

Docket No. 120161-WS -- Analysis of Utilities, Inc.'s financial accounting and customer service computer system.

Witness: **Direct Testimony of Stephen Bart Fletcher**, Appearing on Behalf of the staff of the Florida Public Service Commission

Date Filed: March 31, 2014

1 Q. Please state your name and business address.

2 A. My name is Stephen Bart Fletcher and my business address is 2540 Shumard Oak
3 Boulevard, Tallahassee, Florida 32399-0850.

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

5 A. I am employed by the Florida Public Service Commission as a Public Utilities Supervisor
6 of the Surveillance Section in the Division of Accounting and Finance.

7 Q. How long have you been employed by the Commission?

8 A. I started working at the Commission in November 1997.

9 Q. Would you state your educational background?

10 A. I received an Associate in Arts degree with honors from Tallahassee Community College in
11 August 1993. I received a Bachelor of Science degree with majors in accounting and finance from
12 Florida State University in December 1996.

13 Q. Would you explain what your general responsibilities are as a Public Utilities Supervisor of
14 the Surveillance Section?

15 A. I am responsible for supervising professional technical staff members who are charged with
16 financial, accounting, and rate review and evaluation of complex formal rate proceedings before
17 the Commission. This section coordinates, prepares and presents staff recommendations before
18 the Commission on the above-referenced proceedings. This section is also responsible for
19 preparing testimony, testifying, and writing cross-examination questions for hearings involving
20 complex accounting and financial issues, as well as annual report reviews for water and
21 wastewater utilities and earnings surveillance of electric and gas companies.

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

23 A. Yes, I provided testimony on Aloha Utilities, Inc.'s purchased raw water transactions with
24 related parties in Docket No. 010503-WU.

25 Q. Have you previously testified in any other hearing?

1 A. Yes, I provided testimony in Division of Administrative Hearing Case No. 12-0909 on the
2 following: (1) the charges approved by the Commission in Docket No. 080562-WU and (2) what
3 configuration should two customers receive if it was decided that they complied with the
4 Commission's directive that customers who requested an irrigation meter prior to April 7, 2009,
5 shall only be charged the rates in effect at the time of their application.

6 Q. Can you summarize the areas for which you are providing testimony in the instant case?

7 A. Yes, I am providing testimony regarding the appropriate treatment of Project Phoenix
8 Financial/Customer Care Billing System (Phoenix Project) cost allocated to companies that were
9 subsequently divested, as well as the proper depreciation method for the Phoenix Project costs.

10 Q. Can you provide a timeline for dockets where the Commission addressed the Phoenix
11 Projects costs?

12 A. Yes. Exhibit SBF-1 is a timeline for dockets where the Commission addressed the Phoenix
13 Project costs.

14 **Divested Systems' Share**

15 Q. What was the purpose of the Phoenix Project?

16 A. The purpose of the Phoenix Project was to replace UI's former Legacy system and to
17 improve accounting, customer service, customer billing, and financial and regulatory reporting
18 functions of Utilities, Inc. The Phoenix Project consists of the JD Edwards Enterprise One as the
19 financial system, including asset management, and the Oracle Customer Care and Billing System
20 as the customer information system. These systems are integrated in a manner that allows for the
21 sharing of information between UI's different operational organizations, as well as providing
22 access to UI and its subsidiaries from multiple locations because the system is web-based.

23 Q. When did the Phoenix Project become operational?

24 A. UI's Phoenix Project became operational in December 2008.

25 Q. Has UI divested any systems since December 2008?

1 A. Yes.

2 Q. How has UI allocated the Phoenix Project costs subsequent to those divestitures?

3 A. Based on the equivalent residential connections (ERCs) of the surviving systems and any
4 newly acquired systems, UI has allocated the total Phoenix Project costs to those systems.

5 Q. Is this reallocation of the divested systems' previous share of the Phoenix Project costs to
6 the surviving systems just and reasonable?

7 A. No. It is a utility's burden to show how customers are benefitting from allocated affiliate
8 charges. See Order No. 7692, issued March 22, 1977, in Docket No. 750780-WS, In re:
9 Application of General Waterworks Corporation d/b/a General Waterworks-Central Fla. District
10 for an interim and permanent rate case in Orange County, Florida. (In this case, the Commission
11 found that in order for a utility to be allowed management fees paid to a parent company as an
12 operating expense, it must show the benefit to the utility's customers.) Section 367.081, Florida
13 Statutes, states that the Commission shall, either upon request or upon its own motion, fix rates
14 which are just, reasonable, compensatory, and not unfairly discriminatory. Therefore, in
15 accordance with this statute, I do not believe that UI's reallocation of the divested systems'
16 previous share of the Phoenix Project costs to the surviving systems is just nor reasonable because
17 the ratepayers of the surviving systems receive no added benefit associated with bearing additional
18 allocated Phoenix Project costs.

