

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into rate-)
making consideration of gain)
on sale from sale of facilities)
of Florida Water Services)
Corporation to Orange County.)
_____)

Docket No. 980744-WS
Filed: April 2, 2001

DIRECT TESTIMONY

OF

KIMBERLY H. DISMUKES

On Behalf of the Citizens of the State of Florida

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FPSC-RECORDS/REPORTING

1 TESTIMONY

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7 Before the

8 FLORIDA PUBLIC SERVICE COMMISSION

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10

11 Q. WHAT IS YOUR NAME AND ADDRESS?

12 A. Kimberly H. Dismukes, 401 Fieldcreek Dr. Friendswood, TX 77546.

13 Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

14 A. I am a partner in the firm of Acadian Consulting Group, which specializes in the field of public
15 utility regulation. I have been retained by the Office of the Public Counsel (OPC) on behalf of
16 the Citizens of the State of Florida to analyze Florida Water Services Corporation (FWSC,
17 Florida Water Service, or the Company) proposed ratemaking treatment of the gain on sale of its
18 Orange County water and wastewater systems.

19 Q. DO YOU HAVE AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS IN
20 REGULATION?

21 A. Yes. Appendix I, attached to my testimony, was prepared for this purpose.

22 Q. DO YOU HAVE AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?

23 A. Yes. Exhibit __ (KHD-1) contains 1 Schedule that supports my testimony.

24 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

25 A. The purpose of my testimony is to respond to Florida Water Services proposed ratemaking

1 treatment of the gain on the sale of its Orange County water and wastewater systems.

2 **Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

3 Yes. I recommend that the Commission attribute the gain on the sale of the Orange County
4 systems to ratepayers for several reasons. First, the Commission has consistently required
5 customers to absorb the risk of losses associated with abandon plants and early retirements.
6 Consistency dictates that customers should receive the benefit of the gains associated with the
7 sale of utility assets and/or systems. Second, in the electric industry, the Commission has
8 consistently treated the gains on sale of utility assets as belonging to ratepayers. There is no
9 reason why the Commission should treat the water and wastewater industry any differently than
10 the electric industry. Third, on balance in other jurisdictions, commissions typically attribute
11 some or all of the gain on the sale of utility assets to customers. Fourth, in the Company's last
12 rate case the Commission set forth distinguishing circumstances of the other gains on sales
13 where it did not attribute the gain on sale to customers. None of these circumstances are present
14 in the instant case. In addition, in the Company's last rate case the Commission did attribute
15 some gains on sales to ratepayers. The circumstances of the instant gain are the same as those
16 where the Commission attributed the gain to customers. For these reasons and as described in
17 greater detail below, the Commission should attribute the gain on the sale of the Orange County
18 system to customers.

19 **Q. WOULD YOU PLEASE DESCRIBE THE TRANSACTION WHICH GAVE RISE TO**
20 **THE GAIN ON SALE OF THE COMPANY'S ORANGE COUNTY SYSTEMS?**

21 **A.** Yes. In 1997, Florida Water Services sold its investment in five of its Orange County utility
22 systems to Orange County Utilities for \$13.1 million, subject to certain adjustments. These
23 systems had served approximately 8,000 water and wastewater customers whose service was
24 assumed by the Orange County Utilities Division upon completion of the sale. Florida Water
25 Services recognized a gain of \$4.4 million on this sale in 1997.

1 Q. IT IS OFTEN ARUGED THAT THE PARTY THAT BEARS THE RISK OF LOSS
2 SHOULD ALSO RECEIVE THE BENEFIT OF A GAIN. GIVEN THE
3 COMMISSION'S RATEMAKING PRACTICES, WHO BEARS THE RISK OF LOSS
4 CONCERNING WATER AND WASTEWATER FACILITIES?

5 A. Customers have consistently borne the risk of loss on water and wastewater assets. In the past,
6 under circumstances similar to the present case, the Commission has required customers to
7 absorb the loss on the sale of an entire system. Specifically, in Order No. 17168 the
8 Commission found:

9 Subsequent to the test year, Southern States sold the Skyline Hills water
10 system to the Town of Lady Lake. We believe the gain or loss on the sale of a
11 system should be recognized in setting rates for the remaining systems. Based
12 on the net investment in plant by the utility, closing costs, and the purchase
13 price, the sale of the Skyline Hills system resulted in a loss of \$5,643. This
14 loss should be amortized over a three-year period resulting in an annual
15 expense of \$1,881. (P. 9, emphasis added.)

16

17 Like the instant case, the entire system was sold and the customers of the remaining systems
18 were required to fund the loss on the sold system.

19

20 Not only did the Commission require customers to bear the loss of a sold system, the
21 Commission has consistently required customers to bear the cost and risk of plant
22 abandonments. For example, in Order No. PSC-93-0295-FOF-WS, the Commission required
23 the customers of Mad Hatter Utility, Inc. to pay \$400,535 for abandoned plant. The
24 Commission required an eight-year amortization period with an annual write-off of \$50,067. In
25 Order No. PSC-97-0847-FOF-WS, the Commission allowed Gulf Utility Company to amortize
\$29,600 of costs incurred on a project that was subsequently abandoned, over a five-year

1 period. In Order No PSC-97-1458-FOF-SU the Commission allowed Forest Hills Utility to
2 include in rates the costs of abandoning its wastewater treatment plant and percolation ponds.
3 Specifically, the Commission allowed the utility to amortize the loss on its abandonment assets
4 over a period of 11 years, with the unamortized balance included in rate base. The Commission
5 allowed Bayside Utilities, Inc. to recover an extraordinary loss on an early retirement. The
6 Commission found:

7
8 In Bayside's case the extraordinary loss of \$23,417 is the net of the
9 depreciable retired plant, that is, \$41,377, with estimated related accumulated
10 depreciation of \$17,920.

11
12 A similar situation occurred in 1981 when Broadview Utilities Corporation
13 interconnected with Broward County's regional sewage treatment facility,
14 resulting in the retirement of the utility's sewage treatment plant. The
15 accounting treatment was addressed by the Commission in Docket No.
16 810403-WS, wherein we decided that the net unrecovered investment should
17 be treated as an extraordinary property loss for ratemaking purposes and that
18 the investment should be excluded from rate base and written off over a five-
19 year period. The five-year period was calculated by dividing the net loss by the
20 sum of the annual depreciation expense plus the dollar rate of return that
21 would have been allowed. (Order No. 18624.)

22
23 From these cases it is evident that the Commission has required utility customers to
24 bear the risk of loss on abandoned plant or plant that is retired prematurely. It would be patently
25 unfair for the Commission in the above instance to require the customers to absorb losses, but

1 not to similarly allow them to benefit from any of the gains on systems or assets that are sold.
2 Unless the Commission treats gains and losses consistently, customers will be caught in a "catch
3 22"--if it's a loss, customers pay, but if it's a gain, customers get nothing.

4 **Q. WHAT HAS THE COMMISSION'S PRACTICE BEEN WITH RESPECT TO**
5 **DISTRIBUTING GAINS BETWEEN RATEPAYERS AND STOCKHOLDERS IN**
6 **SITUATIONS?**

7 A. There have been several cases in which the Commission has ruled on the disposition of either a
8 gain or a loss on the sale of utility assets.

9 In 1982, the Commission considered a gain on sale in the context of Tampa Electric
10 Company's (TECO's) petition for a rate increase in Order No. 11307. In this case, the
11 company had sold several properties that had been part of its rate base. These properties
12 included the former corporate headquarters, which was sold for a pretax gain of \$1.7 million.
13 The Commission noted that Public Counsel had argued that the ratepayers, not the stockholders,
14 had paid the depreciation expenses and capital costs when the property was in the company's
15 rate base, and that the ratepayers should receive the gain. The Commission agreed that the gain
16 from this sale should be accounted for above-the-line for ratemaking purposes. In discussing its
17 decision, the Commission referenced two previous dockets involving the same issue. "In Docket
18 Nos. 810002-EU (FPL) and 810136-EU (Gulf Power), we determined that gains or losses on
19 the disposition of property devoted to, or formerly devoted to, public service should be
20 recognized above the line. We consider it appropriate to treat this gain in the same manner. ..."
21 (FPSC, Order No. 11307, p. 26.)

