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**REBUTTAL TESTIMONY OF HUGH GOWER
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
ON BEHALF OF
SOUTHERN STATES UTILITIES, INC.
DOCKET NO. 950495-WS**

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1 **Q. PLEASE STATE YOUR NAME, OCCUPATION AND ADDRESS.**

2 A. My name is Hugh Gower, and I am self-employed. My
3 address is 195 Edgemere Way South, Naples, Florida
4 33999.

5 **Q. ARE YOU THE SAME HUGH GOWER WHO PROVIDED DIRECT**
6 **TESTIMONY IN THIS PROCEEDING?**

7 A. Yes.

8 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

9 A. The purpose of my rebuttal testimony is to show
10 that:

11 1) The imputation of potential future post-test
12 period CIAC collections to offset margin reserve
13 plant investment proposed by OPC witness Hugh
14 Larkin, Jr. and SMWCA witness Buddy L. Hansen is
15 inappropriate and should be rejected; and

16 2) The amortization of gains on sales of utility
17 properties and/or other related ratemaking
18 adjustments proposed by OPC witnesses Kimberly H.
19 Dismukes and Hugh Larkin, Jr. are improper and
20 should be rejected by the Commission.

21 Both proposals are based upon incorrect and
22 unfounded assertions as well as a profound
23 confusion of the cost of service and capital
24 transactions.

25 **Q. ON PAGE 12 OF HIS TESTIMONY MR. LARKIN ASSERTS THAT**

1 **THE REASON SSU IMPUTES NO CIAC AGAINST ITS MARGIN**
2 **RESERVE PLANT IS THAT SSU WANTS TO "RECEIVE A FULL**
3 **BENEFIT, WITHOUT RISK, BY INCLUDING A MARGIN**
4 **RESERVE IN ITS USED AND USEFUL CALCULATIONS"**
5 **WITHOUT ACCEPTING "THE RISK THAT ITS ESTIMATED**
6 **FUTURE ERC'S ARE OVERSTATED." IS THIS**
7 **CHARACTERIZATION OF SSU'S INTENTION CORRECT?**

8 A. No, it is not. Apparently Mr. Larkin missed the
9 point that what SSU seeks is the opportunity to
10 earn a fair return on investors' capital until that
11 investment has been recovered. Not imputing
12 potential post - test period CIAC collections
13 provides that opportunity insofar as the margin
14 reserve plant investment is concerned. By
15 contrast, imputing potential post - test period
16 CIAC collections as an offset to the margin reserve
17 plant investment denies that opportunity.

18 **Q. ISN'T IT TRUE THAT POST-TEST PERIOD CIAC**
19 **COLLECTIONS FROM NEW CUSTOMER CONNECTIONS WILL**
20 **DECREASE THE COMPANY'S RATE BASE RESULTING IN OVER-**
21 **EARNINGS IN THE FUTURE?**

22 A. No, future post-test period CIAC collections from
23 new customer connections will result in neither
24 decreases to rate base nor over-earnings in the
25 future for two reasons.

1 First, as my direct testimony demonstrated,
2 post-test period CIAC collections for the margin
3 reserve period do not equal the amount obtained by
4 multiplying margin reserve ERC's times the service
5 availability charges. This is due, in part, to the
6 fact that a portion of the margin reserve is to
7 meet increased demands of present customers, which
8 generate no CIAC collections. This prospect is
9 confirmed OPC witness Dismukes' increase to test
10 year consumption levels based upon her belief that
11 consumption levels of existing customers were lower
12 than normal due to rainfall.

13 Second, while new customer connections do
14 result in future CIAC collections, it does not
15 follow that a reduction in rate base is the
16 consequence. Anticipation of future rate base
17 reductions assumes that the amount of needed margin
18 reserve plant decreases when new customers connect
19 to the system, but this is not the case.

20 **Q. WHY?**

21 **A.** Because when a portion of margin reserve plant held
22 ready to meet customers' demands is "committed" to
23 serving new customers who connect to the system, it
24 does not decrease the amount of needed margin
25 reserve plant. On the contrary, the amount of

1 margin reserve plant previously available but
2 committed to serving new customers would need to be
3 replaced, all other things being equal.

