

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of : DOCKET NO. 991643-SU
:
APPLICATION FOR INCREASE IN :
WASTEWATER RATES IN SEVEN :
SPRINGS SYSTEM IN PASCO :
COUNTY BY ALOHA UTILITIES, :
INC. :

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VOLUME 6

Pages 648 through 833

PROCEEDINGS: HEARING

BEFORE: COMMISSIONER E. LEON JACOBS, JR.
COMMISSIONER LILA A. JABER
COMMISSIONER BRAULIO L. BAEZ

DATE: Thursday, November 2, 2000

TIME: Commenced at 8:00 a.m.
Concluded at 4:58 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
Bureau Chief, Bureau of Reporting
Official Commission Reporter



DOCUMENT NUMBER-DATE

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5 behalf of Aloha Utilities, Inc.

6 STEPHEN C. BURGESS, Office of Public
7 Counsel, 111 West Madison Street, Room 812,
8 Tallahassee, Florida 32399-1400, appearing on behalf
9 of the Citizens of the State of Florida.

10 RALPH R. JAEGER and JASON FUDGE, FPSC
11 Division of Legal Services, 2540 Shumard Oak
12 Boulevard, Tallahassee, Florida 32399-0850,
13 appearing on behalf of the Commission Staff.

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1 P R O C E E D I N G S

2 (Transcript continues in sequence from Volume 5.)

3 COMMISSIONER JACOBS: Good morning.

4 MR. JAEGER: Good morning, Commissioner.

5 COMMISSIONER JACOBS: We are here for the
6 continuation of the hearing in Aloha Utilities' Seven
7 Springs wastewater rate proceeding. We don't need to read
8 the notice again do we, Counselor?9 MR. JAEGER: Yes, Commissioner Jacobs. Pursuant
10 to notice issued October 6th, 2000, this time and place
11 was set aside for the continuation of the formal hearing
12 in Docket Number 991643-SU, application for increase in
13 wastewater rates in the Seven Springs Division by Aloha
14 Utilities, Incorporated in Pasco County.

15 COMMISSIONER JACOBS: Take appearances.

16 MR. DETERDING: F. Marshall Deterding and John
17 L. Wharton of Rose Sundstrom and Bentley law firm on
18 behalf of Aloha Utilities.19 COMMISSIONER JACOBS: Steve Burgess here for the
20 Office of Public Counsel representing the citizens of the
21 State of Florida.22 MR. JAEGER: Ralph Jaeger and Jason Fudge here
23 on behalf of the Commission staff.24 COMMISSIONER JACOBS: Very well. As I recall we
25 were about to hear knowledge and expertise from Ms.

1 Merchant. Are there any preliminary matters that we need
2 to deal with?

3 MR. JAEGER: Yes, Commissioner, I have three
4 preliminary matters. First, at the October 2nd hearing,
5 the Commission approved several stipulations. One was
6 known as a category one stipulation, stipulation two. And
7 at that time we didn't have the numbers -- let me read
8 that. Okay, here it is. Stipulation two said, "For the
9 wastewater treatment plant expansion from 1999 to 2000
10 plant-in-service should be reduced by \$122,524, which
11 reflects the appropriate allowance for funds used during
12 construction rate of 9.08 percent." And then the second
13 sentence says, "Corresponding adjustments should also be
14 made to reduce accumulated depreciation and depreciation
15 expense."

16 Well, we now know what -- or we now are agreed
17 on those numbers, so the second sentence should now read,
18 "Corresponding adjustments should also be made to reduce
19 accumulated depreciation by \$8,159 and depreciation
20 expense by \$5,903." And all the parties agree that that
21 tweak should be done to that stipulation two.

22 COMMISSIONER JACOBS: Very well.

23 MR. JAEGER: I just wanted, Commissioners, to
24 approve that modification.

25 COMMISSIONER JACOBS: Have we already approved

1 the other stipulation?

2 MR. JAEGER: You have approved all the
3 stipulations, and this is just a tweaking of that
4 stipulation number two.

5 COMMISSIONER JACOBS: Okay. Commissioners.

6 COMMISSIONER JABER: I can move the modification
7 to stipulation two.

8 COMMISSIONER JACOBS: Without objection, show
9 those amendments to stipulation two approved.

10 MR. JAEGER: The second preliminary matter is
11 all the parties are agreed that Trish Merchant's direct
12 testimony and supplemental direct testimony may be taken
13 up together at this time, and so she will do a brief
14 summary of both her direct testimony, which was on all the
15 issues, and then the supplemental direct with the new
16 building, the cost of the new building and that she would
17 be cross-examined on those at the same time so she
18 wouldn't have to come back at a later time.

19 COMMISSIONER JACOBS: Very well.

20 MR. JAEGER: And the third preliminary matter,
21 we have a -- we wanted to add something to the official
22 recognition list, that is Exhibit 3, and I think Mr. Fudge
23 has passed that out. And do you want -- what is it, a
24 memo dated --

25 MR. FUDGE: It is a memo dated October 26th,

1 2000, asking for official recognition of the monthly
2 operating reports from September 30th, 1999 to September
3 30th, 2000 for the Seven Springs Wastewater Treatment
4 Center.

5 COMMISSIONER JACOBS: I'm sorry, I did not get
6 the beginning of that explanation.

7 MR. FUDGE: It is to ask for official
8 recognition of the monthly operating reports.

9 COMMISSIONER JACOBS: Okay. And you would want
10 that to be identified?

11 MR. FUDGE: We already have Exhibit 3, the
12 official recognition list, and we would just like to add
13 this memo to that list.

14 COMMISSIONER JACOBS: Okay. Without objection,
15 we can amend Exhibit 3 to include this memorandum, and we
16 will just -- as described previously in the record.

17 MR. DETERDING: If I may interject here, we
18 didn't talk about this, and we certainly didn't have a
19 problem with that official recognition. I don't believe
20 the report for the period ended September 30th has been
21 filed. So I'm not sure exactly what it is -- how we want
22 to handle that, the 2000 report.

23 COMMISSIONER JACOBS: Is there a due date?

24 MR. DETERDING: I don't know when it is going to
25 be filed because of the situation of the start-up of the

1 new plant occurred during September, and a lot of things
2 are changing, so it is being a little bit delayed. And
3 I'm not clear on when it is going to get in. I mean,
4 hopefully in a couple of weeks or something.

5 MR. FUDGE: We will just take it until August,
6 then.

7 MR. DETERDING: That would be fine, August 31st.

8 COMMISSIONER JACOBS: So the memorandum will
9 cover the period up to August 31st, is that my
10 understanding?

11 MR. FUDGE: Yes, Commissioner.

12 COMMISSIONER JACOBS: Okay. And there was a
13 late-filed exhibit. Has that been filed yet, Exhibit 2?

14 MR. JAEGER: Yes, Commissioner, Late-filed
15 Exhibit 2 has been filed.

16 COMMISSIONER JACOBS: And did we admit that? I
17 didn't show it here.

18 MR. JAEGER: It has not been admitted yet. I
19 think the way that was left was Steve Burgess would be
20 given time to look in over to see if he had any objections
21 to it. When was this filed, the 25th? The 27th. It was
22 just filed last Friday, right?

23 MR. BURGESS: We have looked at it, we don't
24 object to it being filed.

25 COMMISSIONER JACOBS: Very well. So we will

1 show that Exhibit 2 is admitted.

2 (Exhibit 2 admitted into evidence.)

3 COMMISSIONER JACOBS: Anything else?

4 MR. JAEGER: That was all the preliminary
5 matters I had, Commissioner.

6 COMMISSIONER JACOBS: Okay. Ms. Merchant, you
7 were previously sworn, correct?

8 THE WITNESS: Yes, sir.

9 COMMISSIONER JACOBS: Very well. You made
10 proceed, Counsel.

11 MR. FUDGE: Staff calls Patricia W. Merchant as
12 a staff witness.

13 - - - - -

14 PATRICIA W. MERCHANT

15 was called as a witness on behalf of the Staff of the
16 Florida Public Service Commission and, having been duly
17 sworn, testified as follows:

18 DIRECT EXAMINATION

19 BY MR. FUDGE:

20 Q Ms. Merchant, will you please state your name
21 and business address for the record?

22 A Patricia W. Merchant, 2540 Shumard Oak
23 Boulevard, excuse me, Tallahassee, Florida 32399-0851.

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

25 A Florida Public Service Commission, Division of

1 Economic Regulation. I am a supervisor of the section,
2 the file and suspend rate case section.

3 Q Have you prefiled direct testimony in this
4 docket?

5 A Yes, I have.

6 Q And it consists of 20 pages?

7 A Subject to check, yes.

8 Q Did you also file supplemental direct testimony
9 in this docket consisting of seven pages?

10 A Yes.

11 Q Do you have any changes or corrections to your
12 testimony?

13 A No.

14 MR. FUDGE: Chairman, we ask that Ms. Merchant's
15 testimony be entered into the record as though read.

16 COMMISSIONER JACOBS: Without objection, show
17 her direct and supplemental entered into the record as
18 though read.

19 BY MR. FUDGE:

20 Q Ms. Merchant, did you also file Exhibit Numbers
21 PWM-1 through PWM-5?

22 A Yes, I did.

23 Q Do you have any changes or corrections to those
24 exhibits?

25 A No.

1 MR. FUDGE: Mr. Chairman, may we have those
2 exhibits identified?

3 COMMISSIONER JACOBS: Very well. We will mark
4 those as Exhibit 18, composite.

5 MR. FUDGE: Yes, Commissioner.

6 (Composite Exhibit 18 marked for
7 identification.)

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DIRECT TESTIMONY OF PATRICIA W. MERCHANT

1 Q. Please state your name and professional address.

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

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

5 A. I am employed by the Florida Public Service Commission as a Public
6 Utilities Supervisor in the Division of Economic Regulation.

7 Q. How long have you been employed by the Commission?

8 A. I started working at the Commission in September 1981.

9 Q. Would you state your educational background and experience?

10 A. I received a Bachelor of Science degree with a major in accounting from
11 Florida State University in August 1981. Upon graduation, I was employed by
12 the Commission as a Public Utilities Auditor in what was then the Division of
13 Auditing and Financial Analysis. My primary responsibility in that capacity
14 was to perform audits on the books and records of electric, gas, telephone,
15 water and wastewater public utilities. In August 1983, I joined the Division
16 of Water and Wastewater as a Regulatory Analyst in the Bureau of Accounting.
17 In May 1989, I became a Regulatory Analyst Supervisor in the Accounting
18 Section of the Bureau of Economic Regulation. In June 2000, my section became
19 the File and Suspend Rate Cases Section in the Division of Economic
20 Regulation, in which capacity I am currently employed. I have attended
21 various regulatory seminars and Commission in-house training and professional
22 development meetings concerning regulatory matters.

23 Q. Are you a Certified Public Accountant?

24 A. Yes, I am. In September 1983, I received a certificate and a license to
25

1 | practice in the State of Florida by the Florida Board of Accountancy.

2 | Q. Are you a member of any professional associations?

3 | A. Yes. I am a member in good standing of the American Institute of
4 | Certified Public Accountants and the Florida Institute of Certified Public
5 | Accountants (FICPA). I am a former member of the Board of Governors of the
6 | FICPA and was the President of the Tallahassee Chapter of the FICPA for the
7 | year ended June 30, 1994. I served 6 years on the Florida State University
8 | Accounting Conference Committee of the FICPA. I served as chair of that
9 | committee for the year ended June 30, 1999.

10 | Q. Have you ever testified before the Florida Public Service Commission?

11 | A. Yes, in Docket No. 840047-WS, Application of Poinciana Utilities, Inc.
12 | for increased water and wastewater rates; in Docket No. 850031-WS, Application
13 | of Orange/Osceola Utilities, Inc. for increased water and wastewater rates;
14 | in Docket No. 850151-WS, Application of Marco Island Utilities for increased
15 | water and wastewater rates; in Docket No. 881030-WU, Investigation of Sunshine
16 | Utilities rates for possible over earnings; in Docket No. 940847-WS,
17 | Application of Ortega Utility Company for increased water and wastewater
18 | rates; in Docket No. 911082-WS, Water and Wastewater Rule Revisions to Chapter
19 | 25-30, Florida Administrative Code; and in Docket No. 971663-WS, Application
20 | of Florida Cities Water Company, Inc. for a limited proceeding to recover
21 | environmental litigation costs.

22 | Q. Were you accepted as an expert in regulatory accounting?

23 | A. Yes, I was.

24 | Q. Have you ever testified before any other tribunals as an expert in
25 | regulatory accounting?

1 A. Yes. I testified before the Division of Administrative Hearings, Case
2 No. 97-2485RU, Aloha Utilities, Inc., and Florida Waterworks Association,
3 Inc., Petitioners, vs. Public Service Commission, Respondent, and Citizens of
4 the State of Florida, Office of Public Counsel, Intervenors.

5 Q. Would you explain what your general responsibilities are as a Public
6 Utilities Supervisor in the File and Suspend Rate Cases Section of the Bureau
7 of Rate Cases?

8 A. I am responsible for the supervision of five professional accountants
9 in the accounting section. This section is responsible for the financial,
10 accounting and rates review and evaluation of complex formal rate proceedings
11 before the Commission. This specifically includes the analysis of file and
12 suspend rate cases, overearnings investigations and limited proceedings of
13 Class A and B water and wastewater utilities under the jurisdiction of the
14 Florida Public Service Commission. The accounting section is also responsible
15 for the review of smaller filings of Class A and B utilities, such as
16 allowance for funds used during construction (AFUDC), allowance for funds
17 prudently invested (AFPI), service availability applications, and tariff
18 filings. This section coordinates, prepares and presents staff
19 recommendations before the Commission on the above type cases. This section
20 is also responsible for preparing testimony, testifying and writing cross-
21 examination questions for hearings involving complex accounting and financial
22 issues.

23 Q. Can you summarize the issues to which you are providing testimony?

24 A. I am providing testimony on Aloha Utilities, Inc.'s projection of
25 customer deposits and the appropriate amount to include in the capital

1 structure. I am also testifying on the proper reuse rate and revenues to be
2 included in the revenue requirement, and adjustments that I believe should be
3 made to the utility's requested rate case expense.

4 Q. Please comment on the utility's projection of customer deposits?

5 A. In its minimum filing requirements (MFRs), Aloha reflected an historical
6 balance of customer deposits of \$215,795 as of September 30, 1999. It then
7 projected that this amount would decrease to \$129,746 as of September 30,
8 2000, and further decrease to \$93,295 for the test year ended September 30,
9 2001. In Staff witness McPherson's prefiled testimony in this case, he states
10 that the utility incorrectly recorded its 1999 customer deposits. During
11 1999, the utility recorded customer deposits into accounts receivable, thus
12 understating the customer deposit balance reflected on the books as of
13 September 30, 1999. Mr. McPherson states that the balance of customer
14 deposits as of December 31, 1999 was \$458,716. Included in this amount was
15 \$41,782 in non-utility deposits, resulting in net utility deposits of
16 \$416,934. Further, Mr. McPherson stated that he was not able to determine the
17 appropriate level of customer deposits as of September 30, 1999.

18 I have reviewed a worksheet provided by the utility which supports the
19 utility's customer deposit projection methodology. The MFRs, on page 108,
20 reflect 3 months with deposits collected totaling \$4,002 and 9 months of
21 refunds totaling \$81,150. None of the deposits nor refunds occurred during
22 the same month. To calculate the balance for the intermediate year ended
23 September 30, 2000, the utility used its projected growth of 349 equivalent
24 residential connections (ERCs) and multiplied that by \$49 representing the
25 amount for a residential customer deposit. The utility's intermediate year

1 | projected monthly deposits were \$1,511. To project the intermediate year
2 | monthly refunds, the utility used its booked total refunds from the year ended
3 | September 31, 1999, multiplied this times the utility's base year ERC growth
4 | factor of 4.812%, and then divided this total by 12. This resulted in an
5 | intermediate year monthly refund amount of \$7,088. The utility then added the
6 | deposits and subtracted the refunds from the erroneous September 30, 1999
7 | balance to get a projected year-end balance of \$96,282 as of September 30,
8 | 2000.

9 | To project the test year balance, the utility used a consistent
10 | methodology for the monthly deposits by using its projected growth in ERCs
11 | (349) multiplied times its \$49 estimate for the residential customer deposit.
12 | The utility's projected test year monthly deposits were \$1,323. To project
13 | the test year refund amounts, the utility used a different methodology than
14 | it did for the intermediate year projection. It combined the annual deposits
15 | of \$4,002 (recorded) and \$18,150 (projected) for the years ended September 30,
16 | 1999 and 2000, respectively. It then added these amounts and divided the
17 | total by 12. This resulted in a projected monthly refund amount of \$1,819.
18 | The utility then added its test year deposits and subtracted the refunds from
19 | the September 30, 2000, projected balance to get a test year ending balance
20 | for customer deposits of \$90,237. I would point out that this amount is about
21 | 1/5 of the Commission staff audited balance as of December 31, 1999.

22 | In addition to the historical starting point being incorrect, the
23 | utility's projection methodology is inconsistent and illogical. While I agree
24 | with the utility's projection of monthly additions to customer deposits, I do
25 | not agree with its methodology to project the monthly refunds. I believe that

1 | a proper method to project monthly refunds would be based on historical refund
2 | percentages and including factors such as customer growth and number of
3 | customers with poor payment histories. Poor payment histories extend the
4 | amount of time that customer deposits are held as security by the utility and
5 | are not necessarily driven by customer growth rates.

6 | Staff has requested that the utility recalculate its projected
7 | intermediate and test year balance sheets to show the impact of the error in
8 | customer deposits. As of this date, the utility has not provided this
9 | correction. Without reliable historical data, the projection of monthly
10 | refunds is much more difficult. Further, while I do have an audited
11 | historical balance for the base year, I do not have an explanation from the
12 | utility why customer deposits ballooned in 1999. The balance went from an
13 | average of \$220,438 for the years 1995 to 1998 to \$416,934 in 1999. The
14 | utility's customer growth only increased by approximately 5% from 1998 to
15 | 1999. Regardless, the base year historical balance is the only reliable
16 | amount that I have on which to base a reasonable projection of customer
17 | deposits.

18 | Q. What is the appropriate balance for customer deposits to be included in
19 | the capital structure?

20 | A. To determine the appropriate balance for customer deposits, I believe
21 | that several additional adjustments are appropriate. First, I believe that
22 | the utility understated the amount of the average residential customer
23 | deposit. In the utility's tariff, it states that a customer deposit will be
24 | 3 times the average monthly bill. Since the utility does not break down
25 | deposits between its two systems, I have assumed that all new deposits will

1 come from the Seven Springs area and will have both water and wastewater
2 service. Further, I have assumed that the average consumption per month for
3 new customers will be 10,000 gallons for both water and wastewater. Based on
4 the current tariff, I have calculated an average residential deposit of \$157.

5 Secondly, the utility estimated its growth to be 370 and 349 ERCs for
6 the intermediate and projected test years, respectively. Staff witness
7 Stallcup has testified that the utility's revised annual growth in ERCs of 316
8 and 368 for 2000 and 2001, respectively, should be used. If the Commission
9 determines that the utility's proposed growth, as filed, is not appropriate
10 to use in this proceeding, then a corresponding adjustment should be made to
11 the balance of customer deposits to be included in the capital structure.

12 Third, in lieu of specific data to estimate refunds, I will assume that
13 80% of the additional deposits made during 2000 and 2001 will represent
14 amounts refunded. Without sufficient support from the utility or a corrected
15 base year breakdown of deposits and refunds, I cannot assume that the 1999
16 year-end balance will decrease.

17 After applying these assumptions, I have projected the balance of
18 customer deposits to be included in the capital structure to be \$438,412.
19 This is an increase of \$345,117 to the utility's balance of \$93,295.

20 By making this increase (or credit) to customer deposits, a
21 corresponding debit adjustment should also be made to the projected balance
22 sheet. I believe that it is appropriate to decrease (or debit) equity for
23 this error. In its MFRs, the utility stated that retained earnings account
24 was adjusted each month for the net effect of all adjustments to the projected
25 balance sheet. Consistent with the utility's projection to retained earnings,

1 | I believe that this error should also reduce equity.

2 | Q. Do you have a schedule that reflects your calculation of projected
3 | customer deposits?

4 | A. Yes. It is attached as Exhibit ___ (PWM-1)

5 | Q. Please explain your testimony regarding the appropriate reuse rate.

6 | A. In the utility's reuse proceeding, Docket No. 950615-SU, the Commission
7 | established a reuse rate of \$0.25 per thousand gallons of effluent sold. (See
8 | Order No. PSC-97-0280-FOF-WS (Reuse Order), issued March 12, 1997). This rate
9 | was to be applied to all reuse customers except the Mitchell property, for
10 | which the Commission established a rate of zero. This zero rate was allowed
11 | because the Mitchell property owners and Aloha had an existing contract at
12 | that time. However, the Commission ordered that after the contract expired,
13 | the zero reuse rate should be reevaluated and any extension of that contract
14 | shall be filed with the Commission for approval. Aloha did not file this
15 | contract for approval prior to the expiration and this renewal has not been
16 | approved by the Commission to this date. Staff received a copy of the renewed
17 | contract by letter dated March 10, 2000.

18 | When asked why this contract extension was not submitted to the
19 | Commission for approval, the utility responded that this was an oversight.
20 | Regardless, the utility stated that the owners of the Mitchell property are
21 | not willing to pay for effluent under any circumstances at this time. The
22 | utility stated that Aloha is fortunate to be able to dispose of its effluent
23 | at no charge and if a charge were levied, the Mitchell property owners would
24 | refuse to allow the disposal of reuse water on their property. Further, the
25 | utility contended that the only alternatives available to the utility would

1 | be substantially more expensive than the current agreement with the Mitchell
2 | property owners. Based on this information, I believe that it is appropriate
3 | to approve the renewed contract after the fact. However, I believe that no
4 | further extension of the contract after this current term expires should take
5 | place until the utility has Commission approval.

6 | Q. How did the Commission determine the reuse rate for other reuse
7 | customers?

8 | A. In establishing the \$0.25 rate for the other reuse customers, the
9 | Commission, in the Reuse Order, agreed with the utility that the charge should
10 | be market-based to encourage new reuse customers. Since Pasco County was the
11 | nearest utility that provided reuse service and it had a \$0.28 rate per
12 | thousand gallons, the Commission agreed that the utility's requested rate of
13 | \$0.25 was market-based. According to the Department of Environmental
14 | Protection's (DEP) 1999 Reuse Inventory Report, Appendix H, (Exhibit ___ PWM-
15 | 2) the Central Pasco Reuse System has a non-residential reuse gallonage charge
16 | of \$0.32 per thousand gallons.

17 | Q. Did the Commission in the Reuse Order, require any action to be taken
18 | in Aloha's next rate proceeding related to reuse?

19 | A. Yes. The Commission required Aloha's next rate filing to contain
20 | information sufficient to enable this Commission to address reuse rates for
21 | all reuse customers. Further, Aloha was required to explore whether and how
22 | much of its reuse revenue requirement should be allocated to its water
23 | customers.

24 | Q. Do you believe that Aloha provided sufficient data in this current rate
25 | case to establish reasonable reuse rates for all of its reuse customers?

1 A. No, it did not. First, Aloha did not provide information in its
2 application, that I have found, supporting any reuse rate determination. The
3 only mention of the reuse rate is on the Revised MFR Rate Schedule E-13(A),
4 (page 120) and G-1 (page 138). These pages only reflect the current \$0.25
5 charge per thousand gallons multiplied times Aloha's projected test year reuse
6 consumption. I have not seen any information provided by the utility that
7 supports whether the current or any other reuse rate is appropriate. The
8 utility also did not discuss any allocation of revenues to the water system.

9 Q. Does the lack of sufficient information in this filing limit the
10 Commission's ability to review the appropriateness of the reuse rate?

11 A. No, I do not think that it does. I agree with the Commission's decision
12 in the reuse case to establish market-based reuse rates. Since the Commission
13 used the reuse rates for Pasco County as benchmark, I believe that it is
14 appropriate to review what those current reuse rates are in determining
15 whether Aloha's reuse rate should change. As I stated above, Pasco County's
16 reuse rates have increased by \$0.04 per thousand gallons. I think that it is
17 also appropriate to increase Aloha's reuse rate. However, I recommend that
18 Aloha's rate should be equal to Pasco County's rate per thousand gallons.
19 Because the two providers are not in competition, Aloha's reuse rate can be
20 \$0.32 per thousand gallons, and still be market-based.

21 Q. How does this rate change affect Aloha's reuse revenues?

22 A. In its MFRs, Aloha included \$47,359 for reuse revenues. This was based
23 on 189,436 thousand gallons of reuse sold at the current reuse rate of \$0.25.
24 By increasing the cost by \$0.07, the test year reuse revenue would be \$60,620,
25 or an increase of \$13,261.

1 Q. What is your opinion of the Commission's decision in the reuse case that
2 Aloha should bear the risk associated with finding paying reuse customers?

3 A. While I agree that the utility should bear the risk, it should be noted
4 that the utility does not currently have any reuse customers and is disposing
5 of all of its effluent on the Mitchell property. The current contract with
6 the Mitchell Property was initiated on March 19, 1999 and has a five-year
7 term. However, when the utility completes the current construction phase
8 requested in this proceeding, it will be able to provide reuse services for
9 compensation. I believe that Aloha should take all steps necessary to obtain
10 as many reuse customers that it possibly can. It should not sign any
11 agreements with developers of new service areas adjacent to the reuse
12 distribution system without a requirement for the installation of reuse lines.

13 Q. What action did the Commission take in the Reuse Order to reflect that
14 the utility had the burden to find reuse customers?

