. It is assigned to each complaint once staff completes its investigation, and a proposed resolution is provided to the consumer. If a complaint is not assigned a Close-Out Code, the complaint remains under investigation.

Q. How were most UIF complaints received during October 5, 2015, through October 5,

2020, resolved or closed?

A. A review of Exhibit RLH-2 indicates that Commission staff closed the majority of UIF's complaints as GI-25/Improper Billing.

Q. Does a Close-Out Code of GI-25/Improper Billing indicate that UIF improperly billed a customer?

A. No. The Close-Out Code of GI-25/Improper Billing, is a general code that encompasses all billing issues that don't involve a High Bill concern. It would involve issues such as, late fees, disconnect charges, meter reading charges, or any other billing concern except High Bills. Complaints that may be potential violations of Commission rules have Close-Out Codes that begin with WS- or WB-.

Q. How many of the complaints summarized on your exhibit has staff determined may be a violation of Commission rules?

A. Of the 194 complaints logged against UIF during the period October 5, 2015, through October 5, 2020, staff determined that 15 of the complaints may be violations of Commission rules.

Q. Can you summarize the potential rule violations?

A. Yes. The majority of the potential rule violations involve inaccurate meters and meter readings. Other potential rule violations involve customer billing, the refund of deposits, and responding to customers and/or the Commission in a timely manner.

Q. Does this conclude your testimony?

A. Yes, it does.

(Whereupon, prefiled rebuttal testimony of Dylan W. D'Ascendis was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for an increase in water and wastewater rates in Charlotte, Highlands, Lake, Lee, Marion, Orange, Pasco, Pinellas, Polk, and Seminole Counties by Utilities, Inc. of Florida
_____/

Docket No. 20200139-WS

REBUTTAL TESTIMONY

OF

DYLAN W. D'ASCENDIS, CRRA, CVA

on behalf of

Utilities, Inc. of Florida

TABLE OF CONTENTS

I. INTRODUCTION 3
II. PURPOSE AND OVERVIEW OF TESTIMONY 3
III. CAPITAL MARKET CONDITIONS 4
IV. RESPONSE TO OPC WITNESS GARRETT 7
A. Capital Structure 9
B. Lack of Empirical Basis for ROE Recommendation 12
C. Incorrect Assessment of Relationships Between Various Returns and Applicability to the Company's ROE 14
D. Incorrect Observations that Allowed ROEs for Utilities Exceed the Investor-Required Return on the Market 18
E. Misapplication of the DCF Model 21
F. Misapplication of the Capital Asset Pricing Model 28
G. Refusal to Consider a Small Size Premium in his ROE Recommendation 38
H. Response to Mr. Garrett's Critiques of Company Testimony 42
V. SUMMARY AND CONCLUSIONS 46

I. INTRODUCTION

Q. Please state your name, profession, and address.

A. My name is Dylan W. D'Ascendis. I am a Director at ScottMadden, Inc. My business address is 3000 Atrium Way, Suite 241, Mount Laurel, NJ 08054.

Q. On whose behalf are you presenting this testimony?

A. I am presenting this testimony and appearing on behalf of Utilities, Inc. of Florida. ("UIF" or the "Company"), the applicant for rate increase in the present docket.

Q. Did you submit Direct Testimony in this proceeding?

A. Yes, I did.

II. PURPOSE AND OVERVIEW OF TESTIMONY

Q. What is the purpose of your Rebuttal Testimony in this proceeding?

A. The purpose of my Rebuttal Testimony is to respond to and address serious shortcomings in the direct testimony of witness David J. Garrett, testifying on behalf of the Florida Office of Public Counsel ("OPC"), regarding the Company's Cost of Common Equity ("ROE") and capital structure.

Q. Please summarize your conclusions.

A. UIF's proposed ROE of 11.75% should not be reduced as Mr. Garrett recommends. In my response to Mr. Garrett's estimate of the Company's ROE (*see*, Section IV below), I explain the shortcomings of Mr. Garrett's analyses and conclusions, including, but not limited to:

- His reliance on a hypothetical capital structure for ratemaking purposes;
- How far disconnected his recommended ROE is from his own analytical results and observable and relevant data;
- His misinterpretation of the relationships between various returns;
- His misunderstanding of the nature of utility regulation;
- His misapplication of the Discounted Cash Flow ("DCF") model;

- His misapplication of the Capital Asset Pricing Model ("CAPM"); and
- His refusal to consider a small size premium in his ROE recommendation.

In addition, I also respond to Mr. Garrett's unfounded critiques of my Direct Testimony.

Q. Please summarize your interpretation of current capital markets.

A. As explained in Section III below, the turmoil in capital markets attributable to the COVID-19 pandemic has increased risk for the entire economy, generally, and utilities, specifically. Key takeaways include:

- The full impact and duration of the COVID-19 pandemic are unknown, and outcomes are still highly uncertain; and
- The same increased market volatility that caused investors' "flight to safety" also created a situation where utilities traded in tandem with market indices. The correlated returns of utility stocks and market indices, in combination with increased volatility, increases beta coefficients ("beta") (a measure of market risk), and by extension, investor-required returns.

Q. Have you prepared an exhibit supporting your Rebuttal Testimony?

A. Yes, I have. My analyses and conclusions are supported by the data presented in Exhibit DWD-3, which contains Schedules 1 through 6, which have been prepared by me or under my direction and supervision.

III. CAPITAL MARKET CONDITIONS

Q. Have capital market conditions changed significantly since you filed your Direct Testimony?

A. No, they have not. Since the filing of my Direct Testimony, capital markets have continued to be characterized by high levels of volatility and market instability, and utility returns have continued to be highly correlated with the overall market.

Q. Please briefly summarize Mr. Garrett's observations of utility stocks in relation to the capital market and the conclusions he reached.

A. While Mr. Garrett provides no discussion of the capital market environment, in general, and the effects of the recent capital market dislocation on the utility sector, in particular, he argues that the Company's "true" Cost of Equity is low because "utilities are defensive firms that experience little market risk and are relatively insulated from market conditions."[1]

Q. Do you agree with Mr. Garrett's statements that utilities are "low risk" investments and "relatively insulated from market conditions" in the current capital market?

A. No, I do not. While Mr. Garrett considers utility stocks as "low-risk" investments, in this period of extreme market volatility, they are not.

Q. Have you conducted an analysis to determine whether water utility stocks are "low-risk" investments in the current market?

A. Yes, I have. Specifically, I analyzed the relative performance and annualized volatilities[2] of my proxy group, the Dow Jones Utility Average ("DJU"), the Utilities Select SPDR ("XLU"), the Dow Jones Industrial Average ("DJI"), and the S&P 500 to gauge whether utilities weathered the COVID-19 pandemic better than the overall market. As shown on Exhibit DWD-3, Schedule 1 and Table 1, below, from January 31, 2020[3] to November 13, 2020, utilities were generally more volatile (*i.e.*, risky) than the market indices, and had returns that underperformed the DJI and the S&P 500.

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1 Direct Testimony of David J. Garrett, at 31.

2 The annualized volatility of a stock is measured by taking the standard deviation of the price changes within the sample and multiplying by the square root of 252 (the assumed number of trading days in a year).

3 I chose January 31, 2020 because on June 8, 2020, the National Bureau of Economic Research determined that a peak in monthly economic activity occurred in the U.S. economy in February 2020. The peak marks the end of the expansion that began in June 2009 and the beginning of a recession. https://www.nber.org/cycles/june2020.html.

Table 1: Annualized Volatility and Returns of Utility Groups and Market Indices February 2020 – mid-November 2020

	Proxy Group	Dow Jones Utility Average (DJU)	Utilities Select SPDR (XLU)	Dow Jones Industrial Average	S&P 500
Price Change	-1.72%	-2.95%	-4.19%	4.33%	11.15%
Annualized Volatility	55.64%	42.83%	42.97%	40.84%	38.35%

In addition to the analysis in Table 1, I also calculated the correlation coefficients of the price changes of the utility groups relative to the S&P 500 and the DJI from February 1, 2020 to November 13, 2020. Specifically, I calculated correlation coefficients for the following relationships:

- The price changes of the S&P 500 relative to the price changes of my proxy group;
- The price changes of the S&P 500 relative to the price changes of the DJU;
- The price changes of the S&P 500 relative to the price changes of the XLU;
- The price changes of the DJIA relative to the price changes of my proxy group;
- The price changes of the DJIA relative to the price changes of the DJU; and
- The price changes of the DJIA relative to the price changes of the XLU.

Table 2 provides the results of the calculations:

Table 2: Calculation of Correlation Coefficients for Utility Groups Relative to Market Indices from February 2020 through mid-November 2020[4]

Group	S&P 500	DJIA
Water Proxy Group	76.86%	74.94%
DJU	82.92%	82.66%
XLU	83.13%	82.56%

As shown in Table 2, the correlations between utility stocks and the market indices are

[4] Source: S&P Global Market Intelligence.

similar, indicating that utility stocks have been trading in tandem with market indices during the current market dislocation, which is consistent with the risk and return data shown in Table 1. The behavior of utility stocks to move in tandem with the market during market distress is not limited to the current period. During the Great Recession (December 2007 to June 2009), correlations between these same groups were also similar, as also shown in Table 3.

Table 3: Calculation of Correlation Coefficients for Utility Groups Relative to Market Indices from December 2007 through June 2009[5]

Group	S&P 500	DJIA
Water Proxy Group	72.69%	73.36%
DJU	81.57%	82.13%
XLU	78.36%	78.59%

Thus, in view of the above, Mr. Garrett's statements regarding the "low-risk" nature of utility stocks should be dismissed, especially in this volatile capital market.

Q. What conclusions did you draw from your review of the current capital market and its implications on the Company's Cost of Equity?

A. In view of the above, current capital markets are indicating higher investor-required returns for utility companies due to the COVID-19 pandemic. Because of this, Mr. Garrett's "true" Cost of Equity of 6.00% and his recommended ROE of 9.50% are woefully inadequate, and my recommended point estimate of 11.75% for the Company is appropriate, if not conservative.

IV. RESPONSE TO OPC WITNESS GARRETT

Q. Please provide a summary of Mr. Garrett's analyses and recommendations regarding the Company's Cost of Capital.

A. Although Mr. Garrett believes the Company's "true" Cost of Equity is 6.00%, he recommends

[5] Source: S&P Global Market Intelligence.

an ROE of 9.50%.[6] Mr. Garrett estimates the Cost of Equity using the Quarterly DCF model (6.00%) and the CAPM (6.10%).[7]

Regarding his recommended capital structure, Mr. Garrett finds that utilities can generally afford to have "relatively higher debt ratios" given their stable business profile.[8] And while Mr. Garrett reviews the capital structure ratios for the Utility Proxy Group, he finds those levels "lower than what would be observed in a pure competitive environment."[9] He ultimately concludes that the appropriate capital structure for UIF consists of 50.00% long-term debt, 5.00% short-term debt, and 45.00% common equity, based on his review of debt ratios in place at competitive industries as well as the Utility Proxy Group.[10]

Q. In what key areas are Mr. Garrett's analyses and recommendations incorrect or unsupported?

A. There are several areas in which Mr. Garrett's analyses and conclusions are incorrect or unsupported, including: (1) his choice to select a hypothetical capital structure for UIF; (2) his recommended ROE has seemingly no empirical basis, (3) his incorrect assessment of the relationships between returns and their applicability to the Company's ROE; (4) his incorrect observation that authorized ROEs have exceeded the investor-required return on the market for 30 years; (5) his misapplication of the DCF model; (6) his misapplication of the CAPM; and (7) his refusal to consider a small size premium in his ROE recommendation. Those points are discussed in turn, below.

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6 Direct Testimony of David J. Garrett, at 6; and Exhibit DJG-12. Mr. Garrett specifically argues the models he applies estimate the "true cost of equity"; the average of his model results is 6.00%.

7 Exhibits DJG-6 and DJG-11, respectively.

8 Direct Testimony of David J. Garrett, at 76.

9 *Ibid*., at 76.

10 *Ibid*., at 78.

A. Capital Structure

Q. What factors should typically be considered when determining whether to use an actual or hypothetical capital structure for ratemaking purposes?