4 **Q. HOW WOULD THE MARGIN RESERVE PLANT BE REPLACED?**

5 A. An equivalent amount of plant either completed, but
6 held for future use or under construction would
7 become "used and useful" as margin reserve plant.
8 Inasmuch as the investment in construction work-in-
9 progress and plant held for future use exceeds
10 \$30,000,000 at the end of 1995 and the company has
11 a large construction program, as described in Mr.
12 Ludsen's testimony, it seems clear that there are
13 substantial amounts of capital already invested and
14 "waiting" to become "used and useful" as margin
15 reserve plant or otherwise.

16 It is equally clear that new customer
17 connections and related CIAC collections will cause
18 neither a reduction in rate base nor over earnings
19 in the future.

20 **Q. MR. LARKIN STATES ON PAGE 10, LINES 14 THROUGH 17,**
21 **THAT MARGIN RESERVE PLANT INCLUDED IN RATE BASE**
22 **"REPRESENTS INVESTMENT THAT WILL NOT BE USED AND**
23 **USEFUL IN SERVING THE CURRENT CUSTOMERS." IS THIS**
24 **TRUE?**

25 A. No, margin reserve plant has consistently been

1 determined to be "used and useful." SSU, just as
2 other utilities obligated to serve the public, must
3 have capacity to meet future increases in the needs
4 of both present and future customers. Present
5 customers benefit when the utility serving them has
6 capacity to meet demands from new customers without
7 overloading existing facilities and degrading the
8 service to existing customers.

9 **Q. DOES THE USE OF A FUTURE TEST PERIOD PROVIDE SOME**
10 **ADVANTAGE TO THE UTILITY WHICH MAKES IT UNNECESSARY**
11 **FOR THE COMMISSION TO INCLUDE ALL ELEMENTS OF**
12 **INVESTOR-SUPPLIED CAPITAL IN RATE BASE?**

13 A. No, contrary to Mr. Larkin's implication on page
14 10, lines 10 through 12, it does not. While the
15 use of future test periods tends to reduce
16 regulatory lag, neither the utility nor its
17 customers should be advantaged or disadvantaged as
18 a result of that practice.

19 **Q. WHEN SSU DEVELOPED ITS FUTURE TEST PERIOD DATA, DID**
20 **IT INCLUDE ALL REVENUE AND EXPENSE TRANSACTIONS**
21 **WHICH SHOULD BE THE RESULT OF SERVING INCREASED**
22 **NUMBERS OF CUSTOMERS?**

23 A. Yes, it did.

24 **Q. AND DID SSU'S FUTURE TEST PERIOD DATA INCLUDE**
25 **EXPECTED NEW PLANT INVESTMENTS AND CIAC COLLECTIONS**

1 FROM NEW CUSTOMERS THROUGH THE END OF THE TEST
2 PERIOD?

3 A. Yes, it did.

4 Q. HOW MANY ADDITIONAL CUSTOMERS OVER THE NUMBER
5 SERVED IN THE 1994 BASE HISTORICAL PERIOD DID SSU
6 PROJECT THROUGH THE END OF ITS 1996 TEST YEAR?

7 A. SSU projects an increase of 4,590 water customer
8 ERC's and 2,389 wastewater customer ERC's from the
9 end of the 1994 historical period through the end
10 of 1996 for FPSC jurisdiction plants.

11 Q. WHAT AMOUNT OF CIAC COLLECTIONS OVER THE ACTUAL
12 AMOUNT AT THE END OF 1994 DID SSU PROJECT THROUGH
13 THE END OF THE 1996 TEST YEAR FOR FPSC REGULATED
14 PLANTS?

15 A. SSU projected additional CIAC collections through
16 the end of 1996 of \$3,570,878 for water and
17 \$1,373,325 for wastewater.

18 Q. WILL THE CIAC COLLECTIONS FROM 1994 THROUGH THE END
19 OF 1996 PROVIDE RECOVERY OF INVESTMENTS IN UTILITY
20 PLANT MADE FOR THAT SAME PERIOD OF TIME?

21 A. No, they will not. Additional investments in
22 utility plant from 1994 through the end of 1996 are
23 projected in the MFRs to total over \$42,000,000 for
24 FPSC jurisdictional facilities. By comparison,
25 projected CIAC collections of \$4.9 million would

1 recover only 12% of that capital investment.

