

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

DAVID P. SMELTZER

on behalf of

Aqua Utilities Florida, Inc.

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AQUA UTILITIES FLORIDA, INC.

REBUTTAL TESTIMONY OF DAVID P. SMELTZER

DOCKET NO. 080121-WS

1 **Q. What is your name and business address:**

2 A. My name is David P. Smeltzer. My business address is 762 W. Lancaster
3 Avenue, Bryn Mawr, Pennsylvania 19010.

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

5 A. Yes. I filed direct testimony as part of AUF's initial filing in this rate case.

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

7 A. The purpose of my rebuttal testimony is to address issues raised by Paul W.
8 Stallcup, who filed testimony on behalf of the Staff of the Florida Public
9 Service Commission. I also respond to a portion of the prefiled testimony of
10 Office of Public Counsel (OPC) witness Kimberly Dismukes.

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

12 A. No.

13 **Q. Have you reviewed the direct testimony of Mr. Stallcup in this docket?**

14 A. Yes. Mr. Stallcup addressed four issues in his rebuttal testimony: 1) the
15 appropriate repression methodology; 2) the appropriate inclining block rate
16 structure; 3) two potential drawbacks to a consolidated rate proposal; and 4)
17 AUF's proposal to consolidate rates and Mr. Stallcup's alternative rate
18 consolidation methodologies.

19 **Q. Do you have any concerns with respect to Mr. Stallcup's testimony?**

20 A. Yes. As discussed below, I have concerns over Mr. Stallcup's repression
21 recommendation and three-tiered conservation block rate proposal. I also

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1 have serious concerns about Mr. Stallcup's rate structure proposals. I do not
2 believe his two alternative proposals take into consideration a unified cost of
3 service, which is essential to achieving key customer benefits and efficiencies
4 that the Company advocates in this proceeding. I will elaborate on this issue
5 in detail, as it is the crux of AUF's consolidated rate structure proposal.

6 **REPRESSION**

7 **Q. On page 3 of Mr. Stallcup's testimony, he states that AUF has proposed a**
8 **repression adjustment factor of -.2. Can you elaborate on this?**

9 A. Yes. AUF's proposal included a repression adjustment factor of -.2 that was
10 part and parcel of the two-tiered conservation rate structure that AUF
11 proposed.

12 **Q. Has AUF proposed a three tier conservation rate structure in this case?**

13 A. No. The Company has not proposed a three-tiered conservation rate
14 structure, and does not believe that a three-tiered structure is fair or
15 appropriate in this case. In fact, Mr. Stallcup stated in his deposition that his
16 three-tiered proposal contains an "aggressive" rate factor of 3.0 and he was
17 not able to identify any other utility in Florida where this aggressive factor
18 has been applied.

19 **Q. If the Commission ultimately adopts a three-tiered conservation**
20 **structure, does this warrant a change to the repression factor?**

21 A. Yes. Because the third tier would create greater volatility in a customer's
22 water bill based on changing use patterns, I would recommend moving the
23 repression factor from -.2 to -.4 to address this change. Mr. Stallcup
24 acknowledges on pages 2 and 3 of his testimony that "using a price elasticity
25 of demand of -.4 would provide a better estimate of how AUF's customers

1 will react to an increase in rates.” Further, witness Yingling sites a price
2 elasticity factor range from -.23 to -.81, suggesting that the -.4 factor is a
3 better match than the Company’s -.2 initial recommendation.

4 **RATE STRUCTURE**

5 **Q. Do you agree with Mr. Stallcup’s proposal of a three-tiered conservation**
6 **rate structure?**

7 A. No. I believe that AUF’s proposal provides the proper balance to achieve
8 price induced conservation. If, however, the Commission agrees with Staff’s
9 recommendation, I believe that the appropriate repression adjustment should
10 be increased accordingly.

11 **Q. Has Mr. Stallcup addressed the most important concern for AUF filing a**
12 **consolidated rate structure proposal?**

13 A. No.

14 **Q. Why Not?**

15 A. The Company's proposal for a consolidated rate structure in Florida involves
16 two separate, but related concepts – a uniform tariff price (or a plan to achieve
17 such over time) and a single cost of service. I believe Mr. Stallcup has
18 focused exclusively on tariff design without addressing how his tariff design
19 proposals would effect AUF’s proposal for a single cost of service.

