

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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

DOCKET NO. 100330-WS

DATED: October 6, 2011

COMMISSION
CLERK

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Direct Testimony of

Paul W. Stallcup has been served by U.S. Mail this 6th day of October, 2011, to the following:

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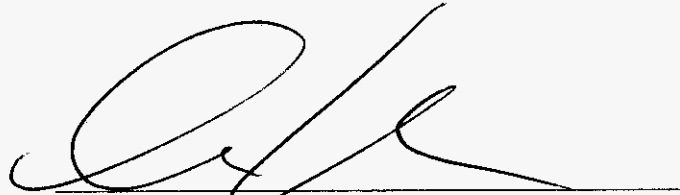
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DOCKET NO.: 100330-WS - Application for increase in water and wastewater rates in Alachua, Brevard, DeSoto, Hardee, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia and Washington Counties by Aqua Utilities Florida, Inc.

WITNESS: Direct Testimony of Paul W. Stallcup,
Appearing on Behalf of the Staff of the Florida Public Service Commission.

DATE FILED: October 6, 2011

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1 Q. Would you please state your name and business address?

2 A. My name is Paul W. Stallcup. My business address is 2540 Shumard Oak Boulevard,
3 Tallahassee, Florida, 32399.

4 Q. By whom and in what capacity are you employed?

5 A. I am employed by the Florida Public Service Commission as the Supervisor of the
6 Economics and Tariffs Section of the Division of Economic Regulation.

7 Q. Would you please summarize your educational and professional experience?

8 A. I graduated from Florida State University in 1977 with a Bachelor of Science degree in
9 Economics with minors in Mathematics and Statistics. I received my Masters of Science
10 Degree in Economics from Florida State University in 1979 and, as a Ph.D. candidate,
11 completed the course work and doctoral examinations required for that degree in 1980.

12 In 1981, I was employed by Florida Power & Light Company as a Load Forecast
13 Analyst. In this capacity, I prepared short and long term forecasts of company sales, peak
14 demand, and customer growth. In 1983, I was employed by the Florida Public Service
15 Commission as an Economic Analyst and in 1991 was promoted to my current position. In
16 this capacity, I have analyzed and made recommendations on a variety of issues in all of the
17 industries regulated by the Commission.

18 Q. Have you previously testified before the Florida Public Service Commission?

19 A. Yes. In 1983 I testified on behalf of the Commission staff in the Florida Power &
20 Light Company rate case (Docket No. 830465-EI). In 1997, I testified on behalf of the staff in
21 Florida Power Corporation's proposed buy-out of Orlando Cogen Limited's energy contract
22 (Docket 961184-EQ). In 2000, I provided testimony in Aloha Utilities' wastewater rate case
23 (Docket No. 991643-SU) and in BellSouth's Permanent Performance Measures case (Docket
24 No. 000121-TP). In 2001, I provided testimony in Aloha Utilities' water rate case (Docket
25 No. 010503-WU), and in 2007, I filed testimony in Aqua Utilities Florida (Aqua Utilities or

1 AUF) water and wastewater systems rate case (Docket No. 060368-WS). Finally, in 2008, I
2 provided testimony in Aqua Utilities' water and wastewater systems rate case (Docket No.
3 080121-WS).

4 Q. What is the purpose of your testimony?

5 A. The purpose of my testimony is to discuss three issues relevant to this case. First, I
6 will discuss why I believe it would not be appropriate to adjust the test year revenues and
7 billing determinants as recommended by the Office of Public Counsel (OPC) witness
8 Dismukes. Second, I will discuss how the values for the Rate Cap Thresholds were
9 determined at the May 24, 2011 Agenda Conference and why I believe that the Rate Cap
10 Threshold values for AUF's water and wastewater systems are appropriate. Third, I will
11 discuss why I believe the rates approved at the May 24, 2011 Agenda Conference are as
12 affordable as possible given the requirements of Section 367.081, Florida Statutes.

13
14 Test Year Revenues and Billing Determinants

15 Q. Have you read the portion of OPC witness Dismukes' direct testimony that describes
16 her recommended adjustments to test year revenues and billing determinants?