22 In another transaction, TECO had transferred certain non-electric property to TECO
23 Energy, Inc., its holding company. This property was transferred at book value, although the
24 property's market value at the time was estimated at \$1.6 million, for an unrealized gain of \$1.2
25 million. Again, the Commission noted that ratepayers, not shareholders, had paid the capital

1 costs and depreciation expenses of this property while it was in rate base.

2 A third transaction had not yet been completed, but the Commission expected TECO to
3 sell the property in the future. The Commission decided to recognize the potential gain at that
4 time, rather than wait for the actual sale of the asset, which was estimated to result in a gain of
5 \$23,000.

6 Although Public Counsel argued that all gains should be recognized in the test year, the
7 Commission ordered instead that the gains from these three transactions be amortized over a
8 five-year period. “We have previously amortized such gains over a five-year period. We
9 consider it appropriate to do so in this case as well.” (Ibid.)

10 In 1983, gain on sale was an aspect of Docket No. 820100-EU, a petition by Florida
11 Power Corporation for a rate increase. In this docket, the utility property had been classified as
12 non-utility property at the time of sale. The Company argued that according to the FERC
13 Uniform System of Accounts (USOA), gains or losses on property that had been recorded as
14 Plant Held for Future Use should not be treated above the line. In its discussion of this issue,
15 the Commission noted that it is the company that decides whether a property is recorded as Plant
16 Held for Future Use when it is first purchased, or if it is immediately recorded as Plant In
17 Service. Thus, the company can determine the future treatment of any gains or losses from the
18 sale of the property well in advance of that event. In this situation, where some property had
19 not been included in rate base for several years, the Commission noted that it “does not
20 necessarily follow that all gains belong to the ratepayers. An equitable basis upon which to
21 apportion any benefits should be developed.” (FPSC, Order No. 11628, p. 31.)

22 In the case of property that had not been included in rate base for several years, the
23 commission allocated gains/losses between ratepayers and shareholders. The allocation was
24 made using the ratio of the years the property was in rate base, divided by the total years the
25 property was owned by the company. These gains/losses were amortized over a five-year period

1 “[c]onsistent with present Commission policy. . .” (Ibid.)

2 In 1984, Florida Power & Light Company (FPL) filed a petition for a rate increase
3 which also involved the proper treatment of a gain on sale. In this case, the gains on sale related
4 to transfers of property held for future use and sales of utility property to affiliates. The
5 company argued that imputed gains on transfers to affiliates generated no cash, and so should
6 not be included in working capital. It also argued that gains from actual sales of utility property
7 should go the shareholders, and not the ratepayers.

8 Regarding the sale of utility property the Commission ruled as follows:

9 We have addressed the issue of the actual sale of Utility property in FPL’s last
10 full rate case and in a number of other rates cases. In those cases, we
11 determined that gains or losses on the disposition of property devoted to, or
12 formerly devoted to, public service should be recognized above-the-line and
13 that those gains or losses, if prudent, should be amortized over a five year
14 period. We reaffirm our existing policy on this issue. (FPSC, Order No.
15 13537, pp.17- 18.)

16
17 Regarding the transfer of property to an affiliated company the Commission stated:

18 We believe that any transfer of property to a subsidiary or affiliated company
19 should be treated as though the property was actually sold to that party and
20 that any imputed gains on the transfer should be recognized and be reflected in
21 working capital. . . . The Company retains the option to sell the surplus
22 property to a third party, but a transfer at the Company’s option should not
23 deprive the ratepayers of their fair share of gains. (Ibid., p. 18.)

24
25 Most recently, in 1997, the Commission considered two instances of gain on sale as

1 part of the depreciation rate review of Florida Public Utilities Company (FPU). In the first
2 instance, a net gain of \$41,554 was forecast for an upcoming sale of building and land owned by
3 the company. The Commission ruled that a five-year amortization period should be used, as
4 that period was “in line with our decisions in previous cases.”

5 In this same case, the Commission also ruled on the gain on sale of FPU's hydraulic
6 production plant. In this instance, the Commission ruled that the gain should be amortized over
7 four years, a time period equal to that between depreciation studies.

8 **Q. HAVE YOU EXAMINED OTHER STATE COMMISSIONS' POLICIES ON GAIN ON**
9 **SALE?**

10 **A.** Yes, I have attempted to do so. Staff distributed a gain on sale questionnaire to public utility
11 commission staffs across the country. Not all commission staffs have yet responded. The
12 responses of those who did complete the survey are summarized on Schedule 1 of my exhibit.

13 As this schedule shows, while there is not complete agreement on how to treat gain on
14 sale, there is a clear trend to recognize that ratepayers have borne the risks associated with
15 utility assets and should be allocated any rewards. Alabama, however, has no established
16 policy on the issue, and in Arkansas, gain on sale has not been addressed by the Commission.

17 Utah states that it has no established policy, but claims a general policy that “gain
18 should follow risk.” In a recent case cited by Utah staff, gain from the sale of PacifiCorp’s
19 Centralia plant was allocated between ratepayers and shareholders with benefits amortized over
20 the remaining life of the plant and any loss to the company spread over a 23-year period.

21 Wisconsin also states it has no established policy, and that in general it follows USOA
22 accounting rules that “the gain or loss, if any should be included in Miscellaneous Credits or
23 Debits to Surplus.” An unidentified case cited by Wisconsin staff resulted in 100% of the gain
24 allocated to ratepayers.

25 Illinois also cited NARUC USOA accounting instructions. Illinois staff cited a recent

1 case in which the Commission had ordered a normalized portion of the gain on sale of a water
2 company's property to be included in test year revenues. The Commission decision was based,
3 in part, on its determination that the property qualified as utility property and was used in utility
4 service and was in rate base at the time of sale. This decision, however, was overturned by a
5 court decision which held that the Commission was erroneous in concluding that the gain was
6 not an isolated, non-recurring event, and that "the Commission improperly relied on accounting
7 rules without considering previously recognized policy implications with regard to the
8 ratemaking treatment of land sale gains." (Illinois Commerce Commission, Order On Remand,
9 95-0307 consolidated 95-0342, p. 1.)

10 In Idaho, gain on depreciable property is shared between ratepayers and shareholders,
11 while any gain on nondepreciable property goes wholly to shareholders. In New York, where
12 only sales of land have been addressed, any gain from the sale of land is given to ratepayers as a
13 reduction to rate base.

14 South Carolina and North Carolina assign all gain to shareholders.

15 Ohio, Oregon, Washington, West Virginia and Montana all agree that ratepayers should
16 receive any gain on sale of utility property. Oregon Staff states that the commission uses a
17 "benefits follows risk" approach. Ohio states that if the property was in the utility's rate base, it
18 is appropriate for ratepayers to benefit from the sale.

19 West Virginia states that in three recent orders, gains were all handled above the line.

20 Montana also states that three recent cases have involved this issue. In all three cases in
21 Montana the dockets were settled through a stipulation in which the gain was allocated to both
22 ratepayers and shareholders.

