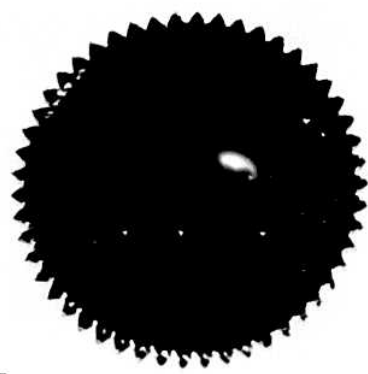


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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Joint Petition for) DOCKET NO. 920949-EU
approval of Certain Matters)
in connection with the sale of)
assets by Sebring Utilities)
Commission to Florida Power)
Corporation.)



VOLUME II
Page 120 - 254

RE: Hearing
BEFORE: CHAIRMAN THOMAS M. BEARD
COMMISSIONER BETTY EASLEY
DATE: Monday, December 7, 1992
TIME: Commenced at 9:30 a.m.
Concluded at 5:00 a.m.
PLACE: 101 East Gaines Street
Tallahassee, Florida
REPORTED BY: JANE FAUROT
Notary Public in and for the
State of Florida at Large

ACCURATE STENOGRAPHY REPORTERS, INC.
100 SALEM COURT
TALLAHASSEE, FLORIDA 32301
(904) 878-2221

DOCUMENT NUMBER-DATE

14255 DEC-8 1992

FPSC-RECORDS/REPORTING

APPEARANCES:

JAMES P. FAMA, Esquire, Post Office Box 14042, St. Petersburg, Florida 33733, on behalf of Florida Power Corporation.

D. BRUCE MAY, Esquire and LARRY P. STEVENSON, Esquire, Holland & Knight, Post Office Drawer 810, Tallahassee, Florida 32302 and ANDREW B. JACKSON, P.O. Box 2025, Sebring, Florida 33871, on behalf of Sebring Utilities Commission.

JAMES FLYNN, 2503 Par Road, Post Office Box 1623, Sebring, Florida 33871, on behalf of Citizens for Utility Rate Equity.

JEREMY P. ROSS, Esquire, 220 South Franklin Street, Tampa, Florida 33602 and HAROLD E. SEAMAN, Chairman, 810 North Ridgewood Drive, Sebring, Florida 33870, on behalf of the Action Group.

ROBERT G. POLLARD, Chairman, 810 North Ridgewood Drive, Sebring, Florida 33870, on behalf of Concerned Citizens of Sebring.

JAMES D. BEASLEY, Esquire, Ausley, McMullen, McGehee, Carothers and Proctor, Post Office Box 391, Tallahassee, Florida 32302, on behalf of Tampa Electric Company.

NATHANIEL DOLINER, Esquire, Post Office Box 3239, Tampa, Florida 33601, on behalf of Florida Power Corporation.

MARTHA CARTER BROWN, Esquire, 101 East Gaines Street, Tallahassee, Florida 32399, on behalf of the Commission Staff.

WILLIAM WYROUGH, Esquire, 101 East Gaines Street, Tallahassee, Florida 32399, on behalf of the Commissioners.

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P R O C E E D I N G S

1 MR. MAY: Sebring would call Nancy Holloway as our
2 next witness.

3 Thereupon,

4 NANCY L. HOLLOWAY

5 was called as a witness, and having been previously sworn,
6 was examined and testified as follows:

DIRECT EXAMINATION

8 BY MR. MAY:

9 Q Ms. Holloway, have you previously been sworn?

10 A Yes, I have.

11 Q Please state your name and address for the record?

12 A My name is Nancy L. Holloway, my business address
13 is 321 Mango Street, Sebring, Florida.

14 Q And by whom are you employed and in what capacity?

15 A I'm employed by Sebring Utilities Commission as
16 their Director of Finance and Chief Financial Officer.

17 Q Ms. Holloway, have you had occasion to prefile
18 direct testimony in this proceeding titled direct testimony
19 of Nancy Holloway dated September 25, 1992?

20 A Yes, I have.

21 Q Do you have any corrections to make to that
22 testimony this morning?

23 A Yes, I do.

24 Q Please cite those corrections for the record?

25 A On Page 4, Line 14, the word revenue needs to be

1 changed to reserve.

2 Q Do you have others?

3 A Yes, I do. On Page 3, Lines 24 and 25, if you
4 will insert a period after the word default, and strike the
5 remainder of Line 24 and Line 25, and insert the bond
6 trustee has declared an event of default.

7 Q Could you very briefly describe to the Commission
8 the reason for that correction on Page 3 of your testimony?

9 A Yes. As I noted in my deposition, we had at that
10 point received a letter from our trustee notifying us that
11 if we did not remedy default or covenant under the bond
12 resolution that an event of default would be declared.
13 There is a 30-day notice period that is allowed within the
14 bond resolution before event of default is determined. The
15 notice was dated October 16th, so November 16th we became --
16 we were in an event of default at that point.

17 Q Thank you, Ms. Holloway. With those corrections
18 noted, if you were asked the questions that appear in your
19 prefiled testimony today would your answers be the same?

20 A Yes, they would.

21 MR. MAY: Mr. Chairman, I would ask that Ms.
22 Holloway's testimony be inserted into the record as
23 though read.

24 CHAIRMAN BEARD: It will be so inserted.

25

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Nancy L. Holloway and my business address is 321 Mango Street, Sebring,
3 Florida 33870.

4 Q. BY WHOM ARE YOU EMPLOYED AND WHAT POSITION DO YOU HOLD?

5 A. I am employed by the Sebring Utilities Commission ("Sebring") as the Director of
6 Finance and Chief Financial Officer.

7 Q. PLEASE DESCRIBE YOUR EDUCATION, BACKGROUND AND BUSINESS
8 EXPERIENCE.

9 A. In March, 1970, I received a Bachelor of Arts in Accounting from the University of
10 South Florida. I have over twenty-one years of experience in public utility accounting
11 and financial management. From 1970 to 1975, I was employed by the City of Bartow,
12 Florida. For approximately two years, I served as Chief Accountant, handling all
13 accounting transactions, and for the remainder of the period, I served as Director of
14 Finance, handling all financial affairs of the City.

15 From 1975 through 1989, I was employed by the City of Gainesville, Florida Regional
16 Utilities. For the first three years, I served as Controller, handling all utility accounting,
17 budgeting and debt management functions, as well as directing all financial systems
18 development. My initial responsibility was to implement the FERC Uniform System of
19 Accounts for the utility. In order to fulfill the total requirements of the FERC Uniform
20 System of Accounts, a valuation study was performed to establish the true net book value
21 of the utility's assets. In that regard, I was responsible for recording the required
22 adjustments to the utility's books and the development of the continuing property records
23 system.

24 Beginning in 1978, I served as the Utility Finance Director. In that capacity, I
25 functioned as the Chief Financial Officer directing all finance and accounting functions.

1 The utility had an annual operating budget of \$136 million and a five year capital budget
2 of \$143 million. It had total assets of \$584 million with total long-term debt outstanding
3 of \$436 million. During this period, I obtained considerable knowledge of tax-exempt
4 bond financings. I was an integral member of the management team that attained the
5 rating improvement by Moody's Investors Service to "AA" while achieving the lowest
6 residential electric rates during the same period.

7 From 1990 to 1991, I was employed by Av-Med Health Plan, the second largest Health
8 Maintenance Organization as its Accounting Manager, directing all aspects of its
9 accounting department.

10 I have been employed as the Director of Finance by the Sebring Utilities Commission
11 (Sebring) since March, 1991. I joined Sebring with the goal of providing rate relief for
12 the ratepayers of Sebring through either a refinancing plan or the sale of its remaining
13 assets. I have directed the process of evaluating proposals and negotiating the contracts
14 for purchase and sale of the electric and water systems to Florida Power Corporation and
15 the City of Sebring, respectively.

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

17 A. I am testifying of behalf of Sebring in this proceeding. My testimony addresses three
18 basic areas: the need for expedited review and approval of the proposed sale of Sebring's
19 utility system to FPC; the background behind the valuation study performed by RMI; and
20 the depreciated net book value of the tangible assets that Sebring proposes to sell to FPC
21 (the "Rate Base Assets").

22 **Q. HAVE YOU PREPARED OR ARE YOU SPONSORING ANY EXHIBITS IN THIS**
23 **PROCEEDING?**

24 A. Yes, I am sponsoring the following portions of Exhibit 1:

25 Pages 207 to 231

Sebring Utilities Commission financial statements -

1		September 30, 1991 (Exhibit E of Joint Petition).
2	Pages 242 to 253	Form of defeasance escrow deposit agreement (Schedule
3		2.1-B of Agreement).
4	Pages 258	Accounts receivable as of September 30, 1991 (Schedule
5		3.8 of Agreement).
6	Pages 574 to 577	Debt service schedule - Series 1986A and B Bonds
7		(Schedule 3.15(a) of Agreement).
8	Page 578	Bond resolutions and agreements (Schedule 3.15(b) of
9		Agreement).
10	Pages 579 to 580	All funds and accounts created under the bond resolution
11		(Schedule 3.15(c) of Agreement).
12	Page 581	Electric customer deposits (Schedule 3.17 of
13		Agreement).

14 **Q. PLEASE EXPLAIN THE NEED FOR EXPEDITED REVIEW AND APPROVAL**
 15 **OF THE PROPOSED SALE OF SEBRING'S UTILITY SYSTEM TO FPC.**

16 A. In order to meet covenants set forth in Sebring's bond documents, Sebring will be
 17 required to substantially increase its rates effective October, 1992. In lieu of such rate
 18 increase and in anticipation of expedited closing of the sale to FPC, Sebring has adopted
 19 a 1993 budget which draws down on its reserve fund to service a significant part of its
 20 debt. Because Sebring is not generating sufficient revenue from its rates to make
 21 principal and interest payments on its outstanding bond obligations, the utility will be
 22 in technical default of its bond covenants. Expedited consideration and approval of the
 23 Joint Petition will accelerate closing of the sale of Sebring assets. This will minimize the
 24 period in which Sebring is in technical default, and substantially lessen the likelihood that
 25 ~~the Bond Trustee will actually declare an Event of Default. The Bond Trustee~~
 has declared a Bond of Default.

1 Q. **WHAT ARE THE CONSEQUENCES IF AN EVENT OF A DEFAULT IS**
2 **DECLARED?**

3 A. Bond holders and the bond insurance company would be entitled to request an immediate
4 acceleration of all outstanding bonds; and, furthermore, could exercise their rights and
5 remedies as creditors under Florida law. This likely would precipitate a flurry of law
6 suits demanding that a receiver be appointed for Sebring and that rates be increased well
7 above current levels to secure the default. Such actions would interfere with Sebring's
8 trade relationships with suppliers and further interrupt the ongoing operations of the
9 utility. Ultimately, Sebring could be forced to file for bankruptcy under Chapter IX.

10 Q. **ARE THERE OTHER REASONS FOR THE COMMISSION TO EXPEDITE**
11 **CONSIDERATION OF THIS MATTER?**

12 A. Yes. Sebring currently is accruing additional financial liability of approximately \$14,000
13 per day in order to resupply its reserve fund, as well as approximately \$3,000 per day
14 to increase its ^{reserve} ~~revenue~~ fund to newly required levels. Expedited consideration and
15 approval of the relief requested in the Joint Petition will further limit the accrual of
16 substantial additional financial liability by Sebring.

17 Expedited consideration and approval of the Joint Petition will insure that FPC is able to
18 take advantage of favorable interest rates in issuing the medium term notes contemplated
19 in the transaction. The benefits of lower financing cost for the transaction will flow
20 directly to the ratepayers of Sebring. Finally, regulatory delay in approving the
21 transaction will deprive ratepayers of the favorable rate relief offered by FPC's rate
22 structure.

23 Q. **ARE YOU FAMILIAR WITH THE VALUATION STUDY PERFORMED BY RMI?**

24 A. Yes, I was responsible for oversight of the project on behalf of Sebring. I provided
25 information to RMI, as well as performing quality assurance.

1 **Q. PLEASE EXPLAIN WHY THE VALUATION STUDY WAS PERFORMED.**

2 A. As more fully explained in the testimony provided by Sebring witness Joe Calhoun,
3 Sebring issued RFPs in May, 1991, to sell the remaining assets of the utility system.
4 The RFP responses received by Sebring indicated that net book value of the tangible
5 assets was an important consideration to the prospective purchasers.

6 This prompted Sebring to review its books and records to determine whether the true net
7 book value of the tangible assets of the system was properly reflected in its accounts.
8 Upon review of the books, I determined that Sebring was not in compliance with the
9 FERC Uniform System of Accounts, and that Sebring's records did not reflect the true
10 net book value of the utility's tangible assets.

11 In order to determine the true net book value of the tangible assets and ultimately record
12 any required adjustments to the books and records of Sebring, a valuation study was
13 authorized by Sebring to be performed by RMI, its consulting engineer.

14 **Q. DID THE VALUATION STUDY PERFORMED BY RMI ESTABLISH A TRUE**
15 **NET BOOK VALUE FOR THE TANGIBLE ASSETS TO BE ACQUIRED BY**
16 **FPC?**

17 A. The RMI Study establishes a portion of the true net book value for the property, plant
18 and equipment assets. However, the RMI Study does not address an adjustment to
19 Property, Plant and Equipment for Contribution-In-Aid-Of-Construction (CIAC). In
20 addition, the Study does not recognize Current Assets and Accrued Unbilled Revenue,
21 both of which are components of the tangible assets to be acquired by FPC.

22 **Q. HOW DID YOU RELY ON THE VALUATION STUDY PERFORMED BY RMI?**

23 A. The RMI valuation study was used to adjust the accounting records of Sebring to reflect
24 the true net book value of the tangible assets, by increasing Property, Plant and
25 Equipment and decreasing the Retained Deficit. Sebring then recorded the proper CIAC

1 adjustment and reflected the appropriate values for Current Assets and Accrued Unbilled
2 Revenues.

3 **Q. DID YOU PREPARE FINANCIAL STATEMENTS FOR SEBRING BASED ON**
4 **THE DETERMINATIONS MADE IN THE RMI STUDY?**

5 A. Yes, I prepared the Financial Statements as of September 30, 1991.

6 **Q. WAS THAT STATEMENT AUDITED?**

7 A. Yes. The audit was performed by Wicks, Brown, Williams & Co., Certified Public
8 Accountants. A copy of the Audited Financial Statement appears in Exhibit 1 at pages
9 207 to 231.

10 **Q. WHAT IS THE NET BOOK VALUE OF THE TANGIBLE ASSETS BEING**
11 **ACQUIRED BY FPC?**

12 A. The Net Book Value of the tangible assets being acquired by FPC as of September 30,
13 1991, is \$17,813,753, as reflected in the "Supplementary Schedule for Electric Systems
14 Assets Identified for Sale" (Exhibit 1, page 230).

15 **Q. WHAT ASSETS ARE INCLUDED IN THE \$17,813,753?**

16 A. The tangible assets being acquired by FPC are comprised of the following categories:

17	a) Property, Plant and Equipment	\$15,429,039
18	(This component is addressed	
19	in testimony presented by Sebring's witness	
20	David J. Rumolo.)	
21	b) CIAC Adjustment	\$ (304,092)
22	c) Current Assets	\$ 1,901,045
23	d) Accrued Unbilled Revenue	\$ 787,761

24 **Q. WHAT ASSETS ARE INCLUDED IN THE PROPERTY, PLANT AND**
25 **EQUIPMENT CATEGORY?**

1 A. The Property, Plant and Equipment category includes the tangible assets contained in the
 2 Valuation Study prepared by RMI, which determined the net book value of the
 3 distribution system, transmission system, two distribution substations, general plant, and
 4 construction work in progress.

5 **Q. WHAT ASSETS ARE INCLUDED IN THE CURRENT ASSETS CATEGORY?**

6 A. The Current Assets are comprised of the following:

7	a)	Customer Accounts Receivable,	\$ 1,146,994
8		Net of Allowance for Doubtful	
9		Accounts of \$43,433	
10	b)	Accounts Receivable - Other,	\$ 202,937
11		Net of Allowance for Doubtful	
12		Accounts of \$18,262	
13	c)	Materials Inventory	\$ 459,476
14	d)	Prepaid Expense	\$ 91,638

15 **Q. PLEASE EXPLAIN WHAT IS CONTAINED IN THE CUSTOMER ACCOUNTS**
 16 **RECEIVABLE CATEGORY.**

17 A. Customer Accounts Receivable includes amounts due from customers for utility services
 18 billed by Sebring. Any overpayments made by customers are reflected as reductions
 19 (credit balances) to the Customer Accounts Receivable. The amount of Customer
 20 Accounts Receivable reflected is net of the Allowance For Doubtful Accounts in the
 21 amount of \$43,433. This allowance is based on actual accounts written-off during the
 22 quarter following the end of the fiscal year that had been billed and were outstanding as
 23 of fiscal year end.

24 **Q. PLEASE EXPLAIN WHAT IS CONTAINED IN THE "ACCOUNTS**
 25 **RECEIVABLE, OTHER" ACCOUNT.**

1 A. Accounts Receivable - Other includes amounts due to Sebring from various entities and
2 individuals as open accounts, other than from customers for utility services. The total
3 amount, which was achieved by reviewing every open invoice, is \$202,937. This amount
4 is net of the Allowance For Doubtful Accounts in the amount of \$18,262. This
5 allowance is based on an account by account review to determine probability of
6 collection. All accounts that were determined to have a substantial doubt of collection
7 were credited to the allowance account.

8 Q. **PLEASE EXPLAIN WHAT IS CONTAINED IN THE MATERIALS INVENTORY**
9 **ACCOUNT.**

10 A. The Materials Inventory includes the cost of materials purchased for use in the utility
11 business for construction, operation and maintenance purposes. The inventory is
12 separated into sub-categories for materials and supplies primarily used by the Electric
13 Line Department and the Electric Metering and Control Department.

14 Q. **WHAT IS THE BASIS FOR RECORDING THE VALUE OF THE MATERIALS**
15 **INVENTORY?**

16 A. The Materials Inventory is stated at the lower of cost or market. Cost is determined
17 based on an average cost method. Reusable materials that have been removed from
18 service are included in the inventory at the carrying value of similar new materials.

19 Q. **PLEASE EXPLAIN WHAT IS CONTAINED IN THE PREPAID EXPENSE**
20 **ACCOUNT.**

21 A. Prepaid Expense includes amounts representing prepayments of insurance, rents, taxes,
22 interest and miscellaneous items.

23 Q. **HOW WAS THE AMOUNT OF PREPAID EXPENSE TO BE ACQUIRED BY FPC**
24 **DETERMINED?**

25 A. The amount of Prepaid Expense to be acquired by FPC was determined by review of

1 each prepaid item prior to assignment.

2 **Q. PLEASE EXPLAIN WHAT IS INCLUDED IN ACCRUED UNBILLED REVENUE.**

3 A. Accrued Unbilled Revenue reflects the estimated amount accrued for services rendered,
4 but not billed, at the end of any accounting period.

5 **Q. HOW WAS THE AMOUNT OF ACCRUED UNBILLED REVENUE TO BE**
6 **ACQUIRED BY FPC DETERMINED?**

7 A. The Accrued Unbilled Revenue is based on the estimated usage between the last meter
8 reading dates and the end of the fiscal year. The calculation uses actual billing registers
9 to determine the amount of revenue to use in the computation.

10 **Q. IN PREPARING THE FINANCIAL STATEMENT AS OF SEPTEMBER 30, 1991,**
11 **DID YOU ADDRESS CONTRIBUTION IN AID OF CONSTRUCTION (CIAC)?**

12 A. Yes, CIAC is the cost or other value of electric plant contributed to the utility.
13 Contributions received toward the construction of electric plant shall be credited to
14 accounts charged with the cost of such construction. Plant constructed from contributions
15 received shall be reflected as a reduction to gross plant constructed when assembling cost
16 data in work orders for posting to plant ledger accounts.

17 **Q. PLEASE EXPLAIN THE CIAC ADJUSTMENT INCLUDED IN THE FINANCIAL**
18 **STATEMENTS AS OF SEPTEMBER 30, 1991.**

19 A. As a part of process to adjust Sebring's books and accounts to properly reflect the true
20 net book value of the tangible assets, it was determined that Sebring had not properly
21 recorded CIAC in prior periods. Electric CIAC was recorded as a capital contribution
22 instead of correctly recording it as a decrease in the cost of property, plant and
23 equipment.