20 **Q. Can you please expand on what you mean by a single cost of service?**

21 A. A single cost of service refers to treating AUF’s Commission-regulated
22 operations as one entity, instead of 82 separate systems, for purposes of
23 establishing the Company's overall revenue requirement. In effect, this would
24 mean that the Company’s costs and expenses would then be tracked by water
25 and wastewater functions, and not by each of the individual systems.

1 However, utility plant and related accounts would continue to be tracked and
2 reported by individual system. As long as the Company receives its full
3 revenue requirement and is accounting for its operations for each utility
4 business, tariff design can then be analyzed to address the affordability and
5 fairness issues that Mr. Stallcup mentions in this testimony.

6 **Q. What do you mean by each utility business?**

7 A. AUF would maintain its accounting of operations for the Commission
8 regulated jurisdictional systems separate from its operations in non-
9 jurisdictional counties, e.g., Sarasota. Further, AUF would also continue to
10 separate water from wastewater.

11 **Q. What would happen to rate base tracking, such as plant in service and**
12 **CIAC?**

13 A. Utility plant records would continue to be maintained and kept separate on a
14 system-by-system basis as has been done in the past.

15 **Q. Please provide an example.**

16 A. Currently, there are 57 AUF water systems and 25 wastewater systems. As it
17 stands now, a utility operator who works for AUF provides services for
18 multiple systems. On a daily basis, he needs to record his time per system as
19 he goes from plant to plant which is burdensome and time consuming. Then,
20 AUF accountants must track not only his time per system per day, but also
21 gas expenses, lease payments, maintenance expense, benefits, vehicle time,
22 insurance coverage, administrative in-state overheads, etc., by accounting unit
23 – and there are 82 different accounting units. In other words, AUF is
24 accounting for 82 systems as if they were each individual businesses. This
25 fragmentation is one of the problems in the water and wastewater industry

1 today and operating like this is not a viable, long-term option. It is extremely
2 burdensome and we spend an unnecessary amount of time splitting invoices
3 and timesheets. AUF is seeking to streamline this accounting methodology
4 by having one cost of service per utility service. For example, this would
5 mean that instead of different accounting units for transportation expense for
6 each of the 82 systems, there would only be one accounting unit for water and
7 one accounting unit for wastewater for this expense. In this example, to
8 ensure that there is a process in place to review expenses for reasonableness,
9 all invoices would still be maintained and tracked for later audits or review by
10 parties.

11 **Q. Jumping ahead briefly for a moment to Mr. Stallcup's two alternative**
12 **proposals, does he address how the Company's proposal for a single cost**
13 **of service would work with his proposals?**

14 A. No, and that is my greatest concern surrounding his proposal. As I stated
15 earlier, I believe he is focused on rate design only, and has not considered its
16 ramifications on the in-state accounting practices of AUF. During his
17 deposition on November 12, 2008, Mr. Stallcup indicated that he did not
18 know who was addressing the Company's proposal regarding a single cost of
19 service. He also indicated that he may be proposing 7 or 8 bands of rates. If
20 that is his proposal, a rate design of 7 or 8 bands would likely be in conflict
21 with moving toward one cost of service, unless such bands included a long-
22 term plan for unification supported by one company-wide cost of service.
23 Furthermore, in my opinion, a rate design with 7 or 8 bands would deprive
24 customers of the efficiencies and cost-savings that flow from a single cost of
25 service approach. I can find no testimony or evidence offered by any party in

1 this case which addresses or rebuts AUF's single cost of service proposal.

2 **Q. Would AUF be opposed to a rate design that was comprised of two or**
3 **three different tariffed rates?**

4 A. Not as long as there was a single cost of service in place. As I explained, one
5 of the most important goals for the Company in this proceeding is achieving a
6 consolidated cost of service for accounting purposes. While I believe it is
7 very important to also streamline the rate design of AUF for the purposes
8 described in my direct testimony, the Company would not be opposed to a
9 rate equalization plan with a rate design comprised of two or three tariffs to
10 address affordability and fairness principles, provided that a single cost of
11 service was permitted for accounting purposes. This alternative has been
12 outlined by Mr. Franceski in Exhibit DTF-2 to his rebuttal testimony. That
13 alternative, which I will discuss later in my rebuttal testimony, could be an
14 option for the Commission to consider when it addresses rate structure.

