

RUTLEDGE, ECENIA, PURNELL & HOFFMAN

PROFESSIONAL ASSOCIATION
ATTORNEYS AND COUNSELORS AT LAW

ORIGINAL

STEPHEN A. ECENIA
JOHN R. ELLIS
KENNETH A. HOFFMAN
THOMAS W. KONRAD
MICHAEL G. MAIDA
MARTIN P. McDONNELL

POST OFFICE BOX 551, 32302-0551
215 SOUTH MONROE STREET, SUITE 420
TALLAHASSEE, FLORIDA 32301-1841

TELEPHONE (850) 681-6788
TELECOPIER (850) 681-6515

J. STEPHEN MENTON
R. DAVID PRESCOTT
HAROLD F. X. PURNELL
GARY R. RUTLEDGE

GOVERNMENTAL CONSULTANTS
MARGARET A. MENDUNI
M LANE STEPHENS

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Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Room 110
Tallahassee, Florida 32399-0850

Re: Docket No. 980744-WS

Dear Ms. Bayo:

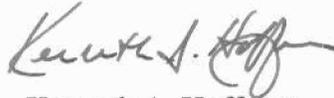
Enclosed herewith for filing in the above-referenced docket on behalf of Florida Water Services Corporation ("Florida Water") are the original and fifteen copies of:

1. The Prefiled Rebuttal Testimony of Hugh Gower; and 07236-01
2. Prefiled Rebuttal Testimony of James A. Perry. 07237-01

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the copy to me.

Thank you for your assistance with this filing.

Sincerely,



Kenneth A. Hoffman

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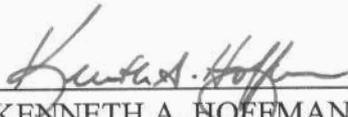
June 11, 2001

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished by U. S. Mail to the following this 11th day of June, 2001:

Jennifer Brubaker, Esq.
Division of Legal Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Room 370
Tallahassee, FL 32399-0850

Charles Beck, Esq.
Office of Public Counsel
111 West Madison Street
Room 812
Tallahassee, FL 32399-1400


KENNETH A. HOFFMAN, ESQ.

PREFILED REBUTTAL TESTIMONY OF
HUGH GOWER
FILED ON BEHALF
OF
FLORIDA WATER SERVICES CORPORATION
DOCKET NO. 980744-WS
JUNE 11, 2001

DOCUMENT NUMBER-DATE
07236 JUN 11 2001
FPSC-RECORDS/REPORTING

1 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

2 A. My name is Hugh Gower and my address is 195 Edgemere Way, S., Naples,
3 Florida 34105. I am self employed as a consultant on public utility financial,
4 economic regulation and cost containment and control matters. I also provide
5 expert testimony on topics related to public utility economics and rate
6 regulation in cases before public service commissions and courts.

7 **Q. ARE YOU THE SAME HUGH GOWER WHO PROVIDED DIRECT**
8 **TESTIMONY IN THIS PROCEEDING?**

9 A. Yes, I am.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. The purpose of my rebuttal testimony is to show that Ms. Kimberly
12 Dismukes recommendation to give all (or nearly all) of the gain on sale of
13 Florida Water Services Corporation's ("Florida Water" or "the Company")
14 Orange County utility systems to the remaining Florida Water customers
15 should be rejected because in formulating her recommendation she has-
16 (1) misconstrued and misinterpreted the regulatory rules and precedents on
17 which she relies;
18 (2) overlooked a key fact in the case; and
19 (3) relied upon unstated assumptions totally contrary to regulatory precedent,
20 including decisions of the Florida Public Service Commission (the
21 "Commission" or the "FPSC").
22 Consequently, Ms. Dismukes recommendation is fatally flawed, contrary to
23 the interests of customers and public utilities and should be rejected.

1 **Q. WHAT REGULATORY RULES, PRECEDENTS AND UNDERLYING**
2 **FACTS HAS MS. DISMUKES MISCONSTRUED,**
3 **MISINTERPRETED OR IGNORED?**

4 A. The issues are numerous and would include her testimony about
5 abandonment losses, contributions-in-aid-of-construction, projected test
6 periods, depreciation, allowed rates of return, the Uniform System of
7 Accounts and other matters.

