BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

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

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APPEARANCES:

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

ALSO PRESENT:
JIM MOORE, President, Florida Waterworks Association.
FRANK SEIDMAN, Management & Regulatory Consultants, Inc.
DEBORAH D. SWAIN, Milian, Swain & Associates
ARSENIO MILIAN, Milian, Swain & Associates

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

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

ALSO PRESENT:
HUGH GOWER
JOHN GUASTELLA, President - Guastella Associates, Inc.

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

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

ALSO PRESENT:
SAM GATLIN, Office of the Public Counsel.

APPEARANCES: (Continued)

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

ALSO PRESENT:
JAY YINGLING, Senior Economist, Southwest Florida Water Management District.

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

ALSO PRESENT:
JOHN WEHLE, Assistant Executive Director, St. Johns Water Management District.

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

ALSO PRESENT:
VAN HOOFNAGLE, P.E., Administrator - Drinking Water Section Department of Environmental Protection.

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

ALSO PRESENT:
N. D. WALKER, FPSC
ROBERT CROUCH, FPSC
JOHN WILLIAMS, FPSC
JOHN STARLING, FPSC
CRAIG HEWITT, FPSC
GREG SHAFER, FPSC

EXHIBITS

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

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 tomorrow.

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

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

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

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

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

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

CHAIRMAN CLARK: Okay.

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

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

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

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

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

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

CHAIRMAN CLARK: Thank you.

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

MS. MOORE: Staff who are here are

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

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

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

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

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

MS. MOORE: That's correct.

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

(Composite Exhibit No. 1 marked for identification.)

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

CHAIRMAN CLARK: Is it this document?

MS. MOORE: That's correct.

CHAIRMAN CLARK: We'll go ahead and mark this as Exhibit 2.

(Exhibit No. 2 marked for identification.)

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

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

MS. MOORE: Thank you.

(Exhibit No. 3 marked for identification.)

CHAIRMAN CLARK: Mr. Williams?

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

In response to these arguments, the Commission has consistently adhered to the practice of allowing a provision for margin reserve, generally using 18 months, allowing an 18-month growth margin in the used and useful calculation. The Commission has likewise adhered to the practice of imputing CIAC on the margin reserve.

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

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

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

The proposed rule that we're considering today is that the Commission should enact rules that codify existing policy. While these rules do not enjoy universal support on the part of the Commission Staff, we recommended adopting the rules that reflect the current Commission policy because it was the most expedient way to get the matter before the Commission and to have the rulemaking hearing today.

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

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

In some respects their testimony reflects a significant departure from the Commission's current policy. These individuals and other Staff members will be present throughout the hearing to offer any testimony or to respond to questions.

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

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

Many hours have been spent on contentious proceedings and testimony with no rule in place. The adoption of a rule with a specified margin reserve and margin reserve period should help decrease the length and cost of the related proceedings. Therefore the proposed rule should have minimal increased regulatory costs over the current no-rule situation.

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

MS. MOORE: That's correct.

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

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

CHAIRMAN CLARK: Go ahead.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

CHAIRMAN CLARK: And you called them cross cutters?

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

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

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

COMMISSIONER JOHNSON: For the next five years.

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

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

MR. HOOFNAGLE: Yes.

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

MR. HOOFNAGLE: That's correct.

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

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

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

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

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

MR. HOOFNAGLE: Yes, the legislature is --

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

COMMISSIONER JOHNSON: Okay. Thank you.

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

As in the wastewater, we would be looking at a 20-year planning horizon and employing a present worth analysis or cost-effectiveness analysis before we could award a loan fund for a project. It is incumbent upon the Department only to give out the taxpayers' money, in this particular case, to projects which are cost-effective over the life of the facilities.

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

I think the bottom line is our concern is that utilities that feel that because of the margin reserve issue only come in for staging of facilities for 18 months, or two years, or even three years, will not be eligible for an SRF loan under our program, because invariably they will fail the cost-effectiveness analysis for staging of those alternatives. It's sort of obvious when you look at a facility that decides on ten-year staging, therefore in a 20-year period, they do construction twice. At 18 months they would do construction about 14 times. And the cost-effectiveness of -- involved with the mobilization and expanding of plant 14 times, or even ten times, or even seven times, in a planning period would not be cost-effective by our criteria.

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

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

COMMISSIONER KIESLING: You want me to start?

CHAIRMAN CLARK: Sure.

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

MR. HOOFNAGLE: Yes, we have reviewed the guidance and actually made comments last month to EPA on the guidance. We did point out our fears that the wastewater program, and everything that you have to go through to access that money, including some of the environmental cross cutters, was very burdensome, and we were concerned about small systems being able to meet those planning requirements.

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

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

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

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

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

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

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

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

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

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

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

MR. HOOFNAGLE: We'll be breaking new ground, but there are also 49 other states that face the same dilemma, and we will be interfacing with them, as well as federal guidance on how they do this. And they may not do it, or you may not do it in your program, or we may not have done it in wastewater, but certainly all the federal programs out there regarding assistance, I'm sure there's a multitude of experience that we can draw on. We'll see.

COMMISSIONER KIESLING: Okay. Thank you.

CHAIRMAN CLARK: Commissioners, other questions?

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

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

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

MR. HOOFNAGLE: That's correct.

MR. McLEAN: And I don't mean to be overly simplistic, but that's part of it. And the functions of this agency here is to decide, with respect to investor-owned water and sewer utilities, water and wastewater utilities, who pays for those things. Would you accept that?

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

MR. McLEAN: Sure.

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

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

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

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

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

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

MR. HOOFNAGLE: No, I do not.

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

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

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

MR. HOOFNAGLE: That's correct.

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

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

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

MR. HOOFNAGLE: Excuse me, reuse?

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

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

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

MR. McLEAN: I understand.

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

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

No further questions. Thank you.

CHAIRMAN DEASON: Mr. Schiefelbein?

MR. SCHIEFELBEIN: Madam Chairman, I don't know if you would believe this to be useful or not, but this witness, other than talking about the SRF comment, has not, to my knowledge, talked at all about the comments that the Department has filed in this docket. And I would actually -- perhaps it's a little out of order, but I would think it might be useful for all of us to hear a summary from Mr. Hoofnagle as to what the Department's position is in this rulemaking. I can pull that out through questioning, but I --

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

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

CHAIRMAN CLARK: Okay.

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

MR. SCHIEFELBEIN: I thought it beared being said.

Mr. Hoofnagle, good morning.

MR. HOOFNAGLE: Good morning.

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

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

MR. SCHIEFELBEIN: Ultimately.

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

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

MR. HOOFNAGLE: In water or wastewater?

MR. SCHIEFELBEIN: Let's start with water.

