DOCKET NO. 960258-WS

WITNESS: DIRECT TESTIMONY OF NORVELL D. WALKER,

APPEARING ON BEHALF OF STAFF

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DIRECT TESTIMONY OF NORVELL D. WALKER

Q. Please state your name and business address.

A. Norvell D. Walker, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850.

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

A. I am employed by the Florida Public Service Commission as a Professional Accounting Specialist with the Division of Water and Wastewater, presently with the Bureau of Policy Development and Industry Structure.

Q. Please give an overview of your educational and professional background.

A. I have worked for the Public Service Commission since my graduation from the University of Florida in 1974, where I received a Bachelor of Science degree in Accounting. On October 1, 1974, I joined the Commission as a field auditor with the Miami District Office. In 1977, I transferred to Tallahassee, thereafter working as a Public Utilities Accounting Analyst with the Commission's gas and transportation sections. In 1981, I transferred to the Commission's Water and Sewer Division. In this position, I have served as the accounting analyst in numerous rate case proceedings, certification proceedings, annual report studies, and various other regulation activities. I was accepted as an expert witness in Docket No. 850288-WS, a case which involved a transfer of plant facilities to Jacksonville Suburban Utilities Corporation; in Docket No. 830421-WS, a rate application filed by General Development Utilities, Inc. for its Port St. Lucie Division; in Docket No. 810485-WS, a rate application filed by Palm Coast Utility Corporation; and in Docket Nos. 850941-WS and 800364-WS, rate applications filed by Rolling Oaks Utilities, Inc.

Q. What is the purpose of your testimony?

A. I will testify concerning the Commission's practice of imputing Contributions in Aid of Construction (CIAC) to offset the margin reserve factor in the used and useful calculation. I will explain the mechanics of the calculation and how imputed CIAC affects the revenue requirement. Mr. Robert Crouch, supervisor of the engineering section of the Division's Bureau of Economic Regulation, will testify concerning the definition of margin reserve and why margin reserve is included in the used and useful determination. I will offer testimony about accounting matters as they relate to regulated water and wastewater utilities.

Q. How is CIAC imputed from a mechanical perspective?

A. Two simultaneous equations must be made. First, the engineer will specify which plant facilities depend upon margin reserve to enlarge the used and useful equation. Then, the rate base amount directly associated with margin reserve is calculated to determine the ceiling for imputation of CIAC. A second calculation of potential CIAC is made by multiplying the utility's plant capacity charges or main extension charges by the number of Equivalent Residential Connections (ERCs) included in the used and useful equation. The smaller amount, either the margin reserve element or the calculated CIAC, is adopted when imputing CIAC. Obviously, the imputed CIAC cannot exceed the rate base amount directly associated with margin reserve. The imputed CIAC, which is a credit entry in the rate base equation, offsets the debit balance associated with margin reserve. Likewise, offsetting provisions for depreciation expense and accumulated depreciation are determined. The net difference, if any, represents the net revenue requirement associated with

margin reserve when CIAC is imputed.

Q. Would you explain how imputation of CIAC affects the revenue requirement calculation in a rate proceeding?

A. In some cases, a provision for margin reserve is not a factor in the engineer's used and useful calculation. For example, if the utility's distribution lines are largely contributed, the engineer will usually disregard margin reserve since the existing lines will be offset by a comparable amount of existing CIAC. In other cases, the subject plant will be deemed 100% used and useful irrespective of projected customer growth, since the full investment is needed to serve existing customers. Thus, since margin reserve is not a factor in these used and useful calculations, an imputation of CIAC is likewise unnecessary. However, when margin reserve is an element in the used and useful determination, that portion of the utility's investment will be reduced to the extent additional CIAC is expected due to customer growth. If connection charges are modest or non-existent, the imputed CIAC will be insubstantial. However, in most cases, particularly following any recent review of the utility's service availability charges, a substantial, if not identical, provision for CIAC is imputed to offset the plant balance associated with margin reserve. Thus, commonly, the utility's revenue requirement does not change when margin reserve is counted in the used and useful calculation, because an equal provision for CIAC is imputed as if, it too, existed during the test year.

Q. Do you harbor any reservations regarding the current practice whereby margin reserve is offset by imputed CIAC?

A. Yes. Personally and professionally, I have opposed this practice since

its inception about twelve years ago. When first adopted, I believe this offsetting practice enjoyed considerable support among the Commission's accounting staff. Over time, this support has eroded to the point of dissolution. Indeed, I understand that the imputation practice is no longer advocated by any members of this Division's accounting staff.

Q. Why do you believe CIAC is imputed?

A. To reduce or eliminate the impact of including margin reserve in the used and useful calculation. Although there may be good technical and economic reasons to justify a margin reserve, those positive aspects are effectively swept aside by the CIAC imputation factor. The utility's existing investment in plant facilities is offset by pro forma recognition of projected CIAC. I believe the margin reserve is an investment pool that is constantly being replenished; when new customers are added, the investment needed to serve still future connections must be planned and completed. This investment may take the form of plant that was previously considered property held for future use, the non-used and useful portion per the utility's last rate proceeding. In this sense, margin reserve is constantly being updated, with expenditures to fund plant improvements preceding receipt of customer contributions.

Q. Isn't it true that the utility will eventually recover its investment in margin reserve from future customers?

A. Yes, to some degree. But, presumably, the utility will also be making future investments to serve additional customer growth. The utility cannot stand still when growth necessitates added expenditures to serve customers.

Q. Does the Allowance for Funds Prudently Invested (AFPI) recovery

mechanism provide a return on margin reserve?

A. No. Since the margin reserve is typically considered part of the utility's investment in used and useful plant, it is excluded from the AFPI recovery formula. Likewise, the imputation amount is usually omitted from the AFPI formula. Thus, the utility does not earn a return on the imputation consideration from existing customers or future customers.

Q. Recently, in Docket No. 950495-WS, the Commission considered arguments regarding economies of scale and timing of CIAC collections, and voted to limit the CIAC imputation to 50% of the anticipated contributions. Do you believe the practice of imputing 50% of the anticipated CIAC is appropriate?

A. No. I believe that practice is a only a compromise consideration, a half-step measure that overlooks the presumptively valid co-argument that margin reserve is likewise being updated on collateral basis. As customers arrive, contributions in hand, the investment in plant capacity must also be enlarged. Maintenance of capacity for growth is a flowing stream. In most cases, an attempt is made to present the test year as a representative period, but under the averaging proposition, the CIAC imputation component is typically the single factor that presumably grows beyond the test year. Also, from another perspective, inclusion of different imputation terms under different averaging propositions is hard to rationalize - six months for lines, nine months or longer for treatment plant facilities, and possibly different terms for water and wastewater projects.

Q. Does this conclude your testimony?

A. Yes.