23 In Washington, Staff states that any deviation from a policy of 100% of the gain
24 allocated to ratepayers "would be on a case by case basis due to specific compelling
25 circumstances." Washington cites two recent gain on sale cases. The first is the sale by Puget

1 Sound Energy of its Colstrip, MT coal plant, in which the Commission ordered the gain to be
2 deferred, with interest, until the company's next rate case in 2001. At that time, the gain would
3 be passed back to ratepayers through reduced rates. The second case was the sale of Puget
4 Sound Energy's share of the Centralia plant. In this instance, the Commission ordered a sharing
5 of the gain between ratepayers and shareholders

6 The Commission agreed with the various parties that the company should first recover
7 its net book value in the plant. The gain above book value was next assigned to ratepayers, up
8 to the amount of the original cost of the plant. The Commission stated that:

9 The ratepayers have supported the Centralia facilities through a return of the
10 investment; they have paid based on straight-line depreciation. The ratepayers
11 have also supported the Centralia facilities through rates that include a return
12 on the investment; they have paid a fair rate of return on the undepreciated
13 balance of the facilities. Centralia was originally developed as a coal mine and
14 generating facility to be used by monopoly utility companies with limited
15 opportunities either to purchase or sell power in a competitive wholesale
16 market. The fact that the facilities are selling for an amount greater than
17 original cost is evidence that the facilities have an increasing, not a decreasing,
18 value, as an asset in a competitive wholesale generation market. This
19 increased value is greater than the depreciation paid by ratepayers. Thus, a
20 portion of the gain equivalent to the difference between net book value and
21 original cost should be returned to ratepayers, as they have, in effect, overpaid
22 necessary depreciation. This amount would be equivalent to accumulated
23 depreciation.

24
25 Lastly, the Commission directed that the remainder of the gain should be allocated the

1 50/50 between shareholders and ratepayers. The Commission stated that this was “not based
2 on a pre-conceived formula, but on the equities of this distinctive case. “ (WA Utilities and
3 Transportation Commission, 2nd Supplemental Order, p. 30.)

4 **Q. WOULD YOU PLEASE DESCRIBE THE OTHER DECISIONS OF THE**
5 **COMMISSION CONCERNING THE TREATMENT OF THE GAIN ON SALE WHEN**
6 **FWSC SOLD OTHER SYSTEMS OR ASSETS?**

7 **A.** Yes. In Order No. PSC-93-0301-FOF-WS, the Commission found that the gain on sale of St.
8 Augustine Shores should not be shared with ratepayers. The Commission stated:

9 We agree with the utility that ratepayers do not acquire a proprietary interest in
10 utility property that is being used for utility service. We also agree that it is the
11 shareholders who bear the risk of loss on their investment, not the Lehigh
12 ratepayers. Further we find that Lehigh’s ratepayers do not contribute to the
13 utility’s recovery of its investment in St. Augustine Shores. Based on the
14 foregoing, we find no adjustment for the gain on sale of the St. Augustine
15 Shores to be appropriate

16
17 OPC filed for reconsideration of the Commission’s decision, stating that the
18 Commission’s decision was inconsistent with its decisions in other cases involving plant
19 abandonment. In denying OPC’s motion for reconsideration, the Commission found that
20 different facts and circumstances distinguished the Mad Hatter case and Lehigh cases, noting
21 that loss of customers was a material difference.

22 In Order No. PSC 93-0423-FOF-WS, the Commission found that since the remaining
23 customers of SSU never subsidized the investment in the St. Augustine Shores they were no
24 more entitled to share in the gain from that sale than they would have been required to absorb a
25 loss from it. With regard to the University Shores facility, the Commission found that those

1 facilities were never included in any approved rate base amount. Therefore, it did not include an
2 above-the-line recognition of the gain.

3 In the most recent docket involving the sale of a FWSC system, the Commission denied
4 sharing of the gain with customers because the Commission did not regulate the systems, the
5 systems were not under uniform rates, the sales involved forced sales, and there was a loss of
6 customers. In Order No. PSC-96-1320-FOF-WS, issued October 30, 1996, the Commission
7 found:

8 We first observe that the sales of VGU and SAS were similar in many respects:
9 they were involuntarily made by condemnation or under threat of condemnation;
10 SSU lost the ability to serve the customers in both service areas, which were both
11 regulated by non-FPSC counties; and the facilities served customers who were
12 never included in a uniform rate structure.

13
14 The Commission, however, did allow ratepayers to receive the benefit of two gains on sales
15 where the asset was included in rate base and part of FWSC's uniform rate structure.

16 Mr. Gower's testimony was contrary to Rule 25-30.433(9), Florida Administrative
17 Code, which allows a utility to recover the cost of forced abandonments or prudent
18 retirements from the customers. Similarly, when a utility sells property that was
19 formerly used and useful or included in uniform rates, the ratepayers should receive
20 the benefit of the gain on the sale of such utility property. This is the case with the
21 \$33,726 gain on the sale of the River Park facilities, as it was included in the
22 uniform rates originally approved in Docket No. 920199-WS. With regard to the
23 6.11 acres in the Spring Hill service area, the record was unclear as to whether the
24 property was used and useful. Had it not been used and useful, the utility should
25 have provided such evidence. The gain realized on that property was \$201,950.

1 Therefore, we find the gain for the River Park facilities to be \$33,726 and the
2 Spring Hill land to be \$201,950. This total of \$235,675 shall be amortized above
3 the line over five years, resulting in a yearly deduction to expenses of \$41,135.
4

5 **Q. HOW DO THE FACTS OF THESE PRIOR CASES COMPARE TO THE ONES IN THE**
6 **INSTANT CASE?**

7 A. The Orange County systems assets were included in rate base, the systems were regulated by the
8 Commission and they were part of FWSC uniform rate design in Dockets 920199 and 950495. In
9 addition, this sale was not a forced sale or a sale under the threat of condemnation which was the
10 situation in the VGU and SAS sales. Instead, while the sale of the Orange County systems resulted in
11 the loss of customers, the proceeds were used to purchase Palm Coast which had approximately
12 30,000 customers compared to the Orange County systems with approximately 8,000. On balance the
13 two transactions produced a net gain of 22,000 customers. The facts of the instant case comport with
14 the Commission's reasoning in Order No. PSC-96-1320-FOF-WS to allocate the gain to ratepayers.

15 **Q. WHAT IS THE COMPANY'S POSITION CONCERNING HOW THIS GAIN SHOULD**
16 **BE TREATED FOR RATEMAKING PURPOSES?**

17 A. The Company's position is that the gain on the sale of the Orange County systems should be
18 attributed to stockholders, not ratepayers. The Company makes several arguments in support of
19 its position. These include:

- 20 • The transaction in question is a capital transaction and therefore the gain should be
21 attributed to stockholders.
- 22
- 23 • Gains or losses arise on sales of operating units or systems because the price
24 purchasers are willing to pay is influenced more by the current fair value of the systems
25 than by the historic original cost recorded on the seller's books. Therefore, the gain

1 should be allocated entirely to stockholders.

2

3 • Depreciation and return included in the price of service cover only the period for which
4 service was provided, the customers' payments covered only the cost of the safe,
5 reliable, adequate service which they received. The obligations of both utility and
6 customer have each been discharged and neither owes the other anything further.
7 Therefore, the gain should be allocated entirely to stockholders.

8

9 • "Ownership" of utility assets is vested in the utility's shareholders, thereby affording the
10 shareholders all of the rights attendant to ownership, including the right to realize and
11 retain increases in the market value of utility assets, as well as the risk of losses.
12 Customers acquire no proprietary or ownership interest in utility property and only the
13 utility bears the risk of loss or benefits from the gain on its investment in the sale of a
14 utility system.

15

16 • Splitting the gain between ratepayers and stockholders may incent utilities to drive up
17 the purchase price of the asset being sold.

18

19 • FWSC argues that from September, 1993 through December, 1997, the Orange County
20 systems subsidized other Florida Water systems under the Commission's jurisdiction by
21 approximately \$465,000. Because the Orange County systems were not subsidized, no
22 gain should be attributed to ratepayers.

23

24 • Retention in full of the gain realized on a sale and the reinvestment of those monies into
25 utility operations is necessary for the promotion of utility viability and capacity

1 development as envisioned by the 1996 amendments to the SDWA and the implementation of
2 viability and capacity development programs in Florida by the Legislature and DEP.

