

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

**ORIGINAL
FILE COPY**

**REBUTTAL TESTIMONY OF AREND J. SANDBULTE
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
ON BEHALF OF
SOUTHERN STATES UTILITIES, INC.
DOCKET NO. 920199-WS**

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Arend J. Sandbulte and my business
3 address is Minnesota Power & Light Company, 30 West
4 Superior Street, Duluth, Minnesota 55802.

5 Q. ARE YOU THE SAME AREND J. SANDBULTE WHO PREVIOUSLY
6 SUBMITTED PREFILED DIRECT TESTIMONY IN THIS
7 PROCEEDING?

8 A. Yes.

9 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN
10 THIS PROCEEDING?

11 A. I will address the proposal by Office of Public
12 Counsel ("OPC") witness Ms. Kimberly H. Dismukes,
13 that the gains realized from the condemnation and
14 sale of the St. Augustine Shores water system and
15 certain University Shores wastewater facilities be
16 applied to reduce Southern States Utilities, Inc.'s
17 ("Southern States" or "SSU") revenue requirements.
18 In other words, the OPC seeks to have these gains
19 given to ratepayers rather than retained by Southern
20 States and its shareholders. I will explain why
21 Southern States should be permitted to retain the
22 gains from these sales.

23 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

24 A. Ms. Dismukes' proposal should be rejected by the
25 Commission for the following reasons:

1 St. Augustine Shores Water System

2 (1) SSU's remaining ratepayers contributed nothing
3 to Southern States' recovery of its investment in
4 the St. Augustine Shores water system and they bore
5 none of the risk of any loss.

6 (2) The condemnation of the St. Augustine Shores
7 system involved not only the sale of Southern
8 States' assets but also the loss of customers to
9 whom service had been previously dedicated and
10 provided through those assets.

11 (3) At the time of condemnation, the St. Augustine
12 Shores' system was regulated by St. Johns County and
13 was not under Florida Public Service Commission
14 jurisdiction.

15 (4) The St. Augustine Shores water system always has
16 been treated on a stand alone basis for ratemaking
17 purposes.

18 University Shores Wastewater Facilities

19 (5) The condemned University Shores wastewater
20 facilities were placed in service in March 1986.
21 The Commission has not established a new rate base
22 for the University Shores wastewater system since
23 1982 (based on a June 30, 1979 rate base).
24 Therefore, neither the customers served by the
25 University Shores system nor Southern States'

1 remaining customers contributed to Southern States'
2 recovery of its investment in the condemned
3 wastewater facilities.

4 (6) Neither the customers currently served by the
5 University Shores wastewater system nor SSU's
6 remaining customers bore any risk of loss of the
7 Company's investment in the condemned facilities.
8 St. Augustine Water System and University Shores
9 Wastewater Facilities

10 (7) A Commission determination that a utility's
11 revenue requirements must be reduced by the gain on
12 the sale of a system (or a portion thereof) would
13 require the Commission to increase the utility's
14 revenue requirements in the event of a loss on the
15 sale of a system (or a portion thereof) regardless
16 of the absence of any relationship between the
17 remaining customers and the system (or portion
18 thereof) sold.

19 (8) To deny utility investors the opportunity to
20 offset the erosion of their investment through the
21 receipt of capital gains would be a deterrent to the
22 reinvestment of retained earnings by the utility and
23 to the attraction of new capital from investors.

24 (9) The proceeds from the condemnations were
25 retained by Southern States as equity and deployed

1 for utility purposes -- no portion of the proceeds
2 were distributed as dividends to shareholders.

3 (10) The Commission's policy concerning gains and
4 losses on the disposition of utility systems should
5 be consistent with the Commission's recently
6 confirmed acquisition adjustment policy -- that is,
7 absent extraordinary circumstances, when a utility
8 purchases a system rates are not adjusted for any
9 discount under or premium over book value. See
10 Order No. 25729 issued February 17, 1992 in Docket
11 No. 891309-WS. Likewise, on the sale of a system,
12 customer rates should not be adjusted to reflect
13 gains or losses absent extraordinary circumstances.

