ORIGINAL

GUASTELLA ASSOCIATES, INC.

UTILITY MANAGEMENT • VALUATION • RATE CONSULTANTS

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January 31, 2003

Ms. Blanca Bayo, Director
Division of Commission Clerk and Administrative Service
Florida Public Service Commission
Capital Circle Office Center
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 020439-SU - Application for Staff Assisted Rate Case
Sanibel Bayous Utility Corporation

Dear Ms. Bayo:

In order to avoid individual express mailings, may I take the liberty of asking you to distribute the enclosed copies to the Staff members listed below. Thank you for your assistance.

Sincerely,
GUASTELLA ASSOCIATES, INC.

John F. Guastella

John F. Guastella
President

AUS
CAF
CMP
COM
CTR
ECR
GCL
OPC
MMS
SEC 1
OTH

CC: Staff members Jaeger, Merta, Iwenjiora, Massoudi and Davis.

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Re: Docket No. 020439-SU - Application for Staff Assisted Rate Case
Sanibel Bayous Utility Corporation

Dear Ms. Bayo:

I am writing this letter on behalf of Sanibel Bayous Utility Corporation ("Company") to request that the Staff of the Division of Economic Regulation ("Staff") reconsider the recommendation in its January 9, 2003 report regarding the proposed rate increase.

Staff has correctly pointed out that the Company must make capital improvements as well as corrective repairs and maintenance. When discussing CIAC (page 15 of Staff's report), Staff correctly advises that, "...the Commission should take into consideration a utility's financial viability and ability to raise debt..." The need to operate the utility and attract capital is essentially what the Supreme Court meant in its decision, <u>Federal Power Commission v. Hope Natural Gas Co., 320 US, 591 (1944),</u> stating "...it is important that there be enough revenue not only for operating expenses but also for the capital costs of business." That decision also established that, regardless of how rate base is determined, it is the bottom line that matters. In other words, the earnings must be adequate to enable the utility to maintain financial viability and attract capital. Despite Staff's recognition of this legal requirement, its revenue recommendation fails to meet that standard.

With respect to rate base, Staff included proforma plant additions in the amount of $47,359. These expenditures are necessary for the Company to comply with DEP directions. But, Staff is so aggressive with other rate base adjustments that its resultant rate base is still a negative $39,997. Staff also rejected the use of an operating margin. Accordingly, without any allowed earnings, the Company will have absolutely no ability to finance the capital improvements with debt. Also, keep in mind that the Supreme Court requires that there be enough earnings to attract capital. The FPSC cannot conscript capital from the existing stockholders, or anyone else.

With respect to operating expenses, Staff recognizes the need for such operating improvements as pond cleaning ($9,911), berm maintenance ($5,000), repairs to the chlorine contact chamber and aeration tanks ($2,000) and lift station repairs ($2,772). However, Staff amortizes these expenses over either 5 or 3 year periods. In addition, Staff disallows or amortizes over 3 years such rate case expenses as filing fee ($1,000), billing data ($100), notices ($244), accounting ($1,000) and consultant ($1,679). Staff's recommendation also requires refunds of $6,732 related to service charges and $750 for late payment charges. The above expenses and refunds total nearly $31,200, for which Staff's amortization allowance is only about $4,700. Thus, in order to make the improvements to its operations and make refunds, the Company must come up with about $26,500 more than the amount included in Staff's $54,755 revenue requirement. Adding the $47, 359 in capital needs, produces a cash shortfall of nearly $74,000, leaving no ability to attract capital on the strength of Company's own financial condition – and no ability to adequately provide wastewater collection and treatment service to its customers.

I am not writing this letter in a vacuum with respect to the Company's billing errors. In reality, the connection fees were needed for operating costs, particularly since there was no general rate increase for about 25 years. Imputing CIAC and eliminating all investment is severe treatment under the circumstances. But, taking rate base to a negative level, to the extent that it effectively eliminates the recognition of the necessary proforma plant improvements, does not provide any opportunity to attract capital for those improvements. Moreover, Staff's recommended rate base remains negative even after including a working capital allowance. Thus, there are no earnings provided in Staff's recommendation for either capital improvements or repairs and maintenance, leaving the Company in the impossible position of having to obtain no-cost capital.

The Company requests that Staff reevaluate its report in light of the fact that the Company cannot make expenditures of some $74,000 over and above Staff's $54,000 recommended revenue requirement.