A. The factors typically considered relative to the use of a regulated subsidiary's actual capital structure, its Parent's, or a hypothetical capital structure, are provided by David C. Parcell in The Cost of Capital – A Practitioner's Guide ("CRRA Guide"), prepared for the Society of Utility and Regulatory Financial Analysts ("SURFA"), and provided as the study guide to candidates for SURFA's Certified Rate of Return Certification Examination. The CRRA Guide discusses the considerations that help determine whether the utility versus parent capital structure are appropriate:

1) Whether the subsidiary utility contains all its capital from the parent, or issues its own debt and preferred stock;
2) Whether the parent guarantees any of the securities issued by the subsidiary;
3) Whether the subsidiary's capital structure is independent of its parent (*i.e.*, existence of double leverage, absence of proper relationship between risk and leverage of utility and non-utility businesses); and
4) Whether the parent (or consolidated enterprise) is diversified into non-utility operations.[11]

The CRRA Guide then notes the circumstances where a hypothetical capital structure is used in favor of an actual capital structure. They are:

1) The utility's capital structure is deemed to be substantially different from the typical or "proper" capital structure; or
2) The utility's capital structure is funded as part of a diversified organization whose

[11] *See,* David C. Parcell, The Cost of Capital – A Practitioner's Guide, Prepared for the Society of Utility and Regulatory Financial Analysts, 2010 Edition, at 46.

overall capital structure reflects its diversified nature rather than its utility operations only.[12]

Phillips echoes the CRRA Guide when he states:

> Debt ratios began to rise in the late 1960s and early 1970s, and the financial condition of the public utility sector began to deteriorate. It became the common practice to use actual or expected capitalizations; actual where a historic test year is used, expected when a projected or future test year is used.[83] (footnote omitted)
>
> The objective, in short, shifted from minimization of the short-term cost of capital to protection of a utility's ability "to raise capital at all times." This objective requires that a public utility make every effort to keep indebtedness at a prudent and conservative level."[84] (footnote omitted)
>
> *A hypothetical capital structure is used only where a utility's actual capitalization is clearly out of line with those of other utilities in its industry or where a utility is diversified.*[85] (footnote omitted) (italics added)[13]

Q. How did you consider these factors when determining the appropriateness of UIF's actual capital structure?

A. As noted below, UIF's parent capital structure is in line with the capital structures in place at the Utility Proxy Group. Further, UIF's parent, Corix Regulated Utilities, Inc., solely operates regulated water utilities. Therefore, the use of UIF's parent company capital structure reflects the risk of the Utility Proxy Group.

Based on the criteria set forth in the CRRA Guide, authored by Parcell and reinforced by Phillips' reasoning, imposing a hypothetical capital structure would be inappropriate. UIF's proposed capital structure is reasonable and should be approved by the Commission.

Q. How does the Company's actual common equity ratio of 49.39% compare with the common equity ratios maintained by the Utility Proxy Group?

A. As noted in my Direct Testimony, the range of equity ratios maintained by the Utility Proxy

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12 *See, Ibid*., p. 47.

13 Charles F. Phillips, Jr., The Regulation of Public Utilities – Theory and Practice, 1993, Public Utility Reports, Inc., Arlington, VA, at 391.

Group is between 38.48% and 57.05%, with an average of 49.34%.[14] The Company's actual capital structure demonstrates both the reasonableness of using it to set rates and the Company's relative financial health. Setting the weighted average cost of capital ("WACC") as requested by the Company will continue to support the long-term financial health of the Company for the benefit of its stakeholders, including its customers.

I also considered *Value Line's* projected capital structures for the Utility Proxy Group for 2023-2025. That analysis shows a range of projected common equity ratios between 41.00% and 64.00%.

Q. Does Mr. Garrett review the Value Line capital structure data for the proxy group?

A. Yes. Mr. Garrett finds the average debt ratio of the proxy group to be 50.00%, which would indicate an equity ratio of 50.00%,[15] which is in line with the Company's requested common equity ratio.

Q. Is Mr. Garrett's review of non-utility industries reasonable in assessing the Company's capital structure?

A. No. As noted in Section IV, the industries which Mr. Garrett uses in his assessment of the Company's capital structure are not comparable to UIF, and his use of non-utility industry capital structures should be dismissed.

Q. What is your conclusion regarding the Company's capital structure?

A. Notwithstanding the issues with Mr. Garrett's analyses discussed above, I maintain that the Company's proposed capital structure to be reasonable compared with the range of equity ratios maintained by the Utility Proxy Group from which I derive my recommended common equity cost rate.

[14] Direct Testimony of Dylan W. D'Ascendis, at 19.
[15] Direct Testimony of David J. Garrett, at 80.

B. Lack of Empirical Basis for ROE Recommendation

Q. Please provide a brief summary of Mr. Garrett's analyses and recommendations regarding the Company's Cost of Equity.

A. Although Mr. Garrett believes the Company's "true" Cost of Equity is 6.00%, he recommends an ROE of 9.50%.[16] Mr. Garrett estimates the Cost of Equity using the Quarterly DCF model (6.00%) and the CAPM (6.10%).[17]

Q. Are Mr. Garrett's analytical results and recommendation reasonable measures of the Company's Cost of Equity?

A. No, they are not. Mr. Garrett's recommended ROE of 9.50% is fundamentally disconnected from his own analyses and conclusions; his analytical model results of 6.10% and lower are far removed from observable and relevant data, including the 2019 aggregated average authorized ROEs provided in his testimony of 9.64%.[18] Throughout his testimony, Mr. Garrett believes his analytical results indicate that the "true" Cost of Equity for the Company is 6.00%. He views the decisions of utility commissions to have been significantly and consistently wrong, but suggests moving all the way to the "true" Cost of Equity would be "a significant, sudden change in the awarded ROE anticipated by regulatory stakeholders" that "could have the undesirable effect of notably increasing the Company's risk profile and would arguably be at odds with the *Hope* Court's 'end result' doctrine."[19] On those points, we agree. However, while I appreciate the need for judgment in developing ROE recommendations, I believe there should be some empirical basis for them. Since Mr. Garrett's 9.50% recommendation is so far removed from his analytical model results, we cannot assess the basis of his ultimate

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16 Direct Testimony of David J. Garrett, at 6; and Exhibit DJG-12. Mr. Garrett specifically argues the models he applies estimate the "true cost of equity"; the average of his model results is 6.00%.

17 Exhibits DJG-6 and DJG-11, respectively.

18 Exhibit DJG-14. Mr. Garrett also points to a 9.40% average authorized ROE in 2017 for water utilities. The average authorized ROE for water utilities is 9.63% for 2019. Source: Regulatory Research Associates

19 Direct Testimony of David J. Garrett, at 7.

recommendation, empirical or otherwise. To justify his recommendation for an ROE which has no connection to his analytical results, Mr. Garrett argues that the Commission should apply the ratemaking concept of "gradualism" to move the Company's ROE to his "true" Cost of Equity.[20]

Q. Has Mr. Garrett similarly disregarded the results of his analytical models in other proceedings?

A. Yes. In Case No. 9651 before the Public Service Commission of Maryland, Mr. Garrett notes that his analysis indicates the "true" Cost of Equity for Washington Gas Light Company to be 7.20%, yet he recommends a 9.00% ROE.[21] Given that Mr. Garrett's analyses in this case point to a lower return of 6.00%, but he recommends a 9.50% return, it is unclear to the extent that Mr. Garrett finds the analyses he presents to be reliable, as they clearly have no correlation with his recommendations.

Q. Do you agree with Mr. Garrett's recommendation to the Commission regarding the use of "gradualism" in determining the appropriate ROE for the Company?

A. No, I do not. The role of ROE witnesses is to testify regarding the return required by equity investors, *i.e.,* the Cost of Equity, as will be discussed in detail below. It is the Commission's difficult task in fixing just and reasonable rates to balance that cost with all other elements of the revenue requirement. As Mr. Garrett himself stated, "gradualism" is "usually applied from the customer's standpoint to minimize rate shock,"[22] and therefore would not be applicable to the ROE recommendation. In view of the above, Mr. Garrett's recommendation is without merit or empirical support, and should be given no weight by the Commission.

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20 *Ibid.*

21 *See, In the Matter of the Application of Washington Gas Light Company for Authority to Increase its Existing Rates and Charges and to Revise its Terms and Conditions for Gas Service,* Case No. 9651, Public Service Commission of Maryland, Direct Testimony of David J. Garrett (November 20, 2020), at 6 – 7.

22 Direct Testimony of David J. Garrett, at 7.

C. Incorrect Assessment of Relationships Between Various Returns and Applicability to the Company's ROE

Q. Please summarize Mr. Garrett's views on the relationship between the Cost of Equity, the investor-required ROE, earned ROE, and awarded ROE for regulated utilities.

A. Mr. Garrett believes the above specified returns are all interrelated, but technically different.[23] He summarizes his view on the relationship between the returns on pages 4-5 of his testimony in the following sentence: "If the awarded ROE reflects a utility's cost of equity, then it should allow the utility to achieve an earned ROE that is sufficient to satisfy the required return of its investors."[24] Mr. Garrett also discusses another type of return, the "expected" return, which in his words, "has nothing to do with what the investor 'expects' the ROE awarded by a regulatory commission to be."[25]

Q. Does Mr. Garrett's views regarding the relationship between allowed and investor-required ROEs for utilities change throughout the course of his testimony?

A. Yes. On page 14 of his testimony, Mr. Garrett contradicts his earlier assertion, stating that awarded ROEs and Cost of Equity (*i.e.,* investor-required returns) are very different concepts because of the regulatory process and may be influenced by a number of factors other than objective market drivers.[26] However, one page earlier, on page 13 of his testimony, Mr. Garrett states:

> The *Hope* Court makes it clear that the allowed return should be based on the actual cost of capital. Under the rate base rate of return model, a utility should be allowed to recover all its reasonable expenses, its capital investments through depreciation, and a return on its capital investments sufficient to satisfy the required return of its investors. The "required return" from the investors' perspective is synonymous with the "cost of capital" from the utility's perspective. Scholars agree that the allowed rate of return should be based on

[23] *Ibid*., at 4.
[24] *Ibid*., at 4 – 5.
[25] *Ibid*.
[26] *Ibid*., at 14.

the actual cost of capital:

> Since by definition the cost of capital of a regulated firm represents precisely the expected return that investors could anticipate from other investments while bearing no more or less risk, and since investors will not provide capital unless the investment is expected to yield its opportunity cost of capital, the correspondence of the definition of the cost of capital with the court's definition of legally required earnings appears clear.[27,28]

Mr. Garrett continues to change his position regarding the equivalency, or non-equivalency, of the allowed and required ROE, sometimes in consecutive sentences. For example, on page 14 of his testimony, Mr. Garrett states that "The two concepts [allowed and required ROEs] are related in that the legal and technical standards encompassing this issue require that the awarded return reflect the true cost of capital. On the other hand, the two concepts are different in that the legal standard do not mandate that awarded returns exactly match the cost of capital."[29]

Q. What is your reaction to Mr. Garrett's views on the relationship between allowed and required ROEs for utility companies?

A. Mr. Garrett is unnecessarily complicating a simple relationship. For regulated utilities, the ROE equals the investor-required ROE which equals the allowed ROE, as reflected in the *Hope* and *Bluefield* Supreme Court decisions cited in both my Direct Testimony[30] and Mr. Garrett's testimony.[31] This relationship holds because utility regulation by regulatory commissions acts as a substitute for competition as Mr. Garrett clearly understands and accepts.[32]

Q. Is the concept of utility regulation as a substitute for market competition widely accepted

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27 A. Lawrence Kolbe, George A. Read, Jr, George Hall, *The Cost of Capital: Estimating the Rate of Return for Public Utilities*, The MIT Press, 1984, at 21.
28 Direct Testimony of David J. Garrett, at 13.
29 *Ibid*., at 14. [Clarification and emphasis added.]
30 Direct Testimony of Dylan W. D'Ascendis, at 6.
31 Direct Testimony of David J. Garrett, at 12 – 13.
32 *Ibid*., at 75.

as a fact and reflected as such in academic literature?