14 **Q. COULD YOU ELABORATE FURTHER ON THE REASONS WHY MS.**
15 **DISMUKES' PROPOSAL SHOULD BE REJECTED?**

16 **A. Ratepayers pay for the use of utility property**
17 **employed in providing service. They do not acquire**
18 **a proprietary interest in that property. Similarly,**
19 **ratepayers have no proprietary interest in non-**
20 **utility and non-regulated property, and hence, are**
21 **not entitled to share in the gain and are not**
22 **required to bear the impact of any loss arising out**
23 **of the disposition of such property. Ownership of**
24 **both utility and non-utility property is**
25 **indistinguishable in this regard -- ownership**

1 continues to reside in the shareholders who,
2 accordingly, must bear the risk of loss.

3 I understand that it has been argued before the
4 Commission in the past that customers acquire an
5 equitable interest in depreciable assets since
6 depreciation expense is factored into rates, and
7 hence, customers should realize the benefits of a
8 portion of a gain realized on the sale of such
9 assets. This argument has no application to the
10 facts in this proceeding. It would be inequitable
11 and unreasonable to flow through the gain from the
12 condemnation of the St. Augustine Shores system to
13 the remaining SSU customers since they never have
14 been assessed any of the capital or depreciation
15 costs associated with the system nor have they been
16 subject to any risk for potential losses associated
17 with the system. The same rationale applies to the
18 condemnation of the University Shores facilities.
19 I am not aware of any instance in which ratepayers
20 were found to be entitled to share in the gain on
21 the sale of property absent them either having
22 contributed to the utility's recovery of its
23 investment or having borne the risk of loss.
24 Neither of these circumstances exists here. Rates
25 for utility service from the St. Augustine Shores

1 system historically were set on a stand-alone basis
2 in accordance with separate accounting data, rate
3 base, depreciation, expenses, etc. Therefore, other
4 SSU customers have been unaffected by the existence
5 of this system in the past and should remain so.

6 I also must note that if the St. Augustine
7 Shores system had been sold at a loss, I am unaware
8 of any legal or equitable principle or precedent
9 that would authorize the Commission to require
10 Southern States' remaining customers to reimburse
11 the Company for its investment in assets used at St.
12 Augustine Shores which were never used to supply
13 other SSU customers with utility service. However,
14 if Ms. Dismukes' proposal were adopted, it does not
15 appear that the Commission would have any
16 alternative but to do so in the future.

17 In addition, the regulated ratepayers of the
18 remaining SSU systems should not be affected by a
19 gain or loss on the sale of a non-jurisdictional
20 entity. Under these circumstances, using the gain
21 generated by the condemnation of the non-
22 jurisdictional St. Augustine Shores system to reduce
23 rate relief to which the Company is otherwise
24 entitled for its jurisdictional systems would
25 deprive the Company and its shareholders of "just

1 compensation."

2 Also, under the Commission's recently
3 reaffirmed acquisition adjustment policy, absent
4 extraordinary circumstances, when a utility
5 purchases an additional system, customer rates are
6 not adjusted for any discount under or premium over
7 book value. Likewise, the Commission's policy on
8 the sale of a system should be to ignore any gain
9 or loss absent extraordinary circumstances. No such
10 circumstances have been identified in this
11 proceeding.

12 **Q. DID SOUTHERN STATES SEEK BUYERS FOR THE ST.**
13 **AUGUSTINE SHORES WATER SYSTEM?**

14 **A.** No. The sale of this system was the result of a
15 condemnation proceeding.

16 **Q. WHY IS IT RELEVANT THAT THIS SALE INVOLVED A**
17 **GOVERNMENTAL CONDEMNATION OF AN ENTIRE WATER UTILITY**
18 **SYSTEM?**

19 **A.** This fact is important for several reasons. SSU not
20 only sold all plant assets which comprise the St.
21 Augustine Shores water system, but also lost
22 customers and part of its business as a result of
23 the condemnation. In this situation, SSU was not
24 just selling excess capacity but rather was required
25 to liquidate part of its on-going enterprise. These

1 types of condemnations have hidden costs. For
2 instance, opportunities to stabilize SSU's business
3 and achieve long-term investment returns are lost
4 as a result of these forced sales.

5 Q. DOES THE FACT THAT THIS SALE INVOLVED A CONDEMNATION
6 PROVIDE FURTHER SUPPORT FOR YOUR POSITION THAT THE
7 GAIN SHOULD BE RETAINED BY THE COMPANY AND ITS
8 SHAREHOLDERS?

