

D. Bruce May, Jr.
850 425 5607
bruce.may@hklaw.com

November 19, 2008

Ms. Ann Cole, Director
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Room 110
Tallahassee, FL 32399-0850

RECEIVED-FPSC
08 NOV 19 PM 4:50
COMMISSION
CLERK

Re: *In Re: Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida, Inc., Docket No. 080121-WS*

Dear Ms. Cole :

Enclosed for filing on behalf of Aqua Utilities Florida, Inc. ("AUF") are the original and fifteen (15) copies each of the rebuttal testimony and exhibits of the following AUF witnesses:

1. Stephen Anzaldo
2. Dan Franceski
3. Chris Franklin
4. Robert Griffin
5. John Guastella
6. Jack Lihvarcik
7. Preston Luitweiler
8. Paul Moul
9. Gary Prettyman
10. David Smeltzer

COM 5+1
 ECR
 GCL 4
 OPC
 RCP
 SSC
 SGA
 ADM
 CLK

Atlanta • Bethesda • Boston • Chicago • Fort Lauderdale • Jacksonville • Los Angeles
 Miami • New York • Northern Virginia • Orlando • Portland • San Francisco
 Tallahassee • Tampa • Washington, D.C. • West Palm Beach
 Abu Dhabi • Beijing • Caracas* • Mexico City • Tel Aviv* • *Representative Office

DOCUMENT NUMBER-DATE

10799 NOV 19 08

FPSC-COMMISSION CLERK

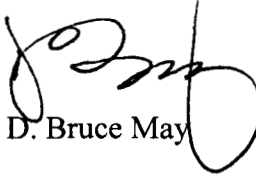
Ann Cole
November 19, 2008
Page 2

11. Stan Szczygiel (with the exception of Confidential Exhibit SS-14 which will be filed under a separate confidential cover along with a request for confidential classification.

For our records, please acknowledge your receipt of this filing on the enclosed copy of this letter. Thank you for your consideration.

Sincerely,

HOLLAND & KNIGHT LLP



D. Bruce May

DBM:kjg

Enclosures

cc: Ralph Jaeger, Esq.
Katherine Fleming, Esq.
Caroline Klancke, Esq.
Erik Sayler, Esq.
Charles Beck, Esq.
Cecilia Bradley, Esq.
Kimberly A. Joyce, Esq.

20944869_v1

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase in water and)
wastewater rates in Alachua, Brevard, DeSoto,)
Highlands, Lake, Lee, Marion, Orange,)
Palm Beach, Pasco, Polk, Putnam,)
Seminole, Sumter, Volusia, and Washington)
Counties by Aqua Utilities Florida, Inc.)
_____)

DOCKET NO. 080121-WS

Dated: November 19, 2008

REBUTTAL TESTIMONY

OF

STEPHEN F. ANZALDO

on behalf of

Aqua Utilities Florida, Inc.

DOCUMENT NUMBER-DATE

10799 NOV 19 8

FPSC-COMMISSION CLERK

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

AQUA UTILITIES FLORIDA, INC.

REBUTTAL TESTIMONY OF STEPHEN F. ANZALDO

DOCKET No. 080121-WS

1 **Q. Please state your name and business address.**

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

4 **Q. Have you previously submitted testimony in this proceeding?**

5 A. Yes. I previously submitted pre-filed direct testimony, and have sponsored the
6 following MFR pages: D-1, D-2, D-3, D-4, D-5, D-6, and D-7.

7 **Q. What is the purpose of your rebuttal testimony?**

8 A. The purpose of my testimony is to respond to portions of the direct testimony
9 presented by Office of Public Counsel (OPC) witness Rothschild relative to capital
10 structure and OPC witness Merchant relative to deferred taxes.

11 **Q. Are you sponsoring any exhibits to your rebuttal testimony?**

12 A. Yes, I'm sponsoring Exhibit SFA-1.

13 **REBUTTAL OF OPC DIRECT TESTIMONY**

14 **Q. What is Mr. Rothschild claiming with respect to capital structure in this rate**
15 **case?**

16 A. Mr. Rothschild claims that the capital structure of AUF's parent, Aqua America Inc.
17 (AAI), should be used in the AUF rate case.

