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Southern States Utilities • 1000 Color Place • Apopka, FL 32703 • 407/880-0058

November 14, 1996

Via Federal Express

Ms. Blanca S. Bayo
Florida Public Service Commission
Director of Records & Reporting
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket No. 960258-WS

Dear Ms. Bayo:

Enclosed herewith for filing in the above-referenced docket on behalf of Southern States Utilities, Inc. ("SSU") are the following documents:

1. Original and fifteen copies of SSU's Notice of Service of Responsive Testimony;
2. Original and fifteen copies of the responsive testimony of Mr. John Guastella; and
3. A disk in Word Perfect 5.1 containing a copy of the aforesaid responsive testimony.

Please acknowledge filing of these documents by date stamping the enclosed copy of this letter and returning it in the postage paid, self-addressed envelope provided.

ACK _____
AFA 1 Very truly yours,

APP 1
CAF _____
CMU _____
CTR _____
EAG _____
LEG _____
LIN 5 + dg
OPC _____
RCH 1
SEC 1

Matthew Feil
Staff Attorney

Enclosures

WAS _____
OTH _____



BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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In Re: Petition to Adopt Rules)
on Margin Reserve and Imputation)
of Contributions-In-Aid-Of-)
Construction on Margin Reserve)
Calculation, by Florida)
Waterworks Association)
_____)

Docket No. 960258-WS

Date: November 14, 1996

SOUTHERN STATES UTILITIES, INC.'S
NOTICE OF SERVICE OF RESPONSIVE TESTIMONY

SOUTHERN STATES UTILITIES. INC., by and through its undersigned counsel, hereby files this Notice that is has served the responsive testimony of Mr. John Guastella filed with the Commission this 14th day of November, 1996, to the persons and in the manner reflected on the attached Certificate of Service on this same date.

Respectfully submitted,



BRIAN P. ARMSTRONG, ESQ.
MATTHEW FEIL, ESQ.
Southern States Utilities, Inc.
1000 Color Place
Apopka, Florida 32703
(407) 880-0058

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished by Federal Express Delivery to the following this 14th day of November, 1996:

Chris Moore, Esquire
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Wayne L. Schiefelbein, Esquire
Counsel for Florida Waterworks Association
Gatlin, Woods & Carlson
1709-D Mahan Drive
Tallahassee, Florida 32308

Harold McLean, Esquire
Office of Public Counsel
111 West Madison Street
Room 812
Tallahassee, Florida 32399-1400

Mark F. Kramer
Manager of Regulatory Accounting
Utilities, Inc.
2335 Sanders Road
Northbrook, Illinois 60062-6196

Richard D. Melson, Esquire
123 S. Calhoun Street
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(904) 425-2313

Samuel E. Poole, Executive Director
South Florida Water Management District
3301 Gun Club Road
West Palm Beach, FL 33406

Peter G. Hubbell, Executive Director
Southwest Florida Water Management District
2379 Broad Street
Brooksville, FL 34609-6899

Henry Dean, Executive Director
St. Johns River Water Management District
Highway 100 West
P. O. Box 1429
Palatka, FL 32178-1429

Elsa Potts, Professional Engineering Administrator
Division of Domestic Wastewater
Department of Environmental Protection
2600 Blair Stone Road, MS 3535
Tallahassee, FL 32399-2400


MATTHEW J. FEIL, ESQ.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition to Adopt Rules)
on Margin Reserve and Imputation)
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MATTHEW J. FEIL, ESQ.

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RESPONSIVE TESTIMONY OF JOHN F. GUASTELLA
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
ON BEHALF OF
SOUTHERN STATES UTILITIES, INC.
DOCKET NO. 960258-WS

DOCUMENT NUMBER-DATE
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FPSC-RECORDS/REPORTING

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. John F. Guastella, P.O. Box 371, Peapack, New
3 Jersey.

4 Q. WHAT IS YOUR OCCUPATION?

5 A. I am President of Guastella Associates, Inc. I am a
6 licensed Professional Engineer, and I have been
7 actively engaged in matters involving utility
8 valuations, management, rates and service for
9 thirty-four years. I formed Guastella Associates in
10 1978 to provide consulting services, specializing
11 in water and wastewater utilities.

12 Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PRO-
13 FESSIONAL EXPERIENCE.

14 A. I graduated from Stevens Institute of Technology in
15 June of 1962, receiving a degree in Mechanical
16 Engineering. I have completed courses in utility
17 regulation sponsored by the National Association of
18 Regulatory Utility Commissioners (NARUC) and con-
19 ducted by the University of South Florida, Florida
20 Atlantic University, the University of Utah and
21 Florida State University.