9 A. Yes. Condemnations are essentially a partial
10 liquidation of the utility's business. In the case
11 of a total liquidation of a utility system, it is
12 clear that any gains or losses should go to the
13 owners of the utility, in other words, the
14 shareholders. Ms. Dismukes fails to address how the
15 St. Augustine Shores condemnation differs from a
16 condemnation of a single utility system which
17 happens to be the only system owned by a particular
18 entity. In such circumstances, no reasonable
19 argument can be made that the owner of the condemned
20 system can be ordered to return all gains to the
21 former customers served by the system. Similarly,
22 the Commission cannot authorize the former owner to
23 look to former customers for compensation of losses
24 the owner may have incurred as a result of the
25 condemnation.

- 1 **Q. WHAT IS AN APPROPRIATE STANDARD FOR ALLOCATING GAINS**
2 **OR LOSSES OF ENTIRE SYSTEMS ARISING OUT OF**
3 **CONDEMNATION PROCEEDINGS?**
- 4 **A. In our view, gains or losses from the sale of an**
5 **entire system should be allocated entirely to the**
6 **shareholders of the utility in all condemnation**
7 **situations. Where a sale of a system is voluntary**
8 **or sought by the utility, the Company and its**
9 **shareholders should still retain the gain absent**
10 **extraordinary circumstances such as a material**
11 **adverse impact on remaining customers who somehow**
12 **have contributed capital to the utility which**
13 **relates to the condemned assets.**
- 14 **Q. HAS THE "EXTRAORDINARY CIRCUMSTANCES" STANDARD BEEN**
15 **USED IN OTHER STATES?**
- 16 **A. Yes. In 1988, the California Public Utilities**
17 **Commission ("C.P.U.C.") instituted a rulemaking on**
18 **this exact issue in Docket No. R88-11-041. The**
19 **C.P.U.C. adopted rules requiring that, where a**
20 **utility system is sold to a governmental entity, the**
21 **capital gain or loss shall accrue to the utility and**
22 **its shareholders to the extent that (1) remaining**
23 **ratepayers on the selling utility's system are not**
24 **adversely affected, and (2) remaining ratepayers**
25 **have not contributed capital to the utility system.**

1 Q. HAVE SSU'S RATEPAYERS BEEN ADVERSELY AFFECTED BY THE
2 CONDEMNATION OF THE ST. AUGUSTINE SHORES WATER
3 SYSTEM AND UNIVERSITY SHORES WASTEWATER FACILITIES?
4 A. No. OPC witness Dismukes argues that Southern
5 States' remaining customers are absorbing the common
6 costs that would have been allocated to the St.
7 Augustine Shores system but for the condemnation and
8 that this reallocation of common costs alone
9 justifies her proposal. I do not believe that this
10 argument is persuasive, particularly since the
11 customer base sharing in the allocation of Southern
12 States' common costs actually grew in 1991 (despite
13 the condemnation of the St. Augustine Shores system)
14 as a result of the purchase of Lehigh Utilities,
15 Inc. Moreover, Ms. Dismukes' strained allocation
16 argument does not apply to the condemnation of the
17 University Shores wastewater facilities since no
18 customers were lost from this sale. Therefore, Ms.
19 Dismukes has provided no justification whatsoever
20 for her proposal regarding the University Shores
21 condemnation.
22 Q. DID MS. DISMUKES IDENTIFY THE ALLEGED COSTS TO SSU'S
23 REMAINING RATEPAYERS RESULTING FROM THE ADDITIONAL
24 COMMON COSTS WHICH SHE BELIEVES ARE NOW ALLOCATED
25 TO THEM?

1 A. No, she did not. In addition, the most compelling
2 evidence against approval of Ms. Dismukes' theory
3 is that it is not logical. Under Ms. Dismukes'
4 theory, the Company only would be permitted to
5 retain a portion of the condemnation gain equal to
6 the common costs which would have been allocated to
7 St. Augustine Shores' customers. If the only
8 adverse impact on SSU's remaining customers is the
9 allocation to them of the portion of the common
10 costs that would have been allocated to St.
11 Augustine Shores' customers, then SSU's remaining
12 customers can be made whole by requiring Southern
13 States to absorb this portion of the common costs.
14 Ms. Dismukes' rationale supports no further
15 adjustment than that. However, as I indicated
16 previously, the suggestion that SSU's remaining
17 customers are entitled to benefit from the
18 condemnation gain based solely on the condemnation's
19 impact on common cost allocations is without merit.