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

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

MR. HOOFNAGLE: No.

MR. SCHIEFELBEIN: Is there a --

MR. HOOFNAGLE: Excuse me.

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

MR. HOOFNAGLE: That's correct.

MR. SCHIEFELBEIN: Why is that?

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

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

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

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

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

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

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

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

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

MR. SCHIEFELBEIN: Thank you.

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

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

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

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

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

MR. HOOFNAGLE: Yes, that's correct.

MR. ARMSTRONG: And I guess just the culmination of your testimony is that under current consideration, DEP would not allow IOUs to be eligible for funding under this state revolving fund program. If an IOU goes to DEP, an investor-owned utility, and says, we need funding for this program, here's what we plan to build, and it's going to build for an incremental capacity to cover 18 months.

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

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

MR. HOOFNAGLE: 18 months.

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

MR. HOOFNAGLE: Eighteen months?

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

MR. HOOFNAGLE: I was saying if the utility were to come in and say we plan on expanding our plant every 18 months over a 20-year horizon, they would be talking about the construction of 14 expansions, which is a little absurd. But in any event, that obviously would not be cost-effective to a two- or three-expansion alternative.

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

CHAIRMAN CLARK: Anyone else have questions?

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

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

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

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

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

Mr. Schiefelbein, this is a rulemaking

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

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

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

MR. SCHIEFELBEIN: Thank you.

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

MR. WILKENING: Madam Chairman --

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

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

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

MR. WILKENING: Sure.

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

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

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

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

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

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

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

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

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

Just as important, the Commission needs to stop imputing CIAC against the margin reserve. Not only is it wrong as a period matching accounting procedure, but it makes it impossible for a utility to ever recover the cost of its investment necessary to meet its obligations and as the result attract the debt and equity necessary to fund the required plant and necessary investment in plant and equipment.

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

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

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

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

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

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

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

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

MR. McLEAN: Yes, sir, I have a question or two. Let us think about a hypothetical utility which is 50 percent used and useful. And we could agree that it was 50 percent used and useful, perhaps. But in my hypothetical it's 50 percent used and useful. The growth which it anticipates in the next five years will not take it to any point where it is in danger, in any way, of having enough capacity to go around. In other words, a somewhat -- I don't want to say stagnant, but a utility sitting there 50 percent used and useful, growth isn't going to get him in trouble anytime soon. The rule which the FWA sponsors, and the one which I take it you strongly support, wouldn't it permit a margin reserve -- let me ask the question differently. What do these observations you make about growth and planning have to do with that utility? Do they help the Commission decide whether that utility should have a margin reserve, and if so, to what size it should be?

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

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

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

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

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

MR. McLEAN: I'm sorry. I'll ask it shorter. Take a hypothetical, 50 percent used and useful utility. Its growth rate is such, its experienced growth rate is such that it will not reach 100 percent used and useful, even for the next five years. You have that? Are you with me so far?

MR. MOORE: I am.

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

MR. MOORE: Absolutely.

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

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

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

MR. McLEAN: So while this utility is not going to be built out for the foreseeable future, there is no need to plan additional capacity. Why -- how can the Commission rely on the arguments and the point of view which you just heard from the DEP to help it determine whether that 50 percent used and useful utility should have a margin reserve?

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

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

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

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

MR. ARMSTRONG: Madam Chair, could I just make some comment? This is a rulemaking, I guess. I think one of the difficulties is Mr. McLean's questions are presupposing the existence of a plant. Now one of the determinations made when you're building plant or when you have built plant, what were the facts and circumstances that existed at the time you built that plant? Given reasonable assumptions, was it prudent for the utility to build that plant at that level? That that's the first thing you have to look at.

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

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

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

It comes down to then we often hear the

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

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

Customers now -- and the reason we're in so often for rates cases is because we're dealing with this 18-month margin reserve period. The studies have to be reviewed, and if there's questions for the studies, or questions of the validity of those studies regarding the fact that the way we are treated right now with 18-month margin reserve and CIAC imputation, it's impossible for investor-owned utilities to earn their authorized rate of return.

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

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

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

MR. McLEAN: Although we probably should hear more from the experts than from Mr. Armstrong and I. But, my point is a very narrow one. If you're trying to determine the used and useful of Sunny Hills over here in the Panhandle, all this talk about the utilities who are planning and following the DER rules is pretty much useless, because the capacity is already there, and it's your job to decide how much of that capacity should be paid for by today's customers.

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

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

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

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

CHAIRMAN CLARK: Exactly.

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

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

MR. McLEAN: You're going to have a lot of testimony that says it's of use to today's customers and of use to tomorrow's customers, but you'll hear not a word on allocating the cost of that endeavor or the investment to today's customers and some to tomorrow's customers.

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

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

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

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

MR. SCHIEFELBEIN: I'm waiting.

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

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

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

CHAIRMAN CLARK: I don't want this to get into a debate over what the case said. You'll have an opportunity to respond to that. I'll let you briefly cover it, and then I'm going to move on.

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

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

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

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

MR. SCHIEFELBEIN: Into the evening as needed then?

CHAIRMAN CLARK: Right.

MR. SCHIEFELBEIN: Great. My preference on this, as far as the FWA's presentation, is as follows. We've had sort of a keynote address from Mr. Moore. I would like Mr. Seidman, Mr. Milian and Ms. Swain, in that order, to make individual presentations that are somewhat concise, and then I would like them to hopefully engage in a dialogue with you all, and whomever else wishes to join in, as a panel.

CHAIRMAN CLARK: That would be fine.

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

CHAIRMAN CLARK: Staff did go first.

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

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

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

Staff, or --

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

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

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

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

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

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

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

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

MR. SCHIEFELBEIN: May we give our presentation?

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

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

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

MR. SCHIEFELBEIN: Yes. All right. We will start with Mr. Frank Seidman. I would ask, Commissioners, that you indulge us, since we may -- our only opportunity to provide responsive comments may be now as well, so I would think we will be covering those as well in our individual and panel presentations.

Mr. Seidman.

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

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

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

COMMISSIONER KIESLING: That would be a good idea.

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

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

CHAIRMAN CLARK: You need to put it where

Ms. Swain is and just at that angle.

MR. SCHIEFELBEIN: Follows direction poorly. Sorry.

CHAIRMAN CLARK: How is that?

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

CHAIRMAN CLARK: Go ahead, Mr. Seidman.

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

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

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

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

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

These are facets of the law that form the basis for a rule. Because in order for a utility to be able to meet the obligations under the law, utilities must have sufficient capacity to protect public health, safety and welfare, be ready to serve, and the Commission should adopt a rule that allows recovery of the costs associated with meeting those requirements. So with the requirements of the law as a basis, we believe that any adopted rule should recognize, one, that the law obligates the utility to provide service; that it should recognize that Commission policies must be consistent with the Department of Environmental Protection statutory and regulatory requirements, for safety -- for safety, adequacy and planning; and that in order for utility to be able to meet its statutory obligations in an economic manner, the Commission must fix rates that are just, reasonable and compensatory, and not unfairly discriminatory.