15 **Q. Do you believe that Mr. Stallcup has addressed all of the goals**
16 **previously established by the Commission for evaluating a proposed rate**
17 **structure?**

18 A. No, I do not. As set forth in my direct testimony, the Commission has already
19 determined that it is appropriate to consider the following goals and objectives
20 in evaluating a proposed rate structure (or alternative rate structures): (1)
21 affordability of rates for all customers, (2) ease of administration, (3) customer
22 acceptance and understandability, (4) fairness (to the degree to which subsidies
23 occur), (5) rate continuity/stability for all customers, (6) conservation and
24 resource protection, (7) revenue stability and predictability for the utility, and
25 (8) impact of rate structure on future acquisitions. I do not believe that Mr.

1 Stallcup has taken an all-inclusive review of these eight goals when addressing
2 AUF's consolidated rate structure proposal. On page 10 of his testimony, Mr.
3 Stallcup recognizes that a most important benefit to be derived from AUF's
4 consolidated structure proposal is "that the cost of system upgrades can be
5 spread over a larger number of customers thereby mitigating the dramatic
6 increases in rates." However, he fails to look at the other factors that the
7 Commission had deemed important in evaluating rate structure.

8 **Q. Mr. Stallcup references only two potential drawbacks to AUF's rate**
9 **consolidation proposal. His first potential drawback concerns the ability**
10 **to target conservation initiatives. Can you address his concern?**

11 A. I agree with his conclusion that any potential drawback could be avoided by
12 including an acknowledgement in the rate consolidation order that the
13 Commission may impose a water conservation program which targets an
14 individual system. Further, in a previous order, the Commission determined
15 that uniform rates would not preclude the implementation of conservation
16 rates, either statewide or system-specific, in subsequent cases. (See Order
17 No. PSC-94-1123-FOF-WS).

18 **Q. Mr. Stallcup next references excessive cross-subsidies as a potential**
19 **drawback to AUF's rate consolidation proposal. Can you please address**
20 **his concern?**

21 A. Yes. This is an issue of fairness and AUF understands the Commission's
22 concerns and past precedent on this issue. However, I do not believe that
23 AUF's proposal is at all in conflict with the Commission's past precedent on
24 rate fairness issues. I believe that these issues can be addressed by simply
25 creating two or three different tariff rates within the overall rate design. As

1 long as a single cost of service is in place, AUF can support this type of rate
2 equalization plan with the goal of reaching one single tariff over time.

3 **Q. Please explain what you mean by a rate equalization plan?**

4 A. I'm referring to a rate equalization plan that would gradually move the
5 multiple rate schedules toward one rate schedule over time (typically done in
6 stages in concert with rate cases). Such movement would be done with key
7 rate design objectives in mind and would ultimately move all rates to one
8 tariff supported by the single cost of service.

9 **Q. You mentioned that, under AUF's consolidated rate structure proposal,
10 AUF could agree with multiple (2-3) tariffs as long as a one cost of service
11 was utilized. Would this address Mr. Stallcup's fairness concern?**

12 A. Yes. For example, in Mr. Franceski's Exhibit DTF-2, he has identified a few
13 systems that could be put into a separate tariff and billed at rates lower than
14 the main group of systems. This would address fairness issues and mitigate
15 the effects of subsidization on these few systems, while raising the rates for
16 the main group slightly to recover the revenue shortfall.

17 **Q. On page 15 of Mr. Stallcup's testimony, he states that there is no single
18 right or wrong answer for determining the appropriate values for
19 limiting cross-subsidies or for defining what is affordable. Do you agree?**

20 A. Yes. I agree that the subsidization levels that Mr. Stallcup references in past
21 Commission orders are somewhat arbitrary and that the focus should really be
22 on fairness, not a specific dollar amount. I also agree that a utility's rate
23 design can be divided up in a myriad of different ways to address many
24 different issues.

1 RATE CONSOLIDATION METHODOLOGIES

2 **Q. Mr. Stallcup proposes two different rate methodologies: 1) a capband**
3 **structure, or 2) a portfolio approach. Do you agree with these two**
4 **proposals?**

5 A. Mr. Stallcup has not described either of these methodologies in sufficient
6 detail to permit an accurate analysis of the pros or cons of either of these
7 proposals. He essentially has proposed concepts without examples, making it
8 impossible for AUF to evaluate these approaches properly.

