

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**  
**DOCKET NO. 150071-SU,**  
**KW RESORT UTILITIES CORPORATION RATE CASE**  
**DIRECT TESTIMONY OF J. TERRY DEASON**  
**September 14, 2016**

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

2 A. My name is Terry Deason. My business address is 301 S. Bronough  
3 Street, Suite 200, Tallahassee, FL 32301.

4  
5 **Q. By whom are you employed and what position do you hold?**

6 A. I am a Special Consultant for the Radey Law Firm, specializing in the  
7 fields of energy, telecommunications, water and wastewater, and public  
8 utilities generally.

9  
10 **Q. Please describe your educational background and professional**  
11 **experience.**

12 A. I have thirty-nine years of experience in the field of public utility  
13 regulation spanning a wide range of responsibilities and roles. I served  
14 as a consumer advocate in the Florida Office of Public Counsel ("OPC")  
15 on two separate occasions, for a total of seven years. In that role, I  
16 testified as an expert witness in numerous rate proceedings before the  
17 Florida Public Service Commission ("Commission" or "PSC"). My tenure

1 of service at OPC was interrupted by six years as Chief Advisor to  
2 Florida Public Service Commissioner Gerald L. Gunter. I left OPC as its  
3 Chief Regulatory Analyst when I was first appointed to the Commission  
4 in 1991. I served as Commissioner on the Commission for sixteen  
5 years, serving as its chairman on two separate occasions. Since retiring  
6 from the Commission at the end of 2006, I have been providing  
7 consulting services and expert testimony on behalf of various clients,  
8 including public service commission advocacy staff and regulated utility  
9 companies. I have also testified before various legislative committees  
10 on regulatory policy matters. I hold a Bachelor of Science Degree in  
11 Accounting, summa cum laude, and a Master of Accounting, both from  
12 Florida State University.

13  
14 **Q. For whom are you appearing as a witness?**

15 A. I am appearing as a witness for Monroe County.

16  
17 **Q. What is the purpose of your testimony?**

18 A. The purpose of my testimony is to discuss Florida's regulatory policy of  
19 establishing rates on appropriate test years and the need for the correct  
20 matching of investment, expenses, and revenues in those test years. I  
21 refer to this principle as the "matching principle." Recognizing that a  
22 utility's revenues are simply its sales (e.g., kilowatt-hours of electricity, or  
23 gallons of water or wastewater service provided to customers) times its

1 rates, it is clear that the “matching principle” requires that rates be  
2 determined using the utility’s allowed revenues (referred to as its  
3 “revenue requirements” in regulatory terminology) and its sales units  
4 from the same time period in which the rates will be in effect.

5

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

7 A. Yes. I am sponsoring Exhibit JTD-1, which is my curriculum vita.

8

9 **Q. How is your testimony organized?**

10 A. My testimony is organized into three parts. First, I provide a brief  
11 overview of the regulatory compact that provides the foundation for the  
12 setting of rates for a regulated utility. Second, I discuss the need for test  
13 years when setting rates. Third, I discuss the need for appropriate  
14 adjustments to comply with the matching principle.

15

16

### **I. Regulatory Compact**

17 **Q. What is the regulatory compact?**

18 A. The regulatory compact is an implied contract that exists between a  
19 regulated public utility, its regulators, and its customers. It lays the  
20 foundation for regulation and balances the interests (and risks) of all  
21 stakeholders. It has been employed to characterize the set of mutual  
22 rights, obligations, and benefits that exist between the utility and its  
23 customers. These rights, benefits, and obligations are supervised and

1 enforced by regulatory utility authorities such as the Florida PSC.

