

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 110200-WU

In the Matter of:

APPLICATION FOR INCREASE IN
WATER RATES IN FRANKLIN COUNTY
BY WATER MANAGEMENT SERVICES, INC.

COMMISSION
CLERK

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VOLUME 1
(Pages 1 through 165)

PROCEEDINGS: HEARING

COMMISSIONER
PARTICIPATING: COMMISSIONER LISA POLAK EDGAR
COMMISSIONER EDUARDO BALBIS
COMMISSIONER JULIE I. BROWN

PLACE: St. George Island Volunteer
Fire Department
324 East Pine Avenue
St. George Island, Florida

TIME: Commenced at 11:18 a.m.
Concluded at 12:58 p.m.

DATE: Wednesday, January 16, 2013

REPORTED BY: LINDA BOLES, CRR, RPR
Official FPSC Reporter
(850) 413-6734

FLORIDA PUBLIC SERVICE COMMISSION

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1 APPEARANCES:

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4 Florida Legislature, 111 West Madison Street, Room 812,
5 Tallahassee, Florida 32399-1400, appearing on behalf of
6 the Citizens of the State of Florida.

7 MARTIN S. FRIEDMAN, ESQUIRE, Sundstrom,
8 Friedman & Fumero, LLP, 766 North Sun Drive, Suite 4030,
9 Lake Mary, Florida 32746, appearing on behalf of Water
10 Management Services, Inc.

11 MARTHA BARRERA and MICHAEL LAWSON, ESQUIRES,
12 FPSC General Counsel's Office, 2540 Shumard Oak
13 Boulevard, Tallahassee, Florida 32399-0850, appearing on
14 behalf of the Florida Public Service Commission Staff.

15 MARY ANNE HELTON, Deputy General Counsel,
16 Florida Public Service Commission, 2540 Shumard Oak
17 Boulevard, Tallahassee, Florida 32399-0850, Advisor to
18 the Florida Public Service Commission.

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1
2 **COMMISSIONER EDGAR:** Good morning again. We
3 are going to go ahead and get started with the next
4 portion of our proceeding. So those of you that would
5 like to stay with us, if you would, please take a seat.
6 And please put any cell phones on silent or vibrate,
7 which will be much appreciated. I hope -- I think
8 that's where mine are.

9 So I am calling the evidentiary portion of
10 this proceeding to order, and I will ask our staff to
11 read the notice.

12 **MS. BARRERA:** By notice, this time and place
13 has been set for hearing in Docket 110200-WU,
14 application for increase, increase in rates by Water
15 Management Services, Inc.

16 **COMMISSIONER EDGAR:** Thank you. And I would
17 like to take appearances at this time from the attorneys
18 representing the parties and our staff.

19 **MR. FRIEDMAN:** I'll get my law firm name right
20 this time. It's Martin Friedman with the law firm of
21 Sundstrom, Friedman & Fumero, and we represent Water
22 Management Services. And with me is Mr. Gene Brown, who
23 is the principal.

24 **COMMISSIONER EDGAR:** Thank you.

25 **MR. SAYLER:** Office of Public Counsel, Erik

1 Sayler on behalf of the Office of Public Counsel. Here
2 today is also our Public Counsel, Mr. J. R. Kelly.

3 **COMMISSIONER EDGAR:** Thank you. And from our
4 legal staff.

5 **MS. BARRERA:** Martha Barrera, staff attorney,
6 PSC.

7 **MR. LAWSON:** Michael Lawson, staff attorney,
8 PSC.

9 **MS. HELTON:** Mary Anne Helton, advisor to the
10 Commission.

11 **COMMISSIONER EDGAR:** Thank you.

12 Ms. Barrera, any preliminary matters?

13 **MS. BARRERA:** Yes, Commissioner. The parties
14 and staff have dropped Issue 15 and are instead
15 requesting approval of the following proposed
16 stipulation.

17 It reads, At the time of the true-up
18 proceeding, the escrow agreement, including the escrow
19 amount, will be reviewed.

20 At this time, staff would request that the
21 panel vote on whether to approve or deny this proposed
22 stipulation.

23 **COMMISSIONER EDGAR:** Thank you.

24 Commissioners, any questions for our staff or
25 the parties on the proposed stipulation?

1 **COMMISSIONER BROWN:** I would move approval of
2 the proposed stipulation, which will drop Issue 15.

3 **COMMISSIONER BALBIS:** Second.

4 **COMMISSIONER EDGAR:** Thank you. And I concur,
5 so we will show that stipulation adopted.

6 **MS. BARRERA:** Thank you. Staff knows of no
7 other preliminary matters.

8 **COMMISSIONER EDGAR:** Any other matters that
9 the parties would like to raise at this time?

10 **MR. FRIEDMAN:** No.

11 **MR. SAYLER:** One question about the staff's
12 request for a stipulation on their composite exhibit.
13 Do we address that now or later, or when do you want to
14 address that?

15 **MS. BARRERA:** We can address it later.

16 **MR. SAYLER:** Certainly.

17 **COMMISSIONER EDGAR:** Okay.

18 **MR. SAYLER:** No preliminary matters.

19 **COMMISSIONER EDGAR:** Okay. Thank you. Then
20 let me just say for planning purposes what I would like
21 to propose is that we will take a lunch break 1:00, a
22 little after, depending when, kind of if there's a
23 natural break right in that time frame for 45 to an
24 hour, and then we will come back at 2:00ish and go to
25 about 5:30, at which point we'll take a break so that

1 the staff can set up again for the customer service
2 hearing to begin at 6:00.

3 And with that, we can move to opening
4 statements. Mr. Friedman and Mr. Sayler, you each,
5 according to the Prehearing Order, get five minutes.
6 And, Mr. Friedman, you are first.

7 **MR. FRIEDMAN:** Thank you. You've had a
8 prelude to some of this, but I'll, I'll repeat it again
9 for consistency. And that's the fact that OPC has
10 protested the PAA order. And they really made this, as
11 you heard from the customer testimony, it's all about
12 Mr. Brown and how WMSI spends its money. You'll hear a
13 lot of money -- a lot of testimony about Account 123.
14 It subsumed the last proceeding, as I'm sure
15 Commissioner Edgar knows as one of the panel members,
16 and it seems to have subsumed most of the time, energy,
17 and effort of the, of the parties in this case as well.

18 And Account 123 is not, it's not complex.
19 It's very simple. It's a way that WMSI accounts for its
20 own money. So don't be misled to think that this is the
21 customers' money. It's not the customers' money. The
22 customers are paying the rates that this Commission has
23 determined that, that they should pay, and receive the
24 revenue that this Commission has determined that they
25 receive. And what the Public Counsel wants you to do is

1 to micromanage the way that WMSI spends its own money.

2 As one of these customers said, you know, they
3 ought to have a reserve account. You know, I'd love for
4 the PSC, and I know that's something that Commissioner
5 Brown and her panel are considering for utilities is to
6 have reserve accounts to take into account, to have
7 money there for, for emergency circumstances.
8 Unfortunately the law is not there now. So, you know,
9 while we would love to do what that customer suggested,
10 it's not in the cards.

11 The Public Counsel asked this Commission in
12 the last rate case to micromanage the utility because of
13 Account 123. They did it in the last case, they did it
14 twice in the last case, and both times this Commission
15 rejected them, pointing out to the OPC prior orders and
16 the Commission's policy that it does not micromanage the
17 way utilities run.

18 And as I pointed out earlier, you know, to
19 bring this closer to home, look at your own salaries.
20 You know, look at your own -- you earn what you get,
21 what the state says you get, and what you do with that
22 money after you get it is, is your business. And if you
23 want to put a new roof on your house or you want to wait
24 to put a little bit of money away every month for your
25 children's college education, that's fine. But if you

1 don't, that's your business as well. And just because
2 Water Management Services is a regulated utility, that
3 doesn't change that. The money is theirs. They have,
4 they have run this utility through challenging times, as
5 this Commission pointed out in the past the financial
6 challenge that this company has. But as you heard from
7 these customers, man, this company does great. Their
8 customers are happy. These people are doing a good job,
9 notwithstanding the financial challenges that a utility
10 such as this has.

11 You know, you're going to hear a lot of
12 testimony from Public Counsel witnesses about
13 speculation: Oh, this could happen, that could happen.
14 It's a Chicken Little argument. The sky is going to
15 fall. The sky never falls.

16 There's no, there's no substance to the
17 arguments, no factual substance to the arguments that
18 OPC is making. It's a hysterical argument that they
19 hope that it will get legs.

20 OPC wants this company micromanaged because it
21 doesn't believe Mr. Brown knows how to run a company.
22 He's been running this company with the challenging
23 financial situation for 35 or --

24 **MR. BROWN:** 38.

25 **MR. FRIEDMAN:** -- 38 years, and there's no

1 indication that he will not continue to do so. Running
2 your own small business involves juggling balls: Paying
3 this bill, not paying that bill until it's due; you get
4 flexibility on a loan from somebody, you know they're
5 gonna, they're gonna sit tight on you; they know they're
6 gonna get paid, they wait an extra day or wait an extra
7 week. That's the way small businesses run. Especially
8 you can think down here when as you walk around and you
9 see this time of year there's nobody down here, and so
10 you can imagine that there's not much water being used
11 in relation to what's used during the season.

12 You know, one of the examples that OPC uses is
13 the DEP loan. And I was on a conversation with the DEP
14 about that when, when Mr. Brown was meeting with them
15 about delaying making one of the payments. And they
16 said, you know, we understand that technically it's a
17 default. Don't worry, we'll wait until the PSC case is
18 over with and we'll deal with it. Well, the next thing
19 you know, Erik Sayler is calling the DEP and DEP is
20 pressured into writing a letter, which is what they
21 want, and you'll probably hear about the default letter.
22 You know, that's because they called them. DEP wasn't
23 going to issue a default letter. Public Counsel did
24 that themselves.

25 That's the same as with the, with the loan.

1 You heard Public Counsel say, well, you know, Water
2 Management Services can't borrow money to do these
3 improvements. Well, they were talking to a lender about
4 doing it, and the lender said, yeah, I'll get back to
5 you after your rate case and see what kind of cash flow
6 it is.

7 Well, Mr. Sayler has conversations and e-mails
8 with that lender and all of the sudden he scares the
9 lender away and the lender has decided that they're not
10 going to continue to deal with Water Management
11 Services.

12 So the mismanagement, if there is any, is
13 caused by Public Counsel doing what they want to do.
14 They, they, they raise an issue and then make it happen
15 by, by calling lenders and killing deals.

16 **COMMISSIONER EDGAR:** Mr. Friedman, your five
17 minutes is up. Do you have just a real quick close?

18 **MR. FRIEDMAN:** The point is that despite the
19 financial challenges that WMSI has endured since it was
20 forced to replace the main across the, across to the
21 island, it continues to provide a good quality service,
22 as evidenced by the fact that that's not an issue in
23 this case and you heard the testimony to that. And in
24 spite of those challenges, the utility is continuing to
25 run well, and there's no reason for this Commission to

1 micromanage how it runs its business.

2 **COMMISSIONER EDGAR:** Thank you very much.

3 Mr. Sayler.

4 **MR. SAYLER:** Ms. Chairman, before I do my
5 opening statements, Mr. Kelly would like to interpose an
6 objection.

7 **COMMISSIONER EDGAR:** Mr. Kelly.

8 **MR. KELLY:** Thank you, Madam Chair, and I'll
9 be very quick. I'm going to pose -- or excuse me -- I'm
10 going to make a motion in limine.

11 For the past year I've endured and my office
12 has endured a lot of unfounded accusations about how we
13 feel toward WMSI and its owner. I'm here to set the
14 record straight. I don't have any vendetta, ill
15 feelings. My job is to carry out the statutory
16 responsibility to represent the customers to the best of
17 my ability.

18 A lot of things that Mr. Friedman just said,
19 and I didn't come up here and make a motion and
20 interrupt him at the time, there is no evidence in the
21 record. I would ask you to please pay attention to the
22 evidence that comes in, such as phone calls made by our
23 office or, or anything else about what we may or may not
24 have done. So my motion in limine is to exclude any
25 accusations, any, any unfounded statements and hearsay

1 that speaks to what our office may or may not have done.

2 I do recognize that hearsay is allowed in
3 administrative hearings; however, it's only allowed if
4 there is some evidence that's appropriate, appropriately
5 admitted that will support that accusation or issue
6 that, that is being raised.

7 And what I would simply end on is that I agree
8 with Mr. Friedman, let's focus on the issues in this
9 case and not all the peripheral, again, unfounded
10 accusations. Thank you.

11 **MR. FRIEDMAN:** May I respond?

12 **COMMISSIONER EDGAR:** In a moment.

13 Mr. Kelly, just so I am clear, your motion in
14 limine is to exclude certain portions of Mr. Friedman's
15 opening statement, or are you talking about testimony
16 that we have yet to have heard?

17 **MR. KELLY:** Good question, Madam Chair. I
18 apologize for not being clear.

19 What I would do is I was -- instead of
20 objecting each and every time, what I wanted to do was
21 just come up here and make it go more smoother, is have
22 a continuing motion in limine -- excuse me -- motion in
23 limine to exclude evidence that is not relevant to the
24 issues that this Commission is going to hear, such as I
25 believe in his opening statement he made a comment about

1 our office contacting bankers or something to that
2 effect, and there is no evidence, there is no witnesses,
3 there's nothing.

4 **COMMISSIONER EDGAR:** Mr. Kelly, thank you. I
5 got it.

6 **MR. KELLY:** I apologize.

7 **COMMISSIONER EDGAR:** That's okay. I
8 appreciate the clarification.

9 Now, Mr. Friedman, briefly.

10 **MR. FRIEDMAN:** I find it ironic, I find it
11 ironic that the Public Counsel is complaining about
12 unfounded accusations about his office when that's
13 what's been going on about Mr. Brown for years now from
14 the Office of Public Counsel.

15 But, you know, what I did was I made an
16 argument. What I said is not evidence. I mean, I don't
17 know how you can exclude what I said. If there's no, if
18 there's no actual testimony to back it up, and there is
19 and Mr. Brown's testimony does, then you can say Marty
20 didn't prove it. What he said, you know, wasn't, wasn't
21 right. You know, I don't know how you exclude
22 somebody's, somebody's opening statement.

23 **COMMISSIONER EDGAR:** Thank you. I agree. And
24 I know that all, every counsel participating in this
25 case understands as well that opening statement is just

1 that. It's comment, it is not sworn testimony. I have
2 complete confidence in the ability of the Commission to
3 know the difference between opening comments and
4 evidence.

5 And I will ask all of, each counsel, ours as
6 well, and for each party, as your witnesses are here and
7 as you're conducting your cross-examination, to keep at
8 the front of your focus what the specific issues are
9 that have been defined that are to be considered in this
10 proceeding.

11 Ms. Helton, anything, any comment that you
12 think is necessary at this time from our legal counsel?

13 **MS. HELTON:** Other than echoing or completely
14 agreeing with what you had said, that I would hope that
15 the parties would keep to the issues at hand and the,
16 and the prefiled testimony that has been filed, no.

17 And to remind everyone that Chapter 120 which
18 governs this proceeding does also state that irrelevant
19 evidence should not be part of an evidentiary
20 proceeding.

21 **COMMISSIONER EDGAR:** Thank you, Ms. Helton.

22 And then I will make just the other, the
23 concluding, at this moment, general comment that at the
24 Commission generally, recognizing the administrative
25 procedure rules and other rules of evidence that guide

1 our proceedings, that the Commissioners individually,
2 during their deliberations, will give any testimony the
3 weight they independently deem it due.

4 Mr. Kelly, as with Mr. Friedman, as we are
5 proceeding with the evidence and testimony, if you do
6 have an individual objection, of course you have the
7 right to make that at that time.

8 **MR. KELLY:** Thank you.

9 **COMMISSIONER EDGAR:** And with that,
10 Mr. Saylor, you have five minutes.

11 **MR. SAYLER:** Thank you, Madam Chair.

12 For my opening remarks I'd like to focus on
13 the facts and the law as it relates to the three major
14 issues in this case that were protested: Issue 10, the
15 \$1.2 million advance issue; Issue 9, which is the
16 carrying forward of the remaining amortization of the
17 gain on sale approved in the last rate case; and Issue
18 7, previously approved but unpaid rate case expense.
19 Testimony by OPC witnesses suggests those are the main
20 (phonetic) issues.

21 Issue 10, have the utility's advances to
22 WMSI's president and associated companies had any
23 adverse impact on the utility or its ratepayers? Yes.

24 Fact, from 2004 to 2010 the utility advanced
25 more than \$1.2 million of utility money to the president

1 and his companies. In 2011 he was still advancing
2 money. And according to his deposition with staff, he
3 is still planning to do so in the future.

4 Fact, this advancement of money took place
5 during a period of financial hardship where this company
6 had to renegotiate its DEP loan five different times and
7 was also having difficulty paying their regulatory
8 assessment fees.

9 Fact, harm to the customers as a result of
10 these five amendments to the DEP loan. The utility
11 president's actions added \$1.2 million -- or
12 \$1.1 million of interest, which, according to the staff
13 at the PAA Agenda Conference, the customers will have to
14 pay.

15 Fact, harm to the utility. As a result of
16 these advances, WMSI eventually defaulted on its DEP
17 loan or technically defaulted. And as a result of this
18 default, according to Mr. Brown's testimony at his
19 deposition with staff, WMSI will potentially have more
20 likely -- more difficulty securing a loan going forward.

21 If this utility cannot secure a loan to make
22 its capital improvement and the water storage tank on
23 this island does fail, that will definitely indirectly
24 and adversely affect not only the utility, but the
25 customers, tourism, and the tax base of Franklin County.

1 The law, Commissioners, there is past
2 Commission precedent for the recommendations being made
3 in this case. According to prior Commission orders,
4 this Commission actively intervened in the utility
5 operations on more than one occasion to ensure that this
6 utility is operated in the best interest of the utility
7 and its customers.

8 The law of the prudent utility manager's
9 standard governs the president's action. Boiled down,
10 it is this: What did the utility manager know or should
11 have known at the time the manager was making these
12 decisions?

13 In this case, Commissioner, you'll be deciding
14 if WMSI's president knew or should have known at the
15 time he was advancing this money while his company was
16 struggling financially and negotiating the missed DEP
17 loan payments. He should have known whether his actions
18 would have had an adverse impact on this utility.

19 Issue 9, continued amortization of rate
20 case -- or, excuse me -- continued amortization of the
21 net gain on sale approved in the last rate case.

22 Fact, the Commission previously determined
23 that there was a \$240,000 net gain on sale to be
24 amortized to the benefit of the ratepayers, resulting in
25 about a \$48,000 per year rate reduction.

1 Fact, WMSI appealed this to the First DCA and
2 lost. Fact, the gain on sale approved in the last rate
3 case was not expressly addressed or discussed in staff's
4 PAA recommendation at the Agenda Conference. Thus, it
5 is OPC's position that this was inadvertently over -- it
6 was an inadvertent oversight to not carry it forward.

7 Fact, only two of the five years of that
8 amortization has been amortized thus far, leaving about
9 \$150,000 to the benefit of the ratepayers.

10 Fact, the customer -- if the Commission
11 carries forward the remaining amortization of the gain
12 on sale, the customers' protest will be largely paid for
13 after you deduct any reasonable rate -- unreasonable
14 incurred rate case expense under the current rate case
15 expense issue.

16 The law, the Commission's final word on the
17 last rate case is Commission precedent, and the
18 Commission precedent should provide guidance to this
19 Commission on how to proceed on this issue.

20 The law, to OPC's knowledge there is no
21 precedent where the Commission has ordered a gain on
22 sale to be amortized for five years to the benefit of
23 the ratepayers but let it expire after less than two
24 years of amortization.

25 Issue 7, previously approved but unpaid rate

1 case expense. Fact, in the last rate case the utility
2 signed a representation agreement with its law firm that
3 spelled out that the utility was required to pay rate
4 case expense regardless of the outcome of the
5 Commission's decision. The Commission approved rate
6 case expense for this utility, and also a 1%, about a 1%
7 rate increase.

8 Fact, after that decision, the utility ceased
9 making payments to its attorneys. Fact, after OPC
10 served discovery in this docket seeking proof of
11 payments, the utility starting making \$1,000 a month
12 payments.

13 Fact, after we protested this issue
14 specifically, the utility increased those payments to
15 \$2,000 a month.

16 The law, this is a case of first impression.
17 To OPC's knowledge there is no precedent dealing with a
18 utility which has done what it has done with regard to
19 past rate case expense.

20 In conclusion, Commissioners, Section 367.011,
21 *Florida Statutes*, sets forth the Commission's
22 jurisdiction and the Legislature's intent for the
23 Commission's regulation of water and wastewater systems.

24 Subsection (3) states, the regulation of the
25 utility is declared to be in the public interest, and

1 this law is an exercise of the police power of the state
2 for the protection of the public health, safety, and
3 welfare.

4 **COMMISSIONER EDGAR:** Mr. Sayler, your five
5 minutes are up.

6 Thank you to Commissioner Balbis for being a
7 timekeeper.

8 **MR. SAYLER:** Would you like me --

9 **COMMISSIONER EDGAR:** As I did -- very brief
10 close.

11 **MR. SAYLER:** Certainly. Just continuing on
12 with Subsection (3), the provisions of this chapter,
13 Chapter 367, shall be liberally construed for the
14 accomplishment of this purpose.

15 Commissioners, that means that you have great
16 authority to ensure that this utility is operating in
17 the public interest; not only that, but also the best
18 interest of the utility and its customers as the facts
19 in the case and the law dictate.

20 Thank you very much.

21 **COMMISSIONER EDGAR:** Thank you.

22 Let me turn to our legal staff. I understand
23 this is the time to take up exhibits.

24 **MS. BARRERA:** Yes, Commissioner. Staff has
25 prepared a Comprehensive Exhibit List. We have

1 distributed copies to the parties and to the
2 Commissioners' individual offices. Staff requests that
3 the list be marked as Exhibit 1 and it be moved into the
4 record.

5 **COMMISSIONER EDGAR:** Okay. Then the
6 Comprehensive Exhibit List that has been compiled by our
7 staff and distributed will be marked as Exhibit 1.

8 (Exhibit 1 marked for identification.)

9 Are there any objections to admitting
10 Exhibit 1 into the record at this time?

11 **MR. FRIEDMAN:** No.

12 **MR. SAYLER:** No, ma'am.

13 **COMMISSIONER EDGAR:** Okay. Then we will so
14 do.

15 (Exhibit 1 admitted into the record.)

16 Ms. Barrera?

17 **MS. BARRERA:** Yes, Commissioner. At this time
18 we request that the items in the Comprehensive Exhibit
19 List be numbered as indicated on the list. And the
20 parties and staff will seek to enter the prefiled
21 exhibits at the time that the individual witnesses are
22 presented.

23 Staff, however, has identified a number of
24 staff exhibits in the Comprehensive Exhibit List. These
25 exhibits are listed as exhibit, they are listed as

1 Exhibits 58 to 76 on the Comprehensive Exhibit List.
2 There may be -- so staff moves that these exhibits be
3 entered into evidence at this time.

4 **COMMISSIONER EDGAR:** Is there any objection to
5 moving either collectively or individually Exhibits
6 marked as 58 through 76 into the record at this time?

7 **MR. FRIEDMAN:** I --

8 **COMMISSIONER EDGAR:** Mr. Friedman.

9 **MR. FRIEDMAN:** Thank you. We object to 75 and
10 76, which is the deposition.

11 **COMMISSIONER EDGAR:** On the basis of? I'm
12 sorry. On the basis of?

13 **MR. FRIEDMAN:** On the basis of the fact that
14 it's -- Mr. Brown is not unavailable. And under the
15 rules of evidence, in order for a deposition to be
16 admitted into evidence, the deponent has to be
17 unavailable. And there's been no showing that Mr. Brown
18 is unavailable. In fact, he's sitting here. So I think
19 he's about as available as you can get.

20 There is a provision, as counsel may point
21 out, in the Evidence Code, 90.803(22), that seems to say
22 that you can use a deposition, former testimony even if
23 the witness is not unavailable. However, the First
24 District Court of Appeal in *Grabau v. Department of*
25 *Health* at 816 So.2d 701 declared that provision to be

1 unconstitutional.

2 So the section in the Evidence Code that said
3 that you could have a declarant who's a party be, use
4 his deposition without him being unavailable is
5 unconstitutional, and therefore you can't rely on that
6 provision of the Evidence Code to allow any testimony of
7 a witness who is not unavailable. He's here. If
8 they've got questions, they ought to ask him.

9 **COMMISSIONER EDGAR:** Mr. Sayler, do you have
10 any objection to any of Exhibits 58 through 76 coming
11 into the record at this time as our staff has requested?

12 **MR. SAYLER:** We do have two very minor
13 objections. One is on one portion of Exhibit 70 --
14 well, hold on.

15 Before we get there, my understanding is that
16 Exhibit 64 was withdrawn by staff. Is that correct?
17 Because we did have an objection to that, but I was told
18 that they were withdrawing Exhibit 64.

19 **COMMISSIONER EDGAR:** Ms. Barrera?

20 **MS. BARRERA:** Yes. At this time staff will
21 withdraw Exhibit 64.

22 **MR. FRIEDMAN:** Well, I'd like to have it in
23 there. I propose that it be in there. If we're going
24 to put all the, all the discovery in there, let's be
25 fair about it and put what we, what we want to be in

1 there too. So if they're withdrawing it, then I'm
2 asking that it be in there.

3 **COMMISSIONER EDGAR:** They have requested that
4 it be withdrawn. That's where we are.

5 **MR. FRIEDMAN:** I'm requesting that it be
6 inserted as one of my exhibits then.

7 **COMMISSIONER EDGAR:** Mr. Saylor?

8 **MR. SAYLER:** The reason we have an objection
9 to it is because it is not relevant or material to any
10 issue that has been protested either by the utility or
11 OPC. This is an exhibit that contains some e-mails that
12 the utility obtained through a public records request of
13 our office that detailed some conversations that I've
14 had with customers and other people. We have no problem
15 with the Commission seeing it. We just don't think
16 it's, we don't think it's appropriate for the hearing
17 record in this case because it's not material to any
18 issue that we protested or they've protested, it's
19 outside the scope. And as earlier you said, if it's not
20 relevant to any material issue in the case, then it
21 shouldn't be included in an administrative hearing.