It's the position of the Association that the current Commission policy and the proposed rule do not reflect the requirements of Chapter 367 or recognize the facts as I've outlined. The Association believes that the proposed rule would codify policies that are inconsistent with the statutory mandates and with the rules of the DEP; that they're inconsistent with reasonable and proper operation of the utilities in the public interest; that they unfairly discriminate in their application to water and wastewater utilities; and that they discourage the development of utility systems in an economic manner and encourage choices that have long-term detrimental impacts on utility customers.

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

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

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

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

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

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

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

Finally, good engineering design will give a growing utility a sufficient capacity over and above actual demand, to act as a cushion for maximum daily flow requirements and normal growth over a reasonable period of time. So all we're looking for in a rule is margin reserve that reflects these concepts already espoused by the Commission: Good engineering design, a cushion over and above actual demand, and sufficient capacity to serve during the course of the prudent operation of the utility's business.

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

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

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

That the margin reserve period be defined as the period during which current capacity is required to be available until the next economic addition that capacity can be placed in service without causing a deterioration of the quality of that service.

Along with these definitions, the Association proposes the following default margin reserve periods. Go to the next chart please.

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

Why do we pick five years? We believe that five years is a proper default period for margin reserve for two important reasons. First, it supports and is consistent with the planning, design and construction period in the regulation of DEP. The utilities must plan a design and construct to meet their approval. The utility should be able to expect that they can recover the cost of an investment necessary to gain DEP approval, and that they should not be caught between two agencies.

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

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

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

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

MR. SEIDMAN: On-site facilities are those that serve specific streets, just specifically customers on those streets. Off-site facilities would serve the system in general. In other words, they would have a -- there would be a design requirement for those facilities to be able to serve not only the neighborhoods they're in, but larger sections, quadrants, or whatever, of the of the system.

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

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

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

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

CHAIRMAN CLARK: Okay, thanks.

MR. SEIDMAN: I would like you to take a look at how the margin reserve periods for water and wastewater compare to those of electric utilities when they're measured in the consistent terms of multiples of annual growth. And I know you're familiar with the reserve margin policies for electric utilities, and they're basically determined on a reliability requirement basis. But those reserves, once they have been established, can be -- can be measured in terms of annual growth by taking the amount of that reserve and dividing it by the annual growth of each utility.

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

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

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

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

MR. SEIDMAN: Into the periods going forward?

CHAIRMAN CLARK: Right.

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

CHAIRMAN CLARK: Okay.

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

I would like to just briefly turn to the used and useful treatment of reuse facilities. The Association takes the position that the prudently incurred cost of studies and facilities, for purposes of reusing reclaimed water that meet the requirements of Chapter 403 of the statutes, shall be considered 100 percent used and useful, and that there is no authority in the statute for the Commission to apply the used and useful analysis to these facilities.

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

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

Imputation defeats the purpose of margin reserve because whereas an allowance for margin reserve provides a utility the ability to recover the costs of used and useful investment, and encourages investments with long-run economic benefits, imputation negates the allowance and the encouragement. And the imputation policy is confiscatory because it denies the utility the ability to ever earn a return on its investment in plant used and useful in the public interest.

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

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

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

MR. SEIDMAN: Yes -- Mr. Milian.

CHAIRMAN CLARK: Okay, go ahead.

MR. MILIAN: Good morning, Commissioners.

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

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

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

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

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

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

In my current capacity as the president of

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

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

As part of the study that we did to determine these environmental regulations, how they are affecting the construction and the planning and the timing which they are taking, and also how the economic regulations and regulatory practices and policies of the Commission at the present time discourage in many times the economies of scales and the prudency of investment. These, actually, we have seen, and by talking to a lot of utilities in our surveys, how they are ultimately penalized. And I think the penalties are not only for the future -- to the present customers, also to the future customers. I hope during our discussions today we may provide some examples to that effect.

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

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

These, of course, have resulted in the evolution of more restrictive regulation requiring more interaction of the multiple regulatory agencies, including the DEP, the Environmental Protection Agency, the South Florida Water Management District, the Corps of Engineers, and even, on many occasions, when you receive all those permits -- and I can discuss about one in particular, where we had gone through the process for more than three years in obtaining all these permits from these different regulatory agencies, we had to go and request from the county an usual use permit, and they required to have all of these permits before they even consider it. They actually denied it, and the utility had to start from scratch all over again. That is a time lag and there is expenses that are scheduled with that.

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

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

we were able to even start doing any construction.

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

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

Discussions this morning were talking about the SRF and availability of funds. I think there's something -- a very measurable consideration that you should take. Some utilities cannot have -- cannot go to financial institutions and expect them to be lending money without having any idea of whether those AFPI charges or revenues are going to be coming in to pay for it, contrary to what municipalities do, where the existing customers pay for the bonds necessary to be expanding these facilities, before you get, you know, the expansion of the facilities.

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

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

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

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

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

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

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

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

MR. MILIAN: I'm sorry?

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

MR. MILIAN: Yes.

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

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

MR. MILIAN: Well, my understanding was that the intent of the expansion to the three years was just to cover the time of construction. And what I'm trying to -- at least to convey to you, is that before you do any construction, there's a lot of investment that the utilities will have to make into the permitting process and the financing of the facilities.

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

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

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

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

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

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

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

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

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

COMMISSIONER GARCIA: How do you address the burdens, though, that you place on the existing customers?

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

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

I would like to, for instance, give you an anecdote or an example. A number of years ago, while I was the president of a utility company, we were -- we went into a rate case that actually disallowed, or had excess used and useful plant, or they considered nonused and useful. And so we finally -- it took about two or three years and we finally settled the case. That same year, or six months later, we had at the most extended drought in the State of Florida, where more than a 200-year type of drought. The demands on the system of those existing customers were so high that we could not provide adequate service, and the pressures went below the 20 PSI. And that was exactly less than six months after they had found that we had excess capacity.

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

CHAIRMAN CLARK: Let me ask you another question. You suggest that even ten years is an appropriate planning horizon. And my concern is this: I think we have to balance reasonable planning on the part of the utility with reasonable cost to existing customers. And my concern is when you get to a five- and ten-year plan, is that the thing we know about forecasts is that they're most likely to be wrong. And your anecdote really just illustrates that; that, you know, you don't plan for a 100-year flood. You use your average.

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

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

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

Sunny Hills.