22 I was employed by the New York State Public
23 Service Commission for sixteen years from 1962 to
24 1978. With the exception of two years in which I
25 was involved in the regulation of electric and gas

1 utilities, my time with the New York Commission was
2 devoted to the regulation of water utilities. After
3 a series of promotions during the years 1962 to
4 1970, attained through competitive examinations, I
5 was promoted to Chief of Rates and Finance in the
6 Commission's Water Division. In 1972 I was made
7 Assistant Director of the Water Division. In 1974 I
8 was appointed by the Chairman of the Commission as
9 Director of the Water Division, a position I held
10 until my resignation from the Commission in August
11 of 1978.

12 My duties with the Commission included the
13 performance and supervision of various engineering
14 and economic studies concerning valuation of
15 utility property, financing, rates and service of
16 electric, gas and water utilities. While in the
17 Water Division, I either examined or supervised the
18 examination of the books and records of literally
19 hundreds of water utilities.

20 As Director of the Water Division, I was
21 responsible for the regulation of more than 450
22 water companies in New York State, heading a
23 professional staff consisting of 32 engineers and
24 three technicians. One of my primary duties was to
25 advise the Commission during its adjudication of

1 formal proceedings, as well as other matters. In
2 the course of those deliberations, testimony,
3 exhibits and briefs submitted in formal proceedings
4 were reviewed and analyzed. My duties and respon-
5 sibilities covered such subjects as the
6 reasonableness of investments in utility plant,
7 appropriate depreciation, contributions in aid of
8 construction, advances in aid of construction,
9 construction work in progress, working capital,
10 amortizations, rate base, revenue level, operation
11 and maintenance expenses, taxes, cost of capital,
12 fundable capital, financing, capital structure,
13 rate of return, rate design, rate structure,
14 quality of service, and in general, all aspects of
15 utility valuation, rate setting and service.

16 Another major responsibility was the review of
17 all proposed legislation affecting water utilities
18 in New York and the subsequent preparation of
19 recommendations for use by the governor or the
20 legislature in considering such legislation. I also
21 made legislative proposals and participated
22 directly in drafting bills that were enacted: one
23 expanded the New York Commission's jurisdiction
24 with respect to the regulation of the service
25 provided by small water companies and another dealt

1 specifically with rate regulations and financing of
2 developer-related water systems. During my
3 employment with the New York Commission, I handled
4 or supervised the handling of thousands of consumer
5 complaints by individuals, corporations and
6 municipal, governmental and political officials.

7 Concurrently with my position as President of
8 Guastella Associates, Inc., I served as President
9 of Country Knolls Water Works, Inc., from 1987 to
10 1991, directing the management and operation of
11 this utility which served some 5,000 customers.

12 I have prepared appraisals and valuations of
13 utility property, depreciation studies, rate
14 analyses, cost allocation and rate design studies,
15 and management and financial analyses. I have
16 provided consulting services for municipal and
17 investor-owned water and wastewater utilities as
18 well as gas utilities and solid waste collection
19 and disposal companies.

20 **Q. BEFORE WHAT REGULATORY AGENCIES AND MUNICIPAL**
21 **JURISDICTIONS HAVE YOU PREVIOUSLY PRESENTED EXPERT**
22 **TESTIMONY?**

23 **A.** I have testified as an expert witness in the areas
24 of water/wastewater utility engineering, rate-
25 making, economics and valuation, and I have

1 testified on one or more of these subjects in the
2 states of Connecticut, Florida, Illinois, Massachu-
3 setts, Missouri, Nevada, New Jersey, New Mexico,
4 New York, North Dakota, Ohio, Pennsylvania, Rhode
5 Island, Texas and Virginia.

6 **Q. BRIEFLY STATE YOUR ACTIVITIES IN CONNECTION WITH**
7 **PROFESSIONAL ORGANIZATIONS AND ASSOCIATIONS.**

8 A. I served as Vice-Chairman of the Staff-Committee on
9 Water of the National Association of Regulatory
10 Utility Commissioners (NARUC). While on that
11 committee, I prepared a 95-page instruction manual
12 entitled, "Model Record-keeping Manual for Small
13 Water Companies," which was published by the NARUC.
14 The manual describes in detail the kinds of
15 operating and accounting records that should be
16 kept by small water utilities, with instructions on
17 how to use those records in order to properly
18 operate a water system and properly keep account of
19 the cost of providing services.

