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ORIGINAL

November 20, 2000

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Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Room 110
Tallahassee, Florida 32399-0850

HAND DELIVERY

Re: Docket No. 980744-WS

Dear Ms. Bayo:

Enclosed herewith for filing in the above-referenced docket on behalf of Florida Water Services Corporation ("Florida Water") are the following documents:

1. Original and fifteen copies of the Prefiled Direct Testimony of Hugh Gower;

2. Original and fifteen copies of the Prefiled Direct Testimony and Exhibits CHH-1 through CHH-4 of Charles H. Hughes;

3. Original and fifteen copies of the Prefiled Direct Testimony and Exhibits JC-1 through JC-3 of John Cirello; and

4. Original and fifteen copies of the Prefiled Direct Testimony and Exhibits JAP-1 through JAP-6 of James A. Perry.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the copy to me.

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3 DOCUMENT NUMBER-DATE 14991 NOV 20 8 FPSC-RECORDS/REPORTING

4 DOCUMENT NUMBER-DATE 14992 NOV 20 8 FPSC-RECORDS/REPORTING

Thank you for your assistance with this filing.

Sincerely,

J. Stephen Menton

JSM/rl
Enclosures
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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished by hand delivery(*) and U. S. Mail to the following this 20th day of November, 2000:

Jennifer Brubaker, Esq.(*)
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
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Tallahassee, FL 32399-0850

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J. Stephen Menton

J. STEPHEN MENTON, ESQ.

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into ratemaking considerations of gain on sale from sale of facilities of Florida Water Services Corporation to Orange County.	)))))	Docket No. 980744-WS Filed: November 20, 2000

PREFILED DIRECT TESTIMONY OF

HUGH GOWER

FILED ON BEHALF

OF

FLORIDA WATER SERVICES CORPORATION

KENNETH A. HOFFMAN, ESQ.
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Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is Hugh Gower and my address is 195 Edgemere Way, S., Naples, Florida 34105. I am self employed as a consultant on public utility financial, economic regulation and cost containment and control matters. I also provide expert testimony on topics related to public utility economics and rate regulation in cases before public service commissions and courts.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. After receiving a Bachelor of Science degree in Accounting and Economics from the University of Florida, I practiced public accounting for more than thirty years with Arthur Andersen & Co., with whom I was a partner for more than twenty years. I am, or have been, registered as a Certified Public Accountant in several states and I am a member of the American Institute of Certified Public Accountants and the Florida Institute of CPAs.

Q. DESCRIBE YOUR EXPERIENCE WITH ARTHUR ANDERSEN & CO.

A. Arthur Andersen, one of the largest international firms of independent public accountants, serves as auditors for a major share of the electric, gas and telephone companies, as well as numerous other utilities operating in the United States and other parts of the world. In addition to audits of financial statements, its work includes tax work and consulting assignments for businesses of all types. Representatives of Arthur Andersen also provide expert testimony in connection with public utility regulatory proceedings before federal and state regulatory authorities on a variety of accounting, financial and rate-making topics.

I was a partner in the utilities and telecommunications division of the Atlanta office of the firm, which serves as the concentration office for Arthur Andersen's regulated industries practice for the Southeastern United States. This area of the practice includes work for electric, gas, telephone, water & sewer utilities, motor carriers and airlines. I served as the Southeastern Area Director for this practice from 1975 until 1992. I had responsibility for supervising the work done for clients, training of firm personnel, and administrative matters. I also had direct responsibility for work done by the firm for numerous clients in this and other areas of the practice.

Q. BRIEFLY DESCRIBE THE NATURE OF THE WORK YOU DID WITH ARTHUR ANDERSEN & CO.

A. I performed independent audits of public utilities and other companies as a result of which Arthur Andersen & Co. issued reports on the financial statements of such companies. I participated in and supervised audits of various statements and schedules and other data required either annually or in connection with rate applications before federal or state regulatory authorities. I have also supervised work in connection with the issuance of billions of dollars of securities by public utilities. I participated in the development of accounting and management information systems designed to promote close control over utility resources such as materials, fuel and construction costs. I have directed the preparation of financial forecasts, conducted independent reviews of financial forecasts and directed the development of financial forecasting models. I participated in management audits, the purpose of which was to assess whether management systems and procedures promoted economy and efficiency in utility operations.