A. Yes, it is. The *Cost of Capital Manual*, which is the training manual for SURFA, of which Mr. Garrett and I are members, states:

> In a sense, the "visible hand of public regulation was (created) to replace the invisible hand of Adam Smith in order to protect consumers against exorbitant charges, restriction of output, deterioration of service, and unfair discrimination."[footnote omitted]
>
> ***
>
> As indicated above, regulation of public utilities reflects a belief that the competitive mechanism alone cannot be relied upon to protect the public interest. Essentially, it is theorized that a truly competitive market involving utilities cannot survive and, thereby, will fail to promote the general economic welfare. But this does not mean that regulation should alter the norm of competitive behavior for utilities. On the contrary, the primary objective of regulation is to produce market results (*i.e.,* price and quantity supplied) in the utility sectors of the economy closely approximating those conditions which would be obtained if utility rates and services were determined competitively.[33]

Additionally, in *Principles of Public Utility Rates*, Dr. Bonbright states:

> Lest the reader of this chapter gain the impression that it is intended to deny the relevance of any tests of reasonable rates derived from the theory or the behavior of competitive prices, let me state my conviction that no such conclusion would be warranted. On the contrary, a study of price behavior both under assumed conditions of pure competition and under actual conditions of mixed competition is essential to the development of sound principles of utility rate control. Not only that: any good program of public utility rate making must go a certain distance in accepting competitive-price principles as guides to monopoly pricing. For rate regulation must necessarily try to accomplish the major objectives that unregulated competition is designed to accomplish; and the similarity of purpose calls for a considerable degree of similarity of price behavior.
>
> Regulation, then, as I conceive it, is indeed a substitute for competition; and it is even a partly imitative substitute. But so is a Diesel locomotive a partly imitative substitute for a steam locomotive, and so is a telephone message a partly imitative substitute for a telegraph message. What I am trying to emphasize by these crude analogies is that the very nature of a monopolistic public utility is such as to preclude an attempt to make the emulation of competition very close. The fact, for example, that theories of pure competition leave no room for rate discrimination, while suggesting a reason for viewing the practice with skepticism, does not prove that discrimination should be

[33] David C. Parcell, *Cost of Capital Manual*, Society of Utility and Regulatory Financial Analysts, 2010 Edition, at 3-4.

> outlawed. And a similar statement would apply alike to the use of an original-cost or a fair value rate base, neither of which is defensible under the theory or practice of competitive pricing.[34]

Finally, Dr. Phillips states in *The Regulation of Public Utilities*:

> Public utilities are no longer, if they were ever were, isolated from the rest of the economy. It is possible that the expanding utility sector has been taking too large a share of the nation's resources, especially of investment.[footnote omitted] At a minimum, regulation must be viewed in the context of the entire economy – and evaluated in a similar context. Public utilities have always operated within the framework of a competitive system. They must obtain capital, labor and materials in competition with unregulated industries. Adequate profits are not guaranteed to them. Regulation then, should provide incentives to adopt new methods, improve quality, increase efficiency, cut costs, develop new markets and expand output in line with customer demand. In short, regulation is a substitute for competition and should attempt to put the utility sector under the same restraints competition places on the industrial sector.[35]

In view of the legal standard cited by me and Mr. Garrett, and treatises on regulation likening regulation of utilities and the competitive market, it is plain to see that allowed returns and investor-required returns are also equal.

Q. What is the relationship between the earned ROE and the required/allowed ROE for utility companies?

A. The earned ROE is the return realized by the utility. The regulatory commission allows the utility an opportunity to earn its required return, but what the utility earns is generally subject to several factors, which may include regulatory lag and management efficiency.

Q. What is the relationship between expected returns and required/allowed ROE?

A. In this instance, I agree with Mr. Garrett that the expected return has nothing to do with what the investor expects the required/allowed return should be. Expected returns from investment houses or pension funds are expectations of what earned returns will be, not what investors require, which means that expected returns have no bearing on ROE determinations.

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[34] James C. Bonbright, *Principles of Public Utility Rates*, Columbia University Press, 1961, at 106-107.

[35] Charles F. Phillips, *The Regulation of Public Utilities*, Public Utility Reports, Inc., 1993, at 173.

D. Incorrect Observations that Allowed ROEs for Utilities Exceed the Investor-Required Return on the Market

Q. Please summarize Mr. Garrett's claim that allowed returns for utility companies exceed the required return on the market.

A. Mr. Garrett estimates the investor-required return on the market by adding the annual average 10-year Treasury bond yield to a market risk premium ("MRP") calculated by the New York University School of Business for the period 1990–2019. He then compares that return to the average annual authorized returns for electric and gas utilities over that same period[36] to support his argument that "awarded ROEs have been consistently *above* the market cost of equity for many years."[37] Mr. Garrett also presents the authorized returns for water utilities as compared to electric and gas utilities, arguing that because the three are similar, authorized ROEs for water utilities have also exceeded the market cost of equity.[38] Mr. Garrett further argues that the excess returns awarded to utilities result in a transfer of wealth from customers to shareholders.[39]

Mr. Garrett also refers to an article published in *Public Utilities Fortnightly*,[40] suggesting that utility stocks have outperformed the broader market and will continue to do so in the future.

Q. What is your response to Mr. Garrett's observations, and the conclusions he draws from them?

A. Mr. Garrett's observations and resulting conclusions are misplaced. As a preliminary matter, Mr. Garrett's conclusion that allowed returns for utility companies exceed the required return

36 Direct Testimony of David J. Garrett, Figure 1; and Exhibit DJG-14.
37 Direct Testimony of David J. Garrett, at 17.
38 *Ibid*., at 18.
39 *Ibid*., at 17.
40 *Ibid*., at 19 – 20.

on the market is his opinion and driven by the inputs he has chosen to estimate the required return on the market. As discussed below, applying more reasonable models and inputs demonstrate allowed ROEs average about 70.00% of the required return on the market, consistent with utility betas over the period from 1990-2019.

Regarding the *Public Utilities Fortnightly* article, it was published in August 2016, shortly after the 30-year Treasury yield fell to its prior cyclical low of 2.11% on July 8, 2016. Between July and December 2016, the utility sector, as represented by the proxy group, lost 8.55% of its value as the broader market (measured by the S&P 500) increased by 5.11%. That is, despite the article's conviction that utilities would continue to outperform the market, shortly after its publication, utility stocks meaningfully underperformed the broad market. From August 2016 through mid-November 2020, the utility sector (measured by the XLU and the Dow Jones Utility Average) significantly underperformed the S&P 500.[41]

Finally, regarding Mr. Garrett's required return on the market, I disagree with his calculation of the implied MRP because reasonable changes in his assumptions have considerable effects on the calculation (as will be discussed in detail in my critique of Mr. Garrett's CAPM analysis).

Q. Have you calculated the investor-required return on the market for the period from 1990–2019?

A. Yes, I have. Using the Predictive Risk Premium Model ("PRPM"),[42] I calculated the investor-required MRP for every month in the period from 1990–2019. I then averaged the monthly MRPs for each year and added the average 30-year Treasury bond yield to those averages to arrive at investor-required returns on the market for each year.

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41 The XLU and DJU gained 26.73% and 28.16%, respectively, while the S&P 500 gained 65.15%. Source: S&P Capital IQ.

42 *See*, Direct Testimony of Dylan W. D'Ascendis, at 23 – 24.

Q. How did you derive the investor-required return on the market using the PRPM??

A. As explained in my Direct Testimony, the inputs to the PRPM are the historical returns on large capitalization stocks minus the historical monthly yield on long-term U.S. Treasury securities for the period from January 1990 through December 2019.[43] Using a generalized form of ARCH, known as GARCH, each projected MRP was determined using Eviews© statistical software. When the GARCH model is applied to the historical returns data, it produces a predicted GARCH variance series and a GARCH coefficient. I then averaged the monthly investor-required return for each year to determine an annual investor-required return. I then added the annual average long-term government bond yield for each year[44] to arrive at annual investor-required returns on the market for the period from 1990-2019.

Next, I compared the investor-required return on the market to the average allowed ROEs for gas, electric, and water utilities for each year. As shown on Chart 1, the investor-required return on the market is consistently, and significantly, higher than the allowed returns for utility companies. These results make intuitive sense, as the ratio of allowed ROE versus required market return averages about 0.70, which is consistent with utility betas over the period. Given the above, Mr. Garrett's claim that allowed ROEs for utilities exceed investor-required market returns is misplaced. In addition, Mr. Garrett's claim that the excess returns awarded to utilities result in a transfer of wealth from customers to shareholders[45] is misplaced as well, since Chart 1, below, shows that utilities have not been earning excess returns.

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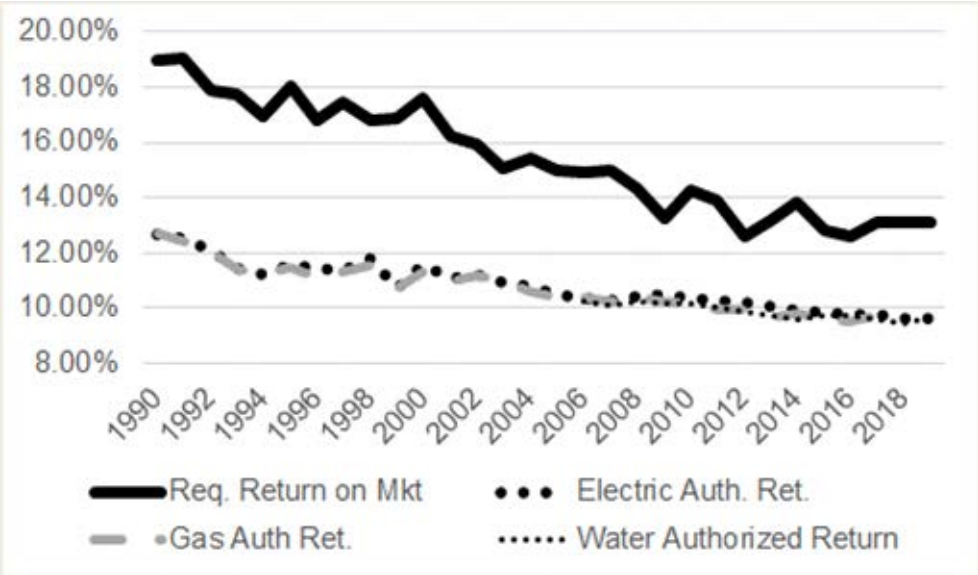
43 Source: 2020 SBBI® Yearbook, Stocks, Bonds, Bills, and Inflation®, Appendix A-1.

44 Source: 2020 SBBI® Yearbook, Stocks, Bonds, Bills, and Inflation®, Appendix A-7.

45 Direct Testimony of David J. Garrett, at 7.

Chart 1:
Relationship Between Investor-Required Returns on the Market and Authorized Returns for Gas, Electric, and Water Utilities 1990 - 2019[46]



E. Misapplication of the DCF Model

Q. Please briefly describe Mr. Garrett's Constant Growth DCF analyses and results.

A. Mr. Garrett applies a quarterly form of the Constant Growth DCF Model, which produces an ROE estimate of 6.00%. For the dividend yield component, Mr. Garrett relies on announced quarterly dividend payments and 30-day average stock prices as of October 28, 2020.[47] To estimate expected growth, Mr. Garrett looks to four measures, including: (1) nominal GDP, (2) real GDP, (3) inflation, and (4) the current Risk-Free rate.[48] Of those four measures, he chooses the highest estimate, 3.90%.[49]

Q. What are your general concerns with the growth rates on which Mr. Garrett's DCF analyses rely?

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46 Source: 2020 SBBI® Yearbook, Stocks, Bonds, Bills, and Inflation®, Appendix A-1, A-7; Exhibit DJG-14; S&P Global Market Intelligence. Please note, data on authorized returns for water utilities is only readily available starting with 2006.

47 Exhibits DJG-3 and DJG-4.

48 Exhibit DJG-5.

49 Direct Testimony of David J. Garrett, at 49.

A. First, Mr. Garrett assumes a single, perpetual growth rate of 3.90% for all his proxy companies.[50] By reference to the Congressional Budget Office's ("CBO") expected inflation rate of 2.00%, Mr. Garrett's method assumes his proxy companies all will grow at real rates of approximately 1.90%, in perpetuity.[51] It is unlikely an investor would be willing to assume the risks of equity ownership in exchange for expected growth only modestly greater than expected inflation. The risk simply is not worth the expected return.[52]

As to Mr. Garrett's remaining growth rate estimates (presented in his Exhibit DJG-5), none are appropriate measures of growth for his DCF analysis. As a practical matter, because they are generic in nature, his estimates fail to account for the risks and prospects faced by the proxy companies.

Q. Do you agree with the 3.90% growth rate assumed for all companies in Mr. Garrett's DCF analysis?

A. No, I do not. Mr. Garrett's 3.90% growth rate is not based on any measure of company-specific growth, or growth in the utility industry in general. Rather, his proxy group serves the sole purpose of calculating the dividend yield. Under the DCF model's strict assumptions, however, expected growth and dividend yields are inextricably related. Mr. Garrett's assumption that one growth rate applies to all companies, even though dividend yields vary across those companies, has no basis in theory or practice.

Q. Mr. Garrett also offers his thoughts regarding the need for qualitative analyses in developing expected growth rates.[53] What is your response to Mr. Garrett's observations?

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50 Exhibit DJG-6.

51 Exhibit DJG-5.

52 In the risk/return space, debt securities, with a higher yield and considerably less risk of capital loss (if held to maturity) may be the preferred alternative.