15 A. The Commission found that when Phase III of the prior reuse plant was
16 completed and in service, that the utility would be able to sell 100% of its
17 effluent within 4 years. Accordingly, the Commission assumed a 25% growth in
18 reuse sales at a rate of \$.25 per thousand gallons and total reuse capacity
19 of 438,000,000 gallons of annual reuse. The total reuse capacity was
20 determined by taking the capacity of the wastewater treatment plant in that
21 proceeding of 1.2 million gallons per day multiplied by 365 days. Based on
22 those calculations, the Commission projected that annual reuse revenue would
23 be \$27,375, \$54,750, \$82,125 and \$109,500 for the initial four years of the
24 Phase III reuse operation. Further, the Commission found that upon
25 implementation of the Phase III reuse system, wastewater rates should be

1 | reduced each year based upon this projected revenue from reuse sales.

2 | Q. Should the Commission decrease wastewater rates in the future to reflect
3 | potential increases in reuse revenues?

4 | A. No, I do not think that this is the proper mechanism to reflect the risk
5 | of finding new reuse customers. While it is certainly an option available to
6 | the Commission, I believe that the utility has supported its position that,
7 | for the projected test year, it will only be able to sell 189,436,000
8 | gallons. This amount may change upon receipt of further discovery. Further,
9 | I do not believe that the Commission should impute revenues for the total
10 | amount of reuse disposal capacity in this proceeding. I believe that it is
11 | only appropriate to project reuse revenue to the extent that there will be
12 | reuse customers during the projected test year. Any imputation beyond that
13 | does not consider the increased expenses associated with transmitting the
14 | reuse to the customers premises.

15 | Q. Do you believe that the Commission should monitor the utility's reuse
16 | revenue and customers?

17 | A. Yes. I believe that the Commission should require Aloha to submit
18 | additional information in its annual report regarding its reuse service.
19 | This information should include the name of each non-residential reuse
20 | customer, number of gallons of reuse sold and the revenue collected for the
21 | year. For residential reuse service, Aloha should provide the number of
22 | residential customers by development, the numbers of gallons sold (if metered)
23 | and the revenue collected for the year.

24 | Q. Do you believe that adjustments should be made to the utility's
25 | requested rate case expense?

1 A. Yes. Based on discovery received as of the date that I filed my
2 testimony, I believe that several adjustments are necessary to the utility's
3 rate case expense request. The first issue relates to legal expenses
4 associated with filing an emergency petition for an emergency rule variance
5 or waiver. The second issue relates to costs associated with filing revisions
6 to the MFRs.

7 Q. Can you please explain your opinion regarding legal fees associated with
8 the petition for emergency rule waiver or variance?

9 A. Yes. When the utility originally filed its MFRs, on February 9, 2000,
10 it also filed a Petition for Emergency Variance from Rule 25-30.440(1)(a) and
11 (b), Florida Administrative Code. This rule requires the utility to provide,
12 as part of its MFRs, a detailed map showing the location and size of the
13 utility's distribution and collection lines as well as its plant sites and the
14 location and respective classification of utility's customers.

15 Q. What was the utility's reason for requesting an emergency waiver or
16 variance of the MFR rule regarding maps of its distribution and collection
17 system?

18 A. In its Petition for Emergency Variance, the utility stated that it did
19 not have any system-wide maps that met the description outlined in the MFR
20 rule. It only had the original system maps provided by the developers of the
21 particular parcels when the facilities were contributed to the utility.
22 Further, those maps on-hand did not have any information concerning which lots
23 were occupied, utilized or receiving service. Aloha's premise was that
24 compliance with this rule would require creation of entirely new system maps
25 at a substantial cost which would have to be passed on to ratepayers, while

1 providing no useful information.

2 Q. Did the Commission approve the utility's emergency variance petition?

3 A. No. It did not. Staff filed its recommendation addressing the emergency
4 petition on February 17, 2000 for the February 29, 2000, agenda conference.
5 Staff stated in that recommendation that we did not believe that the utility's
6 petition constituted an emergency. As early as October 22, 1999, when Aloha
7 filed its request for test year approval, it should have known that it did not
8 have the required maps and could not meet the requirements of Rule 25-
9 30.440(1)(a) and (b), Florida Administrative Code, and that it would need a
10 rule waiver. The staff recommendation further stated that Aloha asserted that
11 it was relying on the waiver provision contained in Rule 25-30.436(6), Florida
12 Administrative Code, that was repealed on January 31, 2000. In addition,
13 Aloha stated that there is no requirement that the utility file a request for
14 variance or waiver in advance of filing a rate case application in either Rule
15 25-30.436(6), Florida Administrative Code, or Rule 28-104.004, Florida
16 Administrative Code. Staff noted, however, that Rule 25-30.436(6), Florida
17 Administrative Code, required that "all requests for waivers of specific
18 portions of the minimum filing requirements shall be made as early as
19 practicable." Even if Rule 25-30.436(6), Florida Administrative Code, still
20 existed and was applicable, staff stated that Aloha could have filed for a
21 waiver of these MFRs earlier and thereby could have avoided the need to
22 request an emergency waiver under Rule 28-104.004, Florida Administrative
23 Code. On February 24, 2000, one week after staff's recommendation was filed,
24 the utility produced the required maps and withdrew its request for an
25 emergency variance of the rule.

1 Q. Why do you believe that the legal fees associated with the Petition for
2 Emergency Variance should be removed from rate case expense?

3 A. I believe that it was imprudent and unnecessary for the utility to
4 request this emergency rule waiver or variance. Rule 25-30.125, Florida
5 Administrative Code, requires utilities under the Commission's jurisdiction
6 to have maps available on file. Further, the MFR requirement to provide maps
7 has been unchanged for at least 10 years. Aloha knew that it would be filing
8 for increased rates and this provision of the rule should have been considered
9 well in advance of its filing of the MFRs.

10 Q. How much were the legal fees associated with the Petition for Emergency
11 Variance?

12 A. Based on the legal invoices, the fees related to filing this variance
13 totaled \$10,014. I believe that these costs should be removed from rate case
14 expense as unreasonable. Although, I have not seen any costs submitted as of
15 yet, any overtime expenses for engineering or technical fees for the
16 production of the maps associated with the emergency variance should also be
17 disallowed.

18 Q. What is your opinion regarding rate case expense incurred for MFR
19 deficiencies?

20 A. I believe that any costs associated with filing revisions to the MFRs
21 should be disallowed to the extent that those costs duplicated or corrected
22 information already submitted. It has been the practice of the Commission to
23 disallow rate case expense associated with filing MFR deficiencies that are
24 duplicative or corrective. (See Orders Nos. PSC-95-1376-FOF-WS, page 25,
25 issued November 6, 1995, Docket No. 940847-WS, Ortega Utility Company; PSC-95-

1 1399-FOF-WS, page 14, issued November 15, 1995, Docket No. 940765-WS,
2 Ferncrest Utilities, Inc.; and PSC-96-0663-FOF-WS, page 14, issued May 13,
3 1996, Docket No. 950336-WS, Rotonda West Utility Corporation).

4 Q. Can you describe the facts surrounding Aloha's MFR deficiencies?

5 A. Yes. After we reviewed the original MFRs, staff mailed a deficiency
6 letter to the utility on March 2, 2000. I have attached this letter as
7 Exhibit ___ (PWM-3). This letter had six pages and included a description of
8 MFR schedule deficiencies along with deficiencies related to detailed
9 descriptions of projection methodologies. This letter also provided
10 descriptions of errors made in the heading of schedules, possible errors
11 between projection descriptions and numbers included in schedules, and a
12 description of other staff concerns of the rate case.

13 Q. Does staff generally include items other than a list of MFR deficiencies
14 in a standard deficiency letter?

15 A. Yes. In reviewing MFRs for any utility, if staff finds deficiencies,
16 we will also delineate errors or discrepancies that we find in the MFRs and
17 include them in a separate section of the deficiency letter. These items are
18 not generally MFR deficiencies that are required to be corrected, but they are
19 included if the utility wishes to correct its filing. Often the errors that
20 the staff identifies may be material enough such that the utility decides to
21 change its requested revenue requirement.

22 Q. Is staff required to provide the utility with supplemental information
23 in addition to the deficiencies?

24 A. No, we are not. We see this as an opportunity to allow the utility time
25 to correct or improve its filing if it wishes. If the change actually

1 increases the revenue requirement, the notice requirements have not been
2 compromised and the utility can correct its mistakes without losing the
3 opportunity for allowance of its increased revenue request. If the case is
4 going to hearing, this information may allow the filing to adequately support
5 its requested costs and allow the filing to be more easily processed by the
6 Commission and the parties than if the corrections were not made. In one
7 prior rate case that went to hearing, the Commission dismissed the entire case
8 at the final agenda conference because of inconsistencies in the MFR filing
9 and unsupported projection methodologies. (See Order No. 24715, issued June
10 26, 1991, in Docket No. 900329-WS).

11 Q. What is the purpose of minimum filing requirements for rate cases?

12 A. I believe that the purpose of MFRs is to provide essential information
13 that staff and the Commission need in every rate case to be able to analyze
14 the utility's request for increased rates. Pursuant to Section 367.081,
15 Florida Statutes, the Commission is required to vote on a rate increase
16 within 5 months if the case is filed as a proposed agency action (PAA) or 8
17 months if it is set for hearing. For a large Class A utility, reviewing the
18 detail supporting a rate increase is voluminous. This statutory deadline
19 benefits the utility to reduce regulatory lag in receiving rate relief. The
20 MFRs, on the other hand, allow staff and the parties necessary information to
21 start the process of reviewing a utility's rate request. If MFR deficiencies
22 are corrected and accepted as complete, then any errors in the application
23 will have to be provided through discovery or other means. The time that the
24 staff and parties have to review supporting information has thus been reduced.
25 I do not believe that it is an audit function to obtain information that

1 | should have been included in the MFRs. The protections of the statutory
2 | deadline and MFRs exist to provide benefits for each side.

3 | Q. When did Aloha respond to the deficiency letter?

4 | A. Aloha filed its revised MFRs and response to staff's deficiency letter
5 | on April 4, 2000. I have attached as Exhibit ___ (PWM-4), a letter dated
6 | March 27, 2000, detailing the utility's response to staff's MFR deficiency
7 | letter. In its response, the utility addressed the majority of items that
8 | staff labeled as deficiencies, corrected the errors staff pointed out and
9 | addressed the concerns that staff mentioned in its letter. The utility also
10 | stated that the bulk of the changes to the MFRs were the result of staff's
11 | desire for additional information related to the bases of the projection
12 | methodologies. The utility does not interpret this additional information to
13 | be deficiencies but the inclusion of workpapers and calculations for each
14 | account that was projected. The utility disagrees with the staff's
15 | interpretation of the rule that required detailed support for the utility's
16 | projection methodologies. Further, the utility stated that staff's request
17 | went far beyond the rule's requirement but the utility complied because of the
18 | urgent need to have the rate case filed. Finally, the utility stated that
19 | since most of the data submitted with the MFR deficiencies was additional
20 | information, the accounting rate case expense has been increased from the
21 | original estimate of \$100,000 to \$125,000. This brought the utility's
22 | requested rate case expense up to \$300,000.

23 | Q. What is the rule requirement regarding support for projection
24 | methodologies?

25 | A. Rule 25-30.437(3), Florida Administrative Code, states, in relevant

1 part, that "A schedule shall also be included which describes in detail all
2 methods and bases of projection, explaining the justification for each method
3 or basis employed."

4 Q. How has staff interpreted this requirement of the rule?

5 A. Staff's interpretation of this rule is that all items and accounts
6 projected in a projected test year rate base should be explained fully so that
7 the Commission and parties can take an historical balance reflected in the
8 MFRs and calculate both the intermediate and projected test year amounts.
9 This does not mean that we should be provided all specific calculations, but
10 that the user can follow the utility's logic and get similar projected
11 results.

12 Q. Do utilities that file projected test years generally submit this detail
13 to allow the users to follow the utility's projection methodologies?

14 A. Yes they do, but many times utilities fail to provide support for all
15 items projected. Based on my experience, the majority of utility's agree that
16 the unsupported projections constitute deficiencies to the MFRs.

17 Q. Do you have any examples of other utilities' supporting detail for
18 projection methodologies?

19 A. Yes. I have attached as Exhibit ___ (PWM-5) copies from the Florida
20 Public Utilities Company MFRs filed in its last rate case, Docket No. 990535-
21 WU. This exhibit is just a small sample of the pages included in support of
22 its projection methodologies. I have also attached a copy of the deficiency
23 letter that staff sent to this utility. This letter also mentioned a
24 deficiency regarding the projection methodologies, but it related specifically
25 to the lack of detail for inflation and growth factors. This utility's detail

1 | of projections otherwise was sufficient for MFR purposes.

2 | Q. Do you believe that the majority of the data that Aloha deems as
3 | "additional information" is in fact MFR deficiencies?

4 | A. Yes, I do. I also believe that had the utility sufficiently submitted
5 | its projection methodologies with its original application, that the
6 | additional rate case expense would have been greatly minimized. Further,
7 | resubmitting a completely revised set of MFRs was not driven by the
8 | "additional information" required to support the projection methodologies but
9 | in fact to correct the numerical and numerous typographical errors that the
10 | utility had in its initial filing. Accordingly, I recommend that the rate
11 | case expense associated with resubmitting the MFRs be disallowed. According
12 | to the utility's response to Staff's Interrogatory No. 7(a) and (b), the
13 | accounting fees associated with the deficiencies were \$18,669 and the legal
14 | fees were \$3,056. This is a total of \$21,725 in rate case expense that should
15 | be disallowed.

16 | Q. Does this complete your testimony?

17 | A. Yes.

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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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1 BY MR. FUDGE:

2 Q Ms. Merchant, could you briefly summarize your
3 testimony.

4 A Yes. My direct testimony consists of three
5 issues. The first issue deals with customer deposits
6 included in the capital structure. I have corrected
7 Aloha's projection methodology and recommend the
8 appropriate amount to include in the capital structure.

9 The second issue I address is the appropriate
10 reuse rate and reuse revenue requirement. For the
11 Mitchell property, I recommend that the Commission
12 continue the zero rate previously approved in Aloha's
13 reuse docket. For all other reuse customers, I recommend
14 a 32 cent per thousand gallons, which is a rate that is
15 equal to the reuse charge by Pasco County.

16 In calculating the annual amount of reuse
17 revenues, I have used the utility's projected gallons of
18 reuse sold. I do not believe the Commission should
19 establish an automatic step down in rates for possible
20 future reuse customers. Instead I believe that monitoring
21 is the proper mechanism for reuse customers and revenues.
22 As such, Aloha should have additional annual reporting
23 requirements so that the Commission can be made aware of
24 the level of reuse customers and gallons of reuse sold in
25 the future.

1 The third issue that I provide testimony relates
2 to rate case expense. I am recommending two adjustments.
3 The first is for attorneys fees related to filing an
4 emergency petition for waiver or variance of the MFR map
5 requirements. I believe that these fees were unnecessary
6 and imprudent.

7 My testimony is not a blanket recommendation
8 that costs associated with filing any rule waiver are
9 imprudent. You need to look at the circumstances for each
10 waiver request for the merits and the benefits. My
11 testimony relates specifically to the circumstances
12 related to Aloha in this case. When Aloha saw staff's
13 recommendation denying the emergency, it then complied
14 with the rule. Had the utility addressed this need early
15 on during test year approval it could have determined
16 whether it could comply with this rule requirement on a
17 timely basis and avoided the cost of any rule waiver
18 whether emergency or not. I do, however, agree with the
19 amount of legal fees related to this waiver in the amount
20 of \$6,205.

21 The second rate case expense issue deals with
22 MFR deficiency cost. My recommendation is that rate case
23 expense associated with fixing MFR deficiencies should be
24 disallowed to the extent the costs duplicated or corrected
25 information that was previously filed in the MFRs. I

1 disagree with the utility's argument that the majority of
2 MFR deficiencies were staff's requests for additional
3 information. Had the utility organized its projection
4 methodologies during the MFR preparation phase, rate case
5 costs for deficiencies would have been greatly reduced.
6 The utility has not shown that providing this required
7 information through the deficiencies was the most
8 economical and efficient method to comply with the MFRs,
9 and as such the MFR deficiency costs should be disallowed.

10 The purpose of my supplemental direct testimony
11 is to address the utility's request for recovery of the
12 cost of purchasing a new office building. This office
13 building was not included in the utility's original MFRs.
14 At the time that my testimony was filed, I did not have
15 sufficient information to support the prudence of the
16 purchase of this building, or whether the requested costs
17 represent the most cost-effective alternative for office
18 space.

19 MR. FUDGE: Thank you, Ms. Merchant.

20 Mr. Chairman, the witness is tendered for cross.

21 COMMISSIONER JACOBS: Mr. Deterding.

22 MR. DETERDING: Thank you, Commissioner.

23 CROSS EXAMINATION

24 BY MR. DETERDING:

25 Q Ms. Merchant, what is the projected test year in

1 this case?

2 A September 30th, 2001.

3 Q So we are already over a month into that
4 projected test year?

5 A Yes.

6 Q Do you know whether the DEP has authorized Aloha
7 to begin sales of public accessed effluent to third
8 parties?

9 A No.

10 Q If, in fact, they have not, isn't it true that
11 the projected reuse sales that you have proposed for the
12 test year would have to be adjusted to recognize that
13 fact?

14 A I relied on the utility's estimate of projected
15 gallons of reuse sold, and there are a lot of estimates
16 throughout this case that may or may not come to actuality
17 throughout the case. It is the nature of a projected test
18 year. But it was an estimate that the company gave staff
19 or filed in its MFRs.

20 Q I understand. But that was based upon a full
21 year's sales of that effluent, was it not?

22 A It was based on the utility's projection of
23 sales.

24 Q For a full year?

25 A For a full year.

1 Q Thank you. So if the -- so if the sales have
2 not even begun, then it would need to be adjusted, would
3 it not?

4 A I think that you would need to annualize it
5 regardless of whether it occurred in a full year or not.
6 Because we are not just looking at rates for one year, or
7 actually the test year itself, we are looking at rates on
8 a prospective basis, especially when we are not
9 recommending any reduction in the future.

10 COMMISSIONER JACOBS: Do you know if those
11 estimates reflected any seasonal factors? It strikes me
12 that given the normal application for reuse, there would
13 be seasonal fluctuations, or is that taken into
14 consideration and then normalized?

15 THE WITNESS: I'm not sure if their number took
16 that into account. It was a total annual amount that they
17 gave us.

18 COMMISSIONER JACOBS: Okay.

19 BY MR. DETERDING:

20 Q You have used Pasco County as a reuse system in
21 the area to compare to Aloha for the establishment of an
22 appropriate reuse rate, have you not?

23 A Correct. That was consistent with what the
24 Commission did in the last case, the reuse case.

25 Q Isn't it true that Pasco County actually gives

1 away at no charge a substantial percentage of its reuse
2 water to golf courses under long-term arrangements with
3 those golf courses?

4 A I don't know.

5 Q Isn't it true that Pasco County began its reuse
6 program by charging virtually no one for reuse water?

7 A I don't know how Pasco County began their reuse
8 system.

9 Q Does that type of methodology of establishing a
10 reuse program by charging little or nothing make sense to
11 you as a method to encourage reuse?

12 A For what type of customer?

13 Q For any type of customer.

14 A I think you need to look at the circumstances.
15 It depends on each utility and how they need to get rid of
16 their effluent. Aloha has a zero reuse rate for the
17 Mitchell property, so that is a substantial component of
18 their reuse. So there is no charge for that in this case.

19 Q Well, but if you are trying to encourage
20 customers; commercial, residential, whatever, to begin
21 using reuse, doesn't it make sense to at least initially
22 charge them nothing for that service?

23 A I think you look at the market. It is our
24 understanding -- my understanding from looking at the last
25 reuse order that they based this charge, I believe it was

1 three or four cents less than what Pasco was charging at
2 that time. And if Pasco County was charging for it, then
3 Aloha could charge for it.

4 Q Well --

5 A And it is a relatively small dollar amount.

6 Q I understand. But doesn't it make sense to you
7 that the lower that dollar amount the more likely that
8 people are going to want to use it?

9 A I'm not sure, because if they need water to
10 water their lawns, they might be willing to pay -- each
11 individual customer would be different. If they can't get
12 water, potable water, and they have to pay an expensive
13 amount for that and the alternative is reuse, I think 32
14 cents would be a bargain compared to --

15 Q Well, let's look at like a golf course. Isn't
16 it true that like Fox Hollow Golf Course currently gets
17 water out of wells as opposed to using potable water for
18 that, for irrigation purposes?

19 A I'm not sure. I don't know, excuse me.

20 Q Do you know where most golf courses get their
21 water if they don't have access to reuse? Do they use
22 potable water generally, is that normally the way it is
23 done?

24 A I would assume that they either have wells or
25 they use ponds that they have on golf courses.

1 Q So, in other words, they are used to paying only
2 whatever the electricity cost is to pump it, as opposed to
3 a reuse rate per thousand gallons?

4 A If they can pump water, if they have a
5 consumptive use permit, then, yes, that would be their
6 cost.

7 Q Did you compare the county's reuse rate to its
8 potable rate?

9 A No, I did not.

10 Q Well, if you believed that the alternative is to
11 use potable water, why didn't you do that comparison? In
12 other words, doesn't that make -- isn't that a major issue
13 in the level that would encourage utilization of reuse
14 water?

15 A I would think you would compare it to Aloha's
16 water rate, not Pasco County's, if they were in Aloha's
17 territory.

18 Q Okay. So you think that Aloha's -- in analyzing
19 Aloha's reuse rate, or the appropriate reuse rate to
20 establish, you should compare it to its potable water
21 rate?

22 A Let me step back a little bit. It would not be
23 appropriate to compare it to Pasco County's water rate.
24 It would be more appropriate to compare it to Aloha's
25 potable water rate. But in this case we are talking

1 reuse. We are not comparing reuse to potable water, we
2 are comparing reuse to reuse. And I think the Commission
3 used that methodology in the last reuse docket, and that
4 was the reason why I stuck with that same ratio. Well, I
5 actually made it equal to it, but the same comparison to
6 Pasco County.

7 Q But the alternative available to the customer,
8 especially the individual, is not Pasco versus Aloha, it
9 is Aloha's potable versus Aloha's reuse, is it not?

10 A It was my understanding that Aloha, the
11 Commission desired in the last reuse case that Aloha be
12 encouraged or be required to obtain -- or to attempt to
13 obtain, not to require -- but more reuse customers. The
14 benefit to Aloha is that they get revenue from reuse
15 customers. And, you know, how they can do that, that is
16 the desire, to get more reuse customers to use the reuse
17 and to obtain revenue for that.

18 Q I understand that. But what I am asking you is
19 if a particular customer out there is considering his
20 options for irrigation, say a school or the YMCA, both of
21 which I think are potential short-term expected customers
22 for Aloha, isn't it true that they would be comparing what
23 they are going to have to pay for potable water to do that
24 irrigation versus reuse water as opposed to comparing what
25 Pasco charges when Pasco is not even in that area?

1 A You're going to have to restate that for me.

2 Q Okay. When a customer is reviewing their
3 alternatives for irrigation, a potential customer like the
4 YMCA or the school in this case, what they are looking at
5 is alternatives, or potable water versus reuse water, and
6 the cost of each, as opposed to the cost from Pasco
7 County, whom they can't get it from in any case?

8 A I am assuming that this customer is in Aloha's
9 service territory and not Pasco County's.

10 Q Correct.

11 A Then they are going to be looking at the
12 availability of water. They might not be able to water.
13 If they have water restrictions on, they are not going to
14 be able to water as much as if they had reuse. If the
15 reuse is available, it is much cheaper. There aren't
16 restrictions on it, to the extent that there is reuse
17 available, so it would be a bargain to use reuse, as long
18 as they had the circumstances that they could apply the
19 reuse for irrigation purposes.

20 Q But the price comparison they are going to be
21 looking at, their alternatives that are available to them
22 for irrigation are going to be reuse from Aloha and
23 potable from Aloha, are they not?

24 A As long as there aren't restrictions on
25 watering.

1 COMMISSIONER JACOBS: Do you have an idea how
2 those restrictions effect the potential client in this
3 case? I know that for golf courses, for example,
4 generally in order to get their consumptive use permit
5 they have to make reuse a priority, is that correct?

6 THE WITNESS: I think there are a lot of
7 different circumstances out there with golf courses, and
8 I'm not familiar with a lot. But the golf courses
9 sometimes aren't required, they don't -- sometimes they
10 don't have restrictions on the consumptive use permit, so
11 they are not required to go to reuse specifically. They
12 are encouraged to go to reuse and find other alternatives,
13 but --

14 COMMISSIONER JACOBS: Bad example. Anyway, are
15 you aware of any requirements such as that for the
16 potential customer being explored with Aloha? Are they
17 required to seek reuse as a priority?

18 THE WITNESS: I would have to look at each
19 individual golf course's consumptive use permit to see
20 would they expire at different times and things like that.

21 BY MR. DETERDING:

22 Q The figure that you have utilized that you got
23 from the utility's information submitted to you for the
24 projected test year includes sales to Fox Hollow Golf
25 Course, does it not?

1 A I believe it does, but I would have to check
2 that. That was based on what the utility provided to us,
3 and I can't recall exactly where that is.

4 Q Isn't it true that the contract that Aloha has
5 and has had since before the reuse case specifically says
6 that the golf course will not pay for effluent for the
7 first four years in which they have that availability of
8 effluent?

9 A I have not seen a contract that says that. But
10 if the utility has a reuse rate for everybody but the
11 Mitchell property, then they -- that is a tariffed charge
12 and they would have to charge that or they would have to
13 impute that revenue. I don't think that the contract
14 would -- I mean, I'm not a lawyer, but to me the tariffed
15 rate is what should be charged, if there is a tariff for
16 all other reuse customers other than the Mitchell
17 property. That is how it is right now.

