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**DIRECT TESTIMONY OF SCOTT W. VIERIMA
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
on behalf of
SOUTHERN STATES UTILITIES, INC.
AND DELTONA UTILITIES, INC.
DOCKET NO. 920199-WS**

DOCUMENT NUMBER-DATE
08056 JUL 22 1992
FPSC-RECORDS/REPORTING

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
2 OCCUPATION.

3 A. My name is Scott W. Vierima. My business address
4 is Southern States Utilities, Inc., 1000 Color
5 Place, Apopka, Florida 32703. I serve as Vice
6 President of Finance and Administration for
7 Southern States Utilities, Inc. and Deltona
8 Utilities, Inc. (hereafter referred to
9 collectively as "Southern States").

10 Q. PLEASE PROVIDE YOUR EDUCATIONAL AND PROFESSIONAL
11 BACKGROUND.

12 A. I received a Bachelors Degree in Electrical
13 Engineering from Montana State University in
14 1973, and a Masters Degree in Business
15 Administration from the University of Iowa in
16 1975. I also have completed various continuing
17 education courses related to financial planning
18 and administration. I have served in the utility
19 industry for approximately fifteen years, all
20 served with Minnesota Power or one of its
21 affiliates, in the capacity of financial analyst,
22 manager or director. Prior to taking my current
23 position with Southern States on May 11, 1992, I
24 served as Director of Finance and Administration
25 for Topeka Group Incorporated ("Topeka"), a

1 wholly owned, diversified subsidiary of Minnesota
2 Power & Light Company ("Minnesota Power"). In
3 that capacity, my duties focused primarily on the
4 provision of advisory services to Topeka
5 subsidiaries in the areas of capital funding,
6 administration of intercompany financial
7 transactions, consolidated group forecasting, and
8 new investment decisions.

9 **Q. TO WHAT TRADE AND/OR PROFESSIONAL ORGANIZATIONS**
10 **DO YOU BELONG?**

11 **A.** I am a member of the American Water Works
12 Association and the National Honor Society for
13 Students of Business and Management.

14 **Q. WHAT ARE YOUR PRESENT DUTIES AS VICE PRESIDENT**
15 **OF FINANCE AND ADMINISTRATION FOR SOUTHERN**
16 **STATES?**

17 **A.** In my position as Vice President, I am
18 responsible for financial planning, financial
19 controls, funding of capital needs and the
20 provision of selected administrative services.
21 My duties include supervision of the Accounting,
22 Treasury, Budgets, Purchasing, Payroll and
23 Administrative Services departments.

24 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

25 **A.** The purpose of my testimony is to discuss

1 Southern States' current financial situation,
2 including (1) our returns during the test year;
3 (2) our test year cost of capital; (3) our
4 difficulty in accessing credit(s) which might
5 otherwise be readily available but for our
6 strained financial situation; and (4) our urgent
7 need to be allowed the opportunity to earn a
8 11.57% rate of return and 12.83% return on equity
9 for water and wastewater operations combined to
10 avoid further deterioration of our financial
11 position.

12 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA**
13 **PUBLIC SERVICE COMMISSION ("COMMISSION")?**

14 **A. Yes. I testified before this Commission in**
15 **Docket No. 900329-WS. My testimony addressed**
16 **matters relating to the cost and structure of**
17 **utility and parent company capital for Southern**
18 **States Utilities, Inc., Deltona Utilities, Inc.,**
19 **and United Florida Utilities Corporation.**

20 **Q. ARE YOU THE SPONSOR OF CERTAIN MINIMUM FILING**
21 **REQUIREMENTS ("MFRs") CONTAINED IN EXHIBIT ____**
22 **(FLL-1)?**

23 **A. Yes. I am sponsoring all of the D schedules**
24 **contained in Volume II, Book 7 of 11 of Exhibit**
25 **____ (FLL-1). These schedules were prepared while**

1 I was still serving as Director of Finance and
2 Administration for Topeka. The Topeka Schedules,
3 D-3, D-4, D-5 and D-6, and Minnesota Power
4 Schedules, D-3, D-4, D-5, D-6 and D-7, were
5 prepared by me or under my direction and
6 supervision. The balance of the D Schedules were
7 prepared by Southern States' former Vice
8 President of Finance and Administration, Richard
9 P. Ausman. I have reviewed and am familiar with
10 all of these schedules and the underlying data
11 supporting these schedules and now wish to
12 sponsor them as evidence in this proceeding.