19 Q. Can you provide an example that illustrates that UI's reallocation of the divested systems'
20 previous share of the Phoenix Project costs to the surviving systems is unjust and unfair treatment?

21 A. Yes. If UI were to divest all its systems except for one system in Florida that serves
22 approximately 1,200 ERCs, I believe that it would be unjust and unfair for those remaining
23 customers to bear the full burden of the Phoenix Project costs and the associated depreciation
24 expense.

25 Q. How many systems has UI acquired and divested since December 2008?

1 A. From January 1, 2009 through December 31, 2013, UI has acquired 8 systems which
2 equates to approximately 3,000 ERCs and has divested 24 systems which equates to approximately
3 40,000 ERCs.

4 Q. What was the previous approximate share of the Phoenix Project costs for these divested
5 systems?

6 A. The previous approximate share of the Phoenix Project costs for these divested systems is
7 \$3.2 million which equates to approximately 14 percent of the total capitalized plant costs.

8 Q. What is the proper allocation methodology of Phoenix Project costs to account for divested
9 systems?

10 A. The proper allocation methodology is to reduce the gross amount of the Phoenix Project
11 costs by the previously ERC-allocated share for the divested systems and to allocate this reduced
12 amount over the surviving and newly acquired systems based on their number of ERCs relative to
13 total ERCs.

14 Q. Has the Commission made similar cost allocation adjustments to parent company
15 information technology (IT) systems for any other utility?

16 A. Yes. The Commission found that it was not fair, just or reasonable for Aqua Utilities
17 Florida, Inc. ratepayers to bear any additional allocated IT plant costs due to divestitures because
18 no added benefit was realized by remaining customers. See Order No. PSC-11-0256-PAA-WS,
19 pp. 67-69, issued June 13, 2011, in Docket Nos. 080121-WS, In re: Application for increase in
20 water and wastewater rates in Alachua, Brevard, DeSoto, Highlands, Lake, Lee, Marion, Orange,
21 Palm Beach, Pasco, Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua
22 Utilities Florida, Inc. and 100330-WS, In re: Application for increase in water/wastewater rates in
23 Alachua, Brevard, DeSoto, Hardee, Highlands, Lake, Lee, Marion, Orange, Palm Beach, Pasco,
24 Polk, Putnam, Seminole, Sumter, Volusia, and Washington Counties by Aqua Utilities Florida,
25 Inc.

1 Q. Do you have any other comments related to UI's divestitures since December 2008?

2 A. Yes. In the Order approving the transfer to Wedgefield Utilities, Inc. (Wedgefield), it
3 states that Wedgefield is a wholly-owned subsidiary of UI and that UI focuses on ownership and
4 operation of small systems and provides centralized management, accounting, and financial
5 assistance to small utilities that were commonly built by development companies. See Order No.
6 PSC-98-1092-FOF-WS, p. 2, issued August 12, 1998, in Docket Nos. 960235-WS, In re:
7 Application for transfer of Certificates Nos. 404-W and 341.-S in Orange County from Econ
8 Utilities Corporation to Wedgefield Utilities, Inc. and 960283-WS, In re: Application for
9 amendment of Certificates Nos. 404-W and 341-S in Orange County by Wedgefield Utilities, Inc.

10 That Order also states the following:

11 Mr. Wenz testified that the previous owner confided that: 'although he wanted to
12 continue to develop property, he was no longer interested in operating a utility or
13 committing funds to it.' In contrast, Mr. Wenz testified that Wedgefield's parent
14 company only operates utility systems. With this affiliation, Wedgefield will be
15 able to attract capital at a reasonable cost and benefit from economies of scale
16 through sharing common vendor and management resources. He testified that
17 Utilities, Inc. is probably the largest active company acquiring troubled water and
18 wastewater systems in Florida and that it relied upon this Commission's acquisition
19 adjustment policy to bargain for and purchase these systems.

20 (Underline emphasis added) UI used the economies of scale assertion with regard to the public
21 interest for acquiring a utility in Bay County. See Order No. PSC-99-1818-PAA-WS, p. 4, issued
22 September 20, 1999, in Docket No. 981403-WS, In re: Application for transfer of Certificates Nos.
23 469-W and 358-S in Bay County from Bayside Utilities, Inc. to Bayside Utility Services, Inc. In
24 its transfer application to acquire a Martin County utility in Docket No. 040179-WS, Utilities, Inc.
25 of Hutchinson Island also asserted the transfer was in the public interest, in part, because it can

1 achieve economies of scale through UI that would be unattainable on a stand-alone basis.