8 **Q. TURNING FIRST TO ABANDONMENT LOSSES, MS. DISMUKES**
9 **CLAIMS THAT INVESTORS HAVE NO RISK OF LOSS ON WATER**
10 **AND WASTEWATER ASSETS BECAUSE “IT IS EVIDENT THAT**
11 **THE COMMISSION HAS REQUIRED CUSTOMERS TO BEAR THE**
12 **RISK OF LOSSES ASSOCIATED WITH ABANDONED PLANT OR**
13 **PLANT THAT IS RETIRED PREMATURELY” (PAGE 4). IS HER**
14 **CLAIM CORRECT?**

15 A. No, it is not. Perhaps her analysis was incomplete, but, for whatever reason,
16 Ms. Dismukes characterizes “abandonment losses” and “early retirements”
17 as isolated, unconnected transactions arising and existing totally independent
18 of the transactions and events to which they actually relate. This leads to her
19 erroneous conclusion.

20 **Q. PLEASE EXPLAIN.**

21 A. Utilities acquire or construct utility properties to meet anticipated customer
22 needs with the expectation that such properties will provide service to
23 customers for many years--at least for the average service lives over which
24 they are depreciated. In the normal course of events, some items of property
25 last longer than the estimated average service life, and others for fewer years

1 than the estimated average service life. Such differences between actual and
2 estimated service lives are trued up through the depreciation process so that
3 investors recover the capital they have invested and, insofar as depreciation
4 is concerned, customers pay no more than the actual cost of properties which
5 serve them.

6 In other cases, unforeseen events occur which results in the need to
7 consider removing utility property from service long before it has provided
8 service for its estimated service life on which its (capital recovery)
9 depreciation schedule was based. This could be caused by environmental
10 requirements with which the existing property cannot comply, or the
11 availability of more technologically advanced equipment which can provide
12 better service or service at a lower cost. In such cases, well managed utilities
13 perform engineering economic analyses to find the course of action which
14 provides the best service at the lowest long run cost. The costs considered in
15 such analyses include not only the cost of new facilities but also the
16 unrecovered cost of any property being considered for replacement. If
17 analysis show that replacing existing equipment is necessary (e.g.,
18 environmental reasons), or can provide better service or lower cost service,
19 it means that the existing equipment has reached the end of its economically
20 useful life. The actual replacement gives rise to what is sometimes referred
21 to as “abandonment losses”, “forced abandonments”, “extraordinary property
22 losses” or “prudent retirements”. Unfortunately, these names are somewhat
23 misleading.

24 **Q. WHY ARE THESE NAMES SOMEWHAT MISLEADING?**

1 A. They are misleading because they do not connote or suggest that they
2 represent part of the cost of achieving either better service or lower cost
3 service for customers and that any amounts deferred and amortized by
4 utilities must meet the test of prudence to qualify for recovery from
5 customers. From an economic standpoint, the old equipment being replaced
6 is analogous to a used automobile many people “trade” along with cash to a
7 dealer when they purchase a new or better automobile. This is the part of the
8 equation Ms. Dismukes conveniently omits when she claims customers bear
9 the risk of loss on utility assets. The propriety of allowing recovery in such
10 situations is well recognized in authoritative literature on cost based rate
11 regulation.

12 **Q. CAN YOU CITE AN EXAMPLE ?**

13 A. Yes, this is clearly explained in Deloitte & Touche’s Public Utilities Manual
14 at page 53:

15 The treatment of large nonrecurring costs is typical of
16 the differences in the time when an expense is
17 recognized by utilities, on the one hand, and by
18 business generally, on the other. A utility is entitled,
19 under traditional ratemaking concepts, to rates that are
20 adequate to recover all amounts reasonably expended
21 in rendering service. The rates are designed to cover
22 the usual and recurring costs of providing service, but
23 extraordinary items are neither usual nor expected to
24 be recurring. Extraordinary events do occur,
25 nevertheless, and recovery is not possible unless the
26 costs are allowed for ratemaking purposes. If the
27 entire loss were charged in full to a single year, it
28 would necessarily be omitted for rate-design purposes.
29 A common solution is to defer the extraordinary items
30 when incurred, and then to amortize them over a
31 period that, in the commission’s opinion, will result in
32 a fair annual charge to income.

33
34 The text goes on to cite as examples of extraordinary items deferred and
35 amortized with commission approval uninsured storm losses, rate case

1 expenses, environmental cleanup costs, abandoned construction projects and
2 losses from early retirement of major plant assets (not provided for in
3 depreciation) (emphasis added).

4 **Q. MS. DISMUKES CITES SEVERAL CASES (PP3-4) TO SUPPORT**
5 **HER CONTENTION THAT THE FPSC FORCES CUSTOMERS TO**
6 **BEAR THE “RISKS OF LOSS ON ABANDONED PLANT”. DO**
7 **THESE ORDERS SUPPORT HER CONTENTION?**

8 A. No, they do not. The Commission’s orders are clear that allowance of
9 recovery of the undepreciated cost of replaced facilities is based upon not
10 only the prudence of the original investments, but also the service
11 improvements (e.g., environmental compliance) which have or will result
12 from the replacement. Ms. Dismukes’s testimony makes no reference to the
13 investors’ need for cost recovery, the prudence of the original investments or
14 the service benefits which result from the replacements.