3
4 **Q. WOULD YOU ADDRESS EACH OF THESE CLAIMS BEGINNING WITH MR.**
5 **GOWER'S CLAIM THAT THE TRANSACTION IS CAPITAL RELATED AND**
6 **THEREFORE BELONGS TO STOCKHOLDERS?**

7 **A.** Mr. Gower suggests that gains on the sale of utility assets “are not ordinary transactions and are
8 not related to the provision of utility service; rather, they are associated with the loss of or
9 cessation of service to customers in a given service area. Such transactions are partial
10 liquidations of the amount of investors’ capital devoted to the utility business similar to sales of
11 utility securities which may be held by investors.” (Gower Testimony, p. 16.) Consequently, Mr.
12 Gower argues that “such transactions should be excluded from rate setting since they are capital
13 in nature and are assignable to investors, not customers. This is totally consistent with the
14 fundamental distinction between the rights and obligations of customers and owners of the
15 utility business.” (Ibid.) I fail to see the distinction drawn by Mr. Gower. Mr. Gower’s
16 suggestion that the transaction in question is related to capital and therefore assignable to
17 stockholders has no logic and is not based upon traditional ratemaking practices or principles.

18 Furthermore, if Mr. Gower’s reasoning were accurate, why does the Commission
19 require ratepayers to pay for extraordinary property losses? As I discussed above, the
20 Commission has consistently required customers to absorb losses on utility plant due to early
21 retirement or abandonment.

22 In addition, the accounting treatment of an expense, revenue or capital item does not
23 translate into the appropriate ratemaking treatment. This Commission, as well as other
24 commissions, frequently treats costs for ratemaking purposes differently than how costs are
25 treated for accounting purposes.

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Finally, Mr. Gower is mistaken with respect to Florida Water Services that the sale of utility assets and systems are not ordinary transactions. Florida Water Services has a record of selling systems and utility assets. In 1991, FWSC sold its St. Augustine Shores system to St. John's County for an after-tax gain of \$4.2 million. In 1991, the Company sold some University Shores assets for an after-tax gain of \$229,703. In 1994, FWSC sold its Venice Garden Utility to Sarasota County for an after-tax gain of \$19.1 million. FWSC also recognized two gains from parcels of land sold at its Spring Hill system in 1995. These two sales produced after-tax gains of \$33,394 and \$44,866. In addition, SSU sold its River Park system in 1995 for an anticipated gain of \$33,726 and another parcel of land at Spring Hill for an after-tax gain of \$201,950. SSU also incurred a loss of \$115 associated with the sale of land in Seminole County.

In addition to these past sales, FWSC has indicated that it would sell systems in the future. In his deposition in Docket No. 950495-WS, Mr. Sweat indicated that his recommendation to divest several additional systems was viewed favorably by the Company's management. Mr. Sweat's recommendation comes from a draft strategic plan developed by himself and others. This plan specifically targeted several systems:

...this look at ourselves must include a look at systems such as Marco Island, Kingswood, Oakwood, Holiday Haven, Leliani Heights, Fox Run, Fisherman's Haven, Beecher's Point, Wootens, Tropical Isle, Jungle Den and Sunny Hills.

An evaluation over an eighteen month period will be conducted on the feasibility of SSU's divestiture [of] these and other specific satellite operations. A critical look will be given to certain operations that fall into singular categories such as:

- geographically strains operating and maintenance performance

- 1 • stagnated growth or no growth
- 2 • politically correct
- 3 • water supply originates from another source
- 4 • exceptionally high operating cost
- 5 • capital intensive

6 These systems for the most part are stifled by small customer numbers,
7 geographical distances, inhibiting water purchase agreements, etc. (Response
8 to Citizens Document Request 161, Docket No. 95-4095-WS.)

9
10 It is evident from the Company's strategic plan that it anticipates sales in the future and
11 that such sales will be a recurring item.

12 For all of the reasons stated above, the Commission should reject Mr. Gower's
13 suggestion that the capital nature of the gain and the nonrecurring nature of the gain warrant that
14 the gain be attributed to stockholders.

15 **Q. MR. GOWER ALSO ARGUES THAT GAINS OR LOSSES ARISE ON SALES OF**
16 **OPERATING UNITS OR SYSTEMS BECAUSE THE PRICE PURCHASERS ARE**
17 **WILLING TO PAY IS INFLUENCED MORE BY THE CURRENT FAIR VALUE OF**
18 **THE SYSTEMS THAN BY THE HISTORIC ORIGINAL COST RECORDED ON THE**
19 **SELLER'S BOOKS. WOULD YOU PLEASE COMMENT?**

20 **A.** Yes. The thrust of Mr. Gower's argument is that because rate setting is historical in nature,
21 customers would be unjustly enriched if they were to receive the gain on sale because they pay
22 rates based upon historical costs. He explains that since "customers paid nothing for values
23 which exceed historic original cost, fairness and regulatory consistency dictate that they not be
24 given the gain attributable to a value for which they did not pay. (Gower Testimony, p. 16.)

25 There are several problems with Mr. Gower's reasoning. First, in the past this

1 Commission has allowed Florida Water Services as well as other utilities to use a
2 projected test year. Therefore, the rates set by the Commission are based upon projected
3 expenses and investments, not historical investments and expenses. Second, the gain on the sale
4 of these assets is a direct result of the depreciation paid for by ratepayers and the CIAC
5 contributed by ratepayers. While the purchase price may well be a function of the fair market
6 value of the systems sold, the gain is a result of the depreciation and CIAC paid by ratepayers.
7 Consistency dictates that ratepayers be given the gain which is a direct result of paying for the
8 assets through depreciation and CIAC. Third, to the extent there are “risks” associated with the
9 historical nature of ratemaking, i.e., regulatory lag, these risks are known to investors who are
10 compensated for this risk through the return authorized by the Commission. The Commission
11 should reject Mr. Gower’s arguments and attribute the gain to ratepayers.

12 **Q. MR. GOWER ARGUES THAT THE UTILITY’S OBLIGATION TO CUSTOMERS IS**
13 **DISCHARGED WHEN SERVICE IS RENDERED AND THERE SHOULD BE NO**
14 **FURTHER OBLIGATIONS TO RATEPAYERS. DO YOU AGREE?**

15 **A.** While I agree that customers pay for service rendered by a utility, I do not agree that this
16 determines how any gain on the sale of assets should be distributed between ratepayers and
17 stockholders. Mr. Gower attempts to support his position by giving an analogy to an apartment
18 tenant. Mr. Gower explains:

19 This is analogous to the rent a tenant pays to the owner of an apartment
20 building for a specified period of time. The rent would likely cover a portion of
21 the owner’s maintenance costs as well as insurance, utilities and mortgage
22 payment, if any. The tenant’s occupation of the premises for the period for
23 which rent was paid ends his or her rights to that property. After that period,
24 the apartment building owner is completely free to rent to others or sell the
25 building at a profit, with no claim by the former tenant. (Gower Testimony, p.

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17.)

It is very difficult to make comparisons between a regulated industry and a competitive industry. In most instances, and in particular in the water and wastewater industry, customers have no choice but to take service from the regulated utility. If the service is poor or the price is too high, unlike the apartment tenant who can move to a more suitable apartment, FWSC's customers cannot change to a more efficient or less costly provider. They pay for the service rendered regardless of the quality of the service or price for the service. Furthermore, if the property is condemned and abandoned, the apartment dweller would not have to continue paying rent while living in another apartment. Unlike the situation in the water and wastewater industry where the Commission requires customers to pay for abandoned plants and again for either a new plant or interconnection to another water or wastewater system, the apartment dweller would not continue to pay rent for an apartment which he/she does not occupy due to abandonment. Mr. Gower's example and rationale provide no insight into how the Commission should distribute the gain on sale of the Orange County systems.




Q. WHAT IS FWSC'S NEXT ARGUMENT CONCERNING THE APPROPRIATE RATEMAKING TREATMENT OF THE GAIN ON SALE FROM THE ORANGE COUNTY SYSTEMS?

