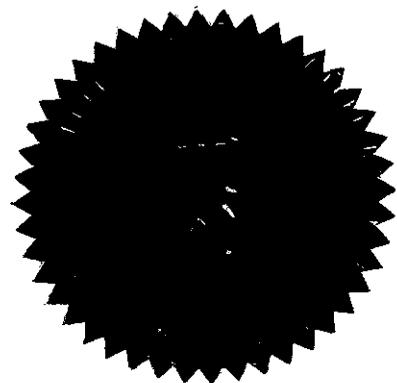


BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition to Adopt Rules) Docket No. 960258-WS
 on Margin Reserve and Imputation)
 of Contributions-In-Aid-Of-)
 Construction on Margin Reserve)
 Calculation, by Florida)
 Waterworks Association)



MORNING SESSION

VOLUME 1

Pages 1 - 183

PROCEEDINGS:

RULE HEARING

BEFORE:

SUSAN F. CLARK, CHAIRMAN
 J. TERRY DEASON COMMISSIONER
 JULIA L. JOHNSON, COMMISSIONER
 DIANE K. KIESLING, COMMISSIONER
 JOE GARCIA, COMMISSIONER

DATE:

Tuesday, December 10, 1996

TIME:

Commenced at 9:40 a.m.
 Concluded at 5:30 p.m.

PLACE:

FPSC Hearing Room 148
 Betty Easley Conference Center
 4075 Esplanade Way
 Tallahassee, Florida

REPORTED BY:

Lisa Girod Jones, RPR, RMR

W. Paul Rayborn
and Associates

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TALLAHASSEE, FLORIDA 32302-2195

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DOCUMENT NUMBER - DATE

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FPSC-RECORDS/REPORTING

1 APPEARANCES:

2

3 WAYNE SCHIEFELBEIN, Attorney at Law, Gatlin,
4 Woods & Carlson, 1790 Mahan Drive, Tallahassee, Florida
5 32308; appearing on behalf of the Florida Waterworks
6 Association.

7 ALSO PRESENT:

8 JIM MOORE, President, Florida Waterworks
9 Association.

10 FRANK SEIDMAN, Management & Regulatory
11 Consultants, Inc.

12 DEBORAH D. SWAIN, Milian, Swain & Associates
13 ARSENIO MILIAN, Milian, Swain & Associates

14

15 BRIAN ARMSTRONG, Attorney at Law, and KENNETH
16 A. HOFFMAN, Attorney at Law, Rutledge, Ecenia,
17 Underwood, Purnell & Hoffman, 215 South Monroe Street,
18 Suite 420, Tallahassee, Florida 32301; appearing on
19 behalf of Southern States Utilities, Inc.

20

21 MATT FEIL, Esquire, Southern States Utilities,
22 Inc., 1000 Color Place, Apopka, Florida 32703; appearing
23 on behalf of Southern States Utilities, Inc.

24

25 ALSO PRESENT:

26 HUGH GOWER

27 JOHN GUASTELLA, President - Guastella
28 Associates, Inc.

29

30 MARK KRAMER, Manager, Regulatory Accounting,
31 2335 Sanders Road, Northbrook Illinois 60062; appearing
32 on behalf of Utilities, Incorporated.

33

34 HAROLD McLEAN, Esquire, Office of the Public
35 Counsel, 111 West Madison Street, Tallahassee, Florida
36 32399; appearing on behalf of Citizens of the State of
37 Florida.

38 ALSO PRESENT:

39 SAM GATLIN, Office of the Public Counsel.

40

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42

1 APPEARANCES: (Continued)

2 KAREN LLOYD, Esquire, 2379 Broad Street,
3 Brooksville, Florida 34609-6809; appearing on behalf of
4 Southwest Florida Water Management District.

4 ALSO PRESENT:

5 JAY YINGLING, Senior Economist, Southwest
6 Florida Water Management District.

6 HAROLD A. WILKENING, III, P.E., Assistant
7 Director, Department of Resource Management, St. Johns
8 Water Management District; appearing on behalf of
9 St. Johns Water Management District.

9 ALSO PRESENT:

10 JOHN WEHLE, Assistant Executive Director,
11 St. Johns Water Management District.

11 CYNTHIA CHRISTEN, Esquire, Department of
12 Environmental Protection, 2600 Blairstone Road,
13 Tallahassee, Florida 32399-2400; appearing on behalf of
14 the Department of Environmental Protection.

14 ALSO PRESENT:

15 VAN HOOFNAGLE, P.E., Administrator - Drinking
16 Water Section Department of
17 Environmental Protection.

17 CHRISTIANA MOORE, Esquire, 2540 Shumard Oak
18 Boulevard, Tallahassee, Florida 32399-0870; appearing on
19 behalf of the Staff of the Florida Public Service
20 Commission.

19 ALSO PRESENT:

20 N. D. WALKER, FPSC
21 ROBERT CROUCH, FPSC
22 JOHN WILLIAMS, FPSC
23 JOHN STARLING, FPSC
24 CRAIG HEWITT, FPSC
25 GREG SHAFER, FPSC

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EXHIBITS

<u>EXHIBIT NO.:</u>	<u>FOR I.D.</u>
1 - (Composite) 22 items (Black binder)	9
2 - Revised Exhibits GCH-3 and RMH-7	10
3 - Letters to Commissioners from water management districts	10

REPORTER'S NOTE: Per Chairman Clark, all exhibits identified will be included as part of the record.

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PROCEEDINGS

CHAIRMAN CLARK: Let's call the hearing to order. Is there a notice to be read?

MS. MOORE: This rulemaking hearing is being held in Docket No. 960258-WS at this time and place pursuant to a notice that was published in the Florida Administrative Weekly on August 2nd, 1996.

CHAIRMAN CLARK: Let's go ahead and take appearances, Mr. Schiefelbein, and would you indicate who is with you that will be presenting -- that will be making comments on the rule.

MR. SCHIEFELBEIN: Am I on? Yes. Good morning, Commissioners. Wayne Schiefelbein, Gatlin, Woods & Carlson representing the Florida Waterworks Association. Appearing with me today are Jim Moore, president of Florida Waterworks Association, Frank Seidman, Debbie Swain and Arsenio Milian.

MR. KRAMER: I'm Mark Kramer for Utilities Incorporated. I'm manager of regulatory accounting.

MR. ARMSTRONG: Brian Armstrong on behalf of Southern States. With me will be Matt Feil and Ken Hoffman. Making presentations will be John Guastella, Hugh Gower. Jerry Hartman will not be available today. He won't be available until tomorrow.

CHAIRMAN CLARK: We are not planning on going

1 tomorrow.

2 MR. ARMSTRONG: He prefiled comments, so
3 they'll be submitted in Exhibit 1. As well as Richard
4 Harvey, he submitted comments as well.

5 MR. McLEAN: Good morning, Commissioners. I'm
6 Harold McLean, Office of the Public Counsel,
7 representing the Citizens the State of Florida. My
8 address is 111 West Madison Street, Tallahassee, Florida
9 32399. With me this morning is Mr. Sam Gatlin, same
10 office, same address. Thank you.

11 CHAIRMAN CLARK: Is anyone else that's not
12 sitting at the table that is here and would like to make
13 an appearance?

14 MR. FEIL: Commissioners, there are
15 representatives here from DEP and the water management
16 districts. I don't -- if you want them to announce
17 their presence, I suppose they can grab a microphone.

18 CHAIRMAN CLARK: I don't think it's --
19 Ms. Moore, would you help me out on this? Would that be
20 appropriate if we have them listed as making comments or
21 will they have an opportunity?

22 MS. MOORE: If those that are planning to make
23 comments or presentation, if they would identify
24 themselves.

25 CHAIRMAN CLARK: Okay.

1 MR. YINGLING: My name is Jay Yingling, and
2 I'm with the Southwest Florida Water Management
3 District. I was not planning to make any comments.
4 Karen Lloyd, one of our attorneys, was supposed to be
5 here this morning. I believe she's running a little bit
6 late, and I believe she will be asking to make
7 comments.

8 MR. WILKENING: Good morning. I'm Hal
9 Wilkening with St. Johns Water Management District.
10 Mr. John Wehle, our assistant executive director, will
11 be making comments. He should be here shortly.

12 CHAIRMAN CLARK: I'm sorry, would you spell
13 your last name?

14 MR. WILKENING: Yes, ma'am. It's
15 W-I-L-K-E-N-I-N-G.

16 CHAIRMAN CLARK: And the other gentleman's
17 last name?

18 MR. WILKENING: John Wehle, W-E-H-L-E.

19 CHAIRMAN CLARK: Thank you.

20 MS. CHRISTEN: Good morning. My name is
21 Cynthia Christen. I'm an attorney with the Department
22 of Environmental Protection. Mr. Van Hoofnagle from our
23 drinking water section is planning on making a few
24 comments this morning. He is not yet here. Thank you.

25 MS. MOORE: Staff who are here are

1 N. D. Walker, Robert Crouch, John Williams, who will be
2 summarizing the rule and giving introductory remarks.
3 I'm Christiana Moore, attorney with the Commission, John
4 Starling, Commission Staff, and Craig Hewitt. And we
5 have Greg Shafer seated behind me. Mr. Hewitt would
6 like to follow Mr. Williams and present a summary of the
7 statement of estimated regulatory costs.

8 CHAIRMAN CLARK: Okay. Ms. Moore, is it
9 appropriate at this time to identify the first exhibit?
10 And you have passed it out, at least to the
11 commissioners, and did you make copies available to the
12 parties?

13 MS. MOORE: That's correct. Everyone that I
14 was aware that was going to participate has a table of
15 contents. There are copies placed on the tables for
16 reference. The court reporter has a copy and each of
17 the commissioners have a copy. That exhibit contains
18 the Florida Administrative Weekly Notice of Rulemaking;
19 the materials provided to the Joint Administrative
20 Procedures Committee; the order noticing rulemaking;
21 comments and testimony that were filed; includes the
22 petitions filed by Southern States Utilities and the
23 Florida Waterworks Association challenging the rule at
24 DOAH; the Division of Administrative Hearings; includes
25 comments and testimony of Florida Waterworks

1 Association, Southern States Utilities, Utilities, Inc.,
2 Public Service Commission Staff members and some
3 responsive comments filed by Florida Waterworks
4 Association and Southern States Utilities; and finally,
5 it includes the revised statement of the estimated
6 regulatory costs.

7 CHAIRMAN CLARK: As I understand it, the
8 composite exhibit contains, as I have it, contains 22
9 items.

10 MS. MOORE: That's correct.

11 CHAIRMAN CLARK: And there is a table of
12 contents with it. We will go ahead and mark that as
13 Composite Exhibit 1.

14 (Composite Exhibit No. 1 marked for
15 identification.)

16 MS. MOORE: There are two additional items
17 that were not included in the composite exhibit.
18 Southern States, this past Friday, filed a correction to
19 exhibits that it had attached to Mr. Hartman's testimony
20 and to Mr. Harvey's. Each -- they have served all the
21 parties, or all the interested persons, and each of the
22 commissioners has a copy.

23 CHAIRMAN CLARK: Is it this document?

24 MS. MOORE: That's correct.

25 CHAIRMAN CLARK: We'll go ahead and mark this

1 as Exhibit 2.

2 (Exhibit No. 2 marked for identification.)

3 MS. MOORE: The third item is letters written
4 by three water management districts that I believe
5 everyone has a copy of, letters written to the
6 commissioners, and they were in the correspondence side
7 of the file and they did not -- were not placed in the
8 composite exhibit.

9 CHAIRMAN CLARK: We'll mark that as Exhibit 3
10 and let the record indicate that all those exhibits will
11 become part of the record.

12 MS. MOORE: Thank you.

13 (Exhibit No. 3 marked for identification.)

14 CHAIRMAN CLARK: Mr. Williams?

15 MR. WILLIAMS: For at least the last decade,
16 in almost every contested rate case, the Commission has
17 heard arguments about how margin reserve affects the
18 used and useful determination for water and wastewater
19 utilities. On the one hand the utilities advocate
20 supporting longer margin reserve periods and oppose
21 imputation of CIAC on the margin reserve. On the other
22 hand, consumer advocates oppose any consideration
23 afforded margin reserve, arguing that existing customers
24 should not pay for growth.

25 In response to these arguments, the Commission

1 has consistently adhered to the practice of allowing a
2 provision for margin reserve, generally using 18 months,
3 allowing an 18-month growth margin in the used and
4 useful calculation. The Commission has likewise adhered
5 to the practice of imputing CIAC on the margin reserve.

6 The 18 months of growth allowance that's been
7 adopted by the Commission has been done so through the
8 years -- or it was developed prior to the DEP having
9 specific rules regarding planning requirements for
10 expansion of facilities.

11 On March 1st, 1996, the Florida Waterworks
12 Association asked the Commission to adopt specific rules
13 to address margin reserve for water and wastewater
14 treatment plant facilities. They proposed a five-year
15 allowance for margin reserve, discontinuing the
16 imputation practice, and they also asked for full
17 recovery of all investments associated with reclaimed
18 water projects.

19 After reviewing this proposal, the Commission
20 Staff recommended, instead, that the Commission should
21 codify its existing practice regarding margin reserve
22 and imputation of CIAC. The Staff did not propose
23 adopting any rules governing reuse facilities at the
24 time of the rule proposal.

25 The proposed rule that we're considering today

1 is that the Commission should enact rules that codify
2 existing policy. While these rules do not enjoy
3 universal support on the part of the Commission Staff,
4 we recommended adopting the rules that reflect the
5 current Commission policy because it was the most
6 expedient way to get the matter before the Commission
7 and to have the rulemaking hearing today.

8 The Staff believes that it's important for the
9 Commission to adopt rules on margin reserve because
10 there is a great deal of time spent in every rate case
11 on this issue, and if we could resolve the matter
12 through rulemaking, it would eliminate a lot of
13 unproductive time that's spent in hearings.

14 In light of the DEP's adoption of rules
15 regarding planning for expansion of wastewater
16 facilities and the expected planning rules for water,
17 the Staff believes that the Commission should reevaluate
18 it's policy on margin reserve. Members of the
19 Commission's technical staff will present opinion
20 testimony regarding the duration of margin reserve
21 period and have proposed discontinuance of the
22 imputation of CIAC practice.

23 In some respects their testimony reflects a
24 significant departure from the Commission's current
25 policy. These individuals and other Staff members will

1 be present throughout the hearing to offer any testimony
2 or to respond to questions.

3 MR. HEWITT: Commissioners, originally an
4 economic impact statement was prepared for the proposed
5 rule. Subsequently, the rules were changed to Chapter
6 120, and now we've prepared a revised statement of
7 estimated regulatory cost to reflect costs.

8 In summary, the proposed rule would implement
9 Commission operating -- standard operating procedures
10 and rulings on margin reserve in file-and-suspend rate
11 cases. The rule would allow the Commission flexibility
12 to exceed the given parameters with justification. The
13 proposed rule would require two additional data
14 filings: One, the most recent wastewater capacity
15 analysis report; two, a linear regression of annual
16 equivalent residential connections. The first report is
17 currently prepared for DEP. The second is currently
18 performed by Commission Staff but can be prepared with a
19 hand calculator. Therefore there should be minimal
20 costs associated with these new requirements.

21 Many hours have been spent on contentious
22 proceedings and testimony with no rule in place. The
23 adoption of a rule with a specified margin reserve and
24 margin reserve period should help decrease the length
25 and cost of the related proceedings. Therefore the

1 proposed rule should have minimal increased regulatory
2 costs over the current no-rule situation.

3 CHAIRMAN CLARK: Thank you. And as I
4 understand it now, the order of presentation is members
5 of the public, and we have included DEP and the water
6 management districts under that category; is that
7 correct?

8 MS. MOORE: That's correct.

9 CHAIRMAN CLARK: Would you give us your name
10 and who you're with?

11 MR. HOOFNAGLE: Yes, ma'am, my name is Van
12 Hoofnagle. I'm the administrator of the drinking water
13 program for the Department of Environmental Protection.

14 CHAIRMAN CLARK: Go ahead.

15 MR. HOOFNAGLE: Well I would like to, of
16 course, thank the Commission for inviting us and
17 allowing us to participate in your rulemaking
18 activities. We find these very useful. And in
19 particular I would also like to thank many of the PSC
20 Staff who over the years have improved the relationship
21 between the two agencies in trying to work out
22 differences of opinion or policy.

23 Regarding the regulation of water and
24 wastewater utilities, special thanks to John Williams,
25 Neal Bephea, Greg Shafer, Ila Jones, and JoAnn Chase.

1 They've been most useful. And I think we're going to be
2 dealing a lot more with each other in area of viability
3 of water systems.

4 The Department comes before you to make two
5 points. I am not going to elaborate on the first one,
6 but just to state that we did file our comments on the
7 proposed rule, we filed on October 18th, and I think
8 it's included in your exhibits, two comments dealing a
9 margin reserve and with reuse.

10 When we made those two comments, we were
11 unaware or did not include another issue that has come
12 up in the interim, and that's my second comment that I
13 would like to bring to your attention today that is not
14 contained in that originally prefiled testimony.

15 As many of you know, and some of the
16 commissioners were intimately involved in the passage of
17 the amendments to the Safe Drinking Water Act of 1997,
18 that act has, of course, sort of restructured the way we
19 regulate water systems. That particular act also
20 established a state revolving fund. Basically, this is
21 a fund for cap for grants or loans, primarily loans, to
22 water systems for the construction of their
23 infrastructure that is needed.

24 It is similar in many ways to the SRF that was
25 established for the wastewater program in the Clean

1 Water Act. But there are some very fundamental
2 differences that affect, or may affect, your decisions
3 today or in the future.

4 In the wastewater SRF, the funds can only be
5 used for municipalities, governments. Under the
6 drinking water SRF, the Congress saw fit, because of the
7 differences between water and wastewater, to allow SRF
8 funds or loans to go to all municipalities regardless of
9 ownership, as well as any nonprofit organization that
10 runs a water system.

11 Our department now is in the process of
12 initiating a rulemaking so that the State of Florida can
13 take advantage of the federal SRF that's coming our
14 way. We anticipate, annually, we will have a fund
15 between 40- and \$45 million for loans to, not just
16 municipalities, but also privately investor-owned
17 community systems. The issue of whether or not we will
18 take advantage of funding nonprofit, noncommunity
19 systems is still being, shall we say, debated.

20 The water program will have a lot of
21 similarities to the wastewater program when we look at
22 the SRF. That is, we will have some of the same
23 environmental requirements. They will have to meet with
24 NEPA cross cutters and they will have to submit to us
25 engineering and planning documents.

1 CHAIRMAN CLARK: I'm sorry, you used the term
2 NEPA?

3 MR. HOOFNAGLE: That's the National
4 Environmental Policy Act.

5 CHAIRMAN CLARK: But then you said something
6 after that, too. NEPA what?

7 MR. HOOFNAGLE: Environmental cross cutters.
8 These are basically environmental laws, like Endangered
9 Species Act, or like Wild and Scenic Rivers, that we
10 have to review the impact of a project on that act and
11 that is not in violation of that act.

12 CHAIRMAN CLARK: And you called them cross
13 cutters?

14 MR. HOOFNAGLE: They're called cross cutters.
15 That's our bureaucratic jargon for the environmental
16 laws that will apply to the loan recipients.

17 COMMISSIONER JOHNSON: You said 40- to
18 \$45 million per year, funds available?

19 MR. HOOFNAGLE: That is correct, approximately
20 for the next five years.

21 COMMISSIONER JOHNSON: For the next five
22 years.

23 MR. HOOFNAGLE: Since they're loans we'll be
24 getting loan repayment, that should keep the loan
25 growing for some time to come.

1 COMMISSIONER JOHNSON: And you said the
2 wastewater is limited to municipal and government-owned
3 utilities?

4 MR. HOOFNAGLE: Yes.

5 COMMISSIONER JOHNSON: And just to make sure
6 this is clear in my note, but with water, it was for
7 private community, and it would include the government
8 municipality, but it would also add private community
9 systems?

10 MR. HOOFNAGLE: That's correct.

11 COMMISSIONER JOHNSON: And nonprofit, but
12 y'all --

13 MR. HOOFNAGLE: The federal law allows
14 nonprofits also to take advantage of the SRF if the
15 State so decides to do that.

16 COMMISSIONER JOHNSON: But it still would be
17 the Department's decision to determine whether or not to
18 include those?

19 MR. HOOFNAGLE: The Department and the
20 legislature, depending upon their involvement, when
21 those statutes are drafted governing the program.

22 COMMISSIONER JOHNSON: But that's another
23 question. It would require legislative action by our
24 legislature before you can even begin implementing it?

25 MR. HOOFNAGLE: Yes, the legislature is --

1 right now we are negotiating with them on three points
2 in order to have an SRF in Florida. One of those points
3 is the issue of the nonprofits. The other issue is they
4 have to give us the authority to prevent the creation of
5 new but nonviable water systems, and they also have to
6 give us administrative penalty authority at a thousand
7 dollars a day per violation for large systems.
8 Additionally, they would have to give us, in the
9 statute, the ability to set up the fund and administer
10 the fund.

11 COMMISSIONER JOHNSON: Okay. Thank you.

12 MR. HOOFNAGLE: Back to the differences
13 between water and wastewater. The primary difference
14 here, of course, is the fact that we can now give out
15 loans to eligible, privately owned systems, community
16 systems. The similarity is that they will have to meet
17 many of the same requirements as they do under the Clean
18 Water Act, and I mentioned some of those environmental
19 requirements that I referred to as the NEPA cross
20 cutters. They will also have to have planning
21 requirements.

22 As in the wastewater, we would be looking at a
23 20-year planning horizon and employing a present worth
24 analysis or cost-effectiveness analysis before we could
25 award a loan fund for a project. It is incumbent upon

1 the Department only to give out the taxpayers' money, in
2 this particular case, to projects which are
3 cost-effective over the life of the facilities.

4 As in wastewater, the kinds of alternatives
5 you look at are such things as consolidation, advances
6 in treatment, and also in the size and staging of those
7 alternatives. When one employs the procedures that we
8 have -- and the federal government has given us some
9 guidelines, especially in wastewater -- for performing a
10 cost-effectiveness analysis, you basically find that
11 alternatives that call for staging for less than five
12 years, sometimes even less than ten years, are not
13 cost-effective and therefore would not be eligible to
14 receive loans.

15 I think the bottom line is our concern is that
16 utilities that feel that because of the margin reserve
17 issue only come in for staging of facilities for 18
18 months, or two years, or even three years, will not be
19 eligible for an SRF loan under our program, because
20 invariably they will fail the cost-effectiveness
21 analysis for staging of those alternatives. It's sort
22 of obvious when you look at a facility that decides on
23 ten-year staging, therefore in a 20-year period, they do
24 construction twice. At 18 months they would do
25 construction about 14 times. And the cost-effectiveness

1 of -- involved with the mobilization and expanding of
2 plant 14 times, or even ten times, or even seven times,
3 in a planning period would not be cost-effective by our
4 criteria.

5 So I wanted to make you all aware, if this is
6 an important issue with you regarding the future of the
7 facilities that you regulate, to be able to access the
8 SRF program and the Safe Drinking Water Act, to also
9 consider the limitations margin reserve might place upon
10 their ability to access that fund.

11 That's basically the only statement that I had
12 from the Department dealing with the water area. If you
13 have any questions, I can take them now or be available
14 during the day.

15 COMMISSIONER KIESLING: You want me to start?

16 CHAIRMAN CLARK: Sure.

17 COMMISSIONER KIESLING: I guess, first of all,
18 have you reviewed the interim guidance that EPA has
19 published but which is not final yet on how to implement
20 the --

21 MR. HOOFNAGLE: Yes, we have reviewed the
22 guidance and actually made comments last month to EPA on
23 the guidance. We did point out our fears that the
24 wastewater program, and everything that you have to go
25 through to access that money, including some of the

1 environmental cross cutters, was very burdensome, and we
2 were concerned about small systems being able to meet
3 those planning requirements.

4 In fact, an analysis that we completed just a
5 couple days ago, it looks like facilities that are even
6 requesting under \$300,000 would not be a cost-effective
7 use for the Department to get involved in small loans
8 because of the cost to administer those loans. When
9 you've give out a loan, you have to track it for 20
10 years, plus review the construction and the planning,
11 and so forth.

12 So we do have a concern for the ability of
13 small systems to access the loan fund. For that
14 reason -- and the difference I didn't point out is that
15 in drinking water there were set-asides for technical
16 assistance, and we plan on utilizing, as much as
17 possible, the technical assistance funds to make
18 contact. And we've estimated that with the use of those
19 funds we can actually send out operators under contract
20 to over 2,000 systems a year.