20 Since 1974 I have prepared the rate case study
21 material, assisted in the coordination of the
22 program and served as an instructor at the Annual
23 Fall Seminar on Water Rate Regulation sponsored by
24 the NARUC and conducted by the University of South
25 Florida, Florida Atlantic University, University of

1 Utah, and currently Florida State University. This
2 seminar is recognized as being one of the best in
3 the country for teaching rate-setting principles
4 and methodology. It is attended by representatives
5 of regulatory agencies, utilities, engineering,
6 accounting, economic and law firms throughout the
7 country. In 1980, as a special consultant to NARUC,
8 I assisted in the establishment of another similar
9 seminar which has been held annually in the spring
10 in the western United States.

11 I served as an instructor and panelist in a
12 seminar on water and sewer utility regulation
13 conducted by the Independent Water and Sewer
14 Companies of Texas. As a member of the National
15 Association of Water Companies (NAWC), I serve on
16 its Rates and Revenue Committee and Small Company
17 Committee. I am a member of the American Water
18 Works Association and served on its Water Rates
19 Committee, and assisted in the preparation of the
20 AWWA Rates Manual, Third Edition. I have also
21 served on a joint committee on rate design composed
22 of staff members of NARUC and NAWC. In connection
23 with my serving on these committees, and in
24 connection with cost allocation and rate design
25 studies I have performed in the course of my work,

1 I have participated in decisional meetings to
2 determine proper engineering and construction
3 criteria in relation to costs in the design of
4 water and sewer systems.

5 I have prepared and presented papers at a
6 number of meetings of the National Association of
7 Water Companies, the National Association of
8 Regulatory Utility Commissioners, the New England
9 Conference of Public Utilities Commissioners, and
10 at meetings of the Mid-America Regulatory
11 Conference, the Public Utility Law Section of the
12 New Jersey Bar Association, the Pennsylvania
13 Environmental Council, the Southeastern Association
14 of Regulatory Utility Commissioners, and the New
15 Jersey Chapter of the American Water Works
16 Association.

17 **Q. WHAT IS THE NATURE OF YOUR INVOLVEMENT IN THIS**
18 **CASE?**

19 A. I have been asked by Southern States Utilities to
20 offer responsive testimony to the direct testimony
21 and comments submitted by other parties in this
22 docket. In that regard I will address the rate
23 setting principles regarding the specific issue of
24 margin reserve and the related issue of imputation
25 of contributions in aid of construction (CIAC).

1 Q. IN WHAT CONTEXT ARE THE ISSUES OF MARGIN RESERVE
2 AND IMPUTATION OF CIAC ADDRESSED IN THE RATE
3 SETTING PROCESS?

4 A. Margin reserve is a component of the used and
5 useful analyses, and the imputation of CIAC is a
6 related rate setting adjustment where margin
7 reserve allowances have been made.

8 Q. WOULD YOU PLEASE EXPLAIN WHAT IS MEANT BY "USED AND
9 USEFUL?"

10 A. The term "used and useful" is simply a regulatory
11 rate setting term which describes the cost of
12 property included in a utility's rate base (net
13 investment) upon which the utility is entitled to
14 earn a rate of return. The balance of the cost of
15 property which is excluded from rate base is
16 referred to as "non-used" plant.

17 Q. WHAT IS YOUR EXPERIENCE IN OTHER STATES REGARDING
18 USED AND USEFUL CONSIDERATIONS?

19 A. I have provided consulting services for utilities
20 in nearly half of the states in the country, and I
21 am generally familiar with rate setting practices
22 in most states as to any unique rate setting
23 methodology. I am not aware of any state which does
24 not require that rates be based on the investment
25 in utility plant in service which is used and

1 useful. However, I am also not aware of any other
2 state which determines used and useful for water
3 and wastewater utilities as the Florida Commission
4 does.

5 In general, all regulatory agencies expect
6 utilities to install economically-sized facilities
7 which have sufficient capacity to meet today's as
8 well as tomorrow's demands. In other states, if a
9 water or wastewater utility merely has a plan to
10 utilize a new or expanded facility, it is
11 considered entirely used and useful -- even if only
12 a small portion of its capacity is utilized when it
13 initially goes into service. There are for
14 example, cases in which the cost of acquiring land
15 for a future reservoir or treatment plant would be
16 considered entirely used and useful for rate
17 setting purposes, despite the fact that it would
18 not actually be "in use" within the immediate
19 future. In contrast, the Florida Commission has
20 recognized land acquired for future plant sites as
21 used and useful only for electric and other
22 utilities, not water and wastewater utilities.