53 Direct Testimony of David J. Garrett, at 43-48.

A. Mr. Garrett suggests that although equity analysts may consider such quantitative factors as historical growth in revenues or earnings, they also should consider "qualitative" factors, such as how a given company may meet some level of "sustainable" growth.[54] He further observes unregulated companies have options not available to utilities, and suggests it would be more appropriate to consider factors such as load growth in measuring growth rate expectations.[55]

There is no question analysts consider qualitative factors. To that point, I reviewed American States Water Company's (one of the companies in Mr. Garrett's proxy group) second quarter 2020 conference call held on August 4, 2020. Analysts from several firms attended the call, including Wells Fargo and Seaport Global. During the call, analysts asked, and were given answers to a number of issues bearing directly on the factors relating to the Return on Common Equity, including regulatory mechanisms; long-term growth and sales guidance; capital expenditures; and regulatory guidance.[56]

In American States Water Company's third quarter 2020 conference call (which took place on November 3, 2020), analysts were provided with updated and additional information. During the course of the call, the company's management discussed earnings guidance and the regulatory environment. After the company's presentation, the analysts asked questions along several lines, all of which are relevant to Mr. Garrett's construct, including the effect of regulatory outcomes and schedules, and the impact of COVID-19.[57] These inquiries reflect the type of considerations analysts typically consider for utility companies.

In the case of just one of his proxy companies, therefore, the level of fundamental research performed by analysts on issues directly related to long-term growth reflected a variety of factors, both quantitative and qualitative. They certainly go beyond "mere increases

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54 *Ibid*., at 43.
55 *Ibid*., at 44 – 45.
56 *See*, American States Water Company, Q2 2020 Earnings Call Transcript, August 4, 2020.
57 *See*, American States Water Company, Q3 2020 Earnings Call Transcript, November 3, 2020.

to rate base or earnings."[58] The analysts' research also far exceeded Mr. Garrett's limited perspective that load growth forecasts, together with other "qualitative factors" support his 3.90% expected growth rate.

Q. It is Mr. Garrett's opinion that growth in a DCF model is limited by the long-term growth in GDP.[59] Why is long-term growth in GDP not an upper limit for terminal growth as Mr. Garrett contends?

A. First, GDP is not a market measure – rather, it is a measure of the value of the total output of goods and services, excluding inflation, in an economy. While I understand that earnings per share ("EPS") growth is also not a market measure, it is well established in financial literature that projected growth in EPS is the superior measure of dividend growth in a DCF model.[60] Furthermore, GDP is simply the sum of all private industry and government output in the United States, and its growth rate is simply an average of the value of those industries. To illustrate, Exhibit DWD-3, Schedule 2 presents the compound annual growth rate of the industries that comprise GDP from 1947 to 2019. Of the 15 industries represented, seven industries, including utilities, grew faster than the overall GDP, and eight industries grew slower than the overall GDP.[61]

Q. Please respond to Mr. Garrett's comment regarding "steady-state" growth rates.

A. On page 39 of his Direct Testimony, Mr. Garrett states, "…it is not necessary to use multi-stage DCF Models to analyze the cost of equity of regulated utility companies. This is because regulated utilities are already in their 'terminal,' low growth stage." While I agree with Mr.

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58 Direct Testimony of David J. Garrett, at 45.

59 *Ibid.*, at 40 – 41.

60 *See*, for example, Robert Harris, *Using Analysts' Growth Forecasts to Estimate Shareholder Required Rate of Return*, Financial Management, Spring 1986; Christofi, Christofi, Lori and Moliver, *Evaluating Common Stocks Using Value Line's Projected Cash Flows and Implied Growth Rate*, Journal of Investing, Spring 1999; Robert Harris and Felicia Marston, *Estimating Shareholder Risk Premia Using Analysts' Growth Forecasts*, Financial Management, Summer 1992; and Vander Weide and Carleton, *Investor Growth Expectations: Analysts vs. History*, The Journal of Portfolio Management, Spring 1988.

61 Exhibit DWD-3, Schedule 2.

Garrett's statement regarding regulated utilities being in the "mature" stage in the company/industry life cycle, I disagree with his conclusion regarding the long-term growth rates of regulated utilities.

As Mr. Garrett describes, the multi-stage DCF and its growth rates reflect the company/industry life cycle, which is typically described in three stages: (1) the growth stage, which is characterized by rapidly expanding sales, profits, and earnings. In the growth stage, dividend payout ratios are low in order to grow the firm; (2) the transition stage, which is characterized by slower growth in sales, profits, and earnings. In the transition stage, dividend payout ratios increase as their need for exponential growth diminishes; and (3) the maturity (steady-state) stage, which is characterized by limited, slightly attractive investment opportunities, and steady earnings growth, dividend payout ratios, and returns on equity.

Since the utility industry is in the mature phase of the company life cycle, it is the company-specific projected EPS growth rate, not the projected GDP growth rate, that is the appropriate measure of growth in a Constant Growth DCF model.

Q. Are there examples in basic finance texts that support your position?

A. Yes. For example, in *Investments*, life cycles and multi-stage growth models are discussed:

> As useful as the constant-growth DDM (dividend discount model) formula is, you need to remember that it is based on a simplifying assumption, namely, that the dividend growth rate will be constant forever. In fact, firms typically pass through life cycles with very different dividend profiles in different phases. In early years, there are ample opportunities for profitable reinvestment in the company. Payout ratios are low, and growth is correspondingly rapid. In later years, the firm matures, production capacity is sufficient to meet market demand, competitors enter the market, and attractive opportunities for reinvestment may become harder to find. In this mature phase, the firm may choose to increase the dividend payout ratio, rather than retain earnings. The dividend level increases, but thereafter it grows at a slower pace because the company has fewer growth opportunities.
>
> Table 18.2 illustrates this pattern. It gives Value Line's forecasts of return on assets, dividend payout ratio, and 3-year growth in earnings per share for a sample of the firms in the computer software industry versus those of east coast electric utilities…

> By in large, the software firms have attractive investment opportunities. The median return on assets of these firms is forecast to be 19.5%, and the firms have responded with high plowback ratios. Most of these firms pay no dividends at all. The high return on assets and high plowback result in rapid growth. The median growth rate of earnings per share in this group is projected at 17.6%.
>
> In contrast, the electric utilities are *more representative of mature firms*. Their median return on assets is lower, 6.5%; dividend payout is higher, 68%; and median growth is lower, 4.6%.
>
> ***
>
> To value companies with temporarily high growth, analysts use a multistage version of the dividend discount model. Dividends in the early high-growth period are forecast and their combined present value is calculated. Then, once the firm is projected to settle down to *a steady-growth phase, the constant-growth DDM is applied to value the remaining stream of dividends*.[62] (Clarification and emphasis added)

The economics of the public utility business indicate that the industry is in the steady-state, or constant-growth stage of a multi-stage DCF, which would mean that the three- to five-year projected growth rates for each company would be the "steady-state" or terminal growth rate appropriate for the DCF model for utility companies, not the GDP growth rate, which is not a company-specific growth rate, nor is it an upward bound for growth, as discussed previously.

Q. Mr. Garrett expressed a concern about using analysts' projected EPS growth rates because he asserts that analysts consider rate base growth in their projected growth rates and that utilities' natural financial incentive is to increase rate base regardless of customer needs.[63] Please respond.

A. The overall premise of Mr. Garrett's concern is without merit and should be dismissed. First, regulated utilities are only allowed to earn returns on and of assets that are considered used and useful in serving the needs of its customers. As the U.S. Supreme Court decision in *Duquesne*

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62 Bodie, Z., Kane, A., and Marcus, A. J., *Investments*, 7th Edition, McGraw-Hill Irwin, 2008, at 616-617.

63 Direct Testimony of David J. Garrett, at 43 – 44.

Light Co. v. Barasch states:

> To the extent utilities' investments turn out to be bad ones (such as plants that are cancelled and so never used and useful to the public), the utilities suffer because the investments have no fair value and so justify no return.[64]

Additionally, capital projects undertaken by utility companies are often subject to prudency reviews from regulatory commissions, which would allow commissions to review and deny any capital project not deemed in the public interest. These two facts would eliminate any type of investment by the utility that is not needed to expressly provide safe, reliable service to their customers. Because of this, equity analysts correctly consider growth in rate base in determining their recommended growth rates for utilities.

Finally, as a depreciation expert, Mr. Garrett should recognize two things: (1) utility assets degrade over time and eventually need to be replaced; and (2) the assets replacing the degraded assets are usually significantly more expensive than the degraded assets. Because of this, rate base will grow consistently *ad infinitum*, which supports both the utility industry's mature position on the company/industry life cycle regarding steady and predictable growth, and the use of company-specific projected analysts' EPS growth rates for use in the Constant Growth DCF model.

Q. Mr. Garrett claims undue reliance on projected EPS growth rates in the DCF model will lead to upward spiraling ROEs for utility companies due to a feedback loop.[65] Please respond.

A. As Mr. Garrett shows in his Figure 1 concerning annual authorized returns, an upward spiraling ROE simply does not exist. The independence of authorized ROEs and market data is consistent with conclusions reached by Dr. Bonbright, who states:

> In the first place, commissions cannot forecast, except within wide limits, the effect their rate orders will have on the market prices of the stocks of the

[64] U.S. Supreme Court, *Duquesne Light Co. v. Barasch*, No. 87-1160 (1989).
[65] Direct Testimony of David J. Garrett, at 46 – 47.

companies they regulate. In the second place, *whatever the initial market prices may be, they are sure to change not only with the changing prospects for earnings, but with the changing outlook of an inherently volatile stock market*. In short, market prices are beyond the control, though not beyond the influence of rate regulation. Moreover, even if a commission did possess the power of control, any attempt to exercise it ... would result in harmful, uneconomic shifts in public utility rate levels.[66] (Emphasis added)

Given this, Mr. Garrett's concerns should be dismissed.

F. Misapplication of the Capital Asset Pricing Model

Q. Please summarize Mr. Garrett's CAPM analysis and results?

A. Mr. Garrett's CAPM estimate relies on a risk-free rate of 1.51%, an average Market Risk Premium of 6.00%, and beta coefficients as reported by *Value Line*. Those assumptions combine to produce an average CAPM estimate of 6.10%.[67]

Q. Do you agree with Mr. Garrett's CAPM analysis?

A. No, I disagree with Mr. Garrett's sole reliance on historical Treasury yields to estimate the risk-free rate and the various methods he uses to estimate the Market Risk Premium. Just as important as our methodological differences, however, is our difference regarding the reasonableness and reliability of an analysis that produces ROE estimates of 6.10%.

Q. Do you agree with Mr. Garrett's use of the average 30-year Treasury yield?

A. No. Mr. Garrett's risk-free rate ignores the fact that the cost of capital and ratemaking are both prospective. Mr. Garrett notes as such on page 56 of his Direct Testimony, "[w]hat matters in the CAPM model, however, is not the actual risk premium from the past, but rather the current and forward-looking risk premium."

Q. How did Mr. Garrett derive his MRP estimate?

A. Mr. Garrett estimates his MRP by reviewing: (1) surveys of expected returns from IESE

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66 James C. Bonbright, Albert L. Danielsen and David R. Kamerschen, *Principles of Public Utility Rates*, Public Utilities Reports, Inc., 1988, at 334.

67 Exhibit DJG-11.

Business School and Graham and Harvey (5.6% and 4.4%, respectively); (2) an expected return reported by Duff & Phelps (6.0%); (3) an implied MRP from Dr. Damodaran (5.8%); (4) a COVID-adjusted implied MRP from Dr. Damodaran (5.0%); and (5) an "Implied Equity Risk Premium" calculation (6.0%).[68] Based on those results, Mr. Garrett concludes that 6.00%, the high end of his range, is appropriate.

Q. Do you have any concerns regarding Mr. Garrett's use of an expected MRP as his selected MRP in his CAPM analysis?

A. Yes, I do. The Duff & Phelps MRP selected by Mr. Garrett is an expected return, which has no relevance to the investor-required return. As discussed previously, both Mr. Garrett and I agree that expected returns "has nothing to do with what the investor 'expects' the ROE awarded by a regulatory commission to be."[69]

Widely used finance texts recommend the use of multiple models in estimating the Cost of Equity, in particular the DCF, CAPM, and Risk Premium approaches. I reviewed articles published in financial journals, as well as additional texts that speak to the methods used by analysts to estimate the Cost of Equity. An article published in Financial Analysts Journal surveyed financial analysts to determine the analytical techniques that are used in practice.[70] Regarding stock price valuation and cost of capital estimation, the author asked respondents to comment only on the DCF, CAPM, and Economic Value-Added models. Nowhere in that article did the author consider asking whether surveys of expected returns are relevant to the determination of the Cost of Capital.

Given Mr. Garrett's correct view that expected returns have nothing to do with the investor-required return, and the lack of use by practitioners, his recommendation to use

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68 Direct Testimony of David J. Garrett, at 61 and Exhibit DJG-10.