I have directed depreciation studies which, based on analysis of utility plant investments, retirement transactions, salvage and cost of removal, developed equitable depreciation rates with which to effect capital recovery during the service lives of the assets. I also developed plans which were accepted by regulators to equitably assign the future outlays for spent nuclear fuel disposal, nuclear plant decommissioning and fossil plant dismantlement costs to customers receiving service, considering the effects of inflation, the time value of money and other variables.

I have directed revenue requirements studies involving analysis of rate base, operating revenues and expenses as well as the analysis of specific transaction or alternative rate-making proposals for various cost-of-service components. I have also directed studies to determine the proper assignment of cost of service between customer classes, regulatory jurisdictions or between regulated and unregulated operations. I have provided expert testimony in cases before regulatory commissions and courts. I frequently served as a speaker on topics such as regulatory practices and procedures at seminars for Arthur Andersen personnel, client companies or those which were open to the public.

I was a representative of the American Institute of Certified Public Accountants on the Telecommunications Industry Advisory Group which advised the Federal Communications Commission on certain matters in connection with the development of its Uniform System of Accounts (Part 32). In this connection, I chaired the Auditing and Regulatory Subcommittee which dealt with issues regarding compliance with generally accepted accounting principles ("GAAP") when regulatory rate-setting practices were based on methods other than GAAP.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to (1) Explain the transaction which gave rise to the reported $4.2 million gain on sale of Florida Water Service Corporation's ("Florida Water" or the "Company") Orange County utility systems, together with associated facilities and the rights to future customer service revenues; (2) State the proper context in which to consider questions inherent in determining the proper ratemaking treatment of the reported gain on sale of these systems; and (3) Describe the proper rate-making treatment of gains or losses from the sale or disposition of public utility systems. My testimony will show that the long run interests of both customers and utility owners are best served when gains or losses on sales of utility systems which occur prior to the end of useful life retirement of the property are excluded from cost of service for ratemaking purposes.

Q. PLEASE OUTLINE THE TRANSACTION WHICH GAVE RISE TO THE REPORTED GAIN ON SALE OF THE COMPANY'S ORANGE COUNTY SYSTEMS.

A. In 1997, the Company liquidated its investment in its Orange County utility systems by selling its water production, treatment, storage, transmission and distribution systems serving five Orange County communities together with the wastewater collection, treatment and effluent disposal system serving one of those communities to Orange County for $13. 1 million, subject to certain adjustments. Upon completion of the sale, the Company ceased service to its

Orange County customers and received no further revenues or earnings from these systems. These systems had served approximately 4,000 customers whose service was assumed by the Orange County Utilities Division upon completion of the sale. Florida Water Services recognized a gain of $4.2 million on this sale in 1997.

Q. WHAT WAS THE DISPOSITION OF THE PROCEEDS RECEIVED BY FLORIDA WATER FROM THIS TRANSACTION?

A. As explained in more detail in Mr. Perry's testimony, the proceeds of the sale of the Orange County systems were applied as part of the $16,000,000 cash payment made in connection with the $35,000,000 purchase of the Palm Coast systems on which Florida Water had an option since 1996.

Q. WHAT IS THE PROPER CONTEXT IN WHICH TO CONSIDER QUESTIONS INHERENT IN DETERMINING THE PROPER RATEMAKING TREATMENT OF THE REPORTED GAIN ON SALE OF THE COMPANY'S ORANGE COUNTY SYSTEMS?

A. The proper context is the meaning and significance of the practices and procedures which have been developed over many years and applied under cost-based ratemaking.

Q. PLEASE EXPLAIN.

A. As the water and wastewater business has developed in the United States, a large number of customers are served by investor-owned utilities. Although these businesses are privately owned, over the years, economic and public interest considerations have led to the development of a regulatory framework which defines the rights and obligations of utility customers and of utility owners to maximize the benefits for both.

Under this regulatory framework, utilities are obligated to provide safe, reliable, adequate service to all customers willing and able to pay for service within their designated service area. Customers must be served without undue discrimination at fair and reasonable prices. Utilities are usually given exclusive rights to provide service within the designated service area and may establish reasonable rules and regulations convering such matters as safety, payment, and other commercial aspects. As with all businesses, utilities are entitled to legal protection of their private property. Among other things, this means that utilities are entitled to charge a fair and reasonable price which covers the costs they incur to provide service.

The customers' rights end when they receive and pay for safe, adequate, reliable, reasonably priced service. In other words, payment by customers for service in no way entitles them to an equity interest in the utility's property.