18 Q So that if the --

19 A The current tariff before this rate case.

20 Q So if they entered into a contract before there
21 was even any tariff, much less one that said zero cost to
22 everyone but Mitchell, that said that they would not
23 charge this golf course for reuse service for four years,
24 do you think they are bound to charge them anyway once the
25 rate is established?

1 A I'm not sure whether they are bound to charge
2 them, but the tariff charge is there. It is a tariffed
3 rate. If they don't charge them, they are not in
4 compliance with the tariff.

5 Q So if the golf course said we will not pay that
6 because we have a contract, do you think the utility
7 should do whatever it has to in order to get them to pay
8 that charge?

9 A I would think that the utility should do what
10 they can to get the golf course to comply with the tariff.
11 But if they can't, then they need to come back to the
12 Commission.

13 Q Are you aware of the circumstances under which
14 this golf course agreed to accept Aloha -- excuse me,
15 accept effluent from Aloha versus the county?

16 A No, I'm not.

17 Q Are you aware that there was even a discussion
18 of this golf course going to the county for reuse service?

19 A Not at all.

20 Q Isn't it true that reuse service as we are
21 dealing with it here is primarily and first a method of
22 effluent disposal, and only secondarily a revenue source
23 or a service that the utility would be providing?

24 A In Aloha's case I believe the Mitchell property
25 takes a majority of the reuse in its effluent disposal.

1 Q Well, but the Mitchell property does not agree
2 to take that indefinitely, does it?

3 A They have a contract right now.

4 Q For how long a period of time?

5 A I can't recall; three years, five years, I'm not
6 sure.

7 Q Well, isn't it true that the DEP specifically
8 requires that Aloha begin providing reuse service other
9 than to Mitchell property, public access reuse service as
10 soon as it can?

11 A I think as soon as they complete their treatment
12 that they were supposed to initiate reuse services, the
13 current treatment that is the subject of this rate case
14 treatment facilities.

15 Q So the Mitchell property as a basis for effluent
16 disposal, as a location for effluent disposal is not a
17 long-term solution, is it?

18 A I'm not sure. I don't know. It was a
19 short-term contract, it was renegotiated, I would assume
20 it could be renegotiated again in the future. I don't
21 know, though.

22 Q Let's move on to the variance. You have
23 proposed an adjustment to remove costs related to the
24 utility's requested variance from the requirements of Rule
25 25-30.440(1) related to maps required by the MFRs,

1 correct?

2 A Yes.

3 Q Would you agree that the staff engineers would
4 be the persons for whom this information is obtained or
5 who would utilize this information?

6 A The maps?

7 Q Yes.

8 A Yes.

9 Q And if a utility wanted to determine whether the
10 Commission staff was agreeable to a variance on these maps
11 or issues related to these maps, the appropriate person to
12 contact would be the staff engineer, correct?

13 A I think initially. But I would do that as early
14 as possible. As soon as I knew I was going to be planning
15 a rate case I would be discussing any possible problems
16 with complying with the minimum filing requirements.

17 Q But if a person was thinking of seeking a
18 variance from those requirements as to the maps, that
19 would be the person to ask, correct?

20 A The staff engineer, yes.

21 Q Isn't it true that the utility contacted the
22 staff, a staff engineer about the maps required by Rule
23 25-30.440 prior to the filing for this emergency variance?

24 A Yes. I believe it was about two weeks prior to
25 the filing of the MFRs.

1 Q And, in fact, the staff engineer agreed that a
2 variance was appropriate, did they not?

3 A I'm not sure.

4 Q Would you agree that one of the main purposes of
5 these maps is to look at the used and useful nature of the
6 lines within the utility's system?

7 A I am not an engineer. I understand that they do
8 use that for used and useful. They might use it for
9 unaccounted for water. I don't actually review maps
10 myself.

11 Q But would you agree that one of the primary
12 purposes would be for the purposes of examining used and
13 useful?

14 A Yes, for lines.

15 Q And if those lines were all contributed, there
16 would be no need for that type of information because
17 there would be no used and useful adjustment performed on
18 those lines, isn't that correct?

19 A If they are 100 percent contributed, there
20 wouldn't be.

21 Q What about if they were all contributed with the
22 exception of one or two well-defined specific pieces in
23 the system?

24 A I would have to defer to an engineer for that
25 answer.

1 Q What was the original filing date in this case?

2 A I believe it was February 9th, 2000.

3 Q And isn't it true that there was a variance
4 provision specifically within the PSC Rules 25-30.436
5 until January 31st, 2000?

6 A Yes, there was a rule that said you could ask
7 for a variance. But it also said to do that as early as
8 practicable.

9 Q Did it require that that be done at any specific
10 time?

11 A Not at all. It just recommended that that would
12 be preferable. That was my interpretation of it.

13 Q And that rule was repealed just eight days prior
14 to the MFRs being filed, correct?

15 A That was the final order approving the repeal of
16 that rule, but that docket actually was initiated in
17 December of 1998.

18 Q Okay. But the effective date of the repeal was
19 January 31st, was it not?

20 A Of 2000, yes.

21 Q As I understand your testimony, your concern is
22 not with the fact that the utility requested a rule -- a
23 waiver of the rule related to the maps, but with the fact
24 that it was filed as an emergency waiver, is that correct?

25 A No, not precisely. I think the utility waited

1 until two weeks prior to filing, and then they filed an
2 emergency. I think had they planned it earlier, they
3 could have looked at their map. And it didn't take
4 them -- once staff wrote the recommendation to deny the
5 emergency, staff did not deny the waiver in that
6 recommendation, it denied that it was an emergency. They
7 issued that recommendation on February 17th, and Aloha
8 supplied the maps seven days after that. In October of
9 1999, if Aloha had looked at their circumstances and
10 contacted the staff engineer, I think that they could have
11 spent seven to ten to 21 days getting information to
12 comply with the MFRs and they wouldn't have needed a
13 waiver at all.

14 Q Well, do you know whether or not the maps as
15 filed, ultimately filed were prepared for the purpose
16 initially prepared, or begun being prepared for the
17 purpose of complying with the MFR?

18 A No.

19 Q You don't know?

20 A No.

21 Q Isn't it true that the utility has stated in
22 both its emergency petition for variance and in its
23 subsequent testimony in this proceeding that those maps
24 were not being prepared for the purposes of complying with
25 the MFR?

1 A I don't have the petition in front of me.

2 Q You did not read the petition?

3 A I have read it, but I don't have it in front of
4 me right now; but I do recall reading that, and I believe
5 it was in your rebuttal testimony, that there was another
6 reason why they were preparing those maps, and they sped
7 up the process.

8 Q And, in fact, those maps were not proposed to be
9 completed for many weeks after the date the MFRs were
10 filed, is that correct?

11 A I don't know that.

12 Q Do you know whether, in fact, those maps --
13 well, first of all, have you reviewed the maps that were
14 ultimately filed?

15 A No.

16 Q So you haven't compared them to the rule to see
17 if they comply with the rule?

18 A That was the staff engineer's responsibility.

19 Q Okay. Isn't it true that the utility
20 specifically said that it had maps available that would --
21 that it would, could provide to the Commission prior to
22 that time and, in fact, in the emergency variance request
23 that would comply with the MFR requirement?

24 A It was my understanding that the utility said
25 they had a lot of maps that didn't have the detail of

1 location of customers on the lines. It wasn't as precise
2 as the rule required, that they would have to prepare new
3 maps that would be a substantial cost to the ratepayers
4 and that was what was in the emergency petition.

5 Q And do the maps as ultimately filed show that
6 detail?

7 A I don't know. I would assume they do, since
8 they complied with the minimum filing requirements.

9 Q Well, you don't know whether they do or not. I
10 mean, you don't know whether they actually show that kind
11 of detail or not, do you?

12 A As I said before, it was the staff engineer's
13 responsibility to review those maps.

14 Q Isn't it possible in light of the fact that the
15 determination was made that the system was 100 percent
16 contributed that there may have been some leeway given in
17 the exact nature of the maps as ultimately filed?

18 A I don't know. The rule I don't believe allows
19 for any provision like that, so I don't know.

20 Q And you don't understand why a utility would
21 want to file a variance when it saw that it was preparing
22 to file MFRs, and the alternative it had readily available
23 was hundreds of pages of individual maps that it did not
24 believe that would be useful to the Commission engineering
25 staff, even though they might comply with that rule. You

1 don't understand why they would want to file a variance as
2 opposed to proceed with creation of new maps for that
3 purpose, or duplication of existing maps?

4 A I guess what I don't understand is why the
5 utility waited two weeks prior to the filing to contact
6 Commission staff to see whether or not they could get an
7 emergency variance. That if they had done that in October
8 of 1999 that they could have avoided a lot of this and
9 created the maps just like they did seven days after
10 staff's recommendation was filed.

11 Q Well, do you know whether, in fact, those
12 maps -- the maps as ultimately filed were even in process
13 at the time the utility was, got test year approval in
14 October?

15 A I don't know that. But I think that it would
16 have been prudent for the utility, if they are planning a
17 rate case, to make sure that the minimum filing
18 requirements, that they have the capability of preparing
19 all the minimum filing requirements. Those minimum filing
20 requirements have not been revised in a long time. And
21 that is just well-known information, that you can look at
22 three and a half months prior to filing a rate case.

23 Q But if the utility perceived that as opposed to
24 creating maps or copying hundreds of maps, literally
25 hundreds of pages of map as it has alleged in that

1 petition, that the better alternative was to seek a
2 variance if the staff would agree that a variance was
3 appropriate. Then goes out and talks to the staff
4 engineer and the staff engineer says, yes, I believe a
5 variance is appropriate under the circumstances, you don't
6 think it is wise for the utility to then seek that
7 variance?

8 A To the extent that the utility completed the
9 maps in seven days, no, I don't think it was wise for the
10 utility to get a variance.

11 Q Isn't it true that the only reason that the
12 utility went out and got those maps completed in seven
13 days was, one, that there were maps already in process,
14 and, two, that the staff had proposed to deny that
15 emergency waiver request?

16 A It is my understanding that number one was true,
17 that you said that they were already in progress. And,
18 number two, the staff recommended denying the emergency.
19 But even if that repealed rule was in effect, it would not
20 have been a real quick approval of a rule waiver. It
21 would have -- staff would have had to analyze it, brought
22 a recommendation down to the Commission, it still would
23 have held up the official date of filing under either
24 scenario.

25 Q Why wouldn't it have been quick if the staff

1 engineer had already previously agreed, and he is the one
2 who would be utilizing this information, and he is the one
3 who would be analyzing this information if, in fact, he
4 did need it, and he had already agreed that he thought it
5 was appropriate?

6 A The staff engineer is not the one who gets to
7 decide whether or not a rule waiver is allowed, it is the
8 Commission that does. And if any parties disagreed with
9 that, they have the opportunity to address the Commission
10 and state their position.

11 Q But we didn't get to that point. We got to a
12 staff recommendation to deny that waiver after the utility
13 had been told that the person primarily concerned with
14 that MFR provision was agreeable to the variance, isn't
15 that true?

16 A The utility then complied with the rule after
17 staff issued its recommendation.

18 Q Well, I understand that. But I asked you -- we
19 never got to the point where it is possible some third
20 party might have objected to the waiver. What happened
21 was the utility asked for a variance based upon assurances
22 from the person within the Commission who would be
23 concerned with that information, and who might need that
24 information, that person agreed that a waiver was
25 appropriate and then after the waiver was requested --

1 MR. BURGESS: Commissioners, I am going to have
2 to object to compounded compounded questions being asked.
3 There have been a number of them. And I understand some
4 of the difficulty in dealing with this, and so I haven't
5 really raised an objection. But there is an awful lot of
6 statements being made underlying the questions, and so I
7 don't know when I am listening to the answers, and the
8 record won't reflect what the witness is actually
9 answering since there is five or six statements being made
10 by counsel before a question is even being asked.

11 MR. DETERDING: Well, I'm trying to lay out the
12 circumstances to the witness upon which I'm asking her her
13 question. The circumstances that occurred in this case.
14 And if she disagrees with those statements that lead up to
15 the question, then she certainly has every right to say
16 so.

17 MR. BURGESS: That is exactly why compound
18 questions are not allowed. There are five or six
19 different items, and I don't know whether the witness is
20 agreeing to all of them, or some of them, or part of them.
21 And so I am objecting on those grounds.

22 MR. DETERDING: I will try and break them down.

23 COMMISSIONER JACOBS: That sounds like a
24 reasonable approach. Maybe you can narrow your predicate
25 for the question.

1 MR. DETERDING: I will try and break them down.

2 COMMISSIONER JACOBS: Proceed.

3 BY MR. DETERDING:

4 Q The staff engineer would be the person who was
5 primarily concerned with these map requirements in the
6 MFRs, were they not?

7 A As I stated before, yes.

8 Q Okay. The staff engineer did agree that these
9 were not needed by him, isn't that correct?

10 A Their minimum filing requirement. But
11 Mr. Crouch, I believe, did agree informally. But an
12 informal approval is not a rule waiver.

13 Q Did the utility ever suggest that an informal
14 agreement was a rule waiver?

15 A I'm not sure.

16 Q Didn't they file a petition seeking a rule
17 waiver?

18 A Yes, an emergency petition.

19 Q And so they did, in fact, seek formal approval?

20 A Yes.

21 Q Who would you suggest the utility contact if
22 they wanted to find out whether or not these maps were
23 needed and whether or not the staff would support a rule
24 waiver?

25 A The staff engineer, but I would do it as early

1 as I could. As soon as I know -- as soon as I was aware
2 that I didn't have the right kind of maps, and I would be
3 looking at that as soon as I -- even prior to test year
4 approval, I would be looking to see if I had all the
5 components there, if I was going to have to incur
6 additional cost for purposes of filing a rate case so that
7 I wouldn't delay the official date of filing.

8 Q Okay. Let's assume for the moment that the
9 utility had filed a regular rule waiver in October,
10 wouldn't they have to still comply with the requirements
11 of the Commission or the other rules related to seeking
12 that waiver?

13 A Yes, they would. And I think part of staff's
14 analysis of a rule waiver would be if it was economically
15 feasible for the utility to comply with the rule. And
16 that was not -- the staff had not gotten to that point
17 yet.

18 Q Well, you say the staff had not gotten to that
19 point. Didn't you just say the person who was responsible
20 for determining whether or not that information was even
21 necessary had already agreed that it was not?

22 A I said informally he had, but he hadn't had the
23 formal application before him.

24 Q Did he decide -- did the staff engineer or the
25 staff engineering department decide after the emergency

1 variance request was filed that this information was,
2 after all, necessary?

3 A Can you say that again?

4 Q Did the staff engineer determine after the
5 variance request was filed that this information was, in
6 fact, necessary? In other words, did he change his mind?

7 A I don't know.

8 MR. DETERDING: Commissioner, what we are
9 handing out now is a copy of the rule under which the
10 emergency variance was sought.

11 COMMISSIONER JACOBS: Very well.

12 BY MR. DETERDING:

13 Q Have you reviewed this rule, Ms. Merchant, in
14 your dealings with this case?

15 A Yes, I have.

16 Q Isn't it true that this rule contains nine
17 specific requirements under the provisions of 28-104.002
18 for a non-emergency variance?

19 A Yes, for a regular variance.

20 Q Okay. And isn't it true that it also contains
21 under the emergency provisions in .004 simply the same
22 information plus two additional requirements, is that
23 correct?

24 A That's correct.

25 Q So the difference between a regular rule

1 variance and an emergency rule variance is basically
2 adding two additional items?

3 A There are two additional items that might not
4 relate to a material increase in cost, but it could
5 depending on the circumstances.

6 Q Have you in reviewing -- I assume you did review
7 the petition for emergency variance, did you not?

8 A Yes, I did.

9 Q And isn't it true that only the last paragraph
10 in that petition on the bottom of the fourth and top of
11 the fifth pages are the only ones that deal with the
12 emergency provisions of the rule?

13 A I don't have that in front of me, so I can't
14 tell you that.

15 COMMISSIONER JABER: Ms. Merchant, would your
16 testimony change if the petition for emergency waiver had
17 been granted?

18 THE WITNESS: For emergency?

19 COMMISSIONER JABER: Uh-huh.

20 THE WITNESS: I think if it had been approved I
21 think it would have. But the ultimate issue for me is
22 that the utility saw staff's recommendation and then
23 completed the MFR requirement within a week. And my
24 thought was that they didn't need a waiver, emergency or
25 not, because they complied with it in such a short time.

1 COMMISSIONER JABER: Whether they needed it or
2 not, if the law allows it, what criteria does staff use in
3 determining which expenses are prudent or not as it
4 relates to waivers? I guess what I'm trying to articulate
5 this morning is if the, you know, statute allows a company
6 to file a request for a waiver and then the uniform rule
7 reinforces the statute by outlining for them when they can
8 file a request for waiver, what criteria do you use in
9 recommending that those expenses be disallowed?

10 THE WITNESS: I think if the utility -- you
11 would have to look at the details of each request. But if
12 it were allowed, then there still could be some imprudent
13 costs inside that, but you would still have to -- it would
14 be -- you know, the fact that it was allowed would right
15 off the bat say that some portion of those costs should be
16 allowed.

17 But if it were disallowed, then I would make the
18 argument that it was not a reasonable request. But then
19 there might be some circumstances where it might be
20 reasonable to allow some rate case costs, even though it
21 was disallowed. It might still have been prudent to do
22 that. But the cases that I have dealt with waivers, we
23 have not allowed -- and they have been disallowed, the
24 rate case costs associated with that has not been allowed.
25 BY MR. DETERDING:

1 Q You have the petition in front of you now?

2 A Yes.

3 Q Isn't it true that only Paragraph 8A on the
4 bottom two-thirds of Page 4 and the top quarter of Page 5
5 deals with the issue of the emergency nature of the
6 variance?

7 A It looks like Paragraph 8 deals with the
8 emergency.

9 Q Okay. And the rest of it deals with complying
10 with the requirements of the regular variance rule, does
11 it not?

12 A I am not sure that it actually complies with the
13 regular components, because we didn't actually get to that
14 point. I mean, for the information supplied, it appears
15 that it does comply with the requirements. I'm not sure
16 that the merits of this would have addressed the actual
17 waiver, because we did not address that in our
18 recommendation. What we addressed was that it was not an
19 emergency.

20 Q If you will take a moment and look at the rule
21 and compare it to the petition, the rule that you were
22 provided a few minutes ago and the petition, isn't it true
23 that all of the paragraphs up through 7 deal specifically
24 with the requirements of the basic variance rule?

25 A It appears that that is the case.

1 Q And only Paragraph 8 deals with the emergency
2 provisions of the variance request?

3 A Yes.

4 Q So this utility, feeling that it was useless to
5 provide the maps, sought the direction of the staff
6 engineer, the person who would be dealing with those maps,
7 correct?

8 A Yes.

9 Q And then they got that staff engineer's
10 agreements that a variance was appropriate, correct?

11 A I need to correct that last one. There was two
12 parts to that first question, I believe, and I was
13 answering yes to they sought the request of the staff
14 engineer. And if you will -- I don't know what the
15 utility was feeling, but if you will address the second
16 question.

17 Q Okay. And the engineer agreed with them that a
18 variance was appropriate, correct?

19 MR. FUDGE: Commissioners, I object. I think
20 Ms. Merchant has already answered this question two or
21 three times before.

22 MR. DETERDING: I think he is right. I
23 apologize. I withdraw the question.

24 COMMISSIONER JACOBS: Very well.

25 BY MR. DETERDING:

1 Q So after all of this happened the utility sought
2 the variance that it had agreement on, and it obtained a
3 staff recommendation to deny that variance. Isn't it true
4 that the utility might reasonably expect that there would
5 be more legal costs in pursuing the variance request in
6 the future?

7 A I need to -- one of those questions in there
8 said that the staff recommendation denied the variance.
9 The staff recommendation denied the emergency. The staff
10 recommendation did not address the variance.

11 Q All right. Denied granting an emergency
12 variance, did it not?

13 A Yes, it did.

14 Q Recommended that to the Commission?

15 A That is what the staff recommended.

16 Q And the utility could reasonably expect to incur
17 more legal expenses in pursuing that emergency variance or
18 a regular variance for that matter, could it not?

19 A I don't know. It depends. They may not have
20 had to file any additional information. What they would
21 have had to do would be wait out the notice period. The
22 Commission sends out the notice, the utility doesn't send
23 out the notice. So it would have been Commission costs
24 that were incurred other than addressing -- they could
25 incur costs addressing the Commission at agenda. So, yes,

1 right there.

2 Q Wouldn't they incur legal costs for the
3 preparation for the agenda on the emergency variance, and
4 if the staff recommendation was accepted incur legal costs
5 in pursuing a regular variance or reconsideration of that
6 emergency variance?

7 A Yes, they would, most likely. But if they had
8 done this early on, they probably could have avoided all
9 of these costs, that is my testimony, in October of 1999.

10 Q Would the staff have -- well, would they have
11 avoided the costs of filing for a regular variance?

12 A I don't know.

13 Q Well, wouldn't they have had to file for a
14 variance in October of 1999?

15 A I guess it depends on how much the maps cost
16 compared to how much the legal fees were for filing the
17 variance.

18 Q Well, if the utility waived that issue and
19 determined that it was cheaper to seek a variance than to
20 have the maps prepared, you don't think that would be a
21 prudent thing to pursue on the utility's point of view?

22 A If it would be cheaper to incur legal costs for
23 waiver than complete maps then, yes, it might have been
24 prudent. I don't know what the costs for compiling the
25 maps were in this case.

1 Q And you don't know what the cost would have been
2 for filing for a regular variance, either, do you?

3 A No, it wasn't done.

4 COMMISSIONER JACOBS: Mr. Deterding, are you at
5 a breaking point?

6 MR. DETERDING: Sure.

7 COMMISSIONER JACOBS: Let's take a break until
8 10:20.

9 MR. JAEGER: Commissioners, these clocks are
10 wrong, so we have to watch out here. Do you mean 9:20?

11 COMMISSIONER JACOBS: Yes. Whatever.

12 (Recess.)

13 COMMISSIONER JACOBS: Let's go back on the
14 record.

15 MR. DETERDING: First of all, I wanted to have
16 those two exhibits that we handed out marked, the first
17 one being the rule.

18 COMMISSIONER JACOBS: And then your petition?

19 MR. DETERDING: And then the petition, right.

20 COMMISSIONER JACOBS: We will mark the Chapter
21 28-104 variance as Exhibit 19. And we will mark the
22 petition of Aloha for variance from Rule 25-30.440 as
23 Exhibit 20.

24 MR. DETERDING: Thank you, Commissioner.

25 (Exhibit 19 and 20 marked for identification.)

1 BY MR. DETERDING:

2 Q Okay, Ms. Merchant, a couple of other questions
3 on that issue. You were asked a question at the top of
4 Page 15 of your testimony. "Question: Why do you believe
5 that the legal fees associated with the petition for
6 emergency variance should be removed from rate case
7 expense?" And in your answer you say, your second
8 sentence of your answer says, "Rule 25-30.125, Florida
9 Administrative Code, requires utilities under the
10 Commission's jurisdiction to have maps available on file."

11 Isn't it true that this utility does have maps
12 available on file?

13 A I believe that is true. They have stated that
14 in their motion.

15 Q And, in fact, they have stated in that motion as
16 well that they have -- those maps comply with the
17 requirements of that rule, do they not?

18 A I would have to check. But subject to check I
19 would say yes.

20 Q Have you done any analysis to determine whether
21 or not those maps comply with that rule?

22 A No, I have not.

23 Q Have you done any analysis to determine whether
24 or not those maps comply with the requirements of the
25 minimum filing requirement map rule?

1 A I believe I said no, I haven't, the staff
2 engineer did.

3 Q And you say the staff engineer, let me clarify
4 that. We are talking about the maps that are in the
5 utility's offices and have been in the utility's offices,
6 as opposed to that which was ultimately filed to comply
7 with the MFR?

8 A Then I don't know what the staff engineer looked
9 at on the maps in the office.

10 Q Okay. In your testimony you state that any
11 costs associated with filing revisions to the MFRs should
12 be disallowed to the extent those costs duplicated or
13 corrected information already submitted, is that correct?

14 A That is true.

15 Q And has the utility claimed that those costs
16 duplicated or corrected information already submitted?

17 A The utility does not believe that it duplicated
18 information already submitted.

19 Q And as to the information -- as to the
20 corrections in the MFRs, isn't it true that those costs
21 were written off?

22 A The corrections of what?

23 Q Corrections of errors within the MFRs?

24 A I mean, I think I need you to be more specific
25 on that. We had a deficiency letter, and there were a lot

1 of deficiencies in the MFRs that needed to be corrected.
2 So I don't know if you would call those errors or not, but
3 there were a lot of deficiencies.

4 Q Well, wasn't there a category, I think, within
5 your deficiency letter that dealt with errors as opposed
6 to deficiencies?

7 A There was a category called errors in the
8 headings of schedules, and a category called possible
9 errors between the utility's descriptions of projection
10 methodologies and the dollar amounts projected. There
11 were other concerns, and there were MFR deficiencies.

12 Q Isn't it true that Mr. Nixon has specifically
13 stated that he has removed all costs related to the errors
14 in the MFRs, correcting the errors?

15 A I believe that his definition of the word
16 errors, the errors in the headings of the schedule and
17 errors in the utility's dollar amounts.

18 Q Okay. What other errors are there in the MFRs?

19 A You could interpret the deficiencies in the MFRs
20 as being errors in not complying with the MFRs.

21 Q Okay. Well, let's for the moment assume that
22 the -- can you distinguish between deficiencies and
23 errors? In other words, those things that you called
24 deficiencies we will call deficiencies, and those things
25 that are not deficiencies but simply errors we will call

1 errors. Isn't it true that Mr. Nixon has written off and
2 not charged to this utility and not included in rate case
3 expense those costs related to correction of errors?