22 **MR. FRIEDMAN:** And my response to that would
23 be that if they're alleging managerial incompetence or
24 mismanagement and they're reciting the same basis that
25 these e-mails are directed to, then it's certainly

1 relevant. If they want to withdraw their objection to
2 any mismanagement by Mr. Brown in dealing with the DEP
3 loan and its financing, then we'll be glad to, to not,
4 to withdraw our request to have those in there.

5 But if they're going to keep continuing to
6 argue that Mr. Brown mismanaged the company, then you
7 need to see the whole picture. And the whole picture is
8 that some of the problems that are being caused are
9 caused because Erik Saylor has been calling and
10 e-mailing the lenders.

11 **COMMISSIONER EDGAR:** Thank you, Mr. Friedman.

12 So at this point from the exhibits marked as
13 staff's cross-examination exhibits, which are 58 through
14 76, we have heard comments and objections on 64, 75, and
15 76. We will take them up individually here in a moment.

16 Mr. Saylor, were there other exhibits?

17 **MR. SAYLER:** Yes, ma'am. For Exhibit 72, we
18 object to the, what was produced as Number 68. Let me
19 make sure that's right.

20 **COMMISSIONER EDGAR:** And, Ms. Helton, I will
21 be looking to you for your opinion, if you have one,
22 when we go through these individually in a moment, just
23 so, so you know that's coming.

24 **MR. SAYLER:** The response to Number 68 was a
25 letter from Ms. Withers to the utility that we just

1 don't think there's any foundation for it being in here.
2 It's our discovery. We asked for proof of that. We
3 think, one, we think it's not necessarily responsive to
4 our discovery. But, two, it's not -- it's just hearsay.
5 It's a letter.

6 Same issue with Exhibit 60 -- or 75. Staff
7 Exhibit Number 2, hearing Exhibit 75, that is a letter
8 from Mr. Seidman to Mr. Friedman as it relates to --

9 **COMMISSIONER EDGAR:** Let me stop you for just
10 a moment. Again, I don't want to throw you by
11 interrupting, but I want to make sure I'm clear. And I
12 don't have the exhibits, I don't have them in front of
13 me at this very moment, but I thought you said 75
14 being a letter from a customer and I have 75 as the
15 deposition of Mr. Brown.

16 **MR. SAYLER:** Sorry. I may have misspoken.
17 Hearing Exhibit Number 75 contains the exhibits to --
18 excuse me. I apologize.

19 **COMMISSIONER EDGAR:** That's okay.

20 **MR. SAYLER:** I'm talking Exhibit 76. Exhibit
21 75 is the deposition of Mr. Brown.

22 **COMMISSIONER EDGAR:** Yes. And 76 are exhibits
23 that, following through with the deposition. Is that --

24 **MR. SAYLER:** Correct. And it's only Exhibit 2
25 of the deposition exhibits to which we would have an

1 objection.

2 **COMMISSIONER EDGAR:** Okay.

3 **MR. SAYLER:** Now if it comes in under one of
4 the grounds of the rules of evidence, it comes in. But
5 we just aren't willing to stipulate to Exhibit 2,
6 hearing Exhibit 76, and we're not willing to stipulate
7 to POD response number 68 of hearing Exhibit 72.

8 **COMMISSIONER EDGAR:** Okay. So just so I am
9 clear, and hopefully we are all on, we are all -- again,
10 Mr. Friedman has objected to 75 and 76. OPC has
11 objected, objected to Exhibit 2 of Exhibit 76, and also
12 Exhibit 64, 68, and a portion of 72. Is that accurate,
13 Mr. Sayler?

14 **MR. SAYLER:** No. I apologize. We, we
15 objected to hearing Exhibit Number 64 on page 6 of the
16 Comprehensive Exhibit List.

17 **COMMISSIONER EDGAR:** Yes.

18 **MR. SAYLER:** And we shared our objections with
19 staff prior to -- this morning and they said that they
20 would withdraw that.

21 **COMMISSIONER EDGAR:** They would withdraw it.
22 But Mr. Friedman has, has opposed that withdrawal and
23 perhaps may offer it.

24 **MR. SAYLER:** And if he would like to
25 potentially try to introduce that somehow through

1 another basis during the hearing through
2 cross-examination of a witness or something like that,
3 under the rules of evidence and administrative procedure
4 he can certainly try to do that. Our office just cannot
5 stipulate to an issue that is not relevant or protested
6 by any of the parties.

7 Now with regard to Exhibit 68, I made a
8 mistake. We can stipulate to the entirety of staff
9 Exhibit 68.

10 **COMMISSIONER EDGAR:** Okay. And you did not
11 have a concern on 68; is that correct, Mr. Friedman?

12 **MR. FRIEDMAN:** I did not have a concern with
13 68, but certainly I would like an opportunity to comment
14 on --

15 **COMMISSIONER EDGAR:** 64?

16 **MR. FRIEDMAN:** -- 64. Right. Right. When
17 counsel --

18 **COMMISSIONER EDGAR:** You will have it. I just
19 want to make sure I've got my numbers accurate. Okay.

20 Mr. Saylor.

21 **MR. SAYLER:** And then for hearing Exhibit
22 Number 72, it contains four POD responses. One of them
23 is response to OPC POD Number 68. We object to the
24 response as being just a hearsay letter.

25 **COMMISSIONER EDGAR:** Okay.

1 **MS. HELTON:** Madam Chairman, may I ask what
2 Bate stamp numbers those are?

3 **COMMISSIONER EDGAR:** You can ask, and I hope
4 somebody can tell us.

5 **MS. BARRERA:** For the Exhibit 72, the Bate
6 stamp numbers are 00439 and 00440.

7 **COMMISSIONER EDGAR:** Ms. Helton.

8 **MS. HELTON:** Thank you. That helps me
9 pinpoint what it is.

10 **COMMISSIONER EDGAR:** Okay. And, Mr. Sayler,
11 anything --

12 **MR. SAYLER:** No. I was just going to say for
13 hearing Exhibit 76, the Bate stamp page number for
14 Exhibit 2 is hearing exhibit 00567 and 00568.

15 **COMMISSIONER EDGAR:** Thank you. Okay. Then
16 so we're in, I hope, I believe, the correct posture
17 procedurally.

18 I am going to at this time go ahead and enter
19 into the record all exhibits from 58 through 76, except
20 64, 72, 75, and 76, which we will take up individually.

21 **MR. FRIEDMAN:** Can you read that a little bit
22 slower? I apologize.

23 **COMMISSIONER EDGAR:** I'll try. Yes. All
24 exhibits marked 58 through 76, except 64, 72, 75, and
25 76, are entered into the record at this time, and we

1 will take up these four exhibits individually so that we
2 can address the objections that have been raised.

3 (Exhibits 2 through 88 marked for
4 identification.)

5 (Exhibits 58, 59, 60, 61, 62, 63, 65, 66, 67,
6 68, 69, 70, 71, 73 and 74 admitted into the record.)

7 Now, Ms. Helton, we can go a couple of
8 different ways. We can address those objections now, we
9 can leave those objections pending and proceed, or we
10 can give you just a minute or two and come, come back to
11 those. Do you have a preference?

12 **MS. HELTON:** Do you mind if I ask a couple of
13 questions? If we could have staff, since these are
14 exhibits that staff has proposed that they be stipulated
15 into the record -- I unfortunately in my set of exhibits
16 don't have the copies for Exhibit Number 64. Maybe
17 that's because there was a discussion about not
18 including them.

19 **COMMISSIONER EDGAR:** We've got a lot of paper
20 here. This is what I'm going to propose. Let me know
21 if there is a problem with this. I do want to keep us
22 moving. We have a lot of ground to cover. So what I
23 would propose is that we leave the motion to enter these
24 four into the record pending, along with the objections
25 which will remain pending as well. We will take a lunch

1 break. And, Ms. Helton, if I may ask you to get with,
2 with our staff and your staff and the parties, if that
3 would be useful, at the lunch break. And then we can
4 take up those objections and that motion when we return
5 from the lunch break approximately 2:00. But I think
6 that will allow us to go into testimony and keep moving.
7 Does that work for you?

8 **MS. HELTON:** That works for me. But with your
9 indulgence --

10 **COMMISSIONER EDGAR:** Yes. Absolutely.

11 **MS. HELTON:** -- if I could ask one more, one
12 more question, and that is directed to Mr. Friedman. Is
13 Mr. Brown being presented as an expert witness in this
14 proceeding?

15 **MR. FRIEDMAN:** No.

16 **MS. HELTON:** No? He's, he's purely a fact
17 witness.

18 **MR. FRIEDMAN:** Absolutely.

19 **COMMISSIONER EDGAR:** Okay? Okay. Any
20 problems with proceeding and we'll address these when we
21 come back from lunch?

22 Okay. Then any other preliminary matters or
23 matters related to exhibits?

24 **MS. BARRERA:** No, Commissioner.

25 **COMMISSIONER EDGAR:** Okay. Let me make sure

1 if we've got anything else.

2 Are we ready to proceed to witnesses, who will
3 need to be sworn in of course? Anything before we do
4 that?

5 Okay. Then I would ask all witnesses who are
6 going to be called to testify in this matter who are
7 present now, stand with me and we will swear you in as a
8 group.

9 (Witnesses collectively sworn.)

10 Thank you very much. Have a seat.

11 Mr. Friedman, you may call your first witness.

12 **MR. FRIEDMAN:** Is this the appropriate time
13 to -- we had produced a witness, Mr. Guastella, who, who
14 had presented both direct and rebuttal testimony, and my
15 understanding is, is that none of the parties had any
16 questions.

17 **COMMISSIONER EDGAR:** My understanding is that
18 there has been agreement amongst the parties to enter
19 Mr. Guastella's direct and rebuttal testimony into the
20 record. Is there any objection to that?

21 Commissioners, are you comfortable with that?
22 Okay. We could that now or we could do it when we come
23 to him. It's fine with me to go ahead and do it now,
24 and I see no objection.

25 So with that, Mr. Guastella's direct and

1 rebuttal prefiled testimony is entered into the record.
2 And help me here, Mr. Friedman. Were there exhibits
3 attached that also need to be entered with that?

4 **MR. FRIEDMAN:** I think there is at least one.
5 I'm sure he's got his -- his resumé, I'm sure, is in
6 there.

7 **COMMISSIONER EDGAR:** Right. And I now have, I
8 think, the appropriate paper in front of me. So that
9 would be Exhibit 10 on direct, which, seeing no
10 objection, we will enter at this time. And is there any
11 on rebuttal?

12 **MR. FRIEDMAN:** I don't think he had any on
13 rebuttal, no.

14 **MS. BARRERA:** No.

15 **COMMISSIONER EDGAR:** Okay. Then with that,
16 Mr. Friedman, I think that takes care of Mr. Guastella.

17 (Exhibit 10 admitted into the record.)
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19
20
21
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25

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

2 A. John F. Guastella, Guastella Associates, LLC, 6 Beacon Street, Suite 200, Boston, MA
3 02108.

4 **Q. By who are you employed?**

5 A. I am President of Guastella Associates, LLC.

6 **Q. Please describe Guastella Associates, LLC.**

7 A. Guastella Associates, LLC provides utility management, valuation and rate consulting
8 services to both regulated and unregulated utilities.

9 **Q. Please briefly describe your professional experience.**

10 A. I have been involved in investor-owned and municipal utility rate and regulatory matters
11 since 1962 -- for 16 years with a regulatory agency and since 1978 as a consultant.

12 **Q. Have you attached to this testimony a summary statement of your qualifications and
13 experience?**

14 A. Yes, a statement of my qualifications and experience is contained in Exhibit JG-1

15 **Q. What is the nature of your involvement in this proceeding?**

16 A. Guastella Associates, LLC has been employed by the Water Management Services, Inc
17 (the "Company" or "WMSI") in connection with the filing of additional testimony in PSC
18 Docket No. 110200-WU. More specifically, I was asked to comment with respect to
19 working capital and the salary of WMSI's President. In addition, I was asked to be
20 available to respond to issues addressed by other parties, if necessary.

21 **Q. Have you reviewed Order No. PSC-12-0435-WU (the "Order") issued August 22,
22 2012 with respect to the president's salary and the working capital?**

23 A. Yes

24 **Q. What is the Commission's explanation for its 15 percent reduction of the president's
25 salary?**

1 A. The discussion leading to the Commission's conclusion to make a 15 percent reduction to
2 the
3 president's salary begins on page 25 of its Order, with a discussion about cash flow.
4 The discussion focusses on the WMSI's loan agreement with DEP which has been
5 extended on at least four occasions, and that the recent extension of the 20 year term of
6 the loan by 10 years will increase interest by approximately \$928,071. The Order states
7 on page 27:

8 "The above-noted actions of the Utility President appear to result in
9 additional costs over the term of the DEP loan of approximately \$928,071.
10 We do not believe that the customers should be required to pay all these
11 additional costs. Given the actions of the Utility's President, we find the
12 allowance for the Utility President's salary shall be reduced by 15 percent,
13 which results in a reduction of \$14,438. Accordingly, corresponding
14 adjustments shall be made to reduce the allowance for the pensions and
15 benefits expense and payroll taxes by \$3,504 and \$1,104, respectively, for a
16 total adjustment of \$19,046. We believe this adjustment is consistent with our
17 prior decisions wherein we have reduced the president's salary."

18 It is simply not correct that the customers have or will pay for the additional costs of
19 \$928,071 related to the extension of the DEP loan. This same mistake is made on
20 page 26 of the Order where it states:

21 "WMSI's approved rates include funds for debt service costs"

22 The traditional rate base/rate of return method used by the Commission, which is
23 typical in all state regulatory jurisdictions, does not include "debt service" in
24 calculating the allowable revenue requirement. Instead, the allowed capital costs are
25 depreciation expense and return on investment. Debt service is comprised of

1 principal and interest on a loan based on the term of the loan. The depreciation
2 allowance is the recovery of the cost of the physical used and useful assets over their
3 average service life, not over the term of the loan that is the basis for principal
4 payments. It simply does not matter in
5 terms of the establishing of utility rates whether the term of the loan is 10, 20, or 30
6 years, because the depreciation allowance does not change with the term of the loan.
7 Similarly, the rate of return allowed for rate setting is based on the weighted cost of
8 capital, applied to the allowed net investment assets - - and that allowed return does
9 not change if the term of the loan is extended. In this case, for example, the
10 Commission determined the revenue requirement by allowing depreciation (not
11 principal payments) and return on net investment based on the weighted cost of
12 capital. There was no change in that return allowance based on the change in debt
13 service resulting from the 10-year extension of the loan. Accordingly, the actions of
14 WMSI's President did not result in any increase of the rates that the customers will
15 pay, and in my opinion the extension of the term of the DEP loan is not a basis for a
16 penalty in terms of a reduction of his salary. I would add that the President's success
17 in obtaining financing for a utility with significant cash flow problems, no equity,
18 and negative retained earnings, is an accomplishment that was in the best interests of
19 the customers in order to make the improvements necessary to continue to provide
20 adequate service.

21 **Q. The Order makes no allowance for working capital, as discussed on pages 16**
22 **and 17. In your opinion, is no working capital allowance appropriate for**
23 **WMSI?**

24 **A.** No. It seems, however, that the Commission recognizes the difficulty of applying the
25 balance sheet approach to working capital because it does not produce a typical

1 result. The Order states:

2 "The summation of our adjustments results in a negative working capital
3 allowance of \$122,445. A negative working capital balance is not typical of a
4 "normal" utility or the expected future condition of a utility. Therefore,
5 consistent with our practice, the working capital allowance shall be set at
6 zero, which results in a reduction in the Utility's working capital allowance of
7 \$39,885."

8 In my opinion, instead of allowing zero because the balance sheet approach produces
9 questionable results, a more representative analysis is required. WMSI is typical of
10 the hundreds of developer related utilities that I have either regulated or provided
11 consulting services. Because developer-related utilities begin with no customers and
12 no revenues, the affiliated developer and/or the stockholders provide all the capital
13 for funding the assets, and they also pay for the operations during the growth years.
14 Eventually, as customers are added, the operating expenses are covered by the rate
15 revenues, and then the utility begins to earn a return on the used and useful net
16 investment in the assets. During this entire growth period, the costs and lack of
17 recovery of capital costs are absorbed by the stockholders - - and never passed on to
18 the customers either retroactively or prospectively. Aside from the accounting that
19 would properly depict this financing resulting - - a subject for another discussion - -
20 the need for and the costs associated with working capital are real.

21 **Q. What are the indicators for WMSI that reflect your analysis?**

22 A. WMSI has a significant level of negative retained earnings, reflecting years of under
23 earnings. The capital structure and overall rate of return has no equity and, therefore,
24 no debt coverage allowance.

25 There is no income tax allowance and, therefore, no cushion to cover a penny of

1 actual expenses above the allowed level. When there are income tax allowances,
2 expense increases above allowed levels are at least tempered by a reduction in taxes
3 due to the higher tax deduction. Without analyzing the reasonableness of the total of
4 \$128,873 of adjustments to operation and maintenance expenses, it seems that the
5 level of allowed expenses essentially reflects a perfectly cost efficient operation. For
6 example, the accepted staff audit adjustments include a \$15 adjustment because of
7 "insufficient support" and another adjustment for 1 hour of a legal fee. While I do not
8 argue the
9 reasonableness of these adjustments, clearly there was no apparent allowance for any
10 imperfection. The point is that future actual expenses may likely not be limited to
11 those allowed. With no equity allowance, no operating margin, and no income tax
12 allowances, any increase in expenses above the level allowed will require the
13 stockholder to subsidize the actual costs - - a stockholder for which no return has
14 been allowed.

15 **Q. What should be the basis for the working capital allowance?**

16 A. The working capital allowance should be based on the one-eighth fraction applied to
17 the adjusted operation and maintenance expenses. It seems that the Commission has
18 recognized that although WMSI has become a Class A utility, it has yet to become a
19 typical utility in terms of its financial position and cash flow. It is my opinion that the
20 Commission's move from a negative working capital to a zero allowance does not
21 adequately reflect the amount of the actual working capital requirement.

22 **Q. Does that conclude your testimony at this time?**

23 A. Yes.

24

25

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

2 A. My name is John F. Guastella. My business address is 133 Mystic Lane, Jupiter, FL
3 33458

4 **Q. By whom are you employed and what is your position?**

5 A. I am President of Guastella Associates, LLC.

6 **Q. Have you previously submitted direct testimony in connection with this docket?**

7 A. Yes.

8 **Q. Have you reviewed the testimonies of Debra M Dobiac on behalf of the Staff of the
9 Public Service Commission, and Denise N. Vandiver and Helmuth Schultz III on
10 behalf of the Office of Public Counsel?**

11 A. Yes.

12 **Q. What is the purpose of your testimony?**

13 A. The purpose of my testimony is to rebut certain issues raised by these witnesses.

14 **Q. Ms. Dobiac's entire testimony concerns Account 123 and most of Mr. Schultz's
15 testimony also concerns Account 123. Do you have any general comments
16 regarding the testimony of Ms. Dobiac and Mr. Schultz that addresses Account
17 123?**

18 A. Yes. There is nothing in their testimony that would support any adjustment to the water
19 rates and revenue requirement established by the Commission in its Order No. PSC-12-
20 0435-PAA-WU, issued August 22, 2012, and they make no specific adjustment to any
21 component of revenue requirement. I have also reviewed Mr. Gene Brown's testimony
22 that rebuts the findings of Ms. Dobiac and Mr. Schultz, and find it to be an accurate
23 analysis not only of the specific amounts in Account 123 but also of the overall funding
24 of WMSI's assets and operations. Mr. Brown describes how he and related entities
25 supported and subsidized the assets and operation of WMSI, which is typical of newly

1 formed and developing water utilities. I would also point out that the Commission's rate
2 setting methodology assures that the customers only pay for the water they receive on the
3 basis of the allowable cost of providing water service, completely unaffected by Account
4 123 or other funding by stockholders or related entities.

5 **Q. Would you explain what you mean by typical newly formed water utilities?**

6 A. As I explained in my direct testimony in this case, when a new water utility is formed it
7 has no customers, no assets and no revenues. Its stockholders and/or related entities must
8 provide funding for planning, design, permitting and construction of a water utility
9 system capable of providing water service that meets environmental requirements. Even
10 after the water system begins adding customers, the first customers, and those added
11 during most of the growth years, do not provide enough revenues to cover all operating
12 expenses. Accordingly, during that growth period the stockholders and related entities
13 that funded the water utility physical assets do not earn any return on their investments,
14 and they also subsidized the operating expenses. Eventually, the revenues from
15 customers will cover operating expenses, and the utility will begin to earn a return on
16 investment. Thus, the utility, not the customers, paid for the water system assets with
17 funds provided by stockholders and/or related entities, not by the customers. Moreover,
18 the unavoidable deficit operations during the growth years were subsidized by the
19 stockholders and/or related entities, not the customers.

20 **Q. What do the customers of newly formed and growing water utilities pay for, and**
21 **how much?**

22 A. The customers pay for the water they receive through rates approved by the regulatory
23 agency. The water rates are based on costs that include a proportionate amount of
24 operation and maintenance expenses, depreciation on non-contributed plant, taxes and a
25 return on the used and useful, non-contributed net investment.

1 **Q. Why do you state a “proportionate” amount?**

2 A. Regulatory agencies set initial water rates so that during the growth years the first
3 customers will not pay for the entire cost of operations. It is only after a substantial
4 complement of customers have been added that rates begin to cover the full cost of
5 operations, and then only for used and useful plant.

6 **Q. Why is the historical development of new water utilities and the Commission’s rate
7 setting methodology significant with respect to Account 123 and other
8 intercompany accounts?**

9 As stated above, the Commission sets rates that cover:

- 10 1) operation and maintenance expenses, with no extra allowance for payments to
11 stockholders or related entities.
- 12 2) annual depreciation that recovers the non-contributed original cost of the
13 depreciable assets, with no extra allowance for payments to stockholders or
14 related entities.
- 15 3) taxes, with no extra allowance for stockholders or related entities, and
- 16 4) return on rate base, with no extra allowance for payments to stockholders and
17 related entities. Note that the return or net operating income is based on the cost
18 of capital or rate of return applied to rate base funded by the stockholders or debt
19 financing, with no extra allowance for payments of an intercompany account.

20 Neither Ms. Dobiac nor Mr. Schultz proposes a specific adjustment to Commissions
21 approved revenue requirement components, because they can’t - - no revenue
22 requirement component is impacted by Account 123.

23 **Q. If there is no possible way the entries reflected in Account 123 have adversely
24 impacted the water rates approved by the Commission, what useful information is
25 provided by such an audit?**

1 A. None in terms of rate setting. It was also unnecessary in order to assure the Commission
2 that the customers only paid for the cost of providing water service, and the stockholders
3 and related entities funded the creation and cost of operation of the WMSI over the years,
4 costs that were not covered by the water rates. The Commission obviously knows that in
5 approving WMSI's water rates, it did not add extra payments to the stockholder. WMSI's
6 2011 annual report to the Commission shows negative equity of \$2.6 million that shows
7 that the rates paid by the customers over the years did not cover the full cost of
8 operations. Clearly, therefore, the stockholders and related entities subsidized the
9 provision of water service. Thus, just as Mr. Brown states in his rebuttal testimony and as
10 contained in his August 1, 2012 report to the Commission, whatever payments were
11 made to the stockholder or related entities, they were not made by the customers but from
12 advances of the stockholders and related entities. In other words, the net flow of funds
13 has been to WMSI from the stockholders and other related entities, not from WMSI's
14 customers to them.

15 Q. **On page 21 of his testimony, Mr. Schultz states: "However, WMSI's advancing**
16 **funds to other entities does not provide a benefit to WMSI or ratepayers unless the**
17 **return earned on those advances reduces the cost of service. I have not seen any**
18 **evidence where there was a return from these advances that reduced the cost of**
19 **service. The advances made have already increased costs for WMSI. There is also**
20 **the possibility that advancing this large amount of money to these Company**
21 **affiliates could potentially cause harm to ratepayers." Would you please comment**
22 **on these statements?**

23 A. As demonstrated by Mr. Brown's and my rebuttal testimony, funds advanced to other
24 entities did not come from rate revenues from customers, but instead from the
25 stockholders and related entities. As a reminder, the water rates set by the Commission

1 for WMSI only included revenue requirement components reflecting allowable costs,
2 with nothing extra to pay the stockholders or related entities. Another significant error is
3 Mr. Schultz's proposition that if the funds of other entities generate earnings, those
4 earnings should be used to reduce the cost of service. To be clear, the Commission
5 cannot reduce the cost of service with earnings of stockholders or related entities' money.
6 What Mr. Schultz is actually telling the Commission is to have the stockholders or
7 related entities subsidize the cost of service by using earnings on their money, which in
8 my opinion would be confiscation of property. Mr. Schultz is also wrong when he states
9 that the advances made have already increased costs for WMSI. The advances did not
10 increase the rate base, or the operation and maintenance expenses, or the taxes or the
11 return on investment, all as allowed by the Commission.

12 **Q. Mr. Schultz states that advances could potentially harm the ratepayers because**
13 **there would be fewer funds available to pay the cost of day-to-day operations and**
14 **more debt. Would you first comment on the funds available to pay day-to-day**
15 **operations?**

16 **A.** Yes. This "potential harm" scenario seems to be a continuing result of Mr. Schultz's
17 failure to understand that the advances could not possibly have come from the customers
18 because the rates approved by the Commission do not include anything extra above the
19 allowed revenue requirement components. Moreover, the allowed revenue requirement
20 included operation and maintenance expenses for the day-to-day operations. On the
21 other hand, if Mr. Schultz recognizes that there is a need for cash working capital, he
22 should be recommending that the allowed rates be increased. On the contrary, later in his
23 testimony Mr. Schultz recommends no working capital - - because he believes that the
24 investor funds do not exist where equity is negative. What he fails to recognize is that the
25 lead/lag between expenses and revenues is real, which creates a real need for working

1 capital. The cost of working capital will be absorbed by the stockholders since it is not
2 being reflected in the allowed rates. My previously submitted direct testimony contains
3 my recommendations regarding working capital.