2 Further, as of March 31, 2014, UI's website states that its growth strategy is as follows:

3 Utilities, Inc. pursues a disciplined growth strategy of acquiring attractively valued
4 utility systems in geographically diverse locations with long-term potential. Our
5 strategy of assimilating new and small utilities has been greatly supported by
6 various Public Service Commissions who see Utilities, Inc. as the solution to non-
7 compliant and inefficient stand-alone utilities.

8 Based on the above, I believe UI's decisions to divest multiple systems is contrary to its
9 stated growth strategy and has reduced the economies of scale it has previously claimed to have
10 created for the benefit of the ratepayers of its surviving systems and newly acquired systems.

11 **Proper Depreciation Method for the Phoenix Project Costs**

12 Q. What is the service life of the Phoenix Project?

13 A. In three 2007 docketed UI cases, the Commission approved a 6-year amortization period.
14 In five UI cases opened in 2008 and 2009, the Commission found that an 8-year amortization
15 period was more appropriate for a software project of this magnitude. For all other 2009 and
16 subsequent cases, the Commission found that the amortization period for the Phoenix Project
17 should be 10 years. The Commission established a 10-year service life for a number of reasons.
18 First, the Phoenix Project was specifically tailored to meet all of UI's needs. Such a project is not
19 "off the shelf" software, but software designed to fulfill long-term accounting, billing, and
20 customer service needs. Second, the software will be used at least 10 years. For example, UI's
21 former Legacy accounting system had been used for 21 years. Third, in a 2009 docketed case
22 involving a UI subsidiary in Nevada, UI responded that any amortization period between 4 and 10
23 years would be in compliance with Generally Accepted Accounting Principles. Based on these
24 factors, this Commission found that 10 years is a more reasonable amortization period for which I
25 believe is appropriate.

1 Q. What is the proper depreciation method for the Phoenix Project costs given the different
2 service lives used in Florida and for subsidiaries in other states?

3 A. I believe the remaining life depreciation rate method should be used to determine the
4 proper amount of depreciation for the Phoenix Project costs.

5 Q. What is the remaining life depreciation rate method?

6 A. The remaining life depreciation rate method is designed to recover the remaining
7 unrecovered balance (investment less net salvage less reserve) over the remaining life of the
8 associated investment. In accordance with Rule 25-30.140(1)(u), Florida Administrative Code, the
9 formula for the remaining life rate is the appropriate plant investment (represented as 100 percent)
10 minus accumulated reserve percent minus net future salvage percent divided by the average
11 remaining life in years. The reserve represents the portion of the investment accumulated through
12 depreciation expense to date. Exhibit SBF-2 illustrates the remaining life depreciation rate
13 method.