15 **Q. HAVE CASES IN WHICH THE FPSC ALLOWED RECOVERY OF**
16 **THE COST OF REPLACED FACILITIES PREVIOUSLY BEEN**
17 **URGED AS A REASON THE COMMISSION SHOULD ASSIGN**
18 **GAINS ON SALES OF UTILITY SYSTEMS TO REMAINING**
19 **CUSTOMERS?**

20 A. Yes, this was a reason argued in the reconsideration of Docket No. 911188-
21 WS involving Lehigh Utilities, Inc. The Commission’s Order No. PSC-93-
22 1023-FOF-WS issued July 12, 1993, rejected the argument.

23 **Q. HAVE YOU READ THE COMMISSION’S DECISIONS DEALING**
24 **WITH GAINS ON SALES IN THE ELECTRIC COMPANY CASES**
25 **MS. DISMUKES CITES (PP. 5-8)?**

1 A. Yes, I have.

2 **Q. PLEASE COMPARE THOSE CASES TO FLORIDA WATER'S SALE**
3 **OF ITS ORANGE COUNTY UTILITY SYSTEMS.**

4 A. Although the wording in these orders appears inconsistent with the
5 Commission's previous decisions concerning gains on sales realized by
6 Florida Water, it is important to recognize that these cases involved
7 transactions which were dissimilar from the Florida Water transactions. The
8 electric company sales relate to the disposition of specific assets in the course
9 of operating an ongoing business. They did not sell the customers, the
10 revenues and all assets necessary to provide service to customers as did
11 Florida Water when Florida Water sold the Orange County facilities. In other
12 words, the electric companies sold specific assets as part of an ongoing
13 business while Florida Water sold the business and could no longer provide
14 service to Orange County customers. While Florida Water did realize a gain
15 on those sales, its future revenue and earnings stream was reduced as a
16 consequence of the sales. By contrast, sales of specific assets are unlikely to
17 result in a loss of customers or future revenue streams.

18 **Q. DOES THE EXISTENCE OF CONTRIBUTIONS-IN-AID-OF-**
19 **CONSTRUCTION ("CIAC") AFFECT THE PROPER RATEMAKING**
20 **TREATMENT OF GAINS ON SALES OF UTILITY PROPERTIES AS**
21 **MS. DISMUKES SUGGESTS (P. 18)?**

22 A. No, CIAC arising from developer contracts or direct customer payments
23 should not affect the ratemaking treatment of gains and losses on the sale of
24 utility properties. CIAC, also known as "service availability charges" or
25 "impact fees", represent a pricing attempt to assign responsibility for the

1 higher costs of system growth to new customers who cause that growth and
2 to insulate existing customers from the higher costs which they did not cause.
3 As such, CIAC charges are merely a part of the price of utility service, and
4 should have no effect on the ratemaking treatment of gains on sales any more
5 than should the unit price for consumption.

6 **Q. WHO PROVIDED THE CIAC ASSOCIATED WITH THE ORANGE**
7 **COUNTY UTILITY SYSTEMS SOLD?**

8 A. The CIAC associated with the Orange County utility systems sold was
9 provided by either the developers of the affected communities or the
10 customers whose service is now provided by The Orange County Utilities
11 Division.

12 **Q. HOW MUCH OF THE CIAC ASSOCIATED WITH FLORIDA**
13 **WATER'S ORANGE COUNTY UTILITY SYSTEMS WHICH IT**
14 **SOLD TO THE ORANGE COUNTY UTILITIES DIVISION WAS**
15 **PROVIDED BY THE COMPANY'S OTHER CUSTOMERS?**

16 A. None.

17 **Q. DID THE ORANGE COUNTY UTILITIES DIVISION CHARGE THE**
18 **CUSTOMERS WHOSE SERVICE IT ASSUMED UPON PURCHASE**
19 **OF THE COMPANY'S ORANGE COUNTY SYSTEMS AN "IMPACT**
20 **FEE", A "SERVICE AVAILABILITY CHARGE" OR REQUIRE**
21 **CIAC IN ANY OTHER FORM?**

22 A. No.

23 **Q. WHY DOES MS. DISMUKES URGE THE EXISTENCE OF CIAC ON**
24 **THE ORANGE COUNTY SYSTEMS SOLD AS A REASON TO**

1 **ASSIGN THE GAIN ON SALE TO THE COMPANY’S NON-**
2 **ORANGE COUNTY CUSTOMERS?**

3 A. Although her testimony is not clear as to her analytical process on this point,
4 she must have reached the conclusion that, because Florida Water (or its
5 predecessors) had received CIAC, Florida Water somehow had lost its
6 ownership rights to the related utility property.