4 A I believe that is his testimony.

5 Q Do you have anything to demonstrate that that is
6 not correct?

7 A No.

8 Q As I understand your testimony, you believe that
9 the deficiencies that the utility was -- and the
10 information the utility was required to file would require
11 more time to prepare if filed later, isn't that true?

12 A I believe that it is inefficient for the utility
13 to complete the MFRs through deficiencies. By addressing
14 those items at a later date, it is inefficient. If you
15 had done it up-front where you have to, especially in
16 projected test year, to be able to project you have to
17 come up with assumptions. You have to write those down or
18 you are going to forget them.

19 And if you are writing them down you might as
20 well design a document that is going to be submitted with
21 the minimum filing requirements, and just have one page
22 that all you have to do is just print it out. That is how
23 I have seen it in many rate cases before with projected
24 test years.

25 Q Do you know for a fact that everything that was

1 ultimately filed had to be written down before the initial
2 filing?

3 A Can you be more specific with your question?

4 Q Well, you have stated that it was inefficient
5 for the utility to do so because they had to write
6 everything down in order to file the MFRs as originally
7 filed?

8 A The rule for minimum filing requirements for
9 projected test years say that you have to provide a
10 schedule that shows the method and basis of all
11 projections, a detailed schedule. And when you are doing
12 a projected test year you need to be very aware of that
13 and detail how you project every account. It has to be
14 documented, it has to be submitted through the filing of
15 the MFRs. And to be prudent you should do that up front
16 and just -- it doesn't, it's not going to have -- you are
17 not going to have to go back after the fact and redo
18 something that you already should have done in the
19 beginning.

20 Q Well, obviously there is a difference of opinion
21 between you and Mr. Nixon about the interpretation of that
22 requirement within the MFRs, is there not?

23 A I believe that there is. But I have -- I see a
24 lot of projected test years with the Public Service
25 Commission. There are a lot of utilities that comply with

1 this rule. Some of them don't get it completely correct
2 every single time that they file, but the majority of them
3 comply with that requirement. And if any consultant or
4 utility has any questions about what is sufficient
5 information that needs to be filed to support a projected
6 test year, they can certainly call us up front and we will
7 be more than glad to give them examples of cases that we
8 have looked at and the detail that companies have
9 provided.

10 Q Have you ever prepared the MFRs for a PSC rate
11 case?

12 A No, I have not.

13 Q So you have never accumulated the information
14 necessary to file those MFRs, have you?

15 A No, I have not.

16 Q Am I correct in understanding your testimony in
17 that you were taking the position that because the utility
18 filed the information in an Excel format, or I believe you
19 said Lotus format rather than simply filing the previously
20 accumulated work papers, that they went to additional
21 expense?

22 A I didn't follow that question.

23 Q Well, as I understand some statements you have
24 made, you believe that it costs more for the utility to
25 file this information, the deficiency response in an Excel

1 format than if they had used simply workpapers of the
2 accountants in preparing the MFRs?

3 A I don't know that I said that specifically. My
4 testimony is that the information was required by the
5 minimum filing requirements. It is a very -- the method
6 that I would have used and that I have seen used in a lot
7 of different cases is they create these notes as they go
8 along. The actual manner that utilities use is not
9 identical in every case, but the information is there
10 whether plant projections are on the plant schedule,
11 engineering projections are on the engineering schedule,
12 they are systematically organized so that you can find the
13 information.

14 A lot of companies put all the projections in
15 one section and they are detailed out by primary account,
16 it's all done in one document. It doesn't necessarily
17 entail a whole lot of extra expense. You have got to
18 think through these things when you are planning a
19 projected test year. Every single account has to be
20 looked at whether it is going to be the method that you
21 are going to project it or the fact that you are not going
22 to project it. No change in an account is, in fact, a
23 projection methodology that needs to be described, and it
24 simply says no escalation.

25 Q Well, you just said that different utilities do

1 it different ways, different consultants do it different
2 ways as far as how they put it together, correct?

3 A That's correct.

4 Q Okay. And you have never actually done this?

5 A No, but I have reviewed a large number of
6 projected test years all the way back to like 1984.

7 Q And you are aware that Mr. Nixon has said that
8 the information that you asked for as deficiencies had not
9 previously been prepared, isn't that correct?

10 A Restate that, please.

11 Q You are aware that Mr. Nixon said that the
12 information you asked for in your deficiency letter under
13 the heading of deficiencies had not previously been
14 prepared?

15 A I agree that he said that some of it had not
16 been prepared. And I do believe that it should have been
17 prepared at the beginning to comply with the MFR rule, and
18 to come back at the deficiency stage and to recreate those
19 schedules is an inefficient manner to do that.

20 Q Well, you say recreate, but they were never
21 created in the first place. If they were never created in
22 the first place as he says, and then they had to be
23 created and you believe they were necessary as part --

24 MR. FUDGE: Objection. He is arguing with the
25 witness about what she said.

1 MR. DETERDING: I don't believe I'm arguing with
2 the witness. I'm asking her a question.

3 COMMISSIONER JACOBS: Restate the question,
4 please.

5 BY MR. DETERDING:

6 Q If Mr. Nixon -- you agree Mr. Nixon says those
7 items had not been prepared as part of the original MFRs,
8 correct?

9 A That's what Mr. Nixon said.

10 Q Okay. And you have never prepared the MFRs,
11 have you?

12 A I answered no.

13 Q Okay. Thank you. So if the utility had to file
14 this stuff in order to comply with the MFRs, it cost the
15 same whether it was compiled in January or whether it was
16 compiled in March, does it not?

17 A That's where I am disagreeing with you. No, I
18 don't believe that it would cost the same. I think it
19 would be cheaper to do it all at the beginning when you
20 are planning this information. To come back after the
21 fact is inefficient and it would cost more.

22 Q Well, in addition to the fact that you have
23 never done this, did you go back and try and determine
24 what it would have cost, what the difference in those
25 would be? Because what you have said is simply that it

1 was duplicative. But Mr. Nixon has said it is not
2 duplicative. So did you go back and try and determine
3 what the difference would be as far as the cost to prepare
4 these items after as opposed to before?

5 A No, I didn't. I believe that is the utility's
6 burden to do that.

7 Q Okay. So what you have done instead is just say
8 all the costs that the utility incurred in preparing the
9 information that was necessary to be filed under the rule,
10 in your opinion, should be disallowed because it wasn't
11 filed with the initial application?

12 A My testimony is that the way that the utility
13 chose to do this was inefficient, and if some portion of
14 it is inefficient, I can't determine what portion of it is
15 efficient or was efficient. And, therefore, the number
16 that I have is the total amount, that is my testimony.
17 The company has not justified that expense to be included
18 in rates.

19 Q Is there a requirement that the projections
20 within the MFRs be done by account by month specifically
21 stated in the form?

22 A The MFRs require in a projected test year a
23 schedule to be included which describes in detail all
24 methods and basis of projection. And my interpretation of
25 that rule means if you have a plant item that you are

1 projecting, say it is pumping equipment, you need to tell
2 me how much you project that plant account is going to
3 increase over the two projected test years, the
4 intermediate year and the projected test year, excuse me,
5 not both projected years. Otherwise, we can't tell -- if
6 we make an adjustment to that account, we can't tell what
7 the depreciation rate is, how much accumulated
8 depreciation is applied to that account. Yes, to be able
9 to complete a projected test year, you have to go through
10 and project each primary account. That goes through
11 plant. Depreciation is going to be a fallout of plant.
12 CIAC you have to project by component. O&M expenses you
13 have to project by account. You can't do a projection --
14 I mean, you can, but it is not going to be a reliable
15 projection. If you just take O&M expenses and project O&M
16 expenses, they all move in different directions, some are
17 impacted by different factors. You have to provide the
18 basis in your minimum filing requirements to support your
19 projection.

20 Q But there is nothing in the provision that you
21 just read as supporting your deficiencies in your
22 deficiency letter that requires this information by month
23 by account, is there? Does it say anything about by month
24 by account projections in that thing you just read?

25 A No. It says a schedule which -- it shall be

1 included which describes in detail, and in detail is where
2 we are making the interpretation -- all, and that is
3 pretty inclusive, all methods and basis of projection.
4 And to be able to make a projection you have to either say
5 this account is being projected, this account is not being
6 projected. And that has been our interpretation. We have
7 been consistent with that interpretation with the
8 utilities that file projected test years.

9 Q Where would a utility look to find guidance that
10 would tell them that you had interpreted that to require
11 by month by account projections?

12 A They could contact the staff of the Public
13 Service Commission while they are preparing MFRs. A lot
14 of times we send out examples of minimum filing
15 requirements of companies. I have done that many times.
16 Copies of prior cases. The very first projected test year
17 that I dealt with back in 1984, I believe sometime around
18 that, mid-'80s, the first company that filed a projected
19 test year had a very good example of the information used
20 to project all the accounts, and we used that as our
21 example. And we sent that out for years to utilities and,
22 you know, use this methodology. You don't have to stick
23 to it to the T, but it is a guide.

24 Q So this is a policy of the Commission that has
25 been in effect since 1984, at least, is what you are

1 saying?

2 A For projected test years.

3 Q And it is applied generally to all utilities who
4 file MFRs and projected test years?

5 A This is a minimum filing requirement and a staff
6 interpretation of this. The utilities that complete
7 projected test years have complied with this rule.

8 Q And they are required --

9 A Very few utilities have deficiencies to this
10 magnitude.

11 Q And they are required to comply with that
12 interpretation, are they not?

13 A Yes, they are.

14 Q And it is nowhere stated in a rule or a form
15 with specificity?

16 A It is in the form in some -- in the MFR rule. I
17 don't have the MFR form in front of me.

18 Q It says something about by projections by
19 account by month in that rule, in that form?

20 A No, there are certain schedules that provide --
21 you have to provide the information by account, plant
22 accounts, primary accounts, O&M expense accounts.

23 Q But it requires the projection methodology --
24 there is nothing in there that says to provide the
25 projection methodology by account by month, correct?

1 A Other than the fact that this rule says in
2 detail all methods and basis of projection.

3 Q Okay. Thank you. Let's move on to your
4 supplemental direct, Ms. Merchant. What experience do you
5 have in the commercial real estate market?

6 A None.

7 Q Do you have a degree in real estate?

8 A No.

9 Q Have you ever practiced in any area related to
10 commercial real estate?

11 A No.

12 Q Have you ever rented commercial real estate or
13 purchased commercial real estate for an office building?

14 A No.

15 Q Did you do any research concerning commercial
16 real estate costs or availability in Pasco County?

17 A I only reviewed the information submitted by the
18 utility.

19 Q And also contacted the utility's realtor, did
20 you not?

21 A I called two realtors. One of them happened to
22 be the utility's realtor.

23 Q Just by accident, then?

24 A No, I had the phone number on the information
25 you provided. But I called another one.

1 Q Okay.

2 A And I told them who I was.

3 Q I wasn't accusing you of anything. So you have
4 no training, experience, or expertise in the area of
5 commercial real estate, correct?

6 A No.

7 Q How many cases have you been involved in in
8 which the Commission has required the submission of a,
9 quote, cost/benefit analysis to justify purchase or lease
10 of office space?

11 A I don't know that a purchase or lease of office
12 space, I can't specifically recall that. I know that a
13 cost/benefit analysis is basically a prudence test. And
14 that is a very common tool. I mean, the Commission's
15 role is to determine whether the utility's investment in
16 plant is prudent and its expenses are prudent, and that is
17 a test that we use in many instances.

18 I can recall in the Southern States rate case,
19 Southern States built a laboratory to use, their own
20 personal laboratory for testing. And whereas everybody
21 else has always purchased testing expenses from outside
22 parties. So we investigated that, and we required the
23 utility through discovery to provide information
24 explaining why that is reasonable.

25 Also, in that docket, I believe that Southern

1 States was looking for a source of water down in the Marco
2 Island area, and there were numerous options that they had
3 available to them, and they were required to provide
4 information to explain why those amounts were prudent to
5 be recovered by the ratepayers. It is just a common tool
6 that we use to see whether or not something was prudent.

7 Q Do most utilities regulated by the Commission
8 have offices?

9 A In some form or another they do.

10 Q How many cases has this Commission required the
11 filing of a cost/benefit analysis as a prerequisite to
12 approval of the cost of acquiring that office space?

13 A I don't know that a quote, unquote, cost/benefit
14 analysis, I think that is just a choice of term. But a
15 utility is required to justify its requested costs,
16 whether it is an office building, or whether it is a
17 utility plant, or whether it is a reuse facility or any
18 item. It has to be a prudent expense. And that's what we
19 do is we analyze the prudence of expenses and costs that
20 the utilities request. It is a common tool that we use.

21 Q But you have stated in your testimony that the
22 utility should have performed a cost/benefit analysis.
23 And I'm trying to find out how many cases have you
24 required the filing of a cost/benefit analysis in?

25 A I think I answered the question, that it is

1 numerous occasions. I have listed -- I have got a case
2 right now that -- it's not a rate case, it is just a
3 petition filed before the Commission for early retirement
4 costs. We are sending out discovery to ask for
5 cost/benefit analysis of why an early retirement program
6 is prudent. It might not be prudent. That is a current
7 case going on right now. It is not uncommon.

8 Q We are dealing with the issue of office space.
9 And my question to you, let me try and state it again so
10 you will understand it. How many cases have you been
11 involved in or have you seen at this Commission where the
12 Commission required the submission of a cost/benefit
13 analysis as a basis for approval of rental or purchase of
14 office space?

15 MR. FUDGE: Objection. I think she already
16 answered that one.

17 MR. DETERDING: I have not gotten an answer to
18 that question yet. If you will just tell me what the
19 answer is, then we will move on.

20 COMMISSIONER JACOBS: I think by analogy she
21 gave you an example of a case. But as to the specific
22 requirement of a filing of cost/benefit analysis for real
23 estate, let's get that question answered.

24 MR. DETERDING: I don't think so.

25 THE WITNESS: I don't know. I can't recall.

1 I'm not saying that I haven't. For specifically an office
2 building, I am not saying no. I just became aware of the
3 question yesterday afternoon. If I had some time to do
4 some research on it I might be able to come up with a
5 different answer. But I don't distinguish an office
6 building from -- if the utility is requesting recovery of
7 an office building, that does not escape a prudence
8 evaluation distinguished from any other utility property
9 or expense that they are requesting recovery of.

10 MR. DETERDING: And I'm not asking you about a
11 prudence evaluation. I'm asking you about a document that
12 you term a cost/benefit analysis that you claim this
13 utility should have prepared and must be provided in order
14 to evaluate the purchase or lease of office space.

15 MR. FUDGE: Objection. She has already stated
16 that a cost/benefit analysis is a prudency test, it is
17 just a term of art that has been used.

18 COMMISSIONER JACOBS: Let's try the next round,
19 Mr. Deterding. I think she did answer that.

20 BY MR. DETERDING:

21 Q Is this requirement of a cost/benefit analysis a
22 policy of the Commission in reviewing office space?

23 A As I have stated, it is a tool that we use to
24 measure the prudence of an item. And my distinction was
25 when we asked for a prudence -- I mean, a cost/benefit

1 analysis, we asked for the cost/benefit analysis of
2 whether to purchase or lease a building. It wasn't to --
3 my reading of the information that we got from the utility
4 was it was a comparison of the prudence of purchasing the
5 current building and leasing the old building. It didn't
6 comply with what I was looking for through discovery, a
7 comparison of the various options available to the utility
8 in the market. That's what we were looking for. Was it
9 prudent for this utility to go out and find -- to purchase
10 this building versus leasing property 1, 2 or 3. And that
11 is as simple as what we were asking for. Give me some
12 information. And that's not what we got.

13 Q Isn't the information that the utility has filed
14 in its supplemental rebuttal a comparison of those costs?

15 MR. BURGESS: Commissioner, I object to that.
16 That testimony hasn't come in yet. And, in fact, there is
17 some of that testimony that I think is improper and intend
18 to move to strike. And so in the chronology of events, I
19 would like to keep that distinct. That is that that
20 testimony has not come before the Commission technically
21 at this point. And I would object then to references to
22 evidence that has not been brought before the Commission.

23 COMMISSIONER JACOBS: Which means it is not
24 within her testimony, so probably not within cross.

25 MR. DETERDING: All right. Let me backup then.

1 I will phrase this differently.

2 BY MR. DETERDING:

3 Q Didn't the utility provide in response to
4 discovery from the staff information concerning the
5 alternatives available to it in reviewing its real estate
6 purchase, its office space purchase to the staff?

7 A They provided some information through
8 discovery, but it wasn't as clear. I know the initial
9 discovery was relatively vague, and you couldn't tell --
10 just looking at the information, I couldn't determine if
11 that was actually a comparison of the prudence of those
12 properties or not. There was a lot of information that --
13 I'm not a real estate expert, as you have questioned me.
14 I could not tell whether that cost was reasonable or not.
15 And they didn't look comparative. You couldn't look at
16 one piece of property and compare it to the other. So
17 that was -- I believe that there were just holes in the
18 information that we were provided.

19 Q You state in your testimony at Page 4, Line 17,
20 "I believe that a prudent business owner in the
21 competitive market would perform a cost/benefit analysis
22 to determine whether its decision to lease or purchase a
23 material piece of property was economical and prudent."
24 And I want to ask you, is that a requirement before
25 consideration of a cost incurred by a utility?

1 A No, it is not a requirement of the utility to do
2 that, but I would think it would be a prudent thing to do.

3 Q Okay. And is it required or necessary in your
4 mind that that be a written document?

5 A It is not required. But if they want to show
6 the Commission all the steps that they went through to
7 make the best decision, it is recommended.

8 Q Well, recommended by what?

9 A I would think it would be more prudent to put it
10 in writing.

11 Q Do you have a policy or rule that specifically
12 provides for that?

13 A I don't think we can have a rule for every
14 single circumstance that comes up, but this was -- to me
15 it is a common sense thing that if you want a major item
16 in your rate case to submit documentation that shows that
17 it is prudent. The steps you went through. You know,
18 just a statement of this is what I did.

19 Q But even though the majority of the utilities
20 that you are aware of have some sort of office, you are
21 not aware of any case where such a written document was
22 required for that office space?

23 A I don't know that. There certainly could have
24 been.

25 Q Well, I didn't ask you whether there could have

1 been, Ms. Merchant, I asked you whether you are aware of
2 any where that was required?

3 A In my experience, no. But that doesn't mean
4 that it didn't happen with some other analyst.

5 MR. DETERDING: That's all I have.

6 COMMISSIONER JACOBS: Staff, redirect? I'm
7 sorry.

8 MR. BURGESS: No questions.

9 COMMISSIONER JACOBS: Staff, redirect.

10 REDIRECT EXAMINATION

11 BY MR. FUDGE:

12 Q Ms. Merchant, you stated earlier that it was a
13 policy of the Commission to require some of the detailed
14 analysis in the MFRs, and that you sent out example MFRs,
15 is that correct?

16 A That's correct, when utility's request it.

17 Q So it is not all the time, it is only when the
18 utility's request it, is that correct?

19 A That's correct.

20 Q So is that more of a practice to send it out
21 when it is requested?

22 A I don't know that that is a practice. If they
23 request it, we provide it.

24 Q If it was a policy then you would provide it all
25 the time, is that correct?

1 A If it were a rule that we provided it, that we
2 provide a copy of examples of previous cases, yes, we
3 would provide it.

4 Q Under either the new or the old rule that the
5 Commission had on variances, who had the authority to
6 grant that variance?

7 A The Commission.

8 Q Could a staff engineer grant that variance?

9 A No staff has the authority to grant any waivers.

10 MR. FUDGE: Ms. Bedford is going to pass out a
11 letter from Mr. Deterding to Mr. Jaeger explaining the
12 nature of the emergency variance. We would like to have
13 this identified as Exhibit 21.

14 COMMISSIONER JACOBS: Very well. And the title
15 would be?

16 MR. FUDGE: Letter to Mr. Jaeger from Mr.
17 Deterding.

18 COMMISSIONER JACOBS: Great.

19 (Exhibit 21 marked for identification.)

20 COMMISSIONER JACOBS: You may proceed.

21 BY MR. FUDGE:

22 Q Ms. Merchant, during Mr. Deterding's questioning
23 earlier he said that only one page of the variance was
24 dedicated to an emergency, is that correct?

25 A That's what he said in the motion was only one

1 paragraph, Paragraph 8.

2 Q In this letter, how many pages of the letter are
3 dedicated to the specifics of an emergency?

4 A At least 1-1/2 pages.

5 Q So that is substantially more than just the one
6 paragraph in the petition?

7 A That's correct.

8 Q So you would assume more time was spent on the
9 emergency than has been allocated, is that correct?

10 A In this case, yes. Well, than was identified by
11 Mr. Deterding from the waiver request.

12 MR. FUDGE: That's all.

13 COMMISSIONER JACOBS: Very well. Exhibits.

14 MR. DETERDING: Commissioner, may I ask one or
15 two questions on this letter since this is something
16 totally new?

17 COMMISSIONER JACOBS: You haven't had a chance
18 to review it before?

19 MR. DETERDING: I was not -- I certainly had no
20 idea it was going to be used as an exhibit on redirect,
21 and I would just like to ask one or two questions on this
22 letter.

23 COMMISSIONER JACOBS: It seems like it shouldn't
24 have been a surprise; it's your letter to staff.

25 MR. DETERDING: I agree, and I just want to

1 clarify one or two items on this letter.

2 COMMISSIONER JACOBS: Very narrowly. Go ahead.

3 RECROSS EXAMINATION

4 BY MR. DETERDING:

5 Q Ms. Merchant, the provisions you are talking
6 about in this letter that deal with the emergency nature
7 of the variance, aren't those, in fact, responses to a
8 request by the staff for more information on the emergency
9 nature of the variance?

10 A I didn't address any letter to the utility
11 regarding this, but I would assume that the utility's
12 request for waiver did not contain sufficient information,
13 so it needed to be followed up with additional
14 information.

15 Q So they are response to a staff request for
16 additional information, are they not?

17 A To comply with the rule for rule waiver.

18 Q So you are saying that the provisions of the
19 variance as originally filed did not comply with the rule?

20 A I believe that that is what the staff engineer's
21 analysis was.

22 Q Where is that stated in this letter or any other
23 document that you are aware of?

24 A On Page 2 in the -- I'm not sure which paragraph
25 it is, but it starts with, "You had questioned our meeting

1 of the obligations under the provision of the uniform rule
2 relative to the emergency nature of our variance. In
3 light of the information provided above, I have tried to
4 explain how these requirements are met below." It appears
5 that the staff engineer was -- I mean, excuse me, the
6 staff attorney was not -- needed additional information to
7 be able to determine whether or not it was an emergency.

8 Q So this was additional information requested by
9 the staff attorney to explain the emergency nature of the
10 variance?

11 A I guess it's the -- I can't speak for the
12 attorney, and I don't have the letter from the attorney in
13 front of me, but it appears that the information submitted
14 in the utility's motion for waiver was not sufficient to
15 describe what an emergency was. And the rule requires you
16 to describe what the emergency is.

17 Q There has been no ruling to that effect, has
18 there, by any prehearing officer or the Commission?

19 A No. The utility provided this information,
20 though.

21 Q After this request by the staff?

22 A Yes.

23 MR. DETERDING: That's all I have.

24 COMMISSIONER JACOBS: Very well. Anything,
25 staff?

1 MR. DETERDING: Move Exhibits 19 and 20.

2 COMMISSIONER JACOBS: I was asking if staff had
3 any redirect?

4 MR. DETERDING: I apologize.

5 MR. FUDGE: Staff has one question.

6 FURTHER REDIRECT EXAMINATION

7 BY MR. FUDGE:

8 Q There was no decision on this emergency variance
9 because the utility withdrew their request for emergency
10 variance, is that correct?

11 A That's correct.

12 MR. FUDGE: Thank you.

13 COMMISSIONER JACOBS: Very well.

14 MR. DETERDING: Now I would like to move 19 and
15 20.

16 COMMISSIONER JACOBS: All right. Show 19 and 20
17 admitted.

18 MR. FUDGE: I would like to move 18 and 21.

19 COMMISSIONER JACOBS: Show 18 and 21 admitted.

20 Thank you. You are excused, Ms. Merchant.

21 Next witness.

22 MR. DETERDING: I believe the next witness is
23 the utility's rebuttal, is that correct?

24 COMMISSIONER JACOBS: That's correct.

25 (Exhibit 18, 19, 20, and 21 admitted into

1 evidence.)

2 MR. DETERDING: We would call Robert C. Nixon to
3 the stand.

4 ROBERT C. NIXON

5 was called as a witness on behalf of Aloha Utilities, Inc.
6 and, having been duly sworn, testified as follows:

7 DIRECT EXAMINATION

8 BY MR. DETERDING:

9 Q Mr. Nixon, please state your name and employment
10 address for the record.

11 A Robert C. Nixon, CPA, 2560 Gulf-to-Bay
12 Boulevard, Suite 200, Clearwater, Florida.

13 Q And you have been retained by Aloha to provide
14 testimony and expert opinions this proceeding?

15 A Yes.

16 Q Did you previously provide direct testimony in
17 this case?

18 A Yes.

19 Q Did you prepare in conjunction with my office
20 your document entitled rebuttal testimony of Robert C.
21 Nixon consisting of 70 pages?

22 A Yes.

23 Q And if I asked you the questions contained in
24 that rebuttal testimony today, would your answers be the
25 same?

1 A Not on all of them. I have some corrections.
2 My testimony was finalized while I was on the Appalachian
3 Trail, and part of the problem was with E-mail. Your
4 office has a Word Perfect system, and we use Microsoft
5 Word, so some things got jumbled, so I do need to go
6 through here and make some corrections.

7 Q Okay, go ahead.

8 A The first one is on Page 4, Line 10, 10 and 11,
9 that question should be moved down below Lines 12 through
10 25, so that it is above the answer at the top of Page 5 on
11 Line 1.