2 **Q. DO THESE PROJECTED CIAC COLLECTIONS THROUGH THE END**
3 **OF 1996 REDUCE 1996 RATE BASE AND PROPERLY SHOW THE**
4 **AMOUNT OF INVESTOR-SUPPLIED CAPITAL FOR THE 1996**
5 **TEST PERIOD?**

6 A. Yes.

7 **Q. WHY SHOULDN'T RATE BASE BE FURTHER REDUCED FOR**
8 **POTENTIAL POST-TEST PERIOD CIAC COLLECTIONS DURING**
9 **THE MARGIN RESERVE PERIOD AS MR. LARKIN AND MR.**
10 **HANSEN SUGGEST?**

11 A. Because to do so would reduce rate base to an
12 amount below the actual amount of investor-supplied
13 capital which will exist during the test period.

14 **Q. IS IT TRUE AS MR. LARKIN SUGGESTS THAT SSU WOULD**
15 **NOT BE HARMED BY EXCLUDING MARGIN RESERVE FROM RATE**
16 **BASE?**

17 A. No, it is not. Investors' capital must be in rate
18 base to have the opportunity to earn a return. Mr.
19 Larkin's claim that AFPI charges compensate the
20 company for its investment in margin reserve is
21 simply an unfounded assertion.

22 **Q. WHY IS THAT SO?**

23 A. First, because by definition, (see Rule 25-30.343
24 Florida Administrative Code) AFPI charges are
25 designed to provide compensation to the utility for

1 making prudent investments in plant held for future
2 use -- in other words, plant which is not yet used
3 and useful. Since margin reserve plant investments
4 are "used and useful," AFPI collections are
5 unrelated to it.

6 Second, AFPI collections do not even approach
7 a compensatory return on the plant to which they do
8 relate, much less provide a return on margin
9 reserve plant as well.

10 **Q. WHAT RETURN DOES AFPI COLLECTIONS PROVIDE?**

11 A. In recent years, AFPI collections have increased
12 but still they produce only slightly more than 3%
13 of the investments they were designed to
14 compensate.

15 **Q. IF AFPI COLLECTIONS FAIL TO PROVIDE A COMPENSATORY**
16 **RETURN ON PRUDENT PLANT INVESTMENTS NOT YET USED**
17 **AND USEFUL AND CIAC COLLECTIONS FAIL TO RECOVER**
18 **INVESTMENTS IN NEW CAPACITY, WHAT RATEMAKING**
19 **TREATMENT OF MARGIN RESERVE PLANT SHOULD THE**
20 **COMMISSION ADOPT?**

21 A. The ratemaking objective should be to provide an
22 opportunity for investors to earn a fair return on
23 their capital until it has been recovered. Insofar
24 as the investment in margin reserve plant, that can
25 be accomplished by inclusion of the average

1 unrecovered test period investment -- original
2 cost, less depreciation and CIAC collections --
3 without further reduction for potential future
4 post-test period CIAC collections.

5 **Q. SUGARMILL WOODS CIVIC ASSOCIATION WITNESS BUDDY**
6 **HANSEN ALSO ADVOCATES IMPUTING CIAC AGAINST THE**
7 **MARGIN RESERVE. DO YOU HAVE ANY COMMENTS REGARDING**
8 **HIS TESTIMONY?**

9 A. Mr. Hansen's testimony is premised on the same
10 assertions as Mr. Larkin's, which my previous
11 comments demonstrate are unfounded and erroneous.
12 Mr. Hansen's proposed imputation of CIAC should be
13 rejected for the reasons I have stated here and in
14 my direct testimony.

15 **Q. PLEASE EXPLAIN WHAT OPC WITNESS KIMBERLY H.**
16 **DISMUKES PROPOSES WITH REGARD TO GAINS ON SALES OF**
17 **UTILITY PROPERTIES RECORDED BY SSU DURING RECENT**
18 **YEARS?**

19 A. As explained in pages 34 to 42 of her testimony,
20 Ms. Dismukes proposes that the Commission either
21 (1) amortize \$21,823,331 of gains on sales of
22 utility properties above-the-line over a five-year
23 period, or \$4,264,666 a year, in calculating cost
24 of service in this case, or (2) in the alternative,
25 deduct the amount of gains recorded, less dividends

1 paid to its stockholder, from SSU's common equity
2 in calculating cost of service in this case.

