

ORIGINAL

BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

DOCKET NO. 060368-WS
AQUA UTILITIES FLORIDA, INC.

IN RE: APPLICATION FOR INCREASE IN WATER AND
WASTEWATER RATES IN ALACHUA, BREVARD,
HIGHLANDS, LAKE, LEE, MARION, ORANGE, PALM
BEACH, PASCO, POLK, PUTNAM, SEMINOLE, SUMTER,
VOLUSIA, AND WASHINGTON COUNTIES BY AQUA
UTILITIES FLORIDA, INC.

DECEMBER 1, 2006

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SGA _____
SEC 1
OTH _____

DIRECT TESTIMONY OF:

STEPHEN ANZALDO

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1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **AQUA UTILITIES FLORIDA, INC.**

3 **DIRECT TESTIMONY OF STEPHEN ANZALDO**

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5 **December 1, 2006**

6
7 **Q. Please state your name and business address.**

8 A. My name is Stephen Anzaldo. My business address is 762 West Lancaster Ave.,
9 Bryn Mawr, PA 19010.

10 **Q. By whom are you employed and what is your position?**

11 A. I am employed by Aqua Services, Inc. as Assistant Treasurer for all of the
12 subsidiaries of Aqua America, Inc., including Aqua Utilities Florida, Inc. ("AUF"
13 or "Company"),

14 **Q. Please describe your duties and responsibilities in that position.**

15 A. As the Assistant Treasurer of each of the subsidiaries of Aqua America, I work
16 with the Treasurer in the management and administration of cash and investment,
17 payroll and accounts payable, capital structure and long and short term debt
18 financings for all of the subsidiaries of Aqua America, Inc.

19 **Q. Please describe your educational background and professional experience.**

20 A. I graduated from St. Joseph's University in 1981 with a Bachelor of Science
21 degree in Accounting. I received my C.P.A. Certificate from the Commonwealth
22 of Pennsylvania in 1990. In addition I received a Masters of Business
23 Administration-Finance from St. Joseph's University in 1998.

1 At Aqua America, I was hired as a Financial Analyst in May 2004 and promoted
2 to Assistant Treasurer in February 2005. Prior to joining Aqua America I was
3 employed by Trigen-Philadelphia Energy Corporation from 1991 to 2003 as the
4 Manager of Financial Planning, where I was also responsible for the preparation
5 of three rate cases, and then as Accounting Manager – Cogeneration Facilities. I
6 was employed by General Waterworks Corporation from 1985 to 1991 as a
7 regional accountant and corporate accountant where my duties included
8 consolidated financial reporting and assisting in the SEC reporting. I was
9 employed by two certified public accounting firms in the Philadelphia area from
10 1981 to 1985 where my assignments included manufacturing, financial and
11 insurance clients.

12 **Q. Are you a member of any professional societies?**

13 A. Yes, I am a member of the American Institute of Certified Public Accountants and
14 the Pennsylvania Institute of Certified Public Accountants.

15 **Q. What is the purpose of your testimony?**

16 A. The purpose of my testimony is to support the capital structure and cost of debt
17 of AUF, as well as the cost of common equity determined by application of the
18 PSC leverage formula to the capital structure of AUF.

19 **Q. In connection with your responsibilities with Aqua Utilities, were any portion
20 of the Financial, Rate and Engineering Minimum Filing Requirements
21 ("MFRs") filed in connection with Aqua Utilities' rate case prepared by you
22 or under your supervision?**

23 A. Yes.

1 **Q. Please identify the specific Financial, Rate and Engineering MFRs filed in**
2 **connection with Aqua Utilities' rate case that you are sponsoring.**

3 A. I am sponsoring the following schedules included in Volume 1 of the MFRs:

4 Schedule D-1 Requested Cost of Capital

5 Schedule D-2 Reconciliation to Rate Base

6 Schedule D-3 Preferred Stock

7 Schedule D-4 Short-Term Debt

8 Schedule D-5 Long Term Debt

9 Schedule D-6 Variable Debt

10 Schedule D-7 Customer Deposits

11 **Q. Please explain the capital structure of AUF.**

12 A. The consolidated capital structure of AUF at December 31, 2007 consists of:
13 Common Equity of \$35,740,287 (57.5%), Long-term Debt of \$23,826,858
14 (38.3%), Deferred Taxes of \$1,971,863 (3.2%) and Customer Deposits of
15 \$600,000 (1.0%).