12 Q Let me understand this. Just the one sentence
13 on 10 and 11 is a question that should move to the bottom
14 of that page, is that correct?

15 A That's correct. Because on Lines 12 through 25
16 that is a continuation of my answer to the previous
17 question.

18 Q Okay. All right.

19 A On Page 7, Line 7, the third word from the right
20 should be "to" instead of "of".

21 Q "Payment to DEP"?

22 A Yes.

23 Q Okay.

24 A And on Page 11 on Line 19, 21, and 22, I need to
25 change the dollar figures there. On Line 19, the amount

1 \$42,725 should be changed to 29,357. The figure of
2 \$30,022 on Line 21 should be 16,654. On Page 27, Line 11,
3 the dollar amount after reuse mains, which is the last
4 item on that line, should be \$799,728.

5 COMMISSIONER JABER: Mr. Nixon, let me ask you a
6 question.

7 THE WITNESS: Yes, ma'am.

8 COMMISSIONER JABER: What is the nature of that
9 change? That is not a typographical error, is it?

10 THE WITNESS: It is just to agree to the
11 exhibit. I don't know where that number came from.

12 COMMISSIONER JABER: All right. Thank you.

13 A (Continuing) On Page 46, Line 22, some words
14 got dropped. Beginning with that sentence that presently
15 reads, "That order," we should strike the word "that" and
16 insert "this staff position in," the word order remains,
17 and then insert "No. 21266". On Page 47, Line 21, the
18 year 1986 should read 1987. And on Page 55, Line 20, the
19 word "designed" should be "designing". And on Page 56,
20 Line 3, just past the center of that line the word "on"
21 should be the word "and". On Page 58, my answer "yes"
22 should be changed to "no".

23 Q This is on Line 9?

24 A Yes. Page 61, Line 15, the word "did" should be
25 "did not". On Page 69 -- and these changes reflect -- are

1 made to reflect the updated information that we filed with
2 the Commission concerning rate case expense -- Line 18,
3 the middle of that line the word "composite" should be
4 inserted. Line 20 --

5 Q That is just before the word exhibit?

6 A Yes. On Line 20, the word "composite" should be
7 inserted before "exhibit". On Line 23, Line 23 should be
8 stricken and the words "October 6th, 2000" should be
9 inserted.

10 Q I'm sorry, what on Line 23 should be stricken?

11 A The whole line.

12 COMMISSIONER JABER: What page are you on?

13 THE WITNESS: I'm on Page 69.

14 BY MR. DETERDING:

15 Q Line 23 should be stricken, and what should be
16 put in its place?

17 A October 6th, 2000. That reflects the last date
18 of our rate case expense update.

19 Q And so I assume that the word "engineering" on
20 Line 24 should also be stricken?

21 A Yes. And then on Line 24, the amount should be
22 changed to agree with our update, which is \$374,135. And
23 on the last page, Page 70, Line 1, the \$160,000 should be
24 stricken and \$98,680 should be added. And on Line 3, the
25 \$395,238 should be stricken, and \$472,815 should be

1 inserted. On Line 6, \$95,000 should be stricken and the
2 \$172,815 should be inserted.

3 Q Give me that number again.

4 A \$172,815.

5 Q Okay.

6 A And on Line 10, after the word "issues" insert
7 "and witnesses". And then on Line 15, this is the last
8 one, the word "composite" should be inserted in front of
9 the word "exhibit". I apologize for these lengthy
10 corrections.

11 Q Okay. And you have stated that many of those
12 corrections, especially near the end there, were related
13 to the updated rate case expense?

14 A Yes, that is correct.

15 Q Let me ask you about your exhibits. You have
16 prefiled with your rebuttal testimony, Exhibits RCN-1
17 through RCN-17, is that correct?

18 A That's correct.

19 Q Okay. And the one that deals with rate case
20 expense is RCN-16, correct?

21 A That's correct.

22 Q And pursuant to Commission directive, you have
23 filed updates to that dated September 27th and October
24 10th, correct?

25 A I believe they were filed on October 10th. The

1 actual update is through October 6th.

2 Q But you also provided a previous update dated
3 September 27th, as well?

4 A That's correct.

5 Q Okay. And those both combine to revise RCN-16?

6 A Yes.

7 MR. DETERDING: And, Commissioners, what we
8 would like to do as far as that is concerned in rate case
9 expenses, is make sure that the latest information becomes
10 part of those filings on September 27th and October 10th
11 that we were directed to file by the Commission as
12 updates, become part of RCN-16.

13 COMMISSIONER JACOBS: Okay. How would you like
14 them marked. Would all of his rebuttal exhibits be one
15 composite, or do you want to keep them separate?

16 MR. DETERDING: Well, it's fine to call them all
17 one composite exhibit, and I think that then as we are
18 referring to them, they will be Composite Exhibit 22,
19 RCN-16 and then the --

20 COMMISSIONER JACOBS: As supplemented?

21 MR. DETERDING: Right. The supplements to that
22 RCN-16.

23 COMMISSIONER JACOBS: Great. So we'll note that
24 Exhibit 22 is the full complement of Mr. Nixon's exhibits,
25 including the supplemented RCN-16.

1 (Composite Exhibit 22 marked for
2 identification.)

3 BY MR. DETERDING:

4 Q Now, as far as those exhibits, your exhibits are
5 concerned, you prepared those exhibits, did you not?

6 A Yes.

7 Q And do you have any changes or corrections to
8 make to those exhibits?

9 A I have two pages I would like to add to Exhibit
10 3. They were left off, they should have been included.
11 They don't change my testimony in any way, but they do
12 provide some clarification. And I need to strike some of
13 the invoices as part of the exhibit, since they related to
14 items that were capitalized and the subject of one of our
15 stipulations.

16 Q Which exhibit are you referring to here?

17 A This is RCN-3.

18 COMMISSIONER JACOBS: Do you have copies of
19 those revisions?

20 COMMISSIONER JABER: Chairman Jacobs, at least
21 the copy that I have is marked confidential.

22 COMMISSIONER JACOBS: I noted that, as well. I
23 assume you haven't asked for confidential treatment in
24 this case?

25 MR. DETERDING: No, no.

1 COMMISSIONER JACOBS: All right.

2 BY MR. DETERDING:

3 Q And this would be part of RCN-3, you are saying?

4 A Yes. It is simply a listing of every materials
5 and supplies expense during the historic test year and the
6 previous calendar year 1998. We provided that same
7 information in connection with miscellaneous expense, but
8 we left it off in the materials and supplies exhibit.

9 Q Okay. And you mentioned something about RCN-5,
10 was that correct, am I correct?

11 A If I said 5, it was incorrect.

12 Q Okay. I thought you said something about the
13 previously expensed items, one of the exhibits relating to
14 that?

15 A I don't think I did.

16 Q Okay, I apologize.

17 COMMISSIONER JABER: Can I ask a question?

18 MR. DETERDING: Sure.

19 COMMISSIONER JABER: Have the parties and staff
20 seen this before?

21 THE WITNESS: They saw the one on miscellaneous.
22 I don't think they did see this one.

23 COMMISSIONER JABER: So you are presenting this
24 for the first time today?

25 THE WITNESS: Yes. It just shows where the

1 numbers in my testimony came from.

2 COMMISSIONER JABER: When did you file your
3 testimony?

4 THE WITNESS: I'm not sure of the date. I was
5 out of town. I believe it was sometime around September
6 12th or 13th.

7 BY MR. DETERDING:

8 Q Mr. Nixon, were you saying that RCN-3 had
9 something in it that needed -- I thought I heard you say
10 something needed to be deleted. Am I correct or --

11 A I can either delete them or leave them alone.
12 My schedule with the number changes, I had included as
13 part of the explanation for increase in plant maintenance
14 some of the items that were capital in nature that were
15 discovered by the PSC auditors, and they should be taken
16 out. I guess it doesn't hurt anything to leave those
17 invoices alone in the exhibit.

18 COMMISSIONER JACOBS: Rather than belabor this,
19 let's make this a different exhibit. And if anybody wants
20 to raise questions or objections to it they can do it at
21 the time we admit it. Sound reasonable? We'll mark that
22 Exhibit 23.

23 MR. DETERDING: So this will be separate from
24 the composite, correct?

25 COMMISSIONER JACOBS: Correct. We will title it

1 supplement to RCN-3 rebuttal.

2 MR. DETERDING: Okay.

3 (Exhibit 23 marked for identification.)

4 BY MR. DETERDING:

5 Q Mr. Nixon, please provide us with a summary of
6 your rebuttal testimony?

7 A I am going to try to be very brief. It is hard
8 to summarize 70 pages, and I have chosen a few issues out
9 of there that I would like to summarize.

10 The first one is on the salary of the
11 administrative assistant which was hired pursuant to the
12 DEP consent order. Mr. Larkin has recommended that that
13 salary be removed because her salary and position was not
14 specifically referred to in the consent order. This
15 person is working full-time. She was needed. She was
16 required. And management believed that pursuant to the
17 consent order, her position was needed. I believe we are
18 in some ways just parsing words when we say that that
19 position wasn't required under the consent order.

20 If I had used the words necessary or needed,
21 presumably we wouldn't have any difficulty with this
22 payroll position. One of the reasons management said that
23 the position was required by the consent order is that
24 here is a copy of the monthly DEP reports required prior
25 to the consent order. Here is a copy of the monthly

1 reports required after the consent order. These monthly
2 reports have a substantial amount of additional testing at
3 different sites. The results of those tests have to be
4 calculated on an annual moving average geometric basis,
5 whatever that is.

6 Mr. Porter and Mr. Watford can explain in some
7 detail what is in these monthly reports, but these reports
8 alone take a significant amount of time and was one of the
9 main reasons why that new position was needed and was
10 filled.

11 I would like to talk briefly about the benchmark
12 adjustment to materials and supplies. It has been alleged
13 that the company has not proven the necessity of these
14 expenses beyond customer growth and inflation. We had
15 conference calls with the staff way back at the beginning
16 part of this case explaining that the consent order was
17 going to require more maintenance and more costs in an
18 attempt to try to get recognition of some of those costs
19 in interim rates. I believe the explanation that we gave
20 in the MFRs that these expenses increased faster than
21 customer growth and inflation explained our reasons and
22 the reasons why these expenses exceeded customer growth
23 and inflation.

24 It is somewhat troubling after going through an
25 extensive PSC audit where the auditors looked at the

1 expenses in this category, and except for the few items
2 that they deemed were capitalizable items, to now come in
3 and say we haven't proven our case for these expenses
4 beyond customer growth and inflation. I believe we have.
5 And if we are going to just use the customer growth and
6 inflation model to set rates, then a lot of the expenses
7 in the MFRs that were under customer growth and inflation,
8 we ought to just go ahead and increase those. I believe
9 my Exhibit 3, and if you allow that other two pages in,
10 will document expenses in the same manner that they were
11 documented by the PSC audit.

12 I would like to move on to maintenance expense.

13 Mr. --

14 COMMISSIONER JACOBS: Mr. Nixon, I don't want to
15 disrupt your summary, but I would ask you to --

16 THE WITNESS: Fine, Commissioner.

17 COMMISSIONER JACOBS: Because we are on a tight
18 schedule today, please keep it to as brief a summary as
19 you can.

20 THE WITNESS: Okay. Briefly I want to mention
21 the \$175,000 adjustment to maintenance expense. Mr.
22 Larkin has removed that because he believes those expenses
23 are covered by manufacturers warranty. Mr. Porter
24 provided me with a detailed breakdown of those expenses,
25 and I don't --

1 MR. BURGESS: Commissioners, excuse me, I'm
2 going to object. We are exceeding five minutes even
3 allowing for the time that Commissioner Jacobs took. And
4 with Mr. Biddy we were pretty strict in making sure that
5 he didn't exceed five minutes until he was told that he
6 needed to go ahead and summarize, and I think that's where
7 we are now.

8 COMMISSIONER JACOBS: I'm going to ask you to go
9 ahead and bring your summary to a conclusion. We are on a
10 very tight schedule today.

11 THE WITNESS: Finally, I just want to say a word
12 about regulatory treatment of gross-up. Order 16971 said
13 that tax impact charges or gross-up would not be treated
14 as CIAC for regulatory purposes. I found tariffs from
15 thirty companies that grossed up, I believe this is most
16 of them. Every single tariff issued by the Commission has
17 that language in it.

18 MR. BURGESS: Commissioner, excuse me, I am
19 going to have to object. You asked him to bring it to a
20 close and to summarize, and he has brought up a new issue
21 and is seeking to explain it.

22 COMMISSIONER JACOBS: I assume he is on his last
23 point. I will allow him to finish this point. I assume
24 you are finishing?

25 THE WITNESS: I finished. The only additional

1 point I wanted to make, and it will end my summary is that
2 all of these tariffs issued after the issuance of Order
3 23541 were issued pursuant to a Commission order where the
4 company had to come in to the Commission and justify
5 gross-up. And to the extent you will take official
6 recognition of your own orders approving gross-up which
7 has the language I referred to in it, I would request that
8 that be done. That ends my summary. Thank you.

9 COMMISSIONER JACOBS: Very well.

10 MR. DETERDING: Commissioners, just to let you
11 know, I don't know how you want to handle the supplements
12 to the rate case expense, RCN-16, the two required
13 updates, September 27th and the October 10th. I have
14 copies of them. They were all prefiled. 15 copies with
15 the clerk and so forth, and copies to the parties. I have
16 more if you need them.

17 COMMISSIONER JACOBS: Let's make sure the court
18 reporter has one.

19 MR. DETERDING: I will make sure she has one.
20 If anybody else needs them, I have plenty. And with that,
21 I ask that --

22 COMMISSIONER DEASON: Did we move his testimony
23 into the record?

24 MR. DETERDING: No. That's what I was about to
25 ask, that his testimony be inserted into the record as

1 though read.

2 MR. FUDGE: Commissioners, I object to adding
3 one addition to his testimony. On Page 58 he changed his
4 answer from yes to no on whether he agreed with Ms.
5 Merchant's testimony on reuse rate and revenues, and I
6 think that is a material change to his testimony.

7 COMMISSIONER JACOBS: I don't think there is any
8 question, it definitely is material. So you are
9 suggesting that they have to withdraw their response
10 rather than supplementing the response?

11 MR. FUDGE: Yes, Commissioner.

12 MR. DETERDING: We would -- if that is the
13 ruling, then we would withdraw the response altogether,
14 the question and response altogether.

15 COMMISSIONER JACOBS: Very well. Strike that
16 question and response in his testimony. Very well.

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1 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2 ALOHA UTILITIES, INC.

3 SEVEN SPRINGS WASTEWATER DIVISION

4 DOCKET NO. 991643-SU

5 REBUTTAL TESTIMONY OF ROBERT C. NIXON, C.P.A.

6 Q. Please state your name and professional address.

7 A. Robert C. Nixon, CPA, 2560 Gulf-to-Bay Boulevard, Suite 200,
8 Clearwater, Florida 33765.

9 Q. Have you been retained by Aloha Utilities, Inc. to provide
10 documentary information and testimony on the Company's
11 application for increased rates for its Seven Springs
12 Wastewater Division?

13 A. Yes.

14 Q. Have you previously provided testimony in this case?

15 A. Yes.

16 Q. What is the purpose of this testimony?

17 A. To respond to the various issues raised in the direct
18 testimony of Hugh Larkin, Jr., CPA, accounting witness for the
19 Office of Public Counsel (OPC). Also, I will respond to
20 certain non-engineering issues raised by OPC engineering
21 witness Ted L. Bidy, P.E./P.L.S. After my response to OPC
22 testimony, I will address any testimony of staff as necessary.

23 Q. How is this testimony organized?

24 A. My testimony will discuss the issues and adjustments proposed
25 by Mr. Larkin in Schedules 2 through 7 attached to his

1 testimony. I will address each adjustment Aloha disagrees
2 with in the order the adjustments are shown on his schedules.
3 Where some of Mr. Larkin's adjustments are dependent on the
4 testimony of Mr. Bidy, as related to Law and Commission
5 policy, I will also address his testimony at that point. I
6 will not specifically address the information on Schedule 1,
7 since it is a summary of the adjustments contained in the
8 other schedules I will respond to.

9 Q. How would you like to begin?

10 A. Let's begin with Schedule 2, Pages 1 and 2, and the expenses
11 removed under Column (3) of Page 1, and detailed on Page 2,
12 lines 1 through 5. These are "Expenses Disallowed in Prior
13 Order".

14 Q. Please respond to the adjustment to remove excess officer's
15 salary and benefits of \$15,507 and \$5,319, respectively.

16 A. Mr. Larkin has adopted the recommendation of the PSC auditors
17 in Disclosure No. 4 of the PSC Audit. This recommendation
18 removes salary and benefits of Aloha's vice president because
19 her annualized salary, based on 20% of time devoted to Utility
20 business, is greater than the salary of the President, who
21 devotes 100% of his time to Aloha.

22 The logic of this adjustment rests on the theory that all
23 employees are of equal worth. The proposed adjustment reduces
24 the Vice President's salary and benefits to 20% of the
25 President's salary. The premise supporting this adjustment is

1 unproven and ignores the traditional tests used by the
2 Commission to determine appropriate salary levels. The
3 Florida Public Service Commission (PSC) Audit Manual (August,
4 1986, Pages 4304 and 4305) requires that auditors consider the
5 following factors in assessing officer's salary:

- 6 1) Review the work performed by all directors and officers.
- 7 2) Could the officer contribute to the management and
8 operations of the Company?
- 9 3) Are qualifications (experience, training, education)
10 adequate for the job?
- 11 4) Did they contribute?
- 12 5) Review description of duties and responsibilities.
- 13 6) Was compensation reasonable compared to contribution?
- 14 7) Compare fees and salaries paid by other similar entities.

15 Apparently none of these traditional tests were performed in
16 favor of the simplistic approach used by the auditors and
17 adopted by Mr. Larkin. The fact is the Vice President is a
18 successful, respected, and experienced businessperson whose
19 time would command a higher salary than the President's on an
20 annual basis.

21 A simple example illustrates the folly of an adjustment based
22 on annualized compensation. Assume I have a son who sets up
23 a lemonade stand in the front yard and sells lemonade for \$.50
24 a cup. The first two minutes, he sells 20 cups of lemonade.
25 On an annualized basis, he is earning \$612,000 (20 cups X \$.50

1 X 30 times per hour X 2,040 hours). Is his price unfair?
2 Should I quit my job and sell lemonade? The answer is an
3 obvious no.

4 Aloha believes its officers are fairly compensated and that
5 total officer compensation is less than that for similar-sized
6 utilities.

7 Because this adjustment is unproven and rests on the faulty
8 premise that the worth of all officers is equal, it should be
9 rejected.

10 Q.

Please address the adjustments of \$10,467 to contractual
11 services on each of lines 10, 11 and 12 of Column (3). It
12 should also be noted that the Vice President is on call 24
13 hours a day 7 days a week to provide advice and consultation
14 concerning issues that arise related to the Utility. In fact,
15 the President often discusses matters of this nature with the
16 Vice President, with little or no notice, and the Vice
17 President is called in to consult on those issues. The
18 Utility pays nothing for providing separate offices for the
19 Vice President, or any administrative support. As such, if
20 anything, the arrangement to treat the Vice President as a
21 part-time employee and yet still get the benefits of her
22 expertise, experience, and skills is advantageous to the
23 Utility in the circumstances. The alternative would be to
24 replace her with a full-time Vice President at a substantially
25 higher cost.

1 A. Aloha agrees to these adjustments.

2 Q. The next Column (4), on Schedule 2, Page 1 of 2, is labeled
3 "Audit Disclosures & Exceptions". Does Aloha agree with the
4 adjustments to chemicals of \$1,223 and materials and supplies
5 of \$14,295 shown on lines 8 and 9?

6 A. Yes.

7 Q. The next adjustment in Column (4) is on line 12 to Contractual
8 Services - legal, in the amount of \$29,981. Does Aloha agree
9 with this adjustment?

10 A. Aloha agrees in part and disagrees in part. The detail of
11 this adjustment is found on Page 2 of Schedule 2 on lines 13
12 through 15. \$2,581 of the adjustment relates to a
13 reclassification from legal expense to prepaid loan costs.
14 Aloha agrees with this adjustment, along with a related
15 adjustment to the effective cost of the loan with Bank of
16 America.

17 The second part of the adjustment is for \$27,400 for legal
18 expenses associated with DEP enforcement actions and is based
19 on PSC Audit Disclosure No. 6. Auditors recommended removing
20 this amount from expense and amortizing the balance over five
21 years. The adjustment is over stated by \$9,875 because not
22 all of the legal services were related to the DEP Enforcement
23 Action associated with the amended and restated Consent Order
24 or the resulting Construction Permit.

25 Aloha and every other wastewater utility has normal and

1 recurring expenses associated with operating under DEP rules
2 and regulations. They are no different than expenses incurred
3 for PSC compliance and should be recognized as necessary costs
4 of providing service. I have enclosed Exhibit _____ RCN-1,
5 which summarizes the expenses, which should be removed from
6 this adjustment.

7 Q. Please describe this exhibit.

8 A. This exhibit contains copies of the legal invoices deferred by
9 the PSC auditors on Pages 3 through 22. Those items that
10 should be considered normal and routine operating expenses are
11 marked with an "X". I have then summarized these items on
12 Pages 1 and 2.

13 Q. Is it appropriate to defer and amortize the remaining adjusted
14 balance of \$17,525?

15 A. Yes. They were incurred as part of the normal operating and
16 regulatory environment in which a wastewater utility does
17 business in Florida. Because they may not be recurring, it is
18 appropriate to amortize them over 5 years in accordance with
19 Rule 25-30.433(8)F.A.C.

20 Q. Did Mr. Larkin provide for deferral and amortization of these
21 expenses?

22 A. No. Apparently he believes that any legitimate expenses
23 incurred by a Company related to DEP Regulation are
24 unrecoverable. As a review of the invoices included with
25 Exhibit _____ RCN-1 shows, a good portion of the expenses

1 related to obtaining the permit for the plant upgrade and
2 expansion and should be recovered over 5 years.

3 Q. The last adjustment on Schedule 2, Page 1 in Column (4) is on
4 line 27 for \$20,244. Please discuss this adjustment.

5 A. This adjustment also relates to Audit Disclosure No. 6 and
6 removes \$18,400 from Miscellaneous Expense, plus projected
7 escalation of \$1,844. The \$18,400 was a payment ~~of~~^{to} DEP to
8 cover that agency's costs related to the Revised and Amended
9 Consent Order with Aloha. It was not a fine, and the Audit
10 Report states on Page 13 that "These appear to be legitimate
11 utility expenses, as there was no finding of wrong doing on
12 the Utility's part". This statement applies to the payment of
13 DEP's costs as well as the legal expenses discussed above.
14 Therefore, the Audit recommends deferral of this expense and
15 amortization over 5 years. I agree with this treatment.

16 Q. Did Mr. Larkin provide for deferral or amortization of this
17 expense.

18 A. No, on the basis that any payments associated with alleged
19 violations, even if unproven, are not appropriate expenses.

20 Q. Has the Commission ever addressed this issue in rate orders?

21 A. Yes. A similar issue was addressed in Docket No. 960451-WS,
22 Order No. PSC-97-0618-FOF-WS, issued May 30, 1997 (United
23 Water Florida, Inc. [UWF]).

24 That order (Page 37 of 60) reads in part as follows:

25 "Although we find that fines associated with violations

1 of DEP and EPA should be borne by the
2 shareholders of the utility, we believe it is reasonable
3 for UWF to recover the costs of defending such fines. As
4 the Commission previously concluded, the legal expenses
5 incurred for defending fines from DEP and EPA could
6 facilitate avoided or a reduced amount of fines.
7 Therefore, we find that no such adjustments are necessary
8 to test year expenses."
9

10 I have enclosed the cover page and Page 37 of 60 of that order
11 as Exhibit _____ RCN-2.

12 Q. What is the correct amount of Annual Amortization for the
13 adjustments to legal and miscellaneous expense you have just
14 discussed?

15 A. The adjusted annual amortization over 5 years for these two
16 items is \$7,185 ($\$27,400 - \$9,875 + \$18,400/5$ years).

17 Q. Lets move to Column (5) of Schedule 2, Page 1 titled "OPC
18 Adjustments". What is the nature of these adjustments?

19 A. These are additional adjustments to O&M expenses proposed by
20 Mr. Larkin. Materially, the adjustments are dependent on the
21 testimony of Mr. Bidy.

22 Q. Please discuss the adjustments to Salaries and Wages and
23 Employee Pensions and Benefits shown on lines 1 and 3 of
24 Column (5).

25 A. Aloha hired three new employees in September, November, 1999

1 and December 1999 and included their annualized salaries and
2 benefits in projected test-year expenses. Two of the
3 positions were operational employees hired to meet increased
4 DEP staffing requirements associated with 24 hours a day
5 operation. The third new employee filled an administrative
6 position necessary, in part, to meet the increased workload of
7 various reporting requirements imposed by DEP. Aloha has
8 grown to the point where a full-time position is necessary and
9 required for this task, as well as other necessary
10 administrative duties. Although not required specifically by
11 the Consent Order, the decision to add this position was made
12 in connection with management's assessment of staffing
13 requirements set forth in that order. The administrative
14 position was filled by Pam Yacobelli on November 22, 1999.
15 Mr. Larkin has eliminated the salary and benefits of Pam
16 Yacobelli simply because the position was not specified in the
17 Consent Order. This is ridiculous. The position was needed,
18 filled at a reasonable salary, and is a cost necessary to
19 provide utility service. The salary and related benefits
20 should be viewed as any other known and measurable change in
21 expense or capital, which is prudently incurred to provide
22 service. These expenses should be allowed in accordance with
23 the Commission's long standing policy of recognizing known and
24 measurable changes, whether required by regulatory order, or
25 incurred as a prudent management decision. This OPC

1 adjustment should be rejected.