4 **Q. Would you comment on Mr. Schultz's testimony regarding debt and in particular**
5 **the DEP loan?**

6 A. My direct testimony addresses the extensions of the DEP loan in the context of the
7 adjustment the Commission made to the salary of WMSI's president. I pointed out that
8 the reason the Commission gave for adjusting the president's salary, namely that the
9 customers should not be required to pay the additional interest costs, was incorrect
10 because the added interest over an extended term of the DEP loan is not passed on to the
11 customers - - the customers only pay a return on rate base which does not include interest
12 on the DEP loan. Mr. Schultz does not refer to my direct testimony so I didn't know if he
13 read it, or if he did, it suited his purpose to ignore it. In any event, the extension of the
14 DEP loan provided a lower cost of capital and, therefore, rate of return - - a benefit to the
15 customer - - while having no adverse impact on the water rates. Thus, Mr. Schultz's
16 testimony regarding the DEP loan is meaningless in terms of rate setting. In this context,
17 Mr. Shultz thinks the reduction in the president's salary is appropriate, because of the
18 reasons put forward in Staff's PAA recommendations. Mr. Shultz should, however, have
19 had the expertise to know on his own that the extension of the DEP loan and total related
20 interest does not and will not adversely affect the water rates. Moreover, had Mr. Schultz
21 bothered to make a fair assessment of the WMSI's president, he would have noted Mr.
22 Brown's excellent qualifications; his ability to successfully operate a small water utility
23 for 38 years; his ability to obtain financing despite the fact that the Commission's water
24 rate policies, although equitable from an intergenerational perspective, produce
25 unavoidable deficit operations that make it difficult, at best, to attract capital and not on

1 the strength of the utility's own financial condition but only with the assistance of the
2 stockholders and related entities; he should have mentioned that the overall cost of
3 capital or rate of return allowed WMSI by the Commission is remarkably low; and he
4 would have at least mentioned that the Commission has found that the water service and
5 customer service are satisfactory. On the basis of my experience in the regulation of
6 hundreds of small water utilities and consulting for hundreds more, Mr. Brown should be
7 complimented for an outstanding job against all odds.

8 **Q. Would you comment on Mr. Schultz's testimony that "there may be a going concern
9 issue?"**

10 A. Yes. Mr. Schultz's concern is based on his conjecture about going concern, instead of
11 historical reality. As stated in its August 22, 2012, Order, the Commission found that
12 WMSI's overall quality of service is satisfactory; the water system is in compliance with
13 rules and regulations of DEP and the WMD; WMSI is addressing needed improvements;
14 the quality of product and operational condition of facilities is satisfactory; it appears to
15 be actively involved in maintaining good service to its customers; and its attempts to
16 address customers satisfaction are satisfactory. The utility has been providing water
17 service for 38 years, despite the unavoidable need to subsidize its operation. Its
18 management has also been able to attract financing and at low cost rates, even though it
19 has been negative retained earnings.

20 **Q. Is there another aspect to the potential issue of going concern for water utilities?**

21 A. Yes. Mr. Schultz questions the negative equity and magnitude of debt relative to net
22 investment. He apparently doesn't understand or has never considered the financial
23 reality of the Commission's policy regarding the water utilities. As I previously
24 described, the Commission sets initial rates for newly formed water utilities and rates
25 during growth years so that the partial complement of customers will not pay for the full

1 cost of service. This policy, which is proper, requires stockholders or related entities to
2 subsidize the cost of service - - primarily through "used and useful" allowances. The
3 result is an accumulation of negative retained earnings, with the earnings limited to rate
4 base, not the full investment in the utility system. While this financial result may appear
5 to be going concern issue, it is actually a reflection of a rate setting policy to protect
6 customers from paying more than the proportionate share of the cost of service.
7 Knowingly or not, Mr. Schultz takes the financial results of a Commission policy to
8 protect the customers - - with which WMSI must comply like every other water utility - -
9 and unfairly use it to suggest a potential going concern problem.

10 **Q. Do you agree with Ms. Vandiver's recommendations regarding rate case expenses?**

11 A. No. Rate case expenses are an unavoidable cost of providing service and in my opinion
12 failure to allow such costs would be contrary to the legal guidepost decision of the
13 Supreme Court, Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591
14 which states that it is important that there be enough revenues not only for operating
15 expenses but also for the capital costs of the business. Mr. Brown's testimony on this
16 issue is compelling, especially in light of the issues raised in Mr. Schultz's testimony
17 regarding Account 123. More precisely, it should have been obvious to anyone with
18 utility rate setting experience that the rates set by the Commission for WMSI did not
19 include extra amounts for payments to the stockholder or related entities, regardless of
20 differing opinions about accounting for advances. It should be obvious to anyone with
21 experience as to the Commission's rate setting policy regarding water utilities that
22 subsidies by the stockholders is a requirement established to protect the customers. It
23 should be obvious that the extension of the DEP loan did not add a penny to WMSI's
24 revenue requirement. It should be obvious that the president and his management has
25 successfully operated WMSI for 38 years; the service provided has been satisfactory in

1 every respect; the water the cost of operations has been subsidized as evidenced by the
2 negative retained earnings; and he has not only obtained capital for improvements but the
3 cost of capital is as low as possible. Yet, WMSI has had to incur rate case costs for
4 “issues” that did not need a formal proceeding to address. It would be particularly
5 unreasonable to disallow rate case expenses under these circumstances.

6 **Q. Do you have any general comments with respect to the Service Availability Charge**
7 **(“SAC”) issue?**

8 A. Yes. It is my understanding that the purpose of the Commission’s service availability
9 policy is to balance the rates paid by existing customers and the charges to new
10 customers, and that the SAC will enable the utility to have sufficient capital in the form
11 of CIAC and to help attract additional capital despite earnings limited to a reduced rate
12 base. The projections of the net investment and capacity component of the calculation of
13 the SAC is typically speculative to some extent, and that should not be a reason to reduce
14 the allowable SAC, particularly for a utility with a relative large plant cost in relation to
15 rate base.

16 **Q. Does that conclude your testimony at this time?**

17 A. Yes.

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1 **MR. FRIEDMAN:** Okay. Thank you. And our
2 other witness on direct is Ms. Jeanne Allen.

3 **COMMISSIONER EDGAR:** Then she may come forward
4 at this time.

5 Ms. Allen, right there, please.

6 And I understand that the Prehearing Order
7 gives five minutes, a maximum of five minutes per
8 witness summary, and we'll ask all of the witnesses to
9 stick to that five minutes. Mr. Friedman.

10 **MR. FRIEDMAN:** Thank you.

11 Whereupon,

12 **JEANNE ALLEN**

13 was called as a witness on behalf of Water Management
14 Services, Inc., and, having been duly sworn, testified
15 as follows:

16 **EXAMINATION**

17 **BY MR. FRIEDMAN:**

18 **Q** Would you please state your name?

19 **A** Jeanne Clark Allen.

20 **Q** And, Ms. Allen --

21 **MR. FRIEDMAN:** Did you want me to go ahead and
22 do both? We originally said we didn't want to do both
23 direct and rebuttal at the time same. However, I think
24 that if we do that, then Ms., Ms. Allen probably won't
25 have to stay tonight and we can avoid another, a day of

1 having her here. So if I can change my mind?

2 **COMMISSIONER EDGAR:** Well, let's, let's see.
3 I'm open to the possibility.

4 Mr. Sayler, does that cause you any concern?

5 **MR. SAYLER:** No, ma'am, it doesn't. And I'm
6 prepared to do both at the same.

7 **COMMISSIONER EDGAR:** Okay. And our staff on
8 cross?

9 **MS. BARRERA:** That's fine with us.

10 **COMMISSIONER EDGAR:** Okay. Commissioners, any
11 concern with that?

12 **COMMISSIONER BROWN:** That's great.

13 **MR. FRIEDMAN:** Thank you.

14 **COMMISSIONER EDGAR:** Okay. Then do your
15 thing, and we will look to Ms. Allen for her summary,
16 and then also at the appropriate time the opportunity to
17 receive questions on cross on both direct and rebuttal.

18 **BY MR. FRIEDMAN:**

19 **Q** Okay. Ms. Allen, did you prepare prefiled
20 direct testimony in this case?

21 **A** Yes, I did.

22 **Q** And along with that testimony are there eight
23 exhibits?

24 **A** I believe that's correct. That sounds
25 correct.

1 **COMMISSIONER EDGAR:** Can you pull it a little
2 closer to you? Mr. Durbin can help, if you, if you need
3 it. Just a little closer.

4 **THE WITNESS:** I think that's correct.

5 **COMMISSIONER EDGAR:** You have to speak -- pull
6 it closer. Yeah. I'm sorry.

7 **BY MR. FRIEDMAN:**

8 **Q** And did you prefile rebuttal testimony as
9 well?

10 **A** Yes, I did.

11 **Q** And I don't believe there were any exhibits
12 with your rebuttal testimony.

13 **A** That's correct.

14 **Q** Okay. And if I asked you the questions in
15 your direct and rebuttal testimony, would your answers
16 be the same?

17 **A** Yes.

18 **Q** Do you have any corrections or additions to
19 your testimony?

20 **A** No.

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1 Q. **Please state your, name profession and address.**

2 A. My name is Jeanne Allen. I am an Audit Partner with the accounting firm, Law, Redd, Crona
3 and Munroe, P.A. My address is 2075 Centre Pointe Blvd., Tallahassee, FL 32308.

4 Q. **State briefly your educational background and experience.**

5 A. I am a Certified Public Accountant, licensed in the state of Florida. I have a Bachelor of Science
6 degree, in Accounting and Finance, from The Florida State University. I have over 18 years
7 experience providing auditing, accounting, consulting and analysis services to various entities,
8 including governmental, not-for-profit and for-profit companies in a variety of industries. My
9 experience includes 3 years working as a Regulatory Analyst with the Florida Public Service
10 Commission, where I participated directly in water and wastewater rate case proceedings for
11 Class A and B utilities.

12 Q. **On whose behalf are you presenting this testimony?**

13 A. I am presenting this testimony and appearing on behalf of Water Management Services, Inc.
14 (WMS), the applicant for rate increase in the present docket.

15 Q. **What is the purpose of your direct testimony?**

16 A. The purpose of my direct testimony is to present information supporting the factual basis for
17 WMS' request to increase its rates and charges as originally presented in the MFRs in the PAA
18 filing, to provide supporting schedules to show the basis for the requested service availability
19 charges and to provide information supporting the utility's cross petition filed in response to
20 OPC.

21 Q. **Are you sponsoring any exhibits?**

22 A. Yes, I am sponsoring eight exhibits. Exhibit JA-1 is a summary of my education, experience and
23 professional affiliations. Exhibit JA-2 contains select pages from MFR Volume I – Financial,
24 Rate and Engineering as originally filed in the PAA case, with certain schedules labeled as
25 revised 1/7/2012 and 2/14/2012, as applicable. Exhibit JA-3 contains the schedules supporting

1 the basis for the originally requested revisions to the service availability charges. Exhibit JA-4
2 is a schedule supporting the utility's requested adjustment to working capital allowance.
3 Exhibit JA-5 is a schedule supporting the utility's requested adjustment to contractual services
4 – accounting. Exhibit JA-6 is a schedule supporting the Utility's requested adjustment to
5 transportation expenses. Exhibit JA-7 is supporting documentation for the utility's requested
6 adjustment to miscellaneous expenses. Finally, Exhibit JA-8 is a schedule and documentation
7 supporting the appropriate amount of rate case expense for the Formal Administrative
8 Proceeding.

9 **Q. Did the utility propose any changes in its Service Availability Charges?**

10 A. Yes. Analysis of WMS's ratio of net Contributions in Aid of Construction (CIAC) to net plant
11 indicated that with present CIAC charges and no additions to plant, the ratio is currently only
12 35%. After the proposed additions to plant, that ratio will drop to 24.9% at design capacity.
13 The current charges are \$1,620 composed of a Plant Capacity Charge of \$845, a Main
14 Extension Charge of \$525 and a Meter Installation Fee of \$250. In the PAA filing, the utility
15 proposed that the charge be increased to \$10,004.47, with the Plant Capacity Charge
16 increasing to \$9,079.47, the Meter Installation Fee to increase to \$400 and the Main Extension
17 Charge to remain unchanged. This would result in the net CIAC to net Plant ratio reaching 75%
18 at design capacity. The increased level of CIAC will have a mitigating effect on monthly service
19 rates to existing and future customers. The development of the proposed Service Availability
20 Charges and other supporting documentation required by Rule 25-30.565, Florida
21 Administrative Code, are found in Exhibit JA-3.

22 **Q. Do you agree with the adjustments made by the PSC in Order No. PSC-12-0435-PAA-WU?**

23 A. No, I do not agree with all of the adjustments made by the PSC.

24 **Q. Which of the PSC adjustments are you taking issue with?**

25 A. As raised in the Utility's Cross Petition filed on September 19, 2012, the working capital

1 allowance is understated, the weighted cost of capital is understated, certain expenses are
2 understated, including accounting services, transportation, miscellaneous and salaries
3 expenses, and service availability charges are understated.

4 **Q. What is the appropriate working capital allowance?**

5 A. The Utility's working capital allowance should be \$129,873, as show in Exhibit JA-4. In the
6 original MFR filing on Schedule A-17, the Utility reflected a working capital allowance of
7 \$39,885 using the balance sheet approach. After applying adjustments to the components of
8 working capital, the PSC calculated a negative working capital allowance. On page 16 of the
9 PAA Order, the PSC acknowledges that "a negative working capital balance is not typical of a
10 'normal' utility or the expected future condition of a utility," and then set working capital
11 allowance at zero, citing prior cases as Commission practice. Any normal, viable company
12 needs to have adequate working capital to be able to pay its current liabilities as they come
13 due. Given that the Utility is in loss position and is not earning a fair rate of return on its
14 investment, it seems that the PSC's practice to adjust from a negative to a zero working capital
15 allowance perpetuates the problem for this and other utilities in a similar negative working
16 capital position. If there is no component for working capital factored into rate base, how is
17 the Utility ever supposed to recover this element from rates and turn the situation around?
18 The Utility is proposing the application of the methodology afforded to Class B & C utilities by
19 calculating the working capital allowance at 1/8 of Operation and Maintenance Expenses.
20 Exhibit JA-4 supports the calculation for a working capital allowance of \$129,873.

21 **Q. What is the appropriate weighted average cost of capital?**

22 A. The appropriate weighted average cost of capital is 5.96% as shown on Schedule D-1 of the
23 MFRs. On page 17 of the PAA Order, the PSC reduced the weighted average cost of capital
24 from 5.96% to 4.44%. The PSC's calculation of the interest rate on the Centennial Bank loan
25 that was refinanced on June 14, 2012 is reflecting an interest rate of 6.5% per the newly

1 refinanced agreement. The PAA Order states that the previous interest rate on the loan was
2 8.46%. However, this is incorrect. The interest rate prior to the June 2012 refinancing was
3 prime plus 1%, or 4.25%. The refinanced rate of 6.5%, which was anticipated at the time the
4 MFRs were filed, is accurately reflected in the interest cost on Schedule D-5 of the MFRs,
5 whereas the 8.46% rate actually represents the effective cost rate when applying the 6.5%
6 refinanced rate, including the cost of life insurance that is required collateral on this loan. The
7 annual premium cost of \$39,258 for the life insurance is factored into the cost of capital on
8 Schedule D-1. There were also closing costs and points of \$6,893 that were not included in the
9 MFR filing, increase the cost. Accordingly, the correct weighted average cost of capital should
10 be 5.96% as shown in the Utility's original filing, trued up for the additional closing costs.

11 **Q. Should any adjustments be made to contractual services – accounting expense?**

12 A. Yes. Contractual Services – Accounting should be increased by \$1,585 for total expenses of
13 \$5,252, as shown in Exhibit JA-5. In the previous rate case, the PSC approved amount for
14 normal recurring accounting expense was calculated by applying the 5-year average of actual
15 expenses from 2005 through the 2009 test year in that case, which resulted in expenses of
16 \$3,667. Test year accounting expenses in the current docket were \$9,550. Rather than
17 applying the same methodology used in the previous rate case, the PSC approved the same
18 dollar amount (Page 21 of the PAA Order) as was calculated in the 2009 case, without even an
19 inflationary increase. Using an average hourly rate of \$100, the PSC approved expense does
20 not even cover 40 hours of work for an entire year. For annual tax services and periodic
21 oversight, even on a quarterly basis, to ensure that the in-house accountants are keeping up
22 with the books and records as needed for regulatory and tax presentation purposes, even if
23 these services were primarily performed by a lower level staff accountant, the PSC approved
24 level of accounting service expense is inadequate. The Utility is requesting that the PSC, at a
25 minimum, use the same methodology applied in the previous rate case by approving

1 accounting expenses calculated based on the 5-year average of actual expenses from 2006
2 through the 2010 test year. The appropriate amount of accounting expense based on the 5-
3 year average is \$5,252, and the required increase is \$1,585 as shown in Exhibit JA-5.

4 **Q. Should any adjustments be made to transportation expense?**

5 A. Yes, transportation expense should be increased by \$8,916. On page 19 of the PAA Order, the
6 PSC made several adjustments to transportation expense, including the reversal of the
7 adjustment for test year expenses of \$3,177 and a further reduction of \$5,739 for expenses
8 deemed non-utility related. On Schedule B-3, page 3 of 4 of the MFRs, revision date
9 1/7/2012, the Utility reflected a net adjustment for transportation expense of \$3,177. This net
10 adjustment was comprised of reductions for certain gas purchases and repairs and
11 maintenance costs totaling \$5,739 that the Utility recognized should have been removed from
12 test year expenses. So the PSC's adjustment double counted the gas and auto repairs and
13 maintenance expense that had already been removed from the test year as an adjustment in
14 the MFRs.

15 The net adjustment of \$3,177 in the MFRs also included an estimate for mileage
16 reimbursement for Gene Brown (\$6,096) and Sandy Chase (\$2,820), totaling \$8,916, for
17 normal routine Utility related travel, both in-town and to St. George Island. The overall
18 adjustment by the PSC appears to have removed the estimate for mileage reimbursement as
19 described above.

20 In the previous rate case, the PSC approved a portion of Gene Brown's vehicle and related
21 expenses in the 2009 test year as reasonable and necessary Utility costs. In the current
22 docket, Gene Brown's vehicle has been removed from the 2010 test year and is no longer on
23 the books of the Utility. While the vehicles and related expenses have been removed, it is
24 reasonable to expect that the office employees incurred mileage on their personal vehicles
25 during 2010 for normal recurring Utility business, including trips to the Island, to the bank and

1 other businesses, which is the basis for the Utility's proposed adjustment for proforma
2 expenses based on known recurring mileage expense reimbursements. In accordance with the
3 Final Order in the previous case issued January 3, 2011, the Utility began maintaining mileage
4 logs for all the office staff. Exhibit JA-6 shows the mileage documented and reimbursed based
5 on the actual mileage logs maintained totaled \$9,323 for 2011, the first year that all the office
6 staff were required to maintain logs, as the Order dated June 13, 2011 in the show cause
7 proceeding clarified that the 1994 Order only applied to "field employees." As there were no
8 mileage logs required to be maintained for Gene Brown and Sandy Chase in 2010, the Utility
9 adjusted the test year expenses as stated above based on an estimate of the actual
10 reimbursements that were incurred at the time of the 2010 test year filing. Exhibit JA-6 shows
11 that the net adjustment of \$3,177 was comprised of a reduction of \$5,739 for gas and repairs
12 and maintenance and an increase of \$8,916 representing the mileage estimate. Exhibit JA-6
13 also shows the actual mileage for 2011 was \$9,323 based on documented travel/mileage logs.
14 The amount of \$8,916 included in the test year is reasonable in relation to the actual amounts
15 for 2011. Therefore, transportation expense should be increased by \$8,916. Exhibit JA-6.

16 **Q. Should any adjustments be made to miscellaneous expense?**

17 **A.** Yes, miscellaneous expense should be increased by \$8,754. On page 7 of the PAA Order, the
18 PSC decreased miscellaneous expense by \$9,320 and capitalized plant in the same amount,
19 which was comprised of an adjustment of \$6,735 related to repairs for damage to a drive well
20 and the remainder related to meters. The Order further discusses that the Utility has
21 represented that repairs were emergency repairs for damage to Drive Well No. 4 sustained in a
22 lightning strike. The Order goes on to state that the PSC finds "that the repairs made to the
23 drive plant extended the useful life of the asset" and therefore found it appropriate to
24 capitalize those costs. While I disagree with the contention that emergency repairs should be
25 characterized as extending the useful life of the asset, the Utility is requesting adjustment due

1 to a "double reduction" to expenses. The Utility received insurance proceeds in the amount of
2 \$8,754 to defray the cost of the repairs for the damage sustained in the lightning strike, which
3 included the amount of \$6,735 included in the PSC's adjustment, as well as some additional
4 expenses. The Utility recorded a reduction to expenses (a credit entry in their general ledger)
5 by the amount of the insurance proceeds received. The PSC's adjustment to reduce the
6 expenses further is then duplicative of the reduction already reflected in expenses by the
7 Utility. Exhibit JA-7 shows the insurance proceeds received and an excerpt of the Utility's
8 general ledger showing the reduction to expenses of the same amount as the proceeds.
9 Accordingly, miscellaneous expenses should be increased by \$8,754.

10 **Q. Should any adjustments be made to the president's salary and benefits?**

11 A. Yes, expenses should be increased by \$19,046. On page 27 of the PAA Order, the PSC reduced
12 the president's salary and benefits by 15% based on the PSC's analysis that, by the Utility
13 extending the term of the DEP loan, this would result in additional costs to be borne by the
14 ratepayers. However, this direct reduction to expenses by the PSC does not equate to the rate
15 recovery afforded the utility in the rate-making process, through the calculation of the
16 revenue requirement or in the ultimate rates charged to the customers. The revenue
17 requirement does not factor in the actual annual interest expense that is required to be paid
18 on the Utility's loans. There is no line item in the revenue requirement calculation for interest
19 expense. The Utility can only recover a percentage of these costs, by way of the weighted cost
20 of capital, applied to the Utility's rate base, rather than the actual interest cost. The 15%
21 reduction in expenses is arbitrary and should be reversed. Accordingly, the president's salary
22 and benefits should be increased by \$19,046.

23 **Q. Should there be any adjustments to the service availability charges?**

24 A. Yes, as previously discussed in my testimony and shown in Exhibit JA-3, the total service
25 availability charges should be increased to \$10,004, (adjusted as applicable for any

1 unprotested PSC adjustments from the PAA Order) in order to achieve a net CIAC to net Plant
2 ratio reaching 75% at design capacity, with the plant improvements needed.

3 **Q. What is the appropriate rate case expense for the Formal Administrative Proceeding?**

4 A. The appropriate amount of rate case expense for the Formal Administrative Proceeding is
5 \$105,362, representing the expenses that have and will be incurred due to the protest filed by
6 OPC as shown on Exhibit JA-8. The rate case expense for legal expenses, consulting expenses
7 and related filing and notice expenses are reasonable and necessary.

8 **Q. Does that conclude your direct testimony?**

9 A. Yes, it does.

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1 Q. Please state your, name profession and address.

2 A. My name is Jeanne Allen. I am an Audit Partner with the accounting firm of Law, Redd,
3 Crona and Munroe, P.A. My address is 2075 Centre Pointe Blvd., Tallahassee, FL 32308.

4 Q. Have you previously submitted direct testimony in connection with this docket?

5 A. Yes.

6 Q. On whose behalf are you presenting this testimony?

7 A. I am presenting this testimony and appearing on behalf of Water Management Services,
8 Inc. (WMS), the applicant for rate increase in the present docket.

9 Q. What is the purpose of your rebuttal testimony?

10 A. The purpose of my rebuttal testimony is to refute parts of the testimony of OPC witness,
11 Helmuth Schultz, III.

12 Q. On page 50 of Mr. Schultz's testimony, he argues that the Company is only entitled to a
13 working capital allowance in rate base if the utility uses investor provided funds to
14 operate the company. What is your response to this?

15 A. If you look at schedule A-17 of the MFRs, there is the breakdown of the utility's
16 components of working capital using the balance sheet approach and calculated based on
17 the 13 month average. On line 4, there is an amount for accounts receivable, or amounts
18 due from customers of \$111,302. On line 14, there is an amount for accounts payable, or
19 amounts currently due for operating expenses, of \$343,627. That equates to a deficit of
20 \$232,325 of money coming in from ratepayers to fund the payment of current liabilities,
21 and that is exclusive of accruals for taxes and interest of approximately \$126,000. While
22 there are some prepayments and deferrals that offset a portion of the accrued liabilities,
23 after the PSC adjustments in the PAA Order, they are not sufficient to cover the bills due.
24 If there is such a big deficit between the money due from customers and the amounts to
25 be paid out to vendors and others for operating the utility, the only way to bridge that

1 gap is for the utility to come up with the funds to pay the bills until they are granted the
2 rate relief needed to be able to pay the normal recurring operating expenses of the utility,
3 exclusive of any of the necessary plant improvements.

4 **Q. Mr. Schultz goes on to state that the Company controls its finances. What is your**
5 **response to this?**

6 A. Based on the utility's annual reports on file with this Commission, the utility reported
7 operating income through fiscal year 2008. In fiscal year 2008, the utility had operating
8 income of \$107,567; however, in fiscal year 2009, the utility reported an operating loss of
9 (\$23,496). The utility took action and filed for rate relief.

10 **Q. On page 52 of Mr. Schultz's testimony, he questions the reason for the required life**
11 **insurance and argues that it should not increase the cost of capital. Do you agree with**
12 **his assessment?**

13 A. No. The utility is required to maintain the life insurance in accordance with the debt
14 requirements at an annual premium cost of \$39,258, and as such, is an appropriate cost
15 to the utility. Therefore, it should be factored into the utility's revenue requirement
16 either by inclusion as a component of the weighted cost of capital or as an Operation and
17 Maintenance expense item.

18 **Q. Mr. Schultz states that "the Company is so leveraged in debt" and that "there could be**
19 **an argument for lowering the cost of capital." What is your response to these**
20 **comments?**

21 A. With regard to the utility's overall cost of capital, the PSC has approved 11.16% as the
22 appropriate return on equity. If the utility had less debt and more equity, the utility
23 would be entitled to a much higher weighted cost of capital than what has been
24 requested in the current filing.