A. The Company argues that "ownership" of utility assets is vested in the utility's shareholders and therefore shareholders have the right to realize and retain increases in the market value of utility assets, as well as the risk of losses. Mr. Hughes asserts that customers acquire no proprietary or ownership interest in utility property and that only the utility bears the risk of loss or benefits from the gain on its investment in and the sale of a utility system. (Hughes Testimony, p. 7.)

The utility generally does not bear the risk of the loss, unless the loss is due to imprudent management actions. In the past, the Commission has required that ratepayers bear

1 the loss on utility investment. In addition, ratepayers bear many additional risks.
2 Ratepayers are required to pay depreciation expense, operating and maintenance expenses, taxes
3 and a return on all prudently invested plant and equipment. Ratepayers bear the risk of paying
4 for increased costs due to environmental compliance. Customers pay for the increased costs
5 associated with repairing plant and equipment. Ratepayers bear the risk of paying increased
6 operating costs due to environmental compliance testing. In Florida, ratepayers bear the risks of
7 inflation because the Commission allows annual indexing of operations and maintenance
8 expenses. The Commission's annual indexing rate increases compensate the utility for the
9 effects of inflation on its operating and maintenance expenses. If a water or wastewater utility
10 in Florida purchases utility services from another utility, the Commission allows for the pass-
11 through of purchased utility services rate increases. Customers, not stockholders, bear the risks
12 of rate increases from purchased utility services.

13 **Q. FWSC CLAIMS THAT SPLITTING THE GAIN BETWEEN RATEPAYERS AND**
14 **STOCKHOLDER MAY INCENT UTILITIES TO DRIVE UP THE PURCHASE PRICE**
15 **OF THE ASSET BEING SOLD. DO YOU AGREE?**

16 **A.** No. Management of the selling company would strive to obtain the highest price possible as it
17 is in stockholders best interest to obtain the highest prices possible irrespective of whether they
18 keep all of the gain or share a portion of its with ratepayers. In fact, the agreement between the
19 lawyers hired by FWSC to assist with the sale of the Orange County systems, contains a
20 provision in the agreement 
21  In
22 addition, although the purchase price was negotiated at \$13.1 million, at one point in the
23 negotiations, FWSC offered to sell the systems to Orange County for .

24 Furthermore, the purchasing entity has an incentive to keep the price as low as possible.
25 In the case of the Orange County systems, the county's consultant estimated the value of the
26

1 systems between \$11.5 million and \$14.25 million. Despite the fact that the sales price
2 was in between these two values, two of the county commissioners expressed concern that the
3 county was paying too much for the systems. (The Orlando Sentinel, December 31, 1997.)

4 FWSC sold these systems because those systems had little growth and the service
5 territory was landlocked by Orange County Utilities. The Company states that it used the
6 proceeds from the sale to reinvest in Palm Coast system which had a 6% to 7% growth rate.
7 Therefore, Florida Water Services had an incentive to sell these systems regardless of how the
8 gain was distributed.

9 **Q. MR. CIRELLO CLAIMS THAT THE DECISION TO SELL THE ORANGE COUNTY**
10 **SYSTEMS WAS INFLUENCED BY THE COMMISSION'S PRIOR TREATMENT OF**
11 **THE SALE OF OTHER SYSTEMS. DO YOU AGREE WITH HIS STATEMENT?**

12 **A.** It is possible, however, in all of the documents the Company produced in response to OPC and
13 Staff's data requests, I found no contemporaneous evidence indicating that it was relying on the
14 Commission's prior decisions concerning the sale of other FWSC's systems. To assume that
15 the treatment of the gain on sale in this instance would be the same as other instances would be
16 less than a wise assumption for a variety of reasons. First, the Commission does not have a
17 written policy of the treatment of the gain on sale and it has no rules concerning how a gain
18 should be distributed between ratepayers and stockholders. The Commission decides these cases
19 on a case-by-case basis based upon the facts and evidence in the record. Second, the treatment
20 of the gains on sales of these other Company systems had distinguishing factors, which are not
21 present here. Third, the members of the Commission change and what one set of commissioners
22 may have found relevant or convincing may not be the same for a different set of
23 commissioners. Fourth, in the most recent Commission order addressing the gain on sale issue,
24 the Commission did attribute the gain on two sales to customers. Fifth, in other industries, the
25 Commission has attributed gains on sales of assets to ratepayers. Clearly, FWSC should not

1 have assumed that it would, under any circumstances, retain the gain on the sale of these
2 systems.

3 **Q. WOULD YOU PLEASE ADDRESS FWSC'S NEXT ARGUMENT?**

4 A. Yes. FWSC argues that from September, 1993 through December, 1997, the Orange County
5 systems subsidized other Florida Water systems under the Commission's jurisdiction by
6 approximately \$465,000. Like its other arguments, the Commission should reject this for at
7 least four reasons.

8 First, in Order No. PSC 96-1320-FOF-WS when the Commission found that the gain
9 on the sale of River Park facilities and land at Spring Hill should be attributed to customers, the
10 Commission did not engage in assessing whether or not a these systems received a subsidy or
11 provided a subsidy. Instead, it found that the systems were under uniform rates and therefore the
12 gain should be allocated to ratepayers. If one were to engage in this effort, it would show that
13 the River Park system was subsidized under the uniform rates adopted in Docket No. 920199-
14 WS and that Spring Hill subsidized other systems under uniform rates.

15 Second, while the Orange County systems my be a net contributor, there are other
16 systems that were even greater contributors. Based upon the information provided by FWSC in
17 response to OPC's document request 37, while University Shores was a contributor other
18 systems were even greater contributors, meaning that these other systems subsidized the Orange
19 County Systems. For example, Spring Hill's water and wastewater systems subsidized other
20 systems by over \$4.3 million under the uniform rates set by the Commission in Docket No.
21 920199-WS. Similarly, Sugarmill Woods subsidized other systems, including the Orange
22 County systems by over \$1.2 million. Had it not been for these other systems which provided a
23 greater contribution than the Orange County systems, the statewide
24 rates paid by Orange County's customers would have been higher. Under FWSC theory that the
25 gain on sale should only be shared if there is a subsidy, would require that the Commission

1 untangle over four years worth of rate design issues. In my opinion, this is neither
2 practical nor necessary. FWSC subsidy argument results solely from rate design, and rate design
3 should not determine who gets the benefit of the gain on sale

4 Third, only one of the five Orange County systems subsidized other systems. While
5 University Shores may have subsidized other systems, Daetwyler Shores, Holiday Heights, Lake
6 Conway, and Westmont all received a subsidy under the Commission's uniform rate setting
7 practice.

8 Fourth, FWSC's method of allocating all administrative and general expenses requires
9 that all customers share in these costs regardless of which system incurred the expense. FWSC
10 has made it a policy to treat all of its systems as if they were one, allocating all
11 administrative and general expenses and customer expenses regardless of what
12 system the expenses were incurred to benefit. Either FWSC is one system as it
13 argues, or it is not. Under FWSC's theory—it is one system—there should be no
14 distinction between one group of customers and the next—all should share in the
15 costs and all should share in the benefits, including gains on sales.

16 **Q. WHAT IS THE LAST ARGUMENT ADVANCED BY FWSC?**

17 **A.** The final argument espoused by FWSC is that retention in full of the gain realized on a sale and
18 the reinvestment of those monies into utility operations is necessary to the promotion of utility
19 viability and capacity development as envisioned by the 1996 amendments to the SDWA and
20 the implementation of viability and capacity development programs in Florida by the Legislature
21 and DEP. (Hughes Testimony, p. 21.)

22 I disagree. If the Commission grants FWSC's request to keep all of the gain, this does
23 nothing but provide the Company with a windfall profit. Furthermore, FWSC used the funds
24 from the sale to purchase Palm Coast, not to enhance its existing systems or to comply with the
25 1996 amendments to the Safe Drinking Water Act. While the purchase of Palm Coast does

1 expand FWSC's customer base, this system comes with its own unique set of complexities. In
2 particular, Palm Coast has a fairly sizeable amount of nonused and useful plant, which presents
3 its own ratemaking issues.