14 Q. Does this conclude your testimony?

15 A. Yes.

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UI's Phoenix Project: PSC Timeline of Dockets						
Date	Order	Docket	Utility	Dep. Life (Yrs.)	Adj. for Divestiture	Comments
12/16/2008	PSC-08-0812-PAA-WS	070695-WS	Miles Grant Water and Sewer Co.	6	No	Commission approved recovery of pro forma computer accounting & billing system costs based on ERCs.
12/22/2008	PSC-08-0827-PAA-WS	070694-WS	Wedgfield Utilities, Inc.	6	No	
2/16/2009	PSC-09-0101-PAA-WS	070693-WS	Lake Utilities Services, Inc.	6	No	
4/27/2009	PSC-09-0264-PAA-SU	080247-SU	Utilities, Inc. of Eagle Ridge	8	No	Depreciable life changed to 8 yrs.
5/27/2009	PSC-09-0372-PAA-SU	080248-SU	Tierra Verde Utilities, Inc.	8	No	
5/27/2009	PSC-09-0373-PAA-SU	080250-SU	Mid-County Services, Inc.	8	No	
6/22/2009	PSC-09-0462-PAA-WS	080249-WS	Labrador Utilities, Inc.	8	No	
9/28/2009	PSC-09-0651-PAA-SU	090121-SU	Alafaya Utilities, Inc.	8	No	Limited proceeding to recover the costs that include Phoenix Project.
6/18/2010	PSC-10-0400-PAA-WS	090392-WS	Utilities, Inc. of Pennbrooke	10	Yes	Divested systems removed from ERC total, depreciable life changed to 10 yrs.
6/21/2010	PSC-10-0407-PAA-SU	090381-WS	Utilities Inc. of Longwood	10	Yes	
7/1/2010	PSC-10-0423-PAA-WS	090402-WS	Sanlando Utilities Corporation	10	Yes	
9/22/2010	PSC-10-0585-PAA-WS	090462-WS	Utilities, Inc. of Florida	10	Yes	
11/15/2010	PSC-10-0682-PAA-WS	090349-WS	Cypress Lakes Utilities, Inc.	10	Yes	Limited proceeding to recover the costs that include Phoenix Project.
1/5/2011	PSC-11-0015-PAA-WS	090531-WS	Lake Placid Utilities, Inc.	10	Yes	
11/3/2011	PSC-11-0514-PAA-WS	100426-WS	Lake Utility Services, Inc.	10	Yes	
12/21/2011	PSC-11-0587-PAA-SU	110153-SU	Utilities, Inc. of Eagle Ridge	10	Yes	Regulatory asset/liability added as result settlement, Order No. PSC-12-0346-FOF-SU.
4/17/2012	PSC-12-0206-PAA-WS	110264-WS	Labrador Utilities, Inc.	10	Yes	Computer maintenance expense adjustment added.
12/26/2012	PSC-12-0667-PAA-WS	120037-WS	Utilities, Inc. of Pennbrooke	10	Yes	
2/14/2013	PSC-13-0085-PAA-WS	110257-WS	Sanlando Utilities Corporation	10	Yes	
1/10/2014	PSC-14-0025-PAA-WS	120209-WS	Utilities, Inc. of Florida	10	Yes	
4/28/2014*	4/10/2014 Agenda*	130212-WS	Cypress Lakes Utilities, Inc.			Recommendation to be filed on 3/27/14.*
6/25/2014*	6/5/2014 Agenda*	130243-WS	Lake Utility Services, Inc.			Recommendation to be filed on 5/22/14.*
		120161-WS	Utilities, Inc. Generic Docket			Hearing scheduled for 5/14/14.* Docket opened as a result of Order No. PSC-12-0346-FOF-SU.

* Anticipated Dates ss of 3/31/14.

Note: Highlighted utilities have been sold. Utilities, Inc. of Hutchinson Island was also sold.

Illustration of Remaining Life Depreciation Rate MethodLine No.1 Remaining Life Rate (RLR) = $100\% - \frac{\text{Accumulated Reserve \%} - \text{Future Net Salvage \%}}{\text{Average Remaining Life}}$

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4 **Calculation of 2010 Remaining Life Depreciation Rate**

5 Assume Average Service Life is 10 years.

6 Assume Company's 2010 Accumulated Reserve Balance of \$6,800,000.

7 Formula Accumulated Reserve % = $\frac{\text{Company's Accum. Res. Balance}}{\text{Total Amt. Capitalized to Plant}}$

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9 Average Remaining Life = $\frac{\text{Net Plant/Depreciation Expense}}{\text{Assume zero percent for Future Net Salvage percent.}}$

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12	Year Placed	Amount Capitalized	10-Yr Amort.	Company's Accum. Res. Bal.	Difference
13	<u>In-Service</u>	<u>to Plant</u>	<u>10-Yr Amort.</u>	<u>Res. Bal.</u>	<u>Difference</u>
14	2008	\$21,500,000	\$1,075,000		
15	2009	500,000	2,175,000		
16	2010	300,000	2,215,000		
17		<u>\$22,300,000</u>	<u>\$5,465,000</u>	<u>\$6,800,000</u>	<u>(\$1,335,000)</u>

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19 Average Remaining Life = 7

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21 RLR = $[100\% - (\frac{\$6,800,000}{\$22,300,000} - 0)] / 7$

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23 RLR equals 9.93%

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Test Calculation of RLR of 9.93 Percent			
Year	Depr. Exp.	Accum. Res Balance	Average Remaining Life
2010	\$2,215,000	\$6,800,000	0
2011	\$2,214,286	\$9,014,286	1
2012	\$2,214,286	\$11,228,571	2
2013	\$2,214,286	\$13,442,857	3
2014	\$2,214,286	\$15,657,143	4
2015	\$2,214,286	\$17,871,429	5
2016	\$2,214,286	\$20,085,714	6
2017	\$2,214,286	\$22,300,000	7

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Analysis of Utilities, Inc.'s financial
accounting and customer service computer
system.

DOCKET NO. 120161-WS

DATED: March 31, 2014

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that the testimony of Stephen Bart Fletcher on behalf of the Florida Public Service Commission was filed electronically with the Office of Commission Clerk, Florida Public Service Commission, and copies were furnished to the following, by electronic mail, on this 31st day of March, 2014.

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