17 A. Yes.

18 Q. Please summarize your understanding of witness Dismukes' recommended adjustment.

19 A. OPC witness Dismukes recommends increasing test year revenues by \$372,925 to
20 remove some of the revenue impact of reduced sales since the last rate case. The amount of
21 Ms. Dismukes adjustment is based upon AUF's Budget Variance Reports which document the
22 difference between the actual number of gallons sold and the number of gallons AUF had
23 budgeted to be sold. According to OPC witness Dismukes, this unanticipated decline in
24 AUF's sales should be offset by imputing \$372,925 in test year revenues and adjusting
25 upwards the number of gallons sold by 56,722,489 gallons during the test year. OPC witness

1 Dismukes says AUF should absorb the revenue impact of reduced sales for two reasons: 1) the
2 company has more control of the factors that led to reduced consumption than customers do,
3 and 2) the company's return on equity already includes a risk component which should
4 compensate AUF for reduced sales.

5 Q. Do you believe that this adjustment is appropriate?

6 A. No. Just because AUF underestimated the extent of customers' response to increased
7 prices from the utility's last rate case does not mean that the reduced sales observed during the
8 test year are transitory and not reflective of the period when AUF's new rates will go into
9 effect. In fact, of the 56,722,489 gallon reduction cited in Ms. Dismukes' testimony,
10 approximately 80 percent of those gallons are attributable to the Scottish Highlands area of the
11 Silver Lakes Estates system. This is significant because as AUF states in its Budget Variance
12 Reports, the customers of this area have installed shallow irrigation wells to replace AUF as
13 their source for irrigable water. I believe that once customers have invested in installing
14 shallow wells, they will not return to AUF for their irrigation demands. Thus, these lost
15 gallons and their associated revenues are a permanent reduction in AUF's sales and should not
16 be artificially adjusted back into the test year.

17 Q. What do you believe the ramifications would be of making the adjustments
18 recommended by OPC witness Dismukes?

19 A. If the number of gallons sold were to be increased as Ms. Dismukes recommends, the
20 resulting rates would fall short of generating the utility's revenue requirement. In other words,
21 the rates would not be compensatory as required by Section 367.081, Florida Statutes.

22 Q. Do you believe, as OPC witness Dismukes asserts, that the risk component of the
23 utility's return on equity is intended to compensate AUF for a permanent reduction in sales
24 like those seen in Scottish Highlands?

25 A. No. Although I am not an expert on return on equity, it is my understanding that

1 inherent with the appropriate determination of return on equity is the assumption that rates
2 will be set such that the utility will be able to recover reasonable and prudent costs, including
3 a fair rate of return. If OPC witness Dismukes' adjustment is adopted, then the resulting rates
4 will fall short of fully recovering these costs by \$372,925. Therefore, a fundamental
5 assumption used in determining an appropriate return on equity will not be satisfied and would
6 likely require an additional risk premium to compensate investors for the revenue shortfall.
7 Thus, I do not believe that the normal risk component of the utility's return on equity is
8 intended to compensate the utility for a permanent reduction in sales like those seen in
9 Scottish Highlands.

10
11 Rate Cap Threshold

12 Q. Do you believe that the value of the Rate Cap Thresholds approved at the May 24,
13 2011 Agenda Conference are appropriate?

14 A. Yes. The values of the Rate Cap Thresholds (\$65.00 for water and \$91.55 for
15 wastewater) were calculated such that the rate caps are as low as possible while still allowing
16 AUF to earn the revenue requirements approved by the Commission. Furthermore, these Rate
17 Cap Thresholds were calculated in conjunction with a Subsidy Limit of \$12.50 as originally
18 set in AUF's prior rate case (Docket 080121) and reaffirmed at the May 24, 2011 Agenda
19 Conference for AUF's current case.

20 Q. Once the Commission approved the revenue requirements and the Subsidy Limits, is
21 there any discretion that can be used in setting the Rate Cap Thresholds?

22 A. No. Once the revenue requirements and Subsidy Limits have been determined, the
23 determination of the appropriate Rate Cap Threshold is merely a fallout calculation.