23 **Q. WHY, IN THE EXAMPLE YOU REFERENCED, WOULD THE COST**
24 **OF LAND FOR FUTURE USE BE INCLUDED IN RATE BASE AS**
25 **ENTIRELY USED AND USEFUL EVEN THROUGH IT WILL NOT**

1 ACTUALLY BE IN SERVICE WHEN THE NEW RATES GO INTO
2 EFFECT?

3 A. Because first and foremost rate setting is a
4 process of establishing the cost of providing safe,
5 efficient and sufficient service. Throughout the
6 country and in Florida for utilities other than
7 water and wastewater utilities, "used and useful"
8 allowances are not limited to only the exact
9 proportion of current demands to capacity or
10 existing customers to potential customers. If a
11 utility must install prudently-sized facilities in
12 order to adequately serve customers on a continuous
13 and long-term basis -- in compliance with regulato-
14 ry requirements as to adequacy of service -- then
15 the cost of doing so must be reflected in the
16 allowed rates. Otherwise, the rates would not be
17 consistent with such legal guideposts as the FPC v.
18 Hope Natural Gas Co., 320 U.S., 591, 603 (1944),
19 which states that:

20 It is important that there be enough
21 revenue not only for operating expenses
22 but also for the capital costs of the
23 business. These include service on the
24 debt and dividends on the stock... By
25 that standard the return to the equity

1 owner should be commensurate with risks
2 on investments in other enterprises hav-
3 ing corresponding risks. That return,
4 moreover, should be sufficient to assure
5 confidence in the financial integrity of
6 the enterprise, so as to maintain its
7 credit and attract capital.

8 **Q. WHAT IN YOUR OPINION IS THE PROBLEM IN FLORIDA WITH**
9 **RESPECT TO USED AND USEFUL CONSIDERATIONS FOR WATER**
10 **AND WASTEWATER FACILITIES?**

11 -A. Florida gas, electric, and telephone utilities do
12 not suffer the unjustifiable used and useful
13 treatment imposed on water/wastewater utilities
14 despite the fact all of these utilities make
15 investment in plant necessary to meet peak demands
16 of current customers and to maintain the capability
17 to provide safe, efficient, and sufficient service
18 to all customers in the future. In the past, the
19 Commission has noted that these other utilities do
20 not generally collect CIAC charges at the level
21 received by water/wastewater utilities. This
22 distinction does not justify a grossly divergent
23 method of applying used and useful to
24 water/wastewater utilities. Investment is made by
25 electric, gas, and telephone utilities in

1 facilities necessary to serve the same geographic
2 areas (the same developments) served by
3 water/wastewater utilities; yet, the gas, electric,
4 and telephone utilities are allowed to recover
5 their investment in such facilities as prudent and
6 fully used and useful from current customers while
7 the water/wastewater utilities are not. The
8 collection of CIAC by water/wastewater utilities
9 does not justify this result. If the same used and
10 useful methods that applied to other Florida
11 utilities were applied to water/wastewater
12 utilities and overearnings arose due to CIAC
13 collection (or any other reason), the Commission
14 could and likely would initiate an overearnings
15 investigation. A Commission's overearnings
16 oversight is the historic and almost universally
17 applied system of checks and balances in utility
18 ratemaking. Artificial mechanisms to reduce rates,
19 such as CIAC imputation and margin reserve periods
20 inconsistent with real-world engineering and
21 economic considerations, are not fair or
22 reasonable. Further, since the CIAC which may be
23 collected from each new customer equates to only a
24 portion of the total cost of plant necessary to
25 serve future customers -- at maximum 75% under the

1 Commission's guidelines and often a much smaller
2 portion -- it is unreasonable to consider future
3 collections of CIAC as a justification for reduced
4 margin reserve and used and useful levels, as
5 Public Counsel suggests.

6 **Q. WHAT OTHER PROBLEMS HAVE YOU IDENTIFIED?**

7 A. Used and useful allowances, including the portion
8 related to margin reserve, coupled with the
9 imputation of CIAC, have been made in many
10 instances regardless of their impact on the ability
11 of water and wastewater utilities to cover the cost
12 of providing adequate service. As reflected in the
13 presentation of other industry representatives in
14 this docket, used and useful calculations and
15 margin reserve allowances have not adequately
16 provided for the planning, permitting, design,
17 construction and testing of facilities needed to
18 comply with regulatory and environmental
19 requirements. The existing FPSC practices do not
20 adequately recognize economies of scale, and in
21 certain instances, allowances have not provided
22 enough revenue requirement to cover even the least
23 cost facility. Moreover, the imputation of CIAC
24 related to margin reserve erroneously presumes that
25 future service availability charges are currently

1 available to offset the cost of the existing
2 facilities.