Q. WHAT ARE THE REGULATORY PRACTICES AND PROCEDURES FOR DETERMINING FAIR AND REASONABLE PRICES UNDER THIS REGULATORY FRAMEWORK?

A. Fair and reasonable prices begin with the costs of providing utility service. Costs are limited to those reasonably and prudently incurred. In addition, a utility is entitled to include in its prices a return on the capital it has invested for the provision of utility service.

Expenses of activities unrelated to the provision of utility service are excluded from the price of utility services as are returns on capital not devoted to utility service.

Q. HOW IS THE AMOUNT OF CAPITAL DEVOTED TO THE PROVISION OF UTILITY SERVICE DETERMINED?

A. This amount cannot be specifically or directly identified. It's a rare case indeed when an enterprise conducts only utility service-related activities. In most cases, there are non utility investing activities--if only for short-term cash management purposes. Many companies operate nonutility businesses or operate in more than one regulatory jurisdiction. And, of course, many utilities have utility assets under construction or, which even if complete and ready for service are, for one reason or another, not considered to be yet devoted to utility service. While the total amount of capital is easily identified from the utility's books and records, it is not readily determinable what proportion of that capital is devoted to utility service. Consequently, among those practices and procedures which have evolved in the art of cost-based ratemaking is the method of estimating how much capital is devoted to utility service.

Q. HOW IS THE AMOUNT OF CAPITAL DEVOTED TO UTILITY SERVICE ESTIMATED?

A. Working with values and/or transaction shown on the utility's books of account, a study is made to identify the cost of assets devoted to the provision of utility service. This would include utility plant, inventories, prepayments and other assets together with an allowance for the amount of money needed to fund utility expenses prior to receipt of customers' payment for service. These amounts are reduced by accumulated depreciation, amounts advanced by vendors or customers and other cost-free capital. The amount determined through this technique has come to be known as "rate base".

"Rate base" is a surrogate for the amount of capital investors have supplied for the provision of utility service. "Rate base" represents not so many feet of pipe or number of meters, pumps or structures, but rather the number of dollars of common stock equity or long-term debt devoted to utility service. It is this amount of capital upon which investors are entitled to earn a reasonable return.

Q. HOW IS A REASONABLE RETURN DETERMINED?

A. It begins with the amounts of capital shown on the utility's books of account. For those utilities which utilize debt or preferred stock as part of their capital, the cost of these elements of capital can be calculated. The cost of common equity capital (common stock, other paid-in capital and retained earnings) is estimated using stock market data. The weighted cost of these forms of capital (together with cost-free capital, if any) is the "reasonable return" which is allowed on investors' capital ("rate base").

These methods and procedures result in prices based upon historic original costs rather than current values of the resources devoted to utility service. However calculated, courts have held that a reasonable return must be sufficient to enable the utility to maintain its credit standing and financial integrity, sufficient to enable it to attract new capital at reasonable costs and commensurate with returns being earned on investments attended by corresponding risks.

Q. IF UTILITIES ARE ALLOWED TO SET PRICES BASED ON THEIR EXPENSES TOGETHER WITH A RETURN ON THEIR CAPITAL,

CAN THEIR RATES CAN BE COMPARED TO A "COST PLUS" CONTRACT?

A. No, not at all. Final prices under typical cost-plus contracts are largely determined after the fact, when actual costs are known. By contrast, utility rates are set prospectively and are not adjusted retroactively, even if the utility's revenues and expenses vary from expected amounts and operating results produce returns which are higher or lower than the rates were originally intended to produce. If it turns out that rates do not result in the desired level of return, rates may be adjusted prospectively, but this is very different from a cost-plus contract.

Q. ARE UTILITY INVESTORS TOTALLY PROTECTED FROM RISK WHEN RATES ARE SET AS YOU DESCRIBE?

A. Utility investments are not risk free. Utility investors carry the risk of the success or failure of the enterprise as in any other kind of business. This generally includes weather, customer usage, management's ability to control costs, competition from other providers, inflation and regulatory lag, as well as market risks. As discussed in Mr. Hughes' testimony, the water and wastewater industry has additional risks beyond these normal risks. The rate of return allowed on utility investors' capital is generally lower than might be earned in some other types of businesses, but should include an allowance for the risks investors do face.

Q. ARE UTILITY INVESTORS EXPOSED TO CAPITAL LOSSES ON THEIR INVESTMENTS?

A. Yes, they are. Depending on factors both related and unrelated to the specific utility, some investors have suffered substantial capital losses. Others, more fortunate, have realized capital gains on their investments.