2

3 **Q. How does the regulatory compact balance the interests of the utility**  
4 **and its customers?**

5 A. Under the regulatory compact, the interests of the utility and its  
6 customers are balanced by the following considerations:

- 7
- 8 • A regulated utility has the obligation to provide reliable and cost-  
9 effective service to its customers. To fulfill this obligation to serve,  
10 the utility must deploy needed capital and obtain the labor,  
11 materials, and supplies necessary to operate and maintain its  
12 system to serve its customers. Inherent in this obligation is a  
13 responsibility to manage costs and mitigate risks where  
14 reasonably possible.
  - 15 • Correspondingly, the utility is granted a monopoly in its service  
16 area, and its rates are set by the utility commission (the PSC in  
17 Florida) to recover all of the utility's reasonable and prudent  
18 operating and maintenance costs and to provide fair  
19 compensation for its capital investments.
  - 20 • All utility investments are subject to a determination of prudence,  
21 based on the reasonably anticipated costs, risks, and benefits of  
22 said investment that are known or reasonably known at the time  
23 that the investment is made. Concomitant with this principle is  
that future changed circumstances that can be known and applied

1           only in hindsight are not a valid basis to reverse a previous  
2           determination of prudence.

- 3           • All prudently incurred investments that are used and useful in  
4           providing service are to be afforded rate recovery treatment, both  
5           in the form of a reasonable return on the investment and a  
6           reasonable return of the investment, generally over the useful life  
7           of said investment. The return on investment refers to the  
8           interest expense and the return on the equity investment made by  
9           the utility's owners or shareholders. The return of investment  
10          refers to the allowance for depreciation of the capital assets over  
11          time, where such allowance is also built into the utility's rates. It is  
12          useful to think of the depreciation allowance as the principal  
13          component of a mortgage payment, and the interest expense and  
14          return on equity as being comparable to the interest component of  
15          a mortgage payment, made to fairly compensate the lender for  
16          the use of its money.
- 17          • The reasonable rate of return is a necessary cost to provide  
18          service and should be set at a level to adequately compensate  
19          investors for the risk of their investment and to be fair to  
20          customers on whose behalf the capital is deployed. Inherent in  
21          this principle is the expectation that customer and investor  
22          interests are balanced in a fair and symmetrical manner.
- 23          • While the reasonable return on investment is not guaranteed,

1           there is an expectation that rates will be set to afford a utility a  
2           reasonable opportunity to actually earn its authorized rate of  
3           return.

- 4           • The reasonable rate of return is set and monitored to fall within an  
5           established band, so that the return is neither excessive nor  
6           deficient.

7           These considerations are part of the regulatory compact that has been  
8           the foundation of fair and effective utility regulation in this country for  
9           decades.

10

11   **Q.    What is the role of the PSC in setting the utility's rates under the**  
12   **regulatory compact?**

13   A.    From the utility's perspective, the PSC (in Florida or anywhere else) is  
14   responsible to set rates that allow the utility to recover its reasonable  
15   operating and maintenance costs and the opportunity to recover its  
16   interest costs and earn a reasonable return on the owners' or  
17   shareholders' investment in capital assets. From the customers'  
18   perspective, the PSC is responsible to set rates based on the  
19   reasonable and prudent costs of providing service. In Florida and  
20   elsewhere, this standard is frequently articulated as requiring rates to be  
21   fair, just, and reasonable.

22

23



1 effect. For water and wastewater utilities, the Commission has adopted  
2 Rule 25-30.430(1), Florida Administrative Code ("F.A.C."), which  
3 requires that:

4 (1) Prior to the filing of an application for a general rate  
5 increase, a utility shall submit to the Commission a written  
6 request for approval of a test year, supported by a statement  
7 of reasons and justifications **showing that the requested**  
8 **test year is representative of utility operations.** The  
9 Commission Chairman will then approve or disapprove the  
10 request within 30 days from the receipt of the request. In  
11 disapproving the requested test year, the Chairman may  
12 suggest another test year. Within 30 days of the Chairman's  
13 approval or disapproval of a test year, upon request of any  
14 interested person the full Commission may review the  
15 Chairman's test year decision.

16 I added the emphasis in the cited provision to demonstrate the  
17 Commission's recognition of the importance of having a test year that is  
18 representative of the utility's operations during the time period in which  
19 rates will be in effect,

20 Similarly, for electric utilities, the Commission has adopted Rule  
21 25-6.140 (1)(a), in which a requesting utility must provide:

22 An explanation for requesting the particular test period. If

23 an historical test year is selected, there shall be an

1 explanation of why the historical period is more  
2 representative of the company's operations than a  
3 projected period. If a projected test year is selected, there  
4 shall be an explanation of why the projected is more  
5 representative than an historical period . . . .