3 **Q. WHAT IS THE BASIS FOR MS. DISMUKES' PROPOSED**
4 **TREATMENT OF THESE GAINS?**

5 A. On page 35, lines 4 through 8 of her testimony Ms.
6 Dismukes indicates that she proposes to amortize
7 gains on sales of properties which were included in
8 rate base, but excluded gains on sales of
9 properties which were not in rate base. The
10 distinction she makes implies that inclusion of
11 utility property in rate base conveys an ownership
12 interest of some type to the utility's customers,
13 as a result of which they are entitled to a share
14 of the capital which financed property in rate
15 base.

16 **Q. IS THAT NOT THE CASE?**

17 A. No, it is not. Those who believe it does confuse a
18 calculation made for costing and/or pricing service
19 with the conveyance to customers of the right to
20 share in the capital which finances utility plant
21 or in profits resulting from that capital.

22 **Q. WHAT DOES INCLUSION OF PROPERTY IN A UTILITY'S RATE**
23 **BASE MEAN?**

24 A. It means that the item(s) of property are used and
25 useful in providing rate regulated service to

1 customers. As such, the amount of investor-
2 supplied capital with which the property was
3 financed is entitled to an opportunity to earn a
4 fair return. Regulators include the cost of
5 property (less depreciation, CIAC, etc.) in rate
6 base to provide investors that opportunity through
7 the calculation of the cost of utility service and
8 setting prices to recover the calculated cost of
9 service.

10 **Q. FOR HOW LONG A PERIOD ARE INVESTORS ENTITLED TO THE**
11 **OPPORTUNITY TO EARN A RETURN ON CAPITAL WHICH**
12 **FINANCES PROPERTY WHICH PROVIDES SERVICE TO UTILITY**
13 **CUSTOMERS?**

14 A. Only so long as the property provides service to
15 customers. If it ceases to provide service, it is
16 removed from rate base and the opportunity to earn
17 a return ceases.

18 **Q. WHAT ARE CUSTOMERS ENTITLED TO WHEN THEY PAY THE**
19 **PRICES CALCULATED ON THE BASIS OF PROPERTY INCLUDED**
20 **IN RATE BASE?**

21 A. Customers get exactly what they pay for: the
22 service they have demanded and which was provided
23 by the utility at the lowest price the regulators
24 could set to cover the cost of service.

25 **Q. BUT WHEN PROPERTY IS IN RATE BASE, DON'T PRICES**

1 **CUSTOMERS PAY PROVIDE THE CAPITAL WITH WHICH THE**
2 **PROPERTY IS FINANCED?**

3 A. No, customers do not provide the capital which
4 finances the utility's property -- investors do.

5 Properly constructed cost-based prices do
6 include elements to cover the cost of using
7 investors' capital (return) and for the return of
8 investors' capital (depreciation) for the period of
9 time for which service is provided along with other
10 cost of service elements.

11 **Q. WHY DOESN'T PAYMENT OF PRICES WHICH INCLUDE RETURN**
12 **ENTITLE CUSTOMERS TO SHARE IN THE CAPITAL UPON**
13 **WHICH A RETURN IS PAID?**

14 A. For the same reason that savings institutions
15 return the principal invested in time deposits to
16 the depositors even though the institution has paid
17 interest on the time deposit. The principal
18 invested belongs to the depositor who is also
19 entitled to be paid for the use of his or her
20 money. Further, savings depositors who withdraw
21 their savings and use the funds profitably --
22 perhaps in the stock market or by purchasing a
23 winning Florida lottery ticket -- do so without the
24 prospect of the savings institution in which the
25 funds were previously deposited laying claim to all

1 or some part of their profits.

2 **Q. SHOULD THE COMMISSION AMORTIZE GAINS ON SALES OF**
3 **UTILITY PROPERTIES AS A REDUCTION TO COST OF**
4 **SERVICE AS MS. DISMUKES PROPOSES?**

5 A. No, it should not. Sales of property are capital
6 transactions, not cost of service transactions.
7 The financial results of capital transactions
8 should be excluded from cost of service.

9 **Q. WHAT IS THE BASIS FOR MS. DISMUKES' PROPOSAL TO**
10 **EXCLUDE GAINS ON SALES OF UTILITY PROPERTIES FROM**
11 **SSU'S COMMON EQUITY FOR COST OF SERVICE PURPOSES?**

12 A. Ms. Dismukes' statements on page 42, lines 19
13 through 22 indicate her position is either (1) that
14 if the assets sold were "utility" assets the sales
15 proceeds belong to ratepayers, or (2) if the FPSC
16 declines to allow customers to share in investors'
17 property rights (the gains), the gains must be from
18 "non-utility" operations and should be excluded
19 from SSU's equity capital.