18 **Q. Do you agree?**

19 A. No. In making this recommendation, Mr. Rothschild ignores the facts that the
20 Company is a separate wholly-owned subsidiary of AAI, operates exclusively in

1 Florida, and has its own capital structure that reflects the unique risks that the
2 Company faces in Florida.

3 **Q. Mr. Rothschild also takes issue with AUF's thirteen month average methodology**
4 **for calculating pro-forma capital structure. Do you agree with his position?**

5 A. No, I do not. First, Mr. Rothschild ignores the fact that the thirteen month average
6 methodology is the Commission's required capital structure approach.

7 Second, Mr. Rothschild argues that it would be inappropriate to assign a
8 higher level of common equity to the capital structure than AUF is actually using
9 unless such assignment could be shown to result in a lower, not higher, revenue
10 requirement. His argument assumes that the thirteen month average I have used to
11 calculate AUF's capital structure would result in a higher return than if the December
12 31, 2007 AUF capital structure were used. That simply is not the case. The
13 components of my AUF capital structure that are not contained in Mr. Rothschild's
14 Exhibit JAR-1, Schedule 1 are a zero cost of capital for deferred taxes and 6% cost of
15 capital for customer deposits. These added components result in a lower overall
16 return compared to the AUF capital structure without these items.

17 **Q. Has Mr. Rothschild utilized the thirteen month methodology in presenting his**
18 **recommended capital structure?**

19 A. No.

20 **Q. In light of Mr. Rothschild's testimony, what is your recommendation with**
21 **respect to the appropriate capital structure to be used in this proceeding?**

22 A. For the reasons stated above, I recommend that the AUF capital structure, based on
23 the thirteen month methodology, be utilized in this rate case. The schedule attached
24 to my rebuttal testimony as Exhibit SFA-1 sets forth AUF's recommended capital
25 structure and weighted cost rate in the instant rate case. Please note that the ROE

1 shown in Exhibit SFA-1 is based on the Commission's 2007 leverage formula for
2 illustrative purposes. I understand that the 2008 leverage formula has been issued and
3 may result in slightly higher ROEs.

4 **USE OF PARENT COMPANY DATA**

5 **Q. If the Commission were to adopt Mr. Rothschild's recommendation that capital**
6 **structure should be based on the June 30, 2008 AAI consolidated capital**
7 **structure instead of the AUF capital structure, do you have any substantive**
8 **comments regarding changes that should be made to Exhibit JAR-1, Schedule 1?**

9 A. Yes. First, as stated above, AUF is a separate wholly-owned subsidiary of AAI with
10 its own rate structure. Thus, I believe that AUF's rate structure should be used in this
11 case. However, if the Commission were to disagree with that approach, the
12 Commission should carefully note that Mr. Rothschild's recommended capital
13 structure and cost rates as shown in Exhibit JAR-1, Schedule 1 contain an invalid
14 Long-Term debt cost rate and an unduly low ROE which is disputed by Paul Moul in
15 his rebuttal testimony. It is also important that Mr. Rothschild's recommended
16 capital structure failed to net against the principal amount outstanding the funds held
17 by the trustee of the tax-exempt debt that has not yet been expended on utility assets.
18 The 5.10% weighted cost of Long-Term debt utilized by Mr. Rothschild in Exhibit
19 JAR-1, Schedule 1 is the interest rate of the note between AAI and AUF. The actual
20 AAI weighted cost of Long-Term debt at December 31, 2007 was 5.58%, as reported
21 in AAI's 2007 Annual Report in the MD&A, on page 10. In the second schedule of
22 Exhibit SFA-1, I have corrected for (1) the lack of a thirteen month methodology with
23 the inclusion of customer deposits and deferred taxes in the capital structure, (2) the
24 correct weighted cost of Long-Term debt, and (3) an ROE based on the
25 Commission's leverage formula.