21 So we understand the small system's problem,
22 and as I mentioned to John Williams earlier today, we do
23 plan on getting his involvement, the PSC's involvement,
24 in helping us development a capacity development
25 strategy to assist those small communities staying

1 viable.

2 But back to the original question, yes, we've
3 reviewed the document and issued comments on it.

4 COMMISSIONER KIESLING: And how does the
5 requirement in the act that 15 percent of the state
6 revolving funds be made available to small systems
7 square with your interpretation that would seem to make
8 those small systems -- the burden on those small
9 systems, what they would have to show in order to
10 qualify seems so great, that it doesn't seem like
11 they're going to get access to many of those funds.

12 MR. HOOFNAGLE: Yes, at 15 percent -- there is
13 a 15 percent mandatory requirement that 15 percent of
14 the entire capitalization grant that comes to the
15 State -- which you're looking at about \$6 million or
16 so -- go to systems that are under 10,000, serve under
17 10,000 population. And there's quite a few of those in
18 Florida.

19 The small systems I earlier referred to are
20 those systems that serve 25 to 500 people. They're
21 certainly the Gretnas, Havanas, Fort Whites, that have
22 massive capitalization needs for distribution and
23 treatment. So their loan requests would be rather
24 large. We do have to look into the issue of
25 affordability to manage that kind of loan.

1 The act also gives the states the ability
2 to -- not give grants, although that term is sometimes
3 used. The proper expression is loan forgiveness, which
4 in essence would be a grant, for those communities that
5 meet certain affordability criteria.

6 COMMISSIONER KIESLING: That was going to be
7 my next area of questions. It seems to me that there is
8 now a burden on each state to in some way define
9 affordability. And according to the -- at least the
10 preliminary documents that have come from EPA, they are
11 anticipating that each state will set its own
12 affordability criteria.

13 MR. HOOFNAGLE: This is correct, and that is
14 an area we can probably get your assistance from on how
15 that you do that in your program.

16 COMMISSIONER KIESLING: Well, we don't. And
17 that's why I think it's going to be a sticky area,
18 because at least under the current statutory framework,
19 we really can't consider affordability in calculating
20 rates. And so I'm going to be interested in working
21 with you in figuring out how we're going to set
22 affordability criteria and how mandatory that's going to
23 be.

24 MR. HOOFNAGLE: We'll be breaking new ground,
25 but there are also 49 other states that face the same

1 dilemma, and we will be interfacing with them, as well
2 as federal guidance on how they do this. And they may
3 not do it, or you may not do it in your program, or we
4 may not have done it in wastewater, but certainly all
5 the federal programs out there regarding assistance, I'm
6 sure there's a multitude of experience that we can draw
7 on. We'll see.

8 COMMISSIONER KIESLING: Okay. Thank you.

9 CHAIRMAN CLARK: Commissioners, other
10 questions?

11 Are there questions from any of the
12 participants? Mr. McLean.

13 MR. McLEAN: I wanted to. In the way of
14 clarification, I represent the citizens of the State of
15 Florida who are -- many of whom are customers of these
16 various utilities, and I want to see what it is you
17 bring to this proceeding from the DEP.

18 My sense is that the DEP is an agency which is
19 concerned with the -- among many other things -- with
20 the delivery of safe drinking water to Florida citizens,
21 and with the control of the pollution sources, pollution
22 which is inherent in wastewater disposal.

23 MR. HOOFNAGLE: That's correct.

24 MR. McLEAN: And I don't mean to be overly
25 simplistic, but that's part of it. And the functions of

1 this agency here is to decide, with respect to
2 investor-owned water and sewer utilities, water and
3 wastewater utilities, who pays for those things. Would
4 you accept that?

5 MR. HOOFNAGLE: I can't address what their
6 function is, but --

7 MR. McLEAN: Sure.

8 MR. HOOFNAGLE: But that's my layman's
9 understanding of it.

10 MR. McLEAN: In this endeavor before us today,
11 the question of margin reserve, witnesses will say that
12 margin reserve is required for present customers, in
13 some measure, and for future customers in some measure.
14 Are you familiar enough with the dispute before the
15 Commission to agree with me on that point?

16 MR. HOOFNAGLE: The dispute, I know, is over
17 margin reserve and who pays for future facilities.

18 MR. McLEAN: And the question really before
19 the Commission is, where a utility maintains their
20 margin reserve, for whatever purpose, whether it's for
21 present customers or future customers, who is going to
22 pay for that? And my question is, and I mean it to be a
23 clarification, because I'm not sure I understand, what
24 do you bring to that dispute? What do you say to the
25 Commission as to who should pay?

1 For example, I'm going to take the position
2 that a substantial part, or perhaps all of margin
3 reserve is actually required to serve the needs of
4 future customers, some of whom may not even arrive for
5 five years. Now -- and the Commission is going to hear
6 our point of view on that, and they'll hear it
7 criticized.

8 What can you say to the Commission to suggest
9 to them whether in that scenario present customers
10 should pay for margin reserve, or technically, pay a
11 return on margin reserve, or whether future customers
12 should? Do you have anything to suggest to the
13 Commission on that point?

14 MR. HOOFNAGLE: No, I do not.

15 MR. McLEAN: And I think reading, in a general
16 sense, both from you and the water management districts,
17 you have the general sense that perhaps if present
18 customers are required to pay that it is more likely to
19 occur, that those investments are likely to be made.
20 For example, in your summary this morning you mentioned
21 something -- well, if those plans don't take place, then
22 these people won't be eligible for the money. Are you
23 assuming that if present customers don't pay for the
24 planning, that the planning will not occur?

25 MR. HOOFNAGLE: No, I did not say that.

1 MR. McLEAN: That's not what your agency --
2 you have come here this morning to urge the Commission
3 that the planning horizon is fairly lengthy and that
4 environmental requirements are becoming more stringent,
5 and even that there are some programs of which utilities
6 might avail themselves, right?

7 MR. HOOFNAGLE: That's correct.

8 MR. McLEAN: You're not really suggesting to
9 the Commission who should pay for the investment, who
10 should make the investment in the assets which will be
11 required?

12 MR. HOOFNAGLE: No, that's their decision.

13 MR. McLEAN: Let me ask you too, you mentioned
14 reuse.

15 MR. HOOFNAGLE: Excuse me, reuse?

16 MR. McLEAN: Yes, sir, you mentioned reuse,
17 and that issue stings over at our office from time to
18 time because we are occasionally portrayed as opposing
19 reuse. Nothing could be farther from the truth. But I
20 want to ask you a question or two about that. Let us
21 take a hypothetical utility, related to none that I hope
22 you don't know about, and I certainly don't know about,
23 that engages in reuse facilities and does it in such a
24 way that perhaps the cost is far too high, perhaps the
25 money is borrowed at an outrageous interest rate, or at

1 least an unacceptable interest rate, and that the plant
2 is significantly oversized.

3 Now, does your agency suggest -- let me back
4 up just a minute just a moment. This Commission has a
5 very traditional approach to looking at the money that
6 utilities spend to judge whether it was prudent, whether
7 it was required, whether money was borrowed at
8 reasonable rates. Your agency is not suggesting to the
9 Commission that it should abandon that tradition or
10 approach just because the facilities are regulated --
11 I'm sorry, are related to reuse, are you?

12 MR. HOOFNAGLE: I really can't address your
13 economic hypothetical situation on reuse. It's not even
14 my area.

15 MR. McLEAN: I understand.

16 MR. HOOFNAGLE: It's in wastewater. We do
17 have a representative from the Department here who is
18 our reuse coordinator. That's perhaps more
19 appropriately directed at him.

20 MR. McLEAN: Okay, I'll be happy to ask the
21 questions of him. Thank you very much, sir.

22 No further questions. Thank you.

23 CHAIRMAN DEASON: Mr. Schiefelbein?

24 MR. SCHIEFELBEIN: Madam Chairman, I don't
25 know if you would believe this to be useful or not, but

1 this witness, other than talking about the SRF comment,
2 has not, to my knowledge, talked at all about the
3 comments that the Department has filed in this docket.
4 And I would actually -- perhaps it's a little out of
5 order, but I would think it might be useful for all of
6 us to hear a summary from Mr. Hoofnagle as to what the
7 Department's position is in this rulemaking. I can pull
8 that out through questioning, but I --

9 CHAIRMAN CLARK: Mr. Hoofnagle, will you
10 briefly summarize the points you made in your -- what
11 you filed with the Commission?

12 MR. HOOFNAGLE: Well, it is one of the
13 exhibits. It's, I think, only about two pages long. It
14 would be very easy to read it, and it was entered into
15 testimony.

16 CHAIRMAN CLARK: Okay.

17 MR. HOOFNAGLE: Basically, the Department
18 supports a five-year reserve capacity margin reserve and
19 100 percent of cost of reuse. And we defined those
20 facilities that we would classify as reuse in those
21 comments.

22 MR. SCHIEFELBEIN: I thought it beared being
23 said.

24 Mr. Hoofnagle, good morning.

25 MR. HOOFNAGLE: Good morning.

1 MR. SCHIEFELBEIN: In the case of municipal
2 utilities, who pays for the reserve capacity or the
3 margin reserve?

4 MR. HOOFNAGLE: In the case of municipal
5 facilities who pays for margin reserve?

6 MR. SCHIEFELBEIN: Ultimately.

7 MR. HOOFNAGLE: The customers, it's my
8 understanding. Sometimes, if they get a federal loan,
9 it would be other taxpayers.

10 MR. SCHIEFELBEIN: What sort of the planning
11 horizons do you typically encounter at the municipal
12 level?

13 MR. HOOFNAGLE: In water or wastewater?

14 MR. SCHIEFELBEIN: Let's start with water.

15 MR. HOOFNAGLE: They're usually shorter. We
16 have seen them range from 18 months, two years, up to 20
17 years, sort of my recollection from looking at a small
18 list of projects. I do not do permitting in the field,
19 but in my discussions over the last six years, in
20 looking at some of the permits and so forth, that's what
21 I've noted. It's a tremendous range. Depends upon what
22 they're constructing. If they're constructing
23 buildings, lines, it's an extended period of time. Some
24 lines are for 50 years, 40 years, generally about 20
25 years. Equipment can be as low as five years.

1 MR. SCHIEFELBEIN: Is there going to be
2 another department witness or commenter on water
3 facilities?

4 MR. HOOFNAGLE: No.

5 MR. SCHIEFELBEIN: Is there a --

6 MR. HOOFNAGLE: Excuse me.

7 MR. SCHIEFELBEIN: I believe the Department
8 has taken the position through its comments that they
9 favor a five-year margin reserve for water treatment; is
10 that correct?

11 MR. HOOFNAGLE: That's correct.

12 MR. SCHIEFELBEIN: Why is that?

13 MR. HOOFNAGLE: Well, that is tied into
14 basically our wastewater rule that we have when we --
15 it's a capacity analysis report --

16 MR. SCHIEFELBEIN: If I may stop you, I was
17 talking water specifically.

18 MR. HOOFNAGLE: We're basically matching that
19 because we anticipate rulemaking in the next one to two
20 years to match the wastewater requirement in water.

21 MR. SCHIEFELBEIN: And why the period of five
22 years? Is it just a matching with the existing
23 wastewater rule or --

24 MR. HOOFNAGLE: Yes. That's the primary
25 reason.

1 MR. SCHIEFELBEIN: Regarding your state
2 revolving fund -- one moment, please. With regard to
3 the state revolving fund, do you know whether payments
4 in the future contribute to financing present
5 investment?

6 MR. HOOFNAGLE: No. I don't know.

7 MR. SCHIEFELBEIN: Okay. Will you be
8 available later in the day for additional questioning if
9 the need arises?

10 MR. HOOFNAGLE: Yes. I can be available. I
11 was planning to go back to my office, but if you give me
12 a ten-minute lead time, I'm not that far from here, I
13 can come back.

14 MR. SCHIEFELBEIN: Thank you.

15 MR. ARMSTRONG: Madam Chair, I just have a
16 couple of questions which are clarification.

17 Mr. Hoofnagle, I just want to make sure we're
18 on the score with your comments today. Right now the
19 PSC proposed rule provides for an 18-month margin
20 reserve. The utilities have provided studies and
21 conducted studies which show that with an 18-month
22 margin reserve, it's going to be impossible for
23 utilities to earn their authorized returns on
24 investment, if they invest beyond an 18-month margin
25 reserve.

1 It seems that your position today here is
2 telling us and telling the Commission, that DEP has made
3 its own determination, that if you build plant capacity
4 in increments less than five years, it's not
5 cost-effective to do so. Is that --

6 MR. HOOFNAGLE: Yeah, in our experience in the
7 wastewater area, when it comes to reviewing alternatives
8 analysis for staging, staging of less than five to ten
9 years, in some cases a 20-year staging alternative is
10 the most cost-effective. But certainly at eighteen
11 months, or two years or three years, I wouldn't
12 anticipate there could be any facilities at all that
13 could justify cost-effectiveness analysis eligibility to
14 receive a loan.

15 MR. ARMSTRONG: And it's your position that
16 the same would apply to the water; you're contemplating
17 the rules now to implement the state revolving funds for
18 water. Is it also your comments that it would not be
19 cost-effective to build in shorter increments than five
20 years for the water side?

21 MR. HOOFNAGLE: Yes, that's correct.

22 MR. ARMSTRONG: And I guess just the
23 culmination of your testimony is that under current
24 consideration, DEP would not allow IOUs to be eligible
25 for funding under this state revolving fund program. If

1 an IOU goes to DEP, an investor-owned utility, and says,
2 we need funding for this program, here's what we plan to
3 build, and it's going to build for an incremental
4 capacity to cover 18 months.

5 MR. HOOFNAGLE: We would require an applicant,
6 whether it's investor-owned or not, or a municipality,
7 to go through an alternatives analysis, looking at a
8 20-year planning horizon, and looking at the staging and
9 expansion of their facilities at different increments
10 and choosing an increment which is the most
11 cost-effective.

12 MR. ARMSTRONG: And I guess, for
13 clarification, in your comments you made reference to
14 the fact that -- I think you misstated and said 18
15 years, if you're --

16 MR. HOOFNAGLE: 18 months.

17 MR. ARMSTRONG: I think you mistated and said
18 18 years if you're --

19 MR. HOOFNAGLE: Eighteen months?

20 MR. ARMSTRONG: I think you meant to say 18
21 months there would be 14 incremental capacity
22 additions. Is that what you meant to say?

23 MR. HOOFNAGLE: I was saying if the utility
24 were to come in and say we plan on expanding our plant
25 every 18 months over a 20-year horizon, they would be

1 talking about the construction of 14 expansions, which
2 is a little absurd. But in any event, that obviously
3 would not be cost-effective to a two- or three-expansion
4 alternative.

5 MR. ARMSTRONG: Thank you, Mr. Hoofnagle.
6 Appreciate it.

7 CHAIRMAN CLARK: Anyone else have questions?

8 MS. MOORE: I think Mr. Crouch would like to
9 ask Mr. Hoofnagle a couple questions.

10 MR. CROUCH: Mr. Hoofnagle, I had one question
11 just for clarification here. You say that we do have
12 the DEP Rule 62-600.405, which is planning for
13 wastewater facilities expansion, capacity analysis
14 reports and all that. You do not at this time have a
15 water rule similar to this. Do you have an estimate on
16 when you will have a water rule similar to the
17 wastewater rule?

18 MR. HOOFNAGLE: I have a gross estimate of
19 what my section plans on doing, and that would be within
20 the two years.

21 MR. CROUCH: Within the next two years? Thank
22 you.

23 CHAIRMAN CLARK: Thank you, Mr. Hoofnagle, for
24 coming.

25 Mr. Schiefelbein, this is a rulemaking

1 hearing, and it's not -- we don't require witnesses to
2 be here. What questions do you have? I mean, I am
3 concerned about telling Mr. Hoofnagle we're done with
4 him and then you wanting him to come back.

5 MR. SCHIEFELBEIN: Ma'am, the order of
6 presentation was different than what I anticipated. I
7 can roll with it, and I don't at this point know of any
8 questions that I may want to ask him. I had thought
9 that after members of the public that we would be up,
10 and I apologize for that.

11 CHAIRMAN CLARK: Okay. This is a rulemaking
12 hearing. So your ability to comment later is still
13 there.

14 MR. SCHIEFELBEIN: Thank you.

15 CHAIRMAN CLARK: Thank you very much. Is
16 there anyone else under the category of either members
17 of the public, DEP or water management districts?

18 MR. WILKENING: Madam Chairman --

19 CHAIRMAN CLARK: You need to come to a
20 microphone so we can get it on the record.

21 MR. WILKENING: Yes, ma'am. Mr. John Wehle
22 wishes very much to address the Commission on this
23 issue, and I expect him to be here.

24 CHAIRMAN CLARK: Sure. We'll move on, and
25 just let me know when he comes, okay?

1 MR. WILKENING: Sure.

2 CHAIRMAN CLARK: Thank you. Water and
3 Wastewater Utilities and the Florida Waterworks
4 Association.

5 MR. MOORE: Good morning, Commissioners. My
6 name is Jim Moore. I'm president of Gulf Utility
7 Company, and I'm also president of the Florida
8 Waterworks Association. The FWA is a state association
9 of investor-owned utilities. Together we serve over a
10 million people in the State of Florida.

11 The FWA believes that the most critical
12 problem facing our industry in Florida today is the
13 uncertainty and lack of foresight in the Public Service
14 Commission's used and useful policies. If water and
15 sewer utilities are to be viable, to be able to attract
16 capital and borrow money, and to operate as
17 cost-efficiently as they can, there must be
18 predictability on when decisions are made to invest in
19 plant and equipment. Utilities need to know what the
20 policies of the Commission are and they need to know
21 that these policies will be consistently applied.

22 The FWA does not believe that existing nonrule
23 policies do this. Today there is no certainty that
24 treatment of rate base, plant and equipment will be
25 consistent from rate case to rate case.

1 The only apparent certainty is that investment
2 in efficient design and construction will not be treated
3 in a realistic manner that considers real world facts
4 and circumstances. In an attempt to address these
5 matters, we have asked that this rulemaking be
6 restricted to policies regarding margin reserve, because
7 this is the key issue. On this turns the most
8 fundamental and critical decisions we make regarding
9 long-term planning and the funding of those plans once
10 they are made.

11 Our industry needs rules that match regulatory
12 policy with real world needs, rules that coordinate PSC
13 regulation with FDEP regulation, rules that allow us to
14 recover the cost of investment actually necessary to
15 meet statutory obligations instead of a formulated
16 theoretical level of investment artificially determined
17 to keep rates low. Existing nonrule policies and the
18 proposed rule do not do this.

19 In real world planning, we prefer -- and your
20 charge to our industry should be -- that our engineers
21 design the most economical and efficient facilities that
22 meet our continuing obligations to the public,
23 consistent with high state and federal health and
24 environmental requirements.

25 Unfortunately, the signal we have been getting

1 does not support this approach. The signal we have been
2 getting is it doesn't matter what the most economical
3 choice over the long term may be, utilities will still
4 only be allowed to earn on a formulated investment equal
5 to capacity for today's load plus 18 months' growth.
6 The experts we have retained will provide for you
7 examples that demonstrate this problem.

8 Our member utilities have been denied, time
9 and again, rates sufficient to cover economically sized
10 additions. We have reacted to that signal by downsizing
11 our additions and making them smaller and more
12 frequently and at higher unit costs. The FWA believes
13 the Commission should correct this problem, which is
14 generic, by adopting rules that encourage prudent,
15 long-term economic development. The simplest way to do
16 this is by increasing the margin reserve to five years
17 so that we can meet both FDEP and other regulatory
18 requirements and benefit concurrently from lower unit
19 costs.

20 Just as important, the Commission needs to
21 stop imputing CIAC against the margin reserve. Not only
22 is it wrong as a period matching accounting procedure,
23 but it makes it impossible for a utility to ever recover
24 the cost of its investment necessary to meet its
25 obligations and as the result attract the debt and

1 equity necessary to fund the required plant and
2 necessary investment in plant and equipment.

3 Commissioners, as regulated utilities, we know
4 we have certain responsibilities. We must provide safe,
5 efficient and adequate service to our customers. We
6 must protect the environment. We must be ready to serve
7 all potential customers in our certificated areas, an
8 obligation we bear in exchange for being provided with a
9 protected service area. We know full well we have an
10 obligation to do all this in an economical way, over a
11 realistic period of time.

12 But you also have obligations. You must
13 assure the public that a utility meets its obligations
14 in an economic manner. But you must also provide the
15 utility with an opportunity to earn on the utility's
16 investment necessary to meet its obligations in serving
17 the public. And you must set rates that allow a utility
18 to maintain its financial integrity, so that it can pay
19 its legitimate debts and have an opportunity to earn a
20 reasonable return on capital.

21 The FWA has proposed a rule that we believe
22 protects the public, allows the public to benefit from
23 lower construction costs, and gives the utility an
24 opportunity to earn on proper, economic, long-term
25 investment necessary to serve its public.

1 The FWA has sponsored expert testimony that
2 supports its position and provides valid information,
3 support and facts for the Commission to consider.

4 I would respectfully request that you study
5 their comments carefully and with an open mind. Please
6 question them on their comments and benefit from their
7 input. I sincerely hope you will accept our comments as
8 constructive and well intended, and with the long term
9 benefit of our customers in mind, adopt our proposed
10 rule language. Thank you.

11 CHAIRMAN CLARK: Thank you, Mr. Moore. Are
12 there questions of Mr. Moore? Mr. McLean?

13 MR. McLEAN: Yes, ma'am, I do have a few, but
14 I wonder if I shouldn't go after the friendly
15 questions. Mine might be -- will certainly be friendly,
16 but not --

17 CHAIRMAN CLARK: This is a rulemaking hearing.
18 We'll come back to you.

19 MR. McLEAN: Yes, sir, I have a question or
20 two. Let us think about a hypothetical utility which is
21 50 percent used and useful. And we could agree that it
22 was 50 percent used and useful, perhaps. But in my
23 hypothetical it's 50 percent used and useful. The
24 growth which it anticipates in the next five years will
25 not take it to any point where it is in danger, in any

1 way, of having enough capacity to go around. In other
2 words, a somewhat -- I don't want to say stagnant, but a
3 utility sitting there 50 percent used and useful, growth
4 isn't going to get him in trouble anytime soon. The
5 rule which the FWA sponsors, and the one which I take it
6 you strongly support, wouldn't it permit a margin
7 reserve -- let me ask the question differently. What do
8 these observations you make about growth and planning
9 have to do with that utility? Do they help the
10 Commission decide whether that utility should have a
11 margin reserve, and if so, to what size it should be?

12 MR. MOORE: Well, you lost me in the question,
13 but I would like to defer to our experts, if I could.

14 MR. McLEAN: That's fine. I can ask any -- if
15 you don't know the answer, I would be happy to ask
16 someone else.

17 MR. MOORE: I don't know the question.

18 MR. McLEAN: Then perhaps, before you decide
19 you can't answer it, let me make the question clear.

20 CHAIRMAN CLARK: No. Mr. McLean, he doesn't
21 understand your question because it was so long.

22 MR. McLEAN: I'm sorry. I'll ask it shorter.
23 Take a hypothetical, 50 percent used and useful
24 utility. Its growth rate is such, its experienced
25 growth rate is such that it will not reach 100 percent

1 used and useful, even for the next five years. You have
2 that? Are you with me so far?

3 MR. MOORE: I am.

4 MR. McLEAN: Now the rule that the FWA
5 supports, and has before the Commission today, the rule
6 which the Commission, actually, proposed, although its
7 witnesses may not, the justification for that rule
8 relies in heavy part on the planning responsibilities of
9 the utility, like we just heard from the DEP witness.
10 Correct? Are you with me so far?

11 MR. MOORE: Absolutely.

12 CHAIRMAN CLARK: Mr. Moore, stay close to that
13 microphone so the court reporter can pick it up.

14 MR. McLEAN: Now when the Commission
15 undertakes to decide whether this hypothetical utility,
16 what their used and useful is, whether they should be a
17 margin reserve, what does the planning argument say to
18 the Commission about that? It's my thesis, of course,
19 that it doesn't help them at all because this utility is
20 not in the planning business. But would you agree with
21 that?

22 MR. MOORE: Every utility is in the planning
23 business.

24 MR. McLEAN: So while this utility is not
25 going to be built out for the foreseeable future, there

1 is no need to plan additional capacity. Why -- how can
2 the Commission rely on the arguments and the point of
3 view which you just heard from the DEP to help it
4 determine whether that 50 percent used and useful
5 utility should have a margin reserve?

6 MR. MOORE: I would -- there is a difference
7 between planning and construction. Everybody's planning
8 horizon goes well beyond five years.