13 **Q. PLEASE DESCRIBE THE INFORMATION CONTAINED IN THE**
14 **D SCHEDULES WHICH YOU ARE SPONSORING?**

15 **A.** The D Schedules contain the information required
16 to compute Southern States' cost of capital. The
17 cost of equity reflected in the D schedules was
18 determined by using the Commission's leverage
19 formula as it existed at the time we filed our
20 application for a rate increase. As discussed by
21 Mr. Joseph P. Cresse and Ms. Helena Loucks, we
22 are requesting that the Commission focus on
23 capital supporting the filed systems as a whole
24 for ratemaking purposes. Providers of capital
25 are now looking at the combined financial

1 performance and character of Southern States in
2 making credit decisions. Therefore, the rate of
3 return and return on equity for the 127 systems
4 in the combined companies would be 11.57% and
5 12.83%, respectively, under the rates we are
6 proposing.

7 **Q. PLEASE DESCRIBE SOUTHERN STATES' CURRENT**
8 **FINANCIAL SITUATION.**

9 A. As indicated in Volume I, Book 1 of 4, page 8 of
10 the MFRs, for the year ended December 31, 1991,
11 Southern States produced a rate of return of only
12 3.07% and 1.74% for its water and wastewater
13 operations, respectively. Thus, the rate of
14 return from combined operations was only 2.54%.
15 For the same period, the Company's average
16 weighted cost of long-term debt was 5.80%.
17 Therefore, Southern States was unable to cover
18 its cost of long-term debt through operating
19 revenues in 1991. Indeed, Southern States' poor
20 returns translate into negative returns on equity
21 of -7.07% and -10.18%, respectively, for water
22 and wastewater continuing operations in 1991.

23 **Q. PLEASE DESCRIBE THE IMPACT OF THESE POOR**
24 **FINANCIAL RESULTS ON THE COMPANY.**

25 A. Southern States' poor financial results have had

1 three immediate negative impacts on the Company:
2 (1) difficulty in obtaining needed new financing
3 and credit support; (2) more restrictive terms
4 and conditions on renewals and refinancings of
5 existing credits; and (3) the delay of the legal
6 merger of Southern States Utilities, Inc. and
7 Deltona Utilities, Inc.

8 **Q. PLEASE BRIEFLY DISCUSS THE IMPACT OF THE POOR**
9 **FINANCIAL RESULTS ON SOUTHERN STATES' ABILITY TO**
10 **SECURE DEBT FINANCING.**

11 **A.** As a result of poor 1991 and year-to-date 1992
12 financial results, Southern States has been
13 unable to obtain debt financing from commercial
14 banks or other lending institutions on a stand
15 alone basis. Lenders have also been encouraging
16 increased levels of equity funding to offset
17 their increasing risk.

18 **Q. I SHOW YOU EXHIBIT ____ (SWV-1) UNDER COVER PAGE**
19 **ENTITLED "SAMPLE OF 1991 BANK REJECTION LETTERS**
20 **AND CHRONOLOGY OF FINANCING EVENTS." WAS THIS**
21 **EXHIBIT PREPARED BY YOU OR UNDER YOUR DIRECTION**
22 **AND SUPERVISION?**

23 **A.** Yes, it was.

24 **Q. COULD YOU BRIEFLY DESCRIBE THIS EXHIBIT?**

25 **A.** This exhibit contains copies of letters received

1 by Southern States from financial institutions to
2 which we had applied for credit, and an overview
3 of other credit related events that were
4 influenced by Southern States' weakening
5 financial condition. As an example, the SunBank
6 letter states as follows:

7 Because of the recent problems SSU has
8 experienced in the rate filing process with
9 the PSC, profit from utility operations has
10 suffered to the point that SunBank no longer
11 feels comfortable in responding positively
12 to [SSU's] request on an unsecured basis .
13 . . There may be some alternate collateral
14 that could be established in negotiation
15 with you or Topeka Group, and we would
16 certainly be open to discussion . . . I know
17 this puts some strain on your game plan, and
18 we certainly would like to continue to
19 expand our fine relationship with
20 SSU/Deltona/ Topeka. Its just that with the
21 denial of the filing, the operating profit
22 level is inadequate for us to maintain our
23 former high comfort level relative to
24 unsecured exposure.

25 As demonstrated by the testimony of Mr. Bert T.

1 Phillips in this proceeding, the financing
2 difficulties listed in this exhibit could not
3 have arrived at a worse time. The Company's
4 capital requirements are significant, principally
5 as a result of new and revised laws and
6 regulations. Without improved financial results,
7 we fear that our only recourse to obtain the
8 required capital may be to enter into obligations
9 with exceedingly high associated costs or
10 increasingly restrictive covenants. Of course,
11 financing investments under such terms does not
12 benefit our customers. It must also be
13 recognized that if our financial situation
14 continues to erode, we could reach a point where
15 financing is unavailable at any cost. We believe
16 that only by obtaining the requested rate relief
17 can the Company avoid such a result.