69 Direct Testimony of David J. Garrett, at 5.

70 *See*, Stanley B. Block, *A Study of Financial Analysts: Practice and Theory*, Financial Analysts Journal, July/August 1999.

expected MRPs should be dismissed by the Commission.

Q. Do the surveys referenced by Mr. Garrett provide reasonable MRP estimates for the purpose of estimating the Company's Cost of Equity?

A. No, they do not. For example, the Graham and Harvey survey suggests an expected return on the overall market of 6.79%, based on a risk-free rate of 2.37% and an MRP of 4.42%.[71] Combining those estimates with Mr. Garrett's average beta coefficient estimate of 0.76 produces a Cost of Equity estimate of 5.73%, approximately 27 basis points below Mr. Garrett's estimate of the "true" Cost of Equity. Because utility stocks tend to be somewhat less risky than the broad market,[72] if the Graham and Harvey survey results are meaningful, Mr. Garrett's ROE recommendation would be no more than 6.79%. In fact, his recommendation exceeds the Graham and Harvey estimate by 271 basis points.

As shown in Table 4, below, in the past the Graham and Harvey survey respondents have provided forecasts that significantly underestimated actual market returns. As Table 4 demonstrates, from 2012 through 2019 the average market return was 15.55%, over 3.0 times greater than the Graham and Harvey survey average expected return of 5.30%.

71 *See*, Graham and Harvey, *The Equity Risk Premium in 2018*, at 7 for Q4 2017.

72 As noted above, during times of market volatility this may not hold true.

Table 4:
S&P 500 Market Return vs. Graham-Harvey Survey Expected Return[73]

	Actual	Survey Estimate
2019	31.49%	4.59%
2018	-4.38%	6.57%
2017	21.83%	5.00%
2016	11.96%	4.32%
2015	1.38%	6.07%
2014	13.69%	5.00%
2013	32.39%	3.40%
2012	16.00%	4.00%
Average	15.55%	4.63%

Graham and Harvey also have noted a distinction between the expected market return on one hand, and the "hurdle rate" on the other. In the Third Quarter 2017 survey, the authors reported an average hurdle rate, which is the return required for capital investments, of 13.50%. The authors further reported the average WACC, which includes the cost of debt, was 9.20% even though the expected market return was 6.50%.[74] As a result, I do not believe the Graham and Harvey surveys are a reasonable reflection of the expected MRP going forward.

Q. Do any of the surveys cited by Mr. Garrett provide support for your approach to estimating the current MRP?

A. Yes. As discussed in my Direct Testimony,[75] I calculated the *ex-ante* MRP in a similar manner to a study by Pablo Fernandez, *et al* (cited by Mr. Garrett), using the market capitalization weighted Constant Growth DCF calculation on the individual companies in the S&P 500

[73] Source: Morningstar, Inc., 2020 SBBI Yearbook, Appendix A-1; http://www.cfosurvey.org (one-year return estimates as of fourth quarter of the previous year). Note, Graham and Harvey publish the Duke CFO survey.

[74] *See*, Duke/CFO Magazine Global Business Outlook survey – U.S., Third Quarter 2017.

[75] Direct Testimony of Dylan W. D'Ascendis, at 29, 31.

Index.[76]

Q. Is there academic literature that supports the conclusion that MRPs using surveys are not widely used by practitioners?

A. Yes. Dr. Damodaran, who was cited several times by Mr. Garrett throughout his testimony, states the following about the applicability of survey MRPs:

> While survey premiums have become more accessible, very few practitioners seem to be inclined to use the numbers from these surveys in computations and there are several reasons for this reluctance:
>
> 1. Survey risk premiums are responsive to recent stock prices movements, with survey numbers generally increasing after bullish periods and decreasing after market decline. Thus, the peaks in the SIA survey premium of individual investors occurred in the bull market of 1999, and the more moderate premiums of 2003 and 2004 occurred after the market collapse in 2000 and 2001.
> 2. Survey premiums are sensitive not only to whom the question is directed at but how the question is asked. For instance, individual investors seem to have higher (and more volatile) expected returns on equity than institutional investors and the survey numbers vary depending upon the framing of the question.[footnote omitted]
> 3. In keeping with other surveys that show differences across sub-groups, the premium seems to vary depending on who gets surveyed. Kaustia, Lehtoranta and Puttonen (2011) surveyed 1,465 Finnish investment advisors and note that not only are male advisors more likely to provide an estimate but that their estimated premiums are roughly 2% lower than those obtained from female advisors, after controlling for experience, education and other factors.[footnote omitted]
> 4. Studies that have looked at the efficacy of survey premiums indicate that if they have any predictive power, it is in the wrong direction. Fisher and Statman (2000) document the negative relationship between investor sentiment (individual and institutional) and stock returns.[footnote omitted] In other words, investors becoming more optimistic (and demanding a larger premium) is more likely to be a

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[76] *See*, Pablo Fernandez, Alberto Ortiz, and Isabel Fernandez Acín, *Market Risk Premium used in 71 countries in 2016: a survey with 6,932 answers*, IESE Business School, May 9, 2016, at 10. Specifically, the study states:

> [t]he [implied equity premium] is the implicit [required equity premium] used in the valuation of a stock (or market index) that matches the current market price. The most widely used model to calculate the [implied equity premium] is the dividend discount model: the current price (P_0) is the present value of expected dividends discounted at the required rate of return (K_e). If d_1 is the dividend per share expected to be received in year 1, and g the expected long-term growth rate in dividends per share:
>
> $P_0 = d_1 / (Ke - g)$, which implies:
>
> [implied equity premium] = $d_1/P_0 + g - R_f$

precursor to poor (rather than good) market returns.

> As technology aids the process, the number and sophistication of surveys of both individual and institutional investors will also increase. However, it is also likely that these survey premiums will be more reflections of the recent past rather than good forecasts of the future.[77]

Q. Please now describe the method by which Mr. Garrett calculated his third estimate, the implied MRP.

A. As Mr. Garrett points out, his method develops the Internal Rate of Return that sets equal the current value of the market index to the projected value of cash flows associated with owning the market index.[78] Mr. Garrett observes that Dr. Damodaran "promotes the implied ERP method."[79] Although there are some differences, Mr. Garrett's approach is similar to the model Dr. Damodaran provides on his website.[80]

Mr. Garrett's method, which is a two-stage form of the DCF model, calculates the present value of cash flows over the five-year initial period, together with the terminal price (based on the Gordon Model[81]), to be received in the last (*i.e.*, fifth) year. The model's principal inputs include the following assumptions:

- Over the coming five years, the S&P 500 Index (the "Index") will appreciate at a rate equal to the compound growth rate in "Operating Earnings" from 2014 through 2019;
- Cash flows associated with owning the Index will be equal to the historical average Earnings, Dividends, and Buyback yields, applied to the projected Index value each year; and

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77 Aswath Damodaran, Stern School of Business, *Equity Risk Determinants, Estimation and Implications – The 2020 Edition*, Updated March 2020, at 26-27.

78 Direct Testimony of David J. Garrett, at 58 – 60.

79 *Ibid*., at 60.

80 *See*, http://pages.stern.nyu.edu/~adamodar.

81 Exhibit DJG-9.

- Beginning in the terminal year, the Index will appreciate, in perpetuity, at a rate equal to the 30-day average yield on 30-year Treasury securities, as of October 28, 2020.[82]

As discussed below, reasonable changes to those assumptions have a considerable effect on Mr. Garrett's calculated expected market return.

Q. Do you have any observations regarding Mr. Garrett's assumed first-stage growth rate?

A. Yes. Mr. Garrett's 5.37% growth rate relates to growth in operating earnings, and does not reflect capital appreciation, growth in dividends, or buy-backs.[83] In addition, if Mr. Garrett's position is that historical growth rates are meant to reflect expected future growth, they should reflect year-to-year variation (that is, uncertainty). That is best accomplished using the arithmetic mean. I therefore calculated the average growth (arithmetic mean) for the four metrics included in Mr. Garrett's exhibit. The average growth rate, 7.35%, produces an estimated market return of about 7.98%,[84] which is still well below historical experience.

Q. Why did the market return increase by only 51 basis points (from 7.47% to 7.98%) when the first-stage growth rate increased by 198 basis points (from 5.37% to 7.35%)?

A. Because Mr. Garrett's model assumes the first stage lasts for five years (and the terminal stage is perpetual), the results are sensitive to changes in the assumed terminal growth rate. To put that effect in perspective, the terminal value (which is directly related to the terminal growth rate) represents approximately 76.59% of the "Intrinsic Value" in Mr. Garrett's analysis.[85]

Q. How did Mr. Garrett develop his assumed terminal growth rate?

A. The terminal growth rate represents investors' expectations of the rate at which the broad stock

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82 Exhibits DJG-7 and DJG-9. The model also assumes that all payments are received at year-end, rather than during the year. That assumption also tends to under-state the Implied Market Risk Premium.

83 Exhibit DJG-9. Whereas the compound average growth rate in operating earnings was 5.37%, dividends and buybacks grew by 6.74% and 5.66%, respectively.

84 Exhibit DWD-3, Schedule 3, page 2.

85 Exhibit DWD-3, Schedule 3. Please note that regardless of the assumed first and terminal-stage growth rates, the terminal stage consistently represents approximately 76.00% of the Intrinsic Value.

market will grow, in perpetuity, beginning in the terminal year. Mr. Garrett assumes terminal growth is best measured by the average yield on 30-year Treasury securities over the 30 days ended October 28, 2020. That is, Mr. Garrett assumes the average 30-year Treasury yield between September 2020 and October 2020 is the best measure of expected earnings growth beginning five years from now and extending indefinitely into the future.

Q. Do you agree with Mr. Garrett's assumption?

A. No, I do not. I recognize Mr. Garrett followed the approach described in Dr. Damodaran's method, which Dr. Damodaran refers to as a "default" assumption.[86] In terms of historical experience, over the long-term the broad economy has grown at a long-term compound average growth rate of approximately 6.09%.[87] Considered from another perspective, Duff & Phelps reports the long-term rate of capital appreciation on Large Company stocks to be 7.90%.[88] Mr. Garrett's model assumes, however, that the market index will grow by less than one-half that amount, 2.37%, over the coming four years.[89]

Mr. Garrett has not explained why growth beginning five years in the future, and extending in perpetuity, will be less than one-half of long-term historical growth. From a somewhat different perspective, assuming long-term inflation will be approximately 2.00%[90] implies perpetual real growth will be approximately -0.48%.[91] Again, Mr. Garrett assumes in the long run, real growth will in fact be negative in perpetuity. Nowhere in his testimony has Mr. Garrett explained the fundamental, systemic changes that would so dramatically reduce long-term economic growth, or why they are best measured by the long-term Treasury yield

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86 *See*, http://pages.stern.nyu.edu/~adamodar.

87 Source: Bureau of Economic Analysis for the years 1929 to 2019. https://www.bea.gov/data/gdp/gross-domestic-product

88 Duff & Phelps, 2020 SBBI® Yearbook, 6-17.

89 Exhibit DJG-9. (3724/3391)^(1/4)- 1 = 2.37%.

90 For example, in line with the Federal Reserve's target average rate of inflation. *See also*, Exhibit DJG-5.

91 -0.48% = [(1.0151/1.02)-1]. Please note that the long-term historical average rate of inflation, measured by the difference between real and nominal GDP growth, has been approximately 2.79%, which would also imply perpetual negative real growth.

over 30 days between September 2020 to October 2020.

Further, research by the Federal Reserve Bank of San Francisco calls into question the relationship between interest rates and macroeconomic growth. As the authors noted, "[o]ver the past three decades, it appears that private forecasters have incorporated essentially no link between potential growth and the natural rate of interest: The two data series have a zero correlation."[92]

Q. Please briefly summarize your response to Mr. Garrett's Implied Equity Risk Premium calculation.

A. Mr. Garrett's calculation is based on a series of questionable assumptions, to which a small set of very reasonable adjustments produces a market return estimate more consistent with (yet still below) the historical experience he considers relevant. Although the revised results still produce ROE estimates far below any reasonable measure, they do point out the sensitive nature of Mr. Garrett's analyses, and the tenuous nature of the conclusions he draws from them.

Q. Please summarize Mr. Garrett's concerns with the application of a historical average Equity Risk Premium.

A. Mr. Garrett notes that although a historical ERP is "convenient and easy to calculate," there is evidence that a "forward-looking ERP is *actually* lower than the historical ERP."[93]

Q. Are there studies that show that the long-term arithmetic mean is a good predictor of the next value in a random string of data (*e.g.* market returns)?