9 MR. McLEAN: Even ones who are not -- okay,
10 well, let me change the question a little bit. How
11 about the ones that are built out, 100 percent used and
12 useful today. Let's assume another hypothetical
13 utility, built out, 100 percent, no plans to grow.
14 Does -- and the Commission doesn't provide a margin
15 reserve in those cases. Do you know whether that's
16 correct?

17 MR. MOORE: I'm going to defer -- I'm having a
18 hard time.

19 MR. McLEAN: Commissioners, let me ask these
20 questions to other witnesses. Thank you. Thank you,
21 sir.

22 MR. ARMSTRONG: Madam Chair, could I just make
23 some comment? This is a rulemaking, I guess. I think
24 one of the difficulties is Mr. McLean's questions are
25 presupposing the existence of a plant. Now one of the

1 determinations made when you're building plant or when
2 you have built plant, what were the facts and
3 circumstances that existed at the time you built that
4 plant? Given reasonable assumptions, was it prudent for
5 the utility to build that plant at that level? That
6 that's the first thing you have to look at.

7 You're not making a determination after events
8 have occurred. For instance, a period of economic
9 downturn where building stops or where people can't
10 afford to buy houses any longer, you can't look with
11 20/20 hindsight at that determination.

12 What you have to do then is determine, as is
13 done with electric utilities -- and that's one of the
14 premises of everybody's comments, you're looking for was
15 it prudent to build a plant at that size when they built
16 it, and then you're looking for a determination of was
17 it economical to customers to build, existing and future
18 customers.

19 With electric utilities, the margin reserves,
20 or the reserve capacities, are far in excess of that
21 allowed for the water utilities. There's some wonderful
22 information about that, that demonstrates that, by
23 Mr. Seidman in this proceeding, looking at the three
24 largest electric utilities in the state.

25 It comes down to then we often hear the

1 question of why should existing customers pay for the
2 facilities they're not using? And I think there's a
3 mistake in that analysis because it's our premise that
4 the lower unit costs are benefiting current customers.
5 The fact that the facilities are there in the size that
6 they're there is benefiting them because there's
7 reliability of the supply. When they increase their
8 needs, because they put in a pool, or when existing
9 customers come on line, they've gotten the benefits of
10 that lower unit cost.

11 So the premise that existing customers should
12 not pay for something they're not using is an inaccurate
13 premise. It is not one that's applied so rigidly in any
14 of the other utilities. And it's our premise that
15 because the water and wastewater utilities have been
16 dealt with the 18-month margin reserve period, today,
17 when we go in for rate case today, and we're looking at
18 past investment in plant, we are seeing higher costs and
19 higher rates than we would otherwise have seen had we
20 not faced this 18-month margin reserve period for the
21 last 15 years.

22 Customers now -- and the reason we're in so
23 often for rates cases is because we're dealing with this
24 18-month margin reserve period. The studies have to be
25 reviewed, and if there's questions for the studies, or

1 questions of the validity of those studies regarding the
2 fact that the way we are treated right now with 18-month
3 margin reserve and CIAC imputation, it's impossible for
4 investor-owned utilities to earn their authorized rate
5 of return.

6 If there are questions as to the validity of
7 that, they have to be asked today. But a lot of effort
8 and a lot of time and money was spent to develop that
9 information and to prove that information, those
10 statements and those facts in those studies.

11 MR. McLEAN: I would love to respond to that
12 soliloquy.

13 CHAIRMAN CLARK: Yeah. I mean, I remind
14 everyone this is a rulemaking, and to that extent, it's
15 a discussion of the policy. While we need expert
16 witness to give us some factual basis and information,
17 it's -- you know, the attorneys are free to argue the
18 policy.

19 MR. McLEAN: Although we probably should hear
20 more from the experts than from Mr. Armstrong and I.
21 But, my point is a very narrow one. If you're trying to
22 determine the used and useful of Sunny Hills over here
23 in the Panhandle, all this talk about the utilities who
24 are planning and following the DER rules is pretty much
25 useless, because the capacity is already there, and it's

1 your job to decide how much of that capacity should be
2 paid for by today's customers.

3 CHAIRMAN CLARK: Yeah, and you would agree,
4 though, that the real -- if you start looking further
5 out, and with the notion of making sure that capacity is
6 there for five years, and that hopefully it will cost
7 less, your projections as to growth and forecasting
8 become extremely important?

9 MR. McLEAN: I do indeed. But they don't
10 really answer the question about who ought to pay for
11 it.

12 CHAIRMAN CLARK: I think they have some
13 bearing on who should pay for it.

14 MR. McLEAN: They may well, because it may
15 well be shown that that is of continuing interest, or
16 present interest, to today's customers who don't want
17 their service to deteriorate and who want to enjoy the
18 economies of scale for the future.

19 CHAIRMAN CLARK: Exactly.

20 MR. McLEAN: But who fronts the money to build
21 these things? It may be a different question entirely.

22 CHAIRMAN CLARK: I think, to me, to suggest
23 it's an either/or sort of ignores all the factors that
24 go into deciding what is appropriate.

25 MR. McLEAN: You're going to have a lot of

1 testimony that says it's of use to today's customers and
2 of use to tomorrow's customers, but you'll hear not a
3 word on allocating the cost of that endeavor or the
4 investment to today's customers and some to tomorrow's
5 customers.

6 CHAIRMAN CLARK: Where you set the margin of
7 reserve certainly accomplishes that allocation.

8 MR. McLEAN: It does indeed, Commissioner.
9 And in the Rolling Oaks case, which was argued before
10 the First DCA, the court itself said imputation of CIAC
11 is an excellent way to make that determination.

12 MR. SCHIEFELBEIN: That's not what they said.

13 CHAIRMAN CLARK: I appreciate that,
14 Mr. Schiefelbein, and you'll have an opportunity to
15 respond.

16 MR. SCHIEFELBEIN: I'm waiting.

17 MR. McLEAN: We'll probably brief the
18 particular point of what the cases say, I would think.
19 And I can read it verbatim, but we can all read it later
20 too. Whatever the Commission prefers.

21 CHAIRMAN CLARK: Anything else?
22 Mr. Schiefelbein, did you want to --

23 MR. SEIDMAN: Commissioner Clark, could I
24 respond to that now?

25 CHAIRMAN CLARK: I don't want this to get into

1 a debate over what the case said. You'll have an
2 opportunity to respond to that. I'll let you briefly
3 cover it, and then I'm going to move on.

4 MR. SEIDMAN: Commissioner Clark, what I
5 wanted to respond to was the very narrow scope that
6 Harold was talking about with regard to the margin
7 reserve.

8 CHAIRMAN CLARK: All right, let me ask this.
9 Mr. Schiefelbein, who else on behalf of Waterworks are
10 you planning to make comments right now?

11 MR. SCHIEFELBEIN: First of all, I have some
12 questions, Madam Chairman, of you. At the beginning of
13 the hearing you indicated that we were not going to go
14 for a second day; is that correct?

15 CHAIRMAN CLARK: No. It's my desire not to go
16 for a second day on this. We will stay here and get it
17 done.

18 MR. SCHIEFELBEIN: Into the evening as needed
19 then?

20 CHAIRMAN CLARK: Right.

21 MR. SCHIEFELBEIN: Great. My preference on
22 this, as far as the FWA's presentation, is as follows.
23 We've had sort of a keynote address from Mr. Moore. I
24 would like Mr. Seidman, Mr. Milian and Ms. Swain, in
25 that order, to make individual presentations that are

1 somewhat concise, and then I would like them to
2 hopefully engage in a dialogue with you all, and
3 whomever else wishes to join in, as a panel.

4 CHAIRMAN CLARK: That would be fine.

5 MR. SCHIEFELBEIN: And that is the way. Now,
6 on the other hand I would very much like -- since, until
7 yesterday -- until yesterday I was under the impression
8 that under the procedural order that Staff was going to
9 go first.

10 CHAIRMAN CLARK: Staff did go first.

11 MR. SCHIEFELBEIN: Well, the Staff testimony
12 to which we have filed responsive comments, I had
13 thought would come up first. Now what I would like very
14 much to do, we have filed responsive comments, and I
15 would like to take up our responsive comments at a time
16 where they are responding to something. And so we would
17 like to have the opportunity, however late it is today,
18 as necessary, not to belabor it, but to have that
19 opportunity, in addition to our primary presentation.

20 CHAIRMAN CLARK: Mr. Schiefelbein, let me
21 suggest this. As each individual makes their
22 presentation, also have them comment with regard to what
23 they filed in response to Staff.

24 MR. SCHIEFELBEIN: So, we will not have an
25 opportunity to provide responsive presentation after

1 Staff, or --

2 CHAIRMAN CLARK: Staff has provided their
3 presentation, as I understood it.

4 MS. MOORE: There are two witnesses,
5 Mr. Walker and Mr. Crouch also filed prefiled testimony,
6 but the responsive comments have also been prefiled.

7 CHAIRMAN CLARK: Let me check with you,
8 Ms. Moore. Was it your intention to have Staff orally
9 provide comments that are in their written comments?

10 MS. MOORE: No, the intention was not to
11 duplicate that, but it was make them available at
12 anytime for questions about it. The order on procedure
13 says that -- does not contemplate duplicating what's
14 already been prefiled, but to engage in a discussion and
15 ask questions to clarify each presenter's position.

16 MR. McLEAN: Commissioners, might I be heard
17 on the point of order? Y'all have had this litigated
18 dozens of times before you. Testimony is all filed.
19 There's no -- I doubt there's going to be too many
20 surprises or smoking guns in this thing. You've heard
21 it all before and it's all before you. And to the
22 extent you allow me and Mr. Schiefelbein to debate,
23 you're probably wasting time.

24 MR. SCHIEFELBEIN: Commissioners, I haven't
25 engaged in any debate, and I don't intend to.

1 CHAIRMAN CLARK: Mr. Schiefelbein, hang on
2 just a minute. Go ahead.

3 MR. McLEAN: And I didn't mean to allege that
4 at least it was a unilateral debate. I'm certainly
5 ready to debate on the point. But I don't think it's a
6 useful way for you to spend your time. You've heard all
7 this dozens of times before. The record is pretty much
8 complete as we speak. It seems to me like this would be
9 a good time for commissioners to ask a few questions and
10 figure out, you know, the fine tuning, and let's move
11 on.

12 MR. SCHIEFELBEIN: May we give our
13 presentation?

14 CHAIRMAN CLARK: Yes. And I would suggest,
15 Mr. Schiefelbein, to the extent your presenters have
16 responded to the Staff, let them be specific in their
17 comments now as to what they take issue with with the
18 Staff. We're not -- this is not a hearing like a rate
19 case. This is a rulemaking hearing.

20 MR. SCHIEFELBEIN: I understand, but my
21 understanding --

22 CHAIRMAN CLARK: Notice we haven't put any of
23 the witnesses under oath.

24 MR. SCHIEFELBEIN: Yes. All right. We will
25 start with Mr. Frank Seidman. I would ask,

1 Commissioners, that you indulge us, since we may -- our
2 only opportunity to provide responsive comments may be
3 now as well, so I would think we will be covering those
4 as well in our individual and panel presentations.

5 Mr. Seidman.

6 MR. SEIDMAN: Commissioners, we've put
7 together some poster boards to help focus on some of
8 what we think are major points. They seemed like they
9 were pretty big when we put them together, until we
10 brought them into this room. So it may be difficult for
11 you to see them. I hope they aid in focusing. They
12 don't say anything that's not in --

13 COMMISSIONER KIESLING: However, if you turn
14 the backs of them to our Staff, they can't see them at
15 all.

16 MR. SEIDMAN: We can put it over at that end.

17 COMMISSIONER KIESLING: That would be a good
18 idea.

19 MR. SEIDMAN: But they don't have anything in
20 them that's not filed, so it's not presenting anything
21 that Staff hasn't already read.

22 COMMISSIONER KIESLING: Turn it more this
23 way. No, no, not this way, this way, so everyone can
24 see it, including the people sitting at the table.

25 CHAIRMAN CLARK: You need to put it where

1 Ms. Swain is and just at that angle.

2 MR. SCHIEFELBEIN: Follows direction poorly.

3 Sorry.

4 CHAIRMAN CLARK: How is that?

5 COMMISSIONER KIESLING: Can everybody at the
6 table see it? Can everybody that wants to see it see
7 it?

8 CHAIRMAN CLARK: Go ahead, Mr. Seidman.

9 MR. SEIDMAN: Thank you, Commissioner. For
10 the record, my name is Frank Seidman. I'm with
11 Management and Regulatory Consultants of Tallahassee,
12 Florida. And I'm appearing here this morning to
13 summarize and present the position of the Florida
14 Waterworks Association with regard to the proposed rule
15 on margin reserve. I'm sure you've already gathered
16 from Mr. Moore's comments, the Association believes that
17 the financial integrity of a water and wastewater
18 utility pretty much sinks or swims depending on the
19 policies of this Commission regarding used and useful,
20 and particularly with regard to its policies on margin
21 reserve on the imputation of CIAC.

22 We believe the Commission needs a rule on
23 margin reserve to codify policy, so that we'll know from
24 case to case what to expect and we'll know how to
25 approach our long-term planning.

1 Where do we begin to put a rule together? We
2 believe we should begin by looking at the requirements
3 of Chapter 367, the -- of the Florida Statutes, the
4 Water and Wastewater Regulatory Law.

5 Up on the board that you're looking at, this
6 shows some of the major factors that are -- that have a
7 bearing on the margin reserve policy. And I just want
8 to emphasize those. First, the law empowers the
9 Commission to regulate the rates and service of water
10 and wastewater utilities so as to protect the public
11 health, safety and welfare.

12 It requires the Commission in setting its
13 rates that it shall consider the cost of providing
14 service, including the utility's investment in property
15 used and useful in the public service. I emphasize that
16 "in the public service," that places a
17 readiness-to-serve obligation on the utility. Remember
18 that the State provides water and wastewater utilities
19 with a monopoly status, and in turn, the utility is
20 obligated to serve and obligated to be prepared to
21 serve, within a reasonable time, all applicants for
22 service in its area.

23 These are facets of the law that form the
24 basis for a rule. Because in order for a utility to be
25 able to meet the obligations under the law, utilities

1 must have sufficient capacity to protect public health,
2 safety and welfare, be ready to serve, and the
3 Commission should adopt a rule that allows recovery of
4 the costs associated with meeting those requirements.
5 So with the requirements of the law as a basis, we
6 believe that any adopted rule should recognize, one,
7 that the law obligates the utility to provide service;
8 that it should recognize that Commission policies must
9 be consistent with the Department of Environmental
10 Protection statutory and regulatory requirements, for
11 safety -- for safety, adequacy and planning; and that in
12 order for utility to be able to meet its statutory
13 obligations in an economic manner, the Commission must
14 fix rates that are just, reasonable and compensatory,
15 and not unfairly discriminatory.

16 It's the position of the Association that the
17 current Commission policy and the proposed rule do not
18 reflect the requirements of Chapter 367 or recognize the
19 facts as I've outlined. The Association believes that
20 the proposed rule would codify policies that are
21 inconsistent with the statutory mandates and with the
22 rules of the DEP; that they're inconsistent with
23 reasonable and proper operation of the utilities in the
24 public interest; that they unfairly discriminate in
25 their application to water and wastewater utilities; and

1 that they discourage the development of utility systems
2 in an economic manner and encourage choices that have
3 long-term detrimental impacts on utility customers.

4 Current policy results and rates are not and
5 cannot be compensatory for the investment the utility
6 must make to meet its statutory obligations in an
7 economical manner. This drives the utility to make
8 decisions that will maximize its return in the short run
9 at the expense of investment that will maximize customer
10 welfare in the long run.

11 A large factor in this result is the
12 Commission's policy to impute unrealized CIAC against
13 current investment and margin reserve. This policy, as
14 reflected in the proposed rule, erodes the allowed
15 margin reserve by imputing future CIAC against current
16 investment and margin reserve. Under this policy, a
17 utility never has the opportunity to earn a fair return
18 on its actual investment and plant serving the public.

19 In order to recognize the plant investment
20 that is necessary for a utility to meet its statutory
21 obligations in an economic manner, we need definitions
22 of margin reserve and margin reserve period that reflect
23 the real world considerations of used and useful in the
24 public service.

25 The definitions in the proposed rule are very

1 limiting. They do not reflect real world
2 considerations. They do not recognize the essential
3 elements of the plant necessary for a utility to meet
4 all of its obligations, but instead offer only a little
5 something extra to meet immediate growth. The
6 definition should reflect the real world concept of used
7 and useful that this Commission previously spelled out
8 way back in 1977 in a Delta Utilities case.

9 Order No. 7684 in that case made several
10 meaningful and realistic observations about the used and
11 useful concept, and I would just like to briefly review
12 those.

13 First, the concept of used and useful in the
14 public service is basically an engineering concept.
15 Used and useful assets must be reasonably necessary to
16 furnish adequate service to the utility's customers
17 during the course of the prudent operation of the
18 utility's business.

19 Generally, any asset which is required to
20 perform a function which is a necessary step in
21 furnishing service to the public is considered used and
22 useful.

23 Finally, good engineering design will give a
24 growing utility a sufficient capacity over and above
25 actual demand, to act as a cushion for maximum daily

1 flow requirements and normal growth over a reasonable
2 period of time. So all we're looking for in a rule is
3 margin reserve that reflects these concepts already
4 espoused by the Commission: Good engineering design, a
5 cushion over and above actual demand, and sufficient
6 capacity to serve during the course of the prudent
7 operation of the utility's business.

8 The proposed the definitions do not do this.
9 The proposed definitions ignore the reserve functions --
10 the reserve's functions of meeting changing demands of
11 current customers, of maintaining the integrity of the
12 system for those customers, and of allowing the utility
13 to serve in an economic manner.

14 The Association proposes that the rule include
15 certain definitions to reflect these important
16 elements. Could you go to the next chart? These are
17 the definitions that we're proposing:

18 That margin reserve is defined as the
19 investment needed to meet the changing demands of
20 existing customers and the demand of potential customers
21 in a reasonable time and in an economic manner;

22 That the margin reserve period be defined as
23 the period during which current capacity is required to
24 be available until the next economic addition that
25 capacity can be placed in service without causing a

1 deterioration of the quality of that service.

2 Along with these definitions, the Association
3 proposes the following default margin reserve periods.

4 Go to the next chart please.

5 We're proposing that unless otherwise
6 justified, that water source and treatment facilities
7 and wastewater treatment of disposal facilities have a
8 60-month or a five-year margin reserve period, and this
9 would apply to all those facilities other than reuse;
10 that on-site water distribution lines and on-site
11 wastewater collection lines and laterals have a 24-month
12 reserve period; that prudently constructed transmission,
13 water transmission, and off-site distribution, and
14 off-site collection system components, be considered 100
15 percent used and useful, and that reuse studies and
16 reuse facilities that comply with Chapter 403 of the
17 statutes be considered 100 percent used and useful.

18 Why do we pick five years? We believe that
19 five years is a proper default period for margin reserve
20 for two important reasons. First, it supports and is
21 consistent with the planning, design and construction
22 period in the regulation of DEP. The utilities must
23 plan a design and construct to meet their approval. The
24 utility should be able to expect that they can recover
25 the cost of an investment necessary to gain DEP

1 approval, and that they should not be caught between two
2 agencies.

3 In addition, a five-year period is a minimum
4 period to encourage a utility to take advantage of
5 economies of scale, economies that will provide long run
6 benefits.

7 If you set the margin reserve period to 18
8 months, utilities will be driven to build in increments
9 that can serve only 18 months. They will lose the
10 economies of scale benefits of larger increments. A
11 five-year margin reserve period signals utilities that
12 it could plan for the longer term and anticipate
13 recovery of the associated cost.

14 How does this five-year period compare to
15 that, this five-year margin period, compare to that for
16 other utilities that the Commission regulates? I would
17 like you to take a look at how the margins of water and
18 wastewater --

19 CHAIRMAN CLARK: Mr. Seidman, let me ask you a
20 question. What do you mean by on site and off site?

21 MR. SEIDMAN: On-site facilities are those
22 that serve specific streets, just specifically customers
23 on those streets. Off-site facilities would serve the
24 system in general. In other words, they would have a --
25 there would be a design requirement for those facilities

1 to be able to serve not only the neighborhoods they're
2 in, but larger sections, quadrants, or whatever, of the
3 of the system.

4 CHAIRMAN CLARK: Let me ask you this. Are
5 those terms terms of art that engineers use and there's
6 a pretty clear demarcation of what is on site and what
7 is off site?

8 MR. SEIDMAN: I believe so. They're used now
9 in service availability policies. I know that between
10 us and Staff I think there's a pretty good
11 understanding. I don't know if there is a specific
12 definition that's been set out.

13 CHAIRMAN CLARK: Mr. Williams, is there
14 usually -- or Mr. Crouch, is there usually a debate or
15 no debate over what on site and off site means?

16 MR. WILLIAMS: It is defined in our service
17 availability rules and there generally isn't a debate.

18 CHAIRMAN CLARK: Okay, thanks.

19 MR. SEIDMAN: I would like you to take a look
20 at how the margin reserve periods for water and
21 wastewater compare to those of electric utilities when
22 they're measured in the consistent terms of multiples of
23 annual growth. And I know you're familiar with the
24 reserve margin policies for electric utilities, and
25 they're basically determined on a reliability

1 requirement basis. But those reserves, once they have
2 been established, can be -- can be measured in terms of
3 annual growth by taking the amount of that reserve and
4 dividing it by the annual growth of each utility.

5 If you can see that chart at all, the bar
6 chart part of it represents the margin reserve period
7 for electric utilities, for Florida Power and Light,
8 Florida Power and Tampa Electric Companies, taken from
9 their most recent ten-year site plant responses. And
10 they range from a low of six and a half years of growth
11 equivalency to a high of about 24 and a half years of
12 growth equivalency in any single year, compared to the
13 18-month growth margin reserve.

14 CHAIRMAN CLARK: How did you come up with
15 that, Mr. Seidman? Because usually -- for electric
16 utilities, it's based on serving peak load. I mean, how
17 did you determine --

18 MR. SEIDMAN: The reserve margin for a
19 utility, for an electric utility, is the difference
20 between its capacity and its summer peak load. So I
21 took that amount of --

22 CHAIRMAN CLARK: So how did you project it to
23 be -- how did you project it into a time period?

24 MR. SEIDMAN: Into the periods going forward?

25 CHAIRMAN CLARK: Right.

1 MR. SEIDMAN: They showed -- this coming out
2 of their ten-year site plan submissions, they showed
3 what the reserve would be in each of the years from 1996
4 to 2005. I took the reserves in each of those years and
5 divided it by the ten-year average annual growth for
6 that utility to come out with an equivalent number of
7 years.

8 CHAIRMAN CLARK: Okay.

9 MR. SEIDMAN: So the reserves that you allow
10 electric utilities to maintain, the reserves that
11 reflect economic choices that result in long term --
12 lower long-term costs, are significantly higher than
13 those presently allowed by the Commission, or even
14 proposed by the Association for water and wastewater
15 utilities. We are only asking that the Commission to
16 adopt a margin reserve period that, like those
17 maintained by electric utilities, promote good economic
18 choices that will benefit customers in the long run.

19 I would like to just briefly turn to the used
20 and useful treatment of reuse facilities. The
21 Association takes the position that the prudently
22 incurred cost of studies and facilities, for purposes of
23 reusing reclaimed water that meet the requirements of
24 Chapter 403 of the statutes, shall be considered
25 100 percent used and useful, and that there is no

1 authority in the statute for the Commission to apply the
2 used and useful analysis to these facilities.

3 Now this is different from the -- your ability
4 to review the prudence of it. The law specifically says
5 "prudently incurred costs." We're not taking any
6 argument with that. But that's a different approach
7 than used and useful with regards to measuring it on a
8 percentage basis.

9 And finally, I would like to address the
10 policy of imputing CIAC against margin reserve. As I
11 earlier stated, the Association's position is that this
12 proposed rule must do away with the policy to impute
13 CIAC against margin reserve. Imputation illogically
14 mismatches current period investment against future
15 period CIAC. This is a period mismatch that the
16 Commission would not even consider for any other cost
17 category. The term imputation, to me, is a dead
18 giveaway. If these two elements were truly a match,
19 there would be no need for an imputation.

20 Imputation defeats the purpose of margin
21 reserve because whereas an allowance for margin reserve
22 provides a utility the ability to recover the costs of
23 used and useful investment, and encourages investments
24 with long-run economic benefits, imputation negates the
25 allowance and the encouragement. And the imputation

1 policy is confiscatory because it denies the utility the
2 ability to ever earn a return on its investment in plant
3 used and useful in the public interest.