4 **Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE TREATMENT OF**
5 **THE GAIN ON SALE FROM THE ORANGE COUNTY SYSTEMS?**

6 A. I recommend that the Commission attribute the gain to customers. This is consistent with the
7 Commission's finding in Order No. PSC-96-1320-FOF-WS concerning the sale of the River Park
8 facilities and land at the Spring Hill system. In that order the Commission attributed 100% of the gain
9 to customers.

10 **Q. IF THE COMMISSION DOES NOT ACCEPT YOUR PRIMARY RECOMMENDATION,**
11 **DO YOU HAVE AN ALTERNATIVE?**

12 A. Yes. If the Commission were to decide that some incentive is necessary to give management an
13 incentive to negotiate a good purchase price, the Commission could attribute part of the gain to
14 stockholders. Using the Orange County systems' number of customers as the basis to distribute
15 the gain to stockholders relative to the total number of FWSC's customers indicates that
16 approximately 6% of the gain could be attributed to stockholders.

17 **Q. HOW DO YOU RECOMMEND THAT THE COMMISSION RETURN THESE**
18 **MONIES TO CUSTOMERS?**

19 A. The Commission has at least two options for distributing the gain on sale to customers. It could
20 require a credit to customer bills over the next five year. The five-year amortization period is
21 consistent with the Commission's treatment of other gains on sale. Alternatively, the
22 Commission could require FWSC to defer the gain, and then amortize it above-the-line for
23 ratemaking purposes in FWSC's next rate case. I recommend that the Commission choose the
24 first alternative, as it is uncertain when FWSC will ask for another rate increase.

25 **Q. SHOULD FWSC BE PERMITTED TO RETROACTIVELY USE THIS GAIN TO**

1 **OFFSET PAST EARNINGS SHORTFALLS?**

2 A. No. The Commission has already found that such treatment would constitute retroactive
3 ratemaking. In Order No. PSC-96-1320-FOF-WS, the Commission found:

4 In its post-hearing filing, SSU argued that the denial of any gain on sale from the
5 shareholders would not be proper or lawful, and that at a minimum, any amount to
6 be shared with ratepayers must first be reduced by the amount necessary to increase
7 the level of utility earnings during the historic period to a level equivalent to the
8 authorized rate of return for each year during the historic period. Utility witness
9 Sandbulte testified that MP&L's return on simple average equity investment in
10 SSU has been -3.0 percent in 1992, +1.3 percent in 1993, +16.3 percent in 1994,
11 with a projected loss on investment in 1995 of 3.1 percent. Mr. Sandbulte further
12 testified that the shareholders lost approximately \$3 million from 1992 to 1995.

13
14 OPC witness DeRonne testified that it would be inappropriate to allow SSU to
15 request retroactive treatment for facts it over-looked in the past. Regardless of the
16 treatment afforded to gains on sale, the current recovery of past losses results in
17 retroactive ratemaking. In Order No. PSC-95-1376-FOF-WS, issued on
18 November 6, 1995 (at page 16) we stated:

19
20 ... asking for a one-time adjustment to rate base to recover past
21 losses, is asking us to authorize retroactive ratemaking. See City
22 of Miami v. Florida Public Service Commission, 208 So. 2nd
23 249, 259 (Fla. 1968), Gulf Power Co. v. Cresse, 410 So. 2d 492,
24 (Fla. 1982), and Citizens of the State of Florida v Florida v.
25 Public Service Commission, 448 So. 2d 1024 (Fla. 1984), for

1 the principle that retroactive ratemaking occurs when new rates
2 are applied to prior consumption. In this case, we believe that by
3 making an adjustment to rate base for past losses, increased rates
4 would apply to prior consumption, thus retroactively raising
5 rates.

6
7 Pursuant to the holding in Gulf Power Company v. Wilson, 597 So. 2d 270 (Fla
8 1992), we must set rates so as to give the utility the opportunity to earn a fair rate
9 of return on its investment. The approved rates do not guarantee a fair rate of
10 return. Consequently, we will not make an adjustment to bring the utility's earnings
11 for any historic periods to a level that would be equivalent to its authorized rate of
12 return. Any such adjustment would violate the prohibition against retroactive
13 ratemaking.

14
15 This Commission has already found that applying any gains on sale to past under earnings is
16 inappropriate and would constitute retroactive ratemaking. There are no differences between the
17 circumstances of this case and the circumstances presented in Order No. PSC-96-1320-FOF-WS, that
18 would justify a departure from the Commissions past reasoning.

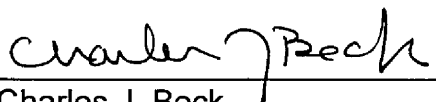
19 **Q. DOES THIS COMPLETE YOUR TESTIMONY PREFILED ON APRIL 2, 2001?**

20 **A. Yes, it does.**

**DOCKET NO. 980744-WS
CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a copy of the foregoing has been furnished by U.S.

Mail or hand-delivery to the following parties on this 2nd day of April, 2001.



Charles J. Beck

Jennifer Brubaker, Esquire
Division of Legal Services
Fla. Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

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Rutledge, Ecenia, Underwood,
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Post Office Box 551
Tallahassee, FL 32302

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1 **APPENDIX I**

2 **QUALIFICATIONS**

3 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

4 A. I graduated from Florida State University with a Bachelor of Science degree in
5 Finance in March, 1979. I received an M.B.A. degree with a specialization in
6 Finance from Florida State University in April, 1984.

7 **Q. WOULD YOU PLEASE DESCRIBE YOUR EMPLOYMENT HISTORY IN**
8 **THE FIELD OF PUBLIC UTILITY REGULATION?**

9 A. In March of 1979 I joined Ben Johnson Associates, Inc., a consulting firm
10 specializing in the field of public utility regulation. While at Ben Johnson
11 Associates, I held the following positions: Research Analyst from March 1979
12 until May 1980; Senior Research Analyst from June 1980 until May 1981;
13 Research Consultant from June 1981 until May 1983; Senior Research Consultant
14 from June 1983 until May 1985; and Vice President from June 1985 until April
15 1992. In May 1992, I joined the Florida Public Counsel's Office, as a Legislative
16 Analyst III. In July 1994 I was promoted to a Senior Legislative Analyst. In July
17 1995 I started my own consulting practice in the field of public utility regulation.

18 **Q. WOULD YOU PLEASE DESCRIBE THE TYPES OF WORK THAT YOU**
19 **HAVE PERFORMED IN THE FIELD OF PUBLIC UTILITY**
20 **REGULATION?**

21 A. Yes. My duties have ranged from analyzing specific issues in a rate proceeding to
22 managing the work effort of a large staff in rate proceedings. I have prepared
23 testimony, interrogatories and production of documents, assisted with the
24 preparation of cross-examination, and assisted counsel with the preparation of
25 briefs. Since 1979, I have been actively involved in more than 170 regulatory

1

1 proceedings throughout the United States.

2 I have analyzed cost of capital and rate of return issues, revenue requirement
3 issues, public policy issues, market restructuring issues, and rate design issues,
4 involving telephone, electric, gas, water and wastewater, and railroad companies.

5 In the area of cost of capital, I have analyzed the following parent
6 companies: American Electric Power Company, American Telephone and
7 Telegraph Company, American Water Works, Inc., Ameritech, Inc., CMS Energy,
8 Inc., Columbia Gas System, Inc., Continental Telecom, Inc., GTE Corporation,
9 Northeast Utilities, Pacific Telecom, Inc., Southwestern Bell Corporation, United
10 Telecom, Inc., and U.S. West. I have also analyzed individual companies like
11 Connecticut Natural Gas Corporation, Duke Power Company, Idaho Power
12 Company, Kentucky Utilities Company, Southern New England Telephone
13 Company, and Washington Water Power Company.