7 **Q. COULD HER CONCLUSION BE CORRECT?**

8 A. No, it could not. If the issue were ever in any doubt, it was emphatically
9 resolved by The Supreme Court of Florida in its 1972 decision in the General
10 Waterworks Corporation case. In its opinion the Court cited the United States
11 Supreme Court decision in Board of Public Utility Commissioners v. New
12 York Telephone Company which stated:

13 “The manner in which defendants came to own this property does not
14 operate to exclude it from the otherwise applicable constitutional
15 requirements.

16 “ ‘ Constitutional protection against confiscation does
17 not depend on the source of the money used to
18 purchase the property. It is enough that it is used to
19 render service.’ Board of Public Utility
20 Commissioners v. New York Telephone Company,
21 271 U.S. 23,46 S. Ct. 363, 70 L.Ed. 808.

22 Dade County v. General Waterworks Corporation, 267 So.2d 633, 640 (Fla.
23 1972).

24 **Q. MS. DISMUKES (PP. 17-18) ASSERTS THAT FLORIDA WATER’S**
25 **RATES ARE NOT LIMITED TO ORIGINAL COST SINCE THE**
26 **FPSC HAS ALLOWED UTILITIES, INCLUDING FLORIDA WATER,**
27 **TO USE PROJECTED TEST PERIODS IN RATE SETTING**
28 **PROCEEDINGS. IS THE COMMISSION’S PRACTICE IN THIS**
29 **PROCEEDINGS. IS THE COMMISSION’S PRACTICE IN THIS**
30 **PROCEEDINGS. IS THE COMMISSION’S PRACTICE IN THIS**

1 **REGARD A DEPARTURE FROM ORIGINAL COST RATE**
2 **SETTING?**

3 A. No, it is not. Use of a projected test period as was done in Florida Water's
4 last general rate case (Docket No. 950495-WS) limits the valuation of rate
5 base, depreciation, return, etc., to original cost.

6 **Q. PLEASE EXPLAIN HOW.**

7 A. The "test year" in Florida Water's Docket No. 950495-WS rate case was
8 calendar year 1996. To develop that data, Florida Water began with actual
9 historic original cost data through 1994, then projected the cost of additions
10 through 1996. Of the total 1996 rate base, actual amounts through 1994
11 constituted over 70% of the test year rate base. The projected additions to rate
12 base through 1996 were valued at estimated cost. In other words, the entire
13 rate base, depreciation, return, etc. for the test period was valued at "cost".

14 Moreover, the final rates resulting from Docker No. 950495-WS
15 became effective in September, 1996, by which time little of the Company's
16 test period data was "projected". This was no departure from historic original
17 cost ratemaking!

18 **Q. MS. DISMUKES ASSERTS (PAGE 15) THAT THE ASSIGNMENT OF**
19 **CAPITAL TRANSACTIONS TO INVESTORS "...HAS NO LOGIC**
20 **AND IS NOT BASED ON TRADITIONAL RATEMAKING**
21 **PRACTICES OR PRINCIPLES". IS HER ASSERTION CORRECT?**

22 A. No, it is not. This distinction was made clear in 1926---a date sufficiently
23 early in history to constitute "traditional ratemaking practices or principles"--
24 by the Supreme Court of the United States in Board of Public Utility
25 Commissioners v. New York Telephone Company when it said:

1 Customers pay for service, not the property used to render it.
2 Their payments are not contributions to depreciation or other
3 operating expenses, or to the capital of the company. By
4 paying bills they do not acquire any interest, legal or
5 equitable, in the property used for their convenience or in the
6 funds of the company. Property paid for out of moneys
7 received for service belongs to the company, just as does that
8 purchased out of proceeds of its bonds and stock.
9

10 Board of Public Utility Commissioners v. New York Telephone Company,
11 271 U.S. 23, 32 (1926).

12 **Q. MS. DISMUKES ALSO ASSERTS (PAGE 15) THAT “...ANY**
13 **ACCOUNTING TREATMENT OF AN EXPENSE, REVENUE OR**
14 **CAPITAL ITEM DOES NOT TRANSLATE INTO THE**
15 **APPROPRIATE RATEMAKING TREATMENT”. DO YOU AGREE?**

16 A. I agree that any party to a regulatory proceeding is free to question the
17 treatment of any transaction. At the very least, however, accounting for
18 transactions in accordance with the prescribed Uniform System of Accounts
19 (“USOA”) creates a strong presumption of consistency with applicable
20 ratemaking treatments. If this were not so, regulatory authorities would only
21 need a list of cash receipts and disbursements from utilities to exercise
22 regulatory surveillance or decide rate cases. But the importance to regulators
23 of financial statements and reports prepared in accordance with the applicable
24 USOA is signaled by the steps taken by regulators to assure compliance with
25 the USOA.

