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September 20, 2022

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Mr. Adam Teitzman, Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 20220067-GU: Petition for rate increase by Florida Public Utilities Company, Florida Division of Chesapeake Utilities Corporation, Florida Public Utilities Company - Fort Meade, and Florida Public Utilities Company - Indiantown Division.

Dear Mr. Teitzman:

Attached, for electronic filing, please find the **Rebuttal Testimony of Terry Deason**, submitted on behalf of Florida Public Utilities Company and the Florida Division of Chesapeake Utilities Corporation.

Sincerely,

/s/Beth Keating
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cc.(Certificate of Service)

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

Docket No. 20220067-GU: Petition for rate increase by Florida Public Utilities Company,
Florida Division of Chesapeake Utilities Corporation, Florida Public Utilities
Company – Fort Meade, Florida Public Utilities Company – Indiantown Division.

Prepared Rebuttal Testimony of Terry Deason

Date of Filing: September 20, 2022

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Q. Please state your name and business address.

A. My name is Terry Deason. My business address is 4377 NW Torreya Park Road, Bristol, Florida 32321.

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

A. I am self-employed as a Special Consultant specializing in the fields of energy, telecommunications, water and wastewater, and public utilities generally.

Q. Did you previously submit direct testimony?

A. Yes, I submitted written testimony in this proceeding on May 24, 2022, addressing the regulatory policy considerations for acquisition adjustments in general and how those policy considerations should be applied to FPUC’s request for increased rates in this proceeding, which includes continued recognition of the positive acquisition adjustments associated with the acquisition of FPUC by Chesapeake and the acquisition of Indiantown Gas Company (“Indiantown”) by FPUC.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to address the testimony of OPC Witness Ralph Smith as it pertains to the acquisition adjustment resulting from the acquisition of Florida Public Utilities Company (“FPUC”) by the Florida Division of Chesapeake Utilities Corporation (“Chesapeake”). I will also address the reasons why Witness Smith’s recommendation to disallow a large portion of FPUC’s total incentive compensation is inconsistent with sound regulatory policy.

Q. Are you sponsoring an exhibit with your rebuttal testimony?

1 A. No.

2 **Q. For whom are you appearing as a witness?**

3 A. I am again appearing as a witness for Florida Public Utilities Company (“FPUC”) and
4 the Florida Division of Chesapeake Utilities Corporation (“Chesapeake”).

5

6

II. ACQUISITION ADJUSTMENT

7 **Q. What does Witness Smith recommend for the Chesapeake acquisition of FPUC?**

8 A. He recommends a total disallowance of all amounts associated with the positive
9 acquisition adjustment, including the rate base impacts of the unamortized balance no
10 longer being included in rate base and the net operating income impacts of ceasing any
11 further above-the-line amortization of the positive acquisition adjustment.

12 **Q. Does Witness Smith also address the acquisition of Indiantown Gas Company by
13 FPUC?**

14 A. Yes, but he recommends no adjustments to the amounts being requested for this
15 acquisition.

16 **Q. If the Commission were to adopt Witness Smith’s recommendation, would FPUC
17 no longer incur these costs on its financial statements?**

18 A. FPUC would continue to incur these costs for financial reporting. They do not go
19 away because of a regulatory disallowance. In essence, FPUC would be unable to
20 achieve its authorized rate of return for financial reporting purposes. And given the
21 size of the recommended disallowances, this could have a material impact on FPUC’s
22 financial integrity on a going forward basis.

23

1 **Q. On what basis does Witness Smith recommend these disallowances?**

2 A. Witness Smith asserts that there is an incentive for a company to pay an acquisition
3 price higher than what would be expected for a similar transaction between
4 unregulated (competitive) companies. He further asserts that FPUC has failed to meet
5 all five of the factors normally used to evaluate an acquisition and concludes that
6 FPUC has not met its burden of proof. He further theorizes that FPUC's request to
7 increase rates is an indication that the acquisition is no longer beneficial.

8 **Q. Do you agree with these positions advanced by Witness Smith?**

9 A. No, I do not. First, Florida's regulatory policies prevent regulated utilities from
10 intentionally paying more for an acquisition than can be economically justified.
11 Regulated utilities in Florida know that an acquisition will be scrutinized by the
12 Commission and will allow recognition only to the extent that it is in the public
13 interest. Thus, regulation acts as a surrogate for competition and places limits on
14 acquisition prices.