18 **Q. IS THERE ANY EVIDENCE THAT THE FINANCIAL STRENGTH**
19 **OF INVESTOR-OWNED WATER UTILITIES, IN GENERAL, IS**
20 **WEAKENING?**

21 **A. Yes, As noted in Staff's June 18, 1992 memorandum**
22 **to the Commission in Docket No. 920006-WS, Water**
23 **and Wastewater Industry, Annual Reestablishment**
24 **of Authorized Range of Returns on Common Equity**
25 **of Water and Wastewater Utilities Pursuant to**

1 Section 367.081(4)(f), Florida Statutes, approved
2 by the Commission on June 30, 1992, the average
3 bond rating of water and wastewater utilities has
4 decreased in the past year such that Staff
5 recommended a 10 basis point increase in the bond
6 yield differential used to calculate equity
7 returns with the Commission's leverage formula.
8 In its recommendation, Staff recognized that
9 Moody's downgraded the index of bonds issued by
10 water and wastewater utilities from a rating of
11 A1 to A2. Staff also advocated an additional
12 bond yield differential of 34 basis points for
13 Florida water and wastewater utilities from the
14 national index to reflect the increased risk
15 faced by investors in, and creditors of,
16 Florida's water and wastewater utilities. In
17 addition, as mentioned by Bert T. Phillips, other
18 rating agencies, such as Standard & Poors, are
19 employing more stringent standards in
20 establishing rating benchmarks. Southern States'
21 inability to cover its cost of debt through
22 operating revenues in 1991 -- in other words, an
23 operating loss -- confirms that Southern States'
24 ability to attract debt or equity capital is
25 severely impaired.

1 Q. DID SOUTHERN STATES' POOR FINANCIAL RESULTS IN
2 1991 HAVE ANY IMPACT ON THE COMPANY'S ATTEMPT TO
3 LEGALLY MERGE SOUTHERN STATES UTILITIES, INC. AND
4 DELTONA UTILITIES, INC.?

5 A. Yes. The poor 1991 financial results prevented
6 the Company from completing the legal merger of
7 Southern States Utilities, Inc. and Deltona
8 Utilities, Inc. ("Deltona") in April of 1992
9 because Southern States was not able to meet
10 certain covenants regarding pro-forma financial
11 performance which were contained in the bonds
12 issued by Deltona in 1984. Southern States could
13 not convince the bondholders to waive the
14 financial covenants without first obtaining
15 additional commitments and security from Southern
16 States' parent company. Furthermore, a loan
17 agreement with Barnett Bank requiring merger
18 consent had to be refinanced with parent support
19 in light of Barnett's credit related refusal to
20 grant such consent. Each time parent credit
21 support is called upon, it reduces the
22 availability of such support for funding of
23 incremental needs.

24 Q. PLEASE DESCRIBE THE EXISTING SOURCE(S) AND
25 APPLIED USE(S) OF DEBT AT THE FIRST AND SECOND

1 **TIER PARENT COMPANIES.**

2 A. As explained by Mr. Phillips, Southern States is
3 a wholly-owned subsidiary of Topeka (second tier
4 parent) and Topeka is a wholly-owned subsidiary
5 of Minnesota Power (first tier parent). Debt is
6 incurred at each of three levels: (1) Southern
7 States -- mortgage obligations and other long
8 term debt used for the acquisition and
9 construction of utility plant, as well as
10 intermediate term lines of credit for operations
11 support and interim construction financing (both
12 of which frequently require credit support from
13 Topeka). Southern States typically relies on
14 Topeka, commercial banks and municipal industrial
15 development bonds for funding; (2) Topeka --
16 long-term private placement debt for acquisitions
17 and affiliate loans and intermediate term credit
18 lines for funding needs between long-term
19 offerings. To date, Topeka has relied solely on
20 commercial banks and insurance institutions as
21 funding sources; and (3) Minnesota Power -- long-
22 term mortgage debt, preferred stock series, and
23 industrial development authority and pollution
24 control revenue obligations issued to finance
25 electric utility assets, with periodic issuances

1 of commercial paper for short-term corporate
2 needs. No long-term debt has been issued to date
3 by Minnesota Power for the expressed purpose of
4 funding water and wastewater investments.
5 Southern States' poor financial performance in
6 1991 has severely limited Southern States'
7 ability to obtain unsupported short or long term
8 debt under acceptable terms. Stand alone debt
9 which might be issued by Southern States at this
10 time would clearly be considered non-investment
11 grade. As evidenced by Deltona's 1984 debt
12 financing, the cost of securing debt of such
13 quality is high. Also, as I indicated
14 previously, Topeka's sources of support for
15 funding Southern States' required investments are
16 becoming more limited as Topeka has increased it
17 commitments to secure Southern States'
18 obligations. In light of these facts and the
19 significant levels of capital investments
20 required of Southern States, without rate relief
21 Southern States soon will have no alternative but
22 to seek out capital under significantly less
23 desirable terms, if such capital is available at
24 all. Finally, we must note that the urgency of
25 obtaining rate relief is ever more pressing as a

1 result of the First District Court of Appeals'
2 recent dismissal of the company's appeal
3 regarding Docket No. 900329-WS.