24 Q. Please explain how this calculation is performed.

25 A. The Subsidy Limit and the Rate Cap Threshold are parameters used in the Capband

1 Rate Consolidation methodology. Under this methodology, once the stand-alone revenue
2 requirements for each of the existing rate bands and stand-alone systems have been
3 determined, the fully compensatory stand-alone rates for each existing rate band and system
4 can be calculated. Next, the rates for the most expensive rate bands and systems (measured in
5 terms of a customer's bill at a predetermined amount of usage) are lowered by the imposition
6 of the Rate Cap Threshold. This Rate Cap Threshold simply reduces rates for the expensive
7 systems so that the resulting customer bill does not exceed the amount of the Rate Cap
8 Threshold. But by reducing rates to a level below the fully compensatory amount, a revenue
9 shortfall is created. This revenue shortfall is then reallocated to the less expensive rate bands
10 and systems. However, by reallocating revenue recovery to the less expensive systems, the
11 rates for these customers will be higher than they otherwise would have been. These higher
12 rates create a subsidy paid by the customers of the less expensive systems to make up for the
13 imposition of the Rate Cap Threshold for the more expensive systems.

14 With Subsidy Limit of \$12.50 per customer bill, only a finite number of dollars can be
15 reallocated from the expensive systems to the less expensive systems without exceeding the
16 \$12.50 limit. The calculation of the Rate Cap Threshold therefore consists of a simple
17 iterative search to find the lowest Rate Cap Threshold possible that will not cause the Subsidy
18 Limit to be exceeded.

19

20

Affordability

21 Q. Do you have an opinion about the affordability of the rates approved at the May 24,
22 2011 Agenda Conference?

23 A. Yes. While I agree that the rates approved at the May 24, 2011 Agenda Conference
24 are higher than most people, including myself, would expect water and wastewater rates to be,
25 I also believe that the rates approved by the Commission are as low, or affordable, as they can

1 be given the requirements of Section 367.081, Florida Statutes. This statute requires water
2 and wastewater rates approved by the Commission to be "just, reasonable, compensatory, and
3 not unfairly discriminatory." It is my opinion that, given the statutory requirement that AUF's
4 rates must be compensatory, the Commission did take additional steps to help make AUF's
5 rates more affordable than they otherwise would have been.

6 Q. Can you provide some examples of how the Commission attempted to make AUF's
7 rates more affordable?

8 A. Yes. One example is the Commission's approval of the Capband Rate Consolidation
9 methodology. Under this methodology, the rates of the more expensive systems are capped
10 such that a customer's water or wastewater bill will not exceed the amount of the Rate Cap
11 Threshold. This methodology is designed to help restrain excessively high stand-alone
12 customer bills and to make them more affordable. For example, had the Commission decided
13 to maintain the stand-alone rates that existed prior to the May 24, 2011 Agenda Conference,
14 customers of the Breeze Hill system would have faced water bills of \$95.03 for 7,000 gallons
15 of usage, while under the Capband methodology, this bill is reduced to \$65.00. More
16 dramatically, for wastewater customers of the old Rate Band 3, approval of the Capband
17 methodology reduces their wastewater from \$204.66 on a stand-alone basis to \$91.55.

18 Another example of how the Commission exercised its discretion to help make rates
19 more affordable is the adoption of the inclining block rate structure for water. Under the
20 approved inclining block rate structure, the gallonage rate for the first 6,000 gallons of usage
21 is significantly lower than it would be under a standard uniform gallonage charge (\$3.59 per
22 1,000 gallons vs. \$5.10 per 1,000 gallons). This lower rate for the first 6,000 gallons of usage
23 results in lower total customer bills for all usage less than 12,000 gallons per month. Thus,
24 approval of the inclining block rate structure provides customers with the opportunity to avoid
25 higher bills by adopting water conservation measures.

1 Because Section 367.081, Florida Statutes, requires that all rates approved by the
2 Commission must be compensatory, AUF's rates will necessarily be relatively high. This is
3 because AUF has a relatively small customer base to support its revenue requirement.
4 However, through its actions at the May 24, 2011 Agenda Conference discussed above, I
5 believe that the Commission did everything possible to help address affordability concerns
6 given the constraints placed on it by Section 367.081, Florida Statutes.

7 Q. Does this conclude your testimony?

8 A. Yes.

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