25 **Q. Mr. Schultz suggests that an increase in costs for Contractual Services – Accounting may**

1 **be appropriate. Do you agree with his comment?**

2 A. Yes, absolutely.

3 **Q. Mr. Schultz further states that the Company has not met its burden of proof for**
4 **justifying the change. Do you have any comments regarding this statement?**

5 A. Yes. In the previous rate case, the utility supplied testimony on the record that explained
6 the need for increased accounting assistance, however, the PSC disregarded that
7 testimony and decided to apply a 5-year average methodology, using fiscal years 2005
8 through 2009. This resulted in a low expense amount of \$3,667 for annual accounting
9 expenses, even though this amount was below the actual expenses incurred in 2009 of
10 \$4,225, and below the amount that had been requested in that case. Further, the PSC in
11 the current docket disregarded the utility's request for accounting expenses of \$9,550
12 and simply allowed the same dollar amount as was approved in the prior case. The utility
13 is requesting that the same methodology be applied in the current docket by updating the
14 5-year average through the current test year of 2010.

15 **Q. Mr. Schultz suggests that the 2010 expenses are skewing the 5-year average. Do you**
16 **have any comments to this?**

17 A. Yes. I would suggest that perhaps the expenses for years 2006 (\$698) and 2008 (\$535), as
18 shown on my previously filed exhibit JA-5, are actually skewing the 5-year average down
19 lower than the actual expenses that are reasonable and necessary to be incurred by the
20 utility. In my opinion, the whole reason in applying a multi-year average is to take into
21 account the outliers that skew the results, regardless of whether the actual of any
22 individual year is higher or lower than the average. Again, at a minimum, the utility is
23 requesting that they be afforded the same methodology approved in the last case, even
24 though the actual expenses were higher for 2010 (\$18,550, as shown on exhibit JA-5) and
25 for 2011 (\$11,181, per the utility's annual report filed for fiscal year 2011).

1 Q. The increase the utility has requested in its cross-protest would yield an annual
2 accounting expense of \$5,252. In your opinion, is this a reasonable amount for this
3 utility?

4 A. While it affords the utility a modest increase of \$1,585 over the amount previously
5 approved by the PSC, it is still on the low side compared to the actual expenses the utility
6 incurred in 2010 and 2011. The utility requires annual tax services, and is in need of
7 assistance with plant and depreciation records and general accounting oversight of the
8 records maintained by the in-house accounting staff for both regulatory and tax purposes.
9 These required accounting services, on a going forward basis, will likely far exceed the
10 amount being requested by the utility.

11 Q. Do you have any comments regarding Mr. Schultz's testimony regarding transportation
12 expenses?

13 A. The PSC's adjustment to transportation expense effectively disallowed any level of normal
14 and routine travel expenses for Gene Brown and Sandy Chase. There is a reasonable and
15 necessary amount of travel expense that is incurred for normal routine utility-related
16 business. The PSC has approved similar travel related expenses in the past for office
17 employees as reasonable and necessary. For the PSC to deny any level of expenses for
18 these two employees is unreasonable.

19 Q. Mr. Schultz states that "the Company's attempt to offer the log reimbursements for
20 2011 as a surrogate" to correct past errors. Do you agree with his statement?

21 A. No. As I discussed in my direct testimony, the utility began maintaining mileage logs for
22 all the office staff in accordance with the final order in the previous case, which was
23 issued on January 3, 2011. And further, the order dated June 13, 2011, in the show cause
24 proceeding clarified that the 1994 order requiring mileage logs applied only to the field
25 employees. Accordingly, there was no requirement for Gene Brown and Sandy Chase to

1 maintain mileage logs in the test year for the current docket. This doesn't change the fact
2 that normal travel related costs for these employees are reasonable and necessary. As
3 such, the utility requested expenses of \$8,916, which was based on an estimate of the
4 actual incurred in 2011, with a cutoff date prior to the test year filing. The reason that the
5 actual logs were provided in exhibit JA-6 was to show that the amount requested as
6 normal travel costs of \$8,916 were reasonable in relation to the actual costs incurred and
7 documented on an annual basis for 2011, the first year that the utility was required to
8 maintain such documentation for these two employees.

9 **Q. Does that conclude your testimony at this time?**

10 **A.** Yes, it does.

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1 BY MR. FRIEDMAN:

2 Q Then would you at this time provide a short
3 five-minute summary to the Commissioners of your
4 testimony?

5 A Sure. Well, thank you.

6 First, I'd like to say that the utility is
7 requesting an increase in the cost of capital. The PAA
8 order reduced what the original filing had in as the
9 cost of -- the interest cost for the Centennial Bank
10 refinancing. That loan came due and it had to be
11 refinanced, and it was refinanced at a rate of 6.5%.
12 That -- when it was refinanced, there was some life
13 insurance that was required as collateral on that loan,
14 and that's reasonable and necessary business expenses
15 for the utility, and we -- the utility included that
16 cost as part of the interest cost, the cost of the debt.

17 If it's not -- if the Commission determines
18 that it's not appropriate to have that cost as part of
19 the debt calculation, then it should be part of the O&M
20 expenses, the operation and maintenance expenses as a
21 line item.

22 Another point that I'd like to talk about are
23 the accounting expenses. The utility is asking for just
24 a modest increase in what the PAA order provided for.
25 The utility believes that the reasonable and necessary

1 expenses for accounting would far exceed what, what were
2 approved in the PAA order, which was about \$3,600 on an
3 annual basis. In 2001 alone there was expenses for
4 accounting worth about \$18,000.

5 What, what we're requesting is that the same
6 methodology that was applied in the prior rate case,
7 which was taking a five-year average, just be updated
8 for the new rate case or for this current rate case.
9 And that's only increasing the accounting expenses by
10 about \$1,500.

11 Another point is the transportation expenses.
12 The PAA order effectively disallowed transportation
13 expenses for two of the administrative employees of the
14 company. I think this is not reasonable in
15 circumstances. There are situations where utility
16 administrative employees have to drive to the island,
17 they have to drive around town to go to the bank, or
18 just other normal recurring business related in-town
19 travel or to the island, and it's fair and reasonable to
20 include a certain portion of those expenses.

21 And what we -- what I did as part of my
22 exhibit was to provide the 2011 mileage logs as an
23 illustration to show that what we requested in the MFRs
24 in the original filing was reasonable under these
25 circumstances.

1 And also miscellaneous expenses, the PAA order
2 included an adjustment to capitalize a certain amount of
3 expenses that were related to -- it was -- there was a
4 piece of equipment that was damaged by lightning and
5 there was an insurance reimbursement that was received
6 by the utility. The utility offset the expense by
7 crediting the expense account with the reinsurance, with
8 the -- excuse me -- with the reimbursement from the
9 insurance company. The PAA order reduced the expenses
10 further and capitalized those items. And if that credit
11 remains as a reduction to expenses, then that assumes
12 going forward that the utility will receive an insurance
13 reimbursement on an annual basis, and that's not, not
14 going to be the case.

15 **COMMISSIONER EDGAR:** Mr. Friedman.

16 **MR. FRIEDMAN:** She's finished her summary.

17 **COMMISSIONER EDGAR:** Are you tendering her for
18 cross?

19 **MR. FRIEDMAN:** Yes, ma'am. And I need to -- I
20 guess I could move her exhibits now, or we could wait
21 until after.

22 **COMMISSIONER EDGAR:** Let's wait until after.
23 Okay. Thank you.

24 Mr. Sayler.

25 **EXAMINATION**

1 **BY MR. SAYLER:**

2 **Q** Thank you, Ms. Allen. Erik Sayler with the
3 Office of Public Counsel.

4 We just have, just for ease, even though we're
5 doing your rebuttal and direct at the same time, I'm
6 going to first ask questions on your direct and then
7 I'll move to the rebuttal.

8 **A** Okay.

9 **Q** So as not to, try not to confuse myself any
10 more than necessary.

11 If you'll please refer, if you'll please refer
12 to page 4 of your testimony, line 19 through 20. Isn't
13 it true you testified using an average hourly rate of
14 \$100, the PSC-approved expense does not even cover 40
15 hours of work for an entire year?

16 **A** That's correct.

17 **Q** In your preparation for your testimony, did
18 you review the final order in the last rate case?

19 **A** I reviewed portions of the final order from
20 the prior rate case in relation to preparing the MFRs
21 for this current case. Yes.

22 **Q** All right. Did you recall from that final
23 order whether there was reference to an accounting
24 manual that the utility has?

25 **A** I believe there was reference to that.

1 **Q** All right. Do you know if the utility
2 accounting manual has been updated since the last rate
3 case?

4 **A** I do not know that.

5 **Q** Have you reviewed the accounting manual?

6 **A** No, I have not.

7 **MR. SAYLER:** Okay. Also with your leave,
8 Madam Chair, we have two exhibits that we'd like to pass
9 out. We'll just go ahead and pass them both out and
10 have them identified for the record.

11 **COMMISSIONER EDGAR:** Okay. Then our staff
12 will go ahead and help us pass those out. Thank you.

13 **MR. SAYLER:** These are two exhibits. One is
14 used for cross-examination purposes, which is the PSC
15 rule. That won't necessarily need to be entered into
16 the record or identified. But the other exhibit, which
17 is IRS requirements for mileage reimbursement, I would
18 like that one marked for identification.

19 **COMMISSIONER EDGAR:** Okay. Then at this time
20 we will mark as Exhibit Number 90 the document that has
21 been handled, handed out with the description IRS
22 Requirements for Mileage Reimbursement and so title it.

23 (Exhibit 90 marked for identification.)

24 **MR. SAYLER:** Thank you.

25 **BY MR. SAYLER:**

1 Q Ms. Allen, if you'll turn to page 5 of your
2 testimony where you testified concerning adjustments to
3 transportation expense.

4 **THE COURT REPORTER:** Excuse me. I'm having a
5 hard time hearing you.

6 **MR. SAYLER:** I'm sorry about that. Maybe I
7 can just hold it.

8 **THE COURT REPORTER:** Okay.

9 **BY MR. SAYLER:**

10 Q Ms. Allen, if you'll turn to page 5 of your
11 testimony, lines 12 through 13, where you testify --
12 well, isn't it true that the PSC's double adjustment --
13 adjustment double counted the gas and auto repairs and
14 maintenance expense that had already been removed from
15 the test year as an adjustment to the MFRs? Do you see
16 that?

17 A That's what it says, yes.

18 Q All right. Isn't it true that the net effect
19 of the adjustment in the PAA order was to reduce
20 transportation expense to \$1,528, which also is the test
21 year expense for the mileage reimbursement for
22 Ms. Jessica Blankenship and Mr. Bob Mitchell?

23 A That's correct.

24 Q Page 6, line 15, please, where you state the
25 transportation expense should be increased by \$8,916.

1 Are you there?

2 A Yes. Uh-huh.

3 Q So essentially you're requesting that the
4 amount approved in the PAA order be increased by this
5 amount, which would bring it, bring the amount back up
6 to what was requested in the company's MFRs; is that
7 correct?

8 A No. Actually I think it's higher than what
9 was requested in the MFRs.

10 Q All right. Thank you. Just trying to
11 understand that.

12 And wouldn't you agree that the PAA order is
13 correct that there are no mileage logs maintained for
14 2010 to support this expense?

15 A It's my understanding that there were not
16 mileage logs required for these particular individuals
17 that we're talking about here for that year.

18 Q Required by the PSC; correct?

19 A Correct.

20 Q Now these vehicles in question for Mr. Brown
21 and Ms. Chase, are they personal vehicles or
22 utility-owned vehicles?

23 A I believe they're personal owned now.

24 Q Would you take a moment and review what's been
25 identified as Exhibit 90, description IRS Requirements

1 for Mileage Reimbursement.

2 A Just for the record, I'm not a tax expert.

3 Which pages?

4 Q Just the exhibit in general.

5 A Okay.

6 MR. SAYLER: And, Commissioners, I'll
7 represent that we added the yellow highlighting to the
8 exhibit.

9 BY MR. SAYLER:

10 Q Ms. Allen, maybe I can speed things up. I
11 understand you testified you're not a tax expert. But
12 as a CPA you're generally familiar with IRS rules,
13 correct, whether in your own personal capacity doing
14 your own taxes or that for your business or things of
15 that nature?

16 A Only specific things that relate to my
17 personal or -- basically just for my personal taxes.

18 Q Okay. To your knowledge, do you know if the
19 IRS has mileage requirement rules for either
20 utility-owned vehicles or privately-owned vehicles used
21 for utility purposes?

22 A I don't know that there would be a difference
23 between if it were privately owned or -- I'm not a tax
24 expert.

25 Q So isn't it true that the IRS does have

1 mileage requirements?

2 **MR. FRIEDMAN:** She just -- asked and answered.
3 She said she didn't know.

4 **MR. SAYLER:** Thank you. I'll move on.

5 **COMMISSIONER EDGAR:** Thank you.

6 **BY MR. SAYLER:**

7 **Q** Ms. Allen, would you turn to page 2 of your
8 direct testimony, and focus on lines 10 through 21.

9 Isn't it true that you are proposing to --
10 that the utility -- excuse me. Isn't it true that the
11 utility is proposing to allocate 75% of the current net
12 plant to future customers for WMSI?

13 **A** The utility is proposing that the service
14 availability charge be revised to move to a 75% net
15 ratio at build out.

16 **Q** All right. Would you please refer to
17 Commission Rule 25-30.580 in that exhibit for
18 cross-examination purposes.

19 You would agree that your testimony about
20 this, the Commission standard of 75% that the utility is
21 requesting comes from this rule?

22 **A** Yes.

23 **Q** Okay. And isn't it correct that the rule
24 states that a utility's service availability policy
25 shall be designed such that 75% is the maximum amount of

1 CIAC?

2 A Yes, I would agree with that.

3 Q Do you know how many future customers WMSI is
4 anticipating will be subject to this increased service
5 availability rule?

6 A The number that was provided to me by the
7 expert engineer was, I believe, 408.

8 Q Okay. And currently how many customers does
9 WMSI have?

10 A At the time of the filing I believe, in terms
11 of ERCs, it was 1,980.

12 Q All right. And the current plant-in-service
13 as it relates to the supply main is in the neighborhood
14 of about \$7 million; is that correct?

15 A I'm sorry. Can you repeat that?

16 Q The plant-in-service as it relates to the
17 supply main is about \$7 million.

18 A I'd have to double-check the numbers. I don't
19 have those committed to memory.

20 Q Well, let me refer you to -- if you have
21 Mr. Brown's testimony, page 13.

22 A I do not have his testimony.

23 **COMMISSIONER EDGAR:** Is that something that we
24 need to try to put in front of the witness?

25 **MR. SAYLER:** Yes.

1 **COMMISSIONER EDGAR:** Do you have a copy?

2 **MR. SAYLER:** I do.

3 **COMMISSIONER EDGAR:** Mr. Friedman, do you want
4 to take a look at that first?

5 **MR. FRIEDMAN:** It's his testimony.

6 **BY MR. SAYLER:**

7 **Q** Isn't it true that in Mr. Brown's testimony it
8 references about \$7 million for the supply main to
9 provide service to current customers as well as future
10 customers?

11 **A** That's what his testimony says here.

12 **Q** All right. Isn't it correct then that WMSI's
13 request for increased service availability charges will
14 put the burden of reaching 75% totally on the
15 approximately 408 customers, even though the plant is
16 currently serving over 1,900 customers?

17 **A** Before I answer that question, can I clarify?
18 I'm not sure that this is the current -- is this the --
19 this could have been the prior supply main. I'm not
20 sure that the \$7 million number is the new --

21 **Q** I believe it might be based upon what was
22 approved by the PAA order, but --

23 **A** Can I just look at my documents real quick?

24 **Q** Sure.

25 **A** I may be guessing at this, but I believe the

1 \$7 million was related to the limited proceeding with
2 the supply main that was put in place. The utility
3 plant-in-service that was requested for the pro forma
4 plant was only 3.3 million, and that was total for all
5 of the items, so.

6 Q Okay. I apologize for having the wrong
7 number.

8 So is it still your testimony that the
9 remaining 408 customers should be paying the vast
10 majority of that \$3 million in new plant-in-service?

11 A My testimony would be that those 408 customers
12 would be paying a higher service availability charge
13 based on current plant and future plant additions.

14 Q Yes or no?

15 A Yes.

16 Q Okay. Thank you.

17 Can I get Mr. Brown's testimony back?

18 Ms. Allen, would you turn to your rebuttal
19 testimony, please. If you will refer to page 2 of your
20 testimony, lines 17 through 20, where you discuss that
21 that equates to a deficit of \$232,325 of money coming in
22 from the ratepayers to fund the payment of current
23 utilities [sic]. Do you see that?

24 A Yes.

25 **MR. FRIEDMAN:** It doesn't say that. It says

1 current liabilities.

2 **MR. SAYLER:** Current liabilities. Thank you.

3 **BY MR. SAYLER:**

4 **Q** When you came up with this number, isn't it
5 true that to perform a true cash analysis of cash flow
6 that you need to look at more than just the accounts
7 receivable and accounts payable?

8 **A** I wasn't trying to perform a true cash flow.

9 **Q** In your expertise as a CPA --

10 **A** Yes.

11 **Q** -- when doing a cash flow analysis, wouldn't
12 you need to look at the change in the total cash
13 receivables from the beginning of the year to the end of
14 the year? The same for cash accounts payable, and then
15 also look at the total revenues for cash operating
16 expenses?

17 **A** If you're going to do a cash analysis, you
18 would look at all cash coming in and all cash going out
19 for whatever purpose.

20 **Q** Okay. In preparing your testimony, Ms. Allen,
21 did you have a chance to review Ms. Vandiver's
22 testimony?

23 **A** I read certain portions of it, yes.

24 **Q** Do you recall the portion of her testimony
25 that indicated that the utility had a past history of

1 slow paying its rate case consultants?

2 A I don't recall if I remember that or not.

3 Q With regard to the current rate case is the
4 utility current and up-to-date with all its payments of
5 its invoices?

6 A I have not performed an analysis of that, so I
7 cannot answer that question.

8 Q Payments to your CPA firm.

9 A To my firm?

10 Q Are they paying timely?

11 A No.

12 Q I'm sorry. I didn't hear you.

13 A I said no.

14 Q No. Okay.

15 Based upon what you know, would it give you
16 and your CPA firm more comfort if the Commission, as
17 part of this rate case, ordered that this utility made
18 quarterly reports to the Commission of the payments that
19 it's making to your accounting firm?

20 A Can you repeat that question?

21 Q Certainly. Based upon what you know, would it
22 give you and your CPA firm more comfort if the
23 Commission, as part of this order, required the utility
24 to make quarterly reports to the Commission showing that
25 the utility is current with its payments for whatever

1 level of rate case expense this Commission approves?

2 A I don't think it makes me comfortable one way
3 or another. If the Commission likes to, would like to
4 impose that, then that's fine. It's their discretion.

5 Q All right. On page 3 of your testimony, lines
6 13 to 14 of your rebuttal, you reference, and you also
7 referenced this in your summary, that the utility is
8 required to maintain life insurance in accordance with
9 debt requirements.

10 A Correct.

11 Q Specifically with regard to this loan, which
12 loan were you talking about? Was it the DEP or
13 Centennial Bank loan?

14 A I believe it's the Centennial Bank loan.

15 Q Did you review the bank documents for the
16 Centennial Bank loan in preparing your testimony?

17 A I did. Yes.

18 Q Are you aware of whether life insurance is
19 required on all or most of Centennial Bank loans?

20 A I looked at the documents that have the
21 collateral assigned to those loans.

22 Q But other loans that Centennial Bank makes, do
23 they require life insurance?

24 **MR. FRIEDMAN:** I object. He hasn't laid a
25 predicate that she knows anything about any loans that

1 Centennial Bank may make to anybody else other than the
2 particular one to Water Management Services.

3 **COMMISSIONER EDGAR:** Mr. Saylor?

4 **MR. SAYLER:** Certainly. I'll move on.

5 **BY MR. SAYLER:**

6 **Q** In the course of your work for your CPA firm,
7 do you on a regular basis review the loan agreements
8 entered into by your clients?

9 **A** Yes.

10 **Q** All right. And over the years have you
11 reviewed hundreds, perhaps thousands of those loan
12 agreements?

13 **A** That may be excessive. Probably not hundreds,
14 but --

15 **Q** More than 50?

16 **A** Probably more than 50, yes.

17 **Q** Okay. Do you know if a life insurance
18 requirement is a usual requirement for a business loan?

19 **A** I don't know that. I have seen it before
20 though.

21 **Q** Okay. In what instances have you seen life
22 insurance as a requirement for a business loan?

23 **A** If it's a small proprietor and probably if
24 there weren't other assets available as collateral or
25 sufficient assets for collateral, then the life

1 insurance would be a substitute for some other form of
2 collateral.

3 Q Would life insurance be required if the
4 utility had struggled -- or difficulty with its
5 finances?

6 A I don't know the answer to that.

7 Q All right. Thank you very much.

8 COMMISSIONER EDGAR: And that, Mr. Sayler,
9 concludes your cross for both direct and rebuttal
10 testimony for this witness?

11 MR. SAYLER: Yes, ma'am.

12 COMMISSIONER EDGAR: Thank you. Are there
13 questions from staff for this witness --

14 MS. BARRERA: Yes.

15 COMMISSIONER EDGAR: -- on cross?

16 MS. BARRERA: Commissioner, at this time we
17 are distributing four exhibits that we would like to
18 introduce into the record and at least for now identify
19 and number.

20 MR. FRIEDMAN: I've got five.

21 MS. BARRERA: Pardon?

22 MR. FRIEDMAN: I've got five.

23 COMMISSIONER BROWN: I do too.

24 COMMISSIONER EDGAR: I do too.

25 MS. BARRERA: I'm sorry. It's five exhibits.

1 **COMMISSIONER EDGAR:** Okay. Then we will take
2 them in order. We'll go ahead and mark them at this
3 time, and then we can take them up at the appropriate
4 time.

5 So we will mark as Exhibit 91 the first
6 document that I have titled OPC's Issues and Concerns.

7 (Exhibit 91 marked for identification.)

8 We will mark as 92 the next document titled
9 Excerpt of Witness Allen's Direct Testimony.

10 (Exhibit 92 marked for identification.)

11 93, WMSI Response to Staff's 5th Data Request.

12 (Exhibit 93 marked for identification.)

13 94, OPC [sic] Response to Staff's Data
14 Request, January 19, 2012.

15 (Exhibit 94 marked for identification.)

16 And 95, the last document distributed, Staff's
17 Data Request to WMSI dated 12/12/11.

18 (Exhibit 95 marked for identification.)

19 Ms. Barrera.

20 **MS. BARRERA:** Yes. Thank you.

21 **EXAMINATION**

22 **BY MS. BARRERA:**

23 **Q** Good morning, Ms. Allen.

24 **A** Good morning.

25 **Q** For purposes of these questions would you

1 please refer to pages 6, line 17 through 25, of your
2 prefiled testimony, and then page 7, lines 1 through 9.

3 A Yes.

4 Q Okay. In this portion of your testimony you
5 state that miscellaneous expense should be increased by
6 \$8,754 and change due to a double reduction of expenses.
7 You explain that WMSI paid for an emergency repair for
8 damage to drive well number 4 in the amount of
9 \$6,735 and change, and was reimbursed for the expense by
10 insurance proceeds which the utility recorded as a
11 credit and reduction to expenses. Am I characterizing
12 your testimony correctly?

13 A That's correct.

14 Q Can you please refer to the document which is
15 staff's data request dated -- do you have the exhibits
16 in front of you?

17 A The ones that were just handed out?

18 Q Yes.

19 A Yes.

20 Q Okay. The document is Staff's Data Request
21 dated December 12, 2011, which is --

22 **COMMISSIONER EDGAR:** 95.

23 **MS. BARRERA:** -- 95. Thank you.

24 **BY MS. BARRERA:**

25 Q Please refer to number 6 on page 2 of the

1 request.

2 A Okay.

3 Q Prior to drafting your testimony did you
4 review this data request?

5 A I'm not sure that I did or not. Some data
6 requests have been provided to me and some haven't.
7 Some I've participated in and some I haven't.

8 Q Okay. And in data request number 6, according
9 to MFR -- which requests according to MFR Schedule B-5,
10 miscellaneous expenses increased substantially in March
11 and December 2010 when compared to other months. The
12 data request requested WMSI provide all the utility's
13 calculations, basis, work papers, and supporting
14 documentation for the above increases in miscellaneous
15 expenses.

16 A Okay. I see that.

17 Q And would you agree that in this data request
18 staff requested documentation in support of the increase
19 in miscellaneous expenses during March and
20 December 2010?

21 A That's what the request says.

22 Q Okay. And please refer next, please refer to
23 WMSI's January 19, 2012, response to the staff's data
24 request number 6.

25 **MR. SAYLER:** Madam Chairman, quick question.

1 **COMMISSIONER EDGAR:** Yes.

2 **MR. SAYLER:** For Exhibit 94, the description
3 says OPC's response to staff data request. I believe
4 that's a typo. It might need to say WMSI's response.

5 **COMMISSIONER EDGAR:** Ms. Barrera?

6 **MS. BARRERA:** Yes. It should be WMSI. I'm
7 sorry.

8 **COMMISSIONER EDGAR:** Okay. Then we will --
9 thank you. We will note for the record that Exhibit
10 94 is correctly titled WMSI's Response to Staff's Data
11 Request dated 1/19/12.

12 Thank you, Mr. Sayler.

13 **BY MS. BARRERA:**

14 **Q** So moving on to -- that was Exhibit 94. It's
15 WMSI's January 19th, 2012, Response to Staff's Data
16 Request Number 6. If you can turn to Exhibit F in the
17 response, which is on pages 5 and 6, and that would be
18 the Graybar invoice.

19 **A** Okay.

20 **Q** Prior to drafting your testimony did you
21 review this document?

22 **A** I'd have to look in my original documents, but
23 it looks familiar.

24 **Q** And based on the invoice would you agree that
25 the invoice appears to be for repair services and that

1 the total amount due was \$6,734.80?

2 A Yes. That's what it says.

3 Q And would you also agree that the page
4 following the invoice shows a credit card payment and a
5 handwritten description that says drive well number 4
6 and drive plant?

7 A Yes, that's what it says.

8 Q Okay. And is that the same drive well
9 discussed on page 6 and 7 of your direct testimony?

10 A I believe it is, yes.

11 Q Now please refer to the document identified, I
12 believe, as Exhibit 91, OPC's List of Issues and
13 Concerns dated May 4th, 2012. And that would be on page
14 9, number 25. Do you have it?

15 A I do.

16 Q Okay. And in that number 25, OPC states that
17 a copy of the invoice to Graybar was included as a
18 response to a data request and that the description was
19 drive well number 4, drive plant.