24 **Q. WHAT WAS THE VALUE OF THE CIAC ADJUSTMENT?**

25 A. The adjustment to gross property, plant and equipment was a reduction of \$339,173.

1 Accumulated depreciation required a corresponding reduction of \$35,081, for a total
2 reduction in the net book value of property, plant and equipment of \$304,092.

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 **A. Yes, it does.**

5 TAL-15248

1 BY MR. MAY:

2 Q Ms. Holloway, you state in your prefiled testimony
3 that you are prefiling in the following portions of what has
4 been identified and admitted into evidence as Exhibit Number
5 1, those portions are Pages 207 through 231, Pages 242
6 through 253, Page 258, Pages 574 through 577, Page 578,
7 Pages 579 through 580, and Page 581. Now are you
8 sponsoring those exhibits today in this proceeding?

9 A Yes, I am.

10 Q Ms. Holloway, would you please summarize your
11 testimony?

12 A My testimony addresses three basic areas. First,
13 I discuss the need for expedited review and approval of the
14 proposed sale of Sebring's electric utility assets to
15 Florida Power. Second, I provide background information on
16 the evaluation study performed by RMI of Sebring's tangible
17 electric utility assets. Third, I show that the tangible
18 assets of Sebring to be acquired by Florida Power include
19 current assets, accrued unbilled revenues, and contribution
20 in aid of construction adjustments, which when added to the
21 depreciated net book value of the property, plant and
22 equipment established in the RMI valuation study reflect
23 \$17,813,853 as the total net book value of the tangible
24 assets being acquired by Florida Power. This concludes my
25 summary.

1 MR. MAY: We would tender the witness for cross.

2 COMMISSIONER EASLEY: Second record in one day.

3 CROSS EXAMINATION

4 BY MR. FAMA:

5 Q Ms. Holloway, I have one question. Chairman Beard
6 asked Mr. Dagostino some questions about what would happen
7 if the deal were to be renegotiated. I want to ask you one
8 question on timing. If the deal could not be renegotiated
9 quickly, how fast would Sebring have to go to raise its
10 rates because of its bond covenants being in default or near
11 default?

12 A Well, we are obviously currently in an event of
13 default. The bond trustee and bond insurer, which is AMBAC
14 Indemnity Corporation (phonetic), have rights under the
15 resolution. They could at any point seek to force Sebring
16 to enforce the rate covenant. That enforcement would be
17 through the court system. That could occur at any point in
18 time.

19 Q So that could, in effect, interrupt any
20 renegotiation that was going on. AMBAC could blow the
21 whistle and say, "I can't wait any longer for that. You
22 need to raise your rates now", is that a fair
23 characterization?

24 A I believe so.

25 MR. FAMA: Thank you. That's all I have.

1 COMMISSIONER EASLEY: Let me follow that one up.
2 Let's say we weren't able to make a bench decision
3 today or by next week, would that not still be a
4 possibility even though the matter was pending? Would
5 they not have the opportunity to say to you we can't
6 wait any longer, you've got to raise your rates today?

7 THE WITNESS: That is correct. I don't know, you
8 know, they have chosen to defer because of this
9 proceeding.

10 CROSS EXAMINATION

11 BY MR. ROSS:

12 Q Ms. Holloway, I guess I will also follow-up that
13 last question just a little bit. What in your understanding
14 would be needed to correct the event of default that
15 currently exists?

16 A In preparing the fiscal '93 budget, part of the
17 process there is utilization of financial models to try to
18 project what the revenue requirements are of the system, and
19 then the result is what the rates would have to be to meet
20 those revenue requirements. In that process this past
21 summer -- our fiscal year, by the way begins October 1st, so
22 our budget process is during the summer period -- I
23 determined that to meet the full requirements it would
24 require a 37.1 percent electric rate increase to comply with
25 the covenant.

1 Q And that would be an annual increase?

2 A Yes, that would have been effective October 1st.
3 In lieu of that, the Utility Commission adopted a budget
4 which did not raise rates, and intended to draw down on its
5 debt service reserve funds to meet its principal and
6 interest payments during this year.

7 Q Thank you. I believe it was Mr. Fama that
8 indicated, or had you indicate that in the event AMBAC
9 should initiate, or the trustee should initiate legal action
10 to require Sebring Utilities Commission to raise its rates,
11 or to take whatever action would be necessary in order to
12 take it out of the state of default, if any of those actions
13 should be taken, that would interrupt the negotiations
14 between Florida Power Corporation and Sebring Utilities
15 Commission. And I gather that you responded affirmatively
16 in your judgment that would interrupt the negotiations. I
17 would like for you to expand that answer if I have properly
18 interpreted your earlier answer. In other words, what I'm
19 trying to ask you is what made you indicate that the
20 negotiations would be interrupted by the initiation of
21 either of those legal actions?

22 A Well, I guess the interruption wouldn't
23 necessarily, I guess, eliminate the negotiations, but it
24 obviously would disrupt or complicate.

25 Q No question about that. I accept that. Thank

1 you. Mr. Calhoun, as you know, passed the ball to you with
2 respect to the first question I posed to him, so I'm going
3 to ask you the same question. Is it your understanding that
4 for Sebring Utilities Commission to be legally able to sell
5 its assets it must first or contemporaneously with such sale
6 fully satisfy the outstanding bond indebtedness?

7 A Let me respond to that in that, you know,
8 obviously that's a legal question.

9 Q And I'm not asking for a legal opinion, I'm asking
10 for your layman's understanding.

11 A But what I would like to do is read I think
12 pertinent excerpts from our master bond resolution that
13 address the sale --

14 MS. BROWN: Mr. Chairman, may I interrupt for a
15 minute? That's our first Staff exhibit, and if we may
16 we would like to pass it out now for everyone.

17 CHAIRMAN BEARD: While this is being passed out,
18 and before you get into that answer, since we have got
19 a panel up here now, we will take a break at this point
20 and come back at high noon. And we will pick up with
21 this question and answer. Before we do that, though, I
22 will go ahead and identify this?

23 MS. BROWN: Yes, Commissioner. A short title is
24 master bond resolution and series resolution.

25 CHAIRMAN BEARD: It will be Exhibit Number 6.

1 (Exhibit Number 6 marked for identification.)

2 COMMISSIONER EASLEY: And, Mr. Chairman, just for
3 clarity for the people who don't know, it is
4 permissible, you don't have to go eat lunch in the next
5 10 minutes. You can go get a sandwich and bring it
6 back in here and eat it. That is all right. You will
7 find us doing that.

8 (Recess taken.)

9 CHAIRMAN BEARD: Okay. I think we left off with
10 your question about what is now labeled Exhibit Number
11 6, the master bond resolution and series resolution.

12 MR. ROSS: Yes, sir.

13 CHAIRMAN BEARD: And you were going to answer with
14 some reading of the excerpts, if you will.

15 COMMISSIONER EASLEY: And if you would point us to
16 where you are reading, now that we can follow with you.

17 THE WITNESS: In the Master Bond Resolution, which
18 is remarked Page Number 71, Section 714.

19 COMMISSIONER EASLEY: You are not going to read
20 the whole section?

21 THE WITNESS: No.

22 COMMISSIONER EASLEY: Thank you.

23 THE WITNESS: The way I'm going to respond is I
24 cannot give a legal interpretation but, what I would
25 like to do is just, you know, direct you to this

1 particular section, which within the bond resolution
2 addresses, and the title of the section is sale, lease,
3 or other disposition of the system. And I will read
4 from that section. The Commission covenant is that so
5 long as any bonds shall be outstanding under the
6 provisions of this resolution, and except as in this
7 resolution otherwise permitted, it will not sell,
8 lease, or otherwise dispose of or encumber any property
9 comprising all or any part of the system except for the
10 sales, leases, or other dispositions. It has a series
11 of specifics, but I will direct you to, on the
12 following page, 72, a small "if", to any person upon
13 fair and reasonable terms, if following such transfer
14 the proceeds received by the Commission are applied to
15 acquire additional property of substantially equivalent
16 value, or are applied to the redemption of the bonds
17 then outstanding. In this particular transaction, they
18 will be applied to the bonds then outstanding.

19 BY MR. ROSS:

20 Q Does that conclude your answer, Ms. Holloway?

21 A Yes, it does.

22 Q Thank you, I appreciate that. Mr. Rumolo
23 testified earlier to the fact that the valuation of tangible
24 assets that are to be made the subject of this purchase and
25 sale were about \$17.8 million. And as you will recall,

1 there has been earlier testimony to the effect that the base
2 price to be paid by Florida Power Corporation to Sebring
3 Utilities Commission is to be up to or about \$54 million.
4 Could you tell us from the perspective of the Sebring
5 Utilities Commission what that balance represents? In other
6 words, the difference between the 54 million base price and
7 the 17.8 million that will be allocated to the rate base
8 assets, which I gather is about \$36.2 million. What is that
9 being paid for from the perspective of the Sebring Utilities
10 Commission?

11 A Well, you know, the total purchase price of, you
12 know, the base purchase price is for the acquired assets
13 which are defined within the agreement for purchase and
14 sale. Included in those acquired assets are rights to serve
15 the Sebring customers as well as other intangible assets,
16 which include going concern.

17 Q So, if I understand your answer, the \$36.2 million
18 will be allocated, first of all, to intangible assets as
19 opposed to tangible, is that what you are saying?

20 A Yes.

21 Q And that within those intangible assets that are
22 to be made the subject of the purchase and sale, certainly a
23 significant part will be this exclusive right of service
24 that Florida Power has contracted for and negotiated for?

25 A I don't believe that I can make that type of an

1 assessment. That would really be, I think, addressed better
2 by a Florida Power witness.

3 Q Fine, thank you. Mr. Calhoun also testified to the
4 effect that the Sebring City Council would not approve a
5 bond refinancing arrangement, and it was that rejection that
6 led to the Commission's decision that it had no choice other
7 than to attempt the sale of its assets. Do you have any
8 understanding as to why the City Council rejected another
9 bond refinancing?

10 A No, I do not.

11 Q There was also an indication that you might be the
12 witness that could speak more directly to the issue as to
13 whether the Commission has considered bankruptcy as an
14 alternative to an asset sale, and, if so, what the
15 consequences of taking the Commission into bankruptcy might
16 be. Could you respond to that area of question?

17 A I'll attempt to, as long as we, again, keep in
18 mind that this, you know, this is a very complicated legal
19 arena, and I have gained some knowledge about bankruptcy as
20 a result of Sebring addressing that as an alternative in
21 this process, and, you know, it has been reviewed and
22 analyzed by Sebring's attorneys. I have been advised that
23 it is a highly complicated proceeding. For Sebring it would
24 be my understanding under the Chapter 9 of the bankruptcy
25 code, Chapter 9 is apparently designed as, you know, a

1 reorganization of municipal debts. Under the provisions
2 there are very strict eligibility requirements. I think, as
3 I understand it, there are five primary requirements under
4 the code, four of which Sebring could very probably meet
5 those requirements. The one remaining deals with
6 insolvency, and it is highly uncertain whether Sebring would
7 qualify as being deemed insolvent, and the reason for that
8 is how the court would view insolvency when Sebring has the
9 ability to raise rates, and how they would determine that if
10 Sebring chose not to raise rates.

11 Q And no resolution had been made of that area of
12 questioning to the best of your understanding?

13 A No, there has not.

14 MR. ROSS: Thank you. I have no further
15 questions.

16 COMMISSIONER EASLEY: Are you advised that there
17 is any relationship in any of this criteria between
18 Sebring Utilities Commission and the City? Is there
19 any --

20 THE WITNESS: That is another area of uncertainty,
21 too. From my lay understanding of this, you know,
22 process, it is fraught with uncertainty. That being
23 one. One of the other overriding ones is whether as a
24 result of, you know, if you can meet the
25 qualifications, the eligibility requirements, whether,

1 in fact, you would achieve lower rates. Because, you
2 know, it is determined really, you know, through that
3 court process. And you have several classes of
4 creditors that need to be dealt with fairly, and --

5 COMMISSIONER EASLEY: So the analysis has gone
6 beyond just looking at the five criteria under Chapter
7 9, you have looked at, I gather, the assumption that if
8 all five criteria are met then what happens?

9 THE WITNESS: That is correct.

10 COMMISSIONER EASLEY: And you are still not sure?

11 THE WITNESS: That is correct. My understanding
12 is that there is not a great deal of precedence that
13 has been set with Chapter 9 filings. And, you know,
14 one of the areas that, through our, you know, financial
15 advisors is the potential for a detrimental effect on
16 the City of Sebring, potentially Highlands County and
17 potentially even the State of Florida, you know, if
18 bankruptcy was ruled in Sebring. It has a stigma,
19 obviously, associated with it, and is generally
20 considered very distasteful.

21 CHAIRMAN BEARD: It's not one of the very real
22 possible options, as well, as I understand it at least,
23 that a judge could order you to raise the rates to
24 cover debt, and everything else, in effect, have occur,
25 what the counsel would otherwise have to do to meet

1 their current liabilities?

2 THE WITNESS: It's not totally clear from my
3 understanding. That is, again, one of the uncertain
4 areas.

5 COMMISSIONER EASLEY: Is Sebring Utilities
6 subsidized by the City?

7 THE WITNESS: No.

8 CHAIRMAN BEARD: Is the City subsidized by Sebring
9 Utilities?

10 THE WITNESS: No.

11 COMMISSIONER EASLEY: Is the City a ratepayer of
12 Sebring Utilities?

13 THE WITNESS: Yes, it is. The City is a
14 ratepayer.

15 COMMISSIONER EASLEY: I just thought I would get
16 some relationship in here somewhere.

17 THE WITNESS: I will have to say that most
18 municipal electric systems do make payments to their
19 cities, and Sebring did up until, I believe, around the
20 1982 to '83 time frame. Subsequent to that they have
21 been financially unable to make contributions.

22 MR. POLLARD: No questions.

23 CROSS EXAMINATION

24 BY MS. BROWN:

25 Q One more question about the bonds, Ms. Holloway.

1 You said that the rate covenant provision, and I am not sure
2 that I understand this stuff very well at all, so if I get
3 off on the wrong track, please put me back on the right one.
4 You said that the rate covenant provision would allow the
5 bond trustee to sue Sebring Utilities Commission to raise
6 rates, is that correct?

7 A Yes.

8 Q What would be a circumstance where the bond
9 insurers would ever pay off these bonds?

10 A I will have to answer I'm honestly not sure.
11 Again, this is speculation, but I would speculate if, you
12 know, there might be potential, if you had a, you know,
13 favorable ruling through bankruptcy proceedings, that
14 possibly some portion might be paid by AMBAC.

15 Q That is very speculative?

16 A It is. This whole --

17 Q That they would ever pay off the bonds that they
18 insured?

19 A That's my understanding. I think, generally, it
20 is bond insurance, but I think the industry seems to view it
21 as more of a credit enhancement.

22 COMMISSIONER EASLEY: Let me be sure I understand
23 that. I mean, you are really talking to a layperson
24 here. You're telling me that bond insurance doesn't
25 get paid in the event that you default on a bond in any

1 amount?

2 THE WITNESS: No. It is uncertain to what extent.

3 COMMISSIONER EASLEY: What kind of coverage was
4 paid for it, if that is the appropriate term?

5 THE WITNESS: There were sizable fees paid on both
6 the 1981 bond issue which was then refinanced in '86.
7 I think the total fees paid were approximately 3
8 million for bond insurance.

9 COMMISSIONER EASLEY: We are in the wrong
10 business.

11 CHAIRMAN BEARD: Who was bonded?

12 THE WITNESS: I couldn't hear you.

13 CHAIRMAN BEARD: Who was bonded?

14 THE WITNESS: The Sebring Utilities Commission.
15 Actually, the revenue bonds have bond insurance.

16 CHAIRMAN BEARD: And whose credit would suffer if
17 those bonds were not paid? If the bond insurance were
18 paid in lieu of that, whose credit would suffer? I'm
19 not sure I'm asking this question right.

20 THE WITNESS: I'm not sure I'm understanding it,
21 either.

22 CHAIRMAN BEARD: Well, you know, you have bond
23 insurance in the event that the bonds aren't paid,
24 right? So let's assume the bonds aren't paid.
25 Somebody's credit or ability to get bonded in the

1 future is going to be effected, I assume.

2 THE WITNESS: That's correct.

3 CHAIRMAN BEARD: I know if I don't pay my bills,
4 and I go out to borrow some money, I know what they are
5 going to tell me. It's not no, but hell no. And I'm
6 trying to find out in this instance, if that occurred,
7 who is it that would have problems getting bonds in the
8 future? The City of Sebring?

9 THE WITNESS: Obviously, the Sebring Utilities
10 Commission.

11 CHAIRMAN BEARD: Which wouldn't exist any more.

12 THE WITNESS: Right. The City of Sebring, I
13 think, would be. And, again, potentially Highlands
14 County because of the location.

15 COMMISSIONER EASLEY: I don't understand that.

16 CHAIRMAN BEARD: I don't understand that. I mean,
17 I'm sitting next to Commissioner Easley, if she doesn't
18 pay her bills, that means that I'm going to have bad
19 credit from now on?

20 COMMISSIONER EASLEY: I hope so.

21 THE WITNESS: Again, you know, this is kind of
22 speculation. But the market views credit sometimes in
23 a more subjective fashion. What I kind of refer back
24 to is the whoops (phonetic) default in the early '80s,
25 and from what my understanding is, is that the whole

1 northwest was really viewed as a potential trouble.
2 And, you know, potentially a penalty through higher
3 interest rates could be extracted from the market, but
4 not necessarily would be.

5 CHAIRMAN BEARD: But let me see if I can then
6 describe what I think I have heard. What I think I've
7 heard is the Commission is being asked to approve a
8 rider that if approved would cause the current
9 customers of Sebring to pay a transition rider for some
10 15 years, that would have the effect of causing Sebring
11 to not have bonding problems in the future, is that a
12 pretty fair -- if it is not a fair translation, then
13 speak up.

14 I mean, you've got a market value that's being
15 paid. You have got, I think it's described as three
16 segments in this, the base payment, the post, and so on
17 and so on. The net effect of this transition rider,
18 which as I understand it is the only difference between
19 current Florida Power Corporation customers and
20 proposed Florida Power Corporation customers currently
21 to Sebring, the only difference is that rider, is that
22 correct?

23 THE WITNESS: That's correct.

24 CHAIRMAN BEARD: So I'm assuming that rider, the
25 bottom line, country boy logic is that rider is being

1 paid over a period of time to offset the difference in
2 the other two components and what is owed.

3 THE WITNESS: That is correct.

4 CHAIRMAN BEARD: And the net effect of that is if
5 that occurs, is that Sebring basically can walk away
6 without any bonding problems or any credit problems,
7 and they can feel free in the future to do whatever
8 they need to do.

9 THE WITNESS: I don't know that I would go to that
10 extent, but at least they have fulfilled their debt
11 obligation. The City of Sebring as a part of this
12 transaction will be issuing bonds to acquire the water
13 system, which is a component within the agreement.

14 CHAIRMAN BEARD: A component that I have
15 absolutely nothing to do with.

16 THE WITNESS: That's correct.

17 You know, if I can possibly clarify an earlier
18 question I think that Mr. Fama had asked about
19 disruption in the process, if there was a delay or not
20 a ruling, let's say, today. I would point out, and I
21 believe that we did share a copy of the follow-up
22 letter from our trustee that addressed the reasons,
23 really, why they were deferring taking any action to,
24 you know, cause us to come into compliance, and it was
25 really because they saw a positive process, you know,

1 in place. And I think as long as they see positive
2 action on our part, that they will defer any court
3 action against us.

4 CHAIRMAN BEARD: Let me tell you what my problem
5 is. I don't mean to be testifying here myself, but I'm
6 struggling with this. We had a previous witness, there
7 was some discussion about the potential for refinancing
8 that the City Council chose not to approve wouldn't
9 agree to do, for whatever reasons, and I don't have all
10 the details, but there is at least the allegation that
11 that would have mitigated to some degree the current
12 situation. We are being asked to provide a transition
13 rider, or approve one over a 15-year period of time,
14 and it appears, it appears that the only one that walks
15 away from this quote, unquote, scot-free is the City
16 Council. And I'm going to tell you, I've got a problem
17 with it. I don't know what the solution is, because
18 the flip of that is being able to provide in the best
19 interest of providing power to the citizens of this
20 town, and I don't know what the answer is, and, you
21 know, I know we are talking about a bench decision
22 possibly today, if we get there, by Tuesday, and I'm
23 struggling. And I have listened to the service
24 hearings, and I have listened to this, and I'm still
25 struggling, because there is a culprit, I hate to use

1 that term, and maybe it is a poor choice of words, but
2 right now there is somebody that it appears walks away
3 from this thing looking pretty good. And I'm not happy
4 about it, because it is in my lap. And I don't mind
5 taking the heat, and I don't mind if the transition
6 rider is the appropriate thing in the best interest of
7 the ratepayers overall, if that is what we have to do
8 we have to do it, but I'm not happy about this, and I
9 don't know what the solution is.