A. Yes. John Y. Campbell of Harvard University states: "When returns are serially uncorrelated, the arithmetic average represents the best forecast of future return in any randomly selected future year."[94]. As shown on pages 6-14 and 6-15 of SBBI – 2020, returns on large stocks and

92 FRBSF Economic Letter, *Does Slower Growth Imply Lower Interest Rates?*, November 10, 2014, at 3.
93 Direct Testimony of David J. Garrett, at 56.
94 Campbell, John Y., *Forecasting US Equity Returns in the 21st Century*, July 2001.

equity risk premiums have serial correlations of 0.00 and 0.01, respectively, showing serial uncorrelation.

Additionally, in SBBI – 2020, regarding the use of the arithmetic mean, Duff & Phelps state:

> The equity risk premium data presented in this book are arithmetic average risk premiums as opposed to geometric average risk premiums. The arithmetic average equity risk premium can be demonstrated to be the most appropriate when discounting cash flows. For use as he expected equity risk premium in either the CAPM or the building-block approach, the arithmetic mean or the simple difference of the arithmetic means of stock market returns and riskless rates is the relevant number. This is because both the CAPM and the building-block approach are additive models, in which the cost of capital is the sum of its parts.[95]

Therefore, the long-term historical arithmetic average MRP is useful, when calculated correctly, in the application of the CAPM.

Q. Does Mr. Garrett employ an Empirical CAPM in his CAPM analysis?

A. No, he does not. Mr. Garrett fails to consider the ECAPM, despite the fact that numerous tests of the CAPM have confirmed that the empirical Security Market Line ("SML") described by the traditional CAPM is not as steeply sloped as the predicted SML, as described in my Direct Testimony.[96] Because of the empirical findings presented in my Direct Testimony, Mr. Garrett should have considered the ECAPM in his CAPM analysis.

Q. Please summarize your concerns with Mr. Garrett's CAPM analysis.

A. Mr. Garrett's CAPM analysis is flawed because he uses a historical risk-free rate and MRPs based on expected returns. Using flawed inputs, in combination with not employing the ECAPM, produces unrealistic results. Given Mr. Garrett's seeming dismissal of the results of his CAPM, the Commission should likewise dismiss Mr. Garrett's CAPM analysis.

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95 SBBI – 2020, at 10-22, 10-23.

96 Direct Testimony of Dylan W. D'Ascendis, at 32.

G. Refusal to Consider a Small Size Premium in his ROE Recommendation

Q. Did Mr. Garrett address the issue of a size premium in his testimony?

A. Yes. Mr. Garrett lists several reasons why he has not included a size premium in his recommendation, including: (1) numerous studies show that "small cap stocks do not consistently outperform large-cap stocks,"[97] and (2) that the "discovery of the size effect phenomenon likely caused its own demise."[98]

Q. Is Mr. Garrett's review of the size premium correct?

A. No, it is not. First, Mr. Garrett notes that after 1983, U.S. small-cap stocks underperformed large-cap stocks.[99] The issue with Mr. Garrett's position is that the size premium measures the increased risk associated with a company's smaller size; Mr. Garrett is only focused on returns. As I discussed in my Direct Testimony, smaller companies face increased business risk as they are less equipped to cope with significant events that affect sales, revenues, and earnings, as the loss of a few larger customers will have a greater effect on a small company than a larger company.[100]

This is further evident when we consider that increasing capital costs (*i.e.* risk) for one set of securities will put downward pressure on those securities as investors transition to securities with lower risk. Under this premise, the underperformance is directly tied to the increase in risk. As such, Mr. Garrett's premise that smaller companies' underperformance indicates a reduction of risk is in fact the opposite – underperformance indicates an increasing level of risk.

Q. Have you performed a study comparing the size of UIF with the average proxy company in Mr. Garrett's proxy group?

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97 Direct Testimony of David J. Garrett, at 68.
98 *Ibid*., at 69.
99 *Ibid*., at 68.
100 Direct Testimony of Dylan W. D'Ascendis, at 38 – 39.

A. Yes. Duff & Phelps' ("D&P") 2017 Valuation Handbook – U.S. Guide to Cost of Capital: Cost of Capital Navigator ("D&P 2017") presents a Size Study based on the relationship of various measures of size and return. Relative to the relationship between average annual return and the various measures of size, D&P state:

> **The size of a company is one of the most important risk elements to consider when developing cost of equity estimates for use in valuing** a firm. Traditionally, researchers have used market value of equity (*i.e.,* "market capitalization" or simply "market cap") as a measure of size in conducting historical rate of return research. For example, the Center for Research in Security Prices (CRSP) "deciles" are developed by sorting U.S. companies by market capitalization. Another example is the Fama-French "Small minus Big" (SMB) series, which is the difference in return of "small" stocks minus "big" (*i.e.*, large) stocks, as defined by market capitalization. (emphasis added) [101]

Exhibit DWD-3, Schedule 4 contains indicated small size risk premiums using various measures of size as described by D&P 2017.[102] The measures are listed below:

- Book Value of Common Equity;
- Five-Year Average Net Income;
- Total Assets;
- Five Year Average EBITDA;
- Total Sales; and
- Number of Employees.

As shown on Exhibit DWD-3, Schedule 4, in all measures, UIF is determined to be smaller than the average water company in Mr. Garrett's proxy group with associated size premiums ranging from 1.13% to 3.43%. In view of these indicated size premiums, an upward size adjustment of 1.00% to the indicated cost of common equity is extremely conservative.

Q. Have you performed an additional study for utility companies that links size and risk?

A. Yes, I have. I performed a study on whether the size effect is applicable to utilities. The study

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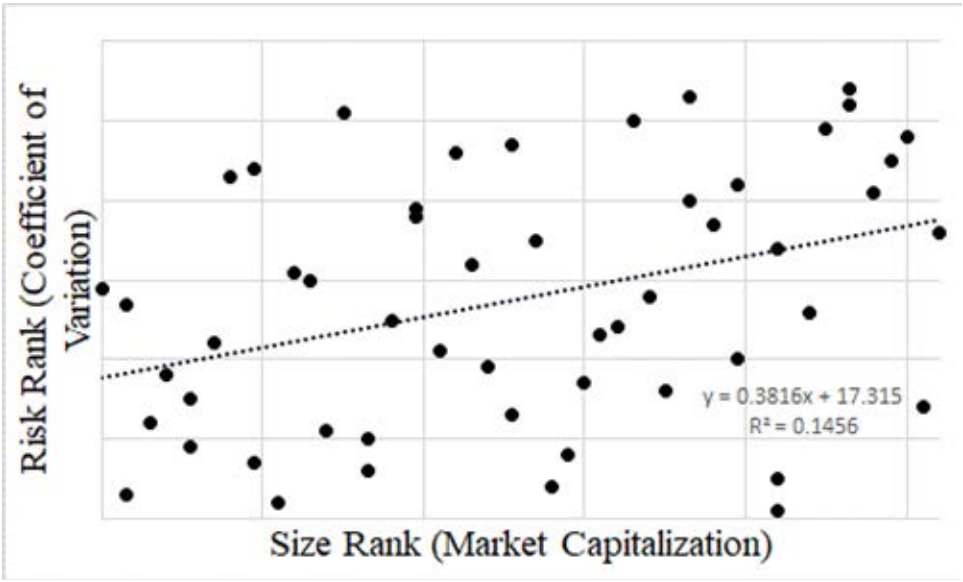
101 D&P-2017, at p. 10-2.

102 *Ibid.*

included the universe of electric, gas, and water companies included in *Value Line Standard Edition.* From each of the utilities' *Value Line Ratings & Reports*, I calculated the ten-year coefficients of variation ("CoV")[103] of net profit (a measure of risk) and current market capitalization (a measure of size) for each company. After ranking the companies by size (largest to smallest) and risk (least risky to most risky), I made a scatter plot of the data, as shown on Chart 2, below:

Chart 2:
Relationship Between Size and Risk for the *Value Line* Universe of Utility Companies



As shown in Chart 2 above, as company size decreases (increasing size rank), the CoV increases, linking size and risk for utilities, which is significant at 95.0% confidence level.

Q. Are you aware of academic articles supporting the applicability of a size premium?

A. Yes. An article by Michael A. Paschall, ASA, CFA, and George B. Hawkins ASA, CFA, *Do Smaller Companies Warrant a Higher Discount Rate for Risk?* also supports the applicability of a size premium. As the article makes clear, all else equal, size is a risk factor which must be taken into account when setting the cost of capital or capitalization (discount) rate. Paschall

[103] The coefficient of variation is used by investors and economists to determine volatility.

and Hawkins state in their conclusion as follows:

> The current challenge to traditional thinking about a small stock premium is a very real and potentially troublesome issue. The challenge comes from bright and articulate people and has already been incorporated into some court cases, providing further ammunition for the IRS. Failing to consider the additional risk associated with most smaller companies, however, is to fail to acknowledge reality. Measured properly, small company stocks have proven to be more risky over a long period of time than have larger company stocks. This makes sense due to the various advantages that larger companies have over smaller companies. Investors looking to purchase a riskier company will require a greater return on investment to compensate for that risk. There are numerous other risks affecting a particular company, yet the use of a size premium is one way to quantify the risk associated with smaller companies.[104]

Hence, Paschall and Hawkins corroborate the need for a small size adjustment, all else equal. Consistent with the financial principle of risk and return discussed previously, upward adjustment must be applied to the indicated cost of common equity derived from the cost of equity models of the proxy groups used in this proceeding.

Q. Mr. Garrett points to a passage published in 2015 by Ibbotson that states that the size premium no longer exists. What is your response?

A. Despite their findings, Duff & Phelps (which now owns Ibbotson) continues to publish data on their findings on the presence of a size premium in the market and has provided additional measures of the size premium, as noted above. If Duff & Phelps found that no size premium ceased to exist, it would not continue to update and publish this information.

Q. Finally, does the Commission's ROE Formula allow for adjustments for increased risk of small utilities?

A. Yes, it does. As stated at page 42 of my Direct Testimony, the Commission's ROE Formula allows a 50-basis point premium for private placement and a size premium of 50 basis points stating "smaller companies are considered by investors to be more risky than larger

[104] Michael A. Paschall, ASA, CFA and George B. Hawkins ASA, CFA, *Do Smaller Companies Warrant a Higher Discount Rate for Risk?*, CCH Business Valuation Alert, Vol. 1, Issue No. 2, December 1999.

companies."[105] In view of all of the above, my 1.00% size premium applicable to UIF is reasonable and conservative.

H. Response to Mr. Garrett's Critiques of Company Testimony

Q. Does Mr. Garrett have any critiques of your analyses presented in your Direct Testimony?

A. Yes, he does. Mr. Garrett's critiques of my Direct Testimony are: (1) my requested ROE is in excess of the investor-required return on the market; (2) my growth rates used in the DCF model exceed GDP growth; (3) my MRP is unreasonable because it is not in line with his MRP estimates; (4) my risk-free rate used in my CAPM is overestimated; (5) my use of a non-regulated proxy group; and (6) my inclusion of a small size premium is unnecessary. I have already addressed critiques (1), (2), (4), and (6) previously and will not address them here. I will discuss Mr. Garrett's remaining critiques in turn.

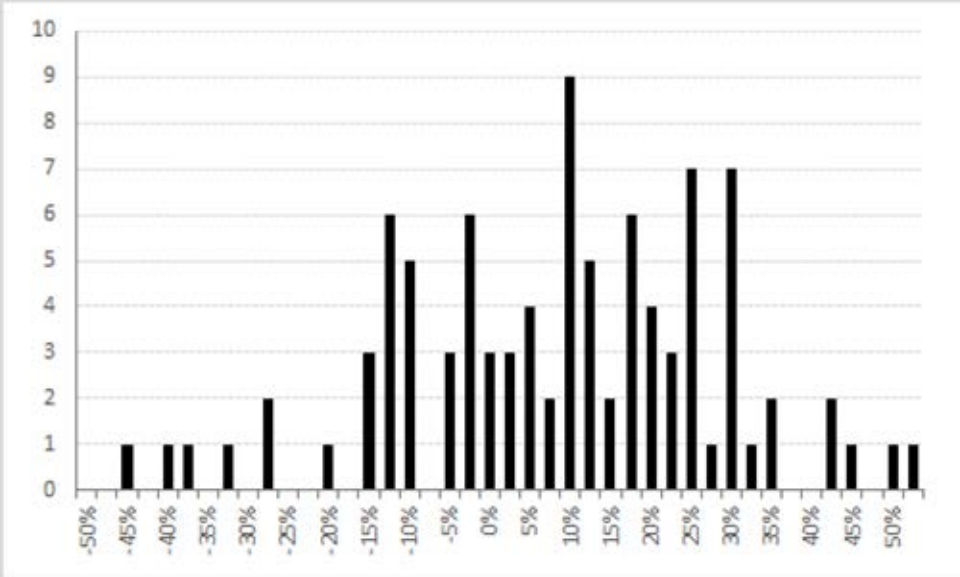
Q. Mr. Garrett states that your MRP is unreasonable in view of his measures of MRP as presented in his CAPM analysis.[106] Please respond.