20 **Q. ARE THERE ANY ADDITIONAL REASONS WHY SOUTHERN**
21 **STATES' SHAREHOLDERS SHOULD RETAIN THE GAIN ON THE**
22 **CONDEMNATION OF THE ST. AUGUSTINE SHORES WATER**
23 **SYSTEM AND UNIVERSITY SHORES WASTEWATER FACILITIES?**

24 A. Yes. If the Commission denies shareholders the
25 opportunity to offset the erosion of their

1 investment through the receipt of capital gains, it
2 would deter the reinvestment of retained earnings
3 by utilities and inhibit the attraction of new
4 capital from investors. The deterrent effect of
5 such a denial would be magnified significantly were
6 Southern States required to return the capital gains
7 to ratepayers in this proceeding. I say this
8 because the remaining customers of SSU whom Ms.
9 Dismukes would have share in the condemnation gains
10 have neither contributed to Southern States'
11 recovery of its investments in the condemned St.
12 Augustine Shores or University Shores assets nor
13 borne any risk of loss of such investments.
14 Southern States operated the St. Augustine Shores
15 water system under the jurisdiction of St. Johns
16 County, not the Florida Public Service Commission.
17 Water rates for the system, without exception, were
18 determined on a stand alone basis. Therefore, none
19 of SSU's remaining customers contributed to the
20 Company's recovery of its investments in the system
21 or the depreciation of plant assets. The condemned
22 University Shores wastewater facilities were not
23 placed into service until March of 1986. As
24 indicated in the Company's MFRs, the rate base for
25 the wastewater system was last established based on

1 the twelve months ended June 30, 1979. Therefore,
2 University Shores' current wastewater customers have
3 never contributed one dime to the recovery of
4 Southern States' investment in the condemned
5 wastewater facilities. Ms. Dismukes refers to
6 Southern States' response to Public Counsel's
7 Interrogatory No. 113 to support her proposal to
8 deny the Company the gain on the condemnation of the
9 University Shores wastewater facilities.
10 Specifically, Ms. Dismukes states as follows: "In
11 response to OPC's Interrogatory 113, the Company
12 stated that [the University Shores] property was
13 previously included in rate base as 100% used and
14 useful" (emphasis added). A review of the Company's
15 response confirms that Ms. Dismukes'
16 characterization of its contents is not accurate.
17 The Company's response states, in pertinent part,
18 as follows:

19 Appendix 113-B-R reflects the sale of the
20 Skyline Hills plant to the City of Lady Lakes
21 in October 1986 and the condemnation of
22 property in Orange County at the University
23 Shores plant. This particular transaction
24 occurred in two different years, 1987 and 1991.
25 Both of these transactions were involving plant

1 which was 100% used and useful and the
2 resulting gain was booked below the line for
3 ratemaking purposes.

4 The Company never indicated that the condemned
5 University Shores facilities were ever included in
6 rate base and, as I have explained and the Company's
7 MFRs confirm, they never were.

8 **Q. WERE THE GAINS ON THE ST. AUGUSTINE SHORES AND**
9 **UNIVERSITY SHORES CONDEMNATIONS RETAINED BY SSU?**

10 **A. Yes. All net proceeds derived from these**
11 condemnations have been retained in SSU and applied
12 to support capital needs in the remaining Florida
13 water and wastewater systems. SSU's shareholders
14 did not receive any of the sale proceeds as
15 dividends.

16 **Q. ARE YOU AWARE OF ANY DECISIONS BY THE REGULATORY**
17 **AUTHORITIES OR COURTS OF OTHER STATES WHICH SUPPORT**
18 **THE VIEWS THAT YOU HAVE ESPOUSED?**

19 **A. Yes, I am. In fact, numerous commissions and courts**
20 have reached the same conclusion that I have with
21 respect to the distribution of the proceeds from the
22 sale of utility assets. Most noteworthy among these
23 decisions are the following:

24 * In Maine Water Company v. Public Utilities
25 Commission, 482 A2d. 443 (Me. 1984), the court

1 reversed the Maine commission and held that the
2 gain on the sale of two utility divisions to
3 a municipal district should be retained by the
4 utility and not used to reduce rates to
5 customers in the remaining divisions. This
6 case involved the transfer of both depreciable
7 and non-depreciable assets.

8 * The Missouri Public Service Commission held in
9 Associated Natural Gas Company, 55 PUR 4th 702
10 (Mo. P.S.C. 1983), that where the utility
11 proposed to apply the proceeds of the
12 condemnation of a gas distribution system to
13 the retirement of bonds and to invest in new
14 plant, resulting in a reduction in interest
15 expense and increased debt coverage, the gain
16 need not be allocated to ratepayers.