4 The Commission must recognize that if it
5 approves an increase in the margin reserve period but
6 continues its imputation policy, there will be no
7 benefit whatsoever from the increased margin reserve
8 period.

9 This completes my summary of my portion of my
10 testimony. I have provided responsive comments, which
11 I'm not really in a position to summarize at this
12 point. They were responses to Mr. Crouch's statements
13 and to Public Counsel's statements, basically.

14 CHAIRMAN CLARK: Mr. Seidman, we'll move to
15 Ms. Swain, and we'll give you some time to look at them
16 and sort of summarize them. Who is next? Ms. Swain?

17 MR. SEIDMAN: Yes -- Mr. Milian.

18 CHAIRMAN CLARK: Okay, go ahead.

19 MR. MILIAN: Good morning, Commissioners.

20 CHAIRMAN CLARK: Let me ask a question.
21 Commissioners, would you like to take a ten-minute break
22 and come back?

23 Let's go ahead and take a break for the court
24 reporter and we'll come back at ten minutes after 11 and
25 start with you.

1 (Recess from 11:00 a.m. until 11:20 a.m.)

2 CHAIRMAN CLARK: Let's reconvene the
3 rulemaking hearing. Mr. Milian?

4 MR. MILIAN: Good morning, Commissioners. For
5 the record, my name is Arsenio Milian. I'm one of the
6 principals in Milian, Swain & Associates, the firm that
7 has been engaged by Florida Waterworks Association to
8 determine the impact of the Commission's proposed rule
9 on the cost of providing utility service and the impact
10 on customers' rates and utility earnings. I think my
11 partner, Debbie Swain, will be addressing the fact --
12 the financial model that we have been working on.

13 My intent -- my presentation here is to share
14 with you some of the different perspectives that I have
15 had throughout my career as a former president of a
16 utility company and also as a former regulator for the
17 South Florida Water Management District -- as a board
18 member of the South Florida Water Management District,
19 which has given me some awareness of the concerns and
20 the intent of the regulators, and also of the problems
21 that are faced by the utility companies in trying to
22 meet those requirements and their financial constraints
23 imposed on them by the -- by the Commission in many
24 cases.

25 In my current capacity as the president of

1 Milian, Swain & Associates, I serve as a consultant to a
2 number of public and private utilities and I have been
3 observing how they are continuously struggling to
4 meeting the compliance with the regulatory requirements,
5 and yet the financial implications of the decisions.

6 One prime example is, as you very well have
7 been heard, is Dade County where they artificially
8 maintain rates at a very low level, and now we have been
9 paying more than double the rates -- they have doubled
10 the rates in less than two years, and still we're having
11 to pay for all the environmental impacts that you have
12 caused those lack of proactive movement to resolve some
13 of the infrastructure problems that they had.

14 As part of the study that we did to determine
15 these environmental regulations, how they are affecting
16 the construction and the planning and the timing which
17 they are taking, and also how the economic regulations
18 and regulatory practices and policies of the Commission
19 at the present time discourage in many times the
20 economies of scales and the prudence of investment.
21 These, actually, we have seen, and by talking to a lot
22 of utilities in our surveys, how they are ultimately
23 penalized. And I think the penalties are not only for
24 the future -- to the present customers, also to the
25 future customers. I hope during our discussions today

1 we may provide some examples to that effect.

2 I think everyone is aware that environmental
3 regulations have an impact on the planning, construction
4 and operation of utilities. In the past few years we
5 have seen a much higher awareness of the impacts of
6 utility expansions and the effects to the natural
7 resources. We have seen how it's more difficult to be
8 withdrawing from an aquifer that is impacting wetlands,
9 or even discharges of the treated effluent into
10 wetlands, from a quantity and quality standpoint, how
11 the estuaries are impacted. So we have seen that there
12 is a lot more consciousness on the regulatory aspects of
13 providing service in a utility.

14 And of course this has taken a tremendous
15 amount of time lag into the actual design and permitting
16 of facilities, sometimes with competing agencies that
17 have different opinions as to the procedures of how to
18 dispose of effluent.

19 These, of course, have resulted in the
20 evolution of more restrictive regulation requiring more
21 interaction of the multiple regulatory agencies,
22 including the DEP, the Environmental Protection Agency,
23 the South Florida Water Management District, the Corps
24 of Engineers, and even, on many occasions, when you
25 receive all those permits -- and I can discuss about one

1 in particular, where we had gone through the process for
2 more than three years in obtaining all these permits
3 from these different regulatory agencies, we had to go
4 and request from the county an usual use permit, and
5 they required to have all of these permits before they
6 even consider it. They actually denied it, and the
7 utility had to start from scratch all over again. That
8 is a time lag and there is expenses that are scheduled
9 with that.

10 In our study, by talking to the many different
11 utilities, we found -- and some consultants of those
12 utilities, we found that typically it requires three and
13 a half to five years to plan, design, permit, construct
14 and then test and then certify water and sewer
15 utilities -- sewer facilities.

16 For instance, I was personally involved in one
17 in one particular utility where we had to -- we spent
18 more than seven years to obtain the permits before we
19 could even do any construction, and that was to obtain
20 the South Florida's water consumptive use permit, to
21 apply for the date, the DERM's approval under the Fresh
22 Water Wetlands Impacts, and the mediation plans, the
23 purchase of the land, obtaining the zoning associated
24 with -- you know, the proper zoning for the facility.
25 So it took approximately seven years before we even --

1 we were able to even start doing any construction.

2 This survey that we did, in talking to the all
3 the different utilities, also describes the experiences
4 of other utilities in expanding all of these
5 infrastructure, and -- but I have to say that these
6 exceptions are not -- these examples are not an
7 exception to the rule. Those examples have been
8 included in our report.

9 Now I would like to emphasize, also, that the
10 fact of one of the principal agencies that regulate
11 utilities, the Department of Environmental Protection,
12 established Rule 62-600.405 requiring a five-year time
13 period for the planning and construction of wastewater
14 facilities. They have also stated that in anticipation
15 of implementing similar policies for water facilities --
16 we heard that this morning and we saw it in a letter
17 that they submitted to you -- they also strongly
18 recommended that the Public Service Commission adopt a
19 margin reserve of five years for water supply and
20 treatment facilities, and wastewater treatment, and
21 disposal facilities, to be consistent with its rules.

22 Discussions this morning were talking about
23 the SRF and availability of funds. I think there's
24 something -- a very measurable consideration that you
25 should take. Some utilities cannot have -- cannot go to

1 financial institutions and expect them to be lending
2 money without having any idea of whether those AFPI
3 charges or revenues are going to be coming in to pay for
4 it, contrary to what municipalities do, where the
5 existing customers pay for the bonds necessary to be
6 expanding these facilities, before you get, you know,
7 the expansion of the facilities.

8 Regulation by the PSC at the present time
9 should encourage utilities in meeting those objectives
10 by allowing recovery of the costs of prudent planning,
11 design and construction of facilities, taking into
12 consideration of economy of scale and good engineering
13 practice.

14 I was faced with one particular utility and
15 had to make a decision whether to expand a 500,000
16 gallons per day sewage treatment plant or to go to a
17 1 million gallons a day sewage treatment plant. And
18 they made the economic evaluation. They found that the
19 half a million gallons would cost them \$1.7 million,
20 while the 1 million would only cost them 1.9. So they
21 will have twice as much capacity with an additional
22 \$200,000, which was less than 10 percent of the
23 additional cost to build the sewage treatment plant, for
24 half a million dollars.

25 Now, the utility had to make the decision

1 based on the fact that if I go with a 1 million gallons
2 a day plant, then they will give me 50 percent capacity,
3 used and useful, and therefore my rate base would be
4 approximately \$900,000. If I go with the .5, then the
5 whole thing will be 100 percent, and therefore I will
6 obtain the \$1.7 million. So these are the kind of
7 things that ultimately the customers, the present
8 customers and the future customers, are going to be
9 suffering if the economies of scale are not taken into
10 consideration.

11 Our financial model will show that expanding
12 in small increments end up costing existing and future
13 customers more. The higher construction costs -- and I
14 think some of the comments made by your own engineering
15 staff will reiterate this. The cost per gallon is much
16 higher for smaller increments. You have the duplication
17 of engineering, you have duplication of permitting and
18 contractual mobilization and higher rate case expenses,
19 not only in the actual construction, but the actual
20 operation and maintenance of those facilities will also
21 be a lot more costly.

22 Both existing and future customers will
23 benefit if expansions are appropriately sized in
24 accordance with good engineering principles, good
25 engineering practice, respecting the economy of scale.

1 The Commission should encourage utilities to do so by
2 giving them the incentives to accomplish that.

3 Finally, I would like to briefly address the
4 reuse facilities issues.

5 CHAIRMAN CLARK: Let me ask you a question,
6 Mr. Milian.

7 MR. MILIAN: I'm sorry?

8 CHAIRMAN CLARK: I would like to ask you a
9 question.

10 MR. MILIAN: Yes.

11 CHAIRMAN CLARK: And I would like you to
12 address it orally or tell me where else I might look in
13 the all the documents that have been filed. But the
14 rule to me sort of indicates a three-year sort of drop
15 dead date, that you've got to have your permit in hand
16 and begin construction in three years. Prior to that is
17 basically planning and preliminary design of the
18 expansion has been initiated or -- and then four years
19 that the plans and specifications are in fact being
20 prepared.

21 Why doesn't it make sense, if we expand it at
22 all, that it be limited to three years? Given those
23 parameters?

24 MR. MILIAN: Well, my understanding was that
25 the intent of the expansion to the three years was just

1 to cover the time of construction. And what I'm trying
2 to -- at least to convey to you, is that before you do
3 any construction, there's a lot of investment that the
4 utilities will have to make into the permitting process
5 and the financing of the facilities.

6 CHAIRMAN CLARK: Well, I would assume that
7 that would be added to the investment when it is allowed
8 in rate base.

9 MR. MILIAN: Eventually, yes. The problem is
10 that the timing differentials.

11 CHAIRMAN CLARK: What is the problem with the
12 timing differentials?

13 MR. MILIAN: I think that is the subject of
14 what my partner here will discuss with the financial
15 model.

16 CHAIRMAN CLARK: All right. Just give me your
17 reaction to why five years is more appropriate, more
18 reasonable, than three years, given the fact that it
19 doesn't appear to me that construction is required to be
20 started until three years?

21 MR. MILIAN: If you look at all of the
22 engineering books that, actually, I took in -- at the
23 university, all of them actually suggest that a good
24 engineering practice will look at 10, 20 years, looking
25 at expansions of wastewater and water treatment

1 facilities.

2 In this situation, where a lot of the
3 utilities are a smaller size, it will make sense to even
4 be looking beyond the five years, to look at the ten
5 years. Why? Because the utility -- and as I mention in
6 my example -- is able to take advantage of a lot of the
7 economies of scale.

8 Now you might say, well, that, in effect, will
9 create a benefit to the future customers. It does not.
10 In fact, the present customers are actually benefited by
11 having additional capacities in that margin reserve. It
12 is not only for the future customers that we're talking
13 about, it's the existing customers are the ones that are
14 benefiting. When you have the additional capacity in a
15 sewage treatment plant, for instance, you have -- you
16 prevent to have the hydraulic shop loadings that
17 sometimes small utilities do take place, and makes a
18 utility actually be in compliance with the regulatory
19 requirements a lot easier.

20 The same thing would apply to storage tanks.
21 There is a lot of variabilities of existing customers in
22 their demands. Therefore, I don't think that 18 months
23 or three years is really sufficient to handle the
24 variability of those customers, the existing customers.

25 COMMISSIONER GARCIA: How do you address the

1 burdens, though, that you place on the existing
2 customers?

3 MR. MILIAN: Well, the existing customers are
4 the ones that are benefiting by having that excess
5 capacity, as you recall. For instance, the -- in my
6 understanding is that the margin reserve that we have
7 been talking about represents the capacity that is
8 necessary to provide the utility, which is a requirement
9 of the law, to tie new customers into their system, but
10 once you start tying system, if you don't have that
11 sufficient capacity, those existing customers are going
12 to suffer. So the utilities is here in a situation
13 where they are required to tie customers, by law, and
14 yet if they continue doing it, then the existing
15 customers are the ones that are going to suffer.

16 The other fact is that when you have this
17 inadequacy of service and you tie the new customers, you
18 have to provide the additional margin reserve, because
19 that margin reserve always has to be available. So as
20 it continues, the existing and the future customers that
21 become existing are the ones that are benefiting by
22 having that adequacy.

23 I would like to, for instance, give you an
24 anecdote or an example. A number of years ago, while I
25 was the president of a utility company, we were -- we

1 went into a rate case that actually disallowed, or had
2 excess used and useful plant, or they considered nonused
3 and useful. And so we finally -- it took about two or
4 three years and we finally settled the case. That same
5 year, or six months later, we had at the most extended
6 drought in the State of Florida, where more than a
7 200-year type of drought. The demands on the system of
8 those existing customers were so high that we could not
9 provide adequate service, and the pressures went below
10 the 20 PSI. And that was exactly less than six months
11 after they had found that we had excess capacity.

12 That's the kind of thing that utilities are
13 facing. They are constructing just whatever is
14 necessary to meet the rate inducement offered of the
15 Service Commission, and ultimately, the existing and the
16 future customers are the ones who pay.

17 CHAIRMAN CLARK: Let me ask you another
18 question. You suggest that even ten years is an
19 appropriate planning horizon. And my concern is this:
20 I think we have to balance reasonable planning on the
21 part of the utility with reasonable cost to existing
22 customers. And my concern is when you get to a five-
23 and ten-year plan, is that the thing we know about
24 forecasts is that they're most likely to be wrong. And
25 your anecdote really just illustrates that; that, you

1 know, you don't plan for a 100-year flood. You use your
2 average.

3 And the same with electric utilities. While
4 Mr. Seidman has presented the notion that they have a
5 margin of reserve that's more, we have experience where
6 we don't have adequate capacity sometimes in severe
7 weather to serve them, as happened in, I guess it was
8 '89.

9 At any rate, my concern is that to the extent
10 you forecast, or rely on a forecast, that is five to ten
11 years out there, you have a situation you might have in
12 Sunny Hills, where you have -- the customers never
13 materialize. And that's what I think we have to balance
14 with the suggestion that we allow a longer planning
15 horizon.

16 MR. MILIAN: I think that there is a
17 distinction here when you're dealing with -- forecasting
18 Mother Nature is a lot more difficult than forecasting
19 what is transpiring with a utility, growth. I think one
20 of the things that is required is to have a relation of
21 the growth, so based on historical growth you can really
22 have a good understanding. Based also on the amount of
23 county permits, building permits that are coming down
24 the pike, you can have a pretty good idea what kind of
25 growth you're anticipating. That was not the case of

1 Sunny Hills.

2 CHAIRMAN CLARK: Well, you have more
3 confidence in that projection than I do.

4 MR. MILIAN: By the way, I just want to make
5 sure you understand, from an engineering standpoint, I
6 think having a ten-year or 20-year plan, I think that
7 makes a lot of sense, but I think that the only thing
8 we're asking is a five-year margin reserve.

9 CHAIRMAN CLARK: I understand.

10 MR. MILIAN: Just want to make sure.

11 MR. ARMSTRONG: Madam Chair, too, if I could,
12 just to address that, again, I think what we've done
13 again is determined the questions about the
14 predictability, and are their forecasts right or wrong.
15 The utility doesn't have an incentive in year one to
16 make outlandish projections of growth in the future so
17 that they can spend more money to build a bigger plant.
18 So that's a supposition there that they have that
19 incentive. That isn't accurate. A utility doesn't want
20 to be spending money it doesn't have to and that it's
21 not going to be able to recover.

22 So there is an incentive of the utility to be
23 conservative in its estimate. And looking at an extreme
24 like Sunny Hills, I mean predominantly, we're talking
25 about lines in the ground and not really treatment plant

1 in the Sunny Hills type example.

2 But if you look, again, at the electric
3 industry and the way the electric utilities are given
4 their reserve capacity consideration, and the extent of
5 it, a significant portion of that is because of the
6 economies of scale. And what we see is the electric
7 utilities, the rate stability that we all know has
8 existed for some time in the electric industry, a large
9 part of that is because they have had those reserve
10 capacities over time. They also benefit, obviously,
11 from reduced marginal costs because of new technology
12 and whatever, but it's a combination of those factors.
13 And it's -- what we see today, and what we've seen with
14 the repetitive rate increases, is the fact that we have
15 to build based on 18 months margin reserve in order to
16 have an opportunity -- any opportunity to recover our
17 investment.

18 And in 1990 the Staff did an analysis, or did
19 a survey, and 16 of the 17 utilities that responded
20 said, we're going to build for shorter periods because
21 of the nonused and useful policies of the Commission.
22 So it was something that we were aware of back then and
23 that was indicated to everybody that was going to
24 happen. What happens when you have building for shorter
25 increments, and that's what the studies show

1 conclusively, is that you have higher rates to
2 customers. And they're paying higher rates today --
3 even though you're applying 18 months, they're paying
4 higher rates today than they would have if 18 months ago
5 we were allowed to have a longer margin reserve period.
6 So what we're requesting is that you don't perpetuate
7 that, where we have to keep on building smaller and
8 coming in and increasing rates to customers, but give us
9 the rate stability that the electric has by giving us
10 appropriate margin reserve periods.

11 CHAIRMAN CLARK: Some people have argued that
12 the existing regulatory framework in electrics has
13 resulted in a lot of uneconomic capacity. That's the
14 current debate on stranded investment.

15 MR. McLEAN: Commissioner, may I have a brief
16 word on that point Mr. Armstrong makes?

17 CHAIRMAN CLARK: Yes.

18 MR. McLEAN: We accept that utilities don't
19 have a tremendous incentive, or perhaps any incentive,
20 to go out and make imprudent investments and to
21 overstate growth. But Commissioner, I think your point
22 is, to the extent that the Commission permits an
23 increment of plant, which is associated with five-year
24 expansion, to the extent that winds up in rate base,
25 they are held harmless from an inaccurate prediction and

1 the customers underwrite that particular endeavor.

2 CHAIRMAN CLARK: Thank you. Go ahead,
3 Mr. Milian.

4 MR. MILIAN: Our study -- actually I thought
5 it was mentioned -- provides details of a number of
6 cases where these utilities have been expanding in small
7 increments in response to these policies. And our
8 financial model shows that expanding in this small
9 increments ends up costing existing and future
10 customers.

11 Finally, I would like to briefly discuss the
12 reuse facilities issues. As you know, the Association
13 has proposed that reuse facilities that have been
14 prudently constructed should be deemed 100 percent used
15 and useful. And this would be in accordance with a
16 memorandum of understanding reached between the
17 Department of Environmental Protection and the
18 Commission.

19 It is a policy of the State of Florida to
20 utilize reuse water, since it is considered a valuable
21 and limited resource. In spite of the fact that we have
22 60 inches of rain, we do have areas of critical water
23 limitations.

24 In my opinion, I think the Commission would
25 be -- should be encouraging utilities to the reuse of

1 effluent and try to determine that these facilities are
2 100 percent used and useful, rather than just the
3 opposite. Whenever you're doing adjustments, you can
4 make the utility the opportunity to argue that it's
5 economically unfeasible and they may look for other
6 alternatives besides just the use of these reuse
7 facilities.

8 In conclusion, it is our recommendation that
9 the Public Service Commission be proactive in providing
10 economic incentives for utilities to size plants, taking
11 into consideration economies of scale and best
12 engineering practices, and to comply with the State's
13 environmental objectives and to protect the public's
14 health and safety. A step in the right direction would
15 be to approve the Florida Waterworks Association's
16 proposed rules for margin reserve and imputation of
17 CIAC.

18 I think my partner now, Debbie Swain, will
19 discuss about the financial model that we worked on.

20 CHAIRMAN CLARK: Thank you. Ms. Swain, go
21 ahead.

22 MS. SWAIN: Thank you, Commissioners. My name
23 is Debbie Swain. I'm a principal with Milian, Swain &
24 Associates. I was asked by the Florida Waterworks
25 Association some time ago to embark upon what seemed

1 like an endless task. At the beginning, and during it,
2 and now at the end, it seems like an endless task. And
3 that was to try and quantify the financial impact of the
4 various proposed rules.

5 In order to do that, the first thing I did was
6 conduct a survey of private utilities, and during
7 that -- during that survey and gathering that
8 information, there were some really startling things
9 that I found out. One thing is that the situations
10 faced by the utilities and the decisions that they are
11 making really truly tie to economic regulation. I felt
12 that that was the case because I have been a controller
13 and vice president and rate analyst with private
14 utilities for over 15 years before I became a
15 consultant, and those were some of the decisions -- some
16 of the decisions that we made were based upon economic
17 considerations.

18 When faced with the choice of building a half
19 a million gallon plant and a 1 million gallon plant,
20 over and over again we found that utilities are making
21 the choice of constructing the smaller increments.
22 Perhaps they only needed a 300,000 gallon plant and they
23 didn't construct just 300; they've gone to 5-, but they
24 didn't go to a million.

25 And I was able, through some financial

1 modeling, to look at and determine what the impact of
2 that was. The models that I did -- which I am going to
3 go through a couple of them, and I imagine that there is
4 going to be some questions about them. I tried to make
5 them as near perfect world as possible. So that the
6 only changes in the models were related to different
7 sized plants and margin reserve periods and imputation
8 of CIAC.

9 And in a perfect world, a utility earns 100
10 percent -- or recovers 100 percent of its O&M cost
11 through rates at the time that they incur it. There's
12 no regulatory lag. Their predicted growth is actually
13 achieved. And the only thing that changed, then, in
14 each one of the models, as I said, was the different
15 sizes of plants, and the various margin reserve
16 periods.

17 I'm going to go through some of the
18 conclusions of that, after I describe some of the other
19 considerations in the financial modeling that I -- that
20 I incorporated. One of the things that we hear over and
21 over again is that the answer to the question of who
22 pays for margin reserve is that future customers should
23 pay some portion of future plant through AFPI, and that
24 if we move the margin reserve, if we move that portion
25 of nonused and useful plant and recover it through AFPI,

1 that that should make us whole.

2 As an alternative, you bring the margin
3 reserve in and recover it through current customers and
4 then impute CIAC on it, we don't get anything. The
5 AFPI, I found, is not a -- is such a high risk of
6 recovery, that utilities are often not even considering
7 it in their rate applications. If they don't request
8 it, they don't get it. AFPI is also not available --
9 because its collected from future customers, it's not
10 available to obtain financing.

11 CHAIRMAN CLARK: Let me back up.

12 MS. SWAIN: Sure.

13 CHAIRMAN CLARK: You say AFPI is such a high
14 risk of recovery that they're not even asking for it?

15 MS. SWAIN: We found many, many utilities are
16 not even asking for it. They're not asking for it
17 because it's complex, they aren't aware of it, or they
18 haven't been successful in recovering it. And
19 there's --

20 CHAIRMAN CLARK: That confuses me, because it
21 seems to me, if you don't ask for it, you're not going
22 to get it.

23 MS. SWAIN: That's right, and they should get
24 it. It should be a standard rate --

25 CHAIRMAN CLARK: So what is the risk in asking

1 for it?

2 MS. SWAIN: Well, I'll give you an example.
3 And a very recent example is apparently what happened in
4 Southern States' recent rate case. When you ask for
5 AFPI the very first time, you identify how much is
6 nonused and useful, and that is called a qualifying
7 asset for the calculation of AFPI. Next rate case I've
8 added one more well, and now I have a new nonused and
9 useful number and it includes that well. But when that
10 calculation is done, I may have gotten to the fifth year
11 for my first rate case at the highest level of
12 accumulation, but now because I've got a new nonused and
13 useful number, a new qualifying asset, it started all
14 over again at zero and began accumulating again.

15 And the only way to prevent that from
16 happening is to look at each individual increment of
17 plant, each individual increment of nonused and useful,
18 and identify the ERCs with that specific increment of
19 plant, and then have a separate charge for each
20 increment. Otherwise, when utilities ask for it, it
21 will start all over again. And that is virtually
22 impossible. It's not possible for a utility, unless
23 they are making very large increments, very identifiable
24 increments, to be able to keep track of it in that
25 minute detail. And you can imagine in the Southern

1 States' case, where they have potentially thousands of
2 wells, how they keep track of each one of them.

3 CHAIRMAN CLARK: Let me ask you this. You say
4 AFPI is such a high risk -- they don't ask for it
5 because it's a high risk of recovery. What I hear you
6 saying is they don't ask for it because it's difficult
7 to keep track of.