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

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

CHAIRMAN CLARK: I understand.

MR. MILIAN: Just want to make sure.

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

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

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

And in 1990 the Staff did an analysis, or did a survey, and 16 of the 17 utilities that responded said, we're going to build for shorter periods because of the nonused and useful policies of the Commission. So it was something that we were aware of back then and that was indicated to everybody that was going to happen. What happens when you have building for shorter increments, and that's what the studies show conclusively, is that you have higher rates to customers. And they're paying higher rates today -- even though you're applying 18 months, they're paying higher rates today than they would have if 18 months ago we were allowed to have a longer margin reserve period. So what we're requesting is that you don't perpetuate that, where we have to keep on building smaller and coming in and increasing rates to customers, but give us the rate stability that the electric has by giving us appropriate margin reserve periods.

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

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

CHAIRMAN CLARK: Yes.

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

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

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

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

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

In my opinion, I think the Commission would be -- should be encouraging utilities to the reuse of effluent and try to determine that these facilities are 100 percent used and useful, rather than just the opposite. Whenever you're doing adjustments, you can make the utility the opportunity to argue that it's economically unfeasible and they may look for other alternatives besides just the use of these reuse facilities.

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

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

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

MS. SWAIN: Thank you, Commissioners. My name is Debbie Swain. I'm a principal with Milian, Swain & Associates. I was asked by the Florida Waterworks Association some time ago to embark upon what seemed like an endless task. At the beginning, and during it, and now at the end, it seems like an endless task. And that was to try and quantify the financial impact of the various proposed rules.

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

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

And I was able, through some financial

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

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

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

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

CHAIRMAN CLARK: Let me back up.

MS. SWAIN: Sure.

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

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

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

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

CHAIRMAN CLARK: So what is the risk in asking for it?

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

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

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

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

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

CHAIRMAN CLARK: Let me just --

MS. SWAIN: Sure.

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

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

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

MS. SWAIN: That's not what I'm saying. It has not become such an exact science that either the utility or the Staff is capable of keeping track of it in the minute detail that is necessary to completely take advantage of it. It is not possible. It's not just the utilities, it's not the experts, it's not the utility rate managers. It's as much the Staff as well.

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

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

And as a recognition of that risk, there is not a company that I am aware of that has ever been successful in convincing its auditors that it should be able to record revenues related to AFPI on an accrual basis. It's only recorded when the cash is actually in hand, because that risk is recognized, not just by the utility, but also in the accounting and auditing industry.

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

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

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

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

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

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

MS. SWAIN: Okay. In the event that your

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

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

I had a situation several years ago, very, very similar, but with regard to distribution lines in Pine Ridge Utilities. And what we did was rather than having different customers pay different AFPI charges when we applied for that second AFPI, just specifically for new lines, is we came out with a method of averaging. And it seemed to work. And I don't know how growth has been in Pine Ridge, and if they've actually recovered their revenues, but there was a mechanism to do it.

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

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

MS. SWAIN: That's correct.

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

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

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

MS. SWAIN: It does. It does. But what's happening is that, as in the first time you applied for it, you start from zero dollars and you accumulate a small amount each month, or some amount each month, it's cumulative; when you make that second application, it starts back from zero again. Those investment dollars are in there. Those ERCs are still in there, but they start back from zero again. So whereas they may have three years of accumulation prior to the rate case, and still two more years of accumulation for the next two years of ERCs to connect, those next two years of ERCs under the second rate case will start back at zero again. They'll -- the accumulation won't continue.

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

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

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

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

MS. SWAIN: No, that's still held. But for example, in the Southern States case, what I understand is that they had reached a level in their AFPI charges on their five-year chart, where they were recovering nearly $1 million in AFPI, that was their projection. They filed a rate case, and their first year's charges after that new rate case is going to be $100,000. And yet they had still not ever recovered, never collected all those fees that were accumulating. They still had more customers to pay those. And yet it went down to zero again.

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

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

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

MS. SWAIN: No.

COMMISSIONER DEASON: -- one of your

simplified model type examples of how that operates?

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

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

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

AFPI if it's not working?

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

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

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

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

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

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

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

And in the bottom example, it's exactly the same. But in a real live wastewater example, where the five-year increment shows that the -- I calculated the rate as actually lower from the very beginning on a five-year increment on my wastewater example. Again, these are real life examples. These are numbers that were -- have either been presented to you in rate cases so the numbers have been scrutinized. The reason why I chose them is only because they have been presented before. But we find these examples over and over and over again. This is not something atypical.

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

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

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

CHAIRMAN CLARK: First year after the five years?

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

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

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

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

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

CHAIRMAN CLARK: Okay.

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

MR. WALKER: Ms. Swain?

MS. SWAIN: Yes.

MR. WALKER: May I inquire? This is -- I'm N. D. Walker. I'm with the Staff. And I know we've talked about some of the concepts that went into your models, and we discussed them on the phone, and you've prepared some new information that indicates that certain things like the return on construction and --

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

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

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

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

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

MR. WALKER: I wouldn't want to.

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

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

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

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

In addition to having a benefit in customer rates, if you look at what I have found as the net present value of the revenue requirement, in the wastewater treatment plant, which there was a -- that was the example where there was a benefit immediately of having constructed the larger sized plant, the net present value of revenues is a -- revenue requirements is lower also for the entire 25-year period that I projected.

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

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

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

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

The next thing that I did --

COMMISSIONER DEASON: Are you leaving that now?

MS. SWAIN: Yes.

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

MS. SWAIN: That is really just a function of the construction cost and the number of ERCs that are served. The construction cost is only a little bit more, and yet a lot more customers are served than there's going to be a difference in the service availability. And then again, that affects -- you see that on a net present value. You realize the customers have to pay that up front. So we wanted to see what the impact is of having to pay that up front as opposed to recovering it through rates over time.

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

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

COMMISSIONER DEASON: Oh, at the time of connection.

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

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

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

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

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

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

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

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

MS. SWAIN: The depreciation is different, as a direct function of that.

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

MS. SWAIN: Right.

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

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

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

For the purpose of comparison, there's -- one of the things I wanted to find out, obviously, was the return impact using these identical models, what the return to the utility was. And the reason why you're getting some new schedules -- those are different than are in my report -- is I did have some conversations with Mr. Walker, and we talked about some of the theories in the report. And there were two that he pointed out that I felt merited changes in the report. One was very minor, and that was, I'm comparing -- I'm calculating my earnings return on investment, and investment I showed as year end that I've changed that to average. So it matches more closely to rate base. And that had a minor impact.