Q. DOES THE RATE OF RETURN ALLOWED BY REGULATORS LIMIT CAPITAL GAINS WHICH INVESTORS MIGHT REALIZE UPON SALE OF THEIR INVESTMENTS?

A. No, it does not. Regulators can place limits on the amount earned from the provision of utility service, but not on capital transactions such as the sale of securities held by an investor. Nor do regulators protect those investors who are unfortunate and lose money on the disposition of their utility investments. This is because transactions of this type--whether complete or partial liquidations of investors' holdings-- are capital transactions and investors should bear the risk of any losses and should be entitled to any gains.

Q. DO UTILITY REGULATORS ADJUST THE AMOUNT THEY WILL ALLOW AS A REASONABLE RETURN ON CAPITAL UPWARD IF THE MARKET VALUE OF THE UTILITY'S OUTSTANDING SECURITIES INCREASES?

A. No, the amounts of return allowed are based upon the book value of the utility's capital accounts, not the market value of its outstanding securities. Changes in market values of securities can translate into an altered capital cost rate, but rate of return calculations would be made using the book value of the utility's capital accounts.

Q. DO CHANGES IN THE VALUE OF ASSETS DEVOTED TO UTILITY SERVICE AND INCLUDED IN RATE BASE" RESULT IN

AN INCREASE OR DECREASE IN THE AMOUNT OF RETURN ON CAPITAL ALLOWED BY REGULATORS?

A. No, values other than actual cost - - usually historic original cost - - are generally not considered. The Commission's interpretation of Chapter 367, Florida Statutes, is that returns allowed must be limited to the original cost of utility assets at the time of dedication to public use. This interpretation has been consistently applied for many years and was reaffirmed in its Order No. 25729 issued February 17, 1992 which states "This Commission has consistently interpreted the "investment of the utility" as contained in Section 367.081(2)(a), Florida Statutes to be the original cost of the property when first dedicated to public service, not only in the context of acquisition adjustments, but elsewhere as well." This interpretation was applied in the Company's last rate case in Commission Order No. PSC-96-1320-FOF-WS, issued October 30, 1996.

Thus, although the book values of utility assets may be significantly lower than replacement values of those assets, customers are totally shielded from price increases which might otherwise reflect those increased costs. And for those assets which provide service to customers until retirement from service, neither depreciation nor return allowances included in utility service prices reflect the higher costs which investors will face upon replacing such assets. This risk rests squarely on investors.

Q. HOW HAS THIS REGULATORY FRAMEWORK BENEFITTED UTILITIES AND THEIR CUSTOMERS?

A. This regulatory framework has benefitted utilities by making it easier for them to finance the facilities required to meet customers' needs. This regulatory framework also benefits customers by assuring adequate, reliable service at prices lower than they might otherwise be.

Q. WHAT IS THE DISTINCTION BETWEEN ORDINARY RETIREMENTS AND SALES OF PUBLIC UTILITY PROPERTIES PRIOR TO RETIREMENT, SUCH AS THE SALE OF THE COMPANY'S ORANGE COUNTY SYSTEMS?

A. Ordinary retirements represent the removal from service of utility plant items in the normal course of business for any one of several possible reasons including wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in demand and requirements of public authorities. In dynamic and growing service areas, a major cause of retirements is removals needed to accommodate changes in the community infrastructure. Whatever the cause, the retirement represents the removal of assets from service at the end of their useful life or when their service and/or economic value has been exhausted. Individually, ordinary retirements generally occur gradually and usually involve a small percentage of the utility assets in place to serve a given area at any one time. Ordinary retirements are not associated with the loss of or cessation of service to customers in a service area. Rather, ordinary retirements occur in the normal course of developing, expanding, improving or optimizing the utility system over time to continue to provide the service utility customers require, and are part of normal utility operations.

By contrast, sales of utility plant and customers --such as the sale of the Orange County systems --also occur from time-to-time for a variety of reasons. Such sales are associated with the loss of or cessation of service to customers in a service area, and represent the removal of utility assets from service by the selling investors prior to the end of their useful life. A sale is an unusual transaction unrelated to the provision of utility service by the selling utility. Rather, it represents a withdrawal of those assets (capital) from utility service by the selling utility and a partial liquidation of investors' capital to that extent. Since a sale results in the recovery of investors' capital (adequate or not), it is a capital transaction.