15 Second, the five factors normally used to evaluate acquisitions have been thoroughly
16 addressed by FPUC Witnesses Cassel and Napier. Witness Smith has chosen not to
17 address the specifics of their testimonies, rather he conveniently concludes that FPUC
18 has not met its burden. While I agree that these five factors are appropriate, the
19 ultimate test is whether the acquisition is in the public interest and the Commission
20 has great discretion in making this determination. I address this in greater detail in my
21 direct testimony. Witness Smith has provided no sound and substantial basis to
22 conclude the acquisition is no longer in the public interest. Quite frankly, it is not the

1 role of a witness to opine on whether a burden has been met. This is the Commission's
2 role, after due consideration of all the evidence.

3 And third, the Commission has never taken the position that a request for a rate
4 increase, especially when an increase is requested some twelve years after the
5 acquisition was first approved, is an indication that the acquisition is no longer in the
6 public interest. There are simply too many extraneous factors occurring that
7 necessitate an increase in rates to conclude that an acquisition is no longer in the public
8 interest.

9 **Q. Do you have any concluding thoughts on the positions taken by Witness Smith?**

10 A. Yes, I have two. First, it needs to be reiterated that the FPUC acquisition has already
11 been thoroughly reviewed by the Commission some twelve years ago. It is an issue
12 now because the Commission wanted to review it again at FPUC's next rate case. To
13 a certain extent, there is some level of a presumption that the acquisition is in the public
14 interest. The issue now is whether there have been any material changes that warrant
15 a different conclusion. Witness Smith has offered no evidence that anything has
16 materially changed to warrant a conclusion that the acquisition is no longer in the
17 public interest.

18 Second, I want to focus on a passage from Witness Smith's testimony. He states:
19 "Ratepayers should not be required to pay higher rates attributable to an acquisition
20 premium paid to acquire other systems." This ignores the possibility that an
21 acquisition can be in the public interest even if rates increase. This could be because
22 of inadequate regulatory compliance, poor quality of service, or an inadequate access
23 to capital, to name a few. So, Witness Smith's testimony has a too narrow of a

1 definition of what constitutes the public interest. But putting that aside and focusing
2 on the rate impacts of an acquisition, Witness Smith again misses the mark. The real
3 test is whether rates would be lower absent the acquisition or conversely whether the
4 acquisition is the sole reason that rates are higher than they otherwise would be.
5 Witness Smith provides no evidence that the FPUC acquisition is now causing rates
6 to be higher than they would be had the acquisition not taken place.

7

8

III. INCENTIVE COMPENSATION

9

10 **Q. Please address Witness Smith's recommendation to disallow a large portion of**
11 **FPUC's total incentive compensation.**

12 A. Witness Smith is also recommending that \$2.180 million, or 50 percent, of FPUC's
13 total incentive compensation be disallowed for ratemaking purposes. If his
14 recommendation were to be adopted in its entirety, it would mean that FPUC would
15 be making payments to employees consistent with its obligations to those employees
16 and yet not have sufficient revenues to cover a full 50 percent of those obligations.
17 Witness Smith is also recommending that stock-based compensation in the amount of
18 \$1.376 million be disallowed for ratemaking purposes. His recommendations in total
19 equate to a 120 basis point reduction in FPUC's allowed return on equity.

20 **Q. On what basis is Witness Smith recommending such a significant disallowance?**

21 A. Witness Smith readily acknowledges that both shareholders and ratepayers stand to
22 benefit from the achievement of performance goals contained in FPUC's incentive
23 compensation plan. However, based on his incorrect personal belief that financial

1 metrics primarily benefit shareholders, he is recommending that half of FPUC's
2 incentive compensation be disallowed and that all of the stock-based compensation be
3 disallowed.

4 **Q. Why should Witness Smith's disallowances be rejected?**

5 A. His recommended disallowances are inconsistent with sound regulatory policy and
6 basic principles of ratemaking and, if accepted, would be detrimental to the long-term
7 best interests of FPUC's customers.