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

The only way it may ever earn its full rate of return is if I have in the -- as I do in the model, that it's a perfect world and there's no regulatory lag, but also that I build in five-year increments and get every penny of that in margin reserve. In that event you will get very close to earning a full return. And my DS-5, which I just handed to you, shows -- the dark black bar in the back is my weighted average cost of capital, which I have identical in all the models, of 10.75 percent. My average actual return is the lighter colored bar that's right in front of it. And then the white line in front is the actual return on my investment.

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

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

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

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

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

I went out in my study and did a comparison of

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

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

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

CHAIRMAN CLARK: Commissioners, questions?

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

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

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

In the event that the margin reserve period is -- or build-out is achieved in just a couple years, and the CIAC in two years from now has been collected, and if it were that factor alone to cause the utility to overearn, then you have the capability, and the Staff reviews the annual reports all the time, that they -- you have the capability of determining whether there's overearning.

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

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

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

MS. SWAIN: There is going to be future plant. But the bottom line is, today I already had to make my investment for the next several years worth of customers. And today when you're imposing -- or allowing me rates, I should be able to recover that investment if it covers the customers to be connected in a reasonable time that we're calling margin reserve. And I would not impute CIAC. We're talking about here a rule that is a default in the absence of something extraordinary or unusual. And that may be one of those cases that you find extraordinary or unusual that needs separate consideration. But my opinion is that it's still appropriate to not impute CIAC, but you may consider it in that example.

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

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

CHAIRMAN CLARK: Give us your name, please.

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

There are a few cases around of declining rate base. And if such a company were before the Commission in a rate case, the question is, is the Commission justified in short changing that Company's return today because of the possibility that it might overearn in the future, for whatever reason? And as I understand the ratemaking procedures, and all the key cases throughout history, the answer is no.

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

MR. GOWER: No, sir.

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

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

MR. McLEAN: Sure.

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

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

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

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

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

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

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

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

MR. McLEAN: To existing customers?

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

MR. McLEAN: No, and I'm not suggesting that they did that. I'm suggesting that neither Tampa, FP&L or FPC -- I'm suggesting to you that none of their most recent additions to their capacity is today in rate base. And if that be true, doesn't that -- does that in any way, you think, impeach your argument that the water and sewer utility industry should be like that industry; and say further to the Commission that when we make investment in capacity which is going to be required by tomorrow's customers, we should earn a return on it from today's customers?

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

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

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

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

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

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

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

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

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

Go ahead, Mr. McLean.

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

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

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

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

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

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

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

Financing of CWIP is not included in the rate base for investor-owned utilities. To some extent, when requested, it may be included with electrics, and is included in water and -- municipal water and sewer. The reason why it's included in municipal water and sewer is because they have to have adequate cash flow today to obtain the financing that they need for their future construction. So for current customers, they recover not only the plant necessary to serve current customers, but also all plant currently on line and also their projected plant expansions for the next several years.

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

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

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

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

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

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

MS. SWAIN: Sure.

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

MS. SWAIN: That is absolutely right.

MR. McLEAN: Now, focusing on the changing needs of existing customers, how does a built-out utility, 100 percent used and useful, with no margin reserve, cope with those changing needs? Or to ask the question differently --

CHAIRMAN CLARK: Give her a chance to answer.

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

MS. SWAIN: Repeat the question, for me.

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

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

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

MR. McLEAN: Let me ask the question a little bit more clearly. Both the Staff and the Commission say to a built-out utility, 100 percent used and useful, no margin reserve. Don't built-out, 100 percent used and useful utilities have a present obligation to serve the changing demands of existing customers within a reasonable time?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

CHAIRMAN CLARK: Okay.

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

MR. CROUCH: If they are 100 percent used and useful and not built-out, this is where DEP's rule comes in, and they better be planning on additional expansion.

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

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

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

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

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

COMMISSIONER CLARK: Whatever.

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

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

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

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

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

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

MR. McLEAN: Yes, sir.

MR. CROUCH: And built out?

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

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

MR. McLEAN: Right.

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

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

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

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

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

CHAIRMAN CLARK: Thank you, Mr. McLean.

MR. SEIDMAN: Could I ask a clarifying question?

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

MS. SWAIN: Yes, I have.

CHAIRMAN CLARK: Okay.

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

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

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

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

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

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

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

COMMISSIONER CLARK: I understand that. I'm just trying to figure out if you are -- your person will give any presentation.

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

COMMISSIONER CLARK: Okay. Ms. Moore.

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

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

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

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

(Pause)

COMMISSIONER CLARK: Go ahead, Mr. Seidman.

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

He goes on and says that, "A legitimate reserve capacity may in fact be a prudent, wise investment by a utility, but it might not be totally included in the margin reserve period covered by the PSC." And I have the same type of comment here. If it's a prudent and wise investment for the utility, then it seems to me it's because it's used and useful in serving the public. That's what we're looking for. If it's not used and useful, why would we build it? Why would it be a prudent utility investment? I think these are almost oxymorons, these types of statements, and they -- if they're followed, they result in rate setting that does not recognize the prudent investment of utilities serving the public.

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

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

A utility is not in a position to wait for express demand with its customers before it commits to provide service. It is not operating out in the free market. We don't have the choice of saying, well, we'll wait until somebody expresses demand and then after it gets up there a little ways, and people have waited a little while for service, we're going to come in then and go ahead and make our investment. We really have to make it ahead of time with the best information we have available in the forecast to meet that demand.

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

Public Counsel also made comments that margin reserve is not needed to provide a cushion for changing load conditions because averages used to calculate used and useful already take plant fluctuations -- plant load fluctuations into consideration. They certainly may take plant load fluctuations into consideration between the minimum load and the maximum load for the period for which calculation is made. But they don't have anything built into them for meeting things above the maximum load in those fluctuations, whatever the reason for those fluctuations, whether it's new customers, changes in the customer demand from existing customers.

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

MR. SCHIEFELBEIN: Commissioners.

MR. SEIDMAN: That concludes the additional comments.

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

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

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

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

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

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

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

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

My role over the past 20 years has ranged --

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

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

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

First, I guess we need to explain a little bit about our role and responsibility in water supply planning. Not only do we have a regulatory role through the consumptive use permitting process, but we also have a water supply goal to ensure the availability of adequate and affordable supply of water for all reasonable beneficial uses while protecting the water resources of the district or of the state as you put all of this together.

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

In that regard, we are currently undertaking intensive effort to help water users, both public and investor-owned utilities, in our water resource caution areas to develop water supply plans that will be implemented through our consumptive use permitting process. In the CUP process, we strive to find reuse, or the use of the lowest quality water for the purpose intended, unless the applicant demonstrates that it's not technically, economically or environmentally feasible. We also have a recent governor's executive order on water supply planning which emphasizes both of these points.