3 Accordingly, rates for water and wastewater
4 utilities in Florida are not consistently
5 established under the same cost recovery principles
6 and used and useful definitions as have been
7 applied throughout the country (and in Florida for
8 other utilities).

9 Q. DO YOU HAVE AN OPINION AS TO WHY THE FPSC TREATS
10 WATER AND WASTEWATER UTILITIES DIFFERENTLY WITH
11 RESPECT TO USED AND USEFUL CONSIDERATIONS?

12 A. I believe the reason the FPSC treats water and
13 wastewater utilities differently with respect to
14 used and useful considerations is to protect
15 utility rate payers from subsidizing the risk of
16 the success or failure of related real estate
17 developers.

18 Q. IS THAT A VALID REASON?

19 A. Affiliated real estate developers should bear the
20 risk associated with the success or failure of
21 their real estate business. That being said, it
22 must be understood that the real estate development
23 business is a highly competitive business for which
24 there is no need for a substitute for competition.
25 A real estate developer's profit is not regulated,

1 nor should it be. There are obviously many factors
2 which determine the success or failure (or level of
3 profitability) of a particular real estate project.
4 While utility rate payers should not subsidize
5 affiliated real estate developers, it is equally
6 appropriate that they should not be subsidized by
7 affiliated real estate developers.

8 With respect to the utility business, there is
9 no competitive market which establishes the
10 profitability of water and wastewater utilities.
11 Utility rate regulation serves as a substitute for
12 competition when establishing the profitability of
13 utilities. When utility rate regulation functions
14 properly, utility rates are established to cover
15 the cost of providing utility service.
16 Establishing utility rates based on the utility's
17 cost of providing service should not add to or take
18 away from the profitability of real estate sales.

19 **Q. ON WHAT BASIS SHOULD USED AND USEFUL CONSIDERATIONS**
20 **BE MADE IN ORDER TO PROTECT UTILITY RATE PAYERS**
21 **FROM SUBSIDIZING AFFILIATED REAL ESTATE DEVELOPERS**
22 **AND, AT THE SAME TIME, PROTECT REAL ESTATE**
23 **DEVELOPERS FROM SUBSIDIZING THE COST OF PROVIDING**
24 **UTILITY SERVICE?**

25 **A. Used and useful determinations for water and**

1 wastewater utilities in Florida should reflect the
2 same considerations and definitions as for other
3 utilities in Florida and throughout the country.

4 With respect to margin reserve, the presenta-
5 tions by other industry representatives have made
6 specific recommendations, supported by thorough
7 analyses and discussions as to why margin reserve
8 allowances are essential and as to the appropriate
9 magnitude of those allowances. I not only agree
10 with those findings and recommendations, I have
11 made similar recommendations in individual rate
12 cases in Florida. Those presentations underscore
13 the fact that Florida water and wastewater
14 utilities have not been treated the same as other
15 utilities, resulting in rates which produce less
16 revenue than the cost of providing service.
17 Therefore, we are not dealing with a situation in
18 which utility rate payers may be subsidizing the
19 real estate business. Instead we are attempting to
20 correct a situation in which used and useful
21 considerations as to margin reserve and the
22 imputation of CIAC have required utility stockhold-
23 ers to subsidize the actual cost of providing
24 utility service.

25 Q. WHAT IS YOUR OPINION WITH RESPECT TO THE IMPUTATION

1 **OF CIAC?**

2 A. With the exception of the comments by Public
3 Counsel, there is universal recognition that
4 imputation of CIAC related to margin reserve
5 creates a mismatch between revenues and costs. I
6 have similarly testified in rate cases on many
7 occasions. The imputation of CIAC, and inadequate
8 margin reserve allowances, deny water and
9 wastewater utilities the same rate setting
10 treatment given other utilities in establishing the
11 cost of providing service.

12 **Q. IN YOUR OPINION, ARE THE RECOMMENDATIONS BY OTHER**
13 **INDUSTRY REPRESENTATIVES REASONABLE?**

14 A. Yes, the industry recommendations regarding margin
15 reserve allowance and the elimination of the
16 imputation of CIAC are consistent with used and
17 useful considerations throughout the country, and
18 would produce rates which balance the need to
19 protect both utility rate payers and utility
20 stockholders from cross-subsidization.

21 In sum, those recommendations are consistent
22 with the establishment of rates equal to the cost
23 of providing service. They are also in the best
24 interest of the rate payers since they will provide
25 the incentive as well as financial ability to

1 construct economically sized facilities which are
2 sufficient to protect the public health and the
3 environment.

4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?**

5 **A. Yes.**