26 **Q. WHAT ARE SOME OF THE STEPS REGULATORS TAKE TO**
27 **ASSURE COMPLIANCE OF FINANCIAL REPORTS WITH THE**
28 **USOA?**

29 A. First, the USOA contains detailed instructions on the classification of
30 transactions designed to distinguish and separate transactions related to

1 utility operations from those which are capital in nature or nonutility. The
2 National Association of Utility Regulatory Commissioners (“NARUC”)
3 maintains committees of staff experts on the USOA to rule on questions or
4 recommend changes when needed. Second, many regulatory bodies require
5 reports on compliance with the USOA from independent public accountants
6 who audit utilities’ financial statements. Third, the staffs of some regulatory
7 commissions conduct audits of utilities’ records themselves to assure
8 compliance with the USOA.

9 If regulators’ reliance on financial statements and reports prepared in
10 compliance with the USOA which distinguishes carefully between operating
11 results, capital transactions and nonutility transactions as well as compliance
12 with ratemaking practices were unimportant, it is doubtful so much effort
13 would be applied.

14 **Q. HAVE COURTS REVIEWING UTILITY CASES PLACED ANY**
15 **WEIGHT ON COMPLIANCE WITH THE USOA?**

16 A. Yes, they have. One of the most oft cited cases in utility regulation is the case
17 of Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64
18 S.Ct. 281, 88 L.Ed. 333 (1944). In supporting regulators’ refusal to allow
19 Hope to retroactively change its accounting to increase its rate base, the Court
20 referred to the USOA:

21 Hope followed the general practice of the natural gas
22 industry and charged the cost of drilling wells to
23 operating expenses. Hope continued that practice until
24 the Public Service Commission of West Virginia in
25 1923 required it to capitalize such expenditures, as
26 does the [Federal Power] Commission under its
27 present Uniform System of Accounts.

28
29 Hope Natural Gas, 320 U.S. at 660.

1 This illustrates the weight assigned to compliance with the USOA as being
2 the proper ratemaking treatment, the focus of the USOA on distinguishing
3 between operating and capital transactions, as well as the impropriety of
4 retroactive ratemaking. It is not a matter to be dismissed with a casual
5 “wave of the hand” as Ms. Dismukes attempts.

6 **Q. MS. DISMUKES CLAIMS THAT “...CONSISTENCY DICTATES**
7 **THAT RATEPAYERS BE GIVEN THE GAIN WHICH IS A DIRECT**
8 **RESULT OF PAYING FOR ASSETS THROUGH DEPRECIATION**
9 **AND CIAC”. IS HER REASONING CORRECT?**

10 A. No, it is not. In addition to the fact that she proposes to give the gain to the
11 customers who did not pay the Orange County system depreciation and
12 CIAC, her logic is flawed.

13 First, the fact that the physical and economic usefulness of utility
14 properties are finite and are “used up” in the process of providing service to
15 customers is widely recognized. For this reason, the Commission has
16 designated useful lives over which such assets are depreciated in order to
17 recognize the consumption of the capital invested in such assets. At any
18 point in time, the amount of accumulated depreciation on the books of a
19 utility means not only that (hopefully) that portion of investors’ capital has
20 been recovered, but also that that portion of the physical and economic
21 usefulness and value of the property has expired. Contrary to Ms. Dismukes’
22 reasoning, a potential purchaser doesn’t pay for values already consumed or
23 expired, but, rather, the physical and economic usefulness which remain.
24 This, of course, is the assets’ remaining useful life---the part for which no

1 customer has yet been charged and the amount of investors' capital yet to be
2 recovered.

3 Second, CIAC was not a consideration in the estimates of value made
4 be either the consulting engineers who advised Orange County, or those who
5 advised the Company in this transaction. Ultimately, the price paid was a
6 matter of current values, earnings capacity of the systems, and the result of
7 arms' length negotiation between independent parties.

