

DOCKET NO.: 991643-SU - Application for increase in wastewater rates in Seven Springs System in Pasco County by Aloha Utilities, Inc.

WITNESS: Supplemental Direct Testimony of Patricia W. Merchant. Appearing On Behalf of Florida Public Service Commission

DATE FILED: October 18, 2000

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1 SUPPLEMENTAL DIRECT TESTIMONY OF PATRICIA W. MERCHANT

2 Q. Please state your name and professional address.

3 A. My name is Patricia W. Merchant and my business address is 2540 Shumard
4 Oak Boulevard, Tallahassee, Florida 32399-0850.

5 Q. Did you previously prepare prefiled direct testimony in this case?

6 A. Yes.

7 Q. What is the purpose of your supplemental direct testimony?

8 A. The purpose of my testimony is to address the utility's requested
9 allowance for a new office building included in the supplemental direct
10 testimony of utility witness Steven Watford.

11 Q. Have you reviewed the utility's request for recovery of the cost of
12 purchasing a new office building?

13 A. To some extent yes. However, given the amount of time that staff had
14 to review the supporting documentation, I cannot support a position on the
15 prudence of the purchase of this building or whether the requested costs
16 represent the most cost effective alternative.

17 Q. Please explain in detail why you cannot take a position at this time.

18 A. The utility's minimum filing requirements for the projected test year
19 ended September 30, 2001, provided no information or costs related to a change
20 in the utility's office location. Further, staff became aware of this change
21 at the end of June, 2000, approximately three months after the official date
22 of filing established in this docket. In the utility's response to Staff's
23 Interrogatory No. 10(a), received by staff on June 30, 2000, the utility
24 stated that Interphase would no longer continue Aloha's current lease for its
25 office building. This response also stated that based upon Aloha's initial

1 search, the cost for similar office space near the utility's service territory
2 would be substantially more expensive than the cost of the space Aloha had
3 been renting from Interphase. Further, Aloha's response stated that the
4 actual cost would be approximately \$100,000 to \$150,000 per year but it did
5 not have any actual amounts at that time. The utility suggested that the
6 Commission should consider this increased cost in this rate case, but it made
7 no formal request for such recovery.

8 Q. Did the utility indicate what properties it was considering at that
9 time?

10 A. Yes, in its response to Staff Interrogatory No. 10(a), Aloha listed
11 several properties that it was considering for either lease or purchase.

12 Q. Did you review any of the properties that were listed in the utility's
13 response to Staff Interrogatory No. 10(a)?

14 A. Yes. This discovery response contained pages that listed several
15 different areas where property was available for either lease or purchase.
16 The first property was in the Center of Seven Springs which is a shopping
17 center in the utility's service territory. It appears that the lease cost for
18 this property was \$9 plus \$2.90 per square foot, triple net. My understanding
19 is that the term triple net means that an allocation of real estate taxes,
20 insurance and maintenance costs are added on top of the lease cost. Without
21 more information, I am guessing that the \$2.90 factor is an estimate of the
22 triple net cost. According to this information submitted for this property,
23 3 contiguous units with a total of 6400 square feet are available for lease.
24 The utility did not state why it did not consider this property as suitable
25 for a utility office. Another property, Rancho del Rio, was listed which

1 reflected a \$12 triple net per square foot cost. The utility also included
2 information regarding the Trinity Oaks Commerce Park site. It appears that
3 this information only listed a price for raw land and it was not clear on this
4 document whether that was the price for the total park or one individual site
5 in the park. Lastly, the utility provided a copy of a diagram of the Costanza
6 Building and a statement that it was on the market for \$800,000. This is the
7 property that is being purchased by Aloha.

8 Q. Did Aloha perform a cost benefit analysis of the different options
9 available to show which option was the most prudent property to either buy or
10 lease?

11 A. No. On October 5, 2000, staff propounded Interrogatory No. 58 and
12 Request for Production of Documents (POD) Request No. 13, to Aloha. In the
13 interrogatory, staff asked whether the utility had "performed any cost benefit
14 analysis to determine whether it should purchase or lease a building." Also,
15 in POD Request No. 13, served on the same date, staff asked that, if Aloha had
16 performed any cost benefit analysis, to provide staff with a copy of this
17 analysis. In an initial response, Aloha's attorney, by letter dated October
18 9, 2000, stated: "No such cost benefit analysis has been performed by the
19 utility in writing." The attorney further stated that any review did not rise
20 "to the level of a 'cost benefit analysis' performed by the utility." Now,
21 however, in formal response to these discovery requests, Aloha states that it
22 has performed an analysis and that such analysis is provided in response to
23 POD Request No. 13. According to POD Request No. 13, the utility states that
24 the analysis was done at the request of the utility's president.

25 Q. What type of analysis did the utility provide in its response to staff's

1 | POD Request No. 13?

2 | A. In its response, received on Monday, October 16, 2000, Aloha compared
3 | its incremental cost of the purchased building to the old lease cost with
4 | Interphase. It also compared the incremental cost of the purchased building
5 | to an average cost to lease comparable space. It did not provide any actual
6 | comparisons of property that were available for lease or purchase. In my
7 | opinion, the utility's response did not provide the information requested by
8 | staff. Further, I do not have a reasonable basis on which to determine
9 | whether the utility made a prudent and cost effective choice in deciding to
10 | buy this building. Further, I am not convinced that all available and
11 | suitable property for lease has been explored or provided to the Commission.