10 COMMISSIONER EASLEY: You know, what is
11 interesting, Mr. Chairman, in this Special Act 90-474
12 that we have taken official notice of, and it is
13 attached to their motion, the second section of that,
14 that 12-24, the approval of borrowing and bonding,
15 anything over \$100,000 according to the special act,
16 requires total approval by the City of Sebring.
17 Sebring Utilities has not been able to do anything
18 without the City of Sebring, as I read this act, that
19 was passed in 1990, although I gather from the initial
20 part of this that the creation of the Utilities
21 Commission must have been done in about 1945, the
22 timing is kind of interesting, as well.

23 CHAIRMAN BEARD: I guess we will progress along.

24 COMMISSIONER EASLEY: Keep going, but you all need
25 to know what my concerns are, anyway.

1 CHAIRMAN BEARD: I've got a problem. And I don't,
2 you know, Florida Power Corporation should have
3 negotiated the best deal they could negotiate, if they
4 did anything less than that, we would be on their
5 butts. There isn't a nicer way to put it than that.
6 But there is a problem here that I want a resolution
7 to. I'm sorry, go ahead.

8 BY MS. BROWN:

9 Q Ms. Holloway, I have one more question about the
10 bond resolution and the insurance, very basic for me. The
11 bond trustee -- who is the bond trustee?

12 A First Union National Bank.

13 Q First Union National Bank is a different entity
14 than AMBAC, the insurance company, is that correct?

15 A That's correct.

16 Q Well, on Page Revised 140 of that exhibit, Exhibit
17 6, it says at the top of the page municipal bond insurance
18 policy, do you have it?

19 A Yes.

20 Q Let me read you the first paragraph, short
21 paragraph of that and see if you can explain it to me. In
22 consideration of the payment of the premium, and subject to
23 the terms of this policy, AMBAC hereby agrees to pay to the
24 United States Trust Company of New York, I guess that is the
25 predecessor to First Union as trustee, or its successor, the

1 insurance trustee, for the benefit of bond holders that
2 portion of the principal of and interest on the
3 above-described debt obligations, the bonds, which shall
4 become due for payment, but shall be unpaid by reason of
5 nonpayment by the issuer. Now, I asked you before when
6 would the insurer pay off the bonds. Can you explain this
7 paragraph to me in relation to that question, and the answer
8 you gave before?

9 A First off, I will note that this is the insurance
10 trustee. When I gave you the answer of who is the bond
11 trustee, First Union, those are two, again, two different
12 entities. AMBAC would make payments to the bond holders.
13 But I guess my answer previously was in whether AMBAC would
14 just stop at that point and not try to, you know, receive,
15 you know, payment back from the Utilities Commission
16 subsequent to --

17 Q Some subrogation claim, or something like that, is
18 that what you are getting at?

19 A I don't know what that is.

20 Q Okay. I didn't mean to interrupt you in
21 midsentence. So maybe we should leave this discussion in
22 this way, that it really is not very clear whether the
23 insurance company would or would not pay off these bonds; do
24 you think that is about the best we can do here?

25 A I believe that the insurance company would make

1 payments to the bond holders, but they would not -- they
2 would then continue to receive payments through enforcement
3 of the rate covenants of the bond resolution from the
4 Utility Commission.

5 Q All right.

6 A So the bond holders would not, necessarily,
7 realize -- there would not necessarily be a lapse of payment
8 to them, but whether AMBAC would, you know, would just cease
9 action at that point is, I think, highly improbable.

10 Q So are you saying that you predict, or it might be
11 reasonable to predict that the Sebring ratepayers would
12 still end up having to pay on this debt?

13 A That would be what I would expect AMBAC to try to
14 enforce, as well as the bond trustee.

15 Q Okay.

16 COMMISSIONER EASLEY: Were you about to leave
17 this?

18 MS. BROWN: I was, yes.

19 COMMISSIONER EASLEY: I hate to belabor this, but
20 I really need to understand. And to the extent that
21 this is going to require a legal answer, one of the
22 reasons I'm asking you the question is because I can't
23 ask them, and it puts them on notice that at some point
24 in time, either in closing arguments, or whenever, I
25 would like to hear the appropriate thoughts on this.

1 When I look at 12-24, which is the second section of
2 the special act in 1990, based on what you have been
3 saying, it sounds to me like the bottom line is that
4 Sebring, the City of Sebring has been able to require
5 that they can give the permission, must give the
6 permission by passing of the resolution, with proper
7 notice, and all the rest of it before the Sebring
8 Utilities Commission has been able to borrow, secure
9 any kind of indebtedness, do whatever, expend monies
10 over \$100,000. You are saying that if the trustees
11 decide they can force Sebring Utilities to raise their
12 rates in order to pay off the bond, could the trustees
13 look to the City of Sebring as the empowerment behind
14 Sebring Utilities being able to go into that
15 indebtedness to begin with? Is that the bottom line
16 problem that just hasn't been said by the City of
17 Sebring?

18 THE WITNESS: I don't think I can answer that
19 question.

20 COMMISSIONER EASLEY: I didn't really think you
21 could, but I had to ask the question to get it to where
22 I could get an answer sooner or later. Thank you.

23 BY MS. BROWN:

24 Q Moving to some accounting issues, is it your
25 testimony that Sebring historically followed governmental

1 accounting practices rather than the FERC's Uniform System
2 of Accounts?

3 A Yes.

4 Q Can you briefly describe some of the differences
5 between governmental accounting and the FERC Uniform System
6 of Accounts?

7 A The primary difference is in the treatment of
8 capital plant. Typically in governmental accounting it is
9 historically expensed. And within the FERC Uniform System
10 of Accounts there are very specific requirements for
11 accounting for the plant assets of the system.

12 Q Are these differences in accounting practice the
13 sole basis for your opinion that the net book value as
14 recorded on the books and records of Sebring was not
15 accurate? You do hold that opinion, don't you?

16 A Yes, I do. I'm troubled with sole, the word sole,
17 but it is the overriding reason for my conclusion.

18 Q On Page 5 of your testimony, Lines 8 through 10.

19 A Yes.

20 Q You state that after reviewing Sebring's books,
21 you found that the Commission was not in compliance with the
22 FERC Uniform System of Accounts and that the records did not
23 reflect the true net book value of the tangible assets,
24 correct?

25 A That's correct.

1 Q Is it correct also that the Sebring Utilities
2 Commission did not have a continuing property records system
3 in place?

4 A That's correct.

5 Q Did Sebring correctly capitalize indirect costs or
6 overhead costs?

7 A No, they did not. Not fully.

8 Q What do you mean by not fully?

9 A In approximately the mid-'70s, the Utility
10 Commission implemented a work order system. Within that
11 work order system it did begin at that point in time to
12 capture some of the indirect costs, but not all, vehicle and
13 A&G being two of the primary ones.

14 Q Vehicle and what?

15 A Administrative and general.

16 Q Thank you. And historically retirements of
17 property were not recorded either, were they?

18 A That's correct, within the transmission and
19 distribution portion of the system.

20 Q How did Sebring handle contributions in aid of
21 construction?

22 A It was not recorded as a reduction in the cost of
23 the plant assets, but was recorded as a reserve within their
24 retained deficit.

25 Q To your knowledge, was Sebring aware that there

1 were regulations requiring municipal utilities to be in
2 compliance with the FERC Uniform System of Accounts?

3 A Yes. Based on previous management letters that
4 were produced by the independent public accounting firms
5 that did the annual audits, the Commission would have been
6 aware.

7 Q And Sebring chose not to take the action that its
8 auditor suggested in those management letters, correct?

9 A It did not.

10 Q Do you have any idea why not? I understand that
11 you weren't there for all of that time, but --

12 A No, I can only speculate of why the Commission did
13 not, and that speculation would be that they did not feel
14 the benefit exceeded the cost to, you know, to achieve
15 compliance.

16 Q Is it expensive?

17 A Yes. I mean, relative to what the financial
18 conditions have been at Sebring, I think any expenditure
19 that was not deemed absolutely necessary and beneficial to
20 the system would have been rejected.

21 Q Now, Ms. Holloway, just for a minute, I want to
22 ask you a little bit about your own background. How long
23 have you been with the Sebring Utilities Commission, and
24 tell us what your purpose for coming there was?

25 A I joined the Utility Commission in March of 1991,

1 so I will fairly soon be approaching two years with the
2 system. I joined the Commission in hopes of being able to
3 improve the financial situation there, primarily for the
4 ratepayers, in achieving the lowest possible rates for the
5 financial situation that they were in.

6 Q Because this is kind of what you do for a living,
7 isn't it? You hop from one municipal utility to another
8 bailing them out of trouble?

9 A I don't know that I would say that.

10 Q Have you done this before in other places?

11 A When I joined Gainesville Regional Utilities, at
12 that point in time it had the highest rates in the State of
13 Florida. Through the combined effort of a City Commission
14 and management team, and through the construction of a
15 highly successful coal-fired generation plant, Gainesville,
16 in the early '80s was able to revert to being the lowest
17 rates in the State of Florida for residential customers at
18 that point in time. To equate, though, Gainesville with
19 Sebring is like night and day in terms of financial
20 condition. So it's very different.

21 Q Did Gainesville comply with the regulations
22 requiring it to keep its accounts as required by the Uniform
23 System of Accounts? What I'm really trying to get at is --

24 A Yes. Actually, my initial and primary role
25 whenever I first joined Gainesville was to implement the

1 FERC Uniform System of Accounts for them. I joined them in
2 June of 1975, and the requirement was that the municipals be
3 in compliance by October of that same year.

4 Q Is it your experience that municipal utilities
5 often are not in compliance with this particular regulation,
6 or is Sebring unique in this?

7 A To my knowledge, there have been other municipals
8 that did not come into compliance on the specified date. I
9 do not have knowledge of how many or who are not currently
10 in compliance, though.

11 Q Do you know of any that are not in compliance now?

12 A No, I do not.

13 Q If Sebring had implemented a continuing property
14 records system, as its auditor suggested, and as it was
15 required to do, the net book value would not have had to be
16 recalculated at this time, is that correct?

17 A That is correct.

18 Q How did Sebring record its plant investment?

19 A At what point in time? I'm not sure.

20 Q Before you got there to help them out?

21 A As I stated before, it did have a work order
22 system in which it was capturing the majority of its direct
23 costs, and some of the appropriate indirect costs, and, you
24 know, that in turn became plant in-service.

25 Q And the subaccounts of generation, transmission,

1 and distribution and substation?

2 A Those were the types of categories. They were not
3 recorded into the FERC account numbers.

4 Q Okay. Now, you stated that Sebring generally
5 expensed overhead costs in prior periods rather than
6 capitalizing those costs with the construction project, is
7 that correct?

8 A That's correct.

9 Q Would it be correct to say that those costs that
10 were expensed were recognized in those prior years revenues,
11 and in the net operating income of Sebring?

12 A I could not say that. The rates structure that is
13 in place at Sebring and has been has not been based on cost
14 of service from my review and determination. There are a
15 few things that point to that conclusion, one being that
16 Sebring has a substantial retained deficit in its books and
17 records, and that deficit has been, you know, growing
18 through time, so obviously the rates have not been set to
19 recover full requirements. Also, the water system has
20 historically subsidized the water system through its rate
21 structure.

22 Q I'm sorry, you said the water system subsidizes
23 the water system.

24 A The water system subsidizes the electric system,
25 I'm sorry. And I am aware, although I do not have personal

1 direct knowledge, but indirectly understand that past rate
2 setting practices at Sebring have been to draw a line that
3 this is where Florida Power rates are, and then draw a line
4 just under that prior to obviously 1981, of where Sebring
5 rates would be; again, not based on cost of service. And I
6 believe that Sebring's witness, Gerald Warren has some
7 actual personal knowledge of that past practice.

8 Q A past practice that I gather you are implying was
9 based more on competition for customers with Florida Power
10 Corporation --

11 A In that particular --

12 Q -- rather than a cost of service?

13 A That's correct.

14 Q Now, you say in your testimony that CIAC had not
15 been properly recorded, and consequently an adjustment was
16 made to plant in-service of \$339,172, is that correct?

17 A Yes, that's correct.

18 Q How was that adjustment determined?

19 A Through a review of each payment that had been
20 received by the Utility Commission for, you know,
21 contributed capital.

22 Q So, in other words, you went through all the
23 invoices which covered the period of time Sebring had any
24 CIAC coming in for capital construction?

25 A That is correct.

1 Q Well, if you did that for CIAC, could you have
2 performed the same investigation regarding plant and
3 accumulated depreciation rather than having RMI make a
4 valuation of the property?

5 A Well, I guess if the records had been available,
6 that more of the work effort could have been performed by
7 Sebring. But the records were not available. It just
8 happened that the contribution in aid of construction began
9 at a period to where our records were available and were not
10 received or recorded prior to that.

11 Q So, as well as not keeping their accounts as
12 required by regulation, they also didn't keep proper books
13 and records, is that what you're saying?

14 A Yes.

15 Q Thank you. Do you know what the reserve ratio of
16 Sebring was prior to the RMI valuation, the reserve ratio of
17 Sebring of accumulated depreciation?

18 A I don't know it off the top of my head; no, I do
19 not.

20 Q Would you accept subject to check that it was
21 about 46 percent?

22 A Without any other evidence, yes, I mean --

23 Q Do you know what the reserve ratio of Sebring was
24 after the RMI restatement?

25 A I do not know the exact numbers, no.

1 Q About 40 percent, would you accept?

2 A As I recall, it was in the 30 to 33 percent range,
3 but I don't know what the exact computation amounted to.

4 Q But there was a considerable differential there?
5 Sebring's reserve ratio was considerably higher, would you
6 agree, than the reserve ratio used by RMI?

7 A Based on the information you just gave me.

8 Q Given that, the RMI valuation had the effect of
9 increasing net plant, did it not?

10 A In terms of arriving at net book value, the way
11 you arrive at net book value is gross plant less accumulated
12 depreciation.

13 Q So the answer is yes?

14 A (Indicating yes.)

15 Q Are you familiar with Mr. Rumolo's testimony?

16 A Yes.

17 Q As I understand it, he recalculated accumulated
18 depreciation using depreciation rates recommended by REA
19 rather than using the depreciation rates historically used
20 by Sebring, is that correct?

21 A That's correct.

22 Q Have you done any comparison of those REA
23 depreciation rates with the ones Sebring was using?

24 A Direct comparisons are extremely difficult because
25 of the accounting categorization of plant assets by Sebring

1 prior to the RMI valuation study. Depreciation rates are
2 applied on a FERC account basis, and that is what RMI
3 included in their study. With Sebring not having their
4 plant assets recorded in FERC account basis, a direct
5 compare is virtually impossible, if not impossible.

6 Q Now, Ms. Holloway, we spoke a little bit about
7 alternatives earlier with you and with Mr. Calhoun. In your
8 opinion, what other reasonable alternatives are available to
9 Sebring at this point to resolve this problem?

10 A Well, I think that Mr. Calhoun covered, you know,
11 the other alternatives that have been explored, and, you
12 know, are available. Of those alternatives, the sale to
13 Florida Power achieves the lowest rates to our customers.
14 So, obviously, that is the, you know, the overriding
15 objective of the Utility Commission as I see it. The other
16 alternatives were sale to the City, which never made an
17 offer; refinancing, which when compared to any sale
18 proposal, cannot compare economically from converting to
19 rates that are equivalent with a sale proposal, which in
20 deposition, you know, I explained some of those differences
21 and penalties that are assessed, really, for refinancing.
22 And then obviously I have already addressed the bankruptcy
23 uncertainties that are present.

24 MS. BROWN: Thank you. No further questions.

25 COMMISSIONER EASLEY: Just one more question. If

1 I could write you a check tomorrow, what would it take
2 to retire the bond indebtedness? What is the actual
3 amount we are talking about?

4 THE WITNESS: The actual amount would be
5 approximately 85-1/2 million.

6 COMMISSIONER EASLEY: 85-1/2?

7 THE WITNESS: That would be from a sale standpoint
8 to actually call the bonds. One of the little caveats
9 in our bond resolution creates an extraordinary call
10 feature. Upon sale of the bonds, you can call at par
11 without any call premiums be assessed. And you can
12 call, if you are retiring all bonds, with just a 30-day
13 notice, which is what is contemplated in this
14 transaction.

15 COMMISSIONER EASLEY: And how much have you paid
16 in fees to the insurance?

17 THE WITNESS: For the '81 and '86 bond issues,
18 approximately 3 million.

19 COMMISSIONER EASLEY: Thank you.

20 CHAIRMAN BEARD: 85 million in bonds. What is the
21 value of the electric utility system?

22 THE WITNESS: Of the assets that are targeted for
23 sale to Florida Power, 17.8 million.

24 CHAIRMAN BEARD: Well, the 85 million obviously
25 was spent on something other than \$17.8 million worth

1 of assets. But assuming that some of that 85 million
2 also went to water plant?

3 THE WITNESS: Very small, a very small amount.

4 CHAIRMAN BEARD: Some of it went to generation?

5 THE WITNESS: Yes.

6 CHAIRMAN BEARD: That is not being sold to Florida
7 Power Corporation?

8 THE WITNESS: It is not being sold to Florida
9 Power Corporation. It has already been sold to Tampa
10 Electric Corporation, or Tampa Electric Company.

11 CHAIRMAN BEARD: Do we have some rough idea of
12 what percentage of that 85 million was used on the
13 plant that is currently attempting to be sold to
14 Florida Power Corporation?

15 THE WITNESS: I have recently done an analysis,
16 but I'm not sure that the analysis is complete enough
17 to be able to tell you how much would be associated
18 with these particular facilities. My analysis was to
19 allocate between electric and water to determine what
20 the appropriate allocation for debt service would be
21 for each of those systems. I did not break the water
22 down into this much for generation, and this much for
23 transmission and distribution.

24 CHAIRMAN BEARD: So a ballpark figure, how much of
25 that 85 million went to water?

1 THE WITNESS: Less than one percent.

2 CHAIRMAN BEARD: Less than one percent, we are
3 talking less than a million bucks. So let's keep it to
4 simple math, we will round that off, and let's say
5 there is 84 million left. Now, my recollection is
6 typically your major investment is in generation, when
7 you have generating facilities, depending on the amount
8 you have relative to what you purchase and all of those
9 other things. If we were to speculate on your
10 experience, based when you were at GRU, and knowing
11 what you know at Sebring, what percentage of the plant
12 would you have said that generation was? And we can
13 dump big old round numbers, if you want. 50 percent of
14 it in generation?

15 THE WITNESS: No, much larger than that. I am
16 trying to --

17 CHAIRMAN BEARD: I'm helping you. 70 percent?

18 THE WITNESS: It would probably be in the 80
19 percent or greater.

20 CHAIRMAN BEARD: I know it has been my general
21 understanding that when you purchase power usually
22 about 70 plus percent of the money you spend and the
23 revenues you take in go to that. So I'm assuming if it
24 is much higher than that you would be purchasing it
25 rather than generating it.

1 THE WITNESS: Well, it is in that --

2 CHAIRMAN BEARD: In the range of 70 to 80 percent.
3 Then I can assume that maybe 70 to 80 percent of that
4 84 million we have got left probably went towards
5 generation?

6 THE WITNESS: That's correct. I mean, you could
7 deduce that.

8 CHAIRMAN BEARD: So if I were to say 84 times, and
9 we can use big old round numbers like 75, we would be
10 looking at 63 million associated with generation, and
11 that would mean about 21 million maybe associated with
12 the plant that is being proposed to be sold. Now, the
13 transition rider that is being proposed over the next
14 15 years, that is being proposed to pay off what
15 percent of that \$85 million?

16 THE WITNESS: The principle amount is for the
17 transition rate, which I think Mr. Nixon, you know,
18 addresses really in his testimony, but it is
19 approximately 38 million.