8 **Q. How are Witness Smith's recommended disallowances inconsistent with sound
9 regulatory policy and basic principles of ratemaking?**

10 A. A fundamental tenet of sound regulatory policy is to provide recovery of all reasonable
11 and necessary costs expected to be incurred to provide service to customers. And a
12 basic principle of ratemaking is to include all such costs as test year expenses in
13 calculating a regulated company's net operating income. Only if the Commission
14 finds that the expenses in question are unreasonable, unnecessary, or not expected to
15 be incurred, should they be disallowed in calculating the company's revenue
16 requirement.

17

18 Another fundamental tenet of sound regulatory policy is to encourage regulated
19 utilities to be efficient and provide high quality service to their customers. Sacrificing
20 efficiency and quality of service in the long run to achieve temporary rate reductions
21 is not in the customers' interest. All regulatory decisions have consequences, and good
22 regulatory policy results when these consequences are adequately considered. Witness
23 Smith's recommendations violate both tenets of sound regulatory policy.

1 **Q. How so?**

2 A. First, Witness Smith makes no allegation that the amount of overall compensation paid
3 to FPUC's employees is unreasonable, unnecessary, or not expected to be incurred. In
4 effect, he abandons the "reasonableness standard." He has not presented any analysis
5 of the employment market to determine what amount of compensation is reasonable
6 and necessary to attract the workforce needed to efficiently and reliably run a gas
7 utility. His complete lack of analysis stands in stark contrast to the testimony of FPUC
8 Witness Galtman who explains in detail that the overall compensation paid by FPUC
9 is reasonable, that it is necessary to attract and retain a qualified workforce, and that it
10 is at or near the median of employee compensation paid by other regulated utilities.

11

12 The primary basis for Witness Smith's recommended disallowance is an unfounded
13 personal belief that incentive compensation tied to financial metrics benefits
14 shareholders and that half of overall incentive compensation should be disallowed.
15 Notably, he does not allege that such financial goals harm FPUC's customers. On the
16 contrary, customers do, in fact, benefit from a financially strong parent company, as I
17 will discuss later in my testimony.

18

19 Notably, neither does Witness Smith provide any analysis of the net amount of
20 compensation to employees that would result from his recommendations. And, he
21 fails to ascertain whether that net amount is reasonable. Consequently, Witness
22 Smith's testimony is totally devoid of any consideration of the reasonableness of the
23 net amount of compensation expense to be included for ratemaking purposes.

1 Again, he is abandoning the reasonableness standard that is universally applied to all
2 other costs incurred to provide service to customers.

3

4 **Q. Why is a part of FPUC's incentive compensation goals tied to Chesapeake's**
5 **financial performance and how is this beneficial to FPUC's customers?**

6 A. One hundred percent of FPUC's investor capital is provided by Chesapeake. FPUC
7 does not publicly issue equity in the equity market and does not issue its own bonds.
8 Thus, FPUC is dependent solely on Chesapeake and it is essential that Chesapeake
9 have the financial integrity necessary to be able to raise new equity capital in the equity
10 market. This is how FPUC is able to obtain capital so that it can, in turn, invest in
11 property, plant, and equipment necessary to provide reliable service to its customers.
12 FPUC's use of Chesapeake financial performance measures in its incentive
13 compensation plan simply mirrors financial reality and, to the customers' benefit,
14 properly focuses FPUC's employees on the financial performance of Chesapeake.
15 FPUC's customers benefit because it is Chesapeake that will be responsible for one-
16 hundred percent of the investor-supplied capital necessary to serve them.

17

18 **Q. What would be the longer-term consequences of accepting Witness Smith's**
19 **recommendation?**

20 A. His recommendation would have longer-term consequences that could affect
21 efficiency and take away a valuable managerial tool that is effective in increasing
22 efficiency and maintaining or improving the quality of service provided to customers.

23 **Q. What do you mean by "take away a valuable managerial tool"?**

1 A. If the Commission were to accept Witness Smith’s recommendation, FPUC would be
2 justified in rethinking its long-standing approach to employee compensation. If a
3 significant amount of otherwise valid and reasonable costs is disallowed, not on the
4 basis of the reasonableness of their amount but rather simply because of the method
5 by which they are paid, FPUC would be justified in implementing a different pay
6 structure that does not call into question the method by which these costs are paid.