8 Finally, those customers who were served by Florida Water's Orange
9 County systems to which the CIAC collections relate received value for the
10 CIAC in the form of reduced rates. Assignment of the gain to customers who
11 weren't even served by the properties in question would be illogical and
12 inconsistent.

13 **Q. MS. DISMUKES CLAIMS (PAGE 18) THAT THE RETURNS**
14 **ALLOWED TO INVESTORS BY THE COMMISSION IS**
15 **SUFFICIENT COMPENSATION FOR RISKS TAKEN AND**
16 **SUGGESTS THIS AS A REASON TO ASSIGN GAINS ON SALES TO**
17 **CUSTOMERS. DO YOU AGREE?**

18 **A.** No, I do not. While the return on equity range of 10.88-12.88% allowed in
19 the Company's last case clearly was intended to compensate investors for
20 some of the normal business risks they faced, no serious, competent analyst
21 would suggest that such returns are sufficient compensation for risking the
22 loss of capital invested. Assignment of gains on sales to customers would
23 mean that investors' capital had been lost (confiscated), which would have
24 serious adverse implications to both the Company and its customers.

1 **Q. DOES THE FACT THAT SALES OF UTILITY SYSTEMS HAVE**
2 **OCCURRED FROM TIME TO TIME IN THE PAST AND MAY**
3 **AGAIN IN THE FUTURE MAKE THEM NORMAL RECURRING**
4 **TRANSACTIONS WHICH SHOULD BE CONSIDERED IN SETTING**
5 **RATES AS MS. DISMUKES ARGUES (PAGES 16-17)?**

6 A. While Ms. Dismukes is correct that several sales of systems have occurred
7 in the past and may again in the future, and, in that sense, are not “unusual”,
8 the key point she fails to recognize is that such sales are not related to utility
9 operations (i.e., the provision of service to customers). Not only have sales
10 of several systems occurred in the past, the Company has also purchased
11 several more systems than it has sold. Like the sales of systems, purchases
12 of systems are not related to utility operations. Instead, both purchases and
13 sales of systems are capital transactions, not ordinary utility operating
14 transactions which should be considered in rate setting. During the 10 years
15 ending December 31, 2000, Florida Water sold eight systems resulting in a
16 reduction in its utility plant-in-service of nearly \$73,000,000 and a decrease
17 in the number of customers served by almost 28,000. During the same period
18 of time, Florida Water purchased seven systems resulting in an increase in its
19 utility plant-in-service by over \$167,000,000 and an increase in the number
20 of customers served by more than 55,000. Importantly, the purchase of
21 systems usually implies a substantial additional commitment of capital for
22 upgrades of various kinds, such as environmental compliance. Additionally,
23 during this 10 year period, as a result of its ongoing construction program to
24 meet customer demands from internal growth, Florida Water’s utility plant-
25 in-service accounts were increased by almost \$297,000,000 and more than

1 69,000 customers were added. While the sales of systems has resulted in the
2 recovery of some of the investors' capital, far greater amounts of capital are
3 being reinvested in the purchase of new systems and the ongoing construction
4 program. Ms. Dismukes' strong desire to invade on behalf of customers a
5 large part of the investors' capital recovered through systems sales is highly
6 inconsistent with the absence of a recommendation from her on what part of
7 the capital invested in systems purchases should be borne by customers.

8 **Q. MS. DISMUKES (PP18-19) ARGUES THAT WHEN CONSIDERING**
9 **THE RELATIVE RIGHTS OF CUSTOMERS AND INVESTORS,**
10 **COMPARISONS BETWEEN REGULATED UTILITIES AND**
11 **COMPETITIVE BUSINESSES ARE "DIFFICULT TO MAKE". DO**
12 **YOU AGREE?**

13 A. No, I don't agree. Perhaps more importantly, neither did the Supreme Court
14 of the United States. In Pacific Gas & Electric Company v. Public Utilities
15 Commission of California, 447 U.S. 1, 106 S. Ct. 903 (1986), the Court
16 reversed a decision of the California Public Utilities Commission ("CPUC")
17 which had concluded that customers "owned" the "extra space" in billing
18 envelopes, holding that the CPUC "misperceives...the relevant property
19 rights...". In his concurring opinion, Justice Marshall clarified the property
20 rights issue by making just such a comparison:

21 The State seizes upon appellant's status as a regulated
22 monopoly in order to argue that the inclusion of
23 postage and other billing costs in the utility's rate base
24 demonstrates that these items "belong" to the public,
25 which has paid for them. However, a consumer who
26 purchases food in a grocery store is "paying" for the
27 store's rent, heat, electricity, wages, etc., but no one
28 would seriously argue that the consumer thereby
29 acquires a property interest in the store. That the
30 utility passes on its overhead costs to ratepayers at a