16 **Q. What is the cost of each component of the capital structure and how has it**
17 **been determined?**

18 A. The cost of long debt is 6.00%, which reflects the interest rate charged by Aqua
19 America, Inc., to AUF on a note issued by AUF to its parent on October 31, 2006.
20 The interest rate was determined by Aqua America, Inc. after consultation with
21 outside investment bankers regarding the interest rate which would be charged to
22 AUF by outside investors based on AUF's balance sheet and income statement.
23 The note carries a bullet maturity with a term of 10 years, maturing on October
24 31, 2016.

1 The cost of Customer Deposits is 6.00%, which is the rate set by the Florida
2 Public Service Commission ("PSC").

3 Deferred Taxes are included in the capital structure at zero cost, because deferred
4 taxes are funds contributed by AUF's customers.

5 The cost of Common Equity has been determined using the PSC leverage
6 formula, which provides a method of calculating the cost of common equity based
7 on the capital structure of the company.

8 **Q. Will you explain the PSC leverage formula?**

9 A. Each year the PSC establishes the range of returns on common equity cost for
10 water and wastewater utilities. The PSC's leverage formula normally eliminates
11 the need for parties in a rate case to retain expensive rate of return witnesses to
12 sponsor cost of equity testimony, respond to extensive discovery related to the
13 derivation of the cost, cross-examination and briefing on the topic, and all of the
14 costs associated with these tasks. In this case, the Company accepts and has
15 applied the leverage formula, which is set forth below:

16
$$\text{Return on Common Equity} = 7.26\% + 1.714/\text{Equity Ratio}$$

17
$$\text{Where the Equity Ratio} = \frac{\text{Common Equity}}{(\text{Common Equity} + \text{Preferred}$$

18
$$\text{Equity} + \text{Long Term and Short Term Debt})}$$

19 **Q. What is the return on common equity produced by the formula when applied**
20 **to the capital structure of AUF?**

21 A.
$$\text{Return on Common Equity} = 7.26\% + 1.714/ .60 =$$

22
$$7.26\% + 4.285 = 10.12\%$$

1 **Q. How has the AUF consolidated capital structure been allocated to each of the**
2 **systems which comprise the filing?**

3 A. Long term debt and equity for each system represents each system's rate base
4 with 40% debt and 60% equity adjusted to reflect deferred taxes and customer
5 deposits. Deferred taxes have been allocated based on fixed assets. Customer
6 Deposits (water systems only) are the actual Customer Deposits of each system.

7 **Q. Is the capital structure of AUF reasonable?**

8 A. Yes. AUF is the combination of the numerous small systems formerly owned by
9 AquaSource Utilities, Inc. ("ASI") and the small systems owned by Florida Water
10 Services Corporation ("FWS"), which remained after FWS sold its larger systems
11 to numerous local governments. All of the systems required capital expenditures
12 to improve service to a reasonable level. As noted by Mr. Schreyer in his
13 testimony, since Aqua America's acquisition of the ASI properties in 2003 and
14 the FWS properties in 2004, AUF will have invested almost \$22 million in capital
15 investments for the systems included in this rate case through December 31, 2007.
16 Moreover, the most recent rate case for any of the systems occurred more than 10
17 years ago in 1995 for the FWS systems. The previous rate cases for the ASI
18 systems range from the most recent one in 1997 and most distant one in 1980. At
19 December 31, 2005, AUF's overall rate of return was a negative 3.55% for the
20 water systems and a negative 5.94% for the wastewater systems. Without the
21 requested rate relief, the overall rate of return would be a negative 6.74% and a
22 negative 6.26%, for the water and wastewater systems, respectively, in the
23 projected 2007 test year. The required capital expenditures as well as the size and

1 lack of growth in most of the systems dictate more equity than a typical water
2 company would carry in order to support a 6% cost of debt.

3 **Q. Does this conclude your direct testimony?**

4 A. Yes, it does.