17 • The New Hampshire Supreme Court held in Appeal
18 of the City of Nashua, 435 A.2d 1126 (N.H.
19 1981), that the New Hampshire commission
20 correctly determined that a water utility
21 should be allowed to retain the gain on the
22 sale of land no longer needed to provide
23 utility service.

24 * In Philadelphia Suburban Water Company v.
25 Pennsylvania Public Utility Commission, 427

1 A.2d 1244 (Pa. Commw. Ct. 1981), the court
2 reversed the Pennsylvania commission's decision
3 reducing rates of a utility by the current
4 market value of land upon the dividend of the
5 land to its parent company. The land had been
6 in service over fifty years and had appreciated
7 more than tenfold. The court found the
8 commission's action constituted confiscation
9 without due process and just compensation. The
10 court relied on the concepts that the investors
11 had not recovered any of their investment
12 through depreciation, that they had earned a
13 return through rates only on the original cost
14 of the land for fifty years and that the
15 utility customers paid only for the use of the
16 land and do not gain equitable or legal rights
17 to the property through the use of it.

18 * The District of Columbia Court of Appeals held
19 in Washington Public Interest Organization v.
20 Public Service Commission, 446 A.2d 28 (D.C.
21 1978) that the commission correctly allowed the
22 gain on the sale of land by two utilities to
23 be retained by the utilities' stockholders
24 rather than using the gain to reduce rates.
25 The court relied on the finding of the

1 commission that depriving the utilities of the
2 gain on the sale, both in terms of the effect
3 on expected earnings and on the investor
4 assessment of the regulatory climate, would
5 increase the cost of capital to the utilities
6 to the ultimate detriment of ratepayers.

7 **Q. ARE YOU AWARE OF ANY OTHER REGULATORY ACTIONS WITH**
8 **RESPECT TO THIS ISSUE?**

9 **A. Yes, as I described earlier, the C.P.U.C. has**
10 **adopted rules whereby gains and losses on sales of**
11 **utility systems to governmental entities are to be**
12 **retained by the shareholders. This action in**
13 **California pertains to the same type of transactions**
14 **(i.e., condemnations) as those I discussed in this**
15 **testimony.**

16 **Q. OPC WITNESS DISMUKES HAS CITED FLORIDA CASES IN**
17 **WHICH GAINS HAVE BEEN SHARED WITH RATEPAYERS.**
18 **SHOULD THESE CASES CONTROL HERE?**

19 **A. No, they should not for the reasons I have described**
20 **above. Moreover, to my knowledge, none of the**
21 **precedents cited involved either the sale of an**
22 **entire system (together with customers served**
23 **thereby) or utility plant which never had been**
24 **included in rate base or otherwise recovered by the**
25 **utility in rates in any way.**

1 Q. DO YOU AGREE WITH MS. DISMUKES' ALTERNATIVE PROPOSAL
2 THAT DOLLARS ASSOCIATED WITH THE GAINS BE REMOVED
3 FROM SSU'S CAPITAL STRUCTURE, THUS REDUCING THE
4 COMPANY'S OVERALL EQUITY RATIO?
5 A. No, I do not agree with this alternate proposal.
6 The proceeds derived from the condemnations have
7 been retained by Southern States as equity and
8 deployed for utility purposes. This capital
9 rightfully belongs to SSU and its shareholders, and
10 SSU should not be penalized for devoting this
11 capital to its other utility systems. Finally, Ms.
12 Dismukes identifies no justification for this
13 alternative proposal other than that set forth as
14 alleged support for her primary proposal. Thus, Ms.
15 Dismukes' alternative proposal is without merit for
16 the same reasons I previously identified concerning
17 her primary proposal. Moreover, Ms. Dismukes'
18 resort to such an alternative is a transparent
19 attempt to reduce the Company's revenue requirements
20 in any way possible, regardless of the absence of
21 justification for such action. Only when the equity
22 ratio is too high should the Florida Commission act
23 to disallow a return on the portion that is
24 excessive; clearly not an issue in this proceeding.
25 In fact, SSU is having serious difficulty funding

1 its capital program with current low levels of
2 earnings. Disallowing a return on a portion of SSU
3 equity is counter-productive to what is needed to
4 restore and sustain SSU's financial capacity.

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

6 **A. Yes.**

7
8
9
10
11
12