7
8 While accepting Witness Smith’s recommendation would deny FPUC the opportunity
9 to recover necessary costs currently, adopting a different compensation plan with less
10 or no incentive pay and a greater reliance on base pay would presumably eliminate the
11 issue in future rate proceedings. By moving more salary to base pay, employees would
12 no longer have to re-earn that pay each year by meeting goals that balance operational
13 and financial measures both in the short term and long term. In essence, the
14 Commission would be substituting its judgment for that of FPUC’s management as to
15 how best to motivate and compensate its employees. Consequently, the incentive for
16 FPUC’s employees to be efficient and productive would be diminished.

17
18 **Q. Do you understand Witness Smith is not recommending that FPUC not pay the**
19 **incentive compensation, he is just recommending that a portion not be recovered**
20 **in rates?**

1 A. Yes, I understand his recommendation. However, disallowing a reasonable and
2 necessary expense, or requiring the Company to pay part of the expense out of the
3 return component that is intended to compensate investors for the use of their invested
4 capital, is nothing more than a backdoor approach to reducing the allowed Return on
5 Equity (ROE). Funds that should go to shareholders as a fair return on investment
6 instead would be diverted to cover costs that should otherwise be recovered in rates.
7 The reduction to FPUC's ROE represented by Witness Smith's recommendation is
8 significant—approximately 120 basis points. This would significantly affect FPUC's
9 opportunity to earn what the Commission determines to be a fair rate of return. It
10 could also violate the Hope and Bluefield cases discussed by OPC Witness David J.
11 Garrett on pages 11 and 12 of his testimony.

12
13 **Q. Witness Smith states that his recommendation is balanced. Do you agree?**

14 A. No, his recommendation is one-sided and actually works to the detriment of
15 customers' best long-term interests. His rationale does not recognize that the
16 Company's incentive compensation program is designed to provide a careful balance
17 that benefits all stakeholders, including its customers, employees and investors.
18 FPUC's incentive compensation programs include operational and financial goals
19 designed to motivate employees to deliver quality services to customers, to improve
20 operational efficiency, and to provide a fair return to investors, all of which benefit
21 FPUC's customers. This balanced approach helps to ensure that the Company is
22 sustainable and that it provides benefits to each of the stakeholders, especially its
23 customers.

1 **Q. Is it your position that Commission precedent and policy supports the recovery**
2 **of incentive pay tied to financial measures?**

3 A. Yes. While the Commission reviews each utility's compensation costs on the facts
4 unique to that utility, the Commission has consistently recognized that incentive pay
5 is an accepted and desirable way to simultaneously achieve corporate goals and to
6 control costs for the benefit of customers. The Commission has also determined that
7 incentive compensation is an appropriate component to consider within context of
8 compensation overall for purposes of assessing whether the overall compensation paid
9 to employees is reasonable.

10

11 **Q. Is there a Commission decision reflective of this policy?**

12 A. Yes. For example, there is a Florida Power Corporation rate case that provided for
13 cost recovery of incentive compensation. There, the Commission found: "Incentive
14 plans that are tied to the achievement of corporate goals are appropriate and provide
15 an incentive to control costs."

16 (Order No. PSC-92-1197-FOF-EI, issued October 22, 1992, in Docket No. 910890-
17 EI, In re: Petition for a rate increase by Florida Power Corporation)

18

19 The Commission has also approved incentive compensation in at least three rate cases
20 for Gulf Power Company. The Commission's finding in the 2001 Gulf rate case, Order
21 No. PSC-02-0787-FOF-EI (Page 45), states:

1 To only receive a base salary would mean Gulf employees would be
2 compensated at a lower level than employees at other companies. Therefore,
3 an incentive pay plan is necessary for Gulf salaries to be competitive in the
4 market. Another benefit of the plan is that 25% of an individual employee's
5 salary must be re-earned each year. Therefore, each employee must excel to
6 achieve a higher salary. When the employees excel, we believe that the
7 customers benefit from a higher quality of service.

8

9 **Q. Why has this been the long-standing policy of the Commission?**

10 A. I believe there are a number of reasons for this. First, the Commission's policy is
11 consistent with the basic tenets of sound regulatory policy which I described earlier.
12 Second, the Commission has recognized that having good management at utilities is
13 essential for regulators to achieve their mission of having safe, reliable, and
14 reasonably-priced service delivered to customers. The Commission has further
15 understood that management needs sufficient tools and incentives to achieve these
16 goals and that regulators should not attempt to "micro-manage" their regulated
17 utilities.