1 rate fixed by law rather than the market cannot affect
2 the utility's ownership of its property, nor its right to
3 use that property for expressive purposes, see
4 Consolidated Edison Co. v. Public Service
5 Commission of N.Y., 447 U.S. 530, 534 n. 1 (1980).
6

7 Pacific Gas & Electric Co. v. Public Utilities Commission of California, 475
8 U.S. 1, 22 (1986).

9 **Q. SHOULD THE ADOPTION OF UNIFORM RATES FOR SOME OR**
10 **ALL OF A UTILITY'S CUSTOMERS AFFECT THE PROPER**
11 **RATEMAKING TREATMENT OF GAINS ON SALES OF UTILITY**
12 **PROPERTIES?**

13 A. No, it should not. Rates, whatever their form, represent a price which
14 regulators have found to be fair and reasonable. Rates-- the actual tariff
15 prices--are normally based upon a number of factors which would include
16 cost, value, conservation, consistency with prior charges, customer
17 understanding, ease of administration, etc. Consequently, actual tariff rates
18 may or may not be set equal to cost. Moreover, the key variables in the
19 calculation of rates, such as number of customers, weather, demand and sales
20 volumes, as well as operations expense and capital investment levels, would
21 likely be different in the months and years after the test period. As a result,
22 the "rates" set on any basis cannot provide a lasting link to or preserve the
23 relative values between the key variables (whatever they were) upon which
24 their calculation was based. Subsequent to the test period upon which rates
25 were set, it is not possible to ascertain with certainty the amount of any
26 particular cost of service element (such as depreciation, income taxes, and
27 return) such rates actually recover. Consequently, rates are "just and
28 reasonable" prices, no more and no less, and provision of service by the

1 utility and payment of the prices for that service by the customer ends any
2 rights and claims each may have against the other.

3 **Q. SHOULD OVER OR UNDER EARNING RELATIVE TO A**
4 **UTILITY'S AUTHORIZED RATE OF RETURN AFFECT THE**
5 **PROPER RATEMAKING TREATMENT OF GAINS ON SALES OF**
6 **UTILITY PROPERTIES?**

7 A. No, it should not. Utility rates are set prospectively, not retroactively. If the
8 history of earnings relative to the authorized level were considered in any
9 calculation to develop the ratemaking disposition of gains on sales of utility
10 properties, it would be retroactive ratemaking. This would clearly be
11 inappropriate.

12 **Q. WHAT KEY FACT HAS MS. DISMUKES OVERLOOKED IN**
13 **ARRIVING AT HER RECOMMENDATION TO GIVE ALL, OR**
14 **NEARLY ALL, OF THE GAIN ON SALE OF FLORIDA WATER'S**
15 **ORANGE COUNTY UTILITY SYSTEMS TO ITS REMAINING**
16 **CUSTOMERS?**

17 A. She must have overlooked the fact that properties included in a utility's rate
18 base are surrogates for investors' capital. This key point has long been
19 recognized in authoritative literature on ratemaking.

20 **Q. WHAT DOES AUTHORITATIVE LITERATURE SAY ABOUT**
21 **INVESTORS' CAPITAL VERSUS SPECIFIC ASSETS?**

22 A. The point is made clear in Bonbright, Danielsen and Kamerschen's Principles
23 of Public Utility Rates (page 223) and also in Charles F. Phillips, Jr.'s The
24 Economics of Regulation (page 224). Interestingly, both texts lean heavily

1 on Justice Brandeis' minority opinion (concurring as to results) in the
2 Southwestern Bell 1923 decision in which he wrote:

3

4 The thing devoted by the investor to the public use is
5 not specific property, tangible and intangible, but
6 capital embarked in the enterprise. Upon the capital
7 so invested the Federal Constitution guarantees to the
8 utility the opportunity to earn a fair return.... The
9 several items of property constituting the utility, taken
10 singly, and freed from public use, may conceivably
11 have an aggregate value greater than if the items are
12 used in combination. The owner is at liberty, in the
13 absence of controlling statutory provision, to
14 withdraw his property from public service; and, if he
15 does so, may obtain for it exchange value. (Footnote
16 omitted; emphasis added).