20 Do you agree that in this concern -- OPC
21 expressed a concern that unless further documentation is
22 provided, we believe that this appears to be an item
23 that should be capitalized?

24 A That's what it says.

25 Q Okay. And prior to drafting your testimony

1 did you review this document?

2 A I can't say that I have or not. I don't --

3 Q Do you know whether WMSI provided any
4 additional documentation prior to the Commission's PAA
5 vote on August 2, 2012?

6 A I'm sorry. Can you repeat that?

7 Q Do you know whether WMSI, in response to this
8 and in response to the staff data request, provided any
9 additional documentation prior to the Commission's PAA
10 vote on August 2nd, 2012? And actually in particular I
11 am referring to the insurance documents that show a
12 payment for the repair costs.

13 A The utility has submitted lots of
14 documentation in this proceeding, and I have not looked
15 at everything. I have looked at the insurance
16 reimbursement. So is there another question related to
17 that or do you want me to look at a document?

18 Q Yes. Could you please refer to your
19 testimony, Exhibit JA-7, page 1-9.

20 A You said JA-7?

21 Q Yes.

22 A Okay.

23 Q Now would you agree that this exhibit is a
24 document reflecting an insurance payment from Gallagher
25 Bassett Services dated September 16, 2010 --

1 **A** Yes. That's what it says.

2 **Q** -- in the amount of \$8,754 for a lightning
3 claim?

4 **A** That's what it says. Yes.

5 **Q** Okay. And can you state where the insurance
6 claim proceeds are contained in the WMSI general ledger?

7 **A** If you look at Exhibit JA-7, page 2 of 9, it's
8 recorded as a credit. And that's in account -- I
9 believe it's 675.13, just repairs and maintenance.

10 **Q** Is there -- can you explain why these
11 documents, specifically the insurance documents, were
12 not provided in response to the increase referenced
13 above or brought up at the PAA conference, specifically
14 the insurance reimbursement?

15 **A** Well, the insurance reimbursement did not
16 increase the expense account. It decreased the expense
17 account. So I don't know that that would have been
18 something provided, or it may have been provided. I
19 don't know the answer to that.

20 **Q** All right.

21 **A** And it also was recorded in September, which I
22 don't believe is one of the months that was requested in
23 that data request.

24 **MS. BARRERA:** All right. Thank you. I have
25 no more questions. And at this time I would like to

1 move these exhibits into the record.

2 **COMMISSIONER EDGAR:** We'll take that up in
3 just a moment.

4 **MS. BARRERA:** Okay. I'm sorry.

5 **COMMISSIONER EDGAR:** We'll leave that request
6 pending. That's all right.

7 Commissioners, any questions for this witness?

8 Commissioner Brown.

9 **COMMISSIONER BROWN:** Thank you. Good
10 afternoon, Ms. Allen.

11 **THE WITNESS:** Good afternoon.

12 **COMMISSIONER BROWN:** I have a question, just
13 two clarifying questions.

14 One question, on page 5 you, of the direct,
15 you, on lines 20 through 22 you said in the previous
16 rate case the Commission approved a portion of
17 Mr. Brown's vehicle-related expenses as reasonable and
18 necessary. Are you aware if the Commission also
19 approved other employees in that last rate case?

20 **THE WITNESS:** I'd have to check directly, but
21 I believe that there were expenses included for two of
22 the other office staff.

23 **COMMISSIONER BROWN:** What does Ms. Chase do?

24 **THE WITNESS:** She's the vice president of the
25 company.

1 **COMMISSIONER BROWN:** And her travel expenses
2 are related to travel to and from St. George to
3 Tallahassee?

4 **THE WITNESS:** There may be instances when she
5 has to come to the island, but there are also cases
6 where she travels to and from the office and the PSC
7 offices quite frequently to conduct other business.

8 **COMMISSIONER BROWN:** Okay. Thank you.

9 My other question relates to, I think it's
10 JA-8 exhibit of your direct.

11 **THE WITNESS:** Okay.

12 **COMMISSIONER BROWN:** It is page 2 of 7. And
13 it's really a clarifying question. At the bottom right
14 before the total estimated cost you have estimated hours
15 182 -- or this document shows 182.5 hours. But then
16 there's an allocation of \$340 an hour and \$350 an hour.
17 I'm assuming that's all Mr. Friedman's charges at the
18 Sundstrom law firm, Sundstrom, sorry, law firm. But can
19 you clarify those two amounts? Because I'm not aware of
20 any other attorney from that law firm performing
21 services in this rate case.

22 **THE WITNESS:** I believe that would be
23 Mr. Friedman's. I don't know if there would be another
24 person in his office at a slightly different rate that
25 would be providing services.

1 **COMMISSIONER BROWN:** Why the discrepancy? Do
2 you know why there would be a discrepancy in the amount?
3 Is it based on the year or what?

4 **THE WITNESS:** Maybe there was an increase. I
5 don't know.

6 **COMMISSIONER BROWN:** Okay. That's all. Thank
7 you.

8 **COMMISSIONER EDGAR:** Commissioner, question?
9 Mr. Friedman, cross -- redirect. Excuse me.

10 **MR. FRIEDMAN:** I do have a redirect. I'm
11 trying to understand the staff.

12 **EXAMINATION**

13 **BY MR. FRIEDMAN:**

14 **Q** On the exhibits that Ms. Barrera showed you --

15 **A** Yes.

16 **Q** -- the, I guess it's Exhibit 91 -- first of
17 all, let me make sure I understand. So the way the
18 utility booked this, this damage to the well at East
19 Point is that when the lightning struck the well, there
20 was an expense of some amount of money that was put in
21 the books under expense; correct?

22 **A** Right.

23 **Q** All right.

24 **A** Yes.

25 **Q** And then that was reimbursed from an insurance

1 coverage?

2 **A** There was a reimbursement from insurance.

3 Yes.

4 **Q** And so basically you deducted that amount of
5 insurance recovery from that expense; is that correct?

6 **A** That's what the utility did. I did not
7 personally do that.

8 **Q** It was debited from that expense?

9 **A** It was credited from the expense.

10 **Q** Okay.

11 **A** So the expense was recorded. The
12 reimbursement was offset against that expense to reduce
13 it.

14 **Q** Okay. And then my understanding is, is that
15 the Public Counsel in their issues and concerns in
16 Exhibit 81 said it should be capitalized. And am I
17 correct that in fact the, the PSC in the PAA order did
18 capitalize that repair?

19 **A** The PAA order did capitalize \$6,775, I believe
20 the number was.

21 **Q** But did the PAA order then also take out the
22 credit for the insurance payment?

23 **A** Not that I'm aware of.

24 **Q** Doesn't that sound like it's a double whammy
25 to the utility?

1 **A** Yes, it does.

2 **Q** You're not concerned about getting paid by
3 Mr. Brown and Water Management Services for your
4 services here today, are you?

5 **A** No.

6 **MR. FRIEDMAN:** No further questions.

7 **COMMISSIONER EDGAR:** Okay. Then this would be
8 the time to take up exhibits. Mr. Friedman.

9 **MR. FRIEDMAN:** If I may start, I would like to
10 move Ms. Allen's Exhibits 1 through 8.

11 **COMMISSIONER EDGAR:** Which are marked as
12 2 through 9 on the Comprehensive --

13 **MR. FRIEDMAN:** I'm sorry.

14 **COMMISSIONER EDGAR:** That's okay. 2 through
15 9 on the Comprehensive Exhibit List. Any objections?

16 **MS. BARRERA:** No.

17 **COMMISSIONER EDGAR:** All right. Thank you.
18 Hearing none, Exhibits 2 through 9 are entered into the
19 record.

20 (Exhibits 2 through 9 admitted into the
21 record.)

22 Mr. Sayler.

23 **MR. SAYLER:** Office of Public Counsel would
24 move Exhibit Number 90.

25 **COMMISSIONER EDGAR:** Any objection?

1 **MR. FRIEDMAN:** I object. I don't think
2 there's been any predicate laid. What the witness said
3 was she's not a tax accountant and she doesn't know
4 whether that's the correct IRS provision or not. I
5 don't know how you can just throw an IRS tax provision
6 in here. We don't know if it's right. There's got to
7 be a witness to sponsor it and she said she can't.

8 **COMMISSIONER EDGAR:** Mr. Sayler.

9 **MR. SAYLER:** In the interest of time, saving
10 time, I could have gone through that exhibit, and based
11 upon her ability to verify that this is in fact from the
12 IRS and it's an official document of the IRS, and I
13 could have walked her through it and gone through all
14 the different passages that show requirements for the
15 IRS for the mileage requirements, but in the interest of
16 time I moved on. So that's the reason why I didn't
17 spend that much time on it. However, if Mr. Friedman
18 would like me to lay a predicate, I'm happy to go back
19 and ask those questions of this witness.

20 **MR. FRIEDMAN:** I don't think that answers the
21 question. I mean, it is a document and it says what the
22 document says. But for somebody to just say, yeah,
23 that's the law that was in effect when, I guess 2011
24 we're talking about, there's nobody here to say that.
25 We don't know if that's the law in 2011 or not. In

1 fact, it may not be if you pulled it off the Internet
2 today. My guess is it's probably the one from the
3 current law.

4 I can tell you just by looking at the
5 insurance reimbursement -- I mean the reimbursement
6 part. But you've got to lay a predicate. You just
7 can't have him walking her through every page and
8 saying, yeah, this says what it says, this says what it
9 says. As a matter of fact, it says 2012. We're talking
10 about 2011.

11 **COMMISSIONER EDGAR:** Thank you, Mr. Friedman.
12 Mr. Sayler.

13 **MR. SAYLER:** Public Counsel's generic question
14 was isn't it true that the IRS does have requirements
15 for maintaining mileage logs? Yes, it is correct, this
16 is the 2012 requirement. But it was more of a general
17 question. So with that, I will withdraw my request to
18 put it in the record.

19 **COMMISSIONER EDGAR:** Okay. That works, that
20 works for me. Thank you. I appreciate your
21 cooperation.

22 And then so the exhibit that was marked as
23 90 has been withdrawn. And, Ms. Barrera, this would be
24 the appropriate time.

25 **MS. BARRERA:** Thank you, Commissioner. At

1 this time staff would like to move Exhibits Number
2 91 through 95 into the record.

3 **COMMISSIONER EDGAR:** Okay. Any objections?

4 **MR. FRIEDMAN:** I'm not sure I understand the
5 relevance of pre-PAA order documentation. I mean, if
6 the staff is saying, whoa, you didn't raise this before,
7 it's irrelevant. I mean it's being raised now.

8 **COMMISSIONER EDGAR:** To which, to which
9 exhibit or exhibits are you speaking?

10 **MR. FRIEDMAN:** It would be 91, 93, 94, and
11 95 all deal with pre-PAA data requests that are
12 irrelevant ones -- you know, like I say, whether or not
13 the company ever gave this particular information at
14 that time is irrelevant to whether they're entitled to
15 it now. It's provided now in this evidentiary hearing
16 and that's what's relevant, not whether it was provided
17 before or not.

18 **COMMISSIONER EDGAR:** Ms. Barrera?

19 **MS. BARRERA:** Yes. We believe that the
20 relevancy is that staff would like to have a
21 confirmation that these documents -- that this document,
22 the insurance document was not provided to staff until
23 the time that Ms. Allen's testimony and exhibits were
24 submitted.

25 **COMMISSIONER EDGAR:** Mr. Friedman.

1 **MR. FRIEDMAN:** I think she just answered, I
2 think she just answered my question.

3 **COMMISSIONER EDGAR:** I was going to give you
4 the opportunity.

5 **MR. FRIEDMAN:** She just said what I -- you
6 know, bolsters my position.

7 **COMMISSIONER EDGAR:** Ms. Helton? Because I do
8 think Mr. Friedman has a point, but I would like to hear
9 your opinion.

10 **MS. HELTON:** I kind of look at it a little bit
11 different way in that if there's an objection -- we do
12 things a little bit different with respect to admitting
13 exhibits at the end of the testimony of the witness.
14 But, so that the parties to the case can deal with any
15 objections while we're, while the witness is testifying,
16 I think it's a better practice to bring your objection
17 up at the time that the objection is relevant. It's
18 kind of hard to go back for Mr. Sayler, for staff, or
19 for Mr. Friedman, if and when that becomes appropriate,
20 to go back and lay a better record with respect to why
21 the objection is there or not there and whether the
22 objection is appropriate or not.

23 And so I see what you're saying, but I think
24 the, I think the better practice is for Mr. Friedman to
25 make an objection at the time that the exhibits are

1 being used for cross-examination purposes so that a
2 better record can be laid.

3 **COMMISSIONER EDGAR:** With that said.

4 **MS. HELTON:** With that said, it sounds to me
5 as if you are questioning the relevance to the, to the
6 record with respect to these exhibits. And if you don't
7 think it's relevant, you're -- it's within your purview
8 to admit them or not.

9 With that being said, it is often our
10 practice, just so that the record is clear, to admit
11 them and then give the exhibits the weight that they're
12 due, so.

13 **COMMISSIONER EDGAR:** Yes, it is, and I made
14 that statement earlier. So with that, I will admit 91,
15 92, 93, 94, and 95, recognizing Mr. Friedman's objection
16 notwithstanding, and leave it to the individual
17 Commissioners to give it the weight they deem it to be
18 due.

19 (Exhibits 91 through 95 admitted into the
20 record.)

21 Anything else at this point before we look to
22 possibly excuse this witness?

23 **MS. BARRERA:** No.

24 **COMMISSIONER EDGAR:** No? Mr. Friedman?

25 **MR. FRIEDMAN:** I have nothing further and

1 would ask that she be excused.

2 **COMMISSIONER EDGAR:** Ms. Allen, thank you very
3 much.

4 **THE WITNESS:** Thank you.

5 **COMMISSIONER EDGAR:** You are excused.

6 **MR. FRIEDMAN:** That's really the brunt of
7 our -- the next witness, I think, would be OPC's
8 witnesses.

9 **COMMISSIONER EDGAR:** It would be.

10 Mr. Sayler, if you can, I'd like to push on
11 for about 15 minutes. Is that okay? Or recognizing
12 that it is your witness, if you would --

13 **MR. SAYLER:** With it being so close to the
14 lunch hour that you had mentioned and a natural pause,
15 by the time we got through all the rigmarole and got him
16 up there, he'd do his summary, then we'd be breaking for
17 lunch.

18 **COMMISSIONER EDGAR:** That is correct.

19 **MR. SAYLER:** So, but whatever your pleasure
20 is. I can bring him up now or --

21 **COMMISSIONER EDGAR:** Let's do it.

22 **MR. SAYLER:** The Office of Public Counsel
23 would call Mr. Helmuth Schultz to the stand, please.

24 **COMMISSIONER EDGAR:** Thank you. I will note
25 for the record Mr. Schultz was sworn. And we're ready

1 when you are.

2 **MR. SAYLER:** Thank you, Madam Chair.

3 Whereupon,

4 **HELMUTH W. SCHULTZ, III**

5 was called as a witness on behalf of the Office of
6 Public Counsel and, having been duly sworn, testified as
7 follows:

8 **DIRECT EXAMINATION**

9 **BY MR. SAYLER:**

10 **Q** Mr. Schultz, please state your name and
11 business address for the record.

12 **A** I am Helmuth W. Schultz, III. My business
13 address is 15728 Farmington Road, Lavonia, Michigan
14 48154.

15 **Q** By whom are you employed and in what capacity?

16 **A** I am employed by Larkin & Associates, PLLC,
17 and I am a Senior Regulatory Analyst.

18 **Q** On behalf of OPC did you cause and prepare and
19 submit direct testimony in this proceeding?

20 **A** I did.

21 **Q** Do you have that testimony before you?

22 **A** I do.

23 **Q** Do you have any corrections, modifications, or
24 revisions to make to your prefiled direct testimony?

25 **A** Not that I'm aware of.

1 **Q** And do you adopt the prefiled testimony as
2 your direct -- as your testimony today?

3 **A** I do.

4 **MR. SAYLER:** Madam Chair, I would ask that the
5 prefiled testimony be inserted into the record as though
6 read.

7 **COMMISSIONER EDGAR:** The prefiled testimony
8 will be inserted into the record as though read.

9 **BY MR. SAYLER:**

10 **Q** Did you also prepare exhibits to your direct
11 testimony?

12 **A** I did.

13 **Q** And those would be HWS-1 through HWS-36, which
14 have been assigned continuing exhibit numbers 11 through
15 46; is that correct?

16 **A** That is correct.

17

18

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DIRECT TESTIMONY

OF

Helmuth Schultz III

On Behalf of the Office of Public Counsel

Before the

Florida Public Service Commission

Docket No. 110200-SU

I. STATEMENT OF QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Helmuth W. Schultz III. My business address is 15728 Farmington Road, Livonia, Michigan 48154.

Q. BY WHOM ARE YOU EMPLOYED?

A. I am a Senior Regulatory Analyst with Larkin & Associates, P.L.L.C.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCITES, P.L.L.C.

A. Larkin & Associates, P.L.L.C., performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). Larkin & Associates, P.L.L.C., has extensive experience in the utility regulatory field as expert witnesses in over 600 regulatory proceedings, including water and sewer, gas, electric and telephone utilities.

1 **Q. HAVE YOU PREPARED AN EXHIBIT WHICH DESCRIBES YOUR**
2 **EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE?**

3 A. Yes. Attached as Exhibit No.__(HWS-1), is a summary of my background,
4 experience and qualifications.

5
6 **Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF**
7 **YOUR TESTIMONY?**

8 A. Larkin & Associates, P.L.L.C., was retained by the Florida Office of Public Counsel
9 (OPC) to address issues remaining due to a protest of the Commission's Proposed
10 Agency Action (PAA) decision in the application to increase rates for Water
11 Management Services, Inc. (the Company or WMSI). Accordingly, I am appearing
12 on behalf of the citizens of Florida ("Citizens") who are customers of WMSI.

13

14 **II. BACKGROUND**

15 **Q. PLEASE BRIEFLY DESCRIBE THE ISSUES YOU WILL BE ADDRESSING**
16 **IN THIS PROCEEDING.**

17 A. I am addressing the appropriateness of the Company's accounting for funds charged
18 and credited to Account 123, the impact that advancing of funds to Mr. Brown and
19 Company affiliates could have on ratepayers. Included within the discussion of
20 Account 123 is a discussion regarding the purported value of the Brown Management
21 Group, Inc. (BMG) stock transfer as it relates to Account 123, how the DEP loan may
22 have been impacted by the Account 123 transactions, a discussion of the Company's
23 compliance with the DEP loan requirements, a discussion as to whether

1 management's decision to advance these funds over that time period may have
2 impacted the Company's ability to meet its obligations, and some recommendations
3 for the Commission to consider. My testimony will highlight important facts already
4 identified in the Commission staff's July 29, 2011 Cash Flow Audit Report and
5 workpapers for Account 123. Where I have formed an opinion based on the
6 Commission's Cash Flow Audit and workpapers, I will identify it as such for the
7 Commission to evaluate the merits of my recommendation. I am also responding to
8 the Company's protest of various expense determinations made by the Commission
9 including the appropriateness of allowing zero working capital in rate base.

10
11 **Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

12 A. My testimony regarding Account 123 will explain the following:

- 13 1. The purported accounting by the Company for advances to and from affiliates
14 and others was not in accordance with the 1996 NARUC Uniform Systems of
15 Accounts (USOA) adopted by the National Association of Regulatory Utility
16 Commissioners (NARUC).
- 17 2. My review of the Account 123 transactions among WMSI, BMG, Mr. Brown,
18 and other entities determined that BMG was a creditor of WMSI and not an
19 investment made by the Company. My review will show, as the Staff audit
20 did, that Mr. Brown was the primary recipient of advances from WMSI, and
21 because no terms for interest were included with the advancing of funds, that
22 the advances were reclassified by WMSI as an investment. The transfer of
23 BMG stock owned outright by Mr. Brown to WMSI, a company which is

1 principally owned and controlled by Mr. Brown is, in my opinion, not
2 sufficient to satisfy this obligation. And not only is the undocumented value
3 of BMG not sufficient to satisfy the obligation of Mr. Brown to WMSI, some
4 of the assets of BMG are not necessary for utility operation, therefore the
5 continued ownership by the Utility is not considered appropriate given the
6 Utility's financial position.

7 3. At the same time WMSI was advancing in excess of \$1.5 million to Mr.
8 Brown, WMSI was unable to make payments on the DEP loan that caused
9 WMSI to negotiate amendments to the DEP loan postponing payments,
10 resulting in additional interest on the loan, and, during this time period, the
11 Company was not current with its accounts payable.

12 4. Absent documented proof that a return was earned, the advances made to Mr.
13 Brown, WMSI affiliates, and others did not provide any benefit to WMSI
14 and/or ratepayers. And that in my opinion, the transactions resulted in a
15 detriment to WMSI and ratepayers.

16
17 **III. ACCOUNT 123**

18 **Q. WHAT IS ACCOUNT 123?**

19 A. Commission Rule 25-30.115, Florida Administrative Code (F.A.C.) requires that
20 water and wastewater utilities shall maintain their accounts and records in conformity
21 with the 1996 NARUC Uniform Systems of Accounts adopted by the NARUC. The
22 USOA for Class A Water Utilities provides an account name and numbering system

1 that a utility must follow. The USOA establishes several accounts to record transfers
2 of money between a utility and affiliated entities. These accounts are as follows:

- 3 • Account 123: Investment in Associated Companies
- 4 • Account 125: Other Investments
- 5 • Account 145: Accounts Receivable from Associated Companies
- 6 • Account 146: Notes Receivable from Associated Companies
- 7 • Account 223: Advances from Associated Companies
- 8 • Account 233: Accounts Payable to Associated Companies
- 9 • Account 234: Notes Payable to Associated Companies

10 If the utility advances money to an affiliated entity, there are definitions in the USOA
11 describing where it should be recorded. I have attached as Exhibit__ HWS-2, entitled
12 NARUC USOA for Class A Water Utilities, a copy of the definitions for Accounts
13 123, 125, 145, 146, 223, 233, and 234, as well as the USOA definitions for
14 Associated Companies and the Accounting Instructions for transactions with
15 Associated Companies. The primary difference between the accounts for Associated
16 Companies is based on whether the payment to or from the entity is intended to be
17 repaid in the short term (one year or less). The definition for Account 123,
18 Investment in Associated Companies is as follows:

19 **123. Investment in Associated Companies**

20 A. This account shall include the book cost of investments in
21 securities issued or assumed by associated companies (See definition
22 5) and investment advances to such companies, including interest
23 accrued thereon when such interest is not subject to current settlement.
24 Include also the offsetting entry to the recording of amortization of
25 discount or premium on interest bearing investments (See account 419
26 - Interest and Dividend Income).

1 B. The account shall be maintained in such manner as to show the
2 investment in securities of, and advances to, each associated company
3 together with full particulars regarding any of such investments that
4 are pledged.

5
6 **Note A:**--Securities and advances of associated companies owned and
7 pledged shall be included in this account, but such securities, if held in
8 special deposits or in special funds, shall be included in the appropriate
9 deposit or fund account. A complete record of securities pledged shall
10 be maintained.

11
12 **Note B:**--Securities of associated companies held as temporary cash
13 investments are includible in account 135 - Temporary Cash
14 Investments.

15
16 **Note C:**--Balances in open accounts with associated companies, which
17 are subject to current settlement, are includible in account 145 -
18 Accounts Receivable from Associated Companies.

19
20 **Note D:**--The utility may write down the cost of any security in
21 recognition of a decline in the value thereof. Securities shall be
22 written off or written down to a nominal value if there is no reasonable
23 prospect of substantial value. Fluctuations in market value shall not be
24 recorded but a permanent impairment in the value of securities shall be
25 recognized in the accounts. When securities are written off or written
26 down, the amount of the adjustment shall be charged to account 426 --
27 Miscellaneous Nonutility Expenses, or to an appropriate account for
28 provisions for loss in value established as a separate subdivision of this
29 account.
30

31 **Q. IN YOUR REVIEW OF THE FILING, DID YOU FORM AN OPINION AS TO**
32 **HOW THE COMPANY APPLIED THIS DEFINITION TO THE**
33 **TRANSACTIONS WHICH WERE RECORDED IN ACCOUNT 123?**

34 A. Yes. In my review, I took notice that the Company selectively relied on parts of the
35 Account 123 definition in classifying the costs they have recorded in the Company's
36 general ledger. The key, in my opinion, is that the Company only applied parts of the
37 definition of what costs are included and how they should be reflected in the

1 Company's ultimate treatment for the seven years of costs which accumulated in
2 Account 123 from 2004 to 2010.

3
4 **Q. WHAT DO YOU MEAN THE COMPANY ONLY APPLIED PARTS OF THE**
5 **DEFINITION?**

6 A. In classifying the costs to Account 123, while relying on the definition for Account
7 146 Notes Receivable from Associated Companies, the Company failed to recognize
8 two important parts of the definition for Account 146. The definitions for the two
9 accounts that are applicable are as follows:

10 **145. Accounts Receivable from Associated Companies**

11 See account 146.

12
13 **146. Notes Receivable from Associated Companies** These accounts
14 shall include notes and drafts upon which associated companies are
15 liable, and which mature and are expected to be paid in full not later
16 than one year from date of issue, together with any interest thereon,
17 and debit balances subject to current settlement in open accounts with
18 associated companies. Items which do not bear a specified due date but
19 which have been carried for more than twelve months and items which
20 are not paid within twelve months from due date shall be transferred to
21 account 123 - Investment in Associated Companies.

22
23 **Note A:**--On the balance sheet, accounts receivable from an associated
24 company may be set off against accounts payable to the same
25 company.

26
27 **Note B:**--The face amount of notes receivable discounted, sold or
28 transferred without releasing the utility from liability as endorser
29 thereon, shall be credited to a separate subdivision of this account and
30 appropriate disclosure shall be made in financial statements of any
31 contingent liability arising from such transaction.

32 There are two parts of the definition of Account 146 which I would like to highlight
33 for the Commission. First, Account 146 is for money advanced or loaned to an

1 associated company and that is expected to be paid in full not later than one year from
2 date of issue. This applies to funds advanced that have a due date and/or funds
3 advanced that do not have a due date. The definition further explains that money
4 which has been carried for more than twelve months and is not repaid is to be
5 included in Account 123. Only after that time period has passed should a transaction
6 be recorded in Account 123, and not before.