20 CHAIRMAN BEARD: And the base rate that is being
21 paid to Sebring Utility, that figure was what?

22 COMMISSIONER EASLEY: 54.

23 THE WITNESS: The base purchase price is
24 approximately 54 million, or whatever it requires to
25 pay off the bonds, but not to exceed 54 million.

1 CHAIRMAN BEARD: What was the second, because
2 there was three components. There was the rider, the
3 base rate, what was the third component that was
4 discussed earlier?

5 COMMISSIONER EASLEY: Are you talking about the
6 final billing to TECO, the 1.5 million and the customer
7 deposits of a million?

8 CHAIRMAN BEARD: Yes, I guess that is the second
9 component.

10 COMMISSIONER EASLEY: Because it came up to
11 56-1/2.

12 THE WITNESS: The total purchase price is the base
13 purchase price, which is that component needed to pay
14 off the bonds. The proceeds from the sale of the water
15 system of -- no, pardon me. The additional purchase
16 price, which is for the 750,000 for wind-up expenses,
17 and approximately, whatever the TECO purchase power
18 invoice is that is outstanding, we have estimated it at
19 750,000, plus customer deposits of approximately a
20 million, that is the purchase price.

21 COMMISSIONER EASLEY: Right.

22 THE WITNESS: But to get from 54 million to the
23 85-1/2 million is where the proceeds from the sale of
24 the water system are applied and then any funds, you
25 know, on hand.

1 CHAIRMAN BEARD: What do you estimate the proceeds
2 from the sale of the water system to be?

3 THE WITNESS: 21-1/2 million.

4 CHAIRMAN BEARD: Well, now I'm trying to
5 understand this. And I know this is far more complex
6 than I can deal with, but you've got 54 million in
7 purchase price, base purchase price, is that roughly
8 right?

9 THE WITNESS: That's correct.

10 CHAIRMAN BEARD: Plus another ballpark 2 million
11 on customer deposits and other odds and ends?

12 THE WITNESS: That's correct.

13 CHAIRMAN BEARD: That is 56 million. Plus we have
14 got a transition rider that adds up to some 38 million,
15 that will contribute to paying off that bond
16 indebtedness.

17 THE WITNESS: (Indicating yes.)

18 CHAIRMAN BEARD: Now, I'm at 94 million so far.
19 Now we going to get about -- now you're shaking your
20 head no.

21 THE WITNESS: No. You know, the 38 million will
22 be funded through the transition rate. If you are
23 trying to -- maybe I'm misunderstanding here. If you
24 are trying to get to the 84-1/2 million to pay off the
25 bonds --

1 CHAIRMAN BEARD: I want to understand what money
2 is going to Sebring Utilities. They are going to get
3 \$54 million from Florida Power Corporation. That 54
4 million, is that funded by the transition rider?

5 THE WITNESS: A portion of that would be.
6 Actually, they will issue medium term notes. I'm
7 getting into Mr. Nixon's testimony. He has exhibits
8 that actually --

9 CHAIRMAN BEARD: He is used to being the wide
10 receiver known as Leroy, so it's not new for him.

11 (Simultaneous conversation.)

12 CHAIRMAN BEARD: You're not leaving anywhere in
13 the next 30 to 40 minutes, are you, because you
14 represent --

15 THE WITNESS: No, I gave up Birmingham to be here,
16 you know.

17 CHAIRMAN BEARD: What I'm suggesting is that -- he
18 doesn't represent Sebring Utilities Commission, so
19 don't go anywhere.

20 THE WITNESS: Okay.

21 COMMISSIONER EASLEY: Redirect.

22 MR. MAY: I have just a couple of questions,
23 Commissioners.

24 REDIRECT EXAMINATION

25 BY MR. MAY:

1 Q Ms. Holloway, Chairman Beard and Commission Easley
2 have asked you a series of questions, as I recollect, that
3 pertain to three basic subject areas. One would be a rate
4 covenant concept, the other would be the bond insurance
5 concept, and finally there is some questions about
6 refinancing. I would like to start with the concept of rate
7 covenants. Would you please explain to the Commission what
8 you mean by rate covenants and how that comes into play in
9 this transaction?

10 A There is a rate covenant within the bond
11 resolution, and what that says is that the Utility
12 Commission will set rates that will achieve a 1.1 times
13 coverage. 1.1 times coverage, when it refers to that is a
14 ratio of net revenues over aggregate debt service in a given
15 fiscal year. The rate covenant is a forward-looking
16 computation.

17 Q Would it be fair to say that a rate covenant would
18 be a contract between Sebring Utilities Commission and the
19 bond insurance company?

20 A Yes.

21 Q Have you inquired with AMBAC, the bond insurance
22 company in this case, as to whether that company would be
23 willing to participate in assisting Sebring in overcoming
24 its financial crisis?

25 A Yes. Sebring has asked and explored that with

1 AMBAC, and they have refused.

2 Q And AMBAC has refused to participate?

3 A That's correct.

4 Q If Sebring were to default on the bond and disavow
5 its obligation to meet its bond indebtedness obligations, do
6 you have any indication what AMBAC would do in response to
7 that?

8 A They have indicated to us that they would seek to
9 -- I'm using layman's terms, sue us in, I guess, circuit
10 court.

11 Q And as a result of that lawsuit, is it possible
12 for the court to order Sebring Utility Commission to meet
13 its contractual obligation and raise rates to meet its rate
14 covenant obligations?

15 A I'm not sure. Would you ask that one for me
16 again?

17 Q As a result of that lawsuit, is it feasible that
18 the court would order Sebring Utilities Commission to raise
19 rates to meet its bond covenant obligation and its rate
20 covenant obligation?

21 A Yes, I believe it would be feasible to believe
22 that the court --

23 Q Is that a possibility?

24 A Yes, to my understanding that would certainly be a
25 possibility.

1 Q Let's move on to the refinancing. I think we have
2 touched on the rate covenant and bond insurance questions
3 that I wanted to cover. Let's talk a second about
4 refinancing as an option or an alternative to this
5 transaction. Commissioner Easley, I believe, referred you
6 to a 1990 special act, Chapter 90-474, which would require
7 Sebring's City Council approval or consent to any
8 indebtedness over \$100,000 by Sebring Utility Commission; do
9 you recall that question?

10 A Yes, I do.

11 Q Now, when the bonds were issued to construct the
12 Phillips plant -- in 1981, is that correct?

13 A That's correct.

14 Q This special act wasn't in effect, was it?

15 A No, it was not.

16 Q And at that time Sebring Utilities Commission was
17 not obligated to obtain Commission consent, City Council
18 consent to issue bonds or to incur indebtedness, right?

19 A That's correct.

20 COMMISSIONER EASLEY: Well, let me ask a follow-up
21 question to that, and I appreciate your help. I think
22 I know where you're going, but now the question
23 certainly recurs, why do I have a special act in 1990
24 that requires it if you're not doing anything? Do you
25 have any idea why this was passed? Have you used it

1 since you got there?

2 THE WITNESS: No, we have not done a refinancing.

3 MR. MAY: We are using that act in this
4 proceeding, that is the statutory basis for the sale of
5 the asset.

6 COMMISSIONER EASLEY: Well, Counselor, I'm sorry,
7 but there has got to be an easier way to do this. If
8 you're using it as the basis, but you just got her to
9 testify that Sebring Utilities -- this wasn't in effect
10 at the time the plant was built, I don't understand how
11 I can say it wasn't in effect for that, but consider it
12 for this. That's precisely the problem I'm having, and
13 I don't know how to get there from here, when I've got
14 a non-lawyer and you can't testify. Try it through the
15 questions like you just did because I did fine right up
16 till that point.

17 CHAIRMAN BEARD: Commissioner, at the risk of
18 doing what we're here to do, and educating us, we'll
19 have some flexibility.

20 COMMISSIONER EASLEY: Well, then answer the
21 question, because I'm really having trouble with that.

22 CHAIRMAN BEARD: Or whoever the right person is.

23 COMMISSIONER EASLEY: Somebody answer the
24 question.

25 MR. MAY: Commissioners, I can address that in

1 closing or I can address it right now.

2 CHAIRMAN BEARD: Why don't you tell us what you
3 would say in a brief or what you would say in a closing
4 argument if we were doing that right now.

5 MR. MAY: Prior to 1990 there was not a clear
6 indication or clear statutory authority for Sebring to
7 divest itself of it's assets, and this act was
8 specifically put before the legislature and passed to
9 address that issue, and that is to give the Sebring
10 Utilities Commission specific authority to divest. The
11 second is that there was considerable political concern
12 in the Sebring area regarding the Sebring Utilities
13 Commission's efforts to refinance, and to go through
14 refinancing, and as a safeguard it's my understanding
15 that the second part of this act was to limit the
16 Sebring Utilities Commission ability to do that in
17 excess of \$100,000 without the City Council's approval.

18 COMMISSIONER EASLEY: So if you were in a closing
19 argument, and I would ask you the question, what you're
20 saying, you're relying on this statute for the first
21 part of it, which is the divestiture of the assets, the
22 explanation that there was some political concern, but
23 you're not relying on the second part of it in any way
24 to cover the bond or refinancing situation in this
25 particular instance?

1 MR. MAY: That's correct. My only point was there
2 was some question suggesting that why didn't the City
3 Council approve, or why did they withhold authority to
4 enter into any kind of indebtedness, and I just wanted
5 to make the point that when the bonds were issued
6 initially the City Council was not in that picture.

7 COMMISSIONER EASLEY: It makes it a lot clearer,
8 Mr. May. Thank you.

9 MR. ROSS: Commissioner Easley, can I comment on
10 Mr. May's answer, or would that not be appropriate?

11 CHAIRMAN BEARD: I don't want to get too far gone,
12 if you could do something very briefly. What would you
13 say in your closing argument if they were right now?
14 And you know the nice thing about this is we are going
15 to be able to streamline the closing arguments, aren't
16 we?

17 MR. ROSS: Once you open the barn door, you see --

18 CHAIRMAN BEARD: I understand.

19 COMMISSIONER EASLEY: Yes, but we can close it.

20 MR. ROSS: You certainly can. I will be
21 enormously brief. I would just point out that from the
22 Intervenor's standpoint, noting that the bond
23 resolution was amended and restated in 1986 before the
24 passage of 90-474, this special act is far more of a
25 limiting act than an enhancing or expansionary act.

1 What it simply does is limit the Commission's power,
2 and places supervisory power in the hands of the City
3 Council. Before this act, I would submit that the bond
4 resolution gave full authority, as Ms. Holloway has
5 testified with respect to Page 71 and the following
6 pages, to do anything it wanted within the terms of the
7 resolution.

8 COMMISSIONER EASLEY: Got you.

9 CHAIRMAN BEARD: I need to go back and ask you a
10 question or two before I let you get away.

11 THE WITNESS: Except I'm not supposed to be going
12 anywhere, right?

13 CHAIRMAN BEARD: Well, that's correct.

14 MR. MAY: Commissioner --

15 CHAIRMAN BEARD: Yes.

16 MR. MAY: Never mind, I will hold off on my
17 questions until --

18 CHAIRMAN BEARD: I thought you might want to let
19 me get mine done, because you may want to ask something
20 about what I ask. I'm trying to protect your rights
21 and all of that stuff. You expect the water utility to
22 sell for a value of some \$21 million, rough figure, is
23 that correct?

24 THE WITNESS: 21-1/2 million is the fixed price.

25 CHAIRMAN BEARD: What is the CIAC associated with

1 the water utility? Ballpark.

2 THE WITNESS: I don't have it. I can look it up.

3 CHAIRMAN BEARD: 15 million, 5 million, 200,000?

4 THE WITNESS: It would be a few million. The
5 purchase price for the water system is not based on net
6 book value.

7 CHAIRMAN BEARD: I guess what I'm trying to get at
8 is if you have a CIAC, and let's use an imaginary
9 figure of some \$5 million. From the bonds you have an
10 amount that has been used in that net construction, as
11 I understand it, of something less than a million. And
12 from that, you generate a value of 21 million? Or is
13 there money that was put in there that I don't know
14 about? It's a business that I want to get into if I
15 can invest six and get 21 out of it. It would be a
16 great business.

17 COMMISSIONER EASLEY: That's not as good as
18 insuring the bonds.

19 THE WITNESS: The City of Sebring has consulting
20 engineers that performed a valuation of the water
21 system and arrived at an offer of 21-1/2 million based
22 on a revenue analysis approach.

23 CHAIRMAN BEARD: Okay. Go ahead, I'm sorry.

24 BY MR. MAY:

25 Q I believe it was Commissioner Easley, Ms.

1 Holloway, asked you some questions about the City of
2 Sebring's involvement in a refinancing option several years
3 ago, and that the City Council did not consent or did not
4 agree with that refinancing; do you recall that line of
5 questioning?

6 A Yes, sir, I recall that line.

7 Q Is it fair to say that many of the citizens of
8 Sebring find efforts by the Sebring Utility Commission to
9 refinance distasteful?

10 A Yes.

11 Q And is it also fair to say that the city council
12 when it elected or decided not to consent to the
13 refinancing, or the pursuit of a refinancing option several
14 years ago, was doing so at the request of its citizenry?

15 A That is my understanding.

16 Q Why isn't refinancing a viable option today?

17 A When compared to a sale option, there are economic
18 penalties associated with refinancing, so sale of assets
19 because of that extraordinary call feature that I talked
20 about before, calls refinancing to be less -- achieve, you
21 know, higher rates than what a sale of assets would. And
22 this is because there are requirements within the resolution
23 that upon refinancing the bonds cannot be called
24 immediately. The earliest call date is in 1996. So a
25 defeasance would have to be achieved through a defeasance

1 escrow. Even to call in 1996, there is a three percent call
2 premium that would be assessed on an early call. For that
3 period of time, from let's say 1993 through 1996, there
4 would be negative arbitrage within the escrow, primarily
5 because you cannot invest in the appropriate instruments at
6 the same rate that the interest rate is on the outstanding
7 bonds; 7-1/2 percent versus probably 3-1/4 or 3-1/2 percent.
8 Even if the investment market was higher, you could only
9 invest in that escrow to the level of your new bond issue,
10 which in today's market would probably be around 6-1/4 to
11 6-1/2 percent, so you would still always have a negative
12 arbitrage or a negative interest cost during that period.
13 Those convert to creating a larger bond size. Thus,
14 creating a higher debt service payment annually, which
15 drives what your resulting rates would have to be set at.

16 Q As I understand your testimony, you have testified
17 that basically Sebring has four options; one, it can
18 continue to operate, and raise rates to meet its rate
19 covenants. Two, it could consider bankruptcy. Three, it
20 could pursue some refinancing. And, four, I guess a sale to
21 the City, which is similar to refinancing. I guess five
22 would be to pursue this transaction. Based upon your review
23 of those alternatives, which of those five alternatives
24 would allow the citizens and the ratepayers of Sebring
25 Utility Commission to enjoy maximum rate relief?

1 A It's my opinion that the sale to Florida Power
2 would achieve the most beneficial rates to the ratepayers of
3 Sebring with the most certainty.

4 MR. MAY: I have no further questions.

5 CHAIRMAN BEARD: The witness is excused. But
6 don't leave the county. Exhibits.

7 MS. BROWN: I'm sorry, Commissioner. Staff moves
8 Exhibit 6.

9 CHAIRMAN BEARD: Without objection. The next
10 witness. We are going to take a ten minute break.
11 (Exhibit Number 6 received into evidence.)

12 (Recess taken.)

13 CHAIRMAN BEARD: Okay. Next witness.

14 MR. STEVENSON: Sebring calls Mr. Frank Williams.

15 Thereupon,

16 FRANK WILLIAMS

17 was called as a witness, and having been first duly sworn,
18 was examined and testified as follows:

19 DIRECT EXAMINATION

20 BY MR. STEVENSON:

21 Q Mr. Williams, have you been previously sworn?

22 A Yes, I have.

23 Q Would you please state your name and address for
24 the record?

25 A Frank Williams, 111 Park Avenue East, Lake Placid,

1 Florida.

2 Q Mr. Williams, by whom are you employed and in what
3 capacity?

4 A I'm currently a member in the accounting firm of
5 Williams and Collette, CPA Firm, which is the successor firm
6 to Wicks, Brown, Williams and Company. I was a partner in
7 Wick, Brown, Williams and Company that performed the annual
8 audits for Sebring Utilities Commission.

9 Q Mr. Williams, have you had occasion to prefile
10 direct testimony in this proceeding entitled direct
11 testimony of Frank Williams, dated September 25th, 1992?

12 A Yes.

13 Q Do you have any corrections to your prefiled
14 testimony?

15 A No, I do not.

16 Q If you were asked the questions that appear in
17 your prefiled direct testimony today, would your answers be
18 the same?

19 A Yes, they would.

20 MR. STEVENSON: Mr. Chairman, I would ask that Mr.
21 Williams' testimony be inserted into the record as
22 though read.

23 CHAIRMAN BEARD: It will be so inserted.
24
25

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Frank L. Williams and my business address is 111 Park Avenue East, Lake
3 Placid, Florida 33852.

4 **Q. WHAT FIRM DO YOU REPRESENT AND WHAT POSITION TO YOU HOLD?**

5 A. I was a partner in Wicks, Brown, Williams & Co., Certified Public Accountants, for
6 over fourteen years and I held the position of partner. I was an employee of the
7 predecessor firm for four years. I am currently a partner in Williams & Collette,
8 Certified Public Accountants, a successor firm to Wicks, Brown, Williams & Co.,
9 formed July 1, 1992. Over the last 18 years, I have provided a broad range of public
10 accounting services including auditing financial statements of governmental and other
11 organizations, tax planning and preparation, management advisory services, and financial
12 planning.

13 **Q. DESCRIBE YOUR EDUCATION AND PROFESSIONAL EXPERIENCE.**

14 A. I graduated from Lee College in Cleveland, Tennessee in 1970 with Bachelors Degrees.
15 I graduated from the University of South Florida in 1973 with a Master of Business
16 Administration Degree. While earning the masters degree, I took sufficient course work
17 in accounting to sit for the certified public accounting examination. I passed the exam
18 on the first sitting in November, 1973. I have been a certified public accountant since
19 November 28, 1974.

20 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE WITH SEBRING
21 UTILITIES COMMISSION.**

22 A. From September 1974 to the current date, I have served on the professional staff of the
23 auditing firm engaged to perform annual audits of the financial statements of the Sebring
24 Utilities Commission (Sebring). Initially, I was a staff accountant. Subsequently, I
25 served as a partner in charge of the engagement.

1 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY TODAY?**

2 A. I am testifying on behalf of Sebring in this proceeding. My testimony will describe our
3 examination of Sebring's financial statements for the year ended September 30, 1991,
4 which included a prior period adjustment to retained earnings to reflect an increase in the
5 value of certain property, plant and equipment of Sebring's electric distribution system
6 and general plant assets targeted to be acquired by FPC.

7 Q. **ARE YOU SPONSORING ANY EXHIBITS IN THIS CASE?**

8 A. Yes. I am sponsoring the following portions of Exhibit 1: Page 210, "Independent
9 Auditor's Report".

10 Q. **WAS YOUR AUDIT OF SEBRING FOR THE YEAR ENDED SEPTEMBER 30,
11 1991, CONDUCTED IN ACCORDANCE WITH GENERALLY ACCEPTED
12 AUDITING STANDARDS?**

13 A. Yes. Our audit was conducted in accordance with generally accepted auditing standards
14 and Government Auditing Standards, issued by the Comptroller General of the United
15 States.

16 Q. **DID THE SCOPE OF YOUR AUDIT INCLUDE THE "SUPPLEMENTARY
17 SCHEDULE OF ELECTRIC SYSTEM ASSETS IDENTIFIED FOR SALE"?**

18 A. Yes. Our audit was made primarily for the purpose of forming an opinion on the basic
19 financial statements taken as a whole. The supplementary schedule was, however,
20 subjected to the auditing procedures applied in the audit of the basic financial statements
21 and, in our opinion, was fairly stated in all material respects in relating to the basic
22 financial statements taken as a whole.

23 Q. **WERE YOUR AUDITING PROCEDURES APPLIED TO THE "SUPPLEMENTARY
24 SCHEDULE OF ELECTRIC SYSTEM ASSETS IDENTIFIED FOR SALE"
25 SUFFICIENT IN SCOPE TO WARRANT RELIANCE THEREON BY THE**

1 **SEBRING UTILITIES COMMISSION, FPC, AND THE FLORIDA PUBLIC**
2 **SERVICE COMMISSION?**

3 A. Yes. Although our opinion rendered on the financial statements for the year ended
4 September 30, 1991, indicates "in our opinion, is fairly stated in all material respects in
5 relating to the basic financial statements taken as a whole," additional auditing procedures
6 were applied to the supplementary schedule with the understanding that the parties to this
7 petition would be relying thereon.