2 Q. Please explain and respond to the adjustments to Purchased
3 Power and Chemicals shown on lines 6 and 8, Column (5) of
4 Schedule 2, Page 1.

5 A. These adjustments relate to the testimony of Mr. Bidy,
6 concerning his contention that Aloha's collection system has
7 excessive inflow and infiltration (I&I) of 280,000 gallons per
8 day or 23.37%. Thus, Mr. Larkin has reduced Purchased Power
9 and Chemicals by \$57,604 and \$9,755, respectively.

10 Aloha does not believe it has excessive infiltration. This
11 issue will be addressed by Aloha's Professional Engineer,
12 David W. Porter. However, in my review of
13 Mr. Bidy's testimony, it is not clear if he made allowance
14 for a normal amount of I&I. Typically, the Commission
15 considers some amount of I&I reasonable and normal,
16 particularly in older systems with clay pipe. The Veterans
17 Village area served by Aloha was built in the 1970s with clay
18 pipe and is believed to be the source of most infiltration.
19 However, Aloha does not believe it is excessive and the
20 adjustments to Purchased Power and Chemicals proposed by Mr.
21 Larkin and Mr. Bidy should be rejected.

22 Q. Under Column (5), line 9 of Schedule 2, Page 1, is an
23 adjustment, which decreases Materials & Supplies by \$17,179.
24 Please discuss this adjustment.

25 A. Mr. Larkin notes that materials and supplies increased

1 approximately 36% after staff audit adjustments and exceptions
2 of \$12,703. He is sponsoring a further adjustment of \$17,179,
3 which reduces this account to the 1998 balance adjusted for
4 customer growth and inflation. The basis for the adjustment is
5 that the Company has not adequately explained the increase
6 from calendar year 1998 to the test year ended September 30,
7 1999.

8 Q. Can you explain the increases?

9 A. Yes. I reviewed and compared the invoices in this account for
10 the two periods and determined which expenses are new and
11 explain the increases to this account. I have attached
12 Exhibit _____ RCN-3, which summarizes my analysis of this
13 account.

14 Q. Please explain this exhibit.

15 A. I have shown the difference between 1998 expenses (as adjusted
16 for customer growth and inflation) and total materials and
17 supplies for the historic test year. This results in a
18 difference to explain of \$27,969 (line 4). On lines 5 through
19 10, I have listed 5 items, which total ~~\$42,725~~^{29,357}, which more
20 than explains and accounts for the difference. Four major
21 maintenance invoices totaling ~~\$30,022~~^{16,654} were identified, which
22 were not incurred in 1998. This agrees with the explanation on
23 Page 54 of the MFRs that "increased routine maintenance at
24 treatment plant" caused the increase.

25 Based on explanation of the increases to this account, the

1 adjustment proposed by Mr. Larkin must be rejected.

2 Q. Mr. Larkin's next adjustment in Column (5) is a decrease to
3 Contract Services - Accounting of \$10,893. What is the basis
4 for this adjustment?

5 A. This adjustment consists of 2 parts as shown on Schedule 2,
6 Page 3, beginning on line 22. The first part reduces
7 accounting expense by \$7,449 for perceived savings associated
8 with the hiring of a new controller. This is accomplished by
9 taking 50% of the controller's salary allocated to Seven
10 Springs Wastewater as the realizable savings. There is no
11 basis or merit to this adjustment.

12 The second part reduces accounting expense for a reduction in
13 the estimated cost of the Annual Audit of \$24,000. There is
14 no real basis for this adjustment either.

15 Q. Please discuss the first part of the reduction associated with
16 the new controller.

17 A. Because Mr. Larkin has not visited the Aloha operations office
18 or spoken to the new Controller, he is unfamiliar with her
19 background, the background of whom she replaced or the
20 involvement of the accounting firm in the maintenance of the
21 books and records.

22 Ms. Vinyard became the company Controller in June 2000. She is
23 not a degreed accountant. Although she has functioned as the
24 Assistant Controller in her previous position, she has no
25 experience in the utility industry. None. On the other hand,

1 her predecessor was the Controller of Aloha for the past 18
2 years. She knew the industry, she knew the company and she
3 knew the accounting records and billing system.

4 For Mr. Larkin to compare these two employees and conclude
5 that the present Controller is more qualified and experienced
6 than her predecessor is simply false. Mr. Larkin's basic
7 premise in proposing this adjustment is incorrect. Mr. Larkin
8 should have asked questions about these individuals before
9 reaching his unsupported conclusion. Mr. Larkin should also
10 be advised that the Controllers of the Company were, and are
11 very capable of maintaining the books and records of the
12 utility. The CPA firm engaged by Aloha did not and does not
13 maintain the books and records. They advise and assist, but
14 the detailed record-keeping maintenance is performed by the
15 Controller. If Mr. Larkin understood the experience
16 backgrounds of Ms. Vinyard and her predecessor, he should have
17 logically concluded that the CPA firm might be asked to assist
18 the new inexperienced Controller to a greater extent than the
19 experienced former Controller.

20 Additionally, Mr. Larkin neglected to factor in the increased
21 costs of Aloha's CPA firm associated with the quarterly
22 unaudited financial statements required by Aloha's lender.

23 Q. On what basis did Mr. Larkin reduce the audit fees?

24 A. According to Mr. Larkin, Aloha allocated a portion of the
25 audit fee to the other Aloha Divisions since long-term debt

1 was allocated prorata by 14.35% in order to reconcile to rate
2 base. This is nonsense. The prorata reconciliation has
3 nothing to do with the audit fee. Virtually all of the debt,
4 except for a minor amount of debt for transportation
5 equipment, was incurred for the Seven Springs Wastewater
6 Division. The Audit is required specifically for the loan to
7 expand and modify the Seven Springs Sewer Plant. The receipt
8 of CIAC, Accumulated Depreciation, and CIAC Amortization cause
9 the rate base to differ from Capital Structure, requiring
10 prorata reconciliation. The cost of the Audit is directly
11 associated with the provision of Seven Springs Wastewater
12 Service. A simple mechanical adjustment to reconcile rate
13 base to Capital is totally unrelated to an expense
14 specifically identified and matched with the provision of
15 service to a specific service area - in this case, audit fees
16 to Seven Springs Wastewater operations.

17 Q. The next adjustment shown under Column (5) of Schedule 2 is a
18 decrease to Contractual Services of \$175,000. What is the
19 basis of this adjustment by Mr. Larkin?

20 A. This adjustment reduces the engineering estimate of routine
21 and recurring maintenance associated with the operation and
22 maintenance of the upgraded and expanded wastewater treatment
23 plant. The estimate was made by Aloha's Engineer, David
24 Porter. Mr. Larkin has eliminated all maintenance associated
25 with operation of the new facility because "As OPC witness

1 Biddy points out, the manufacturer will guarantee the proper
2 function of its installed equipment for a period of one year".

3 Q. What's wrong with this?

4 A. Mr. Biddy and Mr. Larkin have confused the manufacturer's
5 warranty on equipment failure (structural defects,
6 imperfections, etc.) with the cost of routine maintenance
7 necessary for proper functioning of the equipment. No
8 manufacturer can guarantee equipment that is not properly
9 cared for under a routine maintenance protocol. This is no
10 different than an auto manufacturer voiding his guarantee for
11 improper maintenance. Mr. Porter will address this adjustment
12 from a technical engineering standpoint. However, it is
13 incredible that OPC is assuming the manufacturer will pay for
14 all maintenance because the equipment is guaranteed for one
15 year.

16 Q. In explaining this adjustment on Page 10, lines 4 through 9 of
17 his testimony, Mr. Larkin states that it would be
18 inappropriate to include any maintenance costs since none will
19 be incurred. He suggests that if such costs are incurred
20 after the first year, then Aloha could file a petition with
21 the Commission to have these costs reviewed. Do you agree?

22 A. No. First, routine maintenance is the responsibility of Aloha
23 and maintenance costs will be incurred, as I have testified to
24 above. Thus, Aloha would not be over recovering expenses it
25 will not incur.

1 The suggestion that a rate case or limited proceeding be filed
2 to again address this issue would be totally cost inefficient
3 and wind up costing the customers more. Aloha's recent five-
4 year involvement in rate proceedings has proven that there is
5 no such thing as efficient regulation in Florida.

6 Q. Please explain the last adjustment proposed by Mr. Larkin in
7 Column (5), line 27 of Schedule 2, Page 1.

8 A. This is an adjustment of \$16,155 to miscellaneous expense. It
9 is similar to Mr. Larkin's adjustment to Materials & Supplies
10 on line 9 of Column (5). The basis for the adjustment is that
11 Aloha has not explained the reason for the 67% increase in
12 expenses from the 1996 to 1998 average, even after removal of
13 \$18,400 of payments to DEP. Mr. Larkin has removed all
14 expenses in excess of the historic three-year average adjusted
15 for customer growth and inflation.

16 Q. On Page 10, line 18, Mr. Larkin refers to the payment to DEP
17 as a "fine". Is it?

18 A. No, for the reasons previously explained. I agree with the
19 Commission Auditors that this expense should be deferred and
20 recovered over 5 years.

21 Q. Can you explain the increase in miscellaneous expense?

22 A. Yes. I reviewed and compared the invoices in this account for
23 1998 and the historic test year and determined which expenses
24 are new and explained the increases. I have attached Exhibit
25 _____ RCN-4, which summarizes my analysis of this account.

1 Q. Please explain Exhibit _____ RCN-4.

2 A. Lines 1 through 4 show the increase to the account requiring
3 explanation. I have not used Mr. Larkin's 3-year average
4 balance for this account since 1996 and 1997 are outside the
5 information contained in the MFRs. Lines 5 through 17
6 identify the types of new expenses causing the increases and
7 the vendor. Copies of the invoices are attached. The
8 identified new expenses of \$37,491 more than explains the
9 difference of \$35,128.

10 Q. Mr. Larkin's testimony next centers on Schedule No. 3 to his
11 Exhibit _____ (HL-1). What does this schedule contain?

12 A. This schedule shows the adjustments to projected depreciation
13 expense for the test year. These are contained in Columns (4)
14 through (7).

15 Q. What are the adjustments under Column (4)?

16 A. This column removes depreciation expense on capitalized plant
17 previously expensed. This was Audit Exception No. 1 in the
18 current Commission audit.

19 Q. Does the Company agree with this adjustment?

20 A. No.

21 Q. Why not?

22 A. Capitalization corrected an error. Even if these expenses had
23 originally been capitalized, thus increasing earnings, the
24 earnings would not have pushed Aloha outside the range of its
25 established rate of return. To show this, I have enclosed as

1 Exhibit _____ RCN-5, a schedule showing the wastewater
2 earnings as reported and what they would have been had the
3 expenses been capitalized. This is the same schedule filed in
4 response to the PSC audit on June 30, 2000. It shows that had
5 the invoices been correctly capitalized in the first place,
6 the average rate of return for the period would have been
7 10.21%. This compares to Aloha's authorized return of 10.18%
8 for both its Seven Springs and Aloha Gardens Wastewater
9 Divisions. During this time, both divisions had identical
10 rates and the same authorized rate of return, stemming from
11 the 1976 rate case.

12 Q. I notice that the total adjustment under Column (4) is \$7,227.
13 How does this compare with depreciation expense for these
14 items as determined by the PSC Audit?

15 A. In Exception No. 1, the amount stated for the projected test
16 year is \$6,675, a difference of \$552. I was not able to
17 explain the difference and didn't waste any time trying to
18 track it down due to materiality.

19 Q. The next column on Mr. Larkin's Schedule 3 is Column (5),
20 relating to PSC audit findings on AFUDC and O&M expenses which
21 should have been capitalized. Does the Company agree with
22 these adjustments?

23 A. Yes.

24 Q. The next column on Schedule 3 is Column (6) for AFUDC on
25 accounts payable. Please explain this adjustment.

1 A. Construction payables were not included in the calculation of
2 balance sheet working capital because they do not provide a
3 source of investor capital necessary to pay the Company's O&M
4 expense obligations. The source of cash to pay construction
5 invoices and contractor draw requests is the construction loan
6 with Bank of America. This is accounted for elsewhere in the
7 rate making process (Capital Structure). Nonetheless, Mr.
8 Larkin believes these payables provide a source of cost free
9 capital to Aloha. He is proposing that AFUDC be reduced for
10 the 30 days the payable was assumed to be outstanding, since
11 there was no cost to Aloha for the first 30 days the payable
12 was in construction work in progress (CWIP).

13 Q. Do you agree with this adjustment?

14 A. Yes.

15 Q. What adjustments are included in Column (7) of
16 Mr. Larkin's Schedule 3?

17 A. This column contains the impact on depreciation expense for
18 non-used and useful adjustments proposed by
19 Mr. Bidy.

20 Q. Do you want to respond to these adjustments at this point in
21 your testimony?

22 A. Very briefly. Most of my testimony on these adjustments will
23 occur further below in response to the used and useful
24 adjustments to plant. I would point out that
25 Mr. Larkin's adjustment to CIAC is understated, because he has

1 only removed CIAC Amortization on the Southwest Florida Water
2 Management District (SWFWMD) contribution to Aloha for
3 construction of Phases III and III(a) of the reuse force main.
4 A substantial amount of the plant in accounts 360.2
5 (collection sewers force) and 321.3 (pumping plant) were
6 contributed by developers. This will be developed in further
7 detail below.

8 However, the adjustments are misplaced since all plant, and
9 particularly reuse plant, is 100% used and useful.

10 Q. Mr. Larkin's next adjustment is presented on Schedule 4 of his
11 Exhibit and discussed on Page 12 of his testimony. Please
12 discuss this adjustment.

13 A. Mr. Larkin is proposing to increase the amortization rate
14 applied to contributed taxes from the 40 year (2.5%) rate used
15 by Aloha to a rate based on 26.9 years (3.71%). The effect of
16 the proposed change is the increase amortization (income) by
17 \$18,808.

18 Q. Is the change proposed appropriate?

19 A. Aloha believes a change in method may be appropriate.
20 However, I do not agree with the approach used by
21 Mr. Larkin.

22 Q. What do you recommend and why?

23 A. I recommend that the Composite CIAC Amortization rate for CIAC
24 assets acquired during the period CIAC was taxable (1987 -
25 1996) be used. To use the current rate distorts the true

1 depreciable life of these assets because of the addition of
2 significant amounts of assets with shorter lives after 1996.
3 I have enclosed Exhibit _____ RCN-6, which calculates an
4 applicable composite rate of 3.06%. The rate used for
5 amortization of capacity fees is the composite rate of 26.9
6 years used by Mr. Larkin. This will increase amortization
7 from \$38,622 to \$47,273, an increase of \$8,651.

8 Q. What are the next adjustments proposed by Mr. Larkin?

9 A. These are summarized on Schedule 5 of Mr. Larkin's exhibit and
10 discussed on Pages 12 and 13 of his testimony. They relate to
11 reductions to taxes other than income.

12 Q. Briefly describe the adjustments.

13 A. The first reduces payroll tax associated with removal of a
14 portion of the Vice President's salary. I have discussed the
15 salary adjustment previously. If no adjustment to salary is
16 made, this adjustment to payroll taxes (\$1,392) is unnecessary
17 and I will not comment further on it.

18 The second adjustment is based on Audit Disclosure No. 10,
19 which reduces property tax to the amount Aloha would have paid
20 had it had the cash to pay the November 1999, discounted
21 amount (\$23,819).

22 The third adjustment reflects the non-used and useful amounts
23 alleged to exist by Mr. Bidy. Aloha believes all of its
24 plant is used and useful and that this adjustment (\$67,347) is
25 not applicable. Since it is dependent on the issue of used

1 and useful plant, I will not comment further on this
2 adjustment at this point in my testimony.

3 Q. Does Aloha agree with the second adjustment of \$23,819 to
4 property taxes associated with Audit Disclosure No. 10?

5 A. No. While I believe that some adjustment is necessary, the
6 tax rate used by the PSC Auditors to calculate the tax is
7 understated. The best evidence of the appropriate millage
8 rate (tax rate) is found on the personal property tax bill.
9 The auditors used a calculated rate, which I still don't
10 understand.

11 Attached is Exhibit _____ RCN-7 consisting of a calculation of
12 the tax rate and a copy of the tax bill from which the
13 calculations are derived, as well as a copy of Audit
14 Disclosure No. 10. As shown, the actual rate from the return
15 is 19.90754 mills, or 1.990754%. When applied to the audited
16 plant subject to tax of \$17,605,865, the projected tax should
17 be \$350,487. When compared to the projected amount in the
18 MFRs of \$364,804, an adjustment of \$14,318 is required.
19 However, the final amount will differ, depending on resolution
20 of the capitalized plant previously expensed issue, since the
21 auditors excluded these items from their property tax
22 calculation.

23 Q. On Page 14, Mr. Larkin proposes a reduction to deferred income
24 tax expense of \$86,414. His calculations are shown on
25 Schedule 6 of Exhibit _____ (HL-1). Do you agree with this

1 adjustment?

2 A. No. This adjustment reduces deferred tax expense for the non-
3 used and useful adjustments originating with
4 Mr. Bidy. Aloha believes that its plant, especially reuse
5 facilities, is 100% used and useful and will be proven so with
6 the testimony of Mr. Porter. Thus, this adjustment is totally
7 unnecessary.

8 Q. Assuming some portion of Aloha's plant was non-used and
9 useful, and an adjustment to deferred tax expense was
10 necessary, has Mr. Larkin left something out of his testimony
11 on this issue?

12 A. Yes. He has left out the corresponding reduction to
13 accumulated deferred income taxes (credits) included in the
14 Capital Structure at zero cost.

15 Q. We are now to Page 14 of Mr. Larkin's testimony and his
16 discussion of Schedule 7 of his exhibit. Please generally
17 describe Schedule 7.

18 A. Schedule 7 depicts the rate base and adjustments thereto
19 proposed by Mr. Larkin. Page 1 summarizes the adjustments
20 calculated on Pages 2 through 6 of Schedule 7.

21 Q. How would you like to proceed?

22 A. My testimony will follow the issues raised in Pages 2 through
23 6. Page 1 is simply a summary schedule and needs no direct
24 response.

25 Q. Beginning with Page 2 of Schedule 7, what does this show?

1 A. This schedule mirrors the adjustments to depreciation expense
2 shown on Schedule 3, except this schedule relates to plant.
3 The adjustments shown in Columns (3) through (7) have
4 identical headings, so I don't need to restate them.

5 Q. Column (3) is headed "Plant Disallowed in Previous Orders".
6 I take it you disagree with the adjustments for the same
7 reasons you previously testified to in response to Mr.
8 Larkin's adjustments to depreciation?

9 A. Yes. However, this column contains an additional adjustment
10 to land of \$12,120. This relates to Audit Disclosure No. 1,
11 which reclassifies this amount to Aloha Gardens Sewer. Aloha
12 agrees with this adjustment.

13 Q. Columns (4) and (5) relate to Audit findings on AFUDC and O&M
14 items and Mr. Larkin's adjustment to AFUDC on Construction
15 Accounts Payable, respectively. You agreed with these
16 adjustments as they related to depreciation expense. Do you
17 agree with the related plant adjustments?

18 A. Yes.

19 Q. Column (6) is headed "Used and Useful Adjustment". Please
20 generally describe these adjustments?

21 A. Two different used and useful percentages are applied. First,
22 a non-used and useful percentage of 21.3% is applied to
23 account 360.2, Collection Sewers - Force and account 364.2,
24 Flow measuring devices. These amounts and adjustments are
25 found on lines 9 and 13 respectively. Apparently, these are

1 collection plant accounts deemed non-used and useful by Mr.
2 Biddy.

3 Secondly, a non-used and useful percentage of 27.03% is
4 applied to all other plant accounts shown between lines 18 and
5 48.

6 Q. From an accounting, legal and policy standpoint, what errors
7 have been made in making these adjustments?

8 A. From an accounting standpoint, the property CIAC included in
9 many of the plant accounts has not been removed before
10 applying the non-used and useful percentage. From a legal and
11 policy standpoint, no non-used and useful adjustments should
12 have been made to reuse plant. Florida law requires that
13 investment in reuse plant be included in rate base as a matter
14 of public policy. This has been upheld on appeal of recent
15 PSC cases. In those cases, the Commission's attempt to apply
16 non-used and useful adjustments to reuse investments was
17 reversed. Mr. Larkin's non-used and useful adjustments to
18 reuse plant is applied even to reuse plant previously found to
19 be 100% used and useful to Aloha in Order No. PSC-97-0280-FOF-
20 SU issued March 12, 1997.

21 Q. Discuss Aloha's Service Availability Policy, investment in
22 collection facilities, and property CIAC embedded in the
23 various plant accounts.

24 A. Aloha's service availability policy has been to require
25 developers to contribute all on-site and off-site facilities

1 necessary to serve a particular project. Historically, Aloha
2 has had little or no investment in the collection system.
3 However, beginning in 1999, several projects were initiated
4 which will put Aloha in the position of having some investment
5 in its collection facilities by the end of the test year ending
6 September 30, 2001. These are summarized on Schedules G-2 and
7 G-3 of the MFRS. They include the Little Road line relocation
8 (account 361.2 - \$156,923); I&I repairs (account 361.2 -
9 \$381,515); Country Place Master Pumping Station (account 354.3
10 - \$131,477, account 371.3 - \$116,723, and account 360.2 -
11 \$72,523); Interceptor Force Main (account 360.2 - \$674,483);
12 and Little Road Phase III(a) (account 360.2 - \$92,080).

13 Of these projects, both Little Road items would not be subject
14 to used and useful adjustments, since they involve line
15 relocations and the first was already considered 100% used and
16 useful in Order No. PSC-99-1917-PAA-WS issued September 28,
17 1999. The major inflow and infiltration project would
18 likewise not be subject to any non-used & useful adjustments.
19 As to the CIAC embedded in the accounts Mr. Larkin has
20 adjusted, I have enclosed Exhibit _____ RCN-8, which shows the
21 amount of contributed property in each account at December 31,
22 1999.

23 Q. What was the source of the information used to develop the
24 information in Exhibit _____ RCN-8?

25 A. The source was the developer agreements and information from

1 the Annual Reports going back to 1976. This was the same
2 information filed in this Docket in response to Staff Document
3 Request No. 1, in a folder labeled "1973 to 1998 CIAC
4 Analysis". The actual property CIAC additions for 1999 come
5 from Schedule G-2 of the MFRs.

6 Q. Please summarize those balances of property CIAC which Mr.
7 Larkin did not consider in making his used and useful
8 adjustments.

9 A. Collection Sewers - Force (\$1,047,654); Flow Measuring Devices
10 (\$7,363); Pumping Equipment (\$409,613); Structures &
11 Improvements (\$214,543); and Reuse Mains (~~\$736,591~~^{799,728}).

12 Q. Do the collection system projects you outlined above, which
13 will require an investment by Aloha, represent an extension of
14 the system?

15 A. No. Aloha's system has evolved to the point where upgrades to
16 the contributed system are necessary to improve the efficiency
17 and operation of the system for existing flows. Therefore, no
18 used and useful adjustments are appropriate. Mr. Porter will
19 address this in further detail in his rebuttal testimony.

20 Q. Can you respond to the used and useful adjustments made to the
21 treatment plant accounts on lines 24 through 30 of Schedule 7,
22 Page 2?

23 A. I cannot address engineering issues. However, I can point out
24 that adjustments to these accounts really depend on what a
25 normal allowance for I&I is determined to be. There were no

1 significant changes to any of these accounts since September
2 1998. This plant was considered 100% used and useful in Order
3 No PSC-99-1917-PAA-WS.

4 Mr. Larkin has applied the non-used and useful percentage for
5 plant to account 353.4 - Land. This is wholly inappropriate
6 since the usefulness of land is determined by its use. It is
7 unrelated to plant flows. This land was also considered 100%
8 used and useful in the Order just mentioned. If I understand
9 Mr. Biddy's testimony, he is also of the opinion that Land is
10 100% used and useful.

11 Q. Lets move on to the next page of Schedule 7, Page 3 of 6. This
12 schedule shows Mr. Larkin's adjustments to accumulated
13 depreciation. Please respond.

14 A. Mr. Larkin's adjustments are in Column (3) and (4). Column
15 (3) removes accumulated depreciation on capitalized plant
16 previously expensed. I disagree with this adjustment for all
17 of the reasons previously stated and will not repeat them now.
18 Column (4) shows the computation of non-used and useful
19 accumulated depreciation associated with the adjustments to
20 plant on Page 2. Because no adjustments to plant for non-used
21 and useful amounts are necessary, these adjustments will
22 likewise be unnecessary.

23 Q. Please discuss Pages 4 and 5 of Schedule 7, since they are
24 related. First, what's on these schedules?

25 A. Page 4 removes a portion of the CIAC received from SWFWMD for

1 construction of Phases III and III(a) of the Reuse Project.
2 Page 5 removes the associated accumulated amortization.

3 Q. Are these adjustments appropriate or necessary

4 A. No. As I previously testified, reuse facilities are 100% use
5 and useful as a matter of law and public policy. The used and
6 useful adjustment should never have been proposed in the first
7 place.

8 Since the reuse facilities are 100% used and useful, there is
9 no need for this adjustment.

10 Q. Should a similar adjustment have been made for CIAC related to
11 the non-used and useful plant adjustments, other than reuse
12 plant accounts?

13 A. Yes. Although no used and useful adjustments are necessary in
14 the first place, if made, the associated CIAC in those
15 accounts should have been taken into account by Mr. Larkin.
16 As I mentioned above, a significant amount of CIAC was
17 embedded in certain of the plant accounts and not factored
18 into his adjustment.

19 Q. On Page 6 of Schedule 7, Mr. Larkin proposes three adjustments
20 to Balance Sheet working capital. The first removes income
21 tax deposits of \$7,789. Do you agree with this adjustment?