8 MS. SWAIN: Where they do ask for it, what
9 transpires --

10 CHAIRMAN CLARK: Let me just --

11 MS. SWAIN: Sure.

12 COMMISSIONER CLARK: It's the way you phrased
13 it, I think. Is it really because it's a high risk of
14 recovery, or is it because it's cumbersome?

15 MS. SWAIN: It's not worth their time. It's
16 not worth their effort. Because when they do make the
17 effort, they lose what they may have already gained.
18 They may be better off just sitting and either having
19 that margin reserve period included in -- some other
20 fashion.

21 CHAIRMAN CLARK: But what you're saying is the
22 cost to them of pursuing the allowance and then
23 accounting for it is not worth the benefit they get?

24 MS. SWAIN: That's not what I'm saying. It
25 has not become such an exact science that either the

1 utility or the Staff is capable of keeping track of it
2 in the minute detail that is necessary to completely
3 take advantage of it. It is not possible. It's not
4 just the utilities, it's not the experts, it's not the
5 utility rate managers. It's as much the Staff as well.

6 CHAIRMAN CLARK: But I get back to what I
7 said, the effort and the cost of that effort is not
8 worth the benefit, and that's why they're not pursuing
9 it; it's not the risk of recovery?

10 MS. SWAIN: The risk of recovery is also
11 associated with is the growth really going to take
12 place? Are those customers going to connect? At the
13 time that -- at the time that the calculation is done,
14 and there's reasonable best effort attempts to project
15 growth, if something happens and that growth doesn't
16 take place and the fifth year customer doesn't actually
17 tie on until the seventh year, you've continued to
18 accumulate costs, and yet the rate is limited to five
19 years.

20 And as a recognition of that risk, there is
21 not a company that I am aware of that has ever been
22 successful in convincing its auditors that it should be
23 able to record revenues related to AFPI on an accrual
24 basis. It's only recorded when the cash is actually in
25 hand, because that risk is recognized, not just by the

1 utility, but also in the accounting and auditing
2 industry.

3 CHAIRMAN CLARK: So that's -- it's not
4 something that lenders will let you rely on because of
5 the high risk of being able to recover it in the
6 five-year period, or at the end of the five-year
7 period? It may be the seventh year?

8 MS. SWAIN: It may be the seventh year, it may
9 be never.

10 MR. ARMSTRONG: Madam Chairman, if I could
11 just clarify using a hypothetical, but using the premise
12 of the Southern States, for clarification, and to make
13 another point.

14 CHAIRMAN CLARK: Let Ms. Swain finish, and
15 we'll give you -- why don't you just write that down as
16 one thing you want to address.

17 MR. ARMSTRONG: Okay. I've got it written.
18 Thanks.

19 COMMISSIONER DEASON: Let me ask a question.
20 Right here. You made a statement that it gets lost, and
21 you gave some example of a well and one rate case,
22 another rate case, and I think you said it gets lost.
23 And I need clarification. Maybe I misunderstood what
24 you said.

25 MS. SWAIN: Okay. In the event that your

1 first rate case is associated with nonused and useful
2 for one well, the accumulation of the AFPI begins in the
3 first year that the rates are recovered. And it
4 accumulates through a five-year period. If in the third
5 year there's another rate case and AFPI is applied for
6 and there's nonused and useful still from Well 1 and
7 also from Well 2, if those are put together, lumped
8 together, and one AFPI charge is calculated, which
9 happens, fairly consistently, then the accumulation of
10 cost starts back from zero again. It does not continue
11 from the level of Well 1.

12 In that case, where there's two wells, it
13 would have been better to keep the Well 1 AFPI charge
14 intact and then find a nonused and useful just
15 associated with Well 2 and let that start accumulating.
16 But now you've got two different AFPI charges. And to
17 whom do you charge them? How do you apply that to the
18 customers? The first number of customers still pay the
19 first AFPI charge, and then the next ones start paying
20 the second AFPI charge?

21 I had a situation several years ago, very,
22 very similar, but with regard to distribution lines in
23 Pine Ridge Utilities. And what we did was rather than
24 having different customers pay different AFPI charges
25 when we applied for that second AFPI, just specifically

1 for new lines, is we came out with a method of
2 averaging. And it seemed to work. And I don't know how
3 growth has been in Pine Ridge, and if they've actually
4 recovered their revenues, but there was a mechanism to
5 do it.

6 But where you're talking about continuous
7 distribution line, expansions, extensions, new wells,
8 new treatment plant, new sewer treatment plant, and it's
9 happening constantly, and you have 15 different types of
10 well expansions -- or excuse me, plant expansions, since
11 your last rate case, it's very unlikely that the
12 utilities are able to keep track of the ERCs and the
13 capacities and the appropriate AFPI charge for each one
14 of them, and then come out with some mechanism for
15 averaging. It doesn't exist. It hasn't existed yet.
16 So it will going go back to zero.

17 COMMISSIONER DEASON: Well, the AFPI is a
18 calculation based upon the cost of the asset, which is
19 determined to be nonused and useful at any given time;
20 is that correct?

21 MS. SWAIN: That's correct.

22 COMMISSIONER DEASON: So once that AFPI is
23 calculated -- it's AFPI, in the sense that it is --
24 becomes part of the cost of that asset as it is accrued
25 over a period of time; does it not?

1 MS. SWAIN: Right, through the period that
2 that AFPI charge is intact, that's right.

3 COMMISSIONER DEASON: So if there's a rate
4 case, AFPI charge begins, and say its accumulated for
5 three years, and then there's another rate case, and
6 then there's a different calculation of used and useful
7 and a different determination of the amount of the AFPI
8 accrual, I don't understand why what was accrued for the
9 first three years somehow gets lost. Why doesn't it
10 just get included at the new cost of that first well?
11 Say the well -- and this is just for illustrative
12 purposes -- the first well was a thousand dollars.
13 Three years later you've accrued \$100 of AFPI, then why
14 doesn't the cost of that well become \$1100 when you do
15 your next AFPI calculation?

16 MS. SWAIN: It does. It does. But what's
17 happening is that, as in the first time you applied for
18 it, you start from zero dollars and you accumulate a
19 small amount each month, or some amount each month, it's
20 cumulative; when you make that second application, it
21 starts back from zero again. Those investment dollars
22 are in there. Those ERCs are still in there, but they
23 start back from zero again. So whereas they may have
24 three years of accumulation prior to the rate case, and
25 still two more years of accumulation for the next two

1 years of ERCs to connect, those next two years of ERCs
2 under the second rate case will start back at zero
3 again. They'll -- the accumulation won't continue.

4 MR. ARMSTRONG: Madam Chair, that's what I was
5 just trying to clarify, too, was that in year one you
6 have your rate case and you have our AFPI accumulating.
7 In year five or year four, you go in for a rate case.
8 And what the Commission has done -- and it's part of the
9 fallacy of AFPI providing this recovery, because what
10 the Commission has done is said that accumulated AFPI,
11 which is supposed to allow you to recover your costs in
12 prudent investment for that four-year period, have been
13 wiped out and knocked down to zero. And then you
14 start -- you know, you might have a \$300 AFPI charge,
15 but that's wiped out and you start at \$10, month one and
16 year one; \$11 month two and year two.

17 COMMISSIONER DEASON: So you're talking about
18 the actual charge to the customer, AFPI charge?

19 MS. SWAIN: That's what I'm talking about.
20 That is right.

21 COMMISSIONER DEASON: What I'm concerned about
22 is that what you have accrued is the cost of the asset.
23 That does not go away.

24 MS. SWAIN: No, that's still held. But for
25 example, in the Southern States case, what I understand

1 is that they had reached a level in their AFPI charges
2 on their five-year chart, where they were recovering
3 nearly \$1 million in AFPI, that was their projection.
4 They filed a rate case, and their first year's charges
5 after that new rate case is going to be \$100,000. And
6 yet they had still not ever recovered, never collected
7 all those fees that were accumulating. They still had
8 more customers to pay those. And yet it went down to
9 zero again.

10 COMMISSIONER DEASON: Then is that a problem
11 with actually calculating the AFPI charge that would be
12 paid by a connecting customer, as opposed to the accrual
13 method of accounting for the annual accrual of the
14 addition to the asset?

15 MS. SWAIN: The error is in the calculation of
16 the new rate, not in the application of the rate. The
17 rate is applied pursuant to the new schedule. The new
18 schedule is incorrect. The new schedule incorrectly
19 starts them back at zero again. And it should have
20 somehow been averaged.

21 COMMISSIONER DEASON: Do you have an example
22 of that in your -- I didn't see it, if it was in there,
23 of how that -- an example --

24 MS. SWAIN: No.

25 COMMISSIONER DEASON: -- one of your

1 simplified model type examples of how that operates?

2 MS. SWAIN: No. I don't have an example of
3 what happened with the AFPI charges. And I tried to
4 accumulate some information from utilities about what
5 they were facing. And a lot of times they know it's not
6 working, but they don't know why, and they don't know
7 why because there's not tremendous expertise in this.
8 There's not expertise, as I said, among the utilities,
9 nor probably among Staff, on how to do this properly.
10 So I don't have an example. I can put one together,
11 but --

12 COMMISSIONER DEASON: Well, it may not be 100
13 percent on point for the narrow scope of this rule, but
14 at the same time, if there's a problem with the actual
15 application of AFPI policy, perhaps it's something we
16 need to take a look at. Because perhaps we're laboring
17 under the false assumption that AFPI is providing a
18 return on prudently invested nonused and useful
19 facilities, which is the purpose behind AFPI.

20 So at some point perhaps we need to take a
21 look at it. I guess I'm a little concerned that -- and
22 I don't -- I'm not being critical, but it's being
23 presented that this is the reason why we need to change
24 the margin reserve rule and the imputation of CIAC,
25 because AFPI is not working. Well, why don't we fix

1 AFPI if it's not working?

2 MS. SWAIN: Absolutely. And I'm not trying to
3 say that is this the reason. What I am saying is that I
4 have heard that AFPI is the answer to the concern the
5 utilities have about recovering five years' worth of
6 growth through what would have otherwise been nonused
7 and useful. And what I'm saying is, there's a half a
8 dozen reasons why the answer is not AFPI. And that
9 specific example about the error in the calculation of
10 the rate is one of them.

11 The second one is that when I make an
12 investment today, and I go -- or I'm planning to make an
13 investment today, and I need to start getting financing
14 to cover the cost of my planning and permitting and
15 engineering and my construction, I can't go to a bank
16 and obtain financing on some payment a customer is going
17 to make in the future. It's not on my books, my
18 auditors aren't going to allow it, and the banks
19 certainly aren't going to. And I'm not going to be able
20 to obtain that SRF financing through a guarantee of AFPI
21 revenues, some revenues that are coming in the future.
22 They are considered, as well, risky by banks, state
23 institutions and also by the auditors. That's the
24 second reason.

25 The third reason is that the risk, therefore,

1 is put entirely on the utility, rather than either a
2 sharing of risk -- and by risk, I mean risk of whether
3 that's really going to happen. Are my growth
4 projections accurate? Are those customers really going
5 to connect? What if that fifth year customer doesn't
6 come until year seven? I've had to cover that cost now
7 for seven years, waiting for that customer to connect.

8 And then again, because of all the
9 complication, because of the risk, because it doesn't do
10 me any good today, a lot of utilities are not even
11 requesting it, or they aren't aware of it. And there
12 needs to be -- and maybe in what you're saying,
13 Commissioner Deason, as well -- some mechanism to inform
14 utilities, small utilities, that this is available. If
15 a Class C utility files a Staff-assisted rate case, they
16 are not going to get an AFPI charge, unless they're
17 already aware of it. And they're not aware of it.

18 I want to show you some of the results of the
19 financial model that I did. And I have some boards.
20 The first one I want to hit is the impact on customer
21 rates. There is -- everybody seems to be aware that in
22 the long run, that if a utility constructs a larger
23 sized plant, that it's going to be beneficial to the
24 customer. This chart shows -- on the top it's a water
25 example, and on the bottom it's a wastewater example.

1 The water example is a real life example. It
2 was a water facility in Venice Gardens that was shown by
3 Mr. Hartman, I believe, in a Southern States rate case,
4 and also in his filed comments here, where Southern
5 States was faced with two different sized plants. And I
6 reflected that in financially showing a calculation of
7 what the rate would be if Southern States' choice had
8 been the larger plant versus the choice of the smaller
9 plant.

10 The lighter colored line in the front is the
11 larger sized plant. That's the rate that would result
12 in my financial model where everything else is perfect,
13 what the rate would be in a five-year increment, and
14 then the darker area in the back is a two and a half
15 year increment. And in the water example you see that
16 in the third year after the plant is put on line --
17 which is year nine on there, because the first five
18 years were spent planning and designing and constructing
19 it -- after the third year, there's already a benefit to
20 the customer. The rate is lower in the -- where the
21 plant is built in the larger increment.

22 And in the bottom example, it's exactly the
23 same. But in a real live wastewater example, where the
24 five-year increment shows that the -- I calculated the
25 rate as actually lower from the very beginning on a

1 five-year increment on my wastewater example. Again,
2 these are real life examples. These are numbers that
3 were -- have either been presented to you in rate cases
4 so the numbers have been scrutinized. The reason why I
5 chose them is only because they have been presented
6 before. But we find these examples over and over and
7 over again. This is not something atypical.

8 The second thing that I found -- and I think
9 that that is fairly startling. The benefit is so
10 significant in building the larger sized plant, and one
11 of the cases, what, 50 percent of the two cases I looked
12 at, the benefit was immediate. The other thing that I
13 found, or took a look at was --

14 CHAIRMAN CLARK: Wait a minute, the benefit
15 was immediate? I thought you said the benefit showed in
16 three years.

17 MS. SWAIN: In the wastewater example, on the
18 bottom, the benefit was from the first year. In the
19 water example --

20 CHAIRMAN CLARK: First year after the five
21 years?

22 MS. SWAIN: The first year that the plant went
23 on line.

24 CHAIRMAN CLARK: So it would be six years out,
25 benefit to customers?

1 MS. SWAIN: Well, the customers weren't paying
2 anything for it prior to the sixth year, because the
3 first five years it was in construction.

4 COMMISSIONER CLARK: But they would be paying
5 for it -- if you allowed a five-year margin of reserve,
6 they would be paying for it during that five years,
7 right?

8 MS. SWAIN: In this example, this is under the
9 proposed -- the Commission's proposed rule, the Staff's
10 proposed rule, where there's an 18-month margin reserve
11 and an imputation of CIAC. That is reflected on both of
12 those and all these calculations on this one schedule to
13 show the customer rates. So it's not a five-year margin
14 reserve here. It's an 18-month margin reserve. Even
15 with an 18-month margin reserve, the utility -- the rate
16 to the customer is more beneficial to have the larger
17 sized plant.

18 CHAIRMAN CLARK: Okay.

19 MS. SWAIN: Now the other thing that I looked
20 at was the impact on a couple other things. One is the
21 net present value -- it's kind of hard to see.

22 MR. WALKER: Ms. Swain?

23 MS. SWAIN: Yes.

24 MR. WALKER: May I inquire? This is -- I'm
25 N. D. Walker. I'm with the Staff. And I know we've

1 talked about some of the concepts that went into your
2 models, and we discussed them on the phone, and you've
3 prepared some new information that indicates that
4 certain things like the return on construction and --

5 MS. SWAIN: That's what I'm getting to now.

6 MR. WALKER: -- averaging things would change
7 if you bring those things into account.

8 MS. SWAIN: There's no impact on the customer
9 rates. The customer rate schedules are not affected by
10 some of the things that I'm going to discuss now related
11 to the actual return recovered by the utility. The
12 rates are still the same.

13 MR. WALKER: So all of this is based upon
14 information that was your original filing, or it's now
15 the updated information using --

16 MS. SWAIN: You're jumping ahead of me a
17 little bit.

18 MR. WALKER: I wouldn't want to.

19 MS. SWAIN: The customer rate schedule is not
20 affected by any other subsequent -- any discussions that
21 we've had. The customer rates remain the same. This
22 next schedule, which shows net present value of
23 revenues, and also some returns information -- I wish
24 there was a hand-held microphone so I could walk up
25 there and point to you. (Pause)

1 Mr. Walker, the changes that I made to my
2 report I'll distribute and discuss after I go through
3 this. There is no impact. There was no effect on this
4 either.

5 This schedule that you're looking at shows my
6 two examples where I have what I've called wastewater
7 treatment plant A and wastewater treatment plant B, and
8 water treatment plant A and B. The water example is on
9 the bottom. And this provides to you -- what I found
10 was the cost, the capital cost per gallon of
11 construction. The frequency of expansion in the case of
12 my A examples, the expansion was every five years. It
13 was a five-year construction; and in B it was two and a
14 half years.

15 Now that relates to -- on the first chart the
16 dark area in the back was the two and a half year, or B
17 samples, and the lighter one in the front was the sample
18 A, the wastewater treatment plant and water treatment
19 plant A's.

20 In addition to having a benefit in customer
21 rates, if you look at what I have found as the net
22 present value of the revenue requirement, in the
23 wastewater treatment plant, which there was a -- that
24 was the example where there was a benefit immediately of
25 having constructed the larger sized plant, the net

1 present value of revenues is a -- revenue requirements
2 is lower also for the entire 25-year period that I
3 projected.

4 And if you look down at the water at the
5 bottom, even though the rate was -- had a three-year
6 benefit to the customers to build a smaller sized plant,
7 that it was so beneficial in the long term, the net
8 present value is significantly less for the larger sized
9 plant than for the smaller sized plant. So not only is
10 there a very short turnaround time, but the benefit is
11 so significant that even if you discount the future, the
12 future revenue requirement, there is a tremendous
13 benefit.

14 There is also -- I've also shown how much is
15 coming from rates, how much is coming from service
16 availability charges and AFPI, because certainly how you
17 construct your plant is going to impact your AFPI, and
18 also your service availability charges.

19 I have that in my study on Page 21 of the
20 wastewater treatment plant. The waste water treatment
21 plant is summarized there, and it looks virtually
22 identical to what's on the board, except that I had a
23 typographical error, and I just want to hand that out
24 real quickly. So again, that's a replacement of Page 21
25 of my study. So far I've only been dealing with the

1 effect on the customers and the impact on revenues in
2 the long term and the short term.

3 We are finding that under the proposed rules
4 that utilities will build in smaller increments, not the
5 most smallest minute increments, but smaller increments
6 than if they are given a five-year margin reserve, and
7 this would be the impact on the customer rates if that
8 were the case under the proposed rule, or how much
9 higher or how much less beneficial it would be to the
10 customers under the proposed rule if utilities then
11 build in smaller increments.

12 The next thing that I did --

13 COMMISSIONER DEASON: Are you leaving that
14 now?

15 MS. SWAIN: Yes.

16 COMMISSIONER DEASON: Let me ask a question.
17 There seems to be a fairly substantial difference in the
18 amount of service availability charges. Why does that
19 difference exist?

20 MS. SWAIN: That is really just a function of
21 the construction cost and the number of ERCs that are
22 served. The construction cost is only a little bit
23 more, and yet a lot more customers are served than
24 there's going to be a difference in the service
25 availability. And then again, that affects -- you see

1 that on a net present value. You realize the customers
2 have to pay that up front. So we wanted to see what the
3 impact is of having to pay that up front as opposed to
4 recovering it through rates over time.

5 COMMISSIONER DEASON: When you say "pay that
6 up front," are you talking about at the beginning of
7 each construction cycle?

8 MS. SWAIN: At the time of connection. I have
9 the customers paying that --

10 COMMISSIONER DEASON: Oh, at the time of
11 connection.

12 MS. SWAIN: -- at the time of connection, as I
13 do the AFPI. That's the payment.

14 COMMISSIONER DEASON: So you're attributing
15 difference, then, basically, to the difference in
16 capital cost per ERC?

17 MS. SWAIN: That's right. And I have the
18 service availability charge calculation that is done
19 when a utility applies for a rate case and asks for
20 service availability charges and ran these numbers
21 through that to do the actual calculation of a service
22 availability charge.

23 COMMISSIONER DEASON: Did you -- does this
24 account for differences in operating expenses, or do you
25 keep those constant?

1 MS. SWAIN: The operating expenses I have are
2 not part of this because I'm assuming that they are 100
3 percent recovered, no matter what they are. And related
4 to rates, yes, I have the operating costs are the same.
5 I have a certain level of operating costs, and I don't
6 have them changed depending upon --

7 COMMISSIONER DEASON: So the difference in
8 rates -- the net present value of revenue requirement in
9 the rates are the 24.3 million versus the 28.1 million.
10 I assume those rates reflect recovery of operating
11 expenses, but the operating expenses are the same in
12 each scenario.

13 MS. SWAIN: That's right. And remember that
14 I'm trying to get down to the finite point of comparing
15 only these factors. And I realize that in real life
16 there would be other factors, but we're trying to
17 eliminate all those other factors and only look at
18 construction costs, number of ERCs, and then also margin
19 reserve period and imputation of CIAC. And so the only
20 thing that's different between A and B here is the
21 construction period and therefore the number of ERCs
22 that are served.

23 COMMISSIONER DEASON: Would there also be a
24 difference in depreciation expense?

25 MS. SWAIN: The depreciation is different, as

1 a direct function of that.

2 COMMISSIONER DEASON: And that would be part
3 of the difference between the 24.3 and the 28.1?

4 MS. SWAIN: Right.

5 COMMISSIONER DEASON: But it would not be
6 reflected in the difference between the 5.4 and the
7 6.7?

8 MS. SWAIN: That's right, because that's after
9 depreciation.

10 The next thing I looked at, because there's
11 concern as to -- a couple questions came up related to
12 how this affects the return to the utilities. The
13 utilities are making the decision to install the smaller
14 sized plants because they think they'll get faster
15 recovery. So that was the next thing we wanted to test,
16 is to compare what their returns are between the smaller
17 sized plants and the larger sized plant. And that is --
18 I have an exhibit -- actually a couple charts in my
19 study. One is Chart 4.1 and the other one is my Exhibit
20 DS-5. And those relate to investments and returns.

21 For the purpose of comparison, there's -- one
22 of the things I wanted to find out, obviously, was the
23 return impact using these identical models, what the
24 return to the utility was. And the reason why you're
25 getting some new schedules -- those are different than

1 are in my report -- is I did have some conversations
2 with Mr. Walker, and we talked about some of the
3 theories in the report. And there were two that he
4 pointed out that I felt merited changes in the report.
5 One was very minor, and that was, I'm comparing -- I'm
6 calculating my earnings return on investment, and
7 investment I showed as year end that I've changed that
8 to average. So it matches more closely to rate base.
9 And that had a minor impact.

10 The second one is that I took the dollars of
11 earnings and divided them by the total investment of the
12 utility, and that included construction work in
13 progress, for the purpose of finding what the return
14 was. And I've changed that now to add in AFUDC as a
15 source of income that the utility is earning on
16 construction work in progress, whereas in the original
17 study I don't have that in there. And the returns
18 become higher as a result of adding the AFUDC, but the
19 overall results remain the same; and that is that if
20 you -- the utility under the -- what the proposal, the
21 Commission proposal is, it's not going to earn its fair
22 rate of return. It's always going to stay less than
23 that.

24 The only way it may ever earn its full rate of
25 return is if I have in the -- as I do in the model, that

1 it's a perfect world and there's no regulatory lag, but
2 also that I build in five-year increments and get every
3 penny of that in margin reserve. In that event you will
4 get very close to earning a full return. And my DS-5,
5 which I just handed to you, shows -- the dark black bar
6 in the back is my weighted average cost of capital,
7 which I have identical in all the models, of 10.75
8 percent. My average actual return is the lighter
9 colored bar that's right in front of it. And then the
10 white line in front is the actual return on my
11 investment.

12 The numerical support for that particular
13 graph is on the following page, Schedule B-1, and then I
14 also, since I have -- again, I have the four models
15 which are under the Commission proposed rule, water
16 treatment plants A and B and wastewater treatment plants
17 A and B, I went ahead and ran new schedules to show the
18 impact of the changes in return. Again, it didn't
19 affect rates, it just shows what the average return on
20 investment earned is. And it's different than the
21 original report. But as you can see, even in a perfect
22 world, in every single one of those scenarios, there is
23 not a time when the return earned over the 30-year
24 projection period that I earn my fair rate of return
25 under the Commission's proposed rule.

1 The other number, the number to highlight, is
2 that the average return on investment is higher to the
3 utility when it builds a larger sized plant. And that's
4 something that's a surprise to the utilities. They were
5 not aware that that was what was happening. So it's
6 also to their benefit. It's not a significant
7 difference, but it does exist.

8 And I'm -- these models are very complex. I
9 could spend three days explaining them in detail to you,
10 but I imagine there are some specific questions. But I
11 did want to, instead of belaboring the model, talk a
12 little bit about imputation of CIAC.