4 Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

5 A. Yes.

Exhibit ____ (SWV-1)
Cover Page

**SAMPLE OF 1991 BANK REJECTION LETTERS AND
CHRONOLOGY OF FINANCING EVENTS**



SunBank, N.A.
P.O. Box 3833
Orlando, Florida 32802-3833

Exhibit _____ (SWV-1)

Page 1 of 3

October 25, 1991

Mr. Richard Ausman
Southern States Utilities
1000 Color Place
Apopka, FL 32703

Dear Dick:

This letter is pursuant to our conversation of October 23 regarding Sun Bank's willingness to issue a letter of credit in the amount of \$2,859,000 on behalf of SSU's appeal of the summer's rate filing in the Circuit Court. This L/C would support interim rate relief plus interest in the event that the appeal is not successful.

Because of the recent problems SSU has experienced in the rate filing process with the PSC, profit from utility operations has suffered to the point that Sun Bank no longer feels comfortable in responding positively to this request on an unsecured basis.

Acceptable collateral could take the form of a CD at Sun Bank in an equivalent amount to the L/C that would collateralize the credit exposure. This kind of structure would allow for a quick turnaround on our part. Our current 1-year CD rate is a 5.40% at present. Cost on the L/C would be .25% annually. There may be some alternate collateral that could be established in negotiation with you or Topeka Group, and we would certainly be open to discussion.

Dick, I know this puts some strain on your game plan, and we certainly would like to continue to expand our fine relationship with SSU/Deltona/Topeka. Its just that with the denial of the filing, the operating profit level is inadequate for us to maintain our former high comfort level relative to unsecured exposure.

Sincerely Yours,

Guy B. Michel
Vice President
Corporate Banking/Florida Division

/gem

NCNB National Bank
PO Box 2100
Orlando, Florida 32802

Exhibit _____ (SWV-1)

Page 2 of 3

NCNB

December 23, 1991

Ms. Virginia Clark
Southern States Utilities, Inc.
1000 Color Place
Apopka, Florida 32703

Re: Proposed \$5,000,000.00 line of credit

Dear Ms. Clark:

Thank you for affording NCNB National Bank of Florida ("NCNB") the opportunity to review your financing proposal. As we discussed Thursday December 19, NCNB is unable to accommodate your current credit needs. I would however appreciate being afforded the opportunity to keep in touch over the coming months as SSU progresses in applying for rate relief on its existing operations.

Once again thank you for your consideration of NCNB, and I look forward to working with you on your depository and related banking service needs. Should you have any questions or if I may be of service in any manner please do not hesitate to call.

Sincerely,


Kirk A. Ruth
Assistant Vice-President
(407) 648-2866

kr6

SOUTHERN STATES UTILITIES, INC.
CHRONOLOGY OF FINANCING EVENTS

- 10/91 SunBank of Orlando requires Topeka support for issuance of letter of credit on revenue subject to refund under 900329-WS appeal (letter attached).
- 10/91 Topeka is required to seek temporary waiver of certain maintenance tests with Teachers Insurance and Annuity Association in view of eroding consolidating results from SSU.
- 12/91 NCNB National Bank of Florida rejects credit line application (letter attached)
- 2/92 Continental Assurance Company denies request for consent to SSU/DUI merger.
- 3/92 Barnett Bank of South Florida rejects SSU's request for consent to SSU/DUI merger, forcing SSU to find a take-out loan.
- 4/92 Barnett Bank of South Florida rejects SSU's request for waiver of comfort letter provisions, without Topeka subordination agreement.
- 5/92 Equitable Life Assurance Society requires contingent parent company continuing ownership agreement in exchange for SSU/DUI merger consent.
- 5/92 Barnett Bank of Naples rejects SSU financing proposal on raw water supply purchase.
- 6/92 Barnett take-out proposal is initially rejected by SouthTrust Bank of Alabama, then approved with Topeka credit support added.
- 6/92 SouthTrust Bank of Alabama rejects SSU's request for letter of credit support for \$8MM Collier IDRFB funding.
- 6/92 SunBank of Orlando requires Topeka credit support for renewal of \$5MM credit line, and reduces term from 2 years to 1.
- 6/92 SunTrust of Atlanta Corporate Finance Department advises SSU that unsupported corporate obligations under existing financial character would be received in the market as non-investment grade.
- Negotiations with First Union and Chemical Banks progress slowly on credit support for additional IDRFB funding.