6

7 **Q. Has the Commission defined the appropriate use of a test year for a**  
8 **water and sewer utility company?**

9 A. Yes. In its Order No. 15725, addressing a petition for an increase in  
10 water and sewer rates by Martin Downs Utilities, Inc., the Commission  
11 stated:

12 The test year is an analytical device used in ratemaking  
13 proceedings to compute current levels of investment and  
14 income in order to determine the amount of revenue that  
15 will be required to assure a company a fair return on its  
16 investment. Test year data must be adjusted to properly  
17 reflect conditions in the future period for which rates are  
18 being fixed. Based upon historical data we anticipate  
19 Martin Downs will continue to experience a rapid growth of  
20 demand for its services. Therefore, we believe a projected  
21 test year is appropriate in this case.

22

23

1 **Q. In your opinion, is this appropriate utility regulatory policy? Why**  
2 **or why not?**

3 A. Yes, this is the essence of sound and appropriate regulatory  
4 ratemaking policy, because it ensures that the rates charged by  
5 the utility will produce the revenues needed to cover the utility's  
6 costs of providing service and a reasonable return on and of its  
7 investment. This is the essence of determining rates that are fair,  
8 just, and reasonable. If rates were set using non-representative  
9 cost, investment, or sales data, they would likely be unfair, unjust,  
10 or unreasonable, or all of the above, to either the utility or its  
11 customers.

12  
13 **Q. Does the Commission have a preference for projected versus**  
14 **historic test years?**

15 A. For electric utilities, the Commission has primarily relied on projected  
16 test years, especially after the Florida Supreme Court addressed their  
17 use back in 1983. Nevertheless, the Commission still relies on test  
18 years, either historic or projected, that are most representative of future  
19 utility operations and has placed the burden on requesting utilities to so  
20 demonstrate.

21  
22 **Q. What did the Florida Supreme Court say on the subject?**

23 A. In an appeal of a Commission order taken by the Southern Bell

1 Telephone and Telegraph Company in 1983, 443 So.2d 92, the Court  
2 stated:

3 Nothing in the decisions of this Court or any legislative act  
4 prohibits the use of a projected test year by the  
5 Commission in setting a utility's rates. We agree with the  
6 Commission that it may allow the use of a projected test  
7 year as an accounting mechanism to minimize regulatory  
8 lag. The projected test period established by the  
9 Commission is a ratemaking tool which allows the  
10 Commission to determine, as accurately as possible, rates  
11 which would be just and reasonable to the customer and  
12 properly compensatory to the utility.

13 Thus, the Court has recognized that the Commission may utilize  
14 ratemaking tools that minimize regulatory lag and determine, as accurately  
15 as possible, rates that are just and reasonable during the time period that  
16 the rates will be in effect.

17

18 **Q. The Court mentioned regulatory lag. What is it?**

19 A. Regulatory lag is the difference in time between when rates should be  
20 changed and when new rates can be implemented.

21

22 **Q. Does regulatory lag always mean that rates are lower than they**  
23 **should be for longer than is necessary?**

1 A. No. Regulatory lag will exist either when rates are lower than they should  
2 be, exposing the utility to not recovering its costs and earning an adequate  
3 return, or when rates are higher than they should be, exposing customers  
4 to paying rates that are higher than justified by the utility's costs. In other  
5 words, regulatory lag cuts both ways. If rates are not based upon the  
6 most appropriate test year information, the utility could quickly experience  
7 either underearnings or overearnings soon after the new rates are  
8 implemented. That is why it is important that rates be set as close as  
9 possible to what a representative test year shows is the relationship  
10 between investment, expenses, and revenues during the time that rates  
11 will be in effect. This minimizes regulatory lag in both directions.

12

13 **Q. Has the Commission previously addressed the need to adjust the**  
14 **test year to prevent possible overearnings?**

15 A. Yes. In a staff-assisted rate case for Burkim Enterprises, Inc., Docket No.  
16 010396-WS, the Commission opted to use a projected test year, citing the  
17 potential for overearnings if rates were set only on historical information.  
18 In its Order No. PSC-01-2511-PAA-WS, the Commission stated:

19 For audit purposes, we selected a historical test year  
20 ending May 31, 2001. Because the utility is growing at an  
21 exceptionally high rate (29 connections per year), rates  
22 based on historical data alone will be significantly different  
23 than rates based on current or even future conditions, and

1 the potential for overearning exists if a projected test year is  
2 not used. We find that a projected test year ending May 31,  
3 2003 is appropriate in this case and will better match  
4 increasing revenues with the high level of DEP required pro  
5 forma additions that are being approved.