8 **Q. HOW DID SEBRING IDENTIFY "ELECTRIC SYSTEM ASSETS IDENTIFIED**
9 **FOR SALE"?**

10 A. "Electric System Assets Identified for Sale" were identified by reference to the latest draft
11 of the proposed contract for sale of the system available on June 11, 1992. Net property,
12 plant and equipment in service of \$15,152,277, and construction work in progress of
13 \$276,762 as of September 30, 1991, was identified by reference to the valuation study
14 performed by RMI. Property, plant and equipment in service includes an adjustment for
15 contributions-in-aid-of-construction made from the books and records of Sebring.
16 Current Assets were identified by reference to allocations made from the books and
17 records of the Sebring Utilities Commission.

18 **Q. DID SEBRING RECORD AN ADJUSTMENT ON ITS BOOKS AND RECORDS**
19 **TO INCREASE THE VALUE OF PROPERTY, PLANT AND EQUIPMENT IN**
20 **SERVICE IN THE FINANCIAL STATEMENTS FOR THE YEAR ENDED**
21 **SEPTEMBER 30, 1991?**

22 A. Yes. Sebring recorded an adjustment increasing property, plant and equipment resulting
23 from a study made by the Commission's consulting engineer (RMI) which considered,
24 among other things, depreciation rates and a physical inventory of electric and general
25 plant assets.

1 Q. **IN YOUR OPINION, WAS THE PRIOR PERIOD ADJUSTMENT TO RETAINED**
2 **EARNINGS INCREASING NET PROPERTY, PLANT AND EQUIPMENT IN**
3 **SERVICE AS OF SEPTEMBER 30, 1991, MADE IN ACCORDANCE WITH**
4 **GENERALLY ACCEPTED ACCOUNTING PRINCIPLES?**

5 A. Yes. The adjustment was made in accordance with generally accepted accounting
6 principles.

7 Q. **IS THERE ANY PRECEDENT IN THE STATE OF FLORIDA FOR MUNICIPAL**
8 **ELECTRIC UTILITIES TO MAKE SIMILAR PRIOR PERIOD ADJUSTMENTS**
9 **AS A RESULT OF SIMILAR CONSULTING ENGINEER'S STUDIES?**

10 A. Yes. In the 1970's, 1980's, and 1990's, a number of Florida Municipal Utilities have
11 recorded similar adjustments to net property, plant and equipment in service.

12 Q. **PLEASE EXPLAIN WHY SUCH ADJUSTMENTS WERE MADE?**

13 A. Florida Public Service Commission Rule 25-6.014(7) requires municipal electric utilities
14 to comply with the Federal Energy Regulatory Commission's Uniform System of
15 Accounts. This rule requires a municipal utility to implement a continuing property
16 records system. Prior to the adoption of the rule, most municipal utilities in Florida
17 followed governmental accounting practices under which many capital expenditures were
18 being expensed. As a result, most of the systems had not identified retirement units as
19 required by the continuing property records system. To adhere to the rule requirements,
20 many Florida municipal utilities engaged consulting engineers to perform system wide
21 surveys for the purpose of redetermining the value of their electric plant.

22 Q. **DOES THIS CONCLUDE YOUR TESTIMONY?**

23 A. Yes.

1 BY MR. STEVENSON:

2 Q Mr. Williams, are you sponsoring any portion of
3 what has already been marked, identified, and entered into
4 evidence as Exhibit Number 1?

5 A Yes, I am sponsoring Page 210 of that exhibit, the
6 independent auditor's report.

7 Q Mr. Williams, would you summarize your testimony.

8 A I'm testifying on behalf of Sebring Utilities
9 Commission, representing the accounting firm of Wicks,
10 Brown, Williams and Company, CPAs, which has performed
11 annual financial audits for the Commission. More
12 specifically, Wicks, Brown, Williams and Company, CPAs,
13 audited the financial statements for the fiscal year ended
14 September 30th, 1991. During the 1991 fiscal year the
15 Commission recorded a prior period adjustment to retained
16 earnings to reflect an increase in the cost of certain
17 property, plant, and equipment, namely, the electric
18 distribution system, and certain general plant assets
19 targeted to be sold to Florida Power Corporation. The
20 adjustment recorded in the 1991 financial statements by the
21 Commission was based on a study made by the Commission's
22 consulting engineers, RMI, which considered among other
23 things depreciation rates and a physical inventory of
24 electric and general plant assets.

25 The prior period adjustment was made in accordance

1 with Generally Accepted Accounting Principles, and followed
2 precedent established in Florida by other Florida municipal
3 utilities. The scope of the 1991 audit concluded the
4 supplementary schedules attached to the basic financial
5 statements, including the supplementary schedule of electric
6 system assets identified for sale.

7 This concludes the summary of my testimony.

8 MR. STEVENSON: At this time we tender Mr.
9 Williams for cross.

10 CHAIRMAN BEARD: Let me ask a quick question. You
11 are sponsoring Page 210?

12 THE WITNESS: Yes.

13 CHAIRMAN BEARD: Because I had shown, previously,
14 somebody sponsoring Pages 207 through 231, and I'm
15 simply trying to keep my records straight. Mainly I'm
16 filling in gaps, but that was an overlap. Is there
17 something I missed?

18 MR. MAY: Mr. Chairman, Page 210 of Exhibit 1 is
19 part of the financial statements prepared by Sebring
20 Utilities Commission, so there is some overlap on that
21 exhibit.

22 CHAIRMAN BEARD: Okay. I just wanted to make sure
23 I hadn't made a mistake in my record keeping. The main
24 thing is that I get it all sponsored.

25 MR. MAY: Mr. Williams is the independent auditor,

1 and this exhibit does have some overlap between the two
2 witnesses.

3 CHAIRMAN BEARD: Okay. Florida Power.

4 MR. FAMA: No.

5 CROSS EXAMINATION

6 BY MS. BROWN:

7 Q Mr. Williams, you just stated that Sebring's
8 financial statements for the year ended September 1991 were
9 conducted in accordance with Generally Accepted Accounting
10 Principles, correct?

11 A They were prepared in accordance with Generally
12 Accepted Accounting Principles, yes.

13 Q And has it been the determination of your firm and
14 successor firm for many years that Sebring's financial
15 statements were prepared in accordance with Generally
16 Accepted Accounting Principles?

17 A That's correct.

18 Q Did you ever have an audit report released for
19 Sebring with an audit exception?

20 A Yes.

21 Q You did. What year was that, and when was that?

22 A That was prior to refinancing in approximately
23 1986. The qualifications were unrelated to the issues that
24 we have talked about that have to do with continuing
25 property records. There have been others, but I can't tell

1 you off the top of my head what the issues were, or what
2 years were involved.

3 Q You are familiar with governmental accounting
4 auditing standards, correct?

5 A That's correct.

6 Q Under those standards is an auditor supposed to
7 check for compliance with laws and regulations?

8 A Yes, they are.

9 Q Ms. Holloway has testified that her review of
10 Sebring's books and records show that the Utilities
11 Commission was not in compliance with FERC Uniform System of
12 Accounts. Isn't it correct that none of the annual audits
13 your firm performed for Sebring indicated this problem?

14 A I would like to clarify that, if I may.

15 Q Well, would you answer yes or no, and then please
16 clarify?

17 A Would you restate the question?

18 Q Isn't it correct that none of the annual audits
19 your firm performed for Sebring indicated the problem with
20 the Uniform System of Accounts?

21 A No, that is not correct.

22 Q How did the audits that your firm performed
23 indicate that problem?

24 A There are more than one report issued in
25 connection with an audit. There is an opinion rendered on

1 the financial statements. In addition, there is a report
2 issued on internal control problems or difficulties. The
3 early management/internal control letters did indicate that
4 there was a compliance problem with not having continuing
5 property records.

6 Q In fact, several of those letters were issued to
7 Sebring over the years, were they not?

8 A That's correct.

9 Q But was an audit exception ever registered for
10 that problem?

11 A An audit exception in which report? In the
12 opinion on the financial statements?

13 Q Yes.

14 A No.

15 Q Your management letters consistently recommended
16 changes in areas that your firm considered critical in
17 nature, and were found to be less than satisfactory during
18 your review, is that correct?

19 A That's correct.

20 Q And one of those main recommendations that you
21 made repeatedly to Sebring was that Sebring should implement
22 a continuing property record system, correct?

23 A That's correct.

24 Q In fact, as you may remember, in your March 1980
25 letter, your recommendation is that a continuing property

1 record system be developed as soon as possible, but not
2 later than the end of fiscal 1981?

3 A That's correct.

4 Q It appears, however, that as late as 1989 Sebring
5 still had no continuing property records system?

6 A That is also correct.

7 Q Do you have any idea why Sebring did not act on
8 the recommendations of your firm?

9 A In order to answer that question I have to speak
10 to the intention of Commissioners and management, and the
11 Commission and management have changed over the years. So
12 part of what I say to you will be based on hearsay, and my
13 recollection, which may or may not be accurate. My
14 impression is that management, and the Commission acting on
15 management's recommendations over the years did not believe
16 that the benefits of implementation of the system exceeded
17 the cost.

18 Q You are aware, I'm sure, that this Commission has
19 required by rule since 1976 that municipalities develop and
20 maintain continuing property records systems?

21 A That's correct.

22 Q When the Sebring Utilities Commission failed to
23 act upon your March 1980 letter, your firm still did not
24 make notice of this in any of your financial statement
25 audits, is that correct?

1 A We did not make note of it in the audit report on
2 the financial statements, that's correct.

3 Q Would you agree that if Sebring had implemented a
4 continuing property record system, a valuation to restate
5 the net book value of Sebring assets would not have been
6 necessary?

7 A It would have been necessary at the time
8 implemented, and that would have been earlier and therefore
9 not necessary during fiscal '91.

10 MS. BROWN: Excuse me just for one minute.

11 COMMISSIONER EASLEY: While you are looking at
12 that, may I ask one follow-up on that other question.
13 You said that the utility had determined that it wasn't
14 cost-effective to comply with the Commission's rule, is
15 that correct, or was that --

16 THE WITNESS: There is some conjecture on my part
17 when I say that.

18 COMMISSIONER EASLEY: Was it based on that
19 conjecture that you all did not cite them any audit
20 exceptions in subsequent audits?

21 THE WITNESS: No. The reason we did not make
22 mention in the annual opinion that is rendered on the
23 financial statement is because we did not believe the
24 impact of failure to implement continuing property
25 records had a material impact on the financial position

1 or results of operation that is shown in the annual
2 financial statements for the Commission.

3 COMMISSIONER EASLEY: I don't mean to sound
4 argumentative, I just want to understand this. Is it
5 your position that if there is no material effect you
6 don't feel obliged to call attention to the fact that
7 they are not in compliance with regulations?

8 THE WITNESS: Not in that report. On the
9 financial statements, no, we do not. In the management
10 letters, we do.

11 BY MS. BROWN:

12 Q Mr. Williams, what was Sebring's plant balance
13 before the restatement?

14 COMMISSIONER EASLEY: Would you repeat your
15 question.

16 BY MS. BROWN:

17 Q What is Sebring plants balance before the
18 restatement?

19 A I don't have an exact number in front of me. I
20 think it was approximately 6 million less than the restated
21 balance.

22 Q Do you consider that a material difference?

23 A No, we do not. Now, let me go back and tell you a
24 little bit about how we determine materiality. In the first
25 place, we are looking at it after the fact. All of these

1 judgments that were made on financial statements prior to
2 1991 were made before knowing what that difference was. If
3 we had known what the difference was, we would have required
4 the Commission to record that difference, and they would
5 have done so. Materiality is a judgment call. There are
6 qualitative and quantitative considerations that are taken
7 into account. But ultimately it's a judgment call on the
8 part of the auditing firm, would a \$6 million adjustment be
9 material? We weren't looking at a \$6 million adjustment, we
10 were looking at an unquantified unknown adjustment.

11 Typically auditors use a rule of thumb of 5 to 10
12 percent in the best environment for determining materiality,
13 to the extent to which they will allow unknown or
14 unquantified adjustment to slide. For example, the total
15 assets of the Commission for the fiscal year ended September
16 30th, 1990 were \$95,796,000, this is before adjustments.
17 Five percent of that number is approximately \$5 million.

18 Q Well, Mr. Williams, I think the important question
19 to answer here was if you couldn't quantify the difference,
20 how could you know whether it was material or not?

21 A You have to make a judgment call based on your
22 knowledge of the client and the circumstances.

23 COMMISSIONER EASLEY: Do you use the total amount
24 of the assets, or were you aware of the nature of the
25 figure to be slid -- that is me over here.

1 THE WITNESS: Oh, over here, I'm sorry, I was
2 trying to find some moving lips over there, and I
3 was --

4 COMMISSIONER EASLEY: There are those who think if
5 you look at me you still don't find any, but --

6 THE WITNESS: Will you repeat that question.

7 COMMISSIONER EASLEY: What I was trying to find
8 out, Counsel asked you how you could make a
9 determination as to materiality when you didn't know
10 what it was, and you said, well, you considered the
11 overall nature of the client. And what I'm trying to
12 find out is if you look at the 75,000, or whatever you
13 said the assets were at that time, and make a
14 determination of, well, our range is 5 to 10 percent,
15 do you care what the potential expenditure was for, or
16 the potential account that that would have been entered
17 into was for, because all of a sudden I could see, you
18 could be talking about \$20 million in a heart beat?

19 THE WITNESS: Let me try to answer that this way.
20 When you look at 5 to 10 percent, and 5 percent is
21 probably the most popular of those two, of that range.
22 When you look at 5 percent, you look at an applicable
23 statistic depending on the nature of the error. For
24 example, you would use 5 percent of total assets in
25 making a judgment about something that affected the

1 profit and loss statement, you would use 5 percent of
2 net income on the profit and loss statement. When you
3 are looking at the balance sheet, unless it involves
4 the current ratio or some other unique statistic, you
5 might look at 5 percent of total assets.

6 COMMISSIONER EASLEY: That gets me to my question
7 a little bit easier. Let's use your P&L example and 5
8 percent. If I'm looking at a miscellaneous item, I'm
9 not going to use any 5 percent as a guideline for
10 materiality, I'm probably going to go down around one
11 on a miscellaneous item. On A&G, 5 percent is probably
12 reasonable. That is what I'm trying to figure out, is
13 do you look within the P&L, if you will, to Sebring
14 what it is we are talking about before you apply that
15 percentage?

16 THE WITNESS: Yes, you do.

17 COMMISSIONER EASLEY: And you knew what that was
18 going in to not knowing about \$6 million?

19 THE WITNESS: No, that is also an unknown, because
20 depreciation charges that flow through the annual
21 profit and loss statement are effected by the total
22 plant amount. So if your total plant is understated,
23 your depreciation charges will be understated. Not by
24 the same amount, because you are looking at a much
25 smaller figure when you look at annual depreciation

1 versus a cumulative lifetime adjustment to the balance
2 sheet.

3 COMMISSIONER EASLEY: And you were perfectly
4 comfortable taking an unknown account, unknown amount,
5 unknown result and applying a 5 percent to it, whatever
6 that was?

7 THE WITNESS: We were comfortable with the
8 judgments that we made, yes.

9 COMMISSIONER EASLEY: Okay.

10 BY MS. BROWN:

11 Q And you are comfortable with the judgments that
12 you have made with respect to the 1991 financial statement
13 of Sebring?

14 A Yes.

15 Q You're familiar with the RMI valuation study,
16 correct?

17 A Yes.

18 Q Do you believe that the results of that study are
19 reasonable?

20 A Yes. From a layman's or a non-engineer's point of
21 view, yes.

22 Q How did you go about determining the
23 reasonableness of the RMI valuation of investment and
24 accumulated depreciation?

25 A We relied exclusively on their certificate. They

1 issued a certificate on their study and we relied on that in
2 recording the adjustment.

3 MS. BROWN: We have no further questions.

4 CHAIRMAN BEARD: Redirect.

5 MR. STEVENSON: None.

6 CHAIRMAN BEARD: You stay step down.

7 (Off the record briefly.)

8 Thereupon,

9 GERALD E. WARREN, II

10 was called as a witness, and having been first duly sworn,
11 was examined and testified as follows:

12 DIRECT EXAMINATION

13 BY MR. MAY:

14 Q Mr. Warren, have you previously been sworn in this
15 proceeding?

16 A Yes, I have.

17 Q Please state your name and business address for
18 the record?

19 A My name is Gerald Edwin Warren, II. My address is
20 7115 Lake Ellenor Drive, Orlando Florida, 32809.

21 Q And by whom are you employed and in what capacity?

22 A I'm Vice President for Florida Consulting with the
23 firm of Resource Management International, Inc.

24 Q Mr. Warren, have you had occasion to prefile in
25 this docket direct testimony entitled testimony of Gerald E.

1 Warren, II, dated September 25, 1992?

2 A Yes, I have.

3 Q And do you any corrections to make to that
4 testimony?

5 A Yes, I do. I have one correction that occurs at
6 several locations. On Page 11, Line 18, the figure 4.8
7 million should read 4.85 million. Likewise, Page 12, Line
8 5, and Page 14, Lines 15, 17 and 21.

9 Q So where the dollar amount \$4.8 million is
10 reflected in your testimony, you're asking that that number
11 be changed to 4.95 million?

12 A Yes, sir, I am.

13 Q Do you have any other changes to make to your
14 prefiled direct testimony?

15 A No, I don't.

16 Q And if I were to ask you the questions that appear
17 in your testimony today, would your answers be the same?

18 A Yes, they would.

19 MR. MAY: Mr. Chairman, I would ask that Mr.
20 Warren's testimony be inserted into the record as
21 though read.

22 CHAIRMAN BEARD: It will be so inserted.
23
24
25

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Gerald "Jerry" E. Warren, II. My business address is 7115 Lake Ellenor
3 Drive, Orlando, Florida 32809.

4 **Q. BY WHOM ARE YOU EMPLOYED?**

5 A. I am Vice President of Florida Consulting with the firm Resource Management
6 International, Inc. (RMI). I am responsible for consulting services provided from both
7 our Orlando and West Palm Beach, Florida offices.

8 **Q. PLEASE SUMMARIZE YOUR FORMAL EDUCATION.**

9 A. In 1972, I received a Bachelor of Science in Electrical Engineering from the University
10 of Florida. I graduated with honors with my focus of studies in power systems.

11 **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

12 A. I have over 20 years of experience in electric utility planning, operations, engineering,
13 finance and management. From September 1972 through April 1976, I was employed
14 by R. W. Beck & Associates, a nationwide consulting engineering firm. During that
15 period, I assisted in the preparation of power supply planning studies, financial feasibility
16 studies, financing plans, and the preparation of testimony before various regulatory
17 agencies. I was also responsible for the planning, design, and project management of
18 various transmission and distribution facilities.

19 From May 1976 through August 1989, I was employed by Gainesville Regional Utilities.
20 During eight of those years, I was Director of the utility's planning department. In that
21 role, I planned generation, transmission, and major distribution facilities. In addition,
22 I carried out the utility's financial planning. In that regard, I was responsible for
23 obtaining the necessary debt capital to finance the utility system's capital construction
24 program. During that timeframe, I directed the utility's financings which included a
25 \$186 million refinancing of the utility's outstanding debt, the implementation of a \$50

1 million tax-exempt commercial paper program, plus the permanent and interim financings
2 associated with the construction of a 235 MW coal-fired power plant.

3 I was also responsible for joint planning activities with other utilities in the interconnected
4 Florida transmission system. I negotiated interchange contracts with the other Florida
5 generating utilities which provided for the purchase and sale of firm, non-firm, and
6 emergency power.

7 Subsequently, I served for three years as General Manager of the combined electric,
8 water, and wastewater utility system. The utility provided service to 56,000 customers,
9 had assets in excess of \$583 million, had an annual operating budget of \$129 million, and
10 employed over 700 people. As General Manager, I was responsible for all phases of the
11 executive management of the utility system including the planning, design, construction
12 and operation of all utility facilities and personnel.

13 I have been employed by RMI since September 1989. In that timeframe, I have
14 performed or directed various power supply, transmission, financing and
15 management/organizational studies associated with electric utilities. I have carried out
16 negotiations on behalf of client utilities and have performed various financial evaluations
17 for our clients.