22 A. Yes.

23 Q. Mr. Larkin's second adjustment removes cash of \$266,362. Do
24 you agree with this adjustment?

25 A. No.

1 Q. What is Mr. Larkin's rationale for removing cash from the
2 working capital computation?

3 A. This is found on Page 16 of his testimony, beginning at line
4 14 and continuing through line 2 on Page 17. Basically, he
5 has removed cash because some interest was earned on the
6 account. Also, he claims the company has not justified the
7 Company's half million dollar average balance in this account.

8 Q. Please address the interest issue.

9 A. Aloha entered into a "Sweep" arrangement with its bank whereby
10 the bank utilizes the cash in the account to make over-night
11 investments. In exchange, Aloha earns interest for the
12 overnight use of its funds. Interest is earned only to the
13 extent the bank makes use of Aloha's cash. There is no
14 guarantee that interest will be earned.

15 Sweep accounts are a fairly recent phenomenon and in wide use
16 by prudent money managers. The arrangement benefits Aloha's
17 customers since the interest earnings help offset the charges
18 from the bank. During the historic test year, bank charges
19 totaled \$19,289, while interest earnings totaled \$26,588. Of
20 these amounts, \$6,944 of bank charges and \$9,572 of interest
21 income were allocated to the Seven Springs Wastewater
22 Division. Therefore, Aloha receives little or no net benefit
23 from such interest income. The interest was recorded as
24 above-the-line income and the bank charges in account 725 -
25 Miscellaneous Expense. Thus, Mr. Larkin's statement that rate

1 payers would be subsidizing the utility is without merit.

2 Q. Isn't Aloha allowed a fair rate of return on working capital?

3 A. Yes, as a matter of law under Chapter 367.081(2)(a). Such a
4 fair rate of return on working capital is not a
5 "subsidization", as indicated by Mr. Larkin, but a generally
6 recognized cost of providing service.

7 Q. How does Aloha's treatment of interest from this sweep account
8 differ in this case from the treatment in its last case?

9 A. Interest income from the sweep account is now booked above the
10 line for the reasons mentioned above. This effectively makes
11 cash a cost free current asset. At the time of the last rate
12 case, Interest Income from this bank account was recorded
13 below the line.

14 Q. Address Mr. Larkin's contention that Aloha doesn't need the
15 cash balance it has in its account and the reasonableness of
16 Aloha's requested working capital.

17 A. This is hard to understand. On the one hand, Mr. Larkin
18 reduces property tax expense because Aloha didn't have enough
19 cash to pay its tax bill in November, and on the other, says
20 Aloha has too much cash. In fact, he believes it fair for
21 Aloha to have no cash. He can't have it both ways. This
22 reference to a "\$500,000" balance is misleading. Total
23 average cash was allocated 47.80% to Seven Springs Wastewater.
24 Thus, cash of \$266,362 is embedded in Aloha's working capital
25 request.

1 In assessing working capital, one must look at the totality of
2 net working capital to determine its sufficiency or
3 reasonableness. Merely looking at one component, such as
4 cash, is highly misleading.

5 The adjusted working capital requested by Aloha is shown on
6 Schedule A-17(A) of the MFRs, before allocation to Aloha's
7 four divisions. That schedule shows current assets of
8 \$1,426,146 and current liabilities of \$699,744 for a net
9 working capital of \$726,402. One gauge of the adequacy and
10 sufficiency of working capital is the current ratio. This is
11 defined as current assets divided by current liabilities.
12 Lender's view a ratio of 2 times as the generally acceptable
13 benchmark for a healthy company. In Aloha's case, this ratio
14 is 1.96 times. Certainly, Aloha's current ratio is not
15 excessive and its financial integrity should not be diminished
16 by severely reducing its working capital needs.

17 Another way to gauge the reasonableness of Aloha's requested
18 working capital is to compare the average test-year monthly
19 O&M expense, plus accrued taxes, with the allowance requested.
20 Per Schedules No. B-6(A) (monthly O&M), and A-17(A), these
21 obligations average \$450,137 per month ($\$2,175,762/12 +$
22 $\$268,823$). This compares to the working capital requested
23 (before adjustment for rate case expense) of \$347,110 (A-
24 17(A), MFRs).

25 Based on these factors, I believe Aloha's working capital

1 request is reasonable and necessary.

2 Q. Has Mr. Larkin removed anything else from working capital?

3 A. Yes. He removed the increase in rate case expense of \$25,000
4 necessary to provide additional information to meet the
5 minimum filing requirements.

6 Q. Is this justified?

7 A. No. The logic of it escapes me. Staff required Aloha to
8 provide additional new information in order to meet the ever
9 increasing burdens of preparing a rate case filing. Aloha was
10 not previously billed for preparation of this information.
11 Thus, this was new work and legitimate expense. If the work
12 had been done and included in the original filing, the costs
13 would have been \$25,000 higher and apparently prudently
14 incurred according to
15 Mr. Larkin's reasoning. However, the fact the work was done
16 subsequent to the original filing makes the costs unreasonable
17 and therefore unrecoverable.

18 Q. Did the revision to the MFRs require correction of some
19 errors, and was this taken into account in increasing rate
20 case expense by \$25,000?

21 A. Yes. There were a few corrections of errors, mostly minor. In
22 recognition of this, I wrote off and discounted fees totaling
23 \$6,237. I believe this more than compensates for the
24 correction of any errors. In response to Staff Interrogatory
25 7(b), I made a more detailed response to this issue. I have

1 enclosed a copy of that document as Exhibit _____ RCN-9.

2 Q. On Page 18 of his testimony, lines 1 through 7,
3 Mr. Larkin indicates that he has not accepted the Company's
4 proposed Capital Structure. Specifically, he mentions
5 customer deposits and equity. Do you agree?

6 A. Yes. With regard to customer deposits, the monthly balances
7 were inaccurate due to a programming problem in implementing
8 new billing and financial software necessary to become Y2K
9 compliant. At the time the MFRs were prepared, we were
10 unaware of this problem. The balance was corrected as part of
11 the Company's year-end financial audit. So I agree that some
12 adjustment should be made. Also, the balance shown in the MFRs
13 is for the total Company and needs to be allocated to the
14 Seven Springs Wastewater Division, in accordance with Audit
15 Disclosure 8.

16 With respect to equity, Audit Disclosure 8 recommends that
17 equity be averaged and evened out on the assumption that all
18 income and expense occurs evenly throughout the year.
19 Although I reject this assumption as valid, Aloha is willing
20 to accept this averaging adjustment proposed in Disclosure 8.

21 Q. Are there other Capital Structure adjustments which should be
22 made?

23 A. Yes. Since preparation of the MFRs, the Commission has
24 adopted a new leverage formula rate of return and the prime
25 interest rate has increased twice. In keeping with long-

1 standing Commission Policy, the cost rates for equity and debt
2 should be changed to reflect costs at the time rates become
3 effective.

4 Q. On Page 18, Mr. Larkin suggests that if the Commission rejects
5 the used and useful adjustments made to reuse facilities, then
6 additional reuse revenue should be imputed in the amount of
7 \$62,141. How do you respond?

8 A. Mr. Larkin refers to Order No. PSC-97-0280-FOF-WS, wherein the
9 Commission imputed \$109,500 of reuse revenue. The difference
10 in that amount and the projected reuse revenue shown in the
11 MFRs of \$47,359 is the basis for his proposed adjustment. The
12 amount from the Commission Order assumes Aloha could sell 100%
13 of the daily effluent produced. This is unachievable due to
14 weather, rainfall, and other factors. Mr. Porter will address
15 the technical aspects of this issue in his rebuttal testimony.
16 However, no imputation of revenue Aloha will never receive
17 should be made.

18 Q. Do you have any further response to Mr. Larkin's testimony at
19 this time?

20 A. No.

21 Q. How would you like to proceed?

22 A. At this time, I would like to respond to the testimony
23 sponsored by Staff. Staff is presenting direct testimony of
24 four individuals: Paul W. Stallcup, Thomas E. Stambaugh,
25 James A. McPherson, and Patricia W. Merchant. I would like to

1 respond to the testimony of those individuals in the order
2 just given.

3 Paul W. Stallcup

4
5 Q. What was the purpose of Mr. Stallcup's testimony?

6 A. To evaluate the methodology used to project ERC's and growth
7 rate for the projected test year presented on Schedules F-10
8 of the Minimum Filing Requirements.

9 Q. Are you qualified to present a detailed response as it relates
10 to the statistical and econometric models referred to in his
11 testimony?

12 A. No. I have no expertise in mathematics or statistics and I am
13 unable to test the validity of his models. I will confine my
14 response to practical matters.

15 Q. Schedule F-10 of the MFR's contains two projections of
16 residential connections for the projected test year. What was
17 the difference between them?

18 A. In the original projection, we converted all customers to
19 meter equivalents and made the projection based upon total
20 equivalent ERC's. This data and the associated linear
21 regression for the five year period is shown on pages 132 and
22 133 of the MFR's. As a result of the Commission staff's
23 deficiency letter, we revised the projection so that ERC's
24 were derived from single family residential customers and
25 gallons treated.

1 Q. Which projection did you use in the MFR's?

2 A. We used the projection as originally made since we believed
3 that for the purposes used in the MFR's, the two projections
4 were virtually identical.

5 Q. On page 3 beginning at line 15 and continuing through line 20
6 on page 6, Mr. Stallcup presents testimony concerning a
7 statistical comparison of the two projections contained in the
8 MFR's. He concludes that the two forecasts are not
9 statistically virtually identical. Is that correct?

10 A. Yes. Although I cannot comment credibly on the statistical
11 analysis used, apparently Mr. Stallcup concludes that the two
12 projections in the MFR's are not virtually identical and that
13 the revised forecast shown on pages 130 and 131 of the MFR's
14 is statistically reliable.

15 Q. Why did Mr. Stallcup believe the original projection was not
16 identical to the first?

17 A. Because the ending forecast number of ERC's at September 30,
18 2000, was 454 ERC's less than the 10,229 predicted by his
19 econometric model. On the other hand, he concluded that the
20 revised projection was within 101 ERC's of the forecast made
21 by his model.

22 Q. Practically speaking, is the projected number of ERC's
23 important as used in the MFR projections?

24 A. I don't think so. What is important is the projected increase
25 in ERC's from the end of the historic test year to the end of

1 the projected test year. These projected additional ERC's are
2 those which will generate additional projected revenues and
3 expenses.

4 Q. How do the two projections of additional ERC's shown in the
5 MFR's compare to each other?

6 A. The original projection predicts an additional 370 ERC's in
7 2000, and an additional 348 ERC's in 2001, for a total
8 increase of 718 ERC's by the end of the projected test year.
9 The revised forecast predicts an additional 316 ERC's in 2000
10 and an additional 368 ERC's in 2001, for a total increase of
11 684 ERC's by the end of the projected test year. This is a
12 difference of just 34 ERC's. Therefore, from a practical
13 basis, I don't see any difference in the two projections
14 presented in the MFR's.

15 Q. In the MFR schedule, are the predicted ending number of ERC's
16 for any model actually utilized?

17 A. No. Only the projected increase in ERC's is used to project
18 revenue.

19 Q. Why is this?

20 A. Because these projected increases in ERC's are converted to
21 annualized number of bills and added to the historic number of
22 bills rendered.

23 Q. On page 8 lines 3 through 8, Mr. Stallcup recommends using an
24 annual projection factor of 1.03486. What is this based on?

25 A. As I understand his testimony, he believes that the growth

1 rate should be based on the three years ending September 30,
2 2001, as opposed to the historic five-year average growth
3 rate.

4 Q. Is this appropriate?

5 A. From a statistical and mathematical standpoint, I don't know.
6 However, from the standpoint of past Commission practice and
7 the fact that the five year average has been incorporated as
8 a rule on Schedule F-10, I believe that the historic five year
9 average methodology is a good one because it shows average
10 growth over an extended period of time. I believe that the
11 Commission has always believed that this was a better approach
12 than simply using one or two years, much less actual and two
13 projected years.

14 Q. Is there any other impact associated with deviating from the
15 historic five-year average adopted as rule on Schedule F-10?

16 A. Yes. I believe that utility companies filing projected test
17 year rate cases will need to hire a statistician in order to
18 mathematically evaluate the various models which may exist.
19 This can do nothing but drive up the cost of rate case expense
20 to a level already higher than it should be.

21 Q. Do you have anything further to add in response to the
22 testimony of Mr. Stallcup?

23 A. Not at this time.

24

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Thomas E. Stambaugh

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Q. What is the purpose of Mr. Stambaugh's testimony?

A. To sponsor the Staff Audit Report for this case and to testify concerning the audit exceptions and disclosures recommended in that report.

Q. Have you previously responded to the audit exceptions and disclosures with which the utility disagrees in your response to Mr. Larkin's testimony?

A. Yes, with the exception of Audit Disclosure No. 7 related to deferred taxes and contributed taxes. Mr. McPherson is the primary staff witness on this issue and I will not respond to this disclosure until I get to his testimony.

Q. Were there any issues you previously addressed in response to Mr. Larkin's testimony related to audit exceptions or disclosures which you would like to address further?

A. Yes. I would like to offer some additional testimony concerning Audit Exception No. 1. This is the issue of capitalizing previously expensed items.

Q. Have you found any previous orders of the Commission which support your testimony that these types of adjustments have been recognized in other cases?

A. Yes. I have prepared composite Exhibit _____ RCN-10. This exhibit contains excerpts from three prior orders I could find related to the matter of capitalization of previously expensed

1 plant.

2 Q. Briefly go over each of these orders?

3 A. The first is Order No. PSC-95-0363-FOF-WS issued March 14,
4 1995. On page 3 of 22, the Commission increased utility plant
5 in service by \$1,603 for water and \$10,533 for wastewater to
6 reflect a reclassification of O & M expense during the test
7 year. The Commission further increased utility plant by
8 \$10,615 for wastewater to reflect plant that was previously
9 expensed prior to the test year.

10 The next order that I could find was Order No. 10285
11 issued September 9, 1981. From pages 6, 9, and 11 of my
12 exhibit, \$40,237 was added to water plant to capitalize the
13 cost of service connections previously expensed by the
14 utility. \$93,887 was added to the wastewater plant to
15 capitalize a cost of sewer connections previously expensed.

16 The last order is Order No. 22150 issued November 6,
17 1989. On pages 18 and 21 of my exhibit water plant was
18 increased by \$16,443 to capitalize water meters previously
19 expensed.

20 It is extremely difficult to go back and try to find
21 other Orders which support the company's position on this
22 issue. However, based on my experience I believe there may be
23 many others available if they could be found that show that
24 the PSC has regularly and repeatedly capitalized items
25 previously expensed. To my knowledge and based on my many

1 years of experience, I have never seen the Commission decline
2 to do so when it found items that should have appropriately
3 been expensed and to do so now even when the Utility has not
4 earned a return above its authorized range is not only
5 contrary to prior Commission precedent, it effectively denies
6 the Utility a right to earn a fair return on its investment.
7 This is especially true if "breakeven" is the point at which
8 recovery of these items is judged as suggested during the
9 auditor's depositions.

10 Q. Is there anything else you need to address before moving on?

11 A. Yes. At this point I would like to include Exhibit ____ RCN-
12 11. This is Aloha's response to the audit report sponsored by
13 Mr. Stambaugh. This response was prepared by me.

14
15 James A. McPherson

16
17 Q. What is the purpose of Mr. McPherson's testimony?

18 A. Mr. McPherson is testifying primarily about Audit Disclosure
19 No. 7 in the audit completed for this proceeding and also the
20 same issue contained in Audit Disclosure No. 8 in a subsequent
21 second audit of Aloha Utilities, Inc.

22 Q. What does the second audit relate to?

23 A. That audit relates to an earnings review of Aloha's other
24 three systems - Aloha Gardens Water, Aloha Gardens Wastewater,
25 and Seven Springs Water Systems. That investigation has been

1 assigned Docket No. 000737-WS.

2 Q. Is Mr. McPherson sponsoring that second audit as an exhibit in
3 this case?

4 A. Yes. That audit report is sponsored as Exhibit JAM-1.

5 Q. What is the purpose of sponsoring that audit report in this
6 preceding when it relates to a separate Docket?

7 A. As I understand, the purpose of that audit in this case is to
8 support Mr. McPherson's testimony on his recommended
9 regulatory treatment of deferred taxes and contributed taxes.
10 Also, an adjustment of \$1,113 associated with Disclosure No.
11 9 is proposed as a further reduction to accounting expenses in
12 this Docket. Therefore, I will only be addressing these two
13 issues in Mr. McPherson's testimony.

14 Q. Did Aloha file a response to the audit in Docket No. 000737-
15 WS?

16 A. Yes. I have attached the utility's response to this audit as
17 Exhibit ____ RCN-12.

18 Q. Mr. McPherson discusses the adjustment of \$1,113 to accounting
19 expense in this docket beginning on line 25, page 5 of his
20 testimony and continuing through line 11 on page 6. Do you
21 agree with this adjustment?

22 A. No adjustment is warranted. Between January and August of
23 1999, the company was unable to produce a general ledger or
24 financial statements due to the financial and billing software
25 conversion previously discussed. The charges for these

1 services took the place of our ordinary charges for our semi-
2 annual review of the Company's financial statements and
3 general ledger. When I use the term "review" I am not using
4 that term to imply that we prepare reviewed financial
5 statements in the Accounting Standards definition of that
6 term. Rather, I mean simply an overview of the general
7 ledger, financial statements, and journal entries. In
8 addition, the financing agreement with Bank of America
9 requires a submission of quarterly statements, which my firm
10 will review before they are submitted to the bank. Again, I
11 am not using the term "review" to imply anything other with
12 the term than is used outside the accounting profession. The
13 annual estimated cost, I believe, will equal or exceed any
14 costs proposed by this audit adjustment, and therefore I
15 believe that no adjustment is appropriate.

16 Q. Mr. McPherson's testimony on deferred taxes and contributed
17 taxes begins on page 8, line 1 of his testimony. Before
18 proceeding, what is your experience in the area of deferred
19 taxes and CIAC gross-up?

20 A. I was involved with the issue of gross-up from its inception
21 and have dealt with this issue since the later part of 1986.
22 I was a Director of the Florida Water Works Association from
23 1986 through 1993 and was actively involved in formulating the
24 gross-up of CIAC as a means of addressing the burdens imposed
25 by taxation of CIAC. This occurred through passage of the Tax

1 Reform Act of 1986. At the request of the Florida Waterworks
2 Association, the Commission issued Order No. 16971 on December
3 18, 1986. This order allowed companies to modify their Service
4 Availability Policies by filing a tariff for authority to
5 begin collecting the gross-up (tax impact) on CIAC from
6 Contributors.

7 As a result of that order, approximately 44 water and
8 wastewater utilities elected to gross-up. Of this total, I
9 represented as many as 23 of these companies. So I would say
10 my experience with contributed taxes is extensive.

11 Q. On page 9 beginning at line 24 and continuing through line 4
12 on page 10, Mr. McPherson mentions Order No. 11487 issued
13 January 5, 1983. He then uses this order as a basis for his
14 recommendation to include contributed taxes/gross-up as CIAC.
15 On page 11, lines 3 through 5, he concludes that Order No.
16 11487 is very clear and that all contributions including
17 contributed taxes/gross-up should be included as CIAC in the
18 rate base. Is his reliance on this Order correct?

19 A. No. The very first Order issued by the Commission allowing
20 gross-up was Order No. 16971. This order specifically states
21 on page 3, paragraph 4d, the following:

22 "The amount of CIAC tax impact collected by a utility
23 shall not be treated as CIAC for rate making purposes".
24 (emphasis supplied)

25 None of the Commission's subsequent Orders dealing with

- 1 CIAC has ever changed this determination. I have enclosed a
2 copy of that order as Exhibit ___ RCN-13.
- 3 Q. You just mentioned that none of the subsequent general Orders
4 on gross-up affected this very first finding that gross-
5 up/contributed taxes shall not be treated as CIAC for rate
6 making purposes. Is that correct?
- 7 A. Yes.
- 8 Q. Are the terms tax impact, gross-up, and contributed taxes
9 synonymous?
- 10 A. Yes.
- 11 Q. What issues were involved in the ultimate issuance of Order
12 No. 23541 on October 1, 1990?
- 13 A. As one will note in reading Order No. 16971, there were not
14 many restrictions on a utility's ability to elect to gross-up.
15 In addition, that Order did not address how refunds were to be
16 calculated or any specified method of accounting. Naturally,
17 as gross-up was implemented and the issue of refunds arose, it
18 was apparent that additional guidelines were needed simply
19 because of the complexity of the issue. The Commission's
20 Staff handling these matters believed that a company should
21 file for pre-approval to gross-up based on demonstration of
22 need. ^{This staff position in} ~~That~~ order ^{was} protested by the Florida Waterworks
23 ^{No. 21266} Association and several individual utilities. I have attached
24 a copy of that order as Exhibit ___ RCN-14. By the time the
25 hearing of the protest was held, many additional issues were

1 added.

2 Q. Was there ever an issue as to whether or not contributed
3 taxes/gross-up/tax impact charges should be treated as CIAC
4 for rate making purposes?

5 A. No. All parties understood from the beginning that gross-
6 up/contributed taxes/tax-impact charges would not be treated
7 as CIAC for rate making purposes. I was there and this was
8 considered settled by all involved and simply was not an
9 issue. That is why I was really surprised at Mr. McPherson's
10 testimony and proposal regarding this issue. Order No. 23541
11 clarified many of the uncertainties associated with
12 implementation and refund of gross-up. Order No. 23541 is
13 certainly silent on the issue of contributed taxes on CIAC for
14 rate making. I believe that is why Mr. McPherson had to rely
15 on an Order issued January 5, 1983 for misplaced support of
16 his position.

17 Q. Speaking of that Order No. 11487, what was that Order about?

18 A. That case involved a utility recording connection and tap fees
19 as CIAC net of income taxes paid. Connection and tap fees, as
20 well as meter fees, have always been taxable forms of CIAC.
21 They were taxable prior to ¹⁹⁸⁷~~1986~~ and remain taxable to this
22 day. For this reason, the Commission never allowed a utility
23 to gross-up these forms of CIAC.

24 Q. In your opinion, was the Commission's finding in this Order
25 correct?

1 A. Absolutely. The CIAC for connection and tap fees should not
2 have been reduced for the taxes paid by that company. Rather,
3 the tax expense should have been deferred as a deferred tax
4 asset (debit) and either recovered as a rate base item or used
5 as an offset to deferred tax liabilities (credits) included in
6 the capital structure at zero cost. This would be in
7 accordance with the Commission's general rule on regulatory
8 treatment of normalized taxes. This is Rule 25-30.433(3)
9 Florida Administrative Code.

10 Q. Has Aloha ever reduced any form of CIAC for the taxes paid as
11 was done by the utility in Order No. 11487?

12 A. Absolutely not. All CIAC has been recorded in Account 271 at
13 the full amount received.

14 Q. Why then does Mr. McPherson, on page 10 of his testimony,
15 state that the company did something improper by not including
16 the gross-up on CIAC (contributed taxes) with the other CIAC
17 in its MFR rate base schedule?

18 A. I believe his reliance on Order No. 11487 was misplaced since
19 it really doesn't relate at all to the facts in this case.
20 Also, at his deposition on September 6, 2000, he admitted that
21 he did not read any of the gross-up Orders issued by the
22 Commission prior to Order No. 23541.

23 Also, he quotes from the current Uniform System of Accounts on
24 page 10, lines 5 through 12, which states that any taxes
25 collected to offset Federal, State, or local income taxes be

1 recorded in a sub account of account 271. Because the current
2 description for Account 271 says that gross-up/contributed
3 taxes/tax impact charges be recorded as a sub-account, he is
4 concluding that this prescribes the regulatory treatment in
5 Florida.

6 Q. Did Order No. 23541 require that gross-up/contributed
7 taxes/tax-impact charges be recorded in a sub account?

8 A. Yes. However, there was never a requirement to record gross-
9 up as a separate sub-account of CIAC.

10 Q. Why do you have your clients, including Aloha, record these
11 amounts in an account called "Contributed Taxes"?

12 A. First, there was never a NARUC requirement to record these
13 charges in Account 271 at the time Order No. 23541 was issued.
14 Secondly, I wanted to make it absolutely clear to the
15 Commission and Staff that gross-up/contributed taxes were not
16 a form of CIAC for rate making purposes. This is in
17 accordance with Order No. 16971, which I discussed above.

18 Q. In your experience, have you ever heard of a Rate Order issued
19 by this Commission for a gross-up company which classified
20 contributed taxes/gross-up as CIAC?

21 A. No. This is because of the Commission's finding on this issue
22 in Order No. 16971 issued back in 1986.

23 Q. Mr. McPherson takes issue with Aloha's normalization policy
24 and claims that it is not following Rule 25-30.433(3) or the
25 normalization requirements of Order No. 23541. Is this true?

1 A. Absolutely not. That Rule is the general rate making
2 treatment for deferred taxes. It does not cover the special
3 situation for a company that was authorized full gross-up.

4 Q. How must the general rule be modified to account for a full
5 gross-up company?

6 A. Given that the Commission's finding that gross-up/contributed
7 tax is not CIAC for rate making purposes, the rule must be
8 modified in the interest of customer fairness. The deferred
9 tax assets (debits) created by the taxation of CIAC should not
10 be included as a separate rate base item or used to reduce
11 deferred tax liabilities (credits) because a full gross-up
12 company does not have any basis in these deferred tax assets
13 (debits). The contributors of CIAC provided the funds, which
14 enabled the utility to pay the taxes. Order No. 23451
15 recognizes this distinction on page 17 in the middle of the
16 third paragraph on that page. That distinction reads as
17 follows:

18 "Under the full gross-up method, the debit-deferred taxes
19 would be fully offset by the contributed taxes".