13 You're not going to hear, that I'm aware of,
14 anyone, but maybe the -- with the exception of one
15 person, state that imputation of CIAC succeeds in
16 matching future cost with current dollars, that it
17 achieves a matching concept. And as Mr. Seidman said,
18 if it were matching, you wouldn't need to impute it.

19 Once the margin reserve period is identified,
20 it's allowed, the dollars are included in used and
21 useful investment, represents current dollars that have
22 already been spent, why would one go out to future
23 periods and impute future payments by customers as some
24 potential offset to current margin reserve?

25 I went out in my study and did a comparison of

1 CIAC collected and the numbers of dollars of utility
2 plant investment, side by side, and found that by far,
3 when I looked at every single utility that I was able to
4 get an annual report on and put it all together, that
5 the cost of future construction always outpaces the CIAC
6 collected. So when you go outside the test-year period
7 and you impute CIAC, would you not need to therefore
8 impute the future construction costs? Because today
9 I've made an investment, tomorrow I'm going to recover
10 CIAC, and I'm also going to have future construction
11 costs.

12 In order to match it, you would either have to
13 not impute the CIAC, or you would have to bring in
14 future construction costs that I am then incurring for
15 the next future customers.

16 What happens when you impute CIAC is you
17 effectively, nearly completely, remove margin reserve.
18 And I don't think that that's what the intention of
19 margin reserve is. Once we've decided that margin
20 reserve is good and appropriate and utilities should get
21 it, why take it away? That concludes my statements
22 right now. I'll be happy to answer questions.

23 CHAIRMAN CLARK: Commissioners, questions?

24 COMMISSIONER DEASON: Let me ask a quick
25 question. Do you see a difference in the need to --

1 perhaps the no need -- to impute CIAC between a growth
2 and a nongrowth utility? For example, if we've got one
3 utility that is fully built out -- I'm sorry, is not
4 fully built out, and there is a margin of reserve
5 included, but that margin of reserve increment is going
6 to be enough to allow it to serve all the customers that
7 are capable of ever being served by that utility because
8 of, perhaps, geographic growth constraint, that's it,
9 versus another utility that has facilities, has a margin
10 of reserve, but every five years it's going to have to
11 be adding plant because this is a long-range
12 development, and geographically it can expand four or
13 five times its size. Do you see a difference between
14 those scenarios between CIAC and non-CIAC?

15 MS. SWAIN: The difference is almost not
16 noticeable, and that is because in real life, a utility,
17 even when it's at full build-out, is still constructing
18 plant. It's constructing, perhaps, replacement plant,
19 replacing contributing facilities. I don't think that
20 that's ever going to take place.

21 In the event that the margin reserve period
22 is -- or build-out is achieved in just a couple years,
23 and the CIAC in two years from now has been collected,
24 and if it were that factor alone to cause the utility to
25 overearn, then you have the capability, and the Staff

1 reviews the annual reports all the time, that they --
2 you have the capability of determining whether there's
3 overearning.

4 And I think that that might be, perhaps, in
5 a -- a separate consideration you may want to make in a
6 rate case, but in reality, it's not going to cause the
7 utility to overearn on its own.

8 COMMISSIONER DEASON: But the reason, as I
9 take it, that you think there is a -- there a mismatch
10 by imputing the CIAC, is that a utility is constantly
11 having to basically renew its margin reserve investment,
12 so to speak, because every year there's going to be more
13 investment to replace that which was previously part of
14 the margin reserve but is now serving the new
15 connections to the system. That's a growth utility
16 scenario.

17 And I guess my question was for the
18 nongrowth. And you're saying that, well, there's always
19 going to be more investment. It may be replacement of
20 existing plant, even if that plant is not designed to
21 serve new customers. Is that what you're saying?

22 MS. SWAIN: There is going to be future
23 plant. But the bottom line is, today I already had to
24 make my investment for the next several years worth of
25 customers. And today when you're imposing -- or

1 allowing me rates, I should be able to recover that
2 investment if it covers the customers to be connected in
3 a reasonable time that we're calling margin reserve.
4 And I would not impute CIAC. We're talking about here a
5 rule that is a default in the absence of something
6 extraordinary or unusual. And that may be one of those
7 cases that you find extraordinary or unusual that needs
8 separate consideration. But my opinion is that it's
9 still appropriate to not impute CIAC, but you may
10 consider it in that example.

11 COMMISSIONER DEASON: Well, you would agree,
12 would you not, that in -- if we make the assumption that
13 there's not going to be anymore growth, and you allow a
14 margin of reserve, and as customers connect during the
15 next five years, and say we allow five-year margin
16 reserve, and they connect during that five years, and
17 after that five-year period your system is going to be
18 totally built out, that there is going to be the
19 likelihood of overearnings if we make the assumption
20 there's no need to make any further investment in the
21 system? Would you agree with that? Because you would
22 be including the full amount of rate base with your
23 margin of reserve allowance, and you are going to be
24 collecting CIAC evenly over the next five years, but
25 when designing rates, you would not be taking that into

1 consideration. So there is that possibility, is there
2 not?

3 MS. SWAIN: Yes, but not today. It would take
4 in the future periods for me to reach that. And why
5 reduce my current return for something that may
6 eventually happen?

7 CHAIRMAN CLARK: Give us your name, please.

8 MR. GOWER: I'm Hugh Gower, and I will speak
9 to this a little bit further. But the key issue is
10 whether rate base constructed by the Commission equals
11 the capital investors have provided. And it makes no
12 difference whether rate base and capital are growing or
13 actually declining. Anytime the Commission chooses to
14 reach out beyond the test period and reduce rate base
15 for a future transaction, anticipated future
16 collections, then rate base will not be equal to
17 investors' capital, and therefore by definition the
18 return it allows will be less than the required return.

19 There are a few cases around of declining rate
20 base. And if such a company were before the Commission
21 in a rate case, the question is, is the Commission
22 justified in short changing that Company's return today
23 because of the possibility that it might overearn in the
24 future, for whatever reason? And as I understand the
25 ratemaking procedures, and all the key cases throughout

1 history, the answer is no.

2 MR. McLEAN: I have a question for Mr. Gower,
3 just briefly, if I may. Mr. Gower, aren't we reaching
4 out into the future to capture the facilities which will
5 be needed by future customers?

6 MR. GOWER: No, sir.

7 MR. McLEAN: Does that square with the
8 definition which your side has given of margin reserve?
9 Your side says -- if I may roughly quote from Ms. Swain,
10 she says, "Margin reserve is for the very needs of
11 existing customers and for the needs of future
12 customers." Now, isn't it true that you're reaching
13 into the future to take account of the assets which will
14 be used for those future customers?

15 MR. GOWER: No, sir, we're not. That capital
16 investment has already been made in the past. The thing
17 that you lose sight of, Mr. McLean, is the fact that
18 investors' capital is always provided and invested in
19 the company before collections of any kind.

20 MR. McLEAN: Sure.

21 MR. GOWER: Whether charges for service or
22 connection charges are recovered from customers. And
23 customers will pay those at some point in time, no doubt
24 about it. But until that capital is recovered, the
25 investors are entitled to earn a return, or there's

1 confiscation.

2 MR. McLEAN: Unless they are providing assets
3 to be used by future customers, as opposed to collecting
4 from today's customers for those assets. Why can't they
5 look to the future customers to pay that return? And I
6 concede the point you make, the investment has to be
7 made today. But is it used and useful for today's
8 customers? Some of it is, perhaps. But referring to
9 the part which is used for tomorrow's customers, what
10 about that part?

11 MR. GOWER: Yes, it is used and useful today.
12 If you look at any utility besides the water and sewer
13 utilities, and there is capacity available to serve both
14 present and future customers. And that's used and
15 useful. This is the only state I'm aware of that's ever
16 come up with this kind of definition, i.e., the used and
17 useful.

18 MR. McLEAN: Mr. Gower -- yes, sir, I
19 understand that. With respect to the electrics, let's
20 take TECO for example. I think their most recent
21 addition to plant was Polk Unit No. 1. Do you know
22 whether that's in rate base?

23 MR. GOWER: I do not. I have not had any
24 association with Tampa Electric for several years.

25 MR. McLEAN: If you're going to say to the

1 Commission that they should follow the electric example,
2 then if we looked, or if the Commission looked to
3 determine that the latest unit which was added by each
4 of the investors -- investor-owned utilities, was not in
5 rate base, that ought to tell them about something about
6 what they ought to do here, too, shouldn't it? In other
7 words, I think the thesis you just said was, well, the
8 electricians invest their money and they get a return on it
9 up front.

10 MR. GOWER: I didn't say that. I didn't say
11 they get a return up front. They get a return as they
12 provide service.

13 MR. McLEAN: To existing customers?

14 MR. GOWER: They get a return of charges to
15 existing customers for all of their plant investments
16 which are deemed to be used and useful. If Tampa
17 Electric has -- if the Commission has deemed one of
18 Tampa Electric's plants to be nonused and useful, I'm
19 not familiar with it. But it isn't the universal rule.

20 MR. McLEAN: No, and I'm not suggesting that
21 they did that. I'm suggesting that neither Tampa, FP&L
22 or FPC -- I'm suggesting to you that none of their most
23 recent additions to their capacity is today in rate
24 base. And if that be true, doesn't that -- does that in
25 any way, you think, impeach your argument that the water

1 and sewer utility industry should be like that industry;
2 and say further to the Commission that when we make
3 investment in capacity which is going to be required by
4 tomorrow's customers, we should earn a return on it from
5 today's customers?

6 MR. SEIDMAN: Mr. McLean, could you explain to
7 us why they're not in rate base, so we could know from
8 whence you're speaking?

9 MR. McLEAN: I can give you a list of plants.

10 MR. SEIDMAN: No, no, I want to know why.
11 What was the reason?

12 MR. McLEAN: Because the utility hasn't asked
13 for them to be in, so much as I understand. And I
14 believe TECO is refunding \$50 million over the next two
15 years.

16 COMMISSIONER DEASON: There hasn't been a rate
17 case since those plants came on line.

18 MR. SEIDMAN: So it wasn't because the
19 Commission decided they were nonused and useful?

20 MR. McLEAN: No, I'm not suggesting it was.

21 MR. SEIDMAN: Well, you didn't suggest
22 anything when you told Mr. Gower.

23 CHAIRMAN CLARK: Hold on a minute. We can
24 only do one person at a time for the court reporter.

25 Go ahead, Mr. McLean.

1 MS. SWAIN: I would also like to finish.
2 There was a board that spoke to this that I also had
3 prepared.

4 CHAIRMAN CLARK: Hang on, Ms. Swain.
5 Mr. McLean, were you finished?

6 MR. McLEAN: Yes, ma'am, with Mr. Gower, yes.

7 CHAIRMAN CLARK: I thought you were finished,
8 Ms. Swain, and Commissioner Deason was asking you
9 questions.

10 MS. SWAIN: I'm sorry. I remembered I had one
11 more board.

12 CHAIRMAN CLARK: All right, Ms. Swain, go
13 ahead.

14 MS. SWAIN: What I did was lay out what was
15 happening with electrics, which was what reminded me of
16 this board, municipal water and sewer and also
17 investor-owned water and sewer, and what types of costs
18 are being recovered from current customers. In all
19 cases, we are recovering the costs of O&M expenses and
20 financing of current plant.

21 Financing of CWIP is not included in the rate
22 base for investor-owned utilities. To some extent, when
23 requested, it may be included with electrics, and is
24 included in water and -- municipal water and sewer. The
25 reason why it's included in municipal water and sewer is

1 because they have to have adequate cash flow today to
2 obtain the financing that they need for their future
3 construction. So for current customers, they recover
4 not only the plant necessary to serve current customers,
5 but also all plant currently on line and also their
6 projected plant expansions for the next several years.

7 As you see from my chart, that that is not the
8 case with the investor-owned utilities, we are not
9 requesting that CWIP be included in the rate base. We
10 are not asking that nonused and useful plant be included
11 in rate base. We are asking that an adequate margin
12 reserve be included. And I wanted to point this out so
13 that you all are aware that this is not something unique
14 to our investor-owned utility industry that we are
15 asking for.

16 CHAIRMAN CLARK: Commissioners, any other
17 questions? Is there any other party or person here who
18 would like to ask questions of Ms. Swain at this point?

19 MR. McLEAN: Yes, ma'am, one or two.
20 Mr. Deason's observations concerning the built-out -- I
21 don't know which of the panel would care to answer the
22 question. I think Mr. Seidman spoke a little bit about
23 this general area. But my understanding is that a
24 built-out utility, 100 percent used and useful, Staff
25 routinely, and for years, has determined that a margin

1 reserve is inappropriate in those circumstances.

2 And I read, Ms. Swain, your testimony that
3 defines used and useful as an increment of plant which
4 is required for present customers, as well as future
5 customers. And my question is, given the 100 percent
6 used and useful built-out plant, how are they able to
7 cope with the changing needs of today's customers
8 without the margin of reserve?

9 MS. SWAIN: Let me clarify your
10 characterization of my statement. My opinion is that
11 margin reserve is the adequate capacity to provide
12 service to today's customers, so that when I add
13 tomorrow's customers I am not jeopardizing a
14 situation --

15 MR. McLEAN: May I ask you a question about
16 your clarification?

17 MS. SWAIN: Sure.

18 MR. McLEAN: Does that square with, quote,
19 "Margin reserve is the investment in plant needed to
20 meet the demands of potential customers, and the
21 changing demands of existing customers"? You said that
22 in your testimony, right?

23 MS. SWAIN: That is absolutely right.

24 MR. McLEAN: Now, focusing on the changing
25 needs of existing customers, how does a built-out

1 utility, 100 percent used and useful, with no margin
2 reserve, cope with those changing needs? Or to ask the
3 question differently --

4 CHAIRMAN CLARK: Give her a chance to answer.

5 MR. McLEAN: I'm sorry, go ahead.

6 MS. SWAIN: Repeat the question, for me.

7 MR. McLEAN: Yes, ma'am. I'll do my best.

8 Your definition, which is found in your
9 testimony, it says that margin reserve is for future
10 customers, and for the changing demands of existing
11 customers within a reasonable time. It is true, isn't
12 it, that in a 100 percent used and useful utility, which
13 is built out, Staff routinely, and the Commission
14 approves, there is no margin reserve in those
15 instances? Staff doesn't even engage in the
16 calculation; isn't that true?

17 MS. SWAIN: That is -- what's correct is that
18 the margin reserve is a calculation based upon
19 projections of future customers. That's right. But it
20 does not therefore mean that that is not available,
21 because it is available, therefore, to assure the
22 adequate service to current customers.

23 MR. McLEAN: Let me ask the question a little
24 bit more clearly. Both the Staff and the Commission say
25 to a built-out utility, 100 percent used and useful, no

1 margin reserve. Don't built-out, 100 percent used and
2 useful utilities have a present obligation to serve the
3 changing demands of existing customers within a
4 reasonable time?

5 MS. SWAIN: Yes, it does, but the plant --

6 MR. McLEAN: How could they do it without a
7 margin reserve?

8 MS. SWAIN: In a built-out situation, where
9 there is not going to be any additional customers, then
10 that has to be handled through the used and useful
11 calculations, regardless of margin reserve.

12 MR. McLEAN: So they manage to cope without a
13 margin reserve, they manage to meet the changing demands
14 of existing customers without a margin reserve?

15 MS. SWAIN: No, I don't think that that's
16 necessarily the case. The calculation is going to have
17 to be based upon something other than perhaps what has
18 been done routinely in the calculation of used and
19 useful in order to ensure in a build-out situation that
20 adequate supply -- there is adequate capacity and
21 adequate supply for the current customers.

22 MR. McLEAN: Seems to me inherent in your
23 answer that the underlying calculations of used and
24 useful, exclusive of margin reserve, take into
25 consideration the changing demands of existing

1 customers.

2 MS. SWAIN: No, I'm saying that they need to.
3 I don't feel that they do, but that's -- what we're
4 addressing is specifically the margin reserve, which has
5 the added benefit of helping to assure that there is
6 adequate capacity for current customers, as well as to
7 be able to add on future customers without affecting
8 negatively the current customers.

9 MR. McLEAN: But you do concede, do you not,
10 that in those instances which we've just been
11 discussing, that the Commission provides them with no
12 margin of reserve, or margin reserve?

13 MR. CROUCH: Commissioners, could I answer
14 that question a little bit on how Staff handles
15 something like this? Rarely are you ever going to have
16 a situation that works out exactly 100 percent used and
17 useful. It usually is going to be 92, 93, 94 percent.
18 And in most cases like that, if it is a built-out system
19 that works out, under today's standards, 94 percent used
20 and useful, we round that off to 100 percent, because
21 there has to be a little pad built in for tomorrow's
22 emergency demand. And while we don't call it margin
23 reserve, that is considered in used and useful analysis
24 by Staff.

25 MR. McLEAN: And Mr. Crouch, isn't it

1 considered in exactly the same way for utilities that
2 aren't 100 percent used and useful and aren't built
3 out?

4 MR. CROUCH: If they are not 100 percent used
5 and useful, we would not -- depending on what? If it
6 works out 75 percent used and useful, no, we would not
7 round it up to 100. But for the system that is
8 built-out at about 92, 95 percent used and useful, we
9 would round it up, and that is your pad for the --

10 MR. McLEAN: But you're not telling the
11 Commission that a utility which is less than 100 percent
12 used and useful and less than built-out doesn't also
13 have a pad. Surely you wouldn't allow such a utility to
14 operate without a pad, would you?

15 MR. CROUCH: If it is not 100 percent used and
16 useful, we would figure a margin reserve into it.

17 CHAIRMAN CLARK: Okay.

18 MR. McLEAN: Okay, second question then. And
19 this may actually be addressed to Mr. Crouch more so.
20 There is also a utility -- or there are also utilities
21 which are 100 percent used and useful, but not
22 built-out. And in those instances you don't allow a
23 margin reserve, or you don't recommend a margin reserve
24 either, do you?

25 MR. CROUCH: If they are 100 percent used and

1 useful and not built-out, this is where DEP's rule comes
2 in, and they better be planning on additional expansion.

3 MR. McLEAN: How do they cope with that
4 situation without margin reserve? You're suggesting --

5 CHAIRMAN CLARK: Mr. McLean, you keep
6 interrupting people when they're trying to answer.

7 MR. McLEAN: I wasn't done with my question.

8 CHAIRMAN CLARK: You're doing the same thing
9 to me. You ask another question while I'm trying to
10 answer or give you some direction. Ask the question,
11 take a break, let them answer and then follow up.

12 MR. McLEAN: Actually, Commissioner, that was
13 a comma and not period.

14 COMMISSIONER CLARK: Whatever.

15 MR. McLEAN: But Mr. Crouch, if you have the
16 question, give me an answer.

17 MR. CROUCH: Okay. DEP's rule says that when
18 the utility reaches a certain percentage, if there is
19 growth planned and they reach a certain percentage, I
20 think it's 60 percent, they better start planning on an
21 expansion. When it's 80 percent, they better have the
22 permits ready and start construction on expansion. When
23 they reach 90 percent, they better have that expansion
24 ready to take up the slack. So DEP's rule takes that
25 into consideration. If the system is not built-out,

1 they better be planning on expansion, margin reserve.

2 MR. McLEAN: Then why don't you give them a
3 margin reserve?

4 MR. CROUCH: If they do not, then a moratorium
5 can be placed on that system, you will not add anymore.
6 So DEP looks at the system, says, if there is growth,
7 you better be planning on expansion, and that's margin
8 reserve. If there is no growth, if it is built out, and
9 you don't anticipate -- you have no room for another
10 house, no more customers, it's built out, and you can
11 serve everybody you've got right now, we'll call it a
12 wash. Round it off to 100 percent used and useful and
13 everybody is happy.

14 MR. McLEAN: Not everybody. In the instance
15 where it is 100 percent used and useful, and it is
16 growing, do you give a margin reserve in those cases?
17 Do you recommend a margin reserve in those cases?

18 MR. CROUCH: Let me clarify. You're saying
19 100 percent used and useful?

20 MR. McLEAN: Yes, sir.

21 MR. CROUCH: And built out?

22 MR. McLEAN: No, sir. I'm saying 100 percent
23 used and useful, and there is growth, is it true that
24 the Commission Staff recommends to the Commission that
25 no margin reserve be allowed in those circumstances?

1 MR. CROUCH: If it's already 100 percent used
2 and useful, yes, we do not recommend a margin reserve.
3 It's already 100 percent used and useful.

4 MR. McLEAN: Right.

5 MR. ARMSTRONG: Madam Chair, could I just --

6 CHAIRMAN CLARK: No. Finish up, Mr. McLean,
7 and I would point out to you, you can put your own
8 person on to make the point you're making.

9 MR. McLEAN: Sure. Okay. Well, what I want
10 to know is, you don't allow a margin reserve in those
11 instances. One of the rationale which is being offered
12 to the Commission today is that in order to account for
13 growth, we must have a margin reserve.

14 Now, in the situation where the utility is 100
15 percent used and useful and has growth, you allow no
16 margin reserve. Contrast with me, if you will, between
17 that scenario and the one that's before you today, where
18 the utilities are less than built out, less than 100
19 percent used and useful. In other words, both utilities
20 have to plan for the future. One seems to need a margin
21 reserve. One doesn't. What's the difference?

22 MR. CROUCH: The difference is that the system
23 that is 100 percent used and useful and not built-out
24 better be planning on an expansion and should, if they
25 are doing things properly, will have come in and asked

1 for margin reserve.

2 CHAIRMAN CLARK: Thank you, Mr. McLean.

3 MR. SEIDMAN: Could I ask a clarifying
4 question?

5 CHAIRMAN CLARK: I want to take stock of where
6 we are right now. Have you finished your presentation?

7 MS. SWAIN: Yes, I have.

8 CHAIRMAN CLARK: Okay.

9 MS. SWAIN: I have a lot more I could say,
10 but --

11 CHAIRMAN CLARK: Mr. Armstrong, did you want
12 to make a comment?

13 MR. ARMSTRONG: We probably have about 20
14 minutes. We have two witnesses here, and just some
15 comments.

16 CHAIRMAN CLARK: Mr. McLean, how much time do
17 you have?

18 MR. McLEAN: I have probably three or four
19 more questions for the panel.

20 CHAIRMAN CLARK: And would -- is Mr. Gatlin
21 going to make a presentation?

22 MR. McLEAN: No, ma'am. I'm sorry, I
23 didn't -- Southern States has a witness they are going
24 to put on for whom I may have some questions as well.

25 COMMISSIONER CLARK: I understand that. I'm

1 just trying to figure out if you are -- your person will
2 give any presentation.

3 MR. MCLEAN: No, ma'am. We have none
4 planned. We plan to stand on our comments.

5 COMMISSIONER CLARK: Okay. Ms. Moore.

6 MS. MOORE: John Wehle, who is the
7 spokesperson for the water management districts has
8 arrived and has just a few minutes, and a short
9 presentation, I believe. He has to be over at the
10 Senate at 2 p.m., so perhaps we could take him quickly.

11 CHAIRMAN CLARK: We'll go ahead and take --
12 Mr. Seidman, you wanted to make an additional comment?
13 I would like to finish with the presentation the
14 Waterworks was giving. That doesn't mean we won't take
15 further questions, or there might not be further
16 questions for you, but let's finish up with what you
17 sort of wanted to say, initially. We'll go to
18 Mr. Wehle, and then we'll take a break for a short
19 lunch.

20 MR. SEIDMAN: This is to summarize my
21 responsive comments?

22 CHAIRMAN CLARK: To the Staff? All right, let
23 me just indicate and then we'll come back to questions
24 for the full panel, if you have anymore, Mr. McLean.

25 (Pause)

1 COMMISSIONER CLARK: Go ahead, Mr. Seidman.

2 MR. SEIDMAN: Okay, I'll just go over briefly
3 the comments I made that are matters that were really
4 not covered in the initial preparation. I was
5 responding to Mr. Crouch, he had made an observation, or
6 a statement, that says that, "To the Department of
7 Environmental Protection reserve margin represents the
8 amount of capacity needed to function properly, but to
9 the PSC as an economic consideration for setting rates."
10 And to me this doesn't wash. If it's something that the
11 utility needs to function properly, then it seems to me
12 that by itself is a definition that it's necessary and
13 used and useful in serving the public. If the utility
14 needs it for proper function, that's really what we
15 should have in rate base.

16 He goes on and says that, "A legitimate
17 reserve capacity may in fact be a prudent, wise
18 investment by a utility, but it might not be totally
19 included in the margin reserve period covered by the
20 PSC." And I have the same type of comment here. If
21 it's a prudent and wise investment for the utility, then
22 it seems to me it's because it's used and useful in
23 serving the public. That's what we're looking for. If
24 it's not used and useful, why would we build it? Why
25 would it be a prudent utility investment? I think these

1 are almost oxymorons, these types of statements, and
2 they -- if they're followed, they result in rate setting
3 that does not recognize the prudent investment of
4 utilities serving the public.