18 I am a Registered Professional Engineer in the State of Florida.

19 **Q. PLEASE PROVIDE AN OVERVIEW OF THE CAPABILITIES OF YOUR FIRM.**

20 **A.** Resource Management International, Inc. (RMI) is an engineering and management
21 consulting firm with expertise in the areas of energy, water and waste management. Our
22 staff of nearly 300 covers a broad range of disciplines including analysts, economists,
23 rate specialists, engineers, and environmental specialists.

24 RMI provides its services to publicly and privately owned utilities, REA cooperatives,
25 cities, water districts, legal and financial firms, and government agencies. The firm

1 provides its services on a national and international basis from its offices in Sacramento,
2 California; Portland, Oregon; Phoenix, Arizona; Columbus, Ohio; Austin, Texas;
3 Albany, New York; West Palm Beach and Orlando, Florida.

4 **Q. HAVE YOU PREVIOUSLY PROVIDED EXPERT TESTIMONY BEFORE**
5 **REGULATORY COMMISSIONS OR COURTS?**

6 A. Yes. As mentioned above, I served as the Director of Planning, and General Manager
7 for a large Florida municipal utility. During that timeframe, I was periodically called on
8 to submit testimony and other information to various regulatory bodies and courts. Also,
9 I served as an expert witness on behalf of the Virgin Islands Public Service Commission
10 concerning the Virgin Islands Water And Power Authority's facilities and financing
11 plans.

12 **Q. WHOM DO YOU REPRESENT IN THIS PROCEEDING?**

13 A. RMI has been retained by the Sebring Utilities Commission (Sebring) to provide various
14 services associated with the sale of its electric distribution system. As a part of that
15 process, Sebring issued a Request for Proposals for the purchase of its electric
16 distribution system and certain remaining transmission facilities. RMI's services have
17 included the evaluation of the proposals received by Sebring, the valuation of the
18 distribution system, the preparation of load and financial forecasts and assistance in
19 Sebring's negotiations with Florida Power Corporation (FPC).

20 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?**

21 A. FPC and Sebring have jointly petitioned the Florida Public Service Commission for a
22 number of approvals in connection with the sale of certain assets by Sebring to FPC.
23 My testimony focuses on the specific request by FPC and Sebring for PSC approval of
24 any "going concern" to be allocated to the Rate Base Asset portion of the Base Purchase
25 Price.

1 More specifically, my testimony addresses three primary areas: first, I define the term
2 "going concern" as used in the Joint Petition; second, I calculate the appropriate value
3 of the "going concern" and related benefits; and third, I explain that a positive finding
4 of "going concern" value will reduce the amount of the Sebring Rider as discussed in Mr.
5 Nixon's testimony and is in the public interest.

6 **Q. HAVE YOU PREPARED OR ARE YOU SPONSORING ANY EXHIBITS IN THIS**
7 **PROCEEDING?**

8 A. Yes, I am sponsoring one exhibit which is attached to my testimony and identified as
9 Exhibit No. GEW-1 (7) -- Estimate of "Going Concern" and Related Benefits.

10 **DEFINITION OF "GOING CONCERN"**
11 **AND RELATED BENEFITS**

12 **Q. ARE YOU GENERALLY FAMILIAR WITH THE TERMS AND CONDITIONS OF**
13 **THE PROPOSED SALE OF SEBRING TO FPC AS SET FORTH IN THE**
14 **PURCHASE AND SALE AGREEMENT BETWEEN THOSE TWO PARTIES?**

15 A. Yes.

16 **Q. DOES THE AGREEMENT CONTEMPLATE A "GOING CONCERN" VALUE IN**
17 **THE ACQUISITION OF THE SEBRING SYSTEM?**

18 A. Yes, both the Purchase and Sale Agreement and the Joint Petition refer to "going
19 concern" value.

20 **Q. PLEASE EXPLAIN WHAT IS MEANT BY "GOING CONCERN" VALUE.**

21 A. "Going concern" value is the value of an already established and mature business as
22 compared to one that is not.

23 **Q. WHY WAS THE CONCEPT OF "GOING CONCERN" VALUE INCLUDED AS**
24 **PART OF THE ACQUISITION OF THE SEBRING SYSTEM?**

25 A. There are two main reasons that the concept of "going concern" was included in the

1 acquisition of the Sebring system.

2 (1) As I will demonstrate later in my testimony, there is a measurable dollar
3 value associated with the "going concern" and other related benefits that
4 will flow to FPC as part of that company's acquisition of the mature
5 Sebring system. It is important and proper to recognize the value of
6 those assets in setting the level of the Sebring Rider.

7 (2) The Sebring predicament is clearly an extraordinary situation. Even with
8 acquisition by FPC, the Sebring ratepayers will face high rates due to the
9 payment of a Transition Rate for 15 years. Any "going concern"
10 approved by the PSC for inclusion in FPC's rate base will decrease the
11 level of the Sebring Rider and minimize the financial impact on a large
12 group of severely burdened ratepayers.

13 **Q. WILL THE PURCHASE PRICE ASSOCIATED WITH THE TRANSACTION BE**
14 **AFFECTED BY THIS "GOING CONCERN" VALUE?**

15 A. No. As discussed under the terms of the Purchase and Sale Agreement, the Base
16 Purchase Price is capped at \$54,000,000. Any "going concern" value recognized by the
17 PSC will not affect this cap but will be used to offset, directly, the amount to be
18 recovered through the Transition Rate. In other words, "going concern" dollars will be
19 used to reduce the Transition Rate that will be charged to Sebring's rate payers.

20 **Q. ARE YOU SAYING THAT A FINDING BY THE COMMISSION OF "GOING**
21 **CONCERN" AND OTHER RELATED BENEFITS ASSOCIATED WITH THE**
22 **SEBRING SYSTEM WILL LOWER THE TRANSITION RATE TO SEBRING**
23 **RATEPAYERS FOLLOWING THE ACQUISITION BY FPC?**

24 A. Yes.

IDENTIFIED BENEFITS OF
"GOING CONCERN"

1
2

3 **Q. HOW HAVE YOU CALCULATED THE VALUE OF "GOING CONCERN" AND**
4 **OTHER RELATED BENEFITS IN THIS TRANSACTION?**

5 A. I have specifically identified, and assigned a value to, various elements of "going
6 concern" and other related benefits that FPC receives from the purchase of the up and
7 running Sebring system.

8 **Q. WHY IS THERE A VALUE ASSOCIATED WITH AN ALREADY ESTABLISHED**
9 **BUSINESS COMPARED TO ONE THAT'S IN A MORE DEVELOPMENTAL**
10 **PHASE?**

11 A. There are a number of reasons. For instance, the customer base of any up and running
12 business is more established. Developmental costs have already been expended and one
13 would expect that the rate of return on investment from an established business would be
14 higher than one in the early phases of its development. Furthermore, the risks associated
15 with the acquisition of a business in its infancy are clearly greater than those associated
16 with a mature business operation.

17 **Q. HOW CAN YOU DETERMINE IF THERE IS A GOING CONCERN VALUE?**

18 A. There are five criteria that generally must be met to prove that there is a going concern
19 value: (1) the business should be ongoing; (2) the business' distribution outlets should
20 be fixed; (3) the list of customers should be stable from year to year; (4) existing
21 contracts of the business should reflect an ongoing enterprise; and (5) employees of the
22 business should be sufficiently trained and experienced so as to be considered a team.

23 **Q. DOES THE SEBRING ELECTRIC SYSTEM MEET THESE CRITERIA?**

24 A. Yes, I will address each of the factors point by point:

25 (1) Sebring Utilities has been in business for 47 years and has approximately

1 13,000 customers. Like other Florida utilities, it is growing and is
2 continuing to make the necessary investments in its distribution system
3 to provide service for its existing and future customers. It should be
4 clearly understood that Sebring's current financial distress is strictly a
5 function of high debt. When viewed from other perspectives such as
6 load growth, O&M expenses, operating ratios, power supply costs, etc.,
7 Sebring exhibits strong indicators. This is important to understand since
8 a purchase alternative that eliminates the debt problem leaves the
9 acquiring utility, i.e., FPC, with a viable, ongoing business.

- 10 (2) In the case of an electric utility, the distribution outlets are the retail
11 customers and are largely fixed. This is the case with Sebring.
- 12 (3) The list of customers or at least the customer service addresses for an
13 electric utility do largely remain fixed year to year. This is the case with
14 Sebring.
- 15 (4) On February 28, 1991, Sebring entered into a 20-year wholesale power
16 supply agreement that provides for extensions beyond the initial 20-year
17 term. This contract gives clear indication that the business of selling
18 electricity to Sebring's ratepayers is here to stay.
- 19 (5) The tenure (service time) of Sebring's employees is a strong indication
20 of their experience and value to the utility system as a part of their staff
21 team. The average service time of Sebring's staff being retained by FPC
22 is nine (9) years. In the skilled craft area, the average is eleven (11)
23 years.

24 These factors all show clearly that the Sebring system satisfies the test for "going concern
25 value."

1 **Q. IS THERE A DIFFERENCE IN GOOD WILL VALUE AND GOING CONCERN**
2 **VALUE?**

3 A. Yes, there is. Good will is a function of personal relationships, good service that a
4 business has provided to its customers in the past which would likely result in customers
5 continuing to do business with the new owners in the future. Because Sebring and FPC
6 are monopolies, customers do not have the choice in choosing the business from which
7 they buy electricity. Consequently, it's difficult to argue that there is a good will value
8 associated with the transaction. We are, therefore, not arguing that good will value exists
9 and should be included in the purchase price for the Sebring system.

10 **Q. WHY IS IT APPROPRIATE FOR FPC TO PAY GOING CONCERN VALUE AS**
11 **PART OF THE PURCHASE PRICE FOR THE SEBRING UTILITY SYSTEM?**

12 A. It goes back to why an established business has value when compared to one that is not:
13 reduced risk, reduced developmental cost, and higher rates of return. For instance, if
14 a utility had the choice of paying \$25 million for 13,000 established customers or
15 investing \$25 million in the distribution facilities associated with a new development that
16 will ultimately have 13,000 customers, which would be the better choice? From strictly
17 a present value cash flow basis, the revenue stream from the 13,000 existing customers
18 through time would be greater when compared to the development which is not yet built
19 out. In addition, purchasing existing customers is less expensive than making the
20 incremental investment in new customers. Also, there is always the risk of non-
21 development. Typically, utilities try to minimize this risk by phasing the installation of
22 their facilities.

23 **Q. WHY IS PURCHASING AN EXISTING SYSTEM VERSUS INVESTING IN A**
24 **DEVELOPING CUSTOMER GROUP IN FPC'S BEST INTEREST?**

25 A. If the rate base assets are the same and if approved for inclusion in the rate base by the

1 PSC, FPC's stockholders are indifferent. The real value is to FPC's existing customers.
2 Purchasing an existing system brings more customers and KWH sales in the early years
3 to help support the return on the rate base assets than investing in a speculative
4 development.

5 **Q. CAN YOU CALCULATE THIS VALUE TO FPC'S EXISTING CUSTOMERS?**

6 A. Based on information provided to me by FPC, I have calculated the benefits for FPC's
7 existing customers of purchasing a fully developed 13,000 customer system versus
8 investing in a hypothetical speculative development projected to be the same size. That
9 value is in the range of \$1.5 million to \$2.8 million on a present value basis.

10 **Q. HOW DID YOU CALCULATE THAT AMOUNT?**

11 A. I used a present worth analysis of a revenue requirements cash flow to compare a system
12 like Sebring's that is built out to one that is not. Based on information provided to me
13 by FPC, I have estimated the distribution investment less meters and services to be
14 approximately \$2,000 per customer. Using a capital recovery factor of 16% requires
15 annual revenues of \$320 per customer investment. I have assumed both a 5 year and 10
16 year build out case and have used a 10% present value discount rate. This analysis
17 concludes that FPC's existing customers benefit from the purchase of a fully developed
18 system in an amount that ranges from \$6.9 million to \$13.5 million. However, utilities
19 normally phase the installation of facilities.

20 **Q. DOES PHASING THE INSTALLATION OF THE FACILITIES AFFECT YOUR**
21 **CALCULATIONS?**

22 A. Yes. I evaluated an 8 year build out with four phases and a 9 year build out with three
23 phases. The resulting present value benefit to FPC's existing customers ranges from \$1.5
24 million to \$2.8 million. For simplicity, I have included \$2 million on my Exhibit 7
25 (GEW-1).

1 Q. ARE THERE OTHER ITEMS OF VALUE OF "GOING CONCERN" THAT
2 SHOULD BE CONSIDERED?

3 A. Yes. There are other items of value that will be acquired by FPC that are associated
4 with the acquisition of the "going concern" which are not included in the net book value
5 of the system. Examples include items such as maps of the distribution system, records
6 associated with the use and maintenance of various Sebring facilities, and the value of the
7 experience and knowledge of the Sebring employees that are integrally familiar the
8 distribution system. It should be noted that these same employees will become FPC
9 employees and will continue to provide service to the Sebring area customers after the
10 FPC acquisition.

11 Q. WHAT VALUE HAVE YOU PLACED ON EACH OF THESE OTHER
12 ELEMENTS?

13 A. I have made the following calculations to determine an approximate value, each of which
14 are included on Exhibit 7 (GEW-1):

15 (1) Reproduction of Sebring's distribution Maps. We have estimated the
16 cost to reproduce the maps of Sebring's distribution system to be
17 \$250,000. This cost includes the costs associated with the field
18 inventory and drafting efforts necessary to reproduce Sebring's maps.

19 (2) Value of training and experience of Sebring personnel. We have
20 discussed with FPC the value to FPC of bringing on the Sebring
21 personnel with their direct experience with the Sebring system and their
22 training. The benefit can be evaluated based on the training related costs
23 to FPC to move an entry level employee through their pay plan to the
24 journeyman level. FPC has estimated this value to be \$900,000.

25 Q. ARE THERE OTHER VALUES TO FPC ACQUIRING A GOING CONCERN?

1 A. Yes. FPC representatives have indicated that FPC by purchasing the Sebring system will
 2 avoid or defer the construction of a new distribution substation for FPC's existing
 3 customers. Based on discussions with FPC, we estimate the dollar value of that benefit
 4 is \$1,500,000. I have included this value in my Exhibit 7 (GEW-1).

5 In addition, Sebring and FPC have been involved in a number of serious territorial
 6 disputes since 1981. Although there have been a number of agreements to resolve those
 7 disputes, at least two issues remain unresolved (i.e., the airport and future Sebring
 8 annexations). Also, the existing territorial agreement includes the ongoing administration
 9 associated with customer transfers. The resolution of those issues now, as a part of this
 10 transaction, will avoid future legal and management expense to FPC. Based on our
 11 discussions with FPC, we have estimated those costs over a 15 year period conservatively
 12 to be \$200,000. I have included these figures on my summary Exhibit 7 (GEW-1).

13 **Q. BASED ON YOUR EVALUATION OF THE "GOING CONCERN" AND**
 14 **RELATED BENEFITS ASSOCIATED WITH THE SEBRING DISTRIBUTION**
 15 **SYSTEM, CAN YOU PLACE A TOTAL DOLLAR VALUE ON THOSE**
 16 **ELEMENTS REQUESTED IN THE JOINT PETITION?**

17 A. Based on my evaluation, I would place the dollar value of those elements of "going
 18 concern" at ~~\$4.8~~^{4.85} million.

19 **Q. ARE THERE OTHER APPROACHES TO PLACING A VALUE ON THE GOING**
 20 **CONCERN AND RELATED BENEFITS?**

21 A. Yes. In the process of transferring customers as a part of resolving territorial disputes,
 22 utilities commonly pay replacement cost less depreciation for the facilities and a multiple
 23 times annual revenues for the customers. The resulting premium over and above net
 24 book value may be viewed as representing the market value of "going concern" and
 25 related intangible assets associated with the customer transfer.

1 Q. **HAVE YOU ADOPTED THIS APPROACH?**

2 A. No. It has generally been applied to a smaller number of customer transfers.
3 Consequently it is difficult to conclude that it is relevant in this situation. However,
4 calculating Sebring's "going concern" value using this approach yields an amount much
5 greater than the ^{4.85}~~5.8~~ million value calculated under the Identifiable Benefits Approach.

6 Q. **WHY DID YOU USE THE APPROACH THAT YOU SELECTED?**

7 A. There are many benefits obtained by FPC and its customers in acquiring an existing
8 customer base. Our approach with respect to "going concern" was to delineate those
9 benefits which are the most identifiable and are the easiest to quantify in terms of dollar
10 value. Consequently, we believe our approach is the most straight forward and
11 reasonable approach to address "going concern" under the facts of this transaction.

12 Q. **ARE YOU FAMILIAR WITH THE COMMISSION'S POLICY REGARDING**
13 **ACQUISITION ADJUSTMENTS?**

14 A. Yes. The Commission's policy has been that the purchase of a utility system at a
15 premium or discount can be allocated to rate base only if there are extraordinary
16 circumstances.

17 Q. **IS IT YOUR POSITION THAT THE COMMISSION SHOULD APPROVE AN**
18 **ACQUISITION ADJUSTMENT FOR INCLUSION IN FLORIDA POWER**
19 **CORPORATION'S RATE BASE?**

20 A. Yes.

21 Q. **WOULD YOU EXPLAIN THIS POSITION IN LIGHT OF THE COMMISSION'S**
22 **STATED POLICY?**

23 A. The history of the Sebring situation, as is more fully discussed in Mr. Joe Calhoun's
24 testimony, is truly extraordinary. Sebring's ratepayers have been left holding a huge
25 amount of debt which exceeds the asset value. Consequently, Sebring's customers are

1 paying the highest rates in the state and among the highest in the nation. If the system
2 purchase does not take place and Sebring is to remain solvent it will have to charge
3 among the highest rates in the nation. The purchase of the Sebring system by FPC is
4 part of a Sebring strategy to minimize the financial burdens on the Sebring ratepayers.
5 If the Commission sets a "going concern" value of zero dollars, the transition rate that
6 will be paid by Sebring customers over the next 15 years will initially be set at
7 approximately \$21.80 per 1,000 KWH. This transition rate will be paid in addition to
8 FPC's base rate for its existing customers. The result, of course, will be that Sebring
9 ratepayers will be paying approximately \$22.00 per 1,000 KWH or nearly 30% more
10 than FPC's existing retail customers. As I testified earlier, approval by the Commission
11 of a "going concern" value as a prudent FPC investment will be used directly to reduce
12 the Sebring Rider but will not increase the \$54,000,000 base purchase price. With FPC's
13 base rates plus the Rider, Sebring's retail customers still will be paying among the
14 highest rates in the state of Florida for the foreseeable future. Consequently, it is in
15 Sebring's best interest to have as much of the Base Purchase Price as possible allocated
16 to FPC's rate base assets.

17 **Q. ARE YOU SAYING THAT THE COMMISSION SHOULD FIND AND APPROVE**
18 **"GOING CONCERN" VALUE STRICTLY FOR THE PURPOSE OF**
19 **DECREASING THE SEBRING RATEPAYERS' TRANSITION RATE?**

20 **A.** No, I am simply saying that due to the severity of this extraordinary situation, it is
21 important for the Commission to give due consideration to the dollar value associated
22 with "going concern" and related benefits.

23 **Q. WHAT IS THE BENEFIT TO SEBRING CUSTOMERS OF INCREASING THE**
24 **ALLOCATION OF THE BASE PURCHASE PRICE TO RATE BASE ASSETS**
25 **THROUGH RECOGNITION OF A "GOING CONCERN" VALUE?**

1 A. For every million dollars that the allocation to rate base assets is increased through
 2 recognition of "going concern" and related benefits, the transition rate will be reduced
 3 by approximately 60¢ per 1,000 kilowatthours. Of course, it is important to remember
 4 that the contract is built on the presumption that any such additional amounts will be
 5 approved for inclusion in FPC's rate base. Otherwise, the additional amount will not be
 6 included. I believe that it is appropriate to include these asset values in FPC's rate bases
 7 for the reasons discussed above. In other words, I believe the benefits to FPC's and
 8 Sebring's customers from the "going concern" and related benefits are measurable and
 9 real and should be taken into consideration in setting the Sebring Rider.

10 Q. DO THE FLORIDA STATUTES PERMIT AN ELECTRIC UTILITY LIKE FPC
 11 TO ALLOCATE A PORTION OF AN INVESTMENT TO "GOING CONCERN"
 12 AND INCLUDE THAT "GOING CONCERN" AMOUNT IN ITS RATE BASE?