1 **Q. Has Mr. Rothschild correctly identified the amount of AAI Long-Term debt in**
2 **Exhibit JAR-1, Schedule 8?**

3 A. No. The capital structure for AAI and subsidiaries that Mr. Rothschild derived from
4 Aqua's 10-Q, dated June 30, 2008, contains debt items for Industrial Development
5 Bonds and State Revolving Funds in Ohio, New Jersey, Illinois, New York, Maine
6 and Pennsylvania, which is not available for use in Florida. If the capital structure of
7 AAI is to be used in this proceeding, AAI's short-term debt and restricted debt
8 financings must be eliminated because the earmarked capital projects are limited as to
9 County and State, and thus cannot be used in Florida. The cost of AAI Long-Term
10 debt is increased to 6.27% by removing the subsidized tax exempt state financings.
11 Included in Exhibit SFA-1 is a thirteen month workpaper of AAI capital structure
12 without tax-exempt financing and short-term debt. It is important to note that this is
13 not the Company's recommendation. However, it provides a more accurate picture of
14 the AAI capital structure and weighted cost rate.

15 **Q. Why have you removed AAI's short-term debt in your bottom schedule in**
16 **Exhibit SFA-1?**

17 A. AAI's capital structure includes short-term debt that is not part of AUF's capital
18 structure and thus should not be imputed.

19 **Q. Mr. Anzaldo, how should this AAI information be used in the instant rate**
20 **filings?**

21 A. As I indicated earlier in my testimony, there are very good regulatory and legal
22 reasons to adhere to the AUF capital structure. However, I offer corrected, thirteen
23 month AAI capital structure and weighted cost of debt figures to use in the event the
24 Commission is influenced by Mr. Rothschild's arguments. In my opinion, it would
25 be inappropriate and inaccurate to accept Mr. Rothschild's unadjusted figures that are

1 not based on real Long-Term debt rates, the Commission's leverage formula, or the
2 Commission's thirteen month methodology.

3 **CAPITAL STRUCTURE – DEFERRED TAXES**

4 **Q. What has OPC witness Merchant recommended with regard to Accumulated**
5 **Deferred Taxes in the capital structure?**

6 A. Ms. Merchant points out that in AUF's response to OPC's Interrogatory No. 102, it
7 did not consider the deferred taxes related to the pro-forma additions to plant when
8 the MFRs were originally filed. She calculates that deferred taxes should be
9 increased by \$850,382 and that this amount should be added to the capital structure.

10 **Q. Do you agree?**

11 A. No. AUF agrees that the values included on page 25, lines 5 to 10, of Ms. Merchant's
12 testimony are those provided by AUF in response to the referenced interrogatory.
13 However, in developing her proposed adjustment of \$850,318, Ms. Merchant has
14 failed to account for required averaging of the taxes related to IT equipment and 2008
15 pro-forma additions, and has used total Florida values for taxes related to the IT
16 equipment. The deferred taxes related to 2008 pro-forma adjustments of \$712,841
17 represent the full year accumulation of taxes based on accelerated depreciation in
18 2008. Based on the half-year convention used for depreciation in the pro-forma rate
19 base adjustment, this would not be the appropriate amount to be used to adjust the
20 average capital structure. Rather, the appropriate adjustment would be to use the
21 average amount of \$356,421. In addition, taxes of \$117,477 for IT equipment
22 represent the total value for AUF, of which 65.85%, or \$77,353 should be allocated to
23 systems included in the filing. Then, the appropriate capital structure adjustment for
24 deferred tax on the 2008 IT equipment would be the average balance of \$38,677. Ms.
25 Merchant also proposes to adjust for the average balance of \$22,064 for year 2007

1 Corporate IT and Corporate Structures and Improvements related deferred taxes.
2 This adjustment is a duplication. Ms. Merchant fails to realize that a spreadsheet
3 entitled "Analysis of Temporary Differences-2007," which AUF provided to the OPC
4 in response to OPC's Request for Production No. 2, provided support that this
5 \$22,064 was indeed included in the deferred taxes allocated to the capital structure of
6 each AUF system. Therefore, the appropriate average deferred tax correction is
7 \$395,098. Furthermore, Ms. Merchant fails to recognize the offsetting impact of the
8 deferred tax adjustments. The increase in average deferred taxes would be offset by a
9 decrease in current accrued taxes, which would increase the AUF working capital
10 claim by the same \$395,098.