The Company requests that Staff reconsider two adjustments to rate base. Staff's $52,799 adjustment to utility plant, because it could not identify the exact nature of the improvement, relates to the structure at the treatment facility and should be allowed. The other adjustment relates to the imputation of CIAC. On the basis of specific records the Company can identify the actual connection fees charged to its customers. There were no connection fees charged to the 108 multi-family units or the Blind Pass and Ridge single-family units. From the inception through 1981, a fee of $300 was charged to 16 units ($4,800); from 1982 through 1985 a fee of $600 was charged to 6 units ($3,600); in 1986 a fee of $800 was charged to 16 units ($12,800); in 1987 a fee of $975 was charged to 16 units ($15,600); from 1988 through 1990 a fee of $1,825 was charged to 22 units ($40,150); from 1991 to present a fee of $2,625 was charged to 52 units ($136,500). The total amount of connection fees collected was $213,400, not the $341,377 imputed as CIAC by Staff. The Company is prepared to furnish individual customer cards obtained from the original developer to verify the above. I would note that in my earlier review, I calculated the total amount of CIAC at $226,576, beginning with a 1993 balance (per the

Company's accountant) of $118, 951 and adding $2,625 per connection for subsequent years. These two approaches, producing similar results, provide a reasonable verification that the total CIAC should not exceed the $226,596 amount.

The Company also requests a higher level of maintenance and repair expenses. Staff has amortized each of four expenses totaling $19,633 as "non-recurring" (pond, berm, chlorine contact chamber and lift station), allowing $4,106. Although each of those specific items may not recur annually, different types of repair and maintenance items should be anticipated. For example, last December the Company incurred a cost of $5,620 for clearing a section sewer main. Accordingly, a more realistic level of such types of expenses should be allowed, in addition to the cash flow to fund those expenses being amortized.

Even though this is a SARC, the Company has found it necessary to obtain expert assistance in order to respond to Staff's report. This firm was also used to initially assist the Company and responded to various Staff inquiries during its investigation. The Company's survival as a viable utility and its ability to meet regulatory environmental and economic requirements are at stake. Staff has disallowed most of the management fees, reducing them to a bare bones estimate of value based on time alone. The management has had no experience in the rate setting regulatory process, and simply cannot reasonably be expected to cope with complex rate setting issues. Having taught over 3,000 regulators (Staff and Commissioners) at the NARUC rate seminars over the last 29 years, I find the Company management to be at the same level as 90% of those students. They cannot adequately participate in their first exposure to a rate proceeding without considerable assistance. It is unreasonable to allow nothing for outside expertise and, thereby, deny the Company a fair opportunity to function in a complicated regulatory process. The Company, therefore, requests Staff to allow the amortization of at least $6,000 for rate case expenses, which is less than the actual cost it has and will incur.

In considering the above requests, I would point out that the rates proposed by Staff are less than half of the average wastewater service rates of the other utilities regulated by the FPSC. In fact, 9 of 10 wastewater utilities have rates higher than those proposed by Staff for the Company. I know of course that the rates of one utility cannot be established on the basis of the rates of other utilities. However, rates are a general refection of the cost of providing service; and small utilities should be expected to have higher rates than large utilities. While the rate comparison cannot be used to establish the Company's rates, it is an indication that the capital and expense allowances by Staff are far below the average cost of providing service. It seems that the Company's need to attract relatively significant amounts of funding for capital and repair projects, requires earnings and expense allowances at least sufficient to enable it to remain a viable entity.

In sum, the Company requests a meeting with Staff prior to the February 18th agenda meeting in order to provide verification of the above. It would also use that meeting to present mechanisms (ear marking revenue for specific uses and/or escrow accounts, and a funding plan) for Staff's consideration. The Company's stockholders have taken virtually no money out of the Company since its inception. Despite the billing problems, clearly the customers have never paid more than the cost of serving them. The Company is not seeking significant profits from the utility operation, but only enough to cover costs and fund the improvements.

I appreciate Staff's consideration. Please call me if you have any questions, or to arrange a date for the requested meeting.

Respectfully submitted,

GUASTELLA ASSOCIATES, INC.

John F. Guastella
President

CC: Staff members Jaeger, Merta, Iwenjiora, Massoudi and Davis.