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

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

When we permit, say, a 10 million gallon a day well field, for example, they are all staged over a certain period of time, but the investment has to be up front in order to do it properly. The problem that we see with the proposed margin reserve period is that when investors are pushed for trying to capitalize this over an 18-month period, we feel that we're getting into a point where kind of like the difference between having a good regional water treatment system -- wastewater treatment system, versus a series of little package plants that come up and may or may not be as effective in the long run, and in fact become more expensive.

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

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

It's almost -- and when you're getting into major water supply development, it almost takes about, well, seven years to get from proposal to getting the permit, then getting into construction. So we're looking at a much longer period of time because we are putting in many more requirements for resource protection in the consumptive use permitting process than we ever have before. And I don't see that lessening. I see that probably becoming even more so in the future, especially in the areas where you have -- have competition for use.

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

There appears to be a lack of consideration for the time involved in the planning and implementing alternative water supply sources and strategies necessary in water management district designated water resource caution areas. We have a specific program on designating those water resource caution areas, and then what is expected from that point. Right now, if you are in a water resource caution area, reuse is expected. It is not something that is an option. It's only an option if the district determines that it is not economically or environmentally feasible. And these are long term, long term projects.

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

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

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

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

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

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

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

We are available to answer questions, and as I said, we do have Staff from St. Johns and from Southwest here to answer your questions. Thank you.

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

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

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

It is important that the PSC, the DEP and the districts be consistent in their regulatory schemes in order to protect the public interest in the environmental -- in the environment and water conservation, and to avoid unnecessarily high rates due to short-term planning.

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

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

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

MR. McLEAN: No questions.

MR. ARMSTRONG: I just have two clarifications.

CHAIRMAN CLARK: Go ahead, Mr. Armstrong.

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

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

CHAIRMAN CLARK: Okay.

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

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

MR. ARMSTRONG: Thank you.

COMMISSIONER KIESLING: I have a couple of questions.

CHAIRMAN CLARK: Go ahead.

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

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

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

MR. WEHLE: Right.

MS. LLOYD: I am not -- I will not profess to be an expert in the PSC statutes and rules, but I recollect that with respect to at least reuse, there is a provision that directs you to act in the public interest. And I think that that is a charge that is consistent among us, and it's with that in mind that hopefully we can find a way to make our programs consistent within the existing statutory framework. There may well be enhancements or changes that we do need, but I think there is some common thread among us to take -- try to best serve the public interest, and hopefully we all have a similar definition in this regard.

COMMISSIONER KIESLING: All right, thank you.

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

COMMISSIONER CLARK: Go ahead, Mr. Schiefelbein.

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

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

However, when Commissioner Kiesling asked the question, I would say if you need clarification to have that done, then legislation may be appropriate. Now I am not also an expert on PSC law. So I couldn't tell you whether it's definite that it would have to be that way, but I would say at least in the interpretation, if it is an interpretation, that we need to get on the same sheet. There was an OPPAGA report that came out just this last several weeks on reuse. And their conclusion was that there was not a legislative fix needed, but probably some rules and policies needed to be changed. And they didn't direct that to any specific agency. They just talked about it in general. At this point I am in the process of reviewing and responding to that report and having my attorneys look into it.

CHAIRMAN CLARK: Anything else, Mr. Schiefelbein?

MR. SCHIEFELBEIN: No, thank you.

COMMISSIONER CLARK: We're going to go ahead -- I want to thank you all for coming and being available. We will go ahead and take a lunch break until quarter till two, and we will come back at that time and we will -- Mr. Swain and Mr. Milian, give you an opportunity to comment on Staff and OPC's comments, and then we'll continue on.

(Recess from 1:15 p.m. until 1:50 p.m.)

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

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

CHAIRMAN CLARK: Ms. Swain?

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

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

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

CHAIRMAN CLARK: Thank you.

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

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

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

MS. SWAIN: That's correct.

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

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

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

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

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

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

MS. SWAIN: Right, absolutely, no. It has nothing in that magnitude. That's correct.

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

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

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

One of the questions I had concerned the -- the allowance for margin reserve in your models. If you could look at your Schedule DS-2 and Page A-9, or what is Schedule 5. And what I would first like to do is ask Ms. Swain, isn't it true that basically all of your models follow the same pattern, they are based upon full recovery of an investment on allowed rate base and a return on the unused plant, full return?

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

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

MS. SWAIN: That's right.

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

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

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

MS. SWAIN: I'm sorry?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Are those government bodies prevented from capitalizing interest during construction?

MS. SWAIN: No.

MR. WALKER: Do they capitalize interest?

MS. SWAIN: Yes.

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

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

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

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

MR. WALKER: Okay, another question. Do

government-owned utilities collect anything like an AFPI charge?

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

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

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

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

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

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

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

MR. SEIDMAN: Or standby fee.

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

MR. WALKER: Okay, I believe two more questions. I believe in your testimony you indicated that the company is going to select the more costly investment alternative, building the smaller incremental plants to maximize its earnings. If we look at your schedule, or your Page 21 for the Wastewater Division, and your revision, doesn't that indicate in the bottom section that the company seems to be more profitable if it builds the larger plant?

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

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

MS. SWAIN: Well, certainly, because in this model I'm getting all my AFPI revenues, because I am predicting my customer growth 100 percent accurately, and I don't have regulatory lag. So as a matter of fact in this model my AFPI is adequate, but in any event, with all that AFPI, the benefit is still to the customers and the utility in building a larger sized plant.

MR. WALKER: Those are all my questions.

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

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

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

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

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

MS. SWAIN: Okay.

MR. WILLIAMS: Thank you.

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

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

MR. SEIDMAN: Are you going to give me your phone number?

MR. McLEAN: Yes, sir. I'm ready to take that deal if it's a serious one.

MR. SEIDMAN: Ready to take what?

MR. McLEAN: I'm ready to take that deal if it's a serious one. Didn't Mr. -- I think Mr. Crouch, in the discussion with Mr. Crouch, we did learn that there are some operating utilities in the state with zero margin reserve; is that right?

MR. SEIDMAN: I don't know that I got the same conclusions you did from the discussion between you and Mr. Crouch.

MR. McLEAN: Well, then let me ask you, do you know whether there are utilities in the state operating with zero margin reserve?

MR. SEIDMAN: There may be utilities operating in the state with zero margin reserve because they're at 100 percent used and useful, and you're not going to add on margin reserve that hasn't been invested in. If they are at 100 percent and they're in a no-growth situation, if they need capacity to meet the requirements of their system, they will add it and it will still be 100 percent and there will be no margin reserve.

MR. McLEAN: But that's not a viable option for the utilities for whom you speak today, right?

MR. SEIDMAN: If they're in a growth situation, they need the margin reserve recognized in the rate.