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

12 **A. Yes, it does.**

Aqua Utilities Florida, Inc.
Docket No. 080121-WS

Capital Structure and Cost Rates

Company Recommended Capital Structure at Rebuttal Testimony

| | AUF | | | | Weighted |
|-------------------|-------------------|-----|----------------|------------|-----------|
| | 13 Mos. Avg. | | Ratios | Cost Rate | Cost Rate |
| | Rate Base | | | | |
| Long-Term Debt | 13,008,718 | | 36.47% | 5.10% (A) | 1.86% |
| Short-Term Debt | - | | 0.00% | 5.90% (B) | 0.00% |
| Common Equity | 21,570,543 | | 60.47% | 10.25% (C) | 6.20% |
| Customer Deposits | 276,826 | (D) | 0.78% | 6.00% | 0.05% |
| Deferred Taxes | 818,261 | (D) | 2.29% | 0.00% | 0.00% |
| | <u>35,674,348</u> | | <u>100.00%</u> | | 8.10% |

Capital Structure and Cost Rates

Corrected JAR Schedule 1

| | AAI Cap Str | AUF | | | Weighted |
|-------------------|----------------------|-------------------|----------------|------------|-----------|
| | 6/30/2008 | Rate Base | Ratios | Cost Rate | Cost Rate |
| Long-Term Debt | 1,219,425,000 | 18,165,454 | 50.92% | 5.58% (E) | 2.84% |
| Short-Term Debt | 79,725,000 | 1,187,642 | 3.33% | 5.90% | 0.20% |
| Common Equity | 1,022,114,000 | 15,226,164 | 42.68% | 11.55% (C) | 4.93% |
| Customer Deposits | | 276,826 | 0.78% | 6.00% | 0.05% |
| Deferred Taxes | | 818,261 | 2.29% | 0.00% | 0.00% |
| | <u>2,321,264,000</u> | <u>35,674,348</u> | <u>100.00%</u> | | 8.02% |

Capital Structure and Cost Rates

AAI Capital Structure without Tax Exempt Financing & Short-Term Debt

| | AAI Cap Str | AUF | | | Weighted |
|-------------------|----------------------|-------------------|----------------|------------|-----------|
| | 13 Mos. Avg. | 13 Mos. Avg. | Ratios | Cost Rate | Cost Rate |
| | 12/31/2007 | Based on AAI | | | |
| Long-Term Debt | 628,657,087 | 13,795,945 | 38.67% | 6.27% (F) | 2.42% |
| Short-Term Debt | - | - | 0.00% | 5.90% | 0.00% |
| Common Equity | 947,059,400 | 20,783,316 | 58.26% | 10.36% (C) | 6.04% |
| Customer Deposits | | 276,826 | 0.78% | 6.00% | 0.05% |
| Deferred Taxes | | 818,261 | 2.29% | 0.00% | 0.00% |
| | <u>1,575,716,487</u> | <u>35,674,348</u> | <u>100.00%</u> | | 8.51% |

- (A) Direct Testimony of Stephen Anzaldo, Page 4
- (B) Aqua America, Inc. 10K (Management Discussion and Analysis, page 40)
- (C) Based on Commission leverage formula
- (D) AUF recommended customer deposits and deferred taxes from rebuttal case
- (E) Aqua America, Inc. 2007 Annual Report (Management Discussion and Analysis, page 10)
- (F) L-T Debt rate after removing tax-exempt financing & state revolving loans