20 **Q. DO YOU AGREE WITH MS. DISMUKES' POSITION?**

21 A. No, I do not, for several reasons. First, it
22 should be clear from previous comments why the
23 payment of rate regulated prices for the service
24 they receive does not entitle customers to an
25 equity interest in either specific utility assets

1 or the capital with which they were financed.

2 Second, it is irrelevant whether the equity
3 capital which is used to finance the utility arose
4 as (1) proceeds from sales of stock, (2) reinvested
5 profits from utility operations, (3) reinvested
6 profits from non utility operations, or (4)
7 extraordinary gains on sales of operating or non
8 operating assets, proceeds from insurance, etc.
9 Whatever the originating transaction, as long as
10 common shareholders choose to leave the capital
11 invested in the business, it is common equity
12 capital.

13 The relevant questions are (1) what is the
14 total capital devoted to utility operations? and
15 (2) how much of that capital is common equity,
16 preferred stock or debt? These questions are asked
17 and answered by the reconciliation of capital
18 structure and rate base. No further adjustment is
19 necessary or appropriate.

20 **Q. WHAT IS OPC WITNESS HUGH LARKIN, JR.'S POSITION**
21 **WITH REGARD TO GAINS ON SALES OF PROPERTY REALIZED**
22 **BY SSU?**

23 A. At page 7, lines 6 through 9, Mr. Larkin asserts
24 that "... ratepayers have provided most of the
25 equity in the form of gains realized ... on the

1 sale of utility property...". Mr. Larkin further
2 opines that since the parent company's common stock
3 investment in SSU may have been financed with debt,
4 it really isn't an equity position (pages 5 and 6).
5 He suggests the fair return on equity is
6 substantially less than would be the result of
7 multiplying the book equity ratio by the authorized
8 return on equity.

9 **Q. WHAT IS THE BASIS FOR MR. LARKIN'S ASSERTION THAT**
10 **"... RATEPAYERS HAVE PROVIDED MOST OF THE EQUITY IN**
11 **THE FORM OF GAINS REALIZED ... ON THE SALE OF**
12 **UTILITY PROPERTY...?"**

13 A. Other than his unsupported claim, his testimony
14 contains nothing on the subject.

15 **Q. IS IT TRUE AS MR. LARKIN SUGGESTS ON PAGE 6 OF HIS**
16 **TESTIMONY THAT AN EQUITY INVESTMENT FINANCED WITH**
17 **DEBT REALLY ISN'T EQUITY AT ALL?**

18 A. No, it is not. Neither the means of acquisition
19 nor the financing of an equity investment changes
20 the economic characteristic of that investment.

21 **Q. PLEASE EXPLAIN.**

22 A. The primary economic characteristic of an equity
23 investment is that it represents the residual
24 investment, standing last in line after vendors,
25 debtholders or preferred shareholders whose claims

1 on the returns (if any) generated by the business
2 transactions of the enterprise are superior to
3 those of the common equity holder. Whether the
4 common equity holder borrowed 100% of the funds for
5 the investment ... or inherited 100% of the
6 investment from a distant uncle is irrelevant
7 because it does not change the primary economic
8 characteristic of that investment. However,
9 acquired or financed, the common equity holder is
10 still the residual investor, still last in line in
11 claims on returns from the enterprise and still the
12 investor whose risk is the greatest.

13 Those who argue for lower returns on equity
14 due to "double leverage" and similar theories
15 conveniently lose sight of these primary underlying
16 economic facts.

17 **Q. SHOULD THE COMMISSION ADJUST SSU'S COMMON EQUITY**
18 **RATIO BECAUSE OF GAINS REALIZED ON SALES OF**
19 **PROPERTIES OR SOURCE OF FINANCING AS OPC WITNESSES**
20 **DISMUKES AND LARKIN RECOMMEND?**

21 A. No, it should not. To do so would inappropriately
22 lower the return allowed on the common stock
23 portion of the capital which financed SSU's rate
24 base.

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

1 A. Yes.