Q. DOES THE UNIFORM SYSTEM OF ACCOUNTS (THE "USOA") REQUIRE THE SAME ACCOUNTING FOR ORDINARY RETIREMENTS AND SALES OR DISPOSITIONS OF UTILITY PROPERTIES?

A. No. The USOA requires accounting for ordinary retirements and sales and dispositions which recognizes the different nature of these types of transactions.

Q. PLEASE EXPLAIN.

A. Ordinary retirements are part of the ongoing business of providing utility service to customers and represent removal of assets from service at the end of their economically useful lives. Most of the causes of ordinary retirements, not covered by insurance, are contemplated in setting appropriate depreciation rates. The appropriate accounting is, therefore, "retirement accounting"under which the original cost is removed from the plant accounts and charged (along with cost of removal and any salvage) to the accumulated depreciation accounts.

By contrast, sales and dispositions of operating units or systems --such as the Company's liquidation of its investment in its Orange County systems --are not ordinary transactions related to the pr vision of utility service, and their causes are not contemplated in the development of depreciation rates. Such sales and dispositions represent removal of utility assets from service by the seller prior to the end of their useful lives, and they are not treated as "retirements". Although the proper accounting calls for the removal of the original cost of the assets from the plant accounts, such amounts are not chargeable to the accumulated depreciation accounts. Rather the gain or loss (sales proceeds less original cost and the accumulated depreciation) are recorded in income accounts. This reflects the fact that such transactions are unrelated to the provision of utility service, but is rather the withdrawal of that amount of investors' capital from the utility business concurrent with the cessation of service (by the seller) to customers in the affected service area.

Q. IF SALES OF SYSTEMS--SUCH AS THE COMPANY'S ORANGE COUNTY SYSTEMS--REPRESENT CAPITAL TRANSACTIONS, WHY DOESN'T THE USOA DIRECT THAT THE GAIN OR LOSS BE RECORDED IN THE COMPANY'S CAPITAL ACCOUNTS?

A. As a matter of fact, prior to 1976, the USOA did require that gains or losses from sales of operating units or systems--clearly capital transactions--be credited or charged to retained earnings. This same accounting was directed by the National Association of Regulatory Utility Commissioners ("NARUC") systems of accounts for water, sewer, electric and gas utilities, as well as by the Federal Power Commission ("FPC"--now the Federal Energy Regulatory Commission, "FERC") system of accounts.

These accounting directives were changed in response to Opinion No. 9 ("APB No.9") issued by the Accounting Principles Board in 1966. APB

No. 9 applies to businesses of all types, not just utilities, and sought to promote greater consistency in financial reporting practices by limiting transactions (other than net income and dividends) recorded in retained earnings to prior period adjustments. This change in financial reporting, however, did not change the essential characteristic of the transactions.

Q. WHAT IS THE APPROPRIATE RATEMAKING TREATMENT FOR ORDINARY RETIREMENTS?

A. Provisions for depreciation during the service lives of utility plant assets are the method of attempting to equitably assign to customers the cost of using up the assets which provided them service and of attempting to recover the capital which investors provided to finance such assets. Recording ordinary retirement transactions at the end of the utility assets' useful lives in the accumulated depreciation accounts is an appropriate method to true up prior service life and other estimates inherent in the provisions for depreciation. All things being equal, this limits the charge to customers to actual original cost invested, while providing for investors recovery of the same amounts. This treatment reflects the fact that the economic value of the assets and the investors' capital with which they were financed have been exhausted in the provision of utility service.

Q. WHAT IS THE RATEMAKING TREATMENT OF GAINS OR LOSSES FROM SALES OR DISPOSITIONS OF OPERATING UNITS OR SYSTEMS SUCH AS THE COMPANY'S LIQUIDATION OF ITS INVESTMENT IN THE ORANGE COUNTY UTILITY SYSTEMS PRIOR TO THE END OF THE ASSETS' USEFUL LIVES?

A. Sales of operating units or systems are not ordinary transactions and are not related to the provision of utility service; rather, they are associated with the loss of or cessation of service to customers in a given service area. Such transactions are partial liquidations of the amount of investors' capital devoted to the utility business similar to sales of utility securities which may be held by investors. Such transactions should be excluded from rate setting since they are capital in nature and are assignable to investors, not customers. This is totally consistent with the fundamental distinction between the rights and obligations of customers and owners of the utility business.