5 MR. CROUCH: Commissioners, I would like it
6 answer that later on when it comes my time to speak, if
7 I could.

8 MR. SEIDMAN: In OPC's comments they had
9 indicated that the margin reserve was neither used nor
10 useful for the present customers. Of course we take
11 exception to that; that the margin reserve, we say, is
12 necessary to protect the quality of service to existing
13 customers, that it's -- that OPC's arguments fail to
14 recognize that in order to meet DEP requirements a
15 utility cannot operate without a reserve. Specifically
16 with regard to wastewater, a utility must expand its
17 plant before to reaches capacity. It's therefore got to
18 have reserves during that period to protect the quality
19 of service for its existing customers.

20 A utility is not in a position to wait for
21 express demand with its customers before it commits to
22 provide service. It is not operating out in the free
23 market. We don't have the choice of saying, well, we'll
24 wait until somebody expresses demand and then after it
25 gets up there a little ways, and people have waited a

1 little while for service, we're going to come in then
2 and go ahead and make our investment. We really have to
3 make it ahead of time with the best information we have
4 available in the forecast to meet that demand.

5 Public Counsel also stated that there was a --
6 that the risk of serving future customers is a risk that
7 should be borne by stockholders, and that the utility is
8 compensated for that risk in its allowed rate of
9 return. I'm not aware of anywhere in the allowed rate
10 of return or in the leverage formulas that there is a
11 risk factor for serving future customers. The only
12 risks I'm aware of in the formulas set out by the
13 Commission determining rate of return is the risk
14 premiums addressed that are related to the inability of
15 water and wastewater utilities who access the public
16 market. There's just no risk factor that has to do with
17 what-ifs with regard to serving the public.

18 Public Counsel also made comments that margin
19 reserve is not needed to provide a cushion for changing
20 load conditions because averages used to calculate used
21 and useful already take plant fluctuations -- plant load
22 fluctuations into consideration. They certainly may
23 take plant load fluctuations into consideration between
24 the minimum load and the maximum load for the period for
25 which calculation is made. But they don't have anything

1 built into them for meeting things above the maximum
2 load in those fluctuations, whatever the reason for
3 those fluctuations, whether it's new customers, changes
4 in the customer demand from existing customers.

5 And finally, there was a comment made that we
6 should not be compared to electric utilities because
7 water and wastewater utilities are heavily contributed.
8 This is with regard to determining what is a necessary
9 reserve margin. How the plant is paid for makes no
10 difference in determining what the reserve requirements
11 are. Reserve requirements are related to the operation
12 of the utility in meeting all of its obligations. It's
13 either needed or it's not needed. The CIAC factor has
14 nothing to do with making that decision with regard to
15 margin reserve.

16 MR. SCHIEFELBEIN: Commissioners.

17 MR. SEIDMAN: That concludes the additional
18 comments.

19 MR. SCHIEFELBEIN: If Mr. Milian and Ms. Swain
20 could be given a brief opportunity to summarize their
21 responsive comments as well, I would appreciate it.

22 CHAIRMAN CLARK: No, we're going to take
23 Mr. Wehle up at this time. We may need to come back to
24 that, and could we take a lunch. And we are not going
25 to be taking a long lunch.

1 Mr. Wehle, would you come on up and give us
2 your comments?

3 COMMISSIONER KIESLING: Mr. Schiefelbein,
4 could you get your exhibit moved so that everyone can
5 see this witness? Thank you.

6 CHAIRMAN CLARK: If you would just give us
7 your name so we have it on the record, and go ahead and
8 spell your last name.

9 MR. WEHLE: Good afternoon. My name is John
10 Wehle. I'm the assistant executive director of the
11 St. Johns River Water Management District. I want to
12 thank you for having us here today to be available for
13 some discussion on this item.

14 With me are, from my Staff, Hal Wilkening, who
15 is my assistant director for regulatory, who is passing
16 out some information for you, and also Karen Lloyd from
17 the Southwest Florida Water Management District.

18 I am speaking on behalf of the three districts
19 that did provide comments to you, in fact of the three
20 districts that have most of the private or
21 investor-owned utilities in the state, St. Johns River
22 Water Management District the Southwest Florida Water
23 Management and the South Florida Water Management
24 District.

25 My role over the past 20 years has ranged --

1 in fact my very first job in 1973 was to write a public
2 water supply report for the Tampa Bay area. And since
3 that time I've been involved in water supply issues ever
4 since. I've been involved in development of policy and
5 legislative work on water supply, and very actively
6 involved in our needs and sources studies and our
7 consumptive use permitting rules which affect such.

8 The water management district staff from
9 St. Johns, South Florida and Southwest reviewed the
10 proposed amendments. Each of the districts have
11 provided filed comments in this proceeding through
12 letters from our respective executive directors dated
13 October 17th, 1996 to the Commission. In that letter we
14 outlined several concerns and suggestions that we
15 suggest you consider. Since submitting those comments,
16 we have met with the PSC Staff on several occasions to
17 discuss water rate setting in general and this rule
18 amendment and how it relates to our job as resource
19 regulators and resource protectors.

20 I can't underestimate how much we appreciate
21 the PSC Staff assistance. It's gone a long way towards
22 us trying to understand what your specific role is, and
23 also their understanding of how we are -- what our job
24 is legislatively, to protect the resource.

25 First, I guess we need to explain a little bit

1 about our role and responsibility in water supply
2 planning. Not only do we have a regulatory role through
3 the consumptive use permitting process, but we also have
4 a water supply goal to ensure the availability of
5 adequate and affordable supply of water for all
6 reasonable beneficial uses while protecting the water
7 resources of the district or of the state as you put all
8 of this together.

9 Water supply planning and consumptive use
10 permitting are the tools that we use to meet that goal.
11 Our Water Supply Needs and Sources Assessments, which we
12 initially completed in '94 and are in continuous update,
13 assess the water supply needs and sources for the next
14 20 years. The needs and sources studies identified
15 significant increases in public supply demand that would
16 result -- that could result in unacceptable impacts in
17 the future, and many of these areas were designated
18 water use caution areas. Our goal is for that never to
19 occur, but we are in the process now to make sure that
20 we are implementing programs to protect the resource and
21 to provide adequate water supply for the future.

22 In that regard, we are currently undertaking
23 intensive effort to help water users, both public and
24 investor-owned utilities, in our water resource caution
25 areas to develop water supply plans that will be

1 implemented through our consumptive use permitting
2 process. In the CUP process, we strive to find reuse,
3 or the use of the lowest quality water for the purpose
4 intended, unless the applicant demonstrates that it's
5 not technically, economically or environmentally
6 feasible. We also have a recent governor's executive
7 order on water supply planning which emphasizes both of
8 these points.

9 Our goal, and the -- our -- the reason we want
10 to approach you today is because of that role of trying
11 to provide for an adequate water supply and also provide
12 for the protection of that resource.

13 In our resource, we try to allow for the
14 orderly and effective development of expanded capacity.
15 What that means is we may issue a permit. Most of us
16 are issuing permits around ten years. It varies between
17 five and 15 years, but let's say roughly ten years, that
18 we try to have some kind of orderly development of the
19 resource over time so that we can look at the
20 resource -- at the water supply benefits, as well as
21 resource protection over time.

22 When we permit, say, a 10 million gallon a day
23 well field, for example, they are all staged over a
24 certain period of time, but the investment has to be up
25 front in order to do it properly. The problem that we

1 see with the proposed margin reserve period is that when
2 investors are pushed for trying to capitalize this over
3 an 18-month period, we feel that we're getting into a
4 point where kind of like the difference between having a
5 good regional water treatment system -- wastewater
6 treatment system, versus a series of little package
7 plants that come up and may or may not be as effective
8 in the long run, and in fact become more expensive.

9 We feel that if the term is expanded, that
10 generally you will end up with a less expensive per unit
11 cost for even your customers in the longer term, and
12 that you get more effective protection of the water
13 resource.

14 The DEP rules provide for an effective
15 timetable to ensure safe and effective development of
16 drinking water and wastewater systems. First, again, we
17 think that 18 months is clearly too short, that if
18 you're looking at some of the things that we're being
19 asked to emphasize, alternative water supplies, reuse,
20 desal, brackish water conversion, all of these, even in
21 fact for larger conventional systems, the planning and
22 development or the process of getting to the point where
23 you start construction takes more than 18 months.

24 It's almost -- and when you're getting into
25 major water supply development, it almost takes about,

1 well, seven years to get from proposal to getting the
2 permit, then getting into construction. So we're
3 looking at a much longer period of time because we are
4 putting in many more requirements for resource
5 protection in the consumptive use permitting process
6 than we ever have before. And I don't see that
7 lessening. I see that probably becoming even more so in
8 the future, especially in the areas where you have --
9 have competition for use.

10 We think they're -- especially when you get to
11 reuse projects. Typically they serve both the existing
12 and new customers. Often existing potable withdrawals
13 may be reduced for some short of period of time because
14 of the reuse, rather than increasing the capacity on a
15 conventional system to serve new customers. The used
16 and useful method of accounting, which is designed to
17 address the expansion of the capacity, does not appear
18 adequate to consider the factors unique to reuse, or in
19 our long term water resource protection schemes that we
20 have.

21 There appears to be a lack of consideration
22 for the time involved in the planning and implementing
23 alternative water supply sources and strategies
24 necessary in water management district designated water
25 resource caution areas. We have a specific program on

1 designating those water resource caution areas, and then
2 what is expected from that point. Right now, if you are
3 in a water resource caution area, reuse is expected. It
4 is not something that is an option. It's only an option
5 if the district determines that it is not economically
6 or environmentally feasible. And these are long term,
7 long term projects.

8 We are looking at a utility's plan, like I
9 said before, on 20-year horizons. We know that 20 years
10 actually is -- we're looking at that in the plan. When
11 it comes to the implementation, because of the permit
12 periods, we're looking at five- to ten- to 15- year
13 periods in terms of implementation.

14 Implementation of alternative water supplies,
15 again, just require much more time to plan and implement
16 than even the traditional ones. And like I said, the
17 larger ones now even take quite a bit of time.

18 I guess just to summarize on our
19 recommendations, we support and recommend DEP's
20 amendment regarding reuse, which exempts reuse
21 facilities from the margin reserve calculation. We
22 support and recommend DEP's proposed amendment regarding
23 a five-year margin reserve period for water supply and
24 treatment facilities and wastewater treatment and
25 disposal facilities, to be consistent with DEP's rule.

1 In addition, we recommend that proposed rule
2 language be amended to specify that a factor in
3 considering the appropriate margin reserve period longer
4 than five years is whether the facilities will be used
5 to implement alternative water supplies or strategies in
6 accordance with water management district approved water
7 use plans in the water use caution areas.

8 Finally, we recommend that the districts and
9 the PSC continue to explore other methods of rate
10 setting that foster and encourage the development of
11 alternative water supplies that would be necessary in
12 the near future. That is a legislative requirement that
13 was put on to us two sessions ago.

14 The water management districts recognize that
15 this and other issues that concern rate setting and
16 water supply development are very complex and require
17 cooperative effort between the PSC, the Department of
18 Environmental Protection and the water management
19 districts.

20 In the spirit of cooperation we're requesting
21 your careful consideration of these comments. We
22 appreciate the Commission's decision to proceed with
23 rulemaking on this important issue and believe that
24 consideration is very timely.

25 We are available to answer questions, and as I

1 said, we do have Staff from St. Johns and from Southwest
2 here to answer your questions. Thank you.

3 CHAIRMAN CLARK: Thanks very much. Thank you
4 very much for coming over.

5 MS. LLOYD: Chairman Clark, if I might, I have
6 a statement also from the Southwest Florida District.
7 It's very brief. I'm an attorney -- I'm Karen Lloyd.
8 I'm an attorney with the Southwest Florida Water
9 Management District, also known as SWFWMD.

10 There are at least three governmental agencies
11 in the State of Florida regulating investor-owned public
12 water supply utilities. Those are the PSC, the DEP and
13 the Water Management Districts. The districts and DEP
14 require between five and ten years, and in some cases
15 longer, years of planning and projections to obtain
16 water -- or to obtain permits for water supply
17 facilities. Due to pressures from the governor, the
18 legislature and the regulated public to better serve the
19 public interest, the trend around the state has been for
20 even longer term planning and permitting for water
21 supplies, both the traditional sources, and especially
22 for alternative sources like reclaimed water and
23 underground storage and recovery.

24 It is important that the PSC, the DEP and the
25 districts be consistent in their regulatory schemes in

1 order to protect the public interest in the
2 environmental -- in the environment and water
3 conservation, and to avoid unnecessarily high rates due
4 to short-term planning.

5 SWFWMD submitted its comments and concerns in
6 the letter dated October 17th of this year, and I
7 believe that's included in Exhibit No. 3. Ms. Moore has
8 told me -- advised me that it is. I would ask -- that
9 letter asks, and we ask, that again today, the PSC
10 reconsider the proposed margin reserve period, so that
11 rather than 12, 18 or even three years, the margin
12 reserve period is more in line with the State's trend
13 and current programs to take a longer view of water
14 supply and to be more in line with the DEP and the
15 district's permitting.

16 We support the DEP recommendations and rule
17 changes and the suggestions that St. Johns has made. We
18 hope that you will include them in your rule as a way to
19 achieve statewide consistency in this area of regulation
20 of water supplies.

21 CHAIRMAN CLARK: Thank you, Ms. Lloyd. Are
22 there questions of these two witnesses?

23 MR. McLEAN: No questions.

24 MR. ARMSTRONG: I just have two
25 clarifications.

1 CHAIRMAN CLARK: Go ahead, Mr. Armstrong.

2 MR. ARMSTRONG: Mr. Wehle, they're directed to
3 you. Number one, you passed out the amendments here,
4 and I just want to be real clear that in the amended
5 language in 4 and 5, in No. 5 it still refers to 12
6 months and 18-month periods. But I just want to
7 clarify, you do support the five years?

8 MR. WEHLE: Yes, that's correct. We do
9 support the five years, and this was added on that
10 regardless of what period that you put in there, that
11 for reuse projects and alternative water supplies, that
12 you put that in to the mix of whether you want to go
13 longer.

14 CHAIRMAN CLARK: Okay.

15 MR. ARMSTRONG: And that's the second question
16 I had. You referred to exempting reuse facilities from
17 the used and useful mechanism, and by that did you mean
18 to suggest that you support the DEP proposal that reuse
19 facilities be 100 percent used and useful?

20 MR. WEHLE: Yes, I'll repeat that, that we
21 support the DEP's position in that area.

22 MR. ARMSTRONG: Thank you.

23 COMMISSIONER KIESLING: I have a couple of
24 questions.

25 CHAIRMAN CLARK: Go ahead.

1 COMMISSIONER KIESLING: And they go both to
2 reuse, and in general, the comment that we need to have
3 consistent requirements and approaches among our three,
4 what I consider to be in some ways, sister agencies.
5 And I guess one of my concerns is that for those
6 areas -- and I think -- I think that reuse is one of
7 them where there are some inconsistencies between our
8 statutory charges, that would you all agree with me that
9 there needs to be some legislative attention paid also
10 to some changes that would allow us to have a more
11 consistent approach?

12 MR. WEHLE: I would agree to that, yes. Yes,
13 I would.

14 COMMISSIONER KIESLING: I guess I just want to
15 make sure that we're all understanding that part of the
16 problem may be that we need some legislative
17 clarifications before we can be totally consistent in
18 how we each interpret the statutes that we're charged
19 with interpreting.

20 MR. WEHLE: Right.

21 MS. LLOYD: I am not -- I will not profess to
22 be an expert in the PSC statutes and rules, but I
23 recollect that with respect to at least reuse, there is
24 a provision that directs you to act in the public
25 interest. And I think that that is a charge that is

1 consistent among us, and it's with that in mind that
2 hopefully we can find a way to make our programs
3 consistent within the existing statutory framework.
4 There may well be enhancements or changes that we do
5 need, but I think there is some common thread among us
6 to take -- try to best serve the public interest, and
7 hopefully we all have a similar definition in this
8 regard.

9 COMMISSIONER KIESLING: All right, thank you.

10 MR. SCHIEFELBEIN: May I inquire as a
11 follow-up to Commissioner's Kiesling's?

12 COMMISSIONER CLARK: Go ahead,
13 Mr. Schiefelbein.

14 MR. SCHIEFELBEIN: I direct this to the panel
15 from the water management districts. I'm unaware of any
16 inconsistencies between the various statutes on reuse.
17 Could you share with us what your perceptions are on
18 that, from the water management districts' standpoint?

19 MR. WEHLE: In further discussions with PSC
20 Staff, there seems to -- I think we all want to go -- we
21 all want to go the same direction. I'm not so sure that
22 we're interpreting what that same direction is. And
23 it's going to take some more of that discussion between
24 the two agencies' staffs in order to get there.

25 However, when Commissioner Kiesling asked the

1 CHAIRMAN CLARK: Let's reconvene the hearing
2 again. As I understand it, Ms. Swain and Mr. Milian may
3 want to make some more comments. Ms. Swain.

4 MR. MILIAN: I just wanted to make a very
5 brief comment to try and summarize. I think the
6 Commission -- if the Commission wants to make the
7 utilities to build in prudent and economic expansions of
8 the facilities, they should be sending the proper -- or
9 the opposite signals that the utilities are receiving at
10 this time. Allowing one and a half margin reserve, the
11 utilities are going to be -- are going to continue
12 expanding uneconomic and small type of facilities that
13 are actually much higher cost per gallon, and
14 ultimately, what we're trying to accomplish, of
15 maintaining low rates for our customers. In fact, in
16 the long run, it's going to be just the opposite of what
17 would be taking place. And that's about the extent of
18 my summary.

19 CHAIRMAN CLARK: Ms. Swain?

20 MS. SWAIN: Thank you. Just a couple things
21 from my responsive comments. First of all, I want to
22 clarify that we are not asking for future plant or
23 construction work in progress; that we're asking for a
24 margin reserve, a percentage of plant that's already
25 been constructed, that's already a utility investment at

1 its historical, depreciated cost.

2 Secondly, I want to also point out that it is
3 not proper to maintain rates at an artificially low
4 level, which they would be under the current situation,
5 because the benefit to the customer is going to be -- if
6 our proposed rule is in effect, the benefit to the
7 customer is going to be seen in a very short period of
8 time, and it's going to be there forever.

9 And the last thing, not to belabor AFPI, but
10 just a point of clarification, that when AFPI is
11 accumulated, it's not accumulated and capitalized and
12 preserved somewhere. If the customer doesn't pay it,
13 it's lost. And that is the extent of my comments.

14 CHAIRMAN CLARK: Thank you.

15 COMMISSIONER DEASON: Let me ask a question on
16 that last comment. It's lost after the five-year
17 period. Is it accounted for during the five-year
18 period?

19 MS. SWAIN: Any customer who pays it, the
20 utility receives the revenue, but if the customer
21 doesn't pay it, it's lost. It's not preserved somewhere
22 for some future --

23 COMMISSIONER DEASON: It's only realized if a
24 customer actually connects and pays the charge?

25 MS. SWAIN: That's correct.

1 MR. SEIDMAN: And then, Commissioner, it's
2 included as revenue. It doesn't go in as part of the
3 plant cost.

4 COMMISSIONER DEASON: I'm sorry, it's included
5 as revenue to the company at that point?

6 MR. SEIDMAN: Revenue to the company, right.
7 It doesn't become part of a plain cost, like AFUDC, to
8 be earned on additionally.

9 MR. WALKER: Staff would like to ask a few
10 questions of the panel, if it would be all right. So
11 the Commission gets a fairly good understanding, is rate
12 base inclusion of margin reserve usually considered a
13 very significant or a relatively modest element of the
14 company's requested revenues?

15 MS. SWAIN: On a proportional basis, the
16 margin reserve on its own is not significant. It's
17 minimal if there's an imputation of CIAC. If there's no
18 imputation of CIAC, I found that it would -- that the
19 margin reserve period could impact the earnings by
20 approximately 1 percent of rate base, which is
21 significant to a utility.

22 MR. WALKER: But it's -- in a relative sense,
23 it's not anything as large as a doubling of the
24 company's rates if they get margin reserve?

25 MS. SWAIN: Right, absolutely, no. It has

1 nothing in that magnitude. That's correct.

2 MR. WALKER: On a regular sort of basis most
3 utilities are seeing this as being important, but it's
4 not the dominant issue in their rate case?

5 MS. SWAIN: This is a very significant
6 component of used and useful, which in total is a
7 dominant issue in a rate case. Margin reserve on its
8 own is simply a component. It's a very important
9 component.

10 MR. WALKER: Okay. Most of the questions I
11 had were directed towards Ms. Swain, and they dealt with
12 the models, whether those models were going to reflect
13 some changes I thought were needed as comparing the
14 average investment by the -- the average return by the
15 average investment, and whether there would be some sort
16 of provision for the income earned on the construction
17 project. And yesterday in the -- I received a fax with
18 all that information now is available to me, and that
19 takes away most of my questions. But I wondered if we
20 could just briefly go over a few of those points.

21 One of the questions I had concerned the --
22 the allowance for margin reserve in your models. If you
23 could look at your Schedule DS-2 and Page A-9, or what
24 is Schedule 5. And what I would first like to do is ask
25 Ms. Swain, isn't it true that basically all of your

1 models follow the same pattern, they are based upon full
2 recovery of an investment on allowed rate base and a
3 return on the unused plant, full return?

4 MS. SWAIN: No, they include -- the return on
5 nonused plant is only through the form of AFPI. And the
6 current revenues are only on used and useful. But it
7 does assume full recovery through both mechanisms.

8 MR. WALKER: Well, looking at Schedule A-9 and
9 in Column F, I think I see the uniform -- a uniform
10 5,400 ERCs for margin reserve?

11 MS. SWAIN: That's right.

12 MR. WALKER: Are you aware that the Commission
13 usually follows the practice of limiting margin reserve
14 to being 20 percent of the test year ERCs?

15 MS. SWAIN: Yes, I am. The model reflects the
16 Commission proposed rule and not what may have been the
17 Commission practice. I did have an opportunity to take
18 a look at some of the customer rate numbers, if I did
19 that limitation, and there was not a noticeable
20 difference in the results. But this reflects the
21 Commission proposed rule. So I didn't do a 20 percent
22 limitation.

23 MR. WALKER: And if the current rule doesn't
24 indicate there should be a limitation to be no more than
25 20 percent of test year customers, that may be something

1 that needs to be addressed?

2 MS. SWAIN: I'm sorry?

3 MR. WALKER: If the rule -- if the proposed
4 rule doesn't indicate that there should be a limitation
5 imposed on margin reserve to be no more than 20 percent
6 of the test year ERCs, then you didn't consider that in
7 your model?

8 MS. SWAIN: Well, the model considers that
9 there is not a limitation, because that's not what the
10 proposed rule is. I did take a look at what the impact
11 would be if we did limit it to 20 percent. And again,
12 it was not noticeable. Because remember that my model
13 is showing a comparison. So if I made the change in one
14 and made it in all the others, the comparison is the
15 same.

16 MR. SEIDMAN: Are you suggesting that there
17 should be a 20 percent limitation?

18 MR. WALKER: Mr. Crouch's testimony, he
19 explains that consistent with practice we have always
20 limited it to 20 percent, if that's not included in the
21 rule proposal.

22 MR. SEIDMAN: It's not in the proposal.
23 Consistent with practice you've always imputed CIAC.
24 It's not in Mr. Crouch's testimony or yours to support
25 that. Is there some reason that we should limit it to

1 20 percent? I mean does the 20 percent mean anything?
2 Tied to something? Just a nice number that keeps things
3 limited, even when they're needed?

4 MR. WALKER: Only that it results in -- for
5 example, here with a model, in the very first year you
6 have a provision for growth which is three times larger
7 than the number of customers already taking service.
8 And when -- as background, when we set initial rates, we
9 don't generally take into account that there would be so
10 few customers paying for capacity that so far exceeds
11 the initial demand. It may just be that the model
12 itself -- being uniform throughout, it is not a
13 complication, but I'm just suggesting that --

14 MR. SEIDMAN: The model starts with like a new
15 utility, which basically under the standards that you
16 followed, a new utility usually comes in and sets rates
17 based on 80 percent build-out. So it would seem that
18 that type of problem is better answered by the initial
19 rate structure, and then margin reserve might just fit
20 in.