A. I have discussed the inapplicability of Mr. Garrett's MRP estimates for cost of capital purposes previously in this Rebuttal Testimony and will not repeat that discussion here. Since Mr. Garrett's MRP measures are not valid MRPs, they cannot be comparable to my MRP estimates. Even though Mr. Garrett has presented no reliable evidence upon which to gauge the reasonableness of the MRP estimate, I will note that my estimate of 11.94% is consistent with actual realized ERPs. As shown in Chart 3, below, my estimate falls within the 58th percentile of historical MRPs.

105 Order No. PSC-2019-0267-PAA-WS.

106 Direct Testimony of David J. Garrett, at 63 – 64.

Chart 3:
Frequency Distribution of Observed Market Risk Premia, 1926 - 2019[107]



Given all the above, my calculation of the MRPs in my CAPM and ECAPM analyses is reasonable in view of historical returns and is supported by financial literature. Thus, Mr. Garrett's concern should be dismissed.

Q. Please summarize Mr. Garrett's argument against using a non-price regulated proxy group similar in total risk to a utility proxy group to determine an indicated ROE for UIF in this proceeding.

A. Mr. Garrett finds there is no marginal benefit of running a CAPM or DCF model on a group of non-regulated, non-utility companies. Additionally, Mr. Garrett believes that competitive firms typically have higher levels of risk than utilities[108] and that, "a group of non-regulated, non-utility companies will not indicate a required return on investments that is *commensurate* with returns on investments of *corresponding* risk."[109]

Q. Do you agree with Mr. Garrett's reasoning?

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107 Exhibit DWD-3, Schedule 5.
108 Direct Testimony of David J. Garrett, at 66.
109 *Ibid*., at 67. (emphasis in original)

A. No. Regarding Mr. Garrett's claim that there is no marginal benefit to running my non-price regulated analysis, this directly contradicts his own claim that "[i]t is preferable to use multiple models because the results of any one model may contain a degree of imprecision."[110] Because regulation is a substitute for competition, the application of cost of common equity models to comparable risk, non-regulated companies produces a marginal benefit that cannot be replicated using utility companies.

Q. Does Mr. Garrett discuss risk and relevance of risk for cost of capital purposes in his testimony?

A. Yes. In Section V of his direct testimony, Mr. Garrett discusses risk and return concepts in general. On page 29 of his direct testimony, Mr. Garrett states: "Market risk is the only type of risk that is rewarded by the market and is thus the primary type of risk the Commission should consider when determining the allowed return in this case."

Q. How does your selection criteria for your Non-Price Regulated Proxy Group fit into the above discussion?

A. Following Mr. Garrett's logic, given that unadjusted beta coefficients are measures of market risk (the primary measure of risk according to Mr. Garrett), and one of my screening criteria was to generate companies with similar unadjusted beta coefficients as the Utility Proxy Group, my Non-Price Regulated Proxy Group, by definition, would be comparable to the Utility Proxy Group.

Q. In addition to screening your Non-Price Regulated Proxy Group companies using unadjusted beta coefficients and standard errors of the regression, did you conduct

110 Ibid., at 23.

another study to show that the Utility Proxy Group and the Non-Price Regulated Group are similar in total risk?

A. Yes, I did. To further show similarity between the Utility and Non-Price Regulated Proxy Groups, I have analyzed the CoV of net profit for each group (as reported by *Value Line*) and the results of that study are shown on Exhibit DWD-3, Schedule 6. As shown, the mean and median CoV of net profit for the Non-Price Regulated Proxy Group are within the range of CoVs of net profit set by the Utility Proxy Group companies, which suggests that the volatility in net profit is similar between the Utility Proxy Group and the Non-Price Regulated Proxy Group.

Q. Does Mr. Garrett look to non-price regulated companies in any of his analyses?

A. Yes. In assessing the Company's capital structure, Mr. Garrett reviews the debt ratios of competitive industries.[111] The major mistake in Mr. Garrett's analysis is the same mistake he falsely accuses me of. In his comparisons of the capital structures of non-regulated industries to UIF, he does not evaluate the industries' market risk in comparison to UIF. If Mr. Garrett evaluated the market risk (*i.e.,* unadjusted beta coefficients) of those industries, he would have found that those industries are not comparable to utility companies like UIF. Using Mr. Garrett's own source, Dr. Damodaran, the average unadjusted beta coefficient of the industries that have debt ratios over 55% is 1.18, whereas the Utility (Water) unadjusted beta coefficient is 0.68.

Q. Please summarize your discussion regarding the use of non-price regulated proxy groups in cost of capital analyses for regulated utilities.

A. The use of non-price regulated proxy groups in cost of capital analyses for regulated utility companies should be considered by regulatory commissions as another tool in the tool kit to

[111] Direct Testimony of David J. Garrett, at 78.

determine the ROE for a utility, provided the non-price regulated proxy group is shown to be of comparable risk. The Non-Price Regulated Proxy Group used in my analyses was screened using measures of systematic and unsystematic risk, to show similar total risk. Mr. Garrett's non-price regulated industry study was not screened for any risk aside from financial risk, which, as stated previously, is not a proxy for total risk.

For these reasons, my Non-Price Regulated Proxy Group analyses should be considered by the Commission while Mr. Garrett's non-price regulated industry analyses should be rejected by the Commission.

V. SUMMARY AND CONCLUSIONS

Q. Should any or all the arguments made by Mr. Garrett persuade the Commission to lower the ROE it approves for UIF below your recommendation?

A. No, they should not. Based on the analyses discussed throughout my Rebuttal Testimony, and given the current capital market conditions, I continue to believe that an ROE of 11.75% continues to be a reasonable, although conservative, estimate of the Company's Cost of Equity. It will provide UIF with sufficient earnings to enable it to attract necessary new capital efficiently and at a reasonable cost.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

CHAIRMAN CLARK: I assumed everybody was coming back tomorrow.

All right. Next witness, UIF witness, Mr. Chris Snow. Mr. Snow, are you on the line?

THE WITNESS: Good afternoon, Mr. Chairman.

CHARIMAN CLARK: We need your video, Mr. Snow. There we go.

All right. Would you raise your right hand and repeat after me?

Whereupon,

CHRIS SNOW

was called as a witness, having been first duly sworn to speak the truth, the whole truth, and nothing but the truth, was examined and testified as follows:

THE WITNESS: Yes.

CHARIMAN CLARK: All right. Consider yourself sworn in.

Mr. Friedman.

MR. FRIEDMAN: Thank you, Mr. Chairman.

EXAMINATION

BY MR. FRIEDMAN:

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

A Chris Snow. 200 Weathersfield Avenue, Altamonte Springs.

Q And, Mr. Snow, did you prefile rebuttal testimony in this case?

A Yes, sir.

Q And if I asked you the questions in your prefiled rebuttal testimony, would your answers be the same?

A Yes, they would.

Q So you have no changes or connections in your testimony?

A No, I do not.

Q Did you have any exhibits to your testimony?

A No.

MR. FRIEDMAN: Mr. Chairman, I would like to ask that Mr. Snow's prefiled rebuttal testimony be admitted into the record as though read.

CHAIRMAN CLARK: So ordered.

(Whereupon, prefiled rebuttal testimony of Chris Snow was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for an increase in water and wastewater rates in Charlotte, Highlands, Lake, Lee, Marion, Orange, Pasco, Pinellas, Polk, and Seminole Counties by Utilities, Inc. of Florida
_____/

Docket No. 20200139-WS

REBUTTAL TESTIMONY

OF

CHRIS SNOW

on behalf of

Utilities, Inc. of Florida

Q. Please state your, name profession and address.

A. My name is Chris Snow. I am Director of External Affairs for Utilities, Inc. of Florida. My business address is 200 Weathersfield Ave., Altamonte Springs, Florida, 32714.

Q. Please briefly state your educational background and experience.

A. I received a Bachelor of Arts degree from Florida State University in social science in 2004. Prior to my work at Utilities, Inc. of Florida (UIF) I worked 10 years for the quasi-government agency Space Florida both as the Director of Government Affairs but also as a Director of Business Development, managing community affairs. Before then I worked in Washington, D.C. on Capitol Hill and at a trade association analyzing and as an advocate for legislative policy.

Q. Have you previously pre-filed direct testimony in this proceeding?

A. No.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to primarily address the pre-filed testimony of OPC witnesses Lewis and Crane.

Q. Do you agree with OPC witness Lewis' findings when it comes to billing complaints?

A. No, I do not. The procedure of UIF for a high-bill complaint involves checking with the customer to see if there could be a leak. If there is a leak, we have instituted a leak adjustment policy to reduce the customer's bill to help them through that challenge. If it is not a leak, we work with them to determine whether there is a meter malfunction by means of re-reading the meter and/or a meter test to determine its accuracy. We work with each customer individually to address each of their concerns.

Q. Do you agree with OPC witness Lewis in regard to customer Dana Elliot's comments?

A. No, UIF has not received a complaint from Ms. Elliot about her water quality in the more

than 14 years she has been a customer. As with all customers, we are more than happy to investigate individual customers concerns first to try to address them but second to assure there isn't a larger systemic issue involved.

We are aware of iron levels in the water at our Pennbrooke system. This is a function of the source groundwater containing a significant concentration of iron. UIF adds an iron sequestrant as part of the water treatment process to keep the iron in solution. We previously investigated treatment alternatives with the Pennbrooke Homeowners Association after they expressed interest in UIF making specific additional investments to remove iron from the water. The Pennbrooke Homeowners Associations declined to support the treatment upgrade due to the prospective impact on their water bill.

Q. Do you agree with OPC witness Lewis in regard to customer Russakov's comments?

A. No, UIF has not received a complaint about water quality from Ms. Russakov in the approximately 20 years she has been a customer. We are happy to investigate the customer's concerns but are happy to hear she hasn't had any in more than a year.

Q. Do you agree with OPC witness Lewis in regard to customer Saylor's comments?

A. No, UIF has not received a complaint about water quality in the time Mr. Saylor has been a customer. Again, as a customer of Pennbrooke the source water is high in iron content, as previously mentioned, which correlates with Mr. Saylor's concerns. The water quality in Pennbrooke routinely meets all DEP standards and requirements. We are happy to work with Mr. Saylor to resolve his individual concerns.

In regard to his billing concerns, we offer irrigation audits for our customers and are happy to provide information on how he can save money by reducing his water usage. For instance, over the last two years Mr. Saylor has averaged 16,000 gallons of water per month. We typically find that irrigation is the primary driver of high water usage. We offer free irrigation

audits as well as information on our website on how to conserve water as provided by the St. Johns River Water Management District including guidelines for watering. The District's guidance may help Mr. Saylor and others conserve water and reduce their bills.

Q. Do you agree with OPC witness Lewis that Utilities, Inc. of Florida did not respond to complaints until after the customer reached out to the Public Service Commission?

A. No, when customers contact us, we respond via phone, email, or social media messages. We are happy to respond to each customer concern brought to us. Sometimes customers choose to contact the Public Service Commission before reaching out to us, but that is their choice as a consumer. If there are specific instances that Ms. Lewis is referring to, we would be happy to address them individually.

Q. Do you agree with OPC witness Crane's testimony about lobbying costs in your revenue requirement claim?

A: No, I do not. In response to OPC Interrogatory 34 we were asked to identify any organization that is involved in lobbying activity. We did so. However, in Interrogatory 140 we were asked to show the total payments to these entities that related to lobbying activities which is simply $45,827.13 to the Gunster law firm. The lobbying activity was related to the passage of Fair Market Value legislation which not only benefits UIF but also the customer. First, the acquisition of underfunded systems would benefit the customers of those systems by virtue of UIF offering robust financial and operational resources. Additionally, the legislation, if enacted, would help our current customers by allowing us to spread individual system costs over a larger customer base thus achieving economies of scale for the systems acquired. This would reduce the cost to each individual customer similar to the economies of scale realized by the electric and gas industries in Florida.

UIF is a member of other organizations that offer training, certification, technology information and strategic planning resources, all of which are beneficial to the customers by assisting in UIF's mandate to provide safe and reliable service.

Q. Do you agree with OPC witness Hicks that Utilities, Inc. of Florida that the potential rule violations for lack of responding to customers in a timely manner is a current problem?