13 A. Yes. Section 366.01(1) of the Florida Statutes specifically envisions that payments for
 14 "going concern" may be included in an electric utility's rate base.

15 Q. IS \$4.8 MILLION A REASONABLE AMOUNT FOR FPC TO ALLOCATE TO
 16 RATE BASE AS "GOING CONCERN"?

17 A. Yes, as I have demonstrated, ^{4.85}~~\$4.8~~ million is a fair, reasonable and conservative value of
 18 the benefits which FPC will receive by purchasing the Sebring system.

19 Q. WHAT ARE YOU RECOMMENDING?

20 A. I am recommending that the Commission determine that the "going concern" value for
 21 the Sebring Utility System is ^{4.85}~~\$4.8~~ million.

22 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

23 A. Yes, it does.

1 BY MR. MAY:

2 Q Mr. Warren, have you prepared any exhibits to
3 accompany your prefiled direct testimony?

4 A Yes. Attached to my testimony is Exhibit Number
5 GEW-1, entitled going concern and related benefits. I have
6 also filed in this proceeding four other exhibits GEW-2
7 entitled summary of Sebring purchase price; GEW-3, titled
8 benefit of built out system versus speculative development;
9 GEW-4, titled benefit of built out system versus phased
10 speculative development, four phases, eight years. And
11 GEW-5, titled benefit of build-out system versus rephrased
12 speculative development, three phases, nine years.

13 Q Mr. Warren, are you sponsoring those exhibits
14 today in this proceeding?

15 A Yes, I am. I would like to point out, I noticed a
16 drafting error while he were sitting here on one of the
17 exhibits, GEW-2. This particular exhibit is right, and I
18 have corrected it on this, the error goes all the way to the
19 top. And on the ones that I previously filed, it stopped at
20 this line here, which is incorrect. I apologize.

21 MR. MAY: Mr. Warren, let's stop for one second
22 and make sure everyone has a copy of that.

23 COMMISSIONER EASLEY: Mr. May, there is only one
24 exhibit attached to the copy of the direct testimony I
25 have. Were those other exists filed separately?

1 MR. MAY: Yes, ma'am, they were filed separately
2 at a later date, and I have distributed them to the
3 parties.

4 COMMISSIONER EASLEY: Okay. Do you have copies of
5 them?

6 CHAIRMAN BEARD: I'm looking, but I don't see
7 them.

8 COMMISSIONER EASLEY: I don't see one. Do you
9 have extra copies, by any chance?

10 MR. MAY: I have one extra copy. I will be glad
11 to share it with you.

12 MS. BROWN: Commissioner, they should have been
13 filed in the record. If we can take two minutes, we
14 can get copies made.

15 COMMISSIONER EASLEY: You are only going to refer
16 to the chart for the summary, so we can keep going.

17 MR. MAY: Commissioner Easley, later he will be
18 referring to GEW-3, 4 and 5. I don't know if you would
19 like to have those in front of you at this point.
20 During his summary he will only be referring to GEW-2
21 and --

22 COMMISSIONER EASLEY: Mr. Chairman, if you don't
23 have a problem, I say let's keep going --

24 CHAIRMAN BEARD: We'll keep going as long as my
25 eyesight holds out. In the meantime, we are going to

1 identify GEW-1, which is attached to the direct
2 testimony as Exhibit Number 7. GEW-2 would be Exhibit
3 Number 8. GEW-3 will be Exhibit Number 9. GEW-4 will
4 be Exhibit Number 10. And GEW-5 will be Exhibit Number
5 11. And if you will get us Exhibits 8, 9, 10 and 11 it
6 will help me, because I think this is going to go right
7 to one of the places that I was heading, and I might
8 even give Mr. Nixon a little relief before he gets
9 here. It might even let another witness go home
10 tonight.

11 MR. MAY: Yes, sir, we were hoping that. Not you,
12 no. Ms. Holloway, I thought might want to go sometime.
13 Okay.

14 (Exhibit Numbers 7 through 11 marked for
15 identification.)

16 BY MR. MAY:

17 Q Mr. Warren, with that correction noted to Exhibit
18 GEW-2, do you have any other corrections to make to your
19 other --

20 A No, I do not.

21 MR. MAY: Chairman Beard, I understand that Mr.
22 Warren's prefiled exhibits have all been identified at
23 this time.

24 CHAIRMAN BEARD: Yes, they have been.

25 BY MR. MAY:

1 Q Mr. Warren, would you please summarize your
2 testimony?

3 A Be glad to. First, I would like to say, Mr.
4 Chairman, I would be glad to let Mr. Nixon use this chart.
5 We don't need to excuse him too early. My testimony
6 demonstrates that Florida Power, through this transaction,
7 will acquire a mature up and running electric utility
8 business that has a going concern value above the
9 depreciated net book value of the tangible assets. By going
10 concern I refer to the value of an already established and
11 mature business compared to one that is not. I evaluated
12 Florida Power's acquisition of the Sebring system, and
13 identified five specific and readily quantifiable going
14 concern benefits that will accrue to Florida Power and its
15 ratepayers over and above the net book value of the
16 facilities subject to the sale.

17 First, Florida Power directly benefits from the
18 reduced risk, reduced development cost and higher rates of
19 return as a rule of acquiring an ongoing enterprise within
20 an established customer base as opposed to expanding into an
21 area that is not built out.

22 Second, by stepping into the shoes of Sebring,
23 Florida Power will avoid the cost associated with having to
24 reproduce Sebring's system distribution maps.

25 Third, by retaining Sebring personnel with direct

1 experience and expertise in the system, Florida Power will
2 avoid significant training related costs.

3 Fourth, by purchasing the Sebring system, Florida
4 Power will avoid or defer the construction of a new
5 distribution substation.

6 And, fifth, the purchase of the Sebring system
7 will bring to final closure one of the longest running
8 territorial controversies in Florida, and thereby eliminate
9 the administrative and legal expenses associated with those
10 territorial problems. Based on my evaluation, I have
11 concluded that a conservative dollar value for these
12 benefits of going concern is 4 million --

13 COMMISSIONER EASLEY: Slow down a little bit. Get
14 a southern accent for the benefit of our court
15 reporter.

16 CHAIRMAN BEARD: We have what we call the ya'll
17 rule. We make you say ya'll at the end of each
18 sentence, if you don't slow down.

19 A (Continuing) Based on my evaluation, I have
20 concluded that a conservative dollar value for these
21 benefits of going concern is \$4,850,000, ya'll. I believe
22 further that the inclusion of this going concern value in
23 Florida Power's rate base, together with the 17.8 million
24 net book value is prudent and will mutually benefit both
25 existing Sebring customers as well as Florida Power's

1 general body of ratepayers. The inclusion of going concern
2 in a public utilities rate base is specifically recognized
3 in Chapter 366, Florida Statutes, as well as in the purchase
4 and sale agreement and joint petition between Sebring and
5 Florida Power. In fact, as this visual shows, the level of
6 the Sebring rider in this proceeding will be directly
7 affected by this Commission's recognition of going concern.

8 Mr. Chairman, if you don't mind, I would like to
9 pause for a second and talk about this visual. There has
10 been a lot of discussion, and a lot of questions about how
11 the various components of the purchase price break out. And
12 I think this visually does a good job. You can see the
13 various components that make up not only the base purchase
14 price but the total purchase price. Specifically why I
15 prepared this exhibit was to discuss how the impact of going
16 concern does not increase the base purchase price nor does
17 it increase the total purchase price, but yet it really
18 becomes an allocation issue of this component right here, so
19 that as you can see right here, that's supposed to be 4.85
20 million, another error, the \$17,813,753 of the tangible
21 assets plus the going concern amount that we have requested
22 becomes the rate base portion will be included in Florida
23 Power Corporation's rate base. To the degree that this
24 number changes either up or down has no impact on the base
25 purchase price, which is capped in the purchase and sale

1 agreement, and consequently would have no impact on the
2 total purchase price, but really just becomes an allocation
3 issue within this section, and obviously drives the total
4 dollar amount that would be necessary as the principal
5 amount for the transition rider in the rate calculation.

6 So to the degree that you approve \$4.85 million of
7 going concern value, the rate base then becomes \$22,663,753.
8 To the degree that that number changes, then the rate base
9 portion changes, and so does the calculation of the
10 resulting Sebring rider.

11 As the diagram shows, the purchase price is capped
12 at the 54 million, and any going concern value approved by
13 the PSC will not increase the purchase price beyond that
14 cap, but will result in an increase in the portion that is
15 allocated to FPC's rate base over and above the book value
16 of the purchased facility. This, in turn, will operate to
17 reduce the so-called transition amount to be recovered by
18 the Sebring rider, and ultimately decrease the level of the
19 rider that will be paid by Sebring ratepayers.

20 This concludes my summary.

21 MR. MAY: We tender Mr. Warren for cross
22 examination.

23 COMMISSIONER EASLEY: May I ask a clarifying
24 question before we get to cross?

25 MR. MAY: Yes, ma'am.

1 COMMISSIONER EASLEY: The earlier testimony was
2 that if we did not approve the transition rate, that
3 would be a deal breaker. Do I understand your summary
4 that if we did not approve the going concern value, or
5 reduced or increased the going concern value, that
6 would not be a deal breaker, is that correct?

7 THE WITNESS: I think what you heard this morning
8 is if the rider is not approved, that would be a deal
9 breaker, as I believe Mr. Dagostino from FPC testified.
10 The Sebring rider, as it stands before you, is this
11 total amount, the principal amount of 38,134,631, that
12 excludes any going concern value. If you approve the
13 4.85 million of going concern value, that would
14 decrease the \$38,134,000 by the \$4.85 million, and
15 would consequently work to decrease the amount of the
16 rider. It would not eliminate it. If you don't
17 approve going concern, you still have a rider rate that
18 must be approved.

19 CHAIRMAN BEARD: It would transfer 4.85 million
20 from the rider to the rate base?

21 THE WITNESS: Exactly.

22 COMMISSIONER EASLEY: If we did not --

23 CHAIRMAN BEARD: If we approve going concern.

24 COMMISSIONER EASLEY: What do you suppose the
25 value of that would be if you all hadn't been in bond

1 default?

2 THE WITNESS: I didn't hear the last part of your
3 question.

4 COMMISSIONER EASLEY: What would the value of
5 going concern have been if Sebring had not been in
6 default on the bonds? Let me ask it another way,
7 because I'm sure you can't really answer the first one.
8 Is going concern, the figure of 4.85 take into
9 consideration the financial condition of Sebring?

10 THE WITNESS: No, it does not.

11 CHAIRMAN BEARD: The intangible assets would be
12 some 34, call it 33.5 million, roughly?

13 THE WITNESS: As I recall, it's 35-something.

14 CHAIRMAN BEARD: Well, I'm taking 38.1 and
15 subtracting 4.85.

16 THE WITNESS: I see what you are getting at.
17 Well, going concern is also considered loosely
18 intangible assets, so.

19 CHAIRMAN BEARD: I appreciate that, and I am
20 trying to separate the two just for the purposes of
21 this, and you have that dotted line. The portion
22 that's intangible assets, that's not the going concern,
23 that intangible asset number is in the neighborhood of
24 some 33 million bucks, based on the numbers I'm looking
25 at here. What is that supposed to represent?

1 THE WITNESS: You really have to address those
2 questions to Mr. Sam Nixon of Florida Power
3 Corporation.

4 COMMISSIONER EASLEY: You're going to get him to
5 use that chart yet, aren't you?

6 CHAIRMAN BEARD: Go back to my earlier question,
7 maybe you can answer this one. Simple math, I'm trying
8 to understand, if Sebring Utility Commission gets,
9 ballpark, 21 million from the sale of the water assets,
10 21-1/2 million, I guess, is the figure, and there is a
11 transition rider that's worth some 38 million, and
12 there is roughly 18 million intangible assets, okay,
13 that gets me to 77 million, and I have got to add
14 another 2-1/2 because of the customer deposits and the
15 additional purchase price, that gets me to \$79.5
16 million with my little calculator here. And the bond
17 indebtedness is \$85 million, that is a difference of
18 about 5-1/2 million bucks. What figure am I missing?

19 THE WITNESS: I'm not sure, but you may be missing
20 some of the bond reserve funds.

21 CHAIRMAN BEARD: Which are?

22 THE WITNESS: I am not able to answer that
23 question.

24 CHAIRMAN BEARD: Let's go ahead and start in and
25 sooner or later we will get to my numbers. Questions.

1 MR. FAMA: No questions.

2 MR. ROSS: No questions.

3 MR. POLLARD: I have some questions.

4 CHAIRMAN BEARD: Go ahead.

5 CROSS EXAMINATION

6 BY MR. POLLARD:

7 Q Mr. Warren, on Page 9 of your direct testimony,
8 you develop some figures that showed going concern to range
9 between \$6.9 million and 13.5 million. Would you explain
10 how that came out, how you arrived at those numbers?

11 A Yes. Mr. Chairman, probably it would be easier
12 and helpful for me to refer to some of the exhibits. GEW-3
13 would be helpful.

14 MR. MAY: Chairman Beard, while Mr. Warren is
15 doing that, if I may point out some of your questions
16 may be answered in Mr. Nixon's testimony, his exhibit
17 SFN-1, Page 2 of 5 diagrams the allocations and the
18 different amounts that go into the \$85 million that you
19 are looking at.

20 THE WITNESS: In this part of my testimony what
21 I'm addressing is the fact that there is a value for a
22 company like Florida Power Corporation to acquire a
23 utility system that already is up and running and has
24 basically a fully built-out customer base. What this
25 particular chart demonstrates, and it is more of a

1 theoretical approach to trying to evaluate what that
2 dollar benefit is. What I've got here is, say, a
3 13,000 customer utility system, which is about
4 Sebring's size, I've calculated a fixed charge rate
5 that yields \$320 per customer per year in distribution
6 investment. You multiply that out, that is \$4,160,000
7 a year which is represented by the top line. If you
8 buy a utility system, and you have this customer as 100
9 percent to start with, obviously you are in the perfect
10 situation of having the revenues and the revenue
11 requirements being basically the same. If you made the
12 investment in the facilities, and you did it right up
13 front, and your linear build-out of the system over
14 either, say, a ten-year period, obviously there would
15 be some subsidy to the existing ratepayers that that
16 utility system would be paying during the time frame in
17 which that system developed. The shaded area is the
18 area that pictorially shows that subsidization. I
19 calculated it, present value, for ten years and I got
20 13.5 million, and I also did a very similar calculation
21 for a five year build-out, and that is where the 6.9
22 million came from.

23 BY MR. POLLARD:

24 Q How, then, did we arrive at 4.85 as a request
25 instead of one of the higher numbers to benefit the

1 ratepayers?

2 A The item that you have identified in my testimony
3 is one component that showed up on my Exhibit GEW-1. If you
4 would refer to that, item number one, value of established
5 customer base was \$2 million. The reason we didn't use a
6 big number here in the 6.9 and \$13-1/2 million range is
7 utilities don't normally make the full investment up front
8 and then expect speculative development to occur over a five
9 to ten-year period. And so I did a similar analysis, I have
10 got visuals that are probably not necessary, looking at
11 phased development. I think what I will do is just hold
12 them up for a brief moment so that we can get the picture
13 here. Basically to minimize the risk of development, a
14 utility would not build the full system initially, and wait
15 for speculative development to occur over some period, they
16 would phase the installation of their facilities. And so I
17 did two scenarios. One was a nine-year, three-phase
18 scenario, and I did another one eight-years, four phases.
19 These would represent the lines during the various time
20 periods that the investment would be made in which you would
21 be looking for capital recovery from those customers, and
22 you can see the shaded area then becomes the present value
23 of that subsidy.

24 MR. MAY: Mr. Warren, would you for purposes of
25 the court reporter and the record identify the exhibit

1 you are referring to?

2 THE WITNESS: Sure. you may need to help me on
3 that.

4 COMMISSIONER EASLEY: How about Number 4?

5 THE WITNESS: This is GEW-4 that I am referring
6 to.

7 CHAIRMAN BEARD: No, GEW-5. That is the
8 three-year -- that is 5.

9 COMMISSIONER EASLEY: I beg your pardon. The
10 Chairman is, as usual, eminently correct.

11 THE WITNESS: Mr. Chairman, thank you very much.
12 You can see here that the subsidy is significantly
13 impacted by phased development. And I would assume
14 that, you know, a prudent utility would do that, and I
15 did both a three-phased and a four-phased calculation.
16 And the range there was between 1.5 million and 2.8
17 million. And so out of a sense of conservatism and
18 recognition that that would be a normal practice by an
19 efficient utility system, we went with the \$2 million
20 number.

21 BY MR. POLLARD:

22 Q But aren't we not actually discussing a mature
23 system?

24 A We are discussing a mature system, but I think the
25 value of going concern to Florida Power Corporation would be

1 the difference compared to one that's not. I mean, that is
2 the definition of going concern. And I don't think it would
3 be fair to compare it to a scenario where they did not phase
4 development, because that is not their normal.

5 Q Right, we are just trying to be fair.

6 A Right.

7 Q On Page 11, Line 17 and 18, you outline another
8 approach to evaluate going concern, using a replacement cost
9 less depreciation for facilities and a multiple times an
10 annual revenue for customers. What, sir, is the multiple?

11 A I think you've got a wrong line cite. Would you
12 repeat that question.

13 Q Possibly, I have here Page 11, Lines 17 and 18.

14 A I think that issue really is dealt with further
15 down on the page.

16 Q Possibly so. I'm not concerned about the page,
17 I'm concerned about the issue.

18 A Okay. I did make reference in my testimony to
19 some other techniques. We did not elect to use them. The
20 technique that I was referring to in my testimony is an
21 approach that has been pretty commonly used in this state
22 where there have been the exchanges of customers,
23 specifically related to the resolution of territorial
24 disputes. And in that particular situation, and the
25 practice has been common for the purchasing utility to pay

1 replacement costs less depreciation, and that is contrasted
2 to a retail cost less depreciation that Mr. Rumolo testified
3 to earlier as the methodology that was used in the RMI
4 valuation for Sebring's facilities. In addition, generally
5 there is some sort of payment made that's a multiple of the
6 annual revenues associated with the customers. And
7 typically that has ranged from, you know, in my experience I
8 have seen it range from 1 to 2-1/2 times annual revenue.

9 Q Are you aware of any large transfers like that
10 that have happened in the utility system in Florida?

11 A The largest one that I am aware of is one that I
12 participated in directly, and that involved the negotiation
13 of a territorial agreement between Clay Electric Cooperative
14 and Gainesville Regional Utilities. In that case, it seems
15 to me like there was 4,200 Clay customers acquired by
16 Gainesville, and I believe there was like 600 or 700 in the
17 reverse direction, I don't recall.

18 Q Thank you. On Page 14, Line 13, you quote a
19 statutory authority for going concern value to be included
20 in an electric utility rate base, but later note that it's
21 not required to be allowed. What are the circumstances,
22 under what circumstances would it be allowed?

23 A I'm not sure where the second part of your
24 question comes from, but the statute itself basically says
25 that it's permissive, it's not something that is required,

1 it's permissive in that it would allow the Public Service
2 Commission to include going concern in the rate base. And I
3 think the only restraint, as I recall, is that it can't
4 exceed the total purchase price by the utility. So other
5 than those particular limitations in the statute, I'm
6 unaware of any others.

7 MR. POLLARD: I have no further questions. Thank
8 you.

9 CHAIRMAN BEARD: Let's use your chart Number 5,
10 that's the three-phase, nine-year chart as an example.
11 I'm trying to understand this. The shaded area which
12 is, in essence, the difference between revenue and
13 revenue requirements --

14 THE WITNESS: Correct.

15 CHAIRMAN BEARD: -- does not include debt service?

16 THE WITNESS: It's based on a fixed charge rate
17 calculation. I can tell you I have got some assistance
18 from Florida Power Corporation in that regard.