6

7 **Q. What is the test year proposed by KW Resort Utilities Corporation in**  
8 **its request for increased rates in this case?**

9 A. The requested test year is the historic year ended December 31, 2014,  
10 with significant adjustments for pro forma plant additions and increased  
11 pro forma expenses in the future. As this case has developed, the PSC  
12 has issued a proposed order that will have customers pay one set of rates,  
13 called "Phase I rates," for the period beginning in April 2016, and another  
14 set of rates, called "Phase II rates," for the period beginning sometime in  
15 2017 when KWRU's new wastewater treatment plant comes into service.  
16 My understanding is that the utility has also asked that its new rates  
17 include the costs of a new air vacuum tank that is expected to come into  
18 service in roughly the same time frame as the new treatment plant, but the  
19 utility did not include the costs of the new tank in its original filing for a rate  
20 increase.

21

22 **Q. Does Monroe County object to this test year?**

23 A. Monroe County does not object to the selected test year per se. Monroe

1 County does object to pro forma adjustments (or a lack of certain pro  
2 forma adjustments) which results in a test year that is not representative of  
3 future operations and that violates the matching principle by not properly  
4 matching KWRU's costs with its sales during the time periods in which the  
5 utility's rates will be in effect.

6  
7 **III. The Matching Principle**

8 **Q. What is the matching principle?**

9 A. From an accounting standpoint, the matching principle requires a  
10 company to match expenses with related revenues in order to accurately  
11 report a company's net income for any given time interval of financial  
12 reporting. This same principle also applies to the amount of investment,  
13 expenses, and revenues reported in a regulated utility's test year used to  
14 prospectively set rates.

15 From a regulatory ratemaking standpoint, the matching principle  
16 requires that the utility's rates be set using the utility's costs, investments,  
17 revenues, and sales units from the same time period, and that they be  
18 representative of the time period in which the new rates will be in effect.

19  
20 **Q. If the matching principle is not followed, can distortions result?**

21 A. Yes. For example, if a hypothetical company attempted to inappropriately  
22 report current year revenues as being applicable to a future year in an  
23 attempt to reduce a current tax liability, a distortion would result which

1 would not be viewed favorably by the Internal Revenue Service.

2 Likewise, if a hypothetical company attempted to inappropriately  
3 include revenues properly attributable to a future period in its current  
4 year's results in an attempt to inflate its earnings, a distortion would result  
5 that would likely get the attention of its auditors and perhaps the Securities  
6 and Exchange Commission.

7 And in the world of utility ratemaking, if a utility or its public utility  
8 regulatory authority did not properly match its revenues and sales with the  
9 amount of anticipated investment and expenses, a distorted test year that  
10 is not properly representative would be the result. If not corrected, this  
11 would almost certainly result in rates that are not fair, just and reasonable.

12

13 **Q. Is the amount of investment, expenses, and revenues included in a**  
14 **test year important to the matching principle?**

15 A. Yes. Utilities generally are capital intensive and have an obligation to  
16 serve customers within their authorized territories. To meet this  
17 obligation, utilities often have to make substantial investments that can  
18 be driven by the need for modernization, the need to meet environmental  
19 requirements, and the need to meet the demands of new customers  
20 and/or increased demand from existing customers. In the situation  
21 where additional investment is being made, or additional expenses are  
22 being incurred, or both, to serve a growing customer base or growing  
23 customer demands for service, or both, it is imperative that rates be set

1 taking into consideration the additional revenues that will be produced.  
2 In the simplest terms, revenues are equal to units sold times rates; for  
3 any given level of revenues authorized by the PSC, the lower the  
4 amount of sales units used to calculate rates, the higher the utility's rates  
5 will be. This was the conclusion reached by the Commission in the  
6 Burkim case I earlier referenced.

7  
8 **Q. Is it appropriate for the Commission to recognize the additional**  