A: No, I do not. In reviewing the PSC complaints pointed out by OPC witness Hicks I found that these four potential rule violations were from 2015, 2017, and 2018. There are none from 2019 or 2020. We work diligently to assure we are responding to the customer, and PSC, in a thorough and expedient manner. We have a team that handles PSC complaints that come in and we have reorganized our Customer Experience department to prioritize the customer. Additionally, we strive to provide information to the customer in their preferred method. To that end, UIF now provides customer information and feedback on Facebook, Twitter, Google and through our app/webportal MyUtilityConnect.

Q. Do you agree with the assessment made by your customer, Mr. David Joswick, during the December 4th Service Hearing?

A: No, I do not. Mr. David Joswick raised concerns in regard to UIF's customer service. Mr. Joswick is correct in that he received an incorrect meter read in February of 2020. What he did not mention in his testimony is that UIF apologized, reread the meter and corrected his bill. The second item mentioned by Mr. Joswick is from November 30 of 2017 when he called requesting UIF loosen the valve to allow him to turn off his water for repairs. UIF visited his residence the next day and loosened the valve for the customer.

Q. Does that conclude your direct testimony?

A. Yes, it does.

BY MR. FRIEDMAN:

Q Mr. Snow, do you have a brief, no more than three-minute summary of your testimony?

A Yes, I do.

Q Would you go ahead, please?

A Thank you for having me here today.

I was brought on in June of 2018 after, in the last rate case this position was created by Public Service Commission for Utilities, Inc. of Florida to improve our customer service, our communications and our stakeholder relations. Those are my responsibilities here at the company, and I have -- in the process of this rate case, I have overseen the customer service complaints. I have reviewed them. I have overseen the PSC complaints throughout the -- the last year and a little bit, along with my colleague Jared Deason, and I would be happy to answer any questions here today, specifically a couple of questions that were raised earlier that I would be happy to address the adoption for MyUtilityConnect, and I would be happy to talk about our collaboration with working with our sister company with Water Services Corporation.

Thank you, Mr. Chairman.

CHARIMAN CLARK: Thank you.

Mr. Friedman.

MR. FRIEDMAN: Yes, Mr. Chairman, we would offer Mr. Snow for cross-examination.

CHARIMAN CLARK: All right. Ms. Morse.

EXAMINATION

BY MS. MORSE:

Q Good afternoon, Mr. Snow. This is Stephanie Morse with the Office of Public Counsel.

A Good afternoon.

Q Good afternoon.

On page four of your rebuttal testimony, you address Ms. Crane's recommendation that lobbying costs should not be borne by ratepayers, correct?

A Yes, I see that.

Q Okay. And so also on page four, at line 16, you reference the $45,827.13 paid to the Gunster Law Firm, and you state that they assisted with lobbying activities related to passage of the fair market value legislation, correct?

A Yes, that's correct.

Q So that legislation would have mandated the manner in which acquired water and wastewater systems were to be valued for rate-making purse, right?

A Yes. And I would add that it didn't -- it wouldn't manage date a change. It simply allowed that -- it simply allowed fair market value as an

option.

Q Okay. But isn't it true that under that legislation that was proposed, the Florida Public Service Commission would not have been able to required that the rates be set based on original cost approach?

A It would allow for original costs to be utilized, but it would also allow for the fair market value to be used.

Q Okay. But the question was, it would not have -- the Commission would not have been able to require the original cost approach, correct?

A That's correct. Yes.

Q So -- that proposed fair market value legislation did not pass the Legislature, did it?

A No, it did.

Q Now is the Gunster Law Firm currently assisting the company with any lobbying activities?

A I am sorry, can you repeat that question?

Q Sure, is the Gunster Law Firm currently assisting the lobbying activities?

A Yes.

Q Okay. And what are those?

A Specifically monitoring any legislation related to regulatory changes that would take place as a result of the Legislature, and consideration of fair

market value in the future, though there are no pending bills.

Q Okay. Thank you.

Are you familiar with the agreement between the Gunster firm and UIF?

A I am, yes.

Q Okay. I want to reference that agreement along with -- with the email renewal that was provided in response to OPC's Request for Production No. 77, and that is at CEL No. 172 for reference, that's correct OPC's cross Exhibit No. 11, but it's on the CEL as 172.

A Bear with me, I just want to make sure I have it in front of me.

Q Okay.

A Are you referencing the email or the document itself? Go ahead, I am -- I am prepared to answer either way.

Q Okay. So at CEL 172, so that is -- is the agreement between Gunster and UIF, is that correct?

A Yes.

Q Okay. At this point, this exhibit is the letter agreement dated October 26th, 2017, along with e-mails between you and the Gunster firm, dated October 22nd, 2020; correct?

A That's correct.

Q And the agreement, it's basically a flat rate agreement for $5,000 per month, or $60,000 annually, for, quote, PSC and government -- government affairs consulting, end quote; correct?

A Yes, that's correct.

Q So in addition to the four -- $45,827 related to lobbying the Legislature on the fair market value legislation, what, if any, other services did Gunster provide in the test year for the additional amounts included in the total of $60,000 referenced?

A Gunster provides regulatory services to us. I am new to the rule-making process. My background is legislative and communications, and so in addition to my colleague Jared Deason, they provide regulatory services to us -- limited, I would call them.

Q Okay. Now, back to your testimony on page four, you further testified that the fair market value legislation, quote, "not only benefits UIF, but also the customer," end quote, correct?

A Yes.

Q So do you apportion any part of that 45,827 lobbying costs for the fair market value legislation to the company to pay in addition to the shareholders paying it?

A I am sorry, can you repeat that question one

more time?

Q My question was: Did you apportion any part of that $45,827 in lobbying costs for the fair market value legislation to the company?

A I don't know the answer to your question.

Q Okay.

A Can you be a little more specific?

Q Well, my question is: Do you intend for the customers to pay that entire amount?

A That -- I don't know the answer to your question. I apologize.

Q Okay. I understand. So --

A I mean, you said -- I am sorry, just let me ask one quick question. Did you say should they?

Q No. I was asking did -- did the company apportion any part of it to the company, or did you intend for the customers to pay all of it?

A I don't know the answer to your question, as I said.

Q Okay. Well, that's fine.

And finally, isn't it true that the Commission's practice for a number of years, if not decades, has been disallow costs for lobbying activities?

A I am familiar with that practice, yes.

Q Okay. Thank you.

MS. MORSE: I have no further questions for this witness, Mr. Chairman.

CHARIMAN CLARK: Thank you very much.

Staff?

MR. TRIERWEILER: Staff has no questions for this witness. Thank you.

CHAIRMAN CLARK: Commissioners? No Commissioner questions -- Commissioner Fay.

COMMISSIONER FAY: Thank you. Thank you, Mr. Chairman, I didn't want to cheat witness Snow out of his comments about the my connect utility since I had asked his -- his colleague about it.

My question was just trying to hit on, you know, the expertise that the testimony stated basically that there was a 50-percent acceptance rate in the first year, and I think these sort of things are very good for the customers, and of course, we take into account the customer experience and service based on the customer hearings that we've had, and so I was trying to get an idea if that's been beneficial, if you expect it to grow, and overall, if that 50 percent was a good acceptance rate? It sounds like it wasn't really compared to other utilities, but maybe you could

give me a sort of a quick answer on that.

THE WITNESS: So the company that we worked with to designed that -- that app and that portal is called Smart Energy Water. Their benchmarks had the first few years at between 30 and 35 percent. We are up around -- just to give you an accurate number, I just looked at the data a little while ago, we are at 43 percent.

The number that Mr. Flynn pointed out was old data that we had that did not remove people -- customers who are no longer in our service territory anymore. So the most accurate data I have is at 43 percent, which is still excellent for a two-year number.

We have seen significant engagement in MyUtilityConnect that we are pleased with. It has also been a great tool during COVID to be able to point customers to be able to give them an easy way to sign up for payment arrangements and things like that when they are having hard times with their, you know, different financial situations.

COMMISSIONER FAY: Yeah, great. Thank you. I appreciate that.

I know the last rate case was a very different situation, but we have seen improvement with the

customer service communication on our end, so thank you for that answer.

Mr. Chairman, that's all I had.

CHAIRMAN CLARK: Thank you, Commissioner Fay.

Any other Commissioners have a question?

All right. Redirect?

MR. FRIEDMAN: None. Thank you.

CHARIMAN CLARK: All right. That concludes that witness.

Would you like to excuse your witness, Mr. Friedman?

MR. FRIEDMAN: Yes. Yes, I would like to ask that he be excused.

CHAIRMAN CLARK: All right. The witness is excused.

(Witness excused.)

CHAIRMAN CLARK: All right. We are pushing up on the five o'clock our hour. I am going to ask that dreaded question, Ms. Morse. I am going to puts you on the spot.

We have four witnesses left. Can you ballpark how long you are thinking would take to go through all four of them?

MS. MORSE: Let me see.

MR. REHWINKEL: Mr. Chairman?

CHAIRMAN CLARK: Yes, Mr. Rehwinkel.

MR. REHWINKEL: I probably am the longest pole in that tent, and I -- I can say that I have extensive cross-examination on rebuttal for Mr. Deason.

CHARIMAN CLARK: Okay.

MR. REHWINKEL: So it's -- I think it will take a good portion of the morning.

CHAIRMAN CLARK: Okay. No -- no problem at all. I wanted to make sure we couldn't knock at least that one out this afternoon. If that one is going to be a long one, we will start fresh tomorrow morning. I think that is certainly the best way to handle it. I appreciate -- I appreciate that.

I think -- does anyone see any reason -- just to help everybody do a little scheduling, anybody see any reason we should not finish this tomorrow? Nobody sees any reason, okay. Good. I am going to take your word for it. So those of you that have your schedule blocked out on Thursday can feel free to start filling that back up with something else.

All right. Is there anything before we conclude this afternoon?

MR. REHWINKEL: Yeah.

CHAIRMAN CLARK: Mr. Rehwinkel.

MR. REHWINKEL: Mr. Chairman --

CHARIMAN CLARK: Yes, sir.

MR. REHWINKEL: -- just some administrative stuff, if I could.

CHAIRMAN CLARK: Yes, sir.

MR. REHWINKEL: What I am going to do -- you know, and I want to tell you I appreciate the prehearing officer and your staff working with the Public Counsel on the ground rules around the cross-examination exhibits, and I want to commend opposing counsel for the -- for the way they have been good to work with and honored the commitments.

What I am going to do, since I am going go working with a lot of exhibits tomorrow, I am going to email out -- if I don't get it tonight, it will be early in the morning -- a list of the exhibits that I am going go ask the company to preposition, or that they -- they can know that I am going to ask about, as well as the Commissioners and others, so we -- we maybe can get into a rhythm and go through them quickly. And so I will do that for a good number of the exhibits that I am going to be working with.

And I also would like to ask, we've had some

discussion about the GRIP order this morning, Commissioner questions. Mr. Deason quotes from it in his testimony. I have some cross-examination about that order that I don't really need to have the order in front of me, but if others would like it, I can email that order out to staff and opposing counsel, and people can have did if they want it. We don't actually have to put the orders in as exhibits, but if it helps the flow and people following, it will be available. I am not trying to reintroduce new evidence, but just to try to facilitate the flow tomorrow.

CHAIRMAN CLARK: Understood. I think that's common practice for us in regards to previous orders that have been issued, so, yeah, if you guys would like a copy of that, Mr. Rehwinkel will get one to you.

I appreciate that cooperation, and I appreciate any help we can get in -- in figuring out a better way to handle our exhibits. I kind of challenged staff during our break to let's work on the process. I realize that we are trying to get stuff in late -- or we are getting stuff in late, and it's just not enough time to renumber so that everybody is on the same page, but you have my

commitment we are going to do a better job going forward of trying to organize these exhibits. We've done really, really good so far. This is kind of our first little hiccup, and I think we probably have more exhibits here than we've had in other hearings, but you do have our commitment that we are going to work on -- on streamlining that process a little bit better.

Thank you, Mr. Rehwinkel.

Mr. Friedman, are you good with Mr. Rehwinkel's proposal?

MR. FRIEDMAN: Yeah, that's fine. That's fine. My only question was asking what time are we starting in the morning?

CHAIRMAN CLARK: I believe we are scheduled for 9:00 a.m. 9:00 a.m. Eastern time. That's tough on us Central time guys.

MR. FRIEDMAN: Thank you, Mr. Chairman.

CHAIRMAN CLARK: Anybody else have any comments before we break for the day?

All right seeing none, thank you so much for your hard work today. See you at nine o'clock in the morning.

We are adjourned.

(Transcript continues in sequence in Volume

4.)

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, DEBRA KRICK, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 16th day of February, 2021.

DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #HH31926
EXPIRES AUGUST 13, 2024