12 | Q. Do you believe that it was prudent for the utility to purchase a
13 | building without performing a cost benefit analysis?

14 | A. No I do not. Staff has not been provided with information that supports
15 | Aloha's decision to purchase this particular building. If Aloha did perform
16 | any such analysis, the results of its analysis or its conclusions reached,
17 | whether written or not, have not been provided through discovery. I believe
18 | that a prudent business owner in the competitive market would perform a cost
19 | benefit analysis to determine whether its decision to lease or purchase a
20 | material piece of property was economical and prudent. Just because Aloha is
21 | a regulated monopoly does not excuse it from performing a prudent and
22 | essential business analysis.

23 | Q. What kind of analysis do you believe should have been done before
24 | purchasing this building?

25 | A. I believe that Aloha should have documented the minimum requirements for

1 | its new office location. Examples of these requirements could have been size,
2 | location, availability, cost and whether the property was available for
3 | purchase or lease. It then should have researched and compiled a list of all
4 | the available properties that fit the minimum criteria established. Aloha
5 | then should have compared each of the alternatives and documented the
6 | advantages and disadvantages of each property. Any that were found
7 | unsatisfactory should have been documented and removed from the list. All of
8 | the attributes of the acceptable locations should have been detailed and
9 | documented so that an appropriate decision could have been made based on these
10 | facts.

11 | Q. Have you found any other areas of concern in your analysis of this
12 | purchased building?

13 | A. Yes. In response to Staff POD Request No. 13, the utility provided its
14 | revised total cost of the building. This discovery response included costs
15 | in excess of those requested in Witness Watford's supplemental direct
16 | testimony.

17 | Q. What are the new costs that Aloha is requesting in its response to Staff
18 | POD Request No. 13?

19 | A. The new costs include \$11,595 for building improvements, \$42,856 for new
20 | furniture, and \$2,000 to relocate its phone system to the new building. In
21 | my opinion, Aloha has not supported these new costs and it appears that costs
22 | are continually being updated as time goes forward.

23 | Q. Do you also have a concern regarding the land included in the purchase
24 | of the building?

25 | A. Yes. In its calculation of the revenue impact of the new office, Aloha

1 | estimated the amount of land purchased with the building. Aloha took the
2 | prior years' property tax assessed value and escalated this amount by 25%.
3 | Aloha did not provide the reason why it used this methodology, nor did it
4 | provide a copy of the prior property tax bill. Given the amount of growth in
5 | the Seven Springs area, I do not believe that this method is a reliable method
6 | for determining the current market value of the land. The land cost should
7 | be based on the appraisal that is required for the financing of the property.
8 | The utility has not submitted the appraisal for this sale. Without a proper
9 | land value, I cannot agree with the utility's calculation of depreciation for
10 | the building. This appraisal would also provide support that the amount the
11 | utility paid for this building was in line with its appraised value.

12 | Q. Have you reviewed Aloha's estimates for maintenance, real estate taxes
13 | and insurance related to its new building?

14 | A. No. I have seen the amounts that Aloha has projected but these amounts
15 | have not been supported. Aloha has only provided the statement that the
16 | amounts requested are estimates from the prior owner.

17 | Q. Do you believe that the Commission should approve the utility's
18 | requested building costs?

19 | A. At this time, no. I believe that there are too many unanswered
20 | questions. This is a major expenditure and the Commission should have the
21 | best information available to make a decision on the prudence of a new office
22 | building. I do, however, recognize that the utility will have increased costs
23 | in the near future due to the current lease being discontinued. Since the
24 | prior lease was a related party transaction, the utility should have been
25 | notified more than 6 months in advance that Interphase was going to

1 | discontinue the lease. Given that Aloha had entered into a 9-month lease only
2 | three months earlier in March, 2000, it should have been notified at that time
3 | that its lease was going to expire in December, 2000. I also question the
4 | prudence of Aloha entering into 2 short-term leases for its office building.
5 | The prior lease term was 15 months. I believe that Aloha had to rush into a
6 | decision to buy or lease a new building for two reasons: to get recovery of
7 | this new cost in this rate case and because it only had 6 months notice that
8 | its lease with Interphase was being discontinued. If Aloha and its related
9 | party had planned this thoroughly, the costs associated with a new office
10 | location could have been contemplated well before this rate case and
11 | incorporated into this filing at the beginning.

12 | Q. Does this complete your testimony?

13 | A. Yes.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase
in wastewater rates in Seven
Springs System in Pasco County
by Aloha Utilities, Inc.

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FILED: October 18, 2000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Supplemental Direct Testimony of Patricia W. Merchant was furnished to **F. Marshall Deterding, Esquire**, Rose, Sundstrom & Bentley, LLP, 2548 Blainstone Pines Drive, Tallahassee, Florida 32301, and **Steve Burgess, Esquire**, Office of Public Counsel, c/o The Florida Legislature, 111 W. Madison Street, Room 812, Tallahassee, Florida 32399-1400, by U.S. Mail, on this 18th day of October, 2000.



RALPH R. JAEGER, ESQUIRE

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