7
8 Second, I would like to highlight Note A which states an offset is permitted against
9 accounts of the same associated company. Based on my review of Account 123
10 transactions and the Staff Audit findings for Account 123, the Company has not
11 properly accounted for the costs in Account 123. In Response to the Staff Audit
12 Request No. 9 (Exhibit __HWS-3) the Company states that that it has attempted to
13 “resolve the issue of cash advances that were made from WMSI to BMG and Gene D.
14 Brown between January 1, 2004 and December 31, 2010.”¹ But, in my opinion, the
15 Company has unintentionally created a new problem for itself. It has attempted to
16 reclassify the net cash advances to Mr. Brown and his associated companies as an
17 investment in BMG. Based on the Company’s accounting records and assertions
18 made by the Company, this reclassification should not have been made or recorded on
19 the Company’s books in the manner that it has been.

20
21 **Q. PLEASE EXPLAIN WHY YOU BELIEVE THE COSTS IN ACCOUNT 123**
22 **HAVE NOT BEEN ACCOUNTED FOR PROPERLY?**

¹ Staff Rate Case Audit ; Docket No. 110200-WU; Volume 1 of 3; Workpaper Page 8-5.

1 A. The Company's transfer of funds from Account 146 to Account 123 was based on the
2 definition in Account 146 that states that items which are not paid within twelve
3 months shall be transferred to account 123 - Investment in Associated Companies. In
4 reviewing the Account 123 activity, the costs accumulated over a number of years
5 with payments being charged to Account 123 and credits being posted for repayments
6 of money. After initially recording a net amount in Account 123 in 2004 by means of
7 an adjusting journal entry, the Company began charging money into and out of
8 Account 123 in 2005. This was an ongoing process with Account 123. If one applies
9 the proper accounting methodology as prescribed by NARUC, which in my opinion is
10 the appropriate accounting methodology to apply, all the costs recorded by WMSI in
11 Account 123 from 2004 to 2010 would not have been recorded initially in Account
12 123, because many of the costs had not yet been on the books for twelve months.
13 Some of the costs would have been recorded in Account 123 while others would have
14 been recorded in Account 125-Other Investments, Account 223-Advances from
15 Associated Companies and/or Account 233-Accounts Payable Associated Companies
16 until they were twelve months old. The Company made a decision in 2004 to transfer
17 the payments to and from various associated entities that were previously in five
18 different accounts as a net to Account 123. This entry was in error, because it
19 improperly netted accounts that should not have been netted. After making those
20 journal entries, Account 123 became a smorgasbord of charges and credits from and
21 to various entities for the next seven years, until it was brought to the Commission's
22 attention in the last rate case. WMSI's use of Account 123, in my opinion, is not
23 consistent with the NARUC Uniform System of Accounts.

1 **Q. HOW WAS THE COMPANY'S ACCOUNTING INCONSISTENT WITH THE**
2 **NARUC UNIFORM SYSTEM OF ACCOUNTS?**

3 A. As noted in the definition of Account 146, any amounts in Account 146 that are more
4 than twelve months old can be transferred to Account 123. The definition for
5 Account 146 also states that any accounts receivable may be set off against accounts
6 payable for the same company. That would allow for balances ultimately transferred
7 to Account 123 from Account 146 to be receivables that are netted against payables
8 of the same company. WMSI took the various affiliate amounts, receivables and
9 payables, and lumped them together into Account 123 without regard to the set off
10 requirement in Note A of the definition of Account 146. To further cause concern is
11 the fact that there does not appear to be some form of subsidiary ledger system that
12 would allow the Company to readily identify the net amounts due from or to the
13 respective affiliates lumped into Account 123. Finally, as I alluded to earlier, it is not
14 appropriate to include in Account 123 any associated companies where WMSI has a
15 payable due to that Company.

16

17 **Q. WHICH ASSOCIATED COMPANIES SHOULD NOT BE SHOWN IN**
18 **ACCOUNT 123?**

19 A. As shown on Exhibit No. HWS-4 (Staff Reclassification Summarized), Page 1 of 3,
20 Brown Management Group, Inc., Gene Brown PA, and Equity Management Systems,
21 which are affiliates or associated companies of WMSI as defined by NARUC USOA,
22 should have been recorded in either Account 223, Advances from Associated
23 Companies and/or Account 233, Accounts Payable Associated Companies. Based on

1 my interpretation of the NARUC Uniform System of Accounts, the remaining
2 affiliate balances should have been in separate sub accounts for Account 123 and
3 advances to non-affiliates should be reflected in Account 125, Other Investments.
4

5 **Q. DOES YOUR ANALYSIS SHOW THAT ACCOUNT 123 INCLUDES AN**
6 **AMOUNT THAT WMSI ACTUALLY OWES TO BMG?**

7 A. Yes, according to my analysis, the net \$1.175 million Account 123 balance consists
8 of \$1,905,922 owed to WMSI by Mr. Brown and WMSI affiliates and \$730,847 owed
9 by WMSI to affiliates. Included in the \$730,847 owed by WMSI is \$334,890 owed to
10 BMG.
11

12 **Q. IF BROWN MANAGEMENT GROUP IS OWED MONEY, HOW COULD**
13 **THE TRANSFER OF 100% OF THE STOCK OWNERSHIP IN BMG TO**
14 **WMSI ADDRESS ANY CONCERNS WITH THE BALANCE IN ACCOUNT**
15 **123?**

16 A. I do not know. That appears to be another problem with the Company's accounting
17 for affiliate transactions. I first identified this as a concern when I found that WMSI
18 did not have a balance due from BMG but instead had a payable to BMG. I
19 attempted to reconcile this problem by reviewing the financial statements of BMG but
20 only found more issues.
21

22 **Q. WHAT ADDITIONAL ISSUES DID YOU DISCOVER IN REVIEWING THE**
23 **FINANCIAL STATEMENT OF BMG?**

1 A. I initially identified three issues. First, the transfer of BMG stock owned outright by
2 Mr. Brown to WMSI, a company which is principally owned and controlled by Mr.
3 Brown, in my opinion, is not sufficient to repay all the money advanced by WMSI.
4 Second, the payable to BMG does not match the investment in WMSI stock as found
5 on the BMG financials. Third, based on the statements by Mr. Brown in the August
6 2, 2012 Commission Conference, when he indicated BMG owned 10% of WMSI, I
7 began to question how the common equity of WMSI could be significantly lower than
8 what is reflected as an investment in WMSI in the financial statements of BMG. I
9 tried to rationalize the inconsistency.

10

11 I initially thought that some of the advances from BMG could be part of what BMG
12 listed as its investment in WMSI; however, the amount invested by BMG in WMSI
13 did not change significantly from year to year while the balance in Account 123 went
14 from a debit balance to a credit balance for BMG. The following is a comparison
15 between the books of WMSI and the purported financial statements of BMG for
16 2007 to 2010. These purported financial statements were provided by WMSI to Staff
17 in response to Staff Audit Request No. 27. My comparison below shows the level of
18 WMSI's investment in BMG from 2007 to 2010 as reflected in Account 123 and the
19 value of the purported investment in shares of WMSI stock that BMG owned:

	WMSI Account 123 <u>Balance for BMG²</u>	BMG – Water Management <u>Services, Inc. Stock³</u>
3	2007 \$ 126,516	\$600,000
4	2008 \$ 59,942	\$600,000
5	2009 \$ (70,486)	\$600,000
6	2010 \$(268,810)	\$606,459

7

8 This comparison indicates two significant inconsistencies between the books of BMG
9 and WMSI which simply did not make sense. It shows that BMG became a net
10 investor in WMSI over this time period without any increase in its share of WMSI
11 equity. It also shows that BMG was investing in WMSI and not the other way around
12 as claimed by Mr. Brown in his August 1, 2012 Memo and during his November 7,
13 2012 deposition. (Pages 28, 44-45 of Brown Deposition transcript, attached as
14 Exhibit __HWS-5).

15

16 **Q. WERE YOU ABLE TO DETERMINE WHY THE INCONSISTENCIES**
17 **EXISTED?**

18 A. Yes. In Mr. Brown's November 7, 2012 deposition, he testified that the financial
19 statements provided for BMG were based on fair market value (FMV) (page 33).
20 Specifically, Mr. Brown stated that the investment amount in WMSI stock on the
21 financial statements provided for BMG was based on FMV. The purported financial
22 statements are not statements prepared in accordance with Generally Accepted
23 Accounting Principles (GAAP). These financial statements are simply BMG's best

² Select Staff Audit Workpapers of Analysis of Account 123; Exhibit __ HWS-6.

³ Docket No. 100104-WU, response to Staff Audit Request No. 27; Exhibit __ HWS-7.

1 estimate of what they believe BMG's net worth to be. The fact that the statements are
2 purported to be FMV statements also explains why the BMG financial statements for
3 2007 through 2010 provided in response to Staff Audit Request 27 in Docket No.
4 110200-WU did not match the "confidential" financial statements for 2007 through
5 2010 for BMG provided in response to OPC's First Request for Production of
6 Documents, No. 14. (Exhibit__HWS-7 contains the non-confidential BMG financial
7 statements provided in response to Staff Audit Request No. 27, and "confidential"
8 Exhibit__HWS-8 contains BMG's financials 2007-2011 provided in response to
9 OPC's First Request for Production of Documents, No. 14).

10
11 **Q. WHAT ABOUT THE CLAIM THAT THE COMPANY'S PURPORTED**
12 **INVESTMENT IN BMG IS WORTH MORE THAN THE \$1.2 MILLION IN**
13 **ACCOUNT 123?**

14 A. The claim makes no sense for two reasons. First, based on the general ledger of
15 WMSI, there could not be an investment by WMSI in BMG. As mentioned earlier in
16 my testimony, the general ledger of WMSI indicates that BMG invested in WMSI as
17 reflected by the account payable that WMSI owes BMG as shown on Exhibit__HWS-
18 4, Page 1. The fact that Account 123 does not reflect a debit balance for BMG is
19 indicative that WMSI has not made an investment in BMG. Next, the claim that
20 BMG has a purported net worth of more than the \$1.2 million in Account 123 is not
21 documented as Mr. Brown's August 1, 2012 letter claims. I have attached a copy of
22 this letter as Exhibit__HWS-9. As I just stated, the financial statements that
23 purportedly would substantiate this claim are so-called FMV statements based on

1 what BMG has decided the value is. The purported “confidential” BMG financial
2 statements for 2011 still reflect an investment by BMG in WMSI which is
3 inconsistent with Mr. Brown’s statement to the Commission on August 2, 2012 that
4 WMSI’s investment in BMG was transferred back to WMSI.⁴ The Staff’s July 29,
5 2011 Audit of Account 123 not only shows that BMG was a net “investor” in WMSI,
6 but also that included in the net \$1.175 million was \$1,547,614 advanced from WMSI
7 to Mr. Brown, \$273,308 advanced to associated companies and \$395,958 owed to
8 other affiliates.

9
10 **Q. WHAT WAS THE SOURCE OF THOSE FUNDS WHICH WERE**
11 **ADVANCED FROM WMSI TO MR. BROWN AND THE ASSOCIATED**
12 **COMPANIES THROUGH ACCOUNT 123?**

13 **A.** I was not asked to determine the source of those funds advanced to Mr. Brown and
14 associated companies. Absent documentation that establishes that WMSI actually
15 owes Mr. Brown personally, it would appear that the funds came from utility
16 operational funds, the water main settlement proceeds, and/or from increasing the
17 utility debt obligations.

18
19 **Q. BASED ON THE ACTIVITY IN ACCOUNT 123, CAN YOU THINK OF ANY**
20 **WAY THAT THE BMG STOCK COULD BE TRANSFERRED TO WMSI TO**
21 **OFFSET WHAT WAS ADVANCED TO MR. BROWN AND ASSOCIATED**
22 **COMPANIES?**

⁴ Exhibit HWS-10 is a portion of the transcript from the August 2, 2012 Commission Agenda Conference, pages 106-108 in Docket No. 110200-WU.

1 A. At the time these transactions were taking place, Mr. Brown owned 100% of BMG.
2 At any time during this period he could transfer his ownership share in BMG to offset
3 the amount he personally owes to WMSI according to WMSI's general ledger. In
4 fact, he did transfer his ownership interest in BMG to WMSI on January 1, 2011, in
5 an attempt to resolve the Commission's concern with Account 123.

6

7 **Q. IF THAT WAS THE WAY IN WHICH THE TRANSFER TOOK PLACE, TO**
8 **WHAT ACCOUNT 123 TRANSFER BALANCES SHOULD THE TRANSFER**
9 **OF BMG STOCK APPLY?**

10 A. The value of BMG should be applied only to what Mr. Brown owes WMSI. As
11 shown on Exhibit __HWS-4, Page 1 of 3 and page 10 of the Staff's July 29, 2011 cash
12 flow audit, he personally owes \$1,550,614 to WMSI (A/R-Gene Brown of \$2,127,074
13 less A/P-Gene Brown of \$576,460). I have attached a copy of the July 29, 2011 Staff
14 Cash Flow Audit Report as Exhibit __HWS-11. Moreover, the value of BMG which
15 he transferred to the Company should only apply to what Mr. Brown owes and should
16 not be applied to reduce the receivables and payables owed by or to other associated
17 companies. However, even with a transfer, there is not sufficient evidence that BMG
18 has a net worth sufficient to offset Mr. Brown's \$1.5 million obligation. Therefore if
19 the Commission were to consider the transfer as a repayment it should only be
20 considered as a partial payment of Mr. Brown's obligation to WMSI.

21

22 **Q. WHAT IS THE SOURCE OF YOUR INFORMATION ON WHAT WAS**
23 **INCLUDED IN ACCOUNT 123?**

1 A. I developed my schedules using the Staff workpapers and the WMSI General Ledger
2 that was included in the Staff's workpapers.

3

4 **Q. ARE YOU IN FULL AGREEMENT WITH THE STAFF SUMMARY OF THE**
5 **ACCOUNTING IN ACCOUNT 123?**

6 A. I found that the dollar information in the Staff summary was reasonable with one
7 exception. The Staff reclassified part of a \$144,500 payment received from BMG
8 and treated \$85,000 as a payment from SMC Investments. The workpaper indicated
9 that it was "per GDB." Absent documentation that shows that SMC Investments paid
10 BMG \$85,000 prior to BMG paying the \$144,500 to WMSI, I believe that the
11 original \$85,000 loan to SMC Investments should still be reflected on the books of
12 WMSI in Account 125, Other Investments.

13

14 **Q. DID YOU ATTEMPT TO DETERMINE IF DOCUMENTATION EXISTED**
15 **THAT WOULD SUPPORT THE STAFF'S RECLASSIFICATION OF THE**
16 **\$85,000?**

17 A. Yes. OPC's Second Request for Production of Documents No. 5 requested that Staff
18 provide supporting documentation for reclassifying the \$85,000 from being paid by
19 BMG to being paid by SMC Investment Properties. The response identified four
20 workpapers as justification for Staff's "per GDB" entry which I have attached as
21 Exhibit__HWS-12, Staff Audit Workpapers Response to OPC POD 5. In addition, I
22 have attached as Exhibit__HWS-13 two other workpapers that show the initial
23 payment to SMC Investment Properties that prompted my concern. In reviewing the

1 four workpapers identified by Staff in its response to the OPC request, you will not
2 find any documents that show that SMC Investment Properties has repaid the \$85,000
3 to either WMSI or BMG. The workpapers show that BMG, and not SMC Investment
4 Properties, paid WMSI \$144,500. The only way that this reclassification would be
5 considered appropriate is if there was an actual document(s) that shows payment of
6 the \$85,000 being made to BMG by SMC Investment Properties. Mr. Brown testified
7 in his deposition on pages 50-51 that this documentation exists but counsel for WMSI
8 has indicated that he objects to providing the information as a late-filed deposition
9 exhibit because in his opinion it is an inappropriate discovery method. I have
10 attached a copy of the deposition transcript earlier in my testimony as
11 Exhibit__HWS-5. In addition, during the deposition of Bob Mitchell, the Controller
12 for WMSI, counsel for the Company objected to questions about this transaction as
13 being irrelevant (pages 36-39). I have attached a copy of Mr. Mitchell's deposition
14 transcript as Exhibit__HWS-14. In my opinion, these questions are relevant. An
15 advance of utility funds to an entity that is not an affiliate or an associated company
16 as defined by NARUC USOA is an amount that should be repaid to the utility, and
17 absent actual documentary evidence that this repayment was actually made, the funds
18 advanced to SMC Investments are still due to WMSI.

19
20 **Q. HOW DID YOU DETERMINE THAT THE STAFF SUMMARY WAS**
21 **REASONABLE OTHERWISE?**

22 A. The Staff audit was a very comprehensive audit and the workpapers supporting that
23 audit were significantly detailed. I reviewed the documentation from the audit and

1 found it reasonably sufficient to conclude that the amounts in the summary were
2 classified properly with the one exception. As shown on Exhibit__HWS-4, Page 1,
3 Lines 17-41, I started with the initial summary of transactions listed in the Staff
4 analysis and then reviewed the various reclassifications of entries. The result was the
5 same as the Staff final summary as shown on lines 1-16 of Exhibit__HWS-4, Page 1.

6
7 **Q. WHAT DID YOU CONCLUDE FROM YOUR REVIEW OF THE**
8 **COMPANY'S ACCOUNT 123 ENTRIES IN ITS GENERAL LEDGER?**

9 A. The General Ledger of WMSI indicates that the Company has "invested" \$1,905,922
10 in various entities. Of the \$1,905,922, \$85,100 should be recorded in Account 125,
11 Other Investments. The remaining \$1,820,822 consists of nine entities. The two
12 largest amounts advanced by WMSI to related parties or associated companies are
13 \$1,547,614 to Gene Brown personally and \$197,978 to Land in Florida, Inc. There is
14 a caveat to listing the nine entities as being associated companies because based on
15 the July 29, 2011 Staff Audit Report, I cannot determine whether Land in Florida,
16 Inc. is a related party or not.

17
18 **Q. WHY ARE YOU PROPOSING SOMETHING DIFFERENT FROM WHAT**
19 **THE STAFF PROPOSED IN ITS JULY 29, 2011 AUDIT REPORT AS TO**
20 **THE RECLASSIFICATION OF THE AMOUNTS FROM ACCOUNT 123?**

21 A. First, I believe the Company is correct that the related party advances that are not
22 repaid within twelve month should be recorded in Account 123. Second, instead of
23 setting up different receivables and payables for the same entity, the NARUC

1 Uniform System of Accounts provides for a netting of the same associated company
2 receivable and payable balances. That netting does not apply, however, to all the
3 different entities being netted into one as WMSI has in effect done. On
4 Exhibit__HWS-4, I have listed what accounts I believe the amounts in Account 123
5 should be reclassified to. This recommendation comes with a caveat based on
6 Finding No. 1 in the July 29, 2011 Staff Audit Report.

7
8 **Q. WHY IS THERE A CAVEAT TO YOUR RECOMMENDATION?**

9 A. According to the audit report, four of the entities: Equipment Management Systems,
10 Inc., Real Estate Services of North Florida, Inc., Real Estate Equities of Florida, LLC
11 and Gene Brown PA had been dissolved prior to January 1, 2011. That means that
12 the investments in the two affiliate receivables and the two affiliate payables should
13 be written off as an expense or to income. It is obvious that if these associated
14 companies have been dissolved, repayment will not be made. Therefore, it would not
15 be appropriate to maintain those amounts on the books of WMSI. An alternative to
16 that would be to charge and credit the Gene Brown receivable balance; however, that
17 should only be allowed if adequate documentation exists to support that the respective
18 amounts have been accounted for that way and in that manner on the books of the
19 four entities in question before they were dissolved.

20
21 **Q. IN HIS AUGUST 1, 2012 MEMO TO THE COMMISSION, MR. BROWN**
22 **STATES WITH RESPECT TO THE AMOUNTS IN ACCOUNT 123 THAT**
23 **“THESE INVESTMENTS AND TRANSFERS OF FUNDS AS**

1 **CONSOLIDATED UNDER ACCOUNT 123 HAVE BEEN USED FOR THE**
2 **BENEFIT OF THE UTILITY AND HAVE HELPED KEEP IT SOLVENT**
3 **WHEN THERE WERE INSUFFICIENT FUNDS FROM THE RATEPAYERS**
4 **TO COVER THE DAY-TO-DAY CASH OPERATING REQUIREMENTS**
5 **FOR WMSI....” (Page 2) DO YOU AGREE WITH THAT STATEMENT?**

6 A. No. The Company’s statement could be presumed correct with respect to the
7 advances from Brown Management Group, Gene Brown PA, and Equity
8 Management Systems, but I see no basis for that claim with respect to the advances
9 made to the other entities. Funds advanced to WMSI by other entities can provide a
10 benefit to WMSI. However, WMSI’s advancing funds to other entities does not
11 provide a benefit to WMSI or ratepayers unless the return earned on those advances
12 reduces the cost of service. I have not seen any evidence where there was a return
13 from these advances that reduced the cost of service. The advances made have
14 already increased costs for WMSI. There is also the possibility that advancing this
15 large amount of money to these Company affiliates could potentially cause harm to
16 ratepayers.

17
18 **Q. HOW COULD ADVANCES POTENTIALLY CAUSE HARM TO**
19 **RATEPAYERS?**

20 A. Ratepayers may be harmed when the advances that are made to affiliates reduce the
21 amount of funds available to pay the cost of day-to day operations. That creates a
22 need for additional funds. The additional funds in this case appear to come from two
23 sources. The first is an increase in accounts payable by delaying payment to vendors.

1 This was also observed by Staff in Finding 2 of the July 29, 2011 audit report. That
2 can cause vendors to be reluctant to perform services and/or not provide material
3 parts to maintain the system. The second source of additional funds is increasing
4 debt.

5
6 **Q. IN WHAT WAYS HAS WMSI INCREASED DEBT TO GAIN ADDITIONAL**
7 **FUNDS?**

8 A. The Company appears to have increased its debt to gain a small amount of additional
9 funds by refinancing the debt on a backhoe and by refinancing a vehicle that was paid
10 off. This source of additional funds is quite small when compared with the
11 restructuring of the DEP loan through its various Amendments. Not making the
12 regularly scheduled DEP loan payments was another source of funds. The DEP loan
13 balance has been increased due to capitalized interest resulting from delayed
14 payments and an extension of time from 20 to 30 years to repay the loan. This was
15 identified by Staff in Finding 5 of the July 29, 2011 Audit Report to be the cause of
16 an increase of \$928,071 in interest expense over the term of the loan. However, the
17 additional interest identified in Staff's Audit Report is understated because it only
18 included additional interest through December 31, 2010, and not the additional
19 interest through Amendment 6 to the loan, dated September 17, 2012. See Exhibit
20 ___HWS-15. The total amount of additional interest added to the DEP loan by these
21 successive restructuring exceeds \$1.123 million as of the fifth amendment and will
22 only increase with the sixth amendment.

1 While the Company argues in Mr. Brown's August 1, 2012 letter that extending the
2 term of the DEP loan is a benefit to ratepayers, it raises other significant concerns
3 because the amount of debt can only continue to increase to a certain point before the
4 Company can no longer renegotiate or extend the terms of its various loans and the
5 debt bubble bursts. If the debt on any of the Company's two major loans is called,
6 the Company will have significant financial problems operating which could very
7 well adversely impact ratepayers. Because of this and the fact that WMSI is highly
8 leveraged in debt, there may be a going concern issue.

9
10 **Q. WHAT SUGGESTS TO YOU THAT THERE MAY BE A GOING CONCERN**
11 **ISSUE?**

12 A. The going concern concept is an assumption that financial statements are prepared
13 with the understanding that the business is not about to be liquidated. The auditing
14 standards provide the only formal guidance in this area and state, in part, that "the
15 auditor has a responsibility to evaluate whether there is substantial doubt about the
16 entity's ability to continue as a going concern for a reasonable period of time." (See
17 my Exhibit__HWS-16 for the Auditing Standard.) If there is substantial doubt, an
18 explanatory paragraph should be included in the auditors' report. I have not audited
19 this company, but the documents that I have reviewed would cause me to perform
20 additional audit work to determine whether this company is operating as a going
21 concern. The restructuring of debt, as indicated above, is one indicator that there is a
22 possible going concern issue. In addition, according to the Commission PAA order in
23 Docket No. 110200-WU, and the WMSI 2010 Annual Report, the Company has a

1 negative equity. My Exhibit__HWS-17 is a copy of the 2010 WMSI Annual Report
2 from the Commission's website. The "complete" 2011 financial statements for
3 WMSI that were provided in response to OPC's First Request for Production of
4 Documents No. 4 are attached for comparison purposes as "confidential"
5 Exhibit__HWS-18. (The Company filed a request that these be maintained as
6 confidential.) According to the PAA Order, the Company has a negative equity of
7 \$2,163,302. (Order No. PSC-12-0435-PAA-WU at page 44.) The presence of a
8 substantial amount of negative equity is a key trigger in an audit in whether an auditor
9 would be required to perform additional audit work to evaluate whether a company
10 has a going concern issue. Then there is the fact that the 2010 Annual Report reflects
11 notes payable of \$8,096,037 for December 31, 2010, which far exceeds the net plant
12 balance of \$5,551,025. This also could raise some concern as to whether the
13 Company is liquid enough to meet its obligations. While I have not audited the
14 financial statements of WMSI to make a definitive determination there appears, in my
15 opinion, to be an indication that without an infusion of equity or some significant
16 increase in revenue that a going concern issue may exist. Regarding the ongoing cash
17 advances by the Utility, Commission staff's July 20, 2012, proposed agency action
18 recommendation called into question the Company's viability as a going concern in
19 its analysis of Issue 15. (See my Exhibit__HWS-19)

20
21 **Q. HAVE YOU REVIEWED THE 2011 AND 2012 FINANCIAL INFORMATION**
22 **TO DETERMINE WHETHER THERE HAVE BEEN ANY CHANGES IN**
23 **THE FINANCIAL CONDITION OF WMSI?**

1 A. A review of the “confidential” 2011 financial statements provided in response to OPC
2 First Request for Production of Documents No. 4 does not indicate any significant
3 change in debt and/or equity when compared to 2010. With respect to 2012, I can
4 offer no opinion because the response to OPC’s First Request for Production No. 2,
5 states: **BEGIN CONFIDENTIAL** - [REDACTED]
6 [REDACTED]
7 [REDACTED] - **END CONFIDENTIAL**

8

9 **Q. WHAT ABOUT THE FINANCIAL CONDITION OF BMG WHICH WMSI**
10 **NOW OWNS?**

11 A. Evaluating BMG only further complicates matters. I was unable to determine how
12 payments to and/or from WMSI were recorded on the books of BMG. OPC
13 requested the general ledgers of BMG. The Company stated in response to OPC’s
14 First Request for Production No. 13 that “THERE ARE NO GENERAL LEDGERS
15 FOR BROWN MANAGEMENT FOR 2008, 2009, 2010, 2011 AND 2012.” OPC’s
16 request and the Company’s response are attached as Exhibit__HWS-20. It is not
17 clear to me how any well managed company can produce accurate and reliable
18 financial statements without some form of general ledger. It is also not clear how it
19 can be asserted that BMG is worth more than what is in Account 123 when there is no
20 general ledger that would support the asset costs purportedly recorded on the books of
21 BMG.