MR. McLEAN: Do you know whether there are utilities in the state who are in a growth situation who are 100 percent used and useful who do not have a margin reserve?

MR. SEIDMAN: Would you repeat that?

MR. McLEAN: I'll try to. Do you know whether there are utilities in this state, water and sewer investor-owned utilities, that are 100 percent used and useful, who are in a growth situation and to whom no allowance for margin reserve has been made?

MR. SEIDMAN: No, I don't know.

MR. McLEAN: You don't know whether that's true?

MR. SEIDMAN: I don't know if it's true.

MR. McLEAN: In your experience, Mr. Seidman, do 100 percent used and useful utilities, which have been adjudged by this Commission to be used and useful, routinely add customers?

MR. SEIDMAN: I don't know.

MR. McLEAN: Would you be comfortable

testifying to the Commission that that does not happen?

MR. SEIDMAN: That companies that are at 100 percent don't add customers?

MR. McLEAN: Yes, sir.

MR. SEIDMAN: No. I wouldn't be comfortable testifying that they do or don't.

MR. McLEAN: Let's turn to a little bit different matter in your testimony. You said that the -- this is again your responsive testimony. "The OPC wants it to be a one-way arrangement wherein the utility must commit to the investment but speculate as whether it can recover costs." And I want to focus a little bit on that word "speculation." I want to know what is speculative. The utility invests in margin reserve, and in your judgment -- and our position, I'm sorry, is that it should not earn a return on an investment, but that -- but that it should be included in rate base only when customers who need that asset are added to the system. So I want to know why our particular theory of how this should be handled is speculative. I wish you would define for the Commission, if you can, what is the speculative element?

MR. SEIDMAN: The speculative portion would be the AFPI as a source of revenue to pay for plant that's already been placed in service and is considered used and useful.

MR. McLEAN: Why is that speculative? Is the notion that the customers may not materialize?

MR. SEIDMAN: That's right.

MR. McLEAN: Why should the customers take on that speculation?

MR. SEIDMAN: The utility has an obligation under the law to be ready to serve. We don't have a choice in that. We have to make that decision before the customers come, whether or not we think there's going to be growth. We obviously can't be 100 percent right, nobody can. But that doesn't mean that we're not obligated to make the decision. We should do it with the best information we have available and come up with the best forecast we have. If everybody agrees that that was the best information available and was the best forecast we can have, we don't need it, we still have had the obligation to be there. And I think if we had to provide the plant to meet the statutory requirements, we're entitled to a return on it.

MR. McLEAN: Who is in control -- who is in the better position to correctly forecast the future need for assets, the utility or the customers?

MR. SEIDMAN: Doesn't matter whether the

customers or the utility can do it better. The utilities have to do it. That's our responsibility. Just because it's wrong, it doesn't mean it was an imprudent decision or that it wasn't the best forecast with the information available.

MR. McLEAN: Well, it's your testimony that giving credence to those forecasts can be speculative; isn't it?

MR. SEIDMAN: Certainly, because they're based on forecasts.

MR. McLEAN: Okay, so join me for the matter -- join me for the moment in the observation, at least the hypothetical observation, that it does in fact matter who is in the best position to control the forecast, the customers or the utility. And the question recurs: Who is in the best position to ensure the accuracy of the forecast, the customers or the company?

MR. SEIDMAN: The company is in the best position to ensure the accuracy of a forecast to the best of its ability with the information it has at the time it makes the forecast.

MR. McLEAN: And to the extent it does that in a scholarly fashion, it does tend to insulate itself somewhat from that risk, doesn't it?

MR. SEIDMAN: Hopefully so.

MR. McLEAN: Well, what opportunity do customers have to insulate themselves from that risk?

MR. SEIDMAN: They don't, and I don't think it matters. The utility has an obligation to be ready to serve and make that -- meet that obligation by projecting with the best information it has.

MR. McLEAN: In exchange for that obligation, they get to be the only guy on the block, don't they?

MR. SEIDMAN: That's right.

MR. McLEAN: And customers can't go to another utility and say, your forecasts are more accurate, so we'll do business with you, can they?

MR. SEIDMAN: They can't do -- they can move, of course. But I don't expect them to. They're going to have to live with us, if it's our service area, have to live with Florida Power and Light, or Centel, or whatever other utility is serving in their service area if there's no competition. Everybody that's in the utility business has the same problem.

MR. McLEAN: On that point, Mr. Seidman, do you suppose any of them may move within the five-year period for which you would like to include margin reserve in the rate base?

MR. SEIDMAN: Sure.

MR. McLEAN: And when Ms. Swain showed us her work and her projections and her charts and so forth, don't all those pretty much rest upon the assumption that today's customers will be, first of all, in residence, and second of all, perhaps, alive when those benefits comes to fruition?

MR. SEIDMAN: Same process as any other utility.

MR. McLEAN: Exactly. They may well be in another service area.

MR. SEIDMAN: That's right, projected the same way. So hopefully if we keep shifting around, come full circle, someone will leave us and somebody will come in.

MR. McLEAN: And it's your -- so what the Commission is led to believe then by your testimony is that while -- if the Commission includes a margin of reserve in, for example, Southern States, and if the customer dies or moves to another service area within the five years, or seven years, or as high as 20, I think we've heard today, that that customer can look to value received for the value he gave up, or she gave up, to some other utility some time in the future?

MR. SEIDMAN: I didn't think I heard today about the 20-year margin reserve. I heard about a

20-year planning period.

MR. McLEAN: Well, you can cut it back seven if you want to.

MR. SCHIEFELBEIN: Commissioners, are we beyond the point where questions are being asked that are necessary to clarify and understand our position?

CHAIRMAN CLARK: Mr. McLean, are you going to pursue this?

MR. McLEAN: No, ma'am, that's the last question.

MR. SEIDMAN: Okay, repeat it again.

MR. McLEAN: I'm certain that I cannot, but I'll give you a shot.

CHAIRMAN CLARK: Wait a minute, Mr. McLean, do you need to have him answer that question?

MR. McLEAN: I should hope you'd want to hear the answer to it, Commissioner. It stands for the notion that customers whom your rule may require to pay today may never see the benefit. And I think that is of central importance to this inquiry. But if you don't want to hear the answer, no need.

MR. ARMSTRONG: Without reiterating what we've said a number of times, they do see the benefit today, and we went through each one of those benefits in terms of lower costs and availability of capacity, so we don't need to restate.

MR. SEIDMAN: I don't mind answering it.

CHAIRMAN CLARK: Go ahead, Mr. Seidman.

MR. SEIDMAN: We don't -- as utilities, we don't really serve customers on an individual basis. We don't design individual rates for an individual customer on an incremental basis. We designed for the growth in general. We have a 2 or 3 percent growth, net. That usually means that about 97, 98 percent of the people that were there this year are going to be there next year. Some people are going to die, some people are going to be born. Just part of life.