14 **Q. HAVE YOU PREVIOUSLY ASSISTED IN THE PREPARATION OF**
15 **TESTIMONY CONCERNING REVENUE REQUIREMENTS?**

16 A. Yes. I have assisted on numerous occasions in the preparation of testimony on a
17 wide range of subjects related to the determination of utilities' revenue
18 requirements and related issues.

19 I have assisted in the preparation of testimony and exhibits concerning the
20 following issues: abandoned project costs, accounting adjustments, affiliate
21 transactions, allowance for funds used during construction, attrition, cash flow
22 analysis, conservation expenses and cost-effectiveness, construction monitoring,
23 construction work in progress, contingent capacity sales, cost allocations,
24 decoupling revenues from profits, cross-subsidization, demand-side management,
25 depreciation methods, divestiture, excess capacity, feasibility studies, financial

1 integrity, financial planning, gains on sales, incentive regulation, infiltration and
2 inflow, jurisdictional allocations, non-utility investments, fuel projections, margin
3 reserve, mergers and acquisitions, pro forma adjustments, projected test years,
4 prudence, tax effects of interest, working capital, off-system sales, reserve margin,
5 royalty fees, separations, settlements, used and useful, weather normalization, and
6 resource planning.

7 Companies that I have analyzed include: Alascom, Inc. (Alaska), Arizona
8 Public Service Company, Arvig Telephone Company, AT&T Communications of
9 the Southwest (Texas), Blue Earth Valley Telephone Company (Minnesota),
10 Bridgewater Telephone Company (Minnesota), Carolina Power and Light
11 Company, Central Maine Power Company, Central Power and Light Company
12 (Texas), Central Telephone Company (Missouri and Nevada), Consumers Power
13 Company (Michigan), C&P Telephone Company of Virginia, Continental
14 Telephone Company (Nevada), C&P Telephone of West Virginia, Connecticut
15 Light and Power Company, Danube Telephone Company (Minnesota), Duke
16 Power Company, East Otter Tail Telephone Company (Minnesota), Easton
17 Telephone Company (Minnesota), Eckles Telephone Company (Minnesota), El
18 Paso Electric Company (Texas), Entergy Corporation, Florida Cities Water
19 Company (North Fort Myers, South Fort Myers and Barefoot Bay Divisions),
20 Florida Power and Light, General Telephone Company (Florida, California, and
21 Nevada), Georgia Power Company, Jasmine Lakes Utilities, Inc. (Florida),
22 Kentucky Power Company, Kentucky Utilities Company, KMP Telephone
23 Company (Minnesota), Idaho Power Company, Louisiana Gas Service
24 Company, Oklahoma Gas and Electric Company (Arkansas), Kansas Gas &
25 Electric Company (Missouri), Kansas Power and Light Company (Missouri),

1 Lehigh Utilities, Inc. (Florida), Mad Hatter Utilities, Inc. (Florida), Mankato
2 Citizens Telephone Company (Minnesota), Michigan Bell Telephone Company,
3 Mid-Communications Telephone Company (Minnesota), Mid-State Telephone
4 Company (Minnesota), Mountain States Telephone and Telegraph Company
5 (Arizona and Utah), Nevada Bell Telephone Company, North Fort Myers
6 Utilities, Inc., Northwestern Bell Telephone Company (Minnesota), Potomac
7 Electric Power Company, Public Service Company of Colorado, Puget Sound
8 Power & Light Company (Washington), Sanlando Utilities Corporation (Florida),
9 Sierra Pacific Power Company (Nevada), South Central Bell Telephone Company
10 (Kentucky), Southern Union Gas Company (Texas), Southern Bell Telephone &
11 Telegraph Company (Florida, Georgia, and North Carolina), Southern States
12 Utilities, Inc. (Florida), Southern Union Gas Company (Texas), Southwestern Bell
13 Telephone Company (Oklahoma, Missouri, and Texas), Sprint, St. George Island
14 Utility, Ltd., Tampa Electric Company, Texas-New Mexico Power Company,
15 Tucson Electric Power Company, Twin Valley-Ulen Telephone Company
16 (Minnesota), United Telephone Company of Florida, Virginia Electric and Power
17 Company, Washington Water Power Company, and Wisconsin Electric Power
18 Company.

19 **Q. WHAT EXPERIENCE DO YOU HAVE IN RATE DESIGN ISSUES?**

20 A. My work in this area has primarily focused on issues related to costing. For
21 example, I have assisted in the preparation of class cost-of-service studies
22 concerning Arkansas Energy Resources, Cascade Natural Gas Corporation, El
23 Paso Electric Company, Potomac Electric Power Company, Texas-New Mexico
24 Power Company, and Southern Union Gas Company. I have also examined the
25 issue of avoided costs, both as it applies to electric utilities and as it applies to

1 telephone utilities. I have also evaluated the issue of service availability fees, reuse
2 rates, capacity charges, and conservation rates as they apply to water and
3 wastewater utilities.

4 **Q. HAVE YOU TESTIFIED BEFORE REGULATORY AGENCIES?**

5 A. Yes. I have testified before the Arizona Corporation Commission, the Connecticut
6 Department of Public Utility Control, the Florida Public Service Commission, the
7 Georgia Public Service Commission, Louisiana Public Service Commission, the
8 Missouri Public Service Commission, the Public Utility Commission of Texas, and
9 the Washington Utilities and Transportation Commission. My testimony dealt
10 with revenue requirement, financial, policy, rate design, and cost study issues
11 concerning AT&T Communications of Southwest (Texas), Cascade Natural Gas
12 Corporation (Washington), Central Power and Light Company (Texas),
13 Connecticut Light and Power Company, El Paso Electric Company (Texas),
14 Florida Cities Water Company, Kansas Gas & Electric Company (Missouri),
15 Kansas Power and Light Company (Missouri), Houston Lighting & Power
16 Company (Texas), Lake Arrowhead Village, Inc. (Florida), Lehigh Utilities, Inc.
17 (Florida) Jasmine Lakes Utilities Corporation (Florida), Mad Hatter Utilities, Inc.
18 (Florida), Marco Island Utilities, Inc. (Florida), Mountain States Telephone and
19 Telegraph Company (Arizona), North Fort Myers Utilities, Inc. (Florida), Southern
20 Bell Telephone and Telegraph Company (Florida, Louisiana and Georgia),
21 Southern States Utilities, Inc. (Florida), St. George Island Utilities Company, Ltd.
22 (Florida), Puget Sound Power & Light Company (Washington), and Texas Utilities
23 Electric Company.

24 I have also testified before the Public Utility Regulation Board of El Paso,
25 concerning the development of class cost-of-service studies and the recovery and

1 allocation of the corporate overhead costs of Southern Union Gas Company and
2 before the National Association of Securities Dealers concerning the market value
3 of utility bonds purchased in the wholesale market.

4 **Q. HAVE YOU BEEN ACCEPTED AS AN EXPERT IN THESE**
5 **JURISDICTIONS?**

6 A. Yes.

7 **Q. HAVE YOU PUBLISHED ANY ARTICLES IN THE FIELD OF PUBLIC**
8 **UTILITY REGULATION?**

9 A. Yes, I have published two articles: "Affiliate Transactions: What the Rules Don't
10 Say", Public Utilities Fortnightly, August 1, 1994 and "Electric M&A: A
11 Regulator's Guide" Public Utilities Fortnightly, January 1, 1996.

12 **Q. DO YOU BELONG TO ANY PROFESSIONAL ORGANIZATIONS?**

13 A. Yes. I am a member of the Eastern Finance Association, the Financial
14 Management Association, the Southern Finance Association, the Southwestern
15 Finance Association, and the Florida and American Water Association.