21 MR. WALKER: Okay. I understand. Thank you.

22 When you gave us the updated schedules, which
23 is the -- which is led off by DS-5, and it shows the
24 changed rate of return factors, I just had a question in
25 terms of -- in terms of each of the first five years.

1 It doesn't show the company earning a full rate of
2 return during those periods. Isn't the AFUDC designed
3 to allow full recovery of the Company's investment in
4 construction work in progress?

5 MS. SWAIN: The return allowed, or the AFUDC
6 rate allowed, is equal to the cost of capital. However,
7 the utility is investing not only in construction plant
8 and all the costs associated with it, but also interest
9 on construction, and by virtue of the rule that prevents
10 a utility from earning on AFUDC, there is a component in
11 construction related to interest that the utility is not
12 earning on, although it is an investment of the utility,
13 and that's why you see that small difference.

14 MR. WALKER: So, for example, in the fifth
15 year, if a company seems to be earning 9 percent, and is
16 that the result of dividing interest by the combination
17 of plant and accrued interest?

18 MS. SWAIN: That's right, because my
19 investment in CWIP includes a -- the interest
20 component.

21 MR. WALKER: Ms. Swain, on Page 10 of your
22 testimony, you say that -- you discuss the rate setting
23 policies of government-owned utilities. And I believe
24 you said earlier that they have to include in their
25 rates enough to cover the interest on the construction.

1 Are those government bodies prevented from capitalizing
2 interest during construction?

3 MS. SWAIN: No.

4 MR. WALKER: Do they capitalize interest?

5 MS. SWAIN: Yes.

6 MR. WALKER: So they -- in essence, are they
7 deferring recovery of interest on that until some later
8 date?

9 MS. SWAIN: No. They are recovering adequate
10 revenues to cover the cash flow of their current debt
11 requirement, which is including their construction
12 plans. Afterwards, as they're doing construction, they
13 are capitalizing interest. And because their rates are
14 based upon a cash flow analysis, there is not an
15 earnings on rate base, per se, that they test that they
16 have to meet. It's simply a cash flow calculation.

17 MR. WALKER: So if they're capitalizing some
18 of the interest charges, that's not considered cash flow
19 in that year?

20 MS. SWAIN: That's right, because then, in
21 reality, the interest on that debt, even though it's
22 capitalized, is a cash flow requirement. So the rate
23 recovery is adequate to recover the cash paid for
24 interest on that construction, in the current period.

25 MR. WALKER: Okay, another question. Do

1 government-owned utilities collect anything like an AFPI
2 charge?

3 MS. SWAIN: There are some utilities that have
4 something similar to an AFPI charge, but it's been
5 tested in a couple -- in a couple areas. Sometimes it's
6 a standby charge that's paid every month by lot owners,
7 and sometimes -- well, that's really the only way I've
8 seen it, instead of an AFPI charge having a monthly
9 standby fee.

10 MR. WALKER: So it's then considered some kind
11 of return on nonused investment?

12 MS. SWAIN: That's right. The calculation is
13 intended to recover the cost of the facilities --
14 although they don't have a nonused and useful, it's
15 intended to recover the cost of facilities that were
16 constructed to provide them service. I've only seen it
17 calculated for distribution plant. And I have also seen
18 that it does not serve to -- as a full weight in revenue
19 testing for the purpose of obtaining financing. It has
20 a very minor weight in being able to support that.

21 MR. SEIDMAN: Am I correct, Ms. Swain, that
22 that's collected in the current period from lot owners?

23 MS. SWAIN: Right. Right. It's collected
24 currently from future customers. It's not deferred
25 until the customer connects.

1 MR. FEIL: So it's more like guaranteed
2 revenue than AFPI. Is that what you're saying?

3 MS. SWAIN: It's also a replacement for
4 guaranteed revenue.

5 MR. SEIDMAN: Or standby fee.

6 MS. SWAIN: So the -- it's applied to a lot
7 owner where there's not a current connection, and it's
8 collected from. Now at the time the customer connects
9 is when they need to face whether there's been a -- any
10 collection issue until that point. There may be some --
11 some difficulty with collecting. Some counties may put
12 it through property taxes or assessments. There's a
13 variety of ways to collect it, but it's generally
14 considered still having a risk, which is why it's not
15 given full weight in financing. But it is less risky
16 than collecting in the future at the time the customer
17 connects. And that is not a very common practice. I
18 see that very rarely.

19 MR. WALKER: Okay, I believe two more
20 questions. I believe in your testimony you indicated
21 that the company is going to select the more costly
22 investment alternative, building the smaller incremental
23 plants to maximize its earnings. If we look at your
24 schedule, or your Page 21 for the Wastewater Division,
25 and your revision, doesn't that indicate in the bottom

1 section that the company seems to be more profitable if
2 it builds the larger plant?

3 MS. SWAIN: Yes, it does. And I -- and I
4 pointed out earlier that that's the case and that
5 utilities are not aware of that. They're looking at
6 short term decision-making based upon the rules that
7 they're facing, not realizing that in the long term on a
8 30-year period that it's going to be more beneficial to
9 have constructed a larger-sized plant. But the decision
10 is made because of the short term rate impact. And by
11 short term I mean the immediate impact of having made
12 that decision. And I don't think that they're aware,
13 since this is the first time such a model was done, that
14 that may be the result. And as well, remember that this
15 is in a perfect world scenario where all the customers
16 connect at the time that they plan to connect and
17 everything is recovered at the time the cost is
18 incurred.

19 MR. WALKER: Does the difference between the
20 larger income associated with rates relative to AFPI,
21 does that have any relevance?

22 MS. SWAIN: Well, certainly, because in this
23 model I'm getting all my AFPI revenues, because I am
24 predicting my customer growth 100 percent accurately,
25 and I don't have regulatory lag. So as a matter of fact

1 in this model my AFPI is adequate, but in any event,
2 with all that AFPI, the benefit is still to the
3 customers and the utility in building a larger sized
4 plant.

5 MR. WALKER: Those are all my questions.

6 MR. WILLIAMS: As a point of clarification,
7 Ms. Swain, if you look at the effect on the customer's
8 bill, if you take the Commission current policy of
9 allowing 18 months with an imputation of CIAC versus
10 allowing five years with no imputation of CIAC, what
11 percentage change would you expect on a residential
12 bill? Would it be a 2 percent increase or a 5 percent
13 increase, just to give the commissioners some idea of
14 the magnitude to expect of what this decision would have
15 to a residential customer?

16 MS. SWAIN: As a matter of fact, I had the
17 information to give you that calculation, but rather
18 than have everybody watch me run through papers and a
19 calculator, give me a little bit of time to do that and
20 I'll have a response for you. I did an analysis of the
21 PSC rule versus -- or the proposed rule and the
22 Waterworks' proposed rule, and the impact on customer
23 rates. And it still continues to be beneficial to --
24 under our proposal, because the utilities will construct
25 economically sized plant. But I can give you the

1 percentage. It will just take me a few minutes.

2 MR. WILLIAMS: I think the commissioners would
3 like to hear that number. Another question, with
4 respect to the industry criticism of AFPI, are you aware
5 that there are arguments that AFPI becomes so large that
6 taking AFPI in addition to the utility's normal service
7 availability charges, that the utility can't compete, or
8 that it discourages growth in the area because the
9 charges become so excessive? Are you familiar with that
10 scenario?

11 MS. SWAIN: I have seen that, that AFPI was so
12 high that that was a concern to the utility.

13 MR. WILLIAMS: I do think we would like to
14 hear the figure, if you could come up with it, on the
15 first question. Thank you.

16 MS. SWAIN: Okay.

17 MR. WILLIAMS: Thank you.

18 CHAIRMAN CLARK: Anything else? Any other
19 questions for the Florida Waterworks panel?

20 MR. McLEAN: Yes, ma'am. Just very briefly.
21 Question for Mr. Seidman. Mr. Seidman, in your
22 testimony you say -- in your responsive testimony you
23 say, "The most obvious test of the OPC argument would be
24 to build a utility system with zero margin reserve and
25 make the OPC phone number available to each customer for

1 complaints." Do you have a pencil, Mr. Seidman?

2 MR. SEIDMAN: Are you going to give me your
3 phone number?

4 MR. McLEAN: Yes, sir. I'm ready to take that
5 deal if it's a serious one.

6 MR. SEIDMAN: Ready to take what?

7 MR. McLEAN: I'm ready to take that deal if
8 it's a serious one. Didn't Mr. -- I think Mr. Crouch,
9 in the discussion with Mr. Crouch, we did learn that
10 there are some operating utilities in the state with
11 zero margin reserve; is that right?

12 MR. SEIDMAN: I don't know that I got the same
13 conclusions you did from the discussion between you and
14 Mr. Crouch.

15 MR. McLEAN: Well, then let me ask you, do you
16 know whether there are utilities in the state operating
17 with zero margin reserve?

18 MR. SEIDMAN: There may be utilities operating
19 in the state with zero margin reserve because they're at
20 100 percent used and useful, and you're not going to add
21 on margin reserve that hasn't been invested in. If they
22 are at 100 percent and they're in a no-growth situation,
23 if they need capacity to meet the requirements of their
24 system, they will add it and it will still be 100
25 percent and there will be no margin reserve.

1 MR. McLEAN: But that's not a viable option
2 for the utilities for whom you speak today, right?

3 MR. SEIDMAN: If they're in a growth
4 situation, they need the margin reserve recognized in
5 the rate.

6 MR. McLEAN: Do you know whether there are
7 utilities in the state who are in a growth situation who
8 are 100 percent used and useful who do not have a margin
9 reserve?

10 MR. SEIDMAN: Would you repeat that?

11 MR. McLEAN: I'll try to. Do you know whether
12 there are utilities in this state, water and sewer
13 investor-owned utilities, that are 100 percent used and
14 useful, who are in a growth situation and to whom no
15 allowance for margin reserve has been made?

16 MR. SEIDMAN: No, I don't know.

17 MR. McLEAN: You don't know whether that's
18 true?

19 MR. SEIDMAN: I don't know if it's true.

20 MR. McLEAN: In your experience, Mr. Seidman,
21 do 100 percent used and useful utilities, which have
22 been adjudged by this Commission to be used and useful,
23 routinely add customers?

24 MR. SEIDMAN: I don't know.

25 MR. McLEAN: Would you be comfortable

1 testifying to the Commission that that does not happen?

2 MR. SEIDMAN: That companies that are at 100
3 percent don't add customers?

4 MR. McLEAN: Yes, sir.

5 MR. SEIDMAN: No. I wouldn't be comfortable
6 testifying that they do or don't.

7 MR. McLEAN: Let's turn to a little bit
8 different matter in your testimony. You said that
9 the -- this is again your responsive testimony. "The
10 OPC wants it to be a one-way arrangement wherein the
11 utility must commit to the investment but speculate as
12 whether it can recover costs." And I want to focus a
13 little bit on that word "speculation." I want to know
14 what is speculative. The utility invests in margin
15 reserve, and in your judgment -- and our position, I'm
16 sorry, is that it should not earn a return on an
17 investment, but that -- but that it should be included
18 in rate base only when customers who need that asset are
19 added to the system. So I want to know why our
20 particular theory of how this should be handled is
21 speculative. I wish you would define for the
22 Commission, if you can, what is the speculative
23 element?

24 MR. SEIDMAN: The speculative portion would be
25 the AFPI as a source of revenue to pay for plant that's

1 already been placed in service and is considered used
2 and useful.

3 MR. McLEAN: Why is that speculative? Is the
4 notion that the customers may not materialize?

5 MR. SEIDMAN: That's right.

6 MR. McLEAN: Why should the customers take on
7 that speculation?

8 MR. SEIDMAN: The utility has an obligation
9 under the law to be ready to serve. We don't have a
10 choice in that. We have to make that decision before
11 the customers come, whether or not we think there's
12 going to be growth. We obviously can't be 100 percent
13 right, nobody can. But that doesn't mean that we're not
14 obligated to make the decision. We should do it with
15 the best information we have available and come up with
16 the best forecast we have. If everybody agrees that
17 that was the best information available and was the best
18 forecast we can have, we don't need it, we still have
19 had the obligation to be there. And I think if we had
20 to provide the plant to meet the statutory requirements,
21 we're entitled to a return on it.

22 MR. McLEAN: Who is in control -- who is in
23 the better position to correctly forecast the future
24 need for assets, the utility or the customers?

25 MR. SEIDMAN: Doesn't matter whether the

1 customers or the utility can do it better. The
2 utilities have to do it. That's our responsibility.
3 Just because it's wrong, it doesn't mean it was an
4 imprudent decision or that it wasn't the best forecast
5 with the information available.

6 MR. McLEAN: Well, it's your testimony that
7 giving credence to those forecasts can be speculative;
8 isn't it?

9 MR. SEIDMAN: Certainly, because they're based
10 on forecasts.

11 MR. McLEAN: Okay, so join me for the
12 matter -- join me for the moment in the observation, at
13 least the hypothetical observation, that it does in fact
14 matter who is in the best position to control the
15 forecast, the customers or the utility. And the
16 question recurs: Who is in the best position to ensure
17 the accuracy of the forecast, the customers or the
18 company?

19 MR. SEIDMAN: The company is in the best
20 position to ensure the accuracy of a forecast to the
21 best of its ability with the information it has at the
22 time it makes the forecast.

23 MR. McLEAN: And to the extent it does that in
24 a scholarly fashion, it does tend to insulate itself
25 somewhat from that risk, doesn't it?

1 MR. SEIDMAN: Hopefully so.

2 MR. McLEAN: Well, what opportunity do
3 customers have to insulate themselves from that risk?

4 MR. SEIDMAN: They don't, and I don't think it
5 matters. The utility has an obligation to be ready to
6 serve and make that -- meet that obligation by
7 projecting with the best information it has.

8 MR. McLEAN: In exchange for that obligation,
9 they get to be the only guy on the block, don't they?

10 MR. SEIDMAN: That's right.

11 MR. McLEAN: And customers can't go to another
12 utility and say, your forecasts are more accurate, so
13 we'll do business with you, can they?

14 MR. SEIDMAN: They can't do -- they can move,
15 of course. But I don't expect them to. They're going
16 to have to live with us, if it's our service area, have
17 to live with Florida Power and Light, or Centel, or
18 whatever other utility is serving in their service area
19 if there's no competition. Everybody that's in the
20 utility business has the same problem.

21 MR. McLEAN: On that point, Mr. Seidman, do
22 you suppose any of them may move within the five-year
23 period for which you would like to include margin
24 reserve in the rate base?

25 MR. SEIDMAN: Sure.

1 MR. McLEAN: And when Ms. Swain showed us her
2 work and her projections and her charts and so forth,
3 don't all those pretty much rest upon the assumption
4 that today's customers will be, first of all, in
5 residence, and second of all, perhaps, alive when those
6 benefits comes to fruition?

7 MR. SEIDMAN: Same process as any other
8 utility.

9 MR. McLEAN: Exactly. They may well be in
10 another service area.

11 MR. SEIDMAN: That's right, projected the same
12 way. So hopefully if we keep shifting around, come full
13 circle, someone will leave us and somebody will come
14 in.

15 MR. McLEAN: And it's your -- so what the
16 Commission is led to believe then by your testimony is
17 that while -- if the Commission includes a margin of
18 reserve in, for example, Southern States, and if the
19 customer dies or moves to another service area within
20 the five years, or seven years, or as high as 20, I
21 think we've heard today, that that customer can look to
22 value received for the value he gave up, or she gave up,
23 to some other utility some time in the future?

24 MR. SEIDMAN: I didn't think I heard today
25 about the 20-year margin reserve. I heard about a

1 20-year planning period.

2 MR. McLEAN: Well, you can cut it back seven
3 if you want to.

4 MR. SCHIEFELBEIN: Commissioners, are we
5 beyond the point where questions are being asked that
6 are necessary to clarify and understand our position?

7 CHAIRMAN CLARK: Mr. McLean, are you going to
8 pursue this?

9 MR. McLEAN: No, ma'am, that's the last
10 question.

11 MR. SEIDMAN: Okay, repeat it again.

12 MR. McLEAN: I'm certain that I cannot, but
13 I'll give you a shot.

14 CHAIRMAN CLARK: Wait a minute, Mr. McLean, do
15 you need to have him answer that question?

16 MR. McLEAN: I should hope you'd want to hear
17 the answer to it, Commissioner. It stands for the
18 notion that customers whom your rule may require to pay
19 today may never see the benefit. And I think that is of
20 central importance to this inquiry. But if you don't
21 want to hear the answer, no need.

22 MR. ARMSTRONG: Without reiterating what we've
23 said a number of times, they do see the benefit today,
24 and we went through each one of those benefits in terms
25 of lower costs and availability of capacity, so we don't

1 need to restate.

2 MR. SEIDMAN: I don't mind answering it.

3 CHAIRMAN CLARK: Go ahead, Mr. Seidman.

4 MR. SEIDMAN: We don't -- as utilities, we
5 don't really serve customers on an individual basis. We
6 don't design individual rates for an individual customer
7 on an incremental basis. We designed for the growth in
8 general. We have a 2 or 3 percent growth, net. That
9 usually means that about 97, 98 percent of the people
10 that were there this year are going to be there next
11 year. Some people are going to die, some people are
12 going to be born. Just part of life.

13 CHAIRMAN CLARK: Mr. McLean, do you have
14 anything else you want to ask Mr. Seidman or the panel?

15 MR. McLEAN: No, ma'am. Thank you.

16 CHAIRMAN CLARK: Thank you, Mr. Seidman.

17 MR. SEIDMAN: Excuse me. Commissioner, before
18 you leave, could I clarify something with regard to a
19 question Mr. McLean asked --

20 COMMISSIONER CLARK: Go ahead.

21 MR. SEIDMAN: -- Mr. Moore earlier about
22 utility? I think this is right. A utility, a
23 hypothetical utility, that had 50 percent used and
24 useful, but had no growth, I believe, and what would
25 happen. The rules didn't -- I think he speculated that

1 the rules didn't address that type of situation because
2 we would have to give them a five-year margin reserve
3 anyway. Is that the right premise, Mr. McLean?

4 MR. McLEAN: No. Actually, I was wondering
5 how a 100 percent used and useful utility that is
6 experiencing growth can cope with that growth in the
7 absence of an allowance for a margin reserve.

8 MR. SEIDMAN: I think I've already addressed
9 that. That's not the question I'm talking about. It's
10 the one you asked Mr. Moore about a 50 percent used and
11 useful utility that had no growth.

12 CHAIRMAN CLARK: The question you asked
13 Mr. Moore.

14 MR. McLEAN: I'm not sure I recall it. I'll
15 have to think about it.

16 MR. SEIDMAN: Well, let me recall it then to
17 the best of my ability. You gave him a hypothetical
18 that was there was a utility that was 50 percent used
19 and useful and had no further growth, and you thought
20 that the rule that was proposed didn't address that,
21 that he would end up with a margin reserve anyway, even
22 though there was no growth. There is a formula in the
23 proposed rules, both our proposal and the Staff
24 proposal, that figures margin reserve on the basis of a
25 multiple of the annual growth rate, times the margin

1 reserve period, times the demand per ERC. If there is
2 no growth, there will be no margin reserve. That's
3 pretty conservative. It's less than I would want to
4 give a utility, because I think they need a margin
5 reserve regardless. But nevertheless, I think the rule
6 as proposed by either us or the Staff takes care of that
7 situation. I just wanted to make that clear.

8 CHAIRMAN CLARK: Do you have any follow-up?

9 MR. McLEAN: Well, a slight problem. My point
10 was that the hypothetical utility of which I spoke --

11 MR. FEIL: If I could help you, Mr. McLean.
12 As I recall your question, was if a utility is at a 50
13 percent used and useful on a flow base, what does the
14 margin reserve period have to do with that particular
15 utility where the lines are in the ground, the treatment
16 plant is there, what does the planning, permitting,
17 construction horizon have to do with that utility,
18 something along those lines.

19 MR. McLEAN: That's fair, Matt. It's probably
20 more scientific than I would have been. The point is,
21 what does that planning horizon tell us and tell you,
22 the commissioners, when you're trying to decide what
23 portion of an existing plant is used and useful when it
24 is relatively certain that that plant will not need
25 expanding during the foreseeable future? If Mr. Seidman

1 cares to respond, fine.

2 MR. SEIDMAN: Are we talking about margin
3 reserve --

4 MR. McLEAN: Yes.

5 MR. SEIDMAN: -- or existing plant?

6 CHAIRMAN CLARK: I thought you said it was
7 with respect to used and useful.

8 MR. McLEAN: Maybe I misspoke. The question
9 is: A utility, which has existing excess capacity, if
10 we can all agree that there were such a utility, who is
11 not going to need its capacity expanded for a number of
12 years in the future, consider that utility, and then
13 consider the argument that a utility's margin of reserve
14 must be tailored to meet planning horizons, and such as
15 that, for construction periods, it takes five years to
16 build a plant.

17 MR. SEIDMAN: Right.

18 MR. McLEAN: What does that body of evidence
19 tell us about what increment of margin reserve is
20 appropriate to the plant which doesn't need expanding,
21 which doesn't need planning?

22 MR. SEIDMAN: The rule would make the margin
23 reserve come out to zero.

24 MR. McLEAN: Where there's no growth?

25 MR. SEIDMAN: That's a situation you just told

1 me, they didn't need any further capacity. I assume
2 that was because of no growth.

3 MR. McLEAN: Where there is growth, what does
4 the planning horizon tell us? There is 50 percent of
5 the plant --

6 MR. SEIDMAN: Oh, if there is growth, then the
7 planning horizon tells us that they will -- with regard
8 to this rule, that they will get -- they will be allowed
9 to earn on a margin reserve that is compatible with
10 their growth rate. They will have nonused plant above
11 and beyond that.

12 MR. McLEAN: But the margin reserve is to go
13 five years into the future, based upon testimony that
14 we've heard that it takes five years to plan and build a
15 plant. But they don't need to plan and build a plant.
16 It's already there.

17 MR. SEIDMAN: They built the plant already
18 based on the forecasts they had at the time. I'm
19 entitled to protect that margin reserve up until the
20 time that the customers come on. But it's going to be a
21 shrinking margin reserve, because if the growth rate is
22 lower than it was when that plant came on, it's going to
23 be less.

24 MR. CROUCH: Commissioners, I think I can
25 clarify Mr. McLean's concern on that. The Guidelines

1 for Preparation of the Capacity Analysis Report -- this
2 is put out by Department of Environmental Protection.
3 That states that when they're at a certain percentage --
4 if they're only at 50 percent, they don't have to start
5 building a new plant yet. It says when they reach a
6 higher percentage, it gives them guidelines at 60
7 percent, 70 percent, 80 percent, and tells them what
8 they need to do. If they're only at 50 percent, it says
9 you ought to be considering what you might need at some
10 time in the future. It doesn't mean, go out and spend a
11 lot of money and or need a margin reserve. But the
12 Capacity Analysis Report of DEP specifies at what point
13 they have to start planning, permitting and constructing
14 new plant. And at 50 percent they would not.

15 MR. McLEAN: You have my point precisely. So
16 if they don't have to, then why would you tailor the
17 size of the increment, the used and use -- sorry, the
18 margin reserve, why would you tailor that according to
19 evidence which the Commission receives today concerning
20 construction, when construction isn't even an element in
21 that? And according to your testimony, isn't that a
22 rather more typical situation than the expanding
23 utility?

24 MR. SEIDMAN: If the plant is already
25 constructed, of course we don't need to construct it.

1 But the plant that was constructed ahead of time has a
2 portion of its capacity built in for the purposes of
3 margin reserve. I'm not going to take it away. The
4 other side of the coin is they should not have built
5 anything, waited until they were up to 100 percent and
6 then go ahead and start building.

7 MR. McLEAN: Well, what you wind up with then
8 is a plant which is built -- for example, Sunny Hills,
9 which admittedly is the extreme. I think the plant was
10 constructed perhaps in the late seventies or early
11 eighties. It was constructed according to the DER
12 regulations which were in place at that time, according
13 to the lead time which is appropriate to those days and
14 times. Why then would you tailor the margin of reserve
15 to be allowed today according to the construction
16 horizon that DER has told us about?

17 MR. SEIDMAN: Because if the plant that was in
18 place had been built just sufficient to serve the
19 customers that were there and the growth that was going
20 on, the total amount would come out the same, because
21 you've knocked out the rest as nonused plant.

22 MR. McLEAN: I think we have -- I think we
23 have the issue defined well enough as it is.

24 CHAIRMAN CLARK: Okay, any other questions for
25 the Waterworks' panel?

1 We'll come back to -- we'll remember to come
2 back to your question -- I mean John's question with
3 respect to the rate impact.

4 (Transcript continues in sequence in
5 Volume 2.)

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