

REBUTTAL TESTIMONY OF JOHN F. GUASTELLA
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
IN DOCKET NO. 110200-WU
REGARDING THE APPLICATION OF
WATER MANAGEMENT SERVICES, INC.
FOR AN INCREASE IN RATES & CHARGES
AND REVISIONS OF
SERVICE AVAILABILITY CHARGES

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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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