20
21 What this language does is eliminate any deferred tax assets
22 (debits) which were paid for with contributed taxes from the
23 rate making equation. For a company that did not gross-up and
24 invested in the tax on CIAC, no offset is necessary since such
25 a company would have investment basis in those deferred tax

1 assets (debits).

2 Q. Does Mr. McPherson understand this?

3 A. No. During his deposition, noted above, he was unable to see
4 any distinction between a full gross-up company and a no
5 gross-up company.

6 Q. What has been Aloha's treatment of these items in this rate
7 case?

8 A. We have ignored the deferred tax assets (debits) because the
9 company has no basis in them except for the deferred taxes
10 related to meter fees. Because deferred tax assets (debits)
11 on meter fees relate to water operations, I simply ignored
12 them in the capital structure as an offset to deferred tax
13 liabilities (credits).

14 Q. So what did you do with the deferred tax liabilities (credits)
15 in this case?

16 A. The full amount as reconciled to rate base was put in the
17 capital structure as zero cost capital.

18 Q. Why did you use this treatment?

19 A. For two reasons. First, it is required by Rule 25-30.433(3),
20 since there were no offsets due to deferred tax assets
21 (debits) for which the company had basis. Secondly, Order No.
22 23541 requires that the benefits of tax depreciation on CIAC
23 should be passed back to the general body of utility rate
24 payers. This is found on page 21 of the order in the 5th
25 paragraph on that page. The mechanism by which these benefits

1 are passed back is through deferred tax liabilities (credits)
2 in the capital structure at zero cost.

3 Q. How did you treat contributed taxes in this case?

4 A. As I mentioned above, contributed taxes were used to offset
5 the deferred tax assets (debits). So there was no rate making
6 impact by virtue of that treatment. However, the contributed
7 tax account is amortized over a 40-year period to above the
8 line income. I have agreed with Mr. Larkin to change the
9 amortization rate to a composite amortization rate in my
10 response to his testimony and as shown in Exhibit _____ RCN-6.

11 Q. I noticed that the contributed tax account does not exactly
12 equal the amount of deferred tax assets (debits) for taxable
13 CIAC in Accounts 193 and 194. Why is this?

14 A. The difference is simply due to timing as to when amortization
15 of contributed taxes began. As required by Order No. 23541,
16 utilities had to submit a report to the Commission each year
17 after the preparation of the income tax return. This report
18 would show the amount of CIAC collected, taxes paid, and other
19 information. The Commission would then determine if any
20 refunds were necessary. We did not begin amortization of
21 contributed taxes until we received an Order from the
22 Commission as to the appropriate amount of the refund. If
23 amortization of contributed taxes had begun in the year
24 received, without waiting for a Commission Order, then the
25 amounts in the two accounts would be virtually identical.

1 This is discussed in detail in Exhibit ____ RCN-11 under
2 Disclosure No 7. Also, there is a schedule computing what
3 accumulated amortization would have been on page 34 of that
4 Exhibit.

5 Q. For rate making purposes, does it really matter that the two
6 counts are not identical?

7 A. No. As I testified to previously, the important rate making
8 treatment is to eliminate the deferred tax asset (debits)
9 associated with grossed up CIAC so that the company does not
10 unfairly receive a benefit from these deferred tax assets
11 (debits).

12 Q. According to his testimony, what is Mr. McPherson proposing?

13 A. His proposal is found on page 11, line 6 through 19. To
14 summarize, he would increase CIAC by \$1,544,865 and increase
15 accumulated amortization of CIAC by \$171,681. The effect of
16 this is to increase CIAC and reduce rate base by a net amount
17 of \$1,373,184. As I testified to previously, this is in
18 violation of Commission Order No. 16971 issued December 18,
19 1986.

20 The second part of his proposal is to net all deferred
21 tax assets (debits) of \$1,767,109 with the deferred tax
22 liabilities (credits) of \$475,501. This results in a net
23 deferred tax asset (debit) of \$1,003,170, which he proposes to
24 include in the rate base as a line item. I believe this
25 violates the rate making normalization requirements for a

1 gross-up utility as determined in Order No. 23541. The
2 violation occurs because Mr. McPherson does not recognize
3 that, except for deferred tax on meter fees, Aloha has no
4 investment basis in these deferred tax assets (debits).

5 In summary, his proposed regulatory treatment of deferred
6 taxes and contributed taxes must be rejected as contrary to
7 Order No. 16971 and the normalization requirements of Order
8 No. 23541.

9 Q. What is Exhibit JAM-2 attached to his testimony?

10 A. This is simply the calculation of the numbers I just mentioned
11 above and will not comment on this Exhibit further.

12 Q. Please comment on Exhibit JAM-3 which is discussed on page 11
13 beginning at line 20 and continuing through line 1 on page 12?

14 A. This Exhibit is meant to be a hypothetical illustration to
15 show that there is no difference whatsoever between a company
16 which grossed-up CIAC (Company B) vs. one that does not
17 (Company A).

18 Q. What is wrong with the Exhibit?

19 A. First, the assumption is made that contributed taxes are CIAC
20 for regulatory purposes. As I have mentioned several times,
21 this violates Order No. 16971.

22 Secondly, he does not offset the deferred tax asset
23 (debit) for company B with the contributed tax; therefore,
24 company B has a deferred tax asset (debit) in which it has no
25 basis.

1 How about company A in his example?

2 A. Company A is the no gross-up company and made an investment of
3 \$50 in the tax on its authorized capacity fee. Thus, his
4 example for company A is accurate.

5 Q. What would you do to correct his example for the gross-up
6 company B?

7 A. First, gross-up for taxes of \$50 should be removed from CIAC
8 so that total CIAC is \$100. The \$50 collected for gross-up
9 should be put in an account called "contributed taxes". For
10 regulatory purposes the deferred tax asset (debit) would be
11 totally offset by the \$50 contributed tax so that the net
12 deferred tax asset would be zero. The deferred tax liability
13 (credit) would be included in the capital structure at zero
14 cost in order to return the benefits of depreciation on CIAC
15 to the general body of rate payers. In addition, there would
16 be a further customer benefit through the amortization of the
17 contributed tax to above the line income.

18 Q. Mr. Nixon are you familiar with Rule 25-30.580?

19 A. Yes, this is the so called 75-25% Rule in Guidelines for
20 designed^{ing} Service Availability Policy.

21 Q. Briefly summarize this rule?

22 A. The guidelines require that Service Availability charges and
23 policy should be designed so that the maximum amount of net
24 CIAC collected does not exceed 75% of net plant when plant
25 facilities are operating at their designed capacity. The

1 minimum amount of net CIAC should not be less than the
2 percentage of plant and facilities represented by the water
3 transmission and distribution ^{and} ~~on~~ sewage collection systems.

4 Q. What would be the impact on the Commission's rule on
5 guidelines and policy for Service Availability if Mr.
6 McPherson's proposal to include gross-up as CIAC for rate
7 making?

8 A. It would effectively nullify this rule.

9 Q. How So?

10 A. Treating gross-up/contributed taxes/tax impact charges as CIAC
11 would push the CIAC levels of many Company's that grossed-up
12 over the maximum level allowed by rule. The Commission
13 monitors CIAC levels through the Annual Reports and frequently
14 initiated proceedings to lower or eliminate a Utility's
15 Service Availability charges. Thus, the Commission could
16 allow Companies to be in violation or institute proceedings to
17 lower or eliminate their charges.

18 Q. How would such a proposal impact Aloha?

19 A. Aloha has some of the lowest plant capacity charges in the
20 State. At the same time, its CIAC levels have historically
21 been very high. At December 31, 1999, the CIAC levels for
22 Seven Springs Water and Wastewater were 82.36% and 61.08%
23 respectively. Mr. McPherson's proposal would increase these
24 levels to 98.21% for Seven Springs Water and 72.19% for Seven
25 Springs Wastewater.

1 Q. Why is this important for Aloha?

2 A. The Commission has recently imposed an increase of the plant
3 capacity charge for Seven Springs Water from \$162.50 to \$500.
4 Further, it has ordered the Company to file a Service
5 Availability Case by February 1, 2000. I believe it will be
6 extremely difficult, if not impossible, to justify a \$500
7 plant capacity charge if Mr. McPherson's proposal is accepted.
8 With regard to Seven Springs Wastewater, Staff is interested
9 in increasing the plant capacity charge in this proceeding. If
10 Mr. McPherson's proposal is accepted, it will be difficult to
11 justify any increase.

12 Q. What makes justification difficult?

13 A. The Company collects large amounts of contributed property
14 from developers. Such property CIAC is part of the calculation
15 to determine the CIAC level.

16 Q. You have referred repeatedly to Order No. 23541. Do you want
17 to offer it as an Exhibit to your testimony?

18 A. Yes. It is enclosed as Exhibit ____ RCN-15.

19 Q. Do you have any further comments regarding Mr. McPherson's
20 testimony?

21 A. Not at this time.

22

23 Patricia W. Merchant

24

25 Q. What issues are covered in the testimony of Ms. Merchant?

- 1 A. She is testifying on three issues:
2 The projected amount of customer deposits; a recommended reuse
3 rate and revenues; and rate case expense.
- 4 Q. Which issues will you respond to?
- 5 A. I will briefly comment on the customer deposit issue and then
6 address the rate case expense issue.
- 7 Q. Does the company agree with Ms. Merchant's testimony and
8 position concerning the proper reuse rate and revenues?
- 9 A. ~~Yes.~~
No.
- 10 Q. Briefly discuss the customer deposit issue?
- 11 A. As noted earlier, the company had to purchase and install new
12 financial and billing software due to year 2000 problems. As
13 is not unusual, there were problems experienced in the actual
14 implementation of the new software. When a customer deposit
15 was received, the amount was deducted from customer accounts
16 receivable. As noted in the Commissions second Audit and Mr.
17 McPherson's testimony, the affected account balances were
18 corrected as of December 31, 1999, during the course of the
19 company's financial statement audit. At the time the MFR's
20 were prepared, we were unaware of the problem.
- 21 Q. According to Ms. Merchant's testimony, she made a projection
22 of customer deposits for the test year. On page 7 lines 17
23 through 19, she is recommending a 13-month average balance of
24 \$438,412. This is an increase of \$345,117 to the utility's
25 projected balance of \$93,295, do you agree?

1 A. Yes, Aloha can agree with this adjustment. In response to
2 staff interrogatories No. 35, 36 and 37, the company provided
3 revised projections and calculations of customer deposits
4 through the end of the test year. The projected amount of
5 customer deposits on a 13-month average was \$389,962,
6 exclusive of \$41,782 of non-utility deposits. As a result, the
7 company's revised projection is within approximately \$48,000
8 of the projection made by Ms. Merchant. Therefore, we can
9 accept her calculation.

10 Q. On page 7, lines 20 through 25 and continuing through line 1
11 on page 8, Ms. Merchant recommends that this increase be
12 posted as a reduction in equity. Do you agree?

13 A. Yes.

14 Q. I take it the total amount of \$438,412 projected by Ms.
15 Merchant is for total company water and wastewater deposits.
16 Is this correct?

17 A. Yes.

18 Q. Is there any way to specifically identify the wastewater
19 deposits for the Seven Springs System?

20 A. No.

21 Q. How should total company water and wastewater deposits be
22 reconciled to the rate base of Seven Springs Wastewater?

23 A. I agree with the treatment recommended by the PSC Auditors in
24 Disclosure No. 8. Customer deposits associated with rate base
25 should be determined on a prorata basis. This is included in

1 the testimony of Mr. McPherson, with which we agree.

2 Q. Beginning on page 13, Ms. Merchant discusses her recommended
3 adjustments to rate case expense. Please discuss these
4 adjustments?

5 A. Ms. Merchant is proposing two adjustments. The first relates
6 to an adjustment to legal fees in the amount of \$10,014 to
7 disallow expenses related to Aloha's request for an emergency
8 rule waiver or variance for system maps. Her discussion on
9 this issue runs through line 17 on page 15.

10 The second rate case expense adjustment begins on line 20
11 of page 15. She proposes to reduce rate case expense by
12 \$18,669 in accounting fees and \$3,056 in legal fees associated
13 with revisions to the MFR's. The total adjustment is \$21,725.
14 This is summarized on page 20, lines 13 and 14.

15 Q. Will you address the issue of legal expense associated with
16 the emergency request for a rule variance?

17 A. No. Testimony on that issue will be provided by F. Marshall
18 Deterding, Esq.

19 Q. How do you want to proceed with regard to responding to the
20 proposed adjustment related to the Staff deficiency letter?

21 A. Ms. Merchant has attached Exhibits PWM-3 and PWM-4. These are
22 copies of the Staff's deficiency letter and a copy of my cover
23 letter transmitting the revised MFR's to Mr. Deterding for
24 filing. I will review Exhibit PWM-3 to summarize those
25 deficiencies I believe were the correction of errors vs. those

1 which were a request for additional information, not
2 previously prepared.

3 Q. Please summarize those items on Exhibit PWM-3 which you
4 believe were correction of errors?

5 A. I have listed these in the numbered paragraphs as shown in the
6 Exhibit as follows:

7 A-1. Change account description on Schedules 18(A&B) from
8 accounts receivable-other to income tax deposits.

9 A-2. Revise Schedules B-2(A-C) to include a note showing how
10 amortization expense was calculated.

11 A-4. Add the variable cost long-term debt from Schedules D-
12 6(A-C) to Schedules D-5(A-C).

13 A-5. Revise Schedule F-10 to show equivalent residential
14 connections on a single family residential basis.

15 Q. I notice you did ^{not} include Item A-3 on page 2 of the exhibit as
16 a deficiency. Please explain why?

17 A. I served on the Committee of the Florida Waterworks
18 Association which worked with Ms. Merchant and other staff to
19 come up with the MFR schedules which were adopted in Rule
20 form. This schedule was meant only to be a benchmark
21 comparison between the growth of expenses from the company's
22 last test year as compared to the current historical test
23 year. In using the MFR forms, there was considerable
24 confusion in the early years as to which schedules had to be
25 duplicated for a projected test year proceeding vs. those

1 schedules which were only needed for the historic test year.
2 At some point, I don't know when, Rule 25-30.437(3) was
3 amended to attempt to clarify matters. This section of the
4 rule reads in part as follows:

5 "Such schedules shall be submitted for the historical base
6 year, and any year subsequent to the base year and prior to
7 the projected test year, in addition to the projected test
8 year. If no designation is shown on a schedule, submit that
9 schedule for the test year only." (Emphasis supplied).

10
11 Schedule B-8 has no designation on it and I believe it is
12 required for the historic test year only. This has certainly
13 been my experience with this particular schedule in prior
14 projected rate cases I have participated in. Therefore, I do
15 not believe this item was correction of an error but was a
16 request for additional information.

17 Q. I notice that you also did not include the second item under
18 Paragraph A-5 related to a description of the purpose of page
19 2 of Schedule F-10. Please explain why?

20 A. Page 2 is simply the regression analysis output attached to
21 Schedule F-10 for informational purposes. The Commission and
22 its Staff have had a long standing preference for use of the
23 regression analysis technique to determine the projected
24 growth rate. Therefore, providing a description as to why
25 this information was included was unnecessary.

1 Q. How about the next section of the letter under paragraph "B"
2 titled "Detail of Projected Methodologies"? This begins on
3 page 2 of the Exhibit.

4 A. B-1 - This was a request for additional schedules showing, by
5 account number, amount and month each projected plant addition
6 was placed in service. Also requested was an explanation for
7 the capital infiltration and inflow costs. I believe that
8 sufficient information was contained in the original filing
9 without need for additional schedules. First, the same
10 information contained on page 134 of the Revised MFR's through
11 line 12 was presented originally. This information has the
12 starting and completion date as well as a description of the
13 project. By reference to the detailed plant schedules found
14 on Schedules A-6(A-C), the amounts for these projects and
15 accounts could have been determined by reference to the month
16 of completion. Any information related to the detail primary
17 account could have been obtained by the PSC auditors through
18 review of our workpapers. The explanation of the capital
19 infiltration and inflow costs was adequately outlined on
20 Schedule B-11 of the original filing. Therefore, I do not
21 believe that any of this item was correction of an error.

22 B-2 - This item requested additional information concerning
23 CIAC in the amount of \$908,563 in matching funds received from
24 the Southwest Florida Water Management District. Again, this
25 information was adequately presented on Schedule G-1 of the

1 MFR's as originally filed. Any additional information on this
2 amount could have been obtained by the auditors for much less
3 cost.

4 B-3 - Provide calculation of the five-year average used for
5 the projection \$390,527 of donated property. Again, the
6 methodology was described adequately on Schedule G-1 of the
7 original filing.

8 B-4 - This request was for a schedule projecting plant
9 capacity fees/charges by month for both the intermediate and
10 projected test year. The schedule was to include the dollar
11 amount and number of ERC's added. Again, this methodology was
12 explained adequately as originally filed. We explained that
13 the projected growth in ERC's of 370 and 349 in respective
14 intermediate and projected years was multiplied by the
15 company's approved service availability charge to arrive at
16 the projected amounts. I believe this conforms with the
17 requirements of the rule and was not an error.

18 B-5 - This item covers a variety of balance sheet and income
19 statement accounts. In the original filing, a statement as to
20 the basis of the projection and methodology was supplied for
21 cash, customer accounts receivable, deferred tax assets,
22 deferred tax liabilities, accounts payable-trade, salaries and
23 wages-employees, salaries and wages-officers, employee
24 benefits, sludge removal, purchased power, chemicals,
25 materials and supplies, contract services-engineering, and

1 rental of equipment.

2 With regard to transportation expense, vehicle insurance, and
3 general liability insurance, no basis of projection was
4 described due to materiality. From the historic test year,
5 transportation expense increased by \$477, vehicle insurance by
6 \$124, and general liability insurance by \$87. With regard to
7 regulatory commission expense, common stock and additional
8 paid in capital, no changes were predicted. Therefore, there
9 was no need for a statement of the basis of projection.

10 For all of these items noted above, I do not believe that the
11 information presented in the G Schedules of the original
12 filing were insufficient or errors in any way. Any information
13 regarding the specific detail of the calculated projection for
14 each account could have been accomplished by the auditors
15 through review of our workpapers. This would have greatly
16 reduced rate case expense. These so called deficiencies were
17 simply a request for new information not previously prepared.

18 Q. I notice you didn't mention contributed taxes, unamortized
19 debt discount and expense or miscellaneous deferred income
20 taxes. Why?

21 A. For contributed taxes, the balance did not change; however, we
22 did not disclose the amortization rate or amount of
23 accumulated amortization. For unamortized debt discount and
24 expense the amount did not change; however, we did not
25 disclose the annual amortization.

1 I believe that "miscellaneous deferred income taxes" should
2 have read "miscellaneous deferred debits". We did not include
3 any statement regarding this account in the original filing.
4 Therefore, to the extent we did not disclose the basis of
5 amortization or provide a description for miscellaneous
6 deferred debts, I would classify these items in Section B as
7 errors. However, I believe that all of the other accounts and
8 items I discussed under this section of Staff's letter,
9 constituted a request for additional information which was not
10 previously prepared. Thus, the cost to prepare this
11 information is a legitimate recoverable rate case expense
12 which must be allowed.

13 Q. What does the applicable rule require?

14 A. Rule 25-30.437(3) reads in part as follows:

15 "A schedule shall also be included which describes in detail
16 all methods and bases of projection, explaining the
17 justification for each method or basis employed".
18

19 I believe the original filing, with the exception of the items
20 noted met this requirement. As Exhibit ___ RCN-17, I have
21 enclosed the assumptions and estimates used to project rate
22 case data from the original filing.

23 Q. How about Section C on page 3 of the Exhibit titled "Errors in
24 the Headings of Schedules"?

25 A. I believe all of these were errors, though some are very

1 insignificant and correction was not necessary to fully
2 understand what the data was relating to.

3 Q. Please discuss Section D of the exhibit beginning at the
4 bottom of page 4 and continuing on page 5 of the exhibit?

5 A. Each of these items relating to salaries, contract services-
6 other, and working capital did contain some errors.

7 Q. Please address the last item in the letter under Section E-
8 "Other Concerns".

9 A. In this section, Staff requested a schedule showing which
10 adjustments per Order No. PSC-99-1917-PAA-WS had been made to
11 the company's books for the historic test year. Although not
12 a deficiency, the letter indicates that Staff would assume
13 that the adjustments had not been made for purposes of
14 determining interim rates. Clearly, this was a request for
15 additional information with a possible penalty to the utility
16 if such information were not provided.

17 Q. Is it safe to say that Staff apparently expects human
18 perfection in the filing of MFR's?

19 A. That would appear to be the case. Of course, nothing where
20 human beings are involved is ever exactly perfect. For
21 example, there was the error in the Staff Deficiency Letter
22 under Paragraph 5 where "miscellaneous deferred income taxes"
23 should have read "miscellaneous deferred debits". On
24 occasion, even the Commission makes unintentional errors, as
25 was the case in Order No. PSC-99-1917-PAA-WS, as set forth in

1 Audit Disclosure No. 1. I am not being critical of the Staff
2 or the Commission but am merely pointing out that we all make
3 errors as a condition of our humanity. I do believe that
4 Staff has set the bar extremely high as to what is expected
5 from a utility in filing MFR's.

6 Q. Did your firm make an adjustment to write off or discount time
7 related to revising the MFR's?

8 A. Yes. This information is shown in detail in Exhibit ___ RCN-
9 9. That exhibit explains in detail the matter of responding
10 to Staff's Deficiency Letter. As noted in that schedule, I
11 believe that no more than 8 to 10 hours of work was required
12 to correct the items I have identified in my testimony as
13 errors. Nonetheless, I wrote off \$6,237 of the time required
14 to revise the filing. At my hourly rate of \$160, this
15 represents approximately 40 hours of time. Ms. Merchant's
16 proposal to throw out all the remaining expense totaling
17 \$18,669 is simply not fair.

18 Q. Is it reasonable to believe that the cost of creating a
19 schedule while preparing the original MFR's is any different
20 than the cost to prepare that same schedule after receipt of
21 a deficiency letter?

22 A. No, because the time will be incurred in any instance.

23 Q. Would any economies have resulted if you had completed the
24 required additional information originally, as opposed to
25 preparing such information after receipt of the deficiency

- 1 letter which required a revised filing?
- 2 A. I don't believe so. There is an inefficiency in having to
3 rebind and revise an entire volume of information. However,
4 I believe that I have more than adequately compensated for any
5 such inefficiency in my write-offs and discounts to the cost
6 incurred to make the revisions.
- 7 Q. On page 20, lines 4 through 6, Ms. Merchant indicates that if
8 all of the information requested had been presented in the
9 original application, the additional rate case expense would
10 have been greatly minimized. Do you agree?
- 11 A. No. As I mentioned above, the cost to create a new schedule
12 containing the information requested by staff would have been
13 incurred before or after submission of the original MFR's.
- 14 Q. How about the related legal fees of \$3,056?
- 15 A. Mr. F. Marshall Deterding, Esq. will respond to this portion
16 of disallowed legal expense.
- 17 Q. Are there any other issues you need to address at this time?
- 18 A. Yes. I would like to sponsor Exhibit ^{Composite} RCN-16 related to
19 actual and estimated rate case expense for this proceeding.
- 20 Q. Please summarize Exhibit ^{Composite} RCN-16?
- 21 A. This exhibit shows the actual accounting, legal, engineering,
22 and company incurred expenses to process this case through
23 ~~July 31, 2000 for accounting and August 31 for legal and~~
^{October 6th, 2000.}
24 ~~engineering.~~ These expenses total ^{374,135} ~~\$235,238~~. Accounting,
25 legal, engineering, and in-house expenses are projected at

1 this time to amount to ~~\$160,000~~^{98,680.}. When added to the amount of
 2 expense actually incurred, total rate case expense is
 3 estimated to be ~~\$355,238~~^{472,815.}.

4 Q. How does this compare with the estimated shown on Schedule B-
 5 10 of the MFR's?

6 A. It is approximately ~~\$95,000~~^{172,815} higher.

7 Q. Is it possible to accurately predict rate case expense at the
 8 time of filing the MFR's?

9 A. Not in my experience. Many factors come into play including
 10 the number of issues ^{and witnesses} the extent of discovery, depositions,
 11 and information requests. At the time of preparing and filing
 12 a case such as this, none of these facts, which depend on
 13 future events, is known or knowable.

14 Q. Is it likely that the ultimate expense in this case will
 15 differ from the actual and projected costs shown in ^{Composite} Exhibit
 16 ___ RCN-16?

17 A. Without a doubt. As is normal Commission practice, we will
 18 file a late filed Exhibit showing the actual and estimated
 19 costs as close to the completion of this preceding as we can.

20 Q. Do you have anything further to add at this time?

21 A. Not at this time. However, to the extent that new issues are
 22 raised in this preceding, I would like to be given the
 23 opportunity to respond.

24 (Transcript continues in sequence in Volume 7.)

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STATE OF FLORIDA)

:

CERTIFICATE OF REPORTER


COUNTY OF LEON)

I, JANE FAUROT, RPR, Chief, FPSC Bureau of Reporting
FPSC Commission Reporter, do hereby certify that the
Hearing in Docket No. 991643-SU was heard by the Florida
Public Service Commission at the time and place herein
stated.

It is further certified that I stenographically
reported the said proceedings; that the same has been
transcribed under my direct supervision; and that this
transcript, consisting of 186 pages, Volume 6 constitutes
a true transcription of my notes of said proceedings and
the and the insertion of the prescribed prefiled testimony
of the witness(s).

I FURTHER CERTIFY that I am not a relative, employee,
attorney or counsel of any of the parties, nor am I a
relative or employee of any of the parties' attorney or
counsel connected with the action, nor am I financially
interested in the action.

DATED THIS 8TH DAY OF NOVEMBER, 2000.



JANE FAUROT, RPR
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