1 Q. MR. BROWN'S AUGUST 1, 2012 MEMO STATES THAT AFTER
2 DECEMBER 31, 2010, WMSI STOPPED USING ACCOUNT 123 AND HAS
3 NOT USED IT SINCE EXCEPT TO CORRECT AN ACCOUNTING ERROR
4 MADE IN 2010 REGARDING \$40,000 THAT MR. BROWN LOANED TO
5 WMSI. IS THAT A CORRECT STATEMENT?

6 A. To some degree, his statement is accurate, with the exception of the reference that the
7 correction was for \$40,000 that Mr. Brown loaned WMSI. The 2011 general ledger
8 indicates something different. I have attached a copy of the page from the
9 confidential general ledger as Confidential Exhibit__HWS-21. I believe that this is
10 where a lot of the issues in this case have arisen. Based on my review of information
11 in this case and the previous case, it appears that Mr. Brown views the various
12 activities between the various entities as being between him personally and WMSI.
13 This apparent comingling is further evidenced on page 11 of Mr. Brown's August 1,
14 2012 memo where he states: "I have subsidized this company financially and
15 otherwise for 38 years." (Brown's August 1, 2012 letter, p. 11, Exhibit HWS-9).
16 However, this statement, based on the Company's general ledger, is not supported by
17 the facts since Mr. Brown owes the Company \$1.5 million. If Mr. Brown had in fact
18 personally subsidized the utility to the extent that he has asserted, the Company's
19 financial statements would reflect either more equity or a large payable to Mr. Brown.
20 Neither exists. I would note that the Commission in Docket No. 100104-WU made a
21 similar observation with respect to Mr. Brown's same assertion in that case when the
22 Commission stated that, "there has been no increase in the amount of equity invested
23 in WMSI, no loans or advances from Mr. Brown or any associated company to

1 WMSI, and no notes or accounts payable to associated companies or Mr. Brown on
2 the books of WMSI.”⁵

3
4 This is further evidenced in the so-called internal audit attached to the August 1, 2012
5 Memo depicted as the “WMSI FINANCIAL SOURCES AND USES”. In my
6 experience, each entity is a separate entity; thus each entity should be maintaining a
7 separate set of accounting records. It is not appropriate to simply lump all the
8 activities with various entities in one account, as WMSI has done with Account 123,
9 and then arbitrarily decide that they can be netted as a single investment in an entity
10 that according to the financial records of WMSI is actually owed money by WMSI.

11
12 **Q. DID YOU REVIEW THE “WMSI FINANCIAL SOURCES AND USES”**
13 **DOCUMENT ATTACHED TO THE AUGUST 1, 2012 MEMO?**

14 A. Yes. For the record, Mr. Brown has referred to the “WMSI FINANCIAL SOURCES
15 AND USES” document as an internal audit in his August 1, 2012 Memo, page.3.
16 However, the document attached to Mr. Brown’s August 1, 2012 Memo is not an
17 “audit” of WMSI’s cash flow as that term is generally used by auditors. Instead the
18 document is simply a presentation of what Mr. Brown perceives the sources and uses
19 of funds were.

20
21 OPC attempted repeatedly to obtain information about this so-called “internal audit”
22 to determine whether this document, as presented, could be considered as reliable

⁵ Order No. PSC-11-0010-SC-WU at page 53.

1 and/or valid through both service of discovery questions and deposing two utility fact
2 witnesses, Mr. Brown and Mr. Mitchell, the controller. However, the Utility objected
3 to providing answers to OPC's interrogatories concerning this purported internal cash
4 flow audit. When OPC deposed WMSI's controller and asked questions concerning
5 this document, the Utility objected over 20 times and instructed the controller not to
6 answer pursuant to Rule 1.310, claiming these questions were irrelevant and the
7 deposition was being conducted in bad faith or in a manner that is unreasonable, to
8 annoy, embarrass, or oppress the deponent or party. See Mitchell deposition
9 transcript Exhibit__HWS-14, p. 20-26, 31-33. OPC ultimately was forced to resort to
10 filing a motion to compel this and other responses to which the Company objected.
11 In my opinion these are legitimate discovery designed to obtain evidence upon which
12 the Commission could base a decision related to the prudence of the Utility's
13 advancing, on a net basis more than \$1.2 million to Mr. Brown and associated
14 companies. By Order No. PSC-12-0624-PCO-WU, issued November 20, 2012, the
15 Commission compelled the Company to respond to this and other objected discovery.
16 The compelled response to OPC's First Set of Interrogatories No. 4 confirmed what
17 was suspected. This so-called "internal audit" is "not a compilation, review or audit
18 of WMSI's operations as those terms are commonly used by accountants." I have
19 attached OPC's First Set of Interrogatories No. 4, the Company's objection, and the
20 Company's compelled response as Exhibit__HWS-22, entitled Nature of WMSI
21 Financial Sources and Uses Document.

22

1 **Q. DO YOU ATTRIBUTE ANY WEIGHT OR RELIABILITY TO THE**
2 **COMPANY’S “WMSI FINANCIAL SOURCES AND USES” DOCUMENT?**

3 A. None. But it is useful to discuss the deficiencies contained this document and the
4 problems they create.

5

6 **Q. WHAT PROBLEMS DO THE DEFICIENCIES IN THIS DOCUMENT**
7 **CREATE?**

8 A. There is the problem with how the “WMSI FINANCIAL SOURCES AND USES”
9 was presented to the Commission. This document suggests that “Gene Brown,
10 Affiliates & 3rd Parties” provided sources of funds to the Company instead of funds
11 being secured with Company assets. There is no evidence that the “Cash from Loans
12 Secured by GDB/Affiliates” is the debt of any entity other than WMSI. The large
13 amount of debt depicted in the schedules under the caption “Gene Brown, Affiliates
14 & 3rd Parties” appears to be WMSI debt secured with WMSI assets. In my opinion, it
15 is not Gene Brown’s personal debt and/or affiliate debt. There is no documentation
16 identifying the specifics of what the “Cash from third parties” is, so third party source
17 of cash is unknown.

18

19 **Q. DO YOU HAVE ANY CONCERNS WITH THE STATEMENT IN MR.**
20 **BROWN’S MEMO THAT WMSI STOPPED USING ACCOUNT 123?**

21 A. Yes. The statement implies that the Company stopped advancing money to Mr.
22 Brown and associated companies after December 31, 2010. This is simply
23 inaccurate. Instead of recording that activity in Account 123, which had been the

1 Company's practice for seven years, that activity continued and was simply recorded
2 in other accounts. I have attached the Commission staff's rate case audit report, dated
3 March 12, 2012, as Exhibit__HWS-23. Audit Finding 7 is an update to the July 29,
4 2011 Staff Audit Cash Flow Audit. According to the referenced Table 3 on page 20,
5 it shows that disbursements continued to be made to Mr. Gene Brown, BMG, etc. as
6 well as deposits from these entities. These advances are presumed to be included as
7 part of the reference to the ongoing cash advances that were noted on page 36 of
8 Staff's recommendation in staff's "going concern" discussion. See Exhibit__HWS-
9 19. Incidentally, Audit Finding 7 also shows that WMSI made disbursements to
10 Gene Brown PA in 2011, which according to the July 29, 2011 Staff Audit report
11 (page 5) was dissolved in 2008. The Company should not be recording
12 disbursements to a dissolved entity. Those disbursements should be reclassified to
13 the appropriate person or entity that received them.

14
15 **Q. IN YOUR OPINION, IS THERE SUFFICIENT EVIDENCE TO SHOW THAT**
16 **THE SO-CALLED INVESTMENT OF \$1.175 MILLION IN ACCOUNT 123 IS**
17 **PROVIDING A BENEFIT TO RATEPAYERS?**

18 A. No, there is no evidence that the net advance of \$1.175 million benefited the
19 ratepayer. As I have stated above, the transactions in Account 123, according to the
20 general ledger, indicate that some entities have advanced money to WMSI that could
21 be a benefit to ratepayers; however, there have been more funds advanced by WMSI
22 to other associated companies that could have actually caused harm to WMSI and to
23 ratepayers. Even though the stock in BMG has been transferred to WMSI in an

1 attempt to resolve the accounting issue, there is no real evidence that BMG has a net
2 worth equal to or greater than the purported investment of \$1.175 million or that the
3 assets are useful to a water utility in providing service to its customers. But more
4 importantly, there is no evidence that BMG has a net worth equal to or greater than
5 the more accurate Account 123 balance of \$1.821 million as indicated on
6 Exhibit__HWS-4.

7
8 **Q. DO YOU BELIEVE THAT THE NET EFFECT OF THESE CASH**
9 **ADVANCES HAS HARMED THE OPERATION OF THE COMPANY?**

10 A. Yes. Given that this Company, according to its own statements, is struggling to
11 survive, it is tremendously leveraged in debt, and debt greatly exceeds rate base, then
12 in my opinion, the advancing of the net \$1.2 million of utility money can only have a
13 detrimental and harmful effect on the operation of the Company. There are several
14 instances that show where the Company has been harmed by the lack of cash
15 generated by these transfers. First, as discussed earlier, the Company has negotiated
16 with DEP to defer three years of payments on its loan. Those were payments 13-18⁶.
17 Second, the Company requested payment plans for both its 2011 Regulatory
18 Assessment Fees to the commission as it did not have the cash to make the payments.
19 I have attached as Exhibit__HWS-24 the two requests for RAF payment plans. That
20 request would probably not have had to be made if the Company had not advanced
21 the \$1,547,614 to Mr. Brown and the \$358,308 to various other entities. According
22 to Table 3 in Audit Finding 7, Cash Flow Analysis Update, in 2011, while the

⁶ Amendment 6 to Loan Agreement DW1901 010, Water Management Services, Inc.; Exhibit__HWS-26

1 Company was requesting a RAF payment plan from the Commission for 2011 RAFs,
2 the Company made a net advance of \$47,288 to Mr. Brown and associated
3 companies. The Commission in Docket No. 100104-WU noted there was no
4 evidence that the alleged loans by Mr. Brown and BMG were incurred for the benefit
5 of the utility that the advances are purported to represent.⁷ Ultimately, this
6 Commission will have to determine based on the evidence whether the advances to
7 other entities have harmed the utility, and whether that harm was the result of
8 managerial imprudence.

9
10 **VALUE OF BMG**

11 **Q. COULD YOU ELABORATE WHY YOU DO NOT AGREE WITH MR.**
12 **BROWN'S STATEMENT IN HIS AUGUST 1, 2012 LETTER THAT THE**
13 **VALUE OF BMG IS IN FACT WORTH MORE THAN THE**
14 **ACCUMULATED \$1.2 MILLION BALANCE IN ACCOUNT 123?**

15 **A.** Yes. According to WMSI's response to Staff Audit Request No. 27 (Exhibit __HWS-
16 7), the purported value (assets minus liabilities) of BMG as of December 31, 2010
17 was \$1.19 million. The assets on BMG's balance sheet totaled \$2,033,383 the
18 liabilities totaled \$842,156. BMG's assets included the 10% stock ownership of
19 WMSI, which in 2010 BMG valued at \$606,459 using a fair market valuation (FMV).
20 Thus, on the date of the transfer of BMG's stock to WMSI, BMG's largest asset was
21 its ownership share of WMSI, which accounted for more than half of BMG's net
22 book value. As noted previously, all the assets on BMG's balance sheet were

⁷ Order No. PSC-11-0010-SC-WU, at page 55.

1 recorded at FMV instead of cost; therefore, the value of those assets might be
2 overstated if recorded at cost. If the value of the WMSI stock were removed from the
3 assets of BMG, the purported FMV of BMG assets would be \$1,426,924 (\$2,033,383
4 - \$606,459) and the purported net worth would then be only \$584,768. That adjusted
5 FMV is significantly less than the \$1.2 million in Account 123. There is even more
6 of a significant difference when compared to the \$1.5 million in Account 123 due to
7 WMSI from Mr. Brown. Taking the comparison one step further and incorporating a
8 proper accounting, the value of BMG assets should be increased by \$334,890 to
9 reflect the money owed to BMG. That would increase the purported FMV of BMG to
10 \$919,658. That purported FMV is still less than the \$1.5 million due to WMSI from
11 Mr. Brown. The difference could be even greater if it was determined that you could
12 not rely upon the FMV of the other assets as provided by BMG without substantiating
13 documentation such as appraisals.

14
15 **Q. IS THERE AN ISSUE WITH THE FMV OF BMG ASSETS?**

16 A. In my opinion the estimated FMV is not supported by documented evidence. There is
17 also the problem that the 2007 through 2010 balance sheets of BMG provided to in
18 response to Staff Audit Request No. 27 when compared to the "confidential" 2007
19 through 2010 balance sheets provided in response to OPC's First Request for
20 Production of Documents No. 14 (Exhibit__HWS-8) are different. When asked about
21 this difference at his deposition, Mr. Brown testified that BMG will occasionally
22 restate BMG's balance sheets, even the prior balance sheets that included the past

1 FMV of an asset. Page 43 of his deposition (Exhibit__HWS-5) contains the
2 following exchange:

3 Q. So just to be clear, your adjustments can go back in time, even
4 after the year-end is closed; is that right?

5 A. Yes. In other words, if we provided a financial statement two
6 years ago and we're now asked what was the value of assets, and we
7 know, for example, that the value of an asset has decreased -- for
8 example, like on St. George Island, I'm pretty familiar with lot values
9 down there. People bought lots for a million eight, and then they
10 were selling them two years later for 600,000. So it wouldn't be
11 accurate if you said what's the value, you know, so they are adjusted.

12
13 **Q. DO YOU AGREE WITH THE PRACTICE OF USING THE FMV OF ASSETS**
14 **AND THEN RESTATING THE FMV ON HISTORIC BALANCE SHEETS?**

15 A. No. In fact, I have three issues with this practice. The first is the purported use of
16 FMV balance sheet and ignoring a cost based statement. Second, I would take issue
17 with assigning a FMV to assets without supporting documentation. And finally, I do
18 not believe that it is appropriate to restate the financials since the value assigned is
19 supposedly based on the period reflected in the financials not based on subsequent
20 changes in judgment.

21
22 **Q. WHAT IS THE SIGNIFICANCE OF PLACING A FMV ON THE ASSETS OF**
23 **BMG?**

1 A. By Order No. PSC-11-0010-SC-WU, issued January 3, 2011, in Docket No. 100104-
2 WU, the Commission stated that Mr. Brown elaborated that the balance in Account
3 123 did not represent an equity investment in associated companies but was instead
4 an accumulation of advances to repay BMG and himself for debt service.⁸ Now, in
5 an attempt to resolve the Commission's justified concerns surrounding Account 123,
6 the Company now considers the funds in Account 123 an investment. If any of the
7 funds are in fact an investment then it must be determined whether the value of the
8 purported investment is at least equivalent to the funds advanced. As discussed
9 earlier that would mean the FMV should exceed the net advance of \$1.5 million to
10 Mr. Brown. To determine a proper FMV of the BMG balance sheet there should be
11 an independent documented appraisal made.

12

13 **Q. HAVE YOU REVIEWED ANY DOCUMENTATION THAT WOULD**
14 **PROVIDE ANY SUPPORT FOR THE FMV OF BMG ASSETS?**

15 A. No. First, I would note that the Company objected to OPC's Request for Production
16 of Documents No. 12 which requested any independent appraisals and/or valuations
17 by or for WMSI regarding the value of BMG at the time of the transfer. The
18 Company's response to OPC's request, after it was compelled, was: "THERE ARE
19 NO DOCUMENTS RESPONSIVE TO THESE QUESTIONS." I have attached as
20 Exhibit__HWS-25 a copy of the OPC request, the WMSI Objection, and Company's
21 response compelled by Order No. PSC-12-0624-PCO-WU, issued November 20,
22 2012. According to the Company, there are no documents to support the Company's

⁸ Order No. PSC-11-0010-SC-WU at pages 51 and 52.

1 FMV of BMG assets, and this is problematic. What rational basis does the Company
2 have for the FMV? Some of the assets held by BMG are supposed to be real estate,
3 which at a minimum should have a property appraisal at the time of sale or the tax
4 value assessment appraisal. Such documents would at least provide some support for
5 the FMV of these real estate assets. Since the Company had no responsive
6 documents that would purportedly support the value of BMG assets, I reviewed
7 WMSI's response to Staff Audit Document Request No. 27.

8
9 **Q. WHAT DID YOU DETERMINE FROM YOUR REVIEW OF THE**
10 **RESPONSE TO THE STAFF AUDIT REQUEST?**

11 A. The Staff audit request was for "copies of all supporting documentation used to
12 determine the value of the outstanding capital stock of BMG which is in excess of the
13 net amount invested by WMSI under Account 123 through December 31, 2010." The
14 purported support was a memo from Mr. Gene Brown to Ms. Debra Dobiac. The
15 value of the various assets according to the memo was based on purported past
16 appraisals that were not provided and/or what appears to be simple estimates. In my
17 opinion, a simple explanatory paragraph does not equate to supporting documentation
18 for the FMV of the assets of BMG.

19
20 **Q. DOES THE FACT THAT WMSI NOW OWNS ALL THE STOCK OF BMG**
21 **EFFECTIVE JANUARY 1, 2011, CHANGE ANY OF YOUR TESTIMONY**
22 **REGARDING THE VALUE OF BMG?**

1 A. No. As noted on page 2 of the July 29, 2011 Staff Audit Report, the transfer of the
2 security interest in BMG to WMSI did not change any of the conclusions drawn in
3 the Commission's Cash Flow Audit Report. Similarly, now that WMSI owns all of
4 BMG, it does not change my conclusion that the BMG assets have a fair market value
5 that is less than either the net \$1.2 million owed by all affiliated entities to WMSI or
6 the \$1.5 million owed to WMSI by Mr. Brown.

7

8 **DEP LOAN**

9 **Q. WHAT DOES THE DEP LOAN HAVE TO DO WITH THE ISSUE**
10 **RELATING TO ACCOUNT 123?**

11 A. It raises at least two questions, and perhaps more. First, there is the question of
12 whether the advances to Mr. Brown and the associated companies was a direct or
13 indirect cause of the additional interest added to the DEP loan. Second, there is the
14 question of whether the Company's compliance with all the terms of the DEP loan
15 provides any basis for evaluating managerial prudence.

16

17 **Q. WOULD YOU DISCUSS THE POSSIBLE CONNECTION BETWEEN THE**
18 **INCREASED INTEREST ON THE DEP LOAN STEMMING FROM THE**
19 **ADVANCES THROUGH ACCOUNT 123?**

20 A. Audit Finding No. 5 of the Staff Cash Flow Audit Report indicated that the cost of the
21 DEP loan (i.e. interest expense) has been increased and the term extended due to the
22 Company's apparent inability to make scheduled payments. Because of this inability
23 to make the scheduled payments, WMSI renegotiated several additional loan

1 amendments to defer making those schedule payments. Those amendments are
2 memorialized by Amendments 3 through 6. I have attached the DEP Loan and
3 Amendments 1 through 6 as Exhibit__HWS-26. These documents were provided in
4 response to Staff's First Request for Production of Documents No. 3. The
5 Company's inability to make those payments may be in part due to the advances
6 made to WMSI's president and affiliates as recorded in Account 123. Additionally, I
7 would note that in my opinion, the debt on this loan should be less than what it is
8 because WMSI did not apply additional funds to the DEP loan in a manner that they
9 should have been. Instead, those funds were used to meet operating costs that should
10 have been paid for from rates collected, and the funds in question were used to make
11 advances to affiliates and others.

12
13 **Q. WHAT ADDITIONAL FUNDS WERE NOT APPLIED TO THE DEBT IN A**
14 **MANNER THAT YOU BELIEVE THEY SHOULD HAVE BEEN?**

15 A. It is my understanding that the DEP loan was used to finance the construction of a
16 plant and the water main on the new bridge to St. George Island. After the new water
17 main was complete, it was determined that the water main was not coated as it was
18 supposed to be and WMSI received a judgment to compensate for the failure of the
19 supplier to perform the coating. According to the non-confidential general ledger of
20 WMSI, the judgment amount was \$760,000 and distributed by WMSI as shown on
21 Exhibit__HWS-27 (Cash Flow Analysis of Damage Settlement). Essentially
22 \$190,000 was advanced to affiliates and others and recorded in Account 123,
23 \$417,390 was used to make normal DEP debt payments, \$30,413 was used to

1 purchase a vehicle and approximately \$122,000 was used to meet day-to-day
2 operating costs. Since the proceeds were to reimburse WMSI for an inferior product,
3 the Company appropriately reduced the cost of the asset, yet instead of applying all
4 the judgment proceeds directly to the debt, the funds were used for other purposes.
5 The \$190,000 in advances to the WMSI president and affiliates, in my opinion, were
6 not what the proceeds were intended for and the use of those funds for day to day
7 operating costs was not the appropriate use of those funds.

8
9 **Q. WHAT IS THE ISSUE WITH USING THE \$417,390 OF LITIGATION**
10 **PROCEEDS RECEIVED TO PAY THE NORMAL DEBT PAYMENTS?**

11 A. The terms of the DEP loan agreement state that the Company is required to have a
12 Loan Payment Reserve Account. This reserve account was supposed to be funded by
13 the rates collected and loan proceeds. I believe that is why the loan agreement in
14 Article V (5.01) makes reference to rate coverage. Following that theory, the
15 scheduled debt payments were to be made from funds derived from utility revenues
16 and not from the litigation proceeds. All of the litigation proceeds, in my opinion,
17 should have been used to reduce the principal on the DEP loan commensurate with
18 the reduction to plant.

19 **Q. WHAT IS THE ISSUE WITH USING THE LITIGATION PROCEEDS TO**
20 **PAY THE NORMAL OPERATING COSTS?**

21 A. The setting of rates is designed to provide the Company with sufficient revenue to
22 meet its obligations and the normal operating costs. If rates are not sufficient then the

1 Company's management should apply for a rate increase. It is, therefore, incumbent
2 on the Company to prepare a sufficient request to meet the normal debt obligations
3 and the cost of operations. This was addressed by the Commission Order issued in
4 Docket No. 100104-WU where the Commission stated that, if the utility was
5 incurring net operating losses, it is the Company's burden to file for rate relief.⁹
6

7 **Q. WHY WOULD THE COMPANY USE THE LITIGATION PROCEEDS IF**
8 **THE RESERVE HAD BEEN PROPERLY FUNDED?**

9 A. I cannot determine from the information in the Company's filing or obtained in
10 discovery whether the reserve was always properly funded. In reviewing the activity
11 in the general ledger of WMSI, it is not obvious where the reserve funds are
12 maintained because of the various bank accounts utilized by the Company. However,
13 based on the general ledger reference to an account being a reserve account, there
14 appears to be a deficiency in the funding of reserve accounts in 2006, 2007, 2008,
15 2009 and 2010. An example of how deficiencies existed is a January 18, 2006
16 inquiry by the DEP regarding WMSI not providing the monthly verifications that
17 \$35,000 was deposited to restore the reserve balance. WMSI in a reply to DEP's
18 inquiry, dated February 21, 2006, indicated that payments for December 2005 and
19 January 2006 were made and February 2006 would be made. The DEP inquiry letter
20 and WMSI response are attached as Exhibit__HWS-28. According to the general
21 ledger, there was no payment to this reserve account deposited in December 2005, but
22 \$10,000 was deposited in January 2006 and \$60,000 was deposited in February 2006,

⁹ Order No. PSC-11-0010-SC-WU at page 38.

1 suggesting that WMSI caught up for December and January as indicated in its letter
2 to the DEP, but the reserve account was still short for February as of February 28,
3 2006. To add to the deficiency, WMSI did not make payments to that reserve
4 account in either March or April. Instead, WMSI withdrew \$69,900 in April. (See
5 the applicable 2006 general ledger pages related to the Gulf State Bank Reserve
6 attached as Exhibit_HWS-29.) Clearly this is not in compliance with the terms of the
7 loan and/or the letter to DEP regarding restoration of the reserve.

8
9 Unless the Company can identify where it maintained the required reserve account
10 since the initiation of the loan, then WMSI may have violated Article 6.01, Events of
11 Default Paragraph (1), which states: "Each of the following events is hereby declared
12 an event of default: (1) Failure to fund the Loan Repayment Reserve Account or to
13 make any installment of the Semiannual Loan Payment when it is due and such
14 failure shall continue for a period of 15 days." (Exhibit__HWS-26)

15
16 **Q. IS THAT YOUR ONLY CONCERN REGARDING POSSIBLE VIOLATIONS**
17 **OF THE DEP LOAN AGREEMENT?**

18 A. No. Article 2.01, Warranties, Representations and Covenants, Paragraph 12 of the
19 DEP loan requires annual certifications be provided to the DEP regarding pledged
20 revenue collections, the loan payment reserve account, and insurance. In reviewing
21 WMSI's response to Staff First Request Production of Documents No. 3, I was
22 unable to identify the Company satisfying that requirement for each year. The only
23 certifications that were included in the Company's response were one filed on

1 February 4, 2004 that was due August 15, 2003, one filed September 17, 2008 that
2 was due September 30, 2008 and one filed September 28, 2012 that was due
3 September 30, 2012. The required annual certifications for the other years in between
4 could not be located in the Company's response to Staff's First Request for
5 Production No. 3. I have attached to my testimony as Exhibit__HWS-30 the full
6 response to the request for all written communication between DEP and WMSI from
7 the inception of the loan through the present.

8
9 There is also a concern with Article 2.01, paragraph 10, which states that each year
10 until the loan is retired the Project Sponsor (WMSI) shall submit an annual audit
11 report to the Department. It does not appear that the Company has complied with this
12 annual audit report requirement.