18

19 Finally, the Commission has appropriately recognized that not all issues in a rate
20 proceeding are a simple situation of "us vs. them," where every issue has a clear winner
21 and a clear loser. By couching the issue in terms of who should pay (customers or
22 shareholders), Witness Smith is attempting to make it an "us vs. them" issue, when
23 really it is not. Incentive compensation is a good example of a "win-win" situation.

24

25

1 **Q. What do you mean by a “win-win” situation?**

2 A. Incentive compensation is a situation where all stakeholders win. Shareholders get to
3 invest in a company with employees motivated to achieve appropriate corporate goals.
4 Management gets to apply compensation tools that they think are best to motivate and
5 fairly compensate employees. And most importantly, customers pay no more than a
6 reasonable amount in their rates and get a workforce that is motivated to be efficient,
7 to reduce costs where possible, and to maintain a high level of safe and reliable service.

8

9 **Q. The underlying rationale for Witness Smith’s recommendation is that incentive**
10 **payments related to financial performance primarily benefit shareholders and**
11 **therefore should be excluded for ratemaking purposes. Do you agree?**

12 A. No, I do not. Financial goals also significantly benefit customers. Regulated utilities
13 are profit making entities (hopefully) and must make a reasonable profit to be
14 sustainable and to access capital when needed and on reasonable terms. This is the
15 means by which customers receive the service that they expect and deserve. A utility
16 earning a reasonable return is beneficial for both its shareholders and its customers.
17 A financially healthy utility benefits all of its stakeholders – customers, employees and
18 investors – by delivering quality service and earning a fair return on investment. A
19 utility’s ability to earn a fair return assists in attracting the capital required to provide
20 services to the customer. A financially healthy utility provides access to capital on
21 reasonable terms and provides the ability to withstand financial adversity.

1 Moreover, a financially healthy utility will also provide a lower cost of funds for
2 necessary infrastructure investment, resulting in a lower price for the customer. These
3 benefits are consistent with the goals of the Commission. In Gulf Power's 2012 test
4 year rate case, the Commission specifically recognized that ratepayers benefit from
5 Gulf and Southern Company maintaining a healthy financial position. (Order No.
6 PSC-12-0179-FOF-EI, Pages 94-95). It should be noted that Southern Company was
7 Gulf Power's parent before being acquired by NextEra Energy.

8

9 **Q. Do you agree with Witness Smith that the relevant issue is who should bear the**
10 **cost of incentive compensation – shareholders or rate payers?**

11 A. No. To me the most relevant issue is whether incentive compensation is a cost of
12 providing service to customers. It is, and as such, it is properly paid for by customers
13 in their rates just like any other cost of providing service and should be based on its
14 reasonableness. Witness Smith abandons the reasonableness standard and instead uses
15 a strict standard of disallowing an otherwise reasonable amount because of how it is
16 paid. Following Witness Smith's logic to its illogical conclusion would illustrate the
17 fallacy of his position.

18

19 **Q. Please explain.**

20 A. Strictly as a hypothetical, if we were to assume that 100 percent of FPUC's
21 compensation was incentive-based and that 100 percent of the incentive compensation
22 was based on financial metrics, Witness Smith's logic would conclude that zero labor
23 costs should be included in FPUC's rates. This would be the untenable result based

1 on his misguided belief that any pay based on financial metrics primarily benefits
2 shareholders and should not be judged on its reasonableness. Granted, this is an
3 extreme hypothetical pay structure that would not be balanced and not be reflective of
4 the labor market. I do not believe such an extreme pay structure would ever be used
5 by FPUC. Nevertheless, it shows the fallacy of abandoning the reasonableness
6 standard that is applied to all other costs to provide service and replacing it with the
7 “who should pay” standard.

8

9 **Q. What is your recommendation on incentive compensation?**

10 A. I recommend that FPUC’s incentive compensation be evaluated for its reasonableness,
11 along with all other compensation. If total compensation is determined to be
12 reasonable and necessary to adequately compensate and retain experienced and
13 effective employees, that amount should be recognized as a cost of providing service
14 and consequently reflected in FPUC’s rates.

15

16 **Q. Does this conclude your rebuttal testimony?**

17 A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Rebuttal Testimony has been served by Electronic Mail this 20th day of September, 2022, upon the following:

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