17

18 Southwestern Bell Telephone Company v. Public Service Commission of
19 Missouri, 262 U.S. 276, 290 (1923).

20

21 While this point may not be obvious to Ms. Dismukes, a firm grasp
22 and appreciation of its implications is necessary to arrive at a proper
23 conclusion as to the proper ratemaking treatment of gains on sales of utility
24 properties such as the Company's Orange County systems. When recognized
25 for what it really is, it is clear that the only proper ratemaking treatment is to
26 assign the gain to those whose capital it represents, the investors. Had Ms.
27 Dismukes been more sensitive to this point, she might not have reached her
28 unstated conclusion that customers have somehow acquired "ownership
29 rights" to Florida Water's Orange County utility systems.

29

30 **Q. HOW DID MS. DISMUKES ARRIVE AT THE UNSTATED**
31 **CONCLUSION THAT CUSTOMERS HAD ACQUIRED**
32 **"OWNERSHIP RIGHTS" TO THE COMPANY'S ORANGE COUNTY**
PROPERTIES?

1 A. No analysis or support is stated; however, since gains and losses accrue only
2 to those who have ownership rights, her recommendation belies this
3 assumption.

4 **Q. IS HER ASSUMPTION IN THIS REGARD VALID?**

5 A. No, it is not. As my direct testimony described, the regulatory framework
6 which developed over many years and which defines the rights of both
7 customers and owners under cost-based rate regulation does not provide
8 customers with any proprietary interest, equity position or ownership interest
9 in the utility properties from which they may be provided service. On the
10 contrary, ownership or proprietary rights and equity interests belong to the
11 investors whose capital financed the utility properties. Only those with
12 ownership interests are entitled to gains (and losses) resulting from the
13 liquidation of investments, such as Florida Water's sale of its Orange County
14 utility systems.

15 **Q. HAS THE FPSC EVER AGREED WITH THE RIGHTS OF**
16 **CUSTOMERS AND INVESTORS WHICH YOU SAY IS DEFINED BY**
17 **THIS REGULATORY FRAMEWORK?**

18 A. Yes, it has. In its Order No. PSC-93-1821-FOF-WS, issued December 22,
19 1993, in approving North Fort Myers Utility, Inc.'s new rates and in response
20 to certain customers' claims of entitlement to proceeds of utility asset sales,
21 the Commission concluded:

22 We find that a refund to the customers or off-set of
23 connection fees is not appropriate because customers of
24 utilities do not have any propriety claim to utility assets.
25 Although customers pay a return on utility investment
26 through rates for service, they do not have any ownership
27 rights to the assets, whether contributed or paid for by utility
28 investment.
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and further,

The property rights that rest in the ownership of the utility land and facilities are constitutionally protected. To deny this property interest would constitute an unconstitutional taking by this commission. Any contribution to the system by the customers would have no value without the risk and investment of the utility owner(s) in the land and facilities that are now being removed from utility service. Given the customers' lack of proprietary claim and the utility's fundamental property rights, we find no refund of the purchase price to the customers to be appropriate.

Q. HAVE COURTS AGREED THAT CUSTOMERS HAVE NO OWNERSHIP RIGHTS TO UTILITY PROPERTIES AS A RESULT OF PAYING FOR THE SERVICE THEY RECEIVE?

A. Yes, courts have ruled on this issue. The Supreme Court of the United States ruled in the previously quoted 1926 case involving New York Telephone Company in this regard. Importantly, the Court said:

The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary.

and further:

Customers pay for service, not the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to capital of the company. By paying bills they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company, just as does that purchased out of proceeds of its bonds and stock.

New York Telephone Company, 271 U.S. 23, 31-32 (1926).

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The assertions and recommendation contained in Ms. Dismukes' testimony show:

- 1 (1) She fails to appreciate the distinction between capital and operating
2 transactions insofar as how they should affect customers' rates;
- 3 (2) She erroneously assumes or concludes that investors have lost ownership
4 rights because the utility properties which their capital financed was used for
5 public service;
- 6 (3) She erroneously assumes or concludes that customers have acquired
7 ownership rights to Florida Water's utility systems by paying rates set under
8 cost based rate regulation;
- 9 (4) She proposes to give gains on sale of Florida Water's Orange County
10 utility systems to customers who were never served by and who never paid
11 rates for service from the properties in question;
- 12 (5) She fails to recognize that utility assets in rate base are surrogates for the
13 amount of capital investors have provided for utility service, and
- 14 (6) She proposes to confiscate investors' capital by giving customers gains
15 on the sale of Florida Water's Orange County utility systems.

16 Adoption of Ms. Dismukes' recommendation would be a major
17 departure from and break with the regulatory framework for cost based rate
18 regulation which has served both customers and utilities well for many years.
19 Ms. Dismukes' recommendation would not serve the best interests of
20 customers or utilities and should be rejected.

21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes.

23

24 Orange\gower.ora.rebuttal