13
14 **Q. WHAT SUGGESTS TO YOU THAT THE COMPANY HAS NOT COMPLIED**
15 **WITH THIS REQUIREMENT?**

16 A. First, no annual audit reports or audited financials for WMSI were provided in
17 response to OPC's discovery. OPC requested the Company's audited financial
18 statements in OPC's Third Set of Interrogatories No. 37 and Third Request for
19 Production of Documents No. 50, and the Company responded there were no audited
20 financial statements for the Company. See OPC's requests and Company's responses
21 attached as Exhibit__HWS-31. Second, Mr. Brown and Mr. Mitchell, WMSI's
22 controller, both testified that WMSI does not have audited financials. (See Brown
23 deposition, p. 70, Exhibit__HWS-5; Mitchell deposition, p. 15, Exhibit__HWS-14).

1 Third, no copies of annual financial audit reports complying with Article 2.01,
2 Paragraph 10 were contained in the correspondence between DEP and WMSI
3 provided to Staff Request for Production No. 3. See Exhibit__HWS-30. Fourth, in
4 his deposition, Mr. Brown confirmed no audited statements were performed beyond
5 the initial performance audit. See Exhibit__HWS-5, Brown deposition p. 70. Mr.
6 Brown also stated that he believed that this was no longer a requirement as the result
7 of subsequent amendments to the loan agreement. (Brown deposition p. 84)
8 However, my review of the various amendments to the DEP loan agreement did not
9 identify any such waiver. I would note that a July 1, 2005 letter from DEP requesting
10 the project close out audit indicated that the close out audit was “in addition to any
11 annual audit”. Moreover, each of the subsequent loan amendments includes the
12 statement: “All other terms and provisions of the Loan Agreement shall remain in
13 effect.” (Exhibit__HWS-26). That suggests to me that this requirement was not
14 waived.

15
16 **Q. WHOSE RESPONSIBILITY IS IT TO ENSURE THAT WMSI FOLLOWS**
17 **ALL THE PROVISIONS OF THE DEP LOAN AGREEMENT?**

18 A. Ultimately, it is the responsibility of the President of WMSI, who executed this loan
19 on behalf of the Company, to ensure that the Company is in compliance with all
20 provisions of the DEP loan and subsequent amendments.

21
22 **Q. HOW IS THE PERCEIVED LACK OF COMPLIANCE WITH THE DEP**
23 **LOAN PROVISIONS RELEVANT TO THE ISSUES PROTESTED BY OPC?**

1 A. In my opinion, the problems in complying with the DEP loan agreement are
2 symptoms of a greater, more fundamental issue as it relates to the management of this
3 utility. If things are not corrected soon, those issues could continue to grow.
4

5 **Q. IN YOUR OPINION, DID THE COMPANY'S TRANSFER OF FUNDS**
6 **RECORDED IN ACCOUNT 123 TO MR. BROWN AND OTHER**
7 **ASSOCIATED COMPANIES IMPAIR THE UTILITY'S ABILITY TO MEET**
8 **OTHER OBLIGATIONS?**

9 A. Yes, I believe it does. One indication is the significant increase in accounts payable
10 from 2009 through 2011 as shown on Table 2 of the March 12, 2012 Staff Audit
11 Report. Because of the increases, I reviewed the aged accounts payables in the Staff
12 workpapers and noted that there were a number of balances that were more than 90
13 days old. (I have attached a copy of the staff audit work papers that show the aged
14 accounts payable as Exhibit__HWS-32). Instead of making advances to affiliates the
15 accounts payables could have been paid in a more timely manner. Earlier, in my
16 testimony, I discussed how nonpayment of vendors could impact utility operations.
17 Further, advancing this much cash out also could have impaired the Utility's ability to
18 meet its DEP loan debt service payments. It could be argued that instead of using
19 cash to make advances, payments could have been made on the DEP loan. Instead
20 the Utility simply negotiated with DEP to miss those payments, which ultimately
21 added over \$1.2 million in interest on the loan over its extended term.
22

1 **RECOMMENDATIONS**

2 **Q. WHAT IS YOUR OPINION OF THE STAFF'S PAA RECOMMENDATION**
3 **FOR ACCOUNT 123 AND ITS RECOMMENDED FINDINGS?**

4 A. After reviewing the Staff's PAA recommendation for Issue 15 regarding Account
5 123, I would agree for the most part with the recommended findings, which are
6 attached as Exhibit__HWS-19. In my opinion, there is ample evidence to support
7 staff's recommended findings that these transfers impaired the utility. Moreover, the
8 evidence I discuss in my testimony suggests that the transfer of more than \$1,547,614
9 of utility cash to Mr. Brown and \$358,308 to Associated Companies and others
10 through Account 123 has impaired the Utility's ability to satisfy its financial
11 obligations during that time period from 2004 to 2010, and this impairment will
12 continue unless the money is repaid to WMSI.

13
14 **Q. WHAT'S YOUR RECOMMENDATION WITH RESPECT TO WMSI'S**
15 **REQUEST TO RESTORE THE PRESIDENT'S SALARY REDUCED BY THE**
16 **PAA ORDER AS IT RELATES TO THE DEP LOAN COSTS?**

17 A. Similar to the reasoning put forward in Staff's PAA Recommendation, I think a salary
18 reduction is appropriate.

19
20 **Q. DO YOU THINK THAT STAFF'S RECOMMENDED SALARY REDUCTION**
21 **ADEQUATELY COMPENSATES THE COMPANY AND RATEPAYERS**
22 **FOR PAST DECISIONS?**

1 A. Not based on the added DEP loan interest cost as of Amendment 5 and not after the
2 added cost from Amendment 6 is factored in. Staff's recommended salary reduction
3 for managerial imprudence does not take into account all the additional interest added
4 to the life of the loan. The incremental interest expense of \$928,071 referenced in
5 staff's PAA recommendation is through December 31, 2010. Since then, there have
6 been additional amendments to the DEP loan adding additional interest. As of
7 Amendment 5, the incremental difference in interest between the original loan
8 payment schedule and the Amendment 5 payment schedule is \$1,123,060. This is
9 calculated by comparing the original loan payment schedule with the Amendment 5
10 payment schedule. The salary and benefits reduction should be increased to offset the
11 added additional interest. I have attached to my testimony Exhibit__HWS-33 to
12 demonstrate the changes in the DEP loan amortization schedules.

13

14 **Q. SHOULD THE COMMISSION INTERVENE IN THE OPERATION OF THIS**
15 **COMPANY?**

16 A. In my experience, regulatory commissions endeavor to make decisions that are fair
17 and that are best for the utility and ratepayers. In this case the financial viability of
18 the Company could pose a threat to the Company and ratepayers alike. So, in my
19 opinion, I believe that some intervention is necessary. In the last order, the
20 Commission indicated that it generally attempted to avoid "micromanaging" utility
21 business decisions.¹⁰ However, if there is an exception to this general rule, then this
22 utility is the case. If you review the long history of orders entered by this

¹⁰ Order No. PSC-11-0010-SC-FOF at 55.

1 Commission as it relates to the operation of this water system on St. George Island,
2 you will see how the Commission actively intervened and participated in the
3 operation of the utility to ensure that utility funds were used to pay RAFs,¹¹ ensure
4 that funds were available for future capital improvements,¹² and to improve the
5 quality of service.¹³ By Order No. 23258, issued July 27, 1990, in Docket No.
6 871177-WU, the Commission ordered the Company to exercise a buy-out provision
7 in a lease agreement to ensure that the Company obtained title to the elevated storage
8 tank which was built with escrowed money but titled in the name of Armada Bay
9 Company, Inc., which is now known as Brown Management Group.¹⁴ See Exhibit__
10 HWS-34, Secretary of State - BMG name changes from 1994 through present.
11 Because of management decisions which, in my opinion, have adversely impacted
12 utility operations, I believe the Commission should consider taking a more active role
13 with this utility.

14
15 **Q. WHO SHOULD HAVE TITLE TO BMG'S ASSETS?**

16 A. Because the Utility now owns BMG and all of its assets, the Commission could
17 consider ordering that any revenues or rents from those assets, if any, should be used

¹¹ Order No. PSC-92-0478-FOF-WU, issued June 9, 1992, in Docket No. 920318-WU, In re: Initiation of proceeding by Florida Public Service Commission to require St. George Island Utility Company, Ltd. in Franklin to escrow funds for payment of regulatory assessment fees (requiring escrowing of RAFs).

¹² Order No. PSC-94-1383-FOF-WU issued November 14, 1994, in Docket No. 940109-WU, In re: . Petition for interim and permanent rate increase in Franklin County by St. George Island Utility Company, LTD., at page 47 (requiring escrowing of service availability charges to ensure funds are available for future capital expenditures).

¹³ See various orders issued in Docket No. 871177-WS for this utility. Order No. PSC-92-1284-FOF-WS, referenced prior orders imposing a moratorium against any further connections, ordering the utility to comply with a number of requirements relating to quality of service, including submitting plans for a third well and a new water storage tank.

¹⁴ Order No. 23258, issued July 27, 1990, in Docket No. 87177-WU, In re: Application of St. George Island Utility Company, Ltd. for increase rates and service availability charges for water service in Franklin County at page 3 (1990 WL 10548574 (Fla. P.S.C.) at 2).

1 only for utility operations or debt service payments. In addition, the Commission
2 could consider ordering WMSI to title all of the assets currently being held by BMG
3 in the Company's name. In the short term, any income from any income producing
4 asset owned by BMG, not already fully encumbered, could be placed in escrow to
5 help finance the building of the new ground water storage tank. In the future true-up
6 proceeding for the ground water storage tank, the Commission could impute those
7 revenues to reduce customer rates in a manner consistent with how the Commission
8 imputes utility pole rental revenues.

9
10 The Commission could have the cell tower lease rights retitled in the name of WMSI
11 and require that those rights not be sold or assigned absent a Commission order.

12
13 Alternatively, the Commission could order a liquidation of those assets and use the
14 proceeds to pay down remaining utility debt.

15
16 **Q. WHAT IS THE NEXUS BETWEEN OPC'S PROTEST OF ACCOUNT 123**
17 **AND REQUIRING THAT BMG ASSETS BE TITLED IN WMSI'S NAME**
18 **AND THAT ANY PROCEEDS BE USED TO BENEFIT THE UTILITY**
19 **OPERATIONS?**

20 A. If the Commission is concerned that WMSI assets (e.g., the assets of BMG which
21 WMSI ultimately owns) might not be used for utility purposes, the Commission
22 should take measures to ensure that the alleged benefits of owning BMG, as
23 purported by WMSI, inure to WMSI.

1 **Q. DO YOU BELIEVE THE COMMISSION HAS ENOUGH EVIDENCE TO**
2 **SUPPORT A FINDING REGARDING MANAGERIAL IMPRUDENCE?**

3 A. Yes. I believe the record being developed for this case, as requested by the
4 Commissioners at the August 2, 2012 Commission Conference,¹⁵ provides the
5 Commission with enough evidence upon which to base a finding. I have provided the
6 Commission with my observation of what the documents and financial information
7 depicts in this case. The Commission should weigh the evidence presented, and make
8 that determination. In my opinion, the evidence suggests that shareholders' lack of
9 investment and management's decision to continue to increase debt has impacted
10 WMSI's current financial position and could put WMSI in a precarious position that
11 could threaten its ability to provide safe and reliable service to ratepayers in the
12 future.

13

14 **Q. ARE YOU MAKING ANY OTHER RECOMMENDATIONS REGARDING**
15 **THE ADVANCES TO AFFILIATES THAT CREATED THE CONCERNS**
16 **WITH ACCOUNT 123?**

17 A. Yes. To avoid any further possible issues developing with respect to affiliate
18 advances, I am recommending that the Commission order WMSI to stop making
19 random advances to Mr. Brown, associated companies, parties, or interests. While
20 this may appear to be micromanaging, the financial condition of WMSI dictates that
21 some safeguard be implemented to provide creditors and ratepayers assurance that
22 debt obligations will be met and that operations will not be impacted due to a lack of

¹⁵ August 2, 2012 transcript for Docket No. 110200-WU at pages 137-139, 146; Exhibit __HWS-10 includes excerpts of the transcript

1 funds. If the Company is allowed to continue to use utility cash for non-utility
2 purposes, sometime in the not too distant future, customer service may be adversely
3 affected.

4
5 **IV. WORKING CAPITAL**

6 **Q. IS IT APPROPRIATE THAT THE COMPANY IS REQUESTING A**
7 **WORKING CAPITAL COMPONENT IN RATE BASE?**

8 A. No. Company witness Allen states that, because any normal viable company requires
9 working capital to pay its current liabilities as they come due, the Company should be
10 entitled to \$129,873 of working capital. That argument is only appropriate if the
11 utility uses investor provided funds to operate the company. In WMSI's case,
12 management has used debt and accounts payable to fund operations. Investor's funds
13 do not exist when equity is negative. Investors have not provided interest free debt;
14 therefore, there are no investor loans that can be considered as a source of working
15 capital. Simply put, the Company has not provided any real substantial justification
16 that it is entitled to a working capital allowance in rate base.

17
18 **Q. WHAT ABOUT MS. ALLEN'S CLAIM THAT, BECAUSE THE COMPANY**
19 **IS IN A LOSS POSITION, USE OF A ZERO WORKING CAPITAL**
20 **ALLOWANCE ONLY PERPETUATES THE PROBLEM?**

21 A. The Company controls its finances. If the Company cannot earn a profit in a
22 regulated environment, then there may be a problem with management's inability to
23 either control costs or assemble a filing sufficient to allow regulators to determine a

1 level of rates that will allow the Company to meet its operating requirements. An
2 investor in a closely held company should determine what is needed to fund
3 operations. If investors fail to sufficiently provide the capital required to meet the
4 working capital requirements of the operations, then ratepayers should not be required
5 to provide the working capital shortfall and a return on that shortfall. According to
6 James C. Bonbright's book, *Principles of Public Utility Rates*, which has been relied
7 as a reference for public utility pricing theories, policies, and the economic concepts
8 supporting rate designs, a working capital allowance is necessary to bridge the gap
9 between the time costs are incurred in providing service and the time the utility is
10 paid for that service.¹⁶ See Exhibit ___HWS-35, Excerpt from Principles of Public
11 Utility Rates. That would substantiate a claim that a working capital allowance should
12 be allowed. However, Bonbright continues his discussion by stating that including
13 the working capital allowance in rate base is appropriate when the funds have come
14 from investor sources.¹⁷ WMSI has not shown that it has issued sufficient equity or
15 debt as a source of investor funds; therefore, WMSI is not entitled to any working
16 capital allowance.

17 18 **V. WEIGHTED AVERAGE COST OF CAPITAL**

19 **Q. DO YOU HAVE AN OPINION AS TO WHETHER MS. ALLEN'S**
20 **EXPLANATION PROVIDES JUSTIFICATION FOR REVISING THE**
21 **WEIGHTED COST OF CAPITAL?**

¹⁶ *Principles of Public Utility Rates*, Second Edition, Page 242.

¹⁷ *Principles of Public Utility Rates*, Second Edition, Page 243.

1 A. Yes. Her suggestion that the life insurance cost be included in the cost of debt is not
2 appropriate. What Ms. Allen did not address is why the life insurance was required
3 as part of the loan. Most likely the loan required the insurance as collateral because
4 the Company is so leveraged in debt. The next question would be, is the debt that
5 high because of advances to affiliates? There is no justification for changing the cost
6 of capital upward. However, there could be an argument for lowering the cost of
7 capital.

8

9 **VI. CONTRACTUAL SERVICES**

10 **Q. DOES MS. ALLEN'S RECOMMENDATION FOR ACCOUNTING**
11 **SERVICES MAKE SENSE?**

12 A. No. First, the calculation presented by Ms. Allen is skewed by the 2010 expense of
13 \$18,550. As noted on her exhibit JA-5, the costs for 2005-2009 averaged \$3,667, and
14 then suddenly the cost in 2010 is \$18,550. There is no explanation for the significant
15 change in cost which is something that should have been addressed by the Company.
16 While the request may be appropriate for an increase in costs, the Company has not
17 met its burden of proof for justifying the change. There is also a concern that based
18 on the aged accounts payable as of December 31, 2011, that I included in my
19 Exhibit__HWS-32, \$4,500 of accounting costs for 2010 were still not paid.

20 **Q. WHY WOULD YOU SUGGEST THE REQUEST MAY BE APPROPRIATE?**

21 A. As has been discussed throughout my testimony, this Company has had issues with
22 appropriately accounting for costs. That problem may be the lack of attention that

1 has occurred and, in the case of Account 123, the lack of understanding the difference
2 between accounting for costs of different entities separately.

3
4 **VII. TRANSPORTATION EXPENSE**

5 **Q. DO YOU AGREE WITH MS. ALLEN'S RECOMMENDATION FOR AN**
6 **ADJUSTMENT TO TRANSPORTATION EXPENSE?**

7 A. No. Ms. Allen claims that the cost should be increased by \$8,916 and then goes on to
8 suggest that the Commission double counted an adjustment for maintenance costs.
9 My review of the Commission adjustment confirms that there was not a double count
10 as claimed by Ms. Allen. Ms. Allen's claim is that, because the Commission
11 adjustment included the net adjustment of \$3,177 and \$5,739, a double count
12 occurred. This is not correct. The net \$3,177 of cost added by the Company did
13 remove the \$5,739 when it added \$8,916 for mileage. However, as part of its
14 adjustment, the Commission reversed the Company's adjustment by putting the
15 \$5,739 back into the cost of service and removing the \$8,916 (i.e. the removal of the
16 \$3,177). The Commission then made a separate adjustment removing the \$5,739
17 because it was deemed non-utility related.

18
19 **Q. DID MS. ALLEN PROVIDE JUSTIFICATION FOR MAKING THE \$8,916**
20 **ADJUSTMENT?**

21 A. No. As her testimony states, the \$8,916 represents a mileage estimate for 2010. As
22 the Commission order stated, the Company failed to provide the appropriate
23 supporting mileage logs for the 2010 costs; therefore, the costs were disallowed. The

1 Company's attempt to offer the log reimbursements for 2011 as a surrogate is an after
2 the fact attempt to correct for past errors. As the order states, the Company was
3 effectively put on notice as to what was required to be compensated for the costs in
4 question and they failed to meet their obligation. Therefore, the Commission's
5 disallowance is appropriate.

6
7 **VIII. UNAMORTIZED GAIN ON SALES**

8 **Q. ARE YOU RECOMMENDING A REVISION TO THE COMMISSION'S**
9 **ADJUSTMENT FOR THE NET GAIN ON THE SALE OF LAND AND**
10 **OTHER ASSETS?**

11 A. Yes. Commission PAA Order No. PSC-12-0435-PAA-WU recognized a net gain of
12 \$5,794 to be amortized over 5 years resulting in an annual amortization of \$1,159.
13 However, the PAA order apparently omitted the gain on sale adjustment from the last
14 rate case. By Order No. PSC-11-0010-SC-WU, the Commission made a
15 determination that there was a gain on sale and ordered the amortization of \$242,040
16 over five years for an annual amortization of \$48,408. The OPC believes that the
17 remaining amortization of the gain on sale recognized in the last order should be
18 reflected in the rates approved by the Commission in this docket.

19 **Q. HOW MUCH OF THE \$242,040 GAIN ON THE SALE IS LEFT TO BE**
20 **AMORTIZED?**

21 A. According to my calculation, there remains approximately \$153,292 left to be
22 amortized. I have included on Exhibit HWS-36, attached to my testimony, my

1 calculation of the gain on sale remaining to be amortized from the last rate case until
2 the PAA approved rates went into effect.

3

4 **Q. HOW QUICKLY SHOULD THE REMAINING BALANCE BE AMORTIZED?**

5 A. The Commission should order that the remaining balance be amortized over a three to
6 four year period.

7

8 **Q. DOES THAT CONCLUDE YOUR TESTIMONY?**

9 A. Yes, it does.

1 **BY MR. SAYLER:**

2 **Q** Have you prepared a summary of your testimony?

3 **A** I have.

4 **Q** Would you please give that testimony --
5 summary to the Commission?

6 **A** My testimony highlights the fact that the
7 Account 123 balance is composed of advances to and from
8 various entities and not a single entity.

9 Account 123 was a catchall. The company has
10 treated various entities as if they were one. This
11 treatment, according to NARUC, is not appropriate.

12 In reviewing the detail, it should be noted
13 that Mr. Brown was the primary recipient of funds from
14 WMSI, and Brown Management Group is actually a creditor
15 of WMSI.

16 The company, in an effort to resolve this
17 matter, took title to the stock of Brown Management
18 Group by claiming this to be an investment. For this to
19 properly occur, if that is even possible, the various
20 entities would have to account for the monies owed to
21 WMSI as a forgiveness of debt on their books, and for
22 the monies owed by WMSI the entities would have to
23 reflect a debt write-off. The company did not provide
24 any documentation to substantiate this occurred.

25 Ironically, as I stated in my testimony at

1 page 35, the order in Docket Number 100104-WU states
2 that Mr. Brown claimed that the amounts in Account 123
3 were not an investment, but instead were advances.

4 The first major question for this Commission
5 is whether the advancing of funds to Mr. Brown and
6 others reduced cash that would have been available to
7 make debt payments and pay the day-to-day operating
8 costs of WMSI in a timely manner. Another question is
9 whether the proceeds from the pipe litigation should
10 have been used to pay down the debt on the secured
11 constructed property or whether it is okay to use such
12 proceeds for whatever the company decides.

13 My opinion is that the advances impacted the
14 timeliness of debt payments by WMSI, and the litigation
15 proceeds should have been applied to the debt consistent
16 with the write down of the property value.

17 The next issue is whether the value of BMG
18 stock is sufficient to satisfy the net monies owed to
19 WMSI, assuming that one were to accept that the various
20 receivables and payables could be properly netted. My
21 opinion is they cannot be netted according to NARUC.

22 The company has not provided sufficient and/or
23 current evidence that BMG is in fact worth more than
24 \$1.2 million net balance in Account 123 or the
25 1.5 million advance to Mr. Brown personally. The value

1 assigned to BMG by Mr. Brown is either not current, it
2 is not -- it is a company guesstimate, and it included
3 the purported value of BMG's investment in WMSI. The
4 company has a claim that the Account 123 balance was
5 satisfied by BMG stock and it no longer is recording
6 transactions in Account 123.

7 The same type of transactions previously
8 recorded in Account 123 continue to be occurring, just
9 in different accounts now. This was how WMSI previously
10 accounted for the transfers until the different accounts
11 were netted into Account 123 in 2004. Simply put, the
12 company is starting the process all over again with
13 different accounts, and the Commission has to determine
14 whether WMSI should be allowed to continue the practice
15 of advancing funds to and from.

16 WMSI has no equity. WMSI has used ratepayer
17 funds and company debt to operate for years. And the
18 question that needs to be answered is should WMSI be
19 allowed to continue to rely on obtaining debt in hope
20 that the bubble will not burst? I believe restrictions
21 need to be implemented to protect the ratepayers, the
22 company, and Mr. Brown. Without restrictions history
23 will repeat itself. Thank you.

24 **MR. SAYLER:** The Office of Public Counsel
25 would tender Mr. Schultz for cross.

1 **COMMISSIONER EDGAR:** Okay. Then we will in a
2 moment here break for lunch.

3 Before we do that, two matters. Mr. Friedman,
4 my memory very well may be failing me -- it is failing
5 me at this moment. I am not 100 percent certain that
6 you requested and that I granted the request to enter
7 Ms. Allen's prefiled direct and rebuttal.

8 **MR. FRIEDMAN:** If I did not, then I do so.

9 **COMMISSIONER EDGAR:** And we may have. But in
10 an abundance of caution, for the record at this time
11 please show that Ms. Allen's prefiled direct and
12 rebuttal testimony is entered into the record as though
13 read. Thank you.

14 And, Mr. Sayler, may I presume that you plan
15 to request at some point that Exhibit 89, that was
16 marked as 89, which I believe was the customer petition
17 from the earlier customer service portion of our process
18 today, were you planning to request that that be
19 admitted into the record?

20 **MR. SAYLER:** Yes, ma'am, I will. I don't know
21 if everyone has had an opportunity to review that.

22 **COMMISSIONER EDGAR:** And that was going to be
23 my question. So with the understanding that Mr. Sayler
24 will be making that request, when we come back from
25 lunch I would ask Mr. Friedman if you've had an

1 opportunity to look at it.

2 **MR. FRIEDMAN:** My argument doesn't matter
3 whether I look at it or not. I mean, it's, obviously
4 it's hearsay. We don't even know who drafted it. I've
5 got my suspicions, but we don't even know who prepared
6 the document that people signed. And so I don't think
7 it has any probative value. As Ms. Barrera pointed out
8 earlier, it's immaterial -- or Ms. Helton, I'm sorry --
9 it's, you know, it's irrelevant and immaterial. And so,
10 I mean, nobody wants their rates increased. That one
11 gentleman or lady was really blunt; we don't want our
12 rates increased. Nobody does. So the fact that you
13 have a, a document that says, oh, yeah, we all agree and
14 bless what the Public Counsel is doing for us has no
15 probative value and it doesn't belong in the case.

16 **COMMISSIONER EDGAR:** Mr. Saylor?

17 **MR. SAYLER:** It sounds like Mr. Friedman does
18 not need to review it, so then I would move to enter it
19 into the record.

20 **COMMISSIONER EDGAR:** Yes. Mr. Friedman, I
21 recognize your objection; however, I do believe that it
22 is within our discretion to enter that document into the
23 record, and so we will do so at this time.

24 **MR. FRIEDMAN:** I understand.

25 **COMMISSIONER EDGAR:** And that is Exhibit 89.

1 Thank you.

2 (Exhibit 89 admitted into the record.)

3 Okay. We will come back at 2:00. If we are
4 in a position to do so, we will take up the pending
5 objections on the one, two, three, four marked exhibits
6 that we discussed earlier today if we need to do so.
7 And after that, then we will begin cross-examination,
8 looking to Mr. Friedman.

9 Okay. So we will come back at 2:00. Enjoy
10 the island. We'll see you then. And we are in recess.

11 (Recess taken.)

12 (Transcript continues in sequence in Volume
13 2.)

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STATE OF FLORIDA)
 : CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, CRR, Official Commission Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 28th day of January, 2013.



LINDA BOLES, RPR, CRR
FPSC Official Commission Reporter
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