9 **Q. Noting that Mr. Stallcup has not put forth any support or actual**
10 **proposal in his testimony, can you comment on the two rate-structure**
11 **concepts that he has referenced in his testimony?**

12 A. Mr. Stallcup first refers to the capband structure used in the Southern States
13 rate case. In that case, the Commission was critical of a modified stand-alone
14 rate structure for that utility's multiple systems in Florida:

15 . . . this rate structure is complicated, difficult to understand and
16 explain to customers, and cumbersome in that even though bills are
17 capped at the benchmark, there remain separate rates for each service
18 area While the modified stand-alone rate structure has been a
19 viable structure in the short run for this utility, we do not believe it to
20 be the answer in this proceeding. The structure lacks direction: there
21 is no clear "next step" to reach the goal of uniform rates for this
22 utility. [PSC-96-1320-FOF-WS]

23
24 Those exact same criticisms can now be levied against the capband rate
25 structure. Indeed, the capband rate structure has been in effect for many of
26 AUF's systems for well over 12 years, and has proven cumbersome and
27 expensive to administer. In addition, it is very complicated and difficult to
28 explain to customers, and provides no clear next step towards the ultimate
29 goal of uniform rates for the majority of these systems. I would add that if
30 Mr. Stallcup's proposal contained two or three different tariff rates along with

1 a single cost of service, that would ultimately be consistent with AUF's
2 proposal. However, during his deposition, Mr. Stallcup suggested that
3 perhaps 7 or 8 different tariffs would be appropriate. Although it is
4 impossible to evaluate the "7 or 8" tariff proposals without examples, I
5 believe that the key rate design objectives in this case are achievable with far
6 fewer tariffs.

7 **Q. Mr. Stallcup next makes reference to a "portfolio approach" as a**
8 **possible rate-structure. Do you agree with this approach?**

9 A. Again, Mr. Stallcup has not put an actual recommendation into his testimony
10 and has made it impossible for AUF to understand, let alone comment on an
11 actual recommendation. I cannot adequately review, critique or comment on
12 it. He describes it on page 18 as similar to a "financial portfolio management
13 in which securities with high risk are combined with securities with low risk
14 to yield a moderate level of risk for the portfolio." I do not think that this is
15 consistent with the goals of a single tariff pricing. Although not addressed
16 specifically by Mr. Stallcup, I assume he may be under the impression that
17 the cost centers, or revenue requirements of these bands, would remain in
18 place in order to replicate the same rate structure in future cases. If this is the
19 case, then the benefits afforded under a single cost of service are lost. In
20 addition, subsidy comparisons on a prospective basis serve no useful purpose
21 since various subsidy levels have already been merged.

22 **Q. Do you have other concerns with respect to Mr. Stallcup's testimony?**

23 A. Yes. I believe that Mr. Stallcup's analysis of subsidies fails to take into
24 account the true cost of service for many of AUF's systems. I agree with Mr.
25 Stallcup that, in the past, subsidies have been analyzed by comparing the

1 stand alone rates to another resulting rate, either uniform or some form of
2 uniform, I do not believe this simple analysis portrays the complete picture
3 for AUF. As indicated in Mr. Szczyguel's testimony, 26 water AUF systems
4 and 12 AUF wastewater systems are being charged below the true cost of
5 service established in Order No. PSC-1320-FOF-WS. These 38 systems, or
6 46% of the systems represented in this filing, were previously being
7 subsidized by other larger systems throughout Florida. When Florida Water
8 Services sold the larger systems to the Florida Governmental Utility
9 Authority, the subsidies disappeared for the remaining systems that AUF
10 acquired. Therefore, the remaining 26 water and 12 wastewater systems that
11 AUF acquired were not paying their true cost of service at acquisition and
12 were receiving subsidies under the capband structure. The point is – their
13 tariffed rates are lower than what they should be if they were truly covering
14 their cost of service. Mr. Stallcup fails to take this important fact into
15 account.

16 **Q. Do you have other concerns about Mr. Stallcup's analysis of potential**
17 **cross subsidies?**

18 A. Yes. Mr. Stallcup overlooks subsidy principles and the actual subsidy caps
19 that the Commission has used in other cases involving consolidated rates.
20 Subsidies or cross subsidies change throughout time depending on numerous
21 factors, including capitalization needs. I believe many of these concerns were
22 extensively analyzed by the Commission in its investigation of the uniform
23 rate structure in Order No. PSC-94-1123-FOF-WS. I believe that the
24 Commission has thoroughly extolled the benefits of a uniform rate structure.
25 Further, when the Commission first analyzed subsidies in as part of the

1 Southern States rate case in Order No. PSC-96-1320-FOF-WS, it stated, “Of
2 the customers who pay a subsidy, only five percent of those customers pay a
3 subsidy greater than \$2.00, with the maximum of \$3.64 per month.” Thus, in
4 approving the current capband rate structure, the Commission itself
5 recognized that a subsidy of \$3.64 per month in 1996 was not unduly
6 discriminatory. To be consistent, if the Commission wanted to evaluate
7 subsidies and discrimination now, it should do so by taking \$3.64 and
8 increasing by inflation from 1996 up through 2008. Mr. Stallcup fails to take
9 this subsidy cap into effect.