**STATE COMMISSION POLICIES ON
 GAIN ON SALE**

	1. What is commission policy regarding allocation between ratepayers and stockholders of gain on sale of facilities included in rate base?	2. What is commission policy regarding allocation between ratepayers and stockholders of gain on sale of facilities recorded as contributions in aid of construction?	3. Has the commission addressed an allocation of gain on sale? If so, what were the circumstances, outcome, and pertinent orders?	4. What factors were considered in determining the method used to allocate gain on sale between ratepayers and stockholders?
Alabama	No established policy	No established policy	No.	Not applicable.
Arkansas	No instances in which the Commission addressed a gain on sale of assets	No instances in which the Commission addressed a gain on sale of assets.	No instances in which the Commission addressed a gain on sale of assets.	Not applicable.
Idaho	The gain is shared on depreciable property; however, all gains on non-depreciable property flow to the shareholders. Per Commission Order No. 28296	See response to Question No. 1.	See response to Question No.1.	Telecommunications docket in which gain on sale was resolved in a stipulation: Legal precedents, public interest, and desire to avoid costly litigation. (Order No. 28394)

<p>Illinois</p>	<p>Per NARUC USOA, Accounting Instruction 27(E&F).</p>	<p>Per NARUC USOA, Accounting Instruction 27(F).</p>	<p>Yes. The ICC followed the NARUC USOA. The ICC reduced rates for the gain on sale of Consumers Illinois Water Company property in Docket Nos. 95-0307 and 95-0342 (Consolidated), Order dated May 8, 1996 . The ICC included in test year revenues a normalized portion of the gain. This decision was overturned by the Illinois Appellate Court, Third District in Consumer Illinois Water Company v. Illinois Commerce Commission, et al., Case No. 3-996-0317 (3d Dist., July 8, 1997). The Commission Order on Remand, November 19, 1997 increased rates by removing the gain from revenues.</p>	<p>Consistency with USOA-water treatment of land sale gain and past Commission decisions. (95-0307 & 95-0342)</p> <p>Order on Rremand: land sale gain above-the-line adjustment was eliminated and gain was recognized as a non-recurring event.</p>
<p>Montana</p>	<p>If management of the utility has been efficient and effective and ratepayers have shouldered the risks of loss and the economic burdens associated with the property, the gain or loss IS allocated to ratepayers.</p>	<p>Gain on CIAC allocated to ratepayers.</p>	<p>In 2 telephone and 1 electric case, a portion of the gain was allocated to ratepayers.</p>	<p>In all three cases, the allocation of gain was presented to the Commission as a stipulation.</p>

<p>New York</p>	<p>The Commission has only addressed the sale of land. Gains have been preserved in Account 117, Accumulated Gains and Losses from Disposition of Utility Land and Land Rights. If the balance in this account reflects gains, this balance is reflected as a rate base reduction.</p>	<p>See response to Question No. 1.</p>	<p>See response to Question No.1.</p>	<p>See response to Question No. 1.</p>
<p>North Carolina</p>	<p>Prior to 1990, “whoever assumes the risks associated with utility property should receive the gain” (Docket No. W-354, Sub 82, et al., dated Oct 16, 1990)</p> <p>In Docket No. W-354, sub 133 & 134, it was determined that splitting gain on sale was “harmful to public interest” and all gain should go to shareholders. (Order dated Sept. 7, 1994)</p>	<p>N/A</p>	<p>Docket No. W-354, Sub 82, et al. investor-owned water systems sold to a municipality: gain was allocated 50% to ratepayers/50% to shareholders.</p> <p>Docket No. W-354, sub133 & 134: investor-owned water systems sold to municipal utility district: all gain allocated to shareholders.</p> <p>Docket No. W-354, sub 143 & 145: investor-owned water systems sold to municipal utility district: all gain allocated to shareholders.</p>	<p>Reward follows risk and public interest.</p>

<p>Ohio</p>	<p>All gain on sale of a portion of the utility's property is allocated to ratepayers.</p>	<p>This situation has not occurred and no policy has been set.</p>	<p>Cleveland Electric Illuminating sold property that was included in rate base. The gain was allocated to the ratepayers. Case No. 71-634-Y; Commission Opinion and Order dated 11/28/73.</p>	<p>1) The utility regularly disposed of property as its usefulness to the company ended; and 2) the property was in the utility's rate base, so it was appropriate for ratepayers to benefit from its sale.</p>
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<p>Oregon</p>	<p>All or nearly all of the gain from property included in rate base should be credited to the customers. It uses a "benefits follows risk" approach.</p>	<p>Staff is not aware that the PUC has addressed this situation. Asset transfers would most likely be at zero cost, and customers would receive all of the gain.</p>	<p>Portland General Electric case dealing with a restructuring proposal: the PUC stated that PGE would be allocated 5 percent of the gain or loss from the sale of its assets, as incentive to maximize gains. The remainder of the gains would be allocated to customers. Order No. 99-033 (Signed 1/27/99, Docket UE 102) PacificCorp gain from sale of a major electric generating facility: The PUC rejected PacificCorp's proposed use of depreciation reserve method (and resulting 64/36 ratepayer/ stockholder split of gain) PUC ordered (consistent with its decision in Order 99-033) that shareholders were to retain the larger of 5 percent of the gain or the value of any extraordinary action taken by the Company to increase sale price. Order No. 00-</p>	<p>The primary factor is that the property is held in rate base, and that "reward follows risk." Incent utility to manage sale to maximize plant sale value.</p>
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			112 (Docket No. UP 168)	
South Carolina	All gain to Stockholders. The sale of facilities included in rate base are recorded below the line. The ratepayer is impacted by the removal of the facilities from rate base.	See response to Question No.1.	See response to Question No.1.	See response to Question No. 1.
Utah	No set policy, but the general policy is that gain should follow risk.	See response to Question No.1.	The Commission has addressed the allocation of a gain on sale of utility property between ratepayers and stockholders on several occasions. The most recent case involved the sale of the Centralia Plant by PacificCorp.	Adequate compensation of Utah customers for future risks of acquiring replacement power.
Washington	100% of the gain on sale allocated to ratepayers. Any deviation from this policy would be on case by case basis due to specific compelling circumstances	Allocation based on specific case issues. The most compelling issue with CIAC is with who made the contribution. In general, gain on sale of plant <u>not</u> contributed by ratepayers belongs to the shareholders. However, if the ratepayers contributed the funds or plant then the <u>entire</u> proceeds net of applicable taxes and sales costs, not just the gain, would be returned to ratepayers.	Sale of the Colstrip, Montana coal plant. The selling company wanted to amortize the gain over 5 years with no rate effect to ratepayers. The Commission held that the company would defer the gain with interest until its next filing. The gain would then be passed back to ratepayers through reduced rates. The Commission also ordered the company to file a rate case at the end of 2001. (Third Supplemental Order in Docket UE-990267) The sale of the Centralia coal plant: the selling parties proposed different methods to ultimately	Public interest. Protection of ratepayers from loss. Reward should follow risk. Consideration of context in which

			keep the gain. The Commission rejected these proposals. The plant in this case sold at an <u>appreciated</u> value. The Commission decided in this case to share only the appreciated portion of the proceeds 50/50 between ratepayers and shareholders. The remainder of the gain went to ratepayers. The shared portion of the appreciation is net of tax and sales costs incurred equally by both parties. (Second Supplemental Order in Docket UE-991255, et. al.)	asset is being sold.
West Virginia	Gains on sale are reflected above the line resulting in the gain flowing to the benefit of ratepayers. Substantial gains have been required to be deferred and amortized to the benefit of ratepayers.	A case specially on point has not been located. Staff's position is that the fact that it was contributed property should not alter the handling of the gain above the line unless it was contributed by the stockholders.	Three Commission orders dealing with sale of utility property. The gain was handled above the line. No court rulings as this issue has not been contested.	The fact that the property was utility property.
Wisconsin	No established policy or practice, but cites USOA "Unless otherwise ordered by the Commission, the gain or loss, if any, shall be included in Miscellaneous Credits or Debits to Surplus." One sale that did result in a large gain was voluntarily included as a test year revenue component and was allocated by the applicant 100% to ratepayers.	See response to Question No. 1.	See response to Question No. 1.	See response to Question No. 1.

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