CHAIRMAN CLARK: Mr. McLean, do you have anything else you want to ask Mr. Seidman or the panel?

MR. McLEAN: No, ma'am. Thank you.

CHAIRMAN CLARK: Thank you, Mr. Seidman.

MR. SEIDMAN: Excuse me. Commissioner, before you leave, could I clarify something with regard to a question Mr. McLean asked --

COMMISSIONER CLARK: Go ahead.

MR. SEIDMAN: -- Mr. Moore earlier about utility? I think this is right. A utility, a hypothetical utility, that had 50 percent used and useful, but had no growth, I believe, and what would happen. The rules didn't -- I think he speculated that the rules didn't address that type of situation because we would have to give them a five-year margin reserve anyway. Is that the right premise, Mr. McLean?

MR. McLEAN: No. Actually, I was wondering how a 100 percent used and useful utility that is experiencing growth can cope with that growth in the absence of an allowance for a margin reserve.

MR. SEIDMAN: I think I've already addressed that. That's not the question I'm talking about. It's the one you asked Mr. Moore about a 50 percent used and useful utility that had no growth.

CHAIRMAN CLARK: The question you asked Mr. Moore.

MR. McLEAN: I'm not sure I recall it. I'll have to think about it.

MR. SEIDMAN: Well, let me recall it then to the best of my ability. You gave him a hypothetical that was there was a utility that was 50 percent used and useful and had no further growth, and you thought that the rule that was proposed didn't address that, that he would end up with a margin reserve anyway, even though there was no growth. There is a formula in the proposed rules, both our proposal and the Staff proposal, that figures margin reserve on the basis of a multiple of the annual growth rate, times the margin reserve period, times the demand per ERC. If there is no growth, there will be no margin reserve. That's pretty conservative. It's less than I would want to give a utility, because I think they need a margin reserve regardless. But nevertheless, I think the rule as proposed by either us or the Staff takes care of that situation. I just wanted to make that clear.

CHAIRMAN CLARK: Do you have any follow-up?

MR. McLEAN: Well, a slight problem. My point was that the hypothetical utility of which I spoke --

MR. FEIL: If I could help you, Mr. McLean. As I recall your question, was if a utility is at a 50 percent used and useful on a flow base, what does the margin reserve period have to do with that particular utility where the lines are in the ground, the treatment plant is there, what does the planning, permitting, construction horizon have to do with that utility, something along those lines.

MR. McLEAN: That's fair, Matt. It's probably more scientific than I would have been. The point is, what does that planning horizon tell us and tell you, the commissioners, when you're trying to decide what portion of an existing plant is used and useful when it is relatively certain that that plant will not need expanding during the foreseeable future? If Mr. Seidman cares to respond, fine.

MR. SEIDMAN: Are we talking about margin reserve --

MR. McLEAN: Yes.

MR. SEIDMAN: -- or existing plant?

CHAIRMAN CLARK: I thought you said it was with respect to used and useful.

MR. McLEAN: Maybe I misspoke. The question is: A utility, which has existing excess capacity, if we can all agree that there were such a utility, who is not going to need its capacity expanded for a number of years in the future, consider that utility, and then consider the argument that a utility's margin of reserve must be tailored to meet planning horizons, and such as that, for construction periods, it takes five years to build a plant.

MR. SEIDMAN: Right.

MR. McLEAN: What does that body of evidence tell us about what increment of margin reserve is appropriate to the plant which doesn't need expanding, which doesn't need planning?

MR. SEIDMAN: The rule would make the margin reserve come out to zero.

MR. McLEAN: Where there's no growth?

MR. SEIDMAN: That's a situation you just told me, they didn't need any further capacity. I assume that was because of no growth.

MR. McLEAN: Where there is growth, what does the planning horizon tell us? There is 50 percent of the plant --

MR. SEIDMAN: Oh, if there is growth, then the planning horizon tells us that they will -- with regard to this rule, that they will get -- they will be allowed to earn on a margin reserve that is compatible with their growth rate. They will have nonused plant above and beyond that.

MR. McLEAN: But the margin reserve is to go five years into the future, based upon testimony that we've heard that it takes five years to plan and build a plant. But they don't need to plan and build a plant. It's already there.

MR. SEIDMAN: They built the plant already based on the forecasts they had at the time. I'm entitled to protect that margin reserve up until the time that the customers come on. But it's going to be a shrinking margin reserve, because if the growth rate is lower than it was when that plant came on, it's going to be less.

MR. CROUCH: Commissioners, I think I can clarify Mr. McLean's concern on that. The Guidelines for Preparation of the Capacity Analysis Report -- this is put out by Department of Environmental Protection. That states that when they're at a certain percentage -- if they're only at 50 percent, they don't have to start building a new plant yet. It says when they reach a higher percentage, it gives them guidelines at 60 percent, 70 percent, 80 percent, and tells them what they need to do. If they're only at 50 percent, it says you ought to be considering what you might need at some time in the future. It doesn't mean, go out and spend a lot of money and or need a margin reserve. But the Capacity Analysis Report of DEP specifies at what point they have to start planning, permitting and constructing new plant. And at 50 percent they would not.

MR. McLEAN: You have my point precisely. So if they don't have to, then why would you tailor the size of the increment, the used and use -- sorry, the margin reserve, why would you tailor that according to evidence which the Commission receives today concerning construction, when construction isn't even an element in that? And according to your testimony, isn't that a rather more typical situation than the expanding utility?

MR. SEIDMAN: If the plant is already constructed, of course we don't need to construct it.

But the plant that was constructed ahead of time has a portion of its capacity built in for the purposes of margin reserve. I'm not going to take it away. The other side of the coin is they should not have built anything, waited until they were up to 100 percent and then go ahead and start building.

MR. McLEAN: Well, what you wind up with then is a plant which is built -- for example, Sunny Hills, which admittedly is the extreme. I think the plant was constructed perhaps in the late seventies or early eighties. It was constructed according to the DER regulations which were in place at that time, according to the lead time which is appropriate to those days and times. Why then would you tailor the margin of reserve to be allowed today according to the construction horizon that DER has told us about?

MR. SEIDMAN: Because if the plant that was in place had been built just sufficient to serve the customers that were there and the growth that was going on, the total amount would come out the same, because you've knocked out the rest as nonused plant.

MR. McLEAN: I think we have -- I think we have the issue defined well enough as it is.

CHAIRMAN CLARK: Okay, any other questions for the Waterworks' panel?

We'll come back to -- we'll remember to come back to your question -- I mean John's question with respect to the rate impact.

(Transcript continues in sequence in Volume 2.)