10 **Q. Should subsidies be a factor in the Commission's consideration of an**
11 **appropriate rate structure?**

12 A. Yes. However, I believe that the subsidy issue is merely one consideration
13 that should be analyzed. As stated in past Commission orders, there are
14 numerous benefits to uniform rates that cannot be overlooked or ignored. The
15 Commission has previously indicated that uniform rates offer the best answer
16 to affordability concerns because they average the costs of all service areas
17 and spread those costs over all customers. (PSC-96-1320-FOF-WS.) Mr.
18 Stallcup confirmed this in his deposition when he testified that (1)
19 affordability was a key issue for him in evaluating AUF's consolidated rate
20 proposal, and (2) the greatest benefit of AUF's consolidated rate proposal is
21 that it insulated customers from rate shock. Again, AUF is very aware that
22 we are in tough economic times, and thus affordability has been a driving
23 force behind its proposal for a consolidated rate structure.

24 **Q. Can you elaborate on how AUF's consolidate rate proposal addresses**
25 **affordability?**

1 A. As stated in my direct testimony, the Environmental Protection Agency
2 ("EPA"), recommends over \$277 billion in infrastructure improvements over
3 the next 20 years for water and wastewater utilities across the nation. As Mr.
4 Stallcup recognized, AUF's consolidated rate proposal will allow cost to be
5 levelized over a larger customer base. This will allow a multi-utility system
6 utility like AUF to minimize future rate increases, while addressing
7 affordability. Finally, as previously recognized by the Commission, a uniform
8 rate structure facilitates small system viability throughout the state and
9 encourages future acquisitions of smaller troubled systems. This assures
10 customers of those smaller utilities of affordable and reliable utility services,
11 and is important for the future of the water supply business in the state of
12 Florida.

13 I believe the Commission should consider long-term goals in
14 determining the appropriate rate structure, and should not concentrate on short-
15 term results. As stated in Mr. Franklin's rebuttal testimony, AUF is committed
16 to Florida, and intends to remain in the state, addressing the capital needs of the
17 water and wastewater industry and continuing to acquire small, less viable
18 utilities.

19 **Q. In light of Mr. Stallcup's testimony, do you still believe that a statewide**
20 **uniform rate is the appropriate rate structure for AUF?**

21 A. Yes. As indicated in my direct testimony, as well as the direct testimony of
22 Mr. Franceski, AUF carefully analyzed the subsidy and affordability issues
23 previously identified by Mr. Stallcup in his testimony filed in Docket No.
24 060368-WS. However, as I have discussed, AUF acknowledges that there
25 may be other alternatives that bring it closer to a consolidated rate structure as

1 long as a single cost of service is permitted going forward.

2 **Q. Moving to another subject matter, on page 49 of Ms. Dismukes'**
3 **testimony she references an internal audit that that was recently**
4 **completed. Can you elaborate on this internal audit?**

5 A. Yes. The internal audit is dated August 3, 2007. The document that Ms.
6 Dismukes describes was shared with the Commission Staff and Office of
7 Public Counsel in a meeting held at the Commission on August 8, 2007.
8 Company representatives shared the document to make Staff and the OPC
9 aware that the Company was proactively monitoring the post conversion
10 progress to its new billing system. The parties have had a draft of this
11 document for well over a year.

12 **Q. Have you reviewed the internal audit of AUF's revenue and billing cycle?**

13 A. Yes. I have reviewed the report.

14 **Q. Why was the report initiated?**

15 A. AUF had undergone a major computer system conversion. The Company
16 wanted to ensure that the conversion to Aqua's new billing system in Florida
17 was working properly.

18 **Q. Do you believe that the conversion has an impact on AUF's billing**
19 **determinants?**

20 A. No. Mr. Prettyman has analyzed AUF's billing determinants in detail and
21 supports AUF's billing analysis. In addition, I note that the 2007 test year
22 data contained in AUF's rate filing contained actual billing information which
23 has been adjusted through the new billing system.

24 **Q. Does this conclude your rebuttal testimony at this time?**

25 A. Yes.