Further, gains or losses arise on sales of operating units or systems because the price purchasers are willing to pay is influenced more by the current fair value of the systems than by the historic original cost recorded on the seller's books. Having applied regulatory rate setting practices which exclude both increases in the value of securities outstanding and increases in the value of utility systems assets, the Commission has limited customers prices to historic original cost. As customers paid nothing for values which exceed historic original cost, fairness and regulatory consistency dictate that they not be given the gain attributable to a value for which they did not pay.

Q. WHEN ASSETS SOLD PRIOR TO THE END OF THEIR USEFUL LIFE HAD BEEN IN THE UTILITY'S RATE BASE, ISN'T IT TRUE THAT CUSTOMERS HAD PAID PRICES THAT INCLUDED A RETURN ON THE COST OF SUCH ASSETS?

A. Yes, when the cost (less accumulated depreciation) of property investments is included in rate base used to set a utility's rates, the service prices include something for both depreciation of the property as well as a return on its net book value. This represents a charge for use of those assets which provide service to customers, just the same as airfares include the costs of using aircraft to provide customers transportation service.

Q. WOULD THE FACT THAT CUSTOMERS PAID PRICES WHICH INCLUDED DEPRECIATION AND RETURN ON PROPERTIES SOLD AFFECT THE APPROPRIATE RATEMAKING TREATMENT OF THE GAIN OR LOSS ON THE SALE?

A. No, it would not. Since any depreciation and return included in the price of service cover only the period for which service was provided, the customers' payments covered nothing more than the cost of the safe, reliable, adequate service which they received. The obligations of both utility and customer have each been discharged and neither owes the other anything further.

This is analogous to the rent a tenant pays to the owner of an apartment building for a specified period of time. The rent would likely cover a portion of the owner's maintenance costs as well as insurance, utilities and mortgage payment, if any. The tenant's occupation of the premises for the period for which rent was paid ends his or her rights to that property. After that period, the apartment building owner is completely free to rent to others or sell the building at a profit, with no claim by the former tenant. Similarly, the interest a bank pays a depositor covers its use of the funds for the period the funds were on deposit and if such funds are withdrawn and reinvested profitably, the bank has no claim on the subsequent profits earned from those funds.

Investors supply the capital which finances the utility plant which serves customers' needs. Payment of prices which include something for return of and return on the capital investors have provided doesn't change the fact that it's the investors' capital and it is the investors who own the properties which that capital financed. It is investors whose capital is exposed to the risks of ownership and to whom any gains or losses (including those from property sales) should accrue.

Q. SHOULD THE FACT THAT THE ORANGE COUNTY SYSTEMS WERE OPERATED AS DIVISIONS OF FLORIDA WATER SERVICES' CORPORATE ENTITY RATHER THAN AS A SEPARATE CORPORATION AFFECT THE RATEMAKING TREATMENT OF THE BOOK GAIN ON SALE?

A. No, the capital nature of the transaction should determine the ratemaking treatment.

Clearly, had the Company's Orange County customers been the last customers to which the Company was providing service, the sale transaction would be viewed as a total liquidation of the Company's utility business and the "regulatory disposition" of the gain would not be pending before the Commission.

Likewise, had service to the Orange County customers been carried out through a separate corporation, sale of that corporation (or sale of all assets followed by dissolution of the corporation) would clearly be a partial liquidation about which "regulatory disposition" would not likely be a question.

The regulatory treatment should not be influenced by the lack of a more complicated and costly corporate structure, but rather by the fact that the sale was a partial liquidation, was a capital transaction and, as such, should be assigned to investors.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The historic regulatory framework which recognizes the distinctly different rights and obligations of utility customers and of utility owners has benefitted both. This framework has benefitted utilities making it easier for them to attract the large amounts of capital needed to meet customers needs. Customers benefit from this historic regulatory framework because it results in lower prices for customers. Customers rights end when they receive and pay for safe, adequate, reliable, reasonably priced service.

This regulatory framework and its consequent benefits should be preserved by ratemaking practices which recognize that "rate base" is a surrogate for investors' capital and assign to investors gains or losses from sales of operating units or systems or which otherwise represent the withdrawal of assets (capital) from the utility service business. Such transactions represent (at least partial) liquidations and are not operating, but capital in nature. Failure to assign to investors gains and losses on sales of this type is not only confiscatory, unfair and improper, but also has adverse implications to the utilities' ability to raise needed capital. Such a practice would benefit neither utility customers nor utility owners.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.