19 CHAIRMAN BEARD: You are trying to tell me I can
20 ask Sam about this one, too.

21 THE WITNESS: I will do the best I can. If you
22 need to go further than that, perhaps Sam is the one.
23 That fixed charge rate was about 16 percent, it
24 includes items such as return on investment, it
25 includes depreciation, it includes O&M expense, it

1 includes taxes, and it adds up to 16.17 percent, or
2 something like that, I recall. I also received some
3 information from Florida Power Corporation that a
4 typical distribution investment was around \$2,500. I
5 backed out services, and I backed out meters from that
6 and came up with a rough number of about \$2,000
7 investment. The reason I backed out services and
8 meters is generally you don't install those until the
9 customer connects, and at that point you have revenues
10 coming, and you can see what this would represent then
11 would be the fixed charge rate times the investment
12 that would be associated with one-third of the
13 customers, two-thirds of the customers, and
14 three-thirds of the customers, and this would be the
15 revenue generated by those customers. And to the
16 degree there is any shortfall, that would have to be a
17 subsidy from the existing body of ratepayers.

18 COMMISSIONER EASLEY: Isn't the basic question
19 different from a shortfall in revenue, if there is an
20 existing debt that has to be retired either by you or
21 by the acquiring company, why isn't that taken into
22 consideration when looking at net present value of the
23 revenue?

24 THE WITNESS: Are you talking specifically about
25 the Sebring debt?

1 COMMISSIONER EASLEY: Sure. I assume that is what
2 we are talking about here, aren't we?

3 CHAIRMAN BEARD: No.

4 COMMISSIONER EASLEY: Am I asking the wrong
5 question the wrong way?

6 CHAIRMAN BEARD: The answer to my question was
7 not, per se, that debt service is in here, but the
8 answer to the question was that return on investment is
9 in here, which however they got the money to invest it
10 is -- in this case if it were Florida Power Corporation
11 going into a development that was developing they
12 would get dollars from someplace, that is their
13 business where they got them from. If they do their
14 business right, the investment, the return on
15 investment will cover that plus other expenses.

16 COMMISSIONER EASLEY: But what you are comparing
17 in order to get there is the revenue from Sebring,
18 right?

19 THE WITNESS: No.

20 COMMISSIONER EASLEY: How in the world are you not
21 doing it? I don't understand that. Isn't that at
22 least the basis for determining what the value of a
23 built-out system is, or are you using just any
24 built-out system, is that what I'm missing?

25 THE WITNESS: The purpose of this exhibit is

1 really only two-fold, and that is if you are a utility
2 and you have the choice of investing in a system that
3 is fully built-out versus one that is not, these
4 benefits accrue, and it is really a separate issue from
5 the Sebring debt.

6 COMMISSIONER EASLEY: So I'm reading too much into
7 this, and I should not relate it back to the first
8 exhibit with the 4.85?

9 THE WITNESS: Exactly.

10 COMMISSIONER EASLEY: Which ought to have some
11 recognition of debt, if it is Sebring-specific, if that
12 doesn't, right?

13 THE WITNESS: Really, I guess I would rather deal
14 with the debt issue separately.

15 COMMISSIONER EASLEY: Well, I don't know that I
16 can; that's my problem.

17 CHAIRMAN BEARD: I think what we are having to do,
18 and we have got to be careful, because I have been
19 doing it, mentally mixing apples and oranges. One is
20 what is Florida Power Corporation, what dollars are
21 they going to expend for the purchase of this system.
22 Once those dollars are expended, at least in theory,
23 Sebring hopes that between those dollars and the water
24 company and whatever else revenues are available they
25 pay off the bond debt, and don't leave them with a

1 negative. Conversely, we should have great concern if
2 it left them positive. In this instance specifically
3 because, from my perspective, because you've got a
4 rider, okay. And if it's worth that much more money,
5 so there was positive in Sebring, then that revenue
6 ought to be flowing and there should be less of a
7 rider.

8 THE WITNESS: That is the point.

9 CHAIRMAN BEARD: You've got to be careful not to
10 mix the two. That's why I'm trying to ask the question
11 carefully. What I was trying get at with my earlier
12 question is not so much at this stage what Florida
13 Power Corporation is paying, I want to understand what
14 Sebring is receiving from the total assets that they
15 have towards paying off that bond indebtedness, and
16 then I'm going to look at separately, and as a piece of
17 that what Florida Power Corporation is paying relative
18 to that, because that is only one part of it.

19 COMMISSIONER EASLEY: And I agree with you it's
20 only one part of it, but let me clear one other thing
21 up then, because maybe I also don't understand one
22 other little minor detail. I thought early in the
23 testimony, and perhaps it was Mr. Dagostino, I thought
24 part of the arrangement was that FPC would retire any
25 debt that they assumed and would retire any debt of

1 Sebring. Did I misunderstand that?

2 THE WITNESS: I don't know whether there is a
3 semantics problem here or not, but clearly when all the
4 transactions are completed and the money is received
5 from Florida Power Corporation, the money is received
6 from the City for the sale of the water system together
7 with funds on hand from bond funds and so forth, that
8 does, indeed, pay off the debt.

9 COMMISSIONER EASLEY: Maybe what we have is a
10 little bit of a semantics problem. But it translates
11 into a dollar problem if I'm misunderstanding who is
12 actually doing what with those dollars. With that in
13 mind, we will keep going. If I'm thoroughly confused,
14 you all are going to have to notify me of that so I can
15 be straightened out.

16 CHAIRMAN BEARD: Now, I do want to understand the
17 going concern on your first Exhibit GEW-2, the 4.5 on
18 here which you say should be 4.85?

19 THE WITNESS: That's correct.

20 CHAIRMAN BEARD: Now, you arrive at that 4.85
21 through some derivation of either GEW-3, 4 or 5, I
22 assume? Oh, excuse me, I'm back to 1. The value of
23 the established customer base, 2 million. I'm back to
24 GEW-1, apparently. I'm trying to understand the 4.85
25 million.

1 THE WITNESS: The 4.85 million is the sum of these
2 various specific items that we have identified. The 2
3 million is the results of Exhibits 3, 4 and 5.

4 CHAIRMAN BEARD: I'm catching on. So, basically,
5 its a hybrid between the four-phase, eight-year, and
6 the three-phase, nine-year?

7 THE WITNESS: Yes.

8 CHAIRMAN BEARD: It's somewhere between those?

9 THE WITNESS: Yes, sir. And that's making the
10 assumption that a prudent utility would do the best job
11 they could in phasing the installation of their
12 facilities.

13 COMMISSIONER EASLEY: I could almost believe this
14 was a telephone case.

15 CHAIRMAN BEARD: Way too simple. How many
16 personnel are currently at Sebring?

17 THE WITNESS: I believe I heard Mr. Dagostino say
18 that there would be 46 this morning that would be
19 transferred. I assume there are additional personnel
20 that are associated with the water system.

21 CHAIRMAN BEARD: So we are assuming training and
22 experience costs of about \$19,500 per employee, a
23 value, 46 into 900,000?

24 THE WITNESS: The way that number was calculated
25 to my understanding, Florida Power Corporation

1 evaluated the specific classifications that would be
2 brought into their organization and they knew the time
3 that it takes to get folks to the journeyman level when
4 they hire them off the street, and they took into
5 consideration the prior experience and training of the
6 Sebring people. They also made some assumptions about
7 efficiencies that would accrue as a result of having
8 the Sebring's trained personnel on their Staff, and
9 when taking those into consideration they came up with
10 the figure of approximately \$900,000. And really it's
11 a multi-year calculation.

12 CHAIRMAN BEARD: Okay. Where are we? Staff?

13 CROSS EXAMINATION

14 BY MS. BROWN:

15 Q Mr. Warren, I have an exhibit to pass around for
16 you to look at. It is entitled kilowatt hour forecast
17 analysis. I think you may have seen it previously.

18 A Yes.

19 Q RMI did prepare the kilowatt hour forecast used in
20 this case, did it not?

21 A Yes, ma'am, it did.

22 Q Has RMI prepared other kilowatt hour forecasts for
23 use in other regulatory proceedings?

24 A Yes, ma'am.

25 Q As we understand it, the load forecast prepared by

1 RMI contain low, medium and high forecast scenarios. Would
2 you please explain what these forecast scenarios represent?
3 I'm not referring to that exhibit right at the moment, I'm
4 referring to your testimony.

5 A I understand. Mr. Chairman, I can only respond
6 sort of broadly, I guess, to that particular question. But
7 as I understand, we prepared the forecast, it had
8 econometric components in it, and there are various
9 assumptions made that are associated with the preparation of
10 the forecast, and consequently there was a range of
11 reasonableness, some we felt like resulted in the low end of
12 the forecast, some high end, and the middle range was more
13 what we characterized as the expected.

14 Q Another way to say that would be the low load
15 forecast would be the pessimistic side, the high would be
16 the optimistic side, those would be the economic input
17 assumptions you're talking about. The low one would be no
18 growth, and the high one would be tremendous growth?

19 A Exactly.

20 Q And in normal forecasting practices, the actual
21 outcomes are expected to fall somewhere in between those
22 two, is that correct?

23 A That's correct.

24 Q Now, would you please --

25 CHAIRMAN BEARD: Before we go any further, do we

1 need to identify this?

2 MS. BROWN: Yes, I'm just going to.

3 CHAIRMAN BEARD: Let's identify this as Exhibit
4 Number 12.

5 MS. BROWN: Kilowatt hour forecast analysis.

6 CHAIRMAN BEARD: That's fine. And for the record,
7 I inadvertently started to mark something Exhibit 4,
8 and we didn't, and then I skipped that number. So for
9 purposes of this record, there will be no Exhibit 4.
10 We will save and use that number someplace else. Two
11 number fours the next time we have a hearing.

12 (Exhibit 12 marked for identification.)

13 BY MS. BROWN:

14 Q Would you take a look at Exhibit 12, please.

15 A Yes, ma'am.

16 Q Would you accept, subject to check, that beginning
17 on Page 2, numbered Page 2, it's actual Page 3 of this
18 exhibit, there is a description of the load forecast,
19 methodology forecast assumptions and forecasted kilowatt
20 hour sales prepared by Tampa Electric Company for the
21 Sebring service territory?

22 A Yes, ma'am.

23 Q Was the load forecast prepared by RMI produced
24 independently from the forecast prepared by Tampa Electric
25 Company?

1 A Yes, ma'am.

2 Q Would you accept, subject to check, that TECO's
3 kilowatt hour forecast for 1992 through 2001 fall in between
4 the low and high forecasted values of the RMI forecast?

5 A Subject to check, yes, I would.

6 Q All right. Now, we are going to switch to going
7 concern value?

8 A Okay.

9 Q Your Exhibit GEW-1 that we spoke about earlier?

10 A Correct.

11 Q One of the components of the going concerning
12 value in that exhibit is \$1.5 million for the avoidance or
13 deferral of a new FPC distribution substation, is that
14 correct?

15 A Yes, that's correct.

16 Q And is it your reason for including that \$1.5
17 million in going concern that Florida Power Corporation can
18 utilize the existing Sebring facilities rather than
19 construct new facilities at this time?

20 A Yes.

21 Q Florida Power Corporation's ratepayers are already
22 paying for those facilities, are they not, in the \$17.8
23 million net book value of the Sebring assets?

24 A To the degree that there is excess transformer
25 capacity included in Sebring's existing facilities, yes,

1 they would.

2 Q Well, that may well be. What I'm trying to get at
3 is what I consider to be somewhat of a logical inconsistency
4 here, and that is that you want Florida Power Corporation's
5 ratepayers to pay through going concern for the avoidance of
6 a substation that they don't need because they are paying
7 for the distribution facilities, so they are paying twice
8 for the same thing, fundamentally the same thing, do you
9 agree?

10 A I'm not sure I understand your argument.

11 COMMISSIONER EASLEY: Well, let me throw one more
12 in there. Now, put in the additional projected cost of
13 the substation for 1.5 million that Mr. Dagostino told
14 us about, and told me it wasn't going to be recovered
15 yet.

16 THE WITNESS: I'm not sure I follow your question.

17 COMMISSIONER EASLEY: Try again.

18 BY MS. BROWN:

19 Q Do you remember Mr. Dagostino's testimony earlier
20 today that Florida Power Corporation really didn't know when
21 they might need to construct this substation, they would
22 have to reevaluate it, they weren't at all certain when it
23 might come into being? Do you remember that?

24 A I did hear that testimony this morning, yes.

25 Q Well, if it does come into being sooner than they

1 think, then won't we have the situation where Florida Power
2 Corporation's ratepayers will be paying for the new
3 substation, they will have already paid to defer that new
4 substation, and they would have already paid for the
5 facilities that allow them to defer that new substation?

6 A You know, it's a good question, I have not thought
7 of that, I had not thought about that. I guess my immediate
8 reaction is that it's a complicated question dealing with
9 the need for that capacity by Sebring's customers. But to
10 the degree that is included in the net book value of the
11 facilities, you certainly are paying for that capacity.
12 That seems logical to me at this point.

13 Q You assigned in your going concern value a figure
14 of \$200,000 for avoided legal costs related to the
15 territorial dispute that would be avoided as a result of
16 this acquisition?

17 A It's legal and administrative costs, yes.

18 Q Legal and administrative costs. Where did you get
19 the numbers that supported that final number?

20 A The \$200,000?

21 Q Yes.

22 A Initially it was based on discussions with Florida
23 Power Corporation's attorneys. Since then, since my
24 deposition I have had a chance to reconsider it. And the
25 more we talk about the complex territorial situation that is

1 out there, the more convinced I am that the number is
2 extremely conservative, and I would like to give some
3 specifics. As I understand right now there are a number of
4 items that are outstanding that require administration, it's
5 extremely complicated, and Sebring and Florida Power
6 Corporation are both expending a significant amount of money
7 currently dealing with the territorial situation. The first
8 one I'm going to largely categorize as ongoing
9 administrative costs, and there are several subcomponents of
10 that. To the degree that Florida Power Corporation --

11 Q Mr. Warren, I hate to interrupt you, and I don't
12 want to stop you, I want you to keep going, but I want to
13 make sure that you identify where you get these numbers
14 from?

15 A I will give them to you specifically.

16 The first one deals with what is usually called
17 attrition, and that relates to Florida Power Corporation
18 customers that trade over to Sebring, and consequently
19 Sebring has got to trade them back in the reverse direction.
20 That requires bookkeeping on the part of Florida Power
21 Corporation and Sebring to keep track of those changes.

22 The second one is what I will loosely call energy
23 balancing. The number of customers that -- there are
24 customers in areas that are, I guess you would say, are sort
25 of in Florida Power Corporation's area. Florida Power

1 Corporation's facilities serve the customers, but they are
2 Sebring customers, and there is a meter on there, a Sebring
3 meter. Correspondingly, there is the reverse situation
4 where there are customers in what would be Sebring's area
5 served by Sebring's facilities that have a Florida Power
6 Corporation meter. The energy sales to those customers have
7 to be kept track of and balanced, and so I will call that
8 energy balancing.

9 And then the third area is growth in the pure
10 areas. In other words, an area where Sebring, for instance,
11 would be allowed to provide for the growth in that area, but
12 yet Florida Power Corporation has facilities. So there are
13 administrative costs associated there. Sebring estimates
14 that they are spending in the neighborhood of 40,000 to
15 \$50,000 a year on their side of the bookkeeping to do that.
16 Based on conversations with Florida Power Corporation,
17 theirs is considerably less, but amounts to probably about
18 \$14,000 a year. If you do a present value of that over,
19 say, 20 years, that amounts to, you know, something in the
20 neighborhood of \$100,000-plus, so that is one area.

21 The other area is that there are 500 or so
22 customers that are not covered by the joint plan, which
23 causes ongoing administrative difficulties for both Sebring
24 and Florida Power Corporation. The City of Sebring, and I
25 want to say the City apart from Sebring Utilities

1 Commission, and the Sebring Utilities Commission take the
2 position that those customers that Florida Power Corporation
3 has sort of in the area of Sebring's service area that are
4 not covered by the joint plan, upon annexation, if
5 annexation occurred, is the position of Sebring Utilities
6 Commission, and the City of Sebring, that those would become
7 Sebring customers. Based on the past, it's unlikely that
8 Florida Power Corporation would agree with that particular
9 conclusion, and would likely lead to litigation.

10 I would point out that within the last year or two
11 that particular situation has been close to occurring. So
12 it's not some hypothetical thing that might happen out in
13 the future. In rough terms, that could amount to 50 or 200,
14 somewhere, just a rough estimate, 50 to \$250,000 of cost.
15 And then the third area is the airport, which is currently
16 on appeal before the Supreme Court, and, you know, a rough
17 estimate to finish that up might be 25 to 50,000. So you
18 add it all up and I think you can see that the \$200,000
19 figure is probably pretty conservative. Where it came from
20 originally, and I would like to give you that.

21 COMMISSIONER EASLEY: Mr. Warren, while I
22 appreciate it, you really are giving us probably a lot
23 more than we need, I think.

24 THE WITNESS: Mr. Chairman, what I --

25 MS. BROWN: At a very late time, also.

1 THE WITNESS: The original number was developed
2 through discussion with Florida Power Corporation, and
3 it came with an estimate of 75,000 for avoided
4 administrative costs regarding the ongoing territorial
5 matter, and 125,000 to cover dispute, that is where the
6 original number came from.

7 BY MS. BROWN:

8 Q Mr. Warren, these are all estimates, is that
9 correct?

10 A Yes, ma'am.

11 MS. BROWN: No further questions.

12 CHAIRMAN BEARD: Redirect.

13 MR. MAY: Just a couple of clarifying points, Mr.
14 Chairman.

15 REDIRECT EXAMINATION

16 BY MR. MAY:

17 Q Mr. Warren, when you referred to your first
18 Exhibit GEW-2, the numbers that were reflected in that
19 study, were they as of September 30, 1991?

20 A Yes, they were.

21 Q Just so I understand the concept of going concern,
22 hypothetically, if Sebring were to shut down its system
23 today, fire all of its employees, cancel all of the
24 contracts, would you expect that the value of the utility to
25 be less than what Florida Power Corp is asking to be

1 included as a prudent investment in its rate base?

2 A Including the value of going concern, yes, I
3 would.

4 MR. MAY: No further questions.

5 CHAIRMAN BEARD: Let me ask a quick one. I'm
6 looking at your GEW-4, four-phase, eight-year?

7 THE WITNESS: Right.

8 CHAIRMAN BEARD: Net present value of 1.453
9 million, because that's the closest. How long would it
10 take you to give me a number on a two-phase,
11 eight-year, net present value?

12 THE WITNESS: Well, if I went over in the corner
13 and huddled there with my calculator for 20 or 30
14 minutes, I could give you a number.

15 CHAIRMAN BEARD: Why don't you go huddle in the
16 corner with a calculator.

17 THE WITNESS: Okay.

18 CHAIRMAN BEARD: And I'll get back to you somehow.
19 Don't leave town without me.

20 THE WITNESS: I won't.

21 CHAIRMAN BEARD: The witness is excused.

22 Exhibits.

23 MS. BROWN: Staff moves exhibit whatever it was.

24 CHAIRMAN BEARD: 12. Without objection.

25 (Exhibit Number 12 received into evidence.)

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CHAIRMAN BEARD: Mr. May.

MR. MAY: Mr. Chairman, we would move Exhibits GEW-1, which you have identified as Exhibit 7; GEW-2, which you have identified as Exhibit 8; GEW-3, which is Exhibit 9; GEW-4, which is Exhibit 10; GEW-5, which is Exhibit 11.

CHAIRMAN BEARD: Without objection. They're in the record.

(Exhibit Numbers 7 through 11 received into evidence.)

CHAIRMAN BEARD: The next witness.

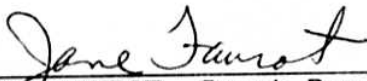
MR. MAY: Florida Power calls Mr. Southwick.

(Transcript resumes with Volume III.)

1 CERTIFICATE OF REPORTER

2 STATE OF FLORIDA)

3 COUNTY OF LEON)

4 I, JANE FAUROT, Court Reporter, Notary Public in
5 and for the State of Florida at Large:6 DO HEREBY CERTIFY that the foregoing proceedings
7 was taken before me at the time and place therein
8 designated; that before testimony was taken the
9 witness/witnesses were duly sworn; that my shorthand notes
10 were thereafter reduced to typewriting; and the foregoing
11 pages are a true and correct record of the proceedings.12 I FURTHER CERTIFY that I am not a relative,
13 employee, attorney or counsel of any of the parties, nor
14 relative or employee of such attorney or counsel, or
15 financially interested in the foregoing action.16 WITNESS MY HAND AND SEAL this 8th day of
17 December, 1992, in the City of Tallahassee, County of Leon,
18 State of Florida.19
20 
21 JANE FAUROT, Court Reporter
22 Notary Public in and for the
23 State of Florida at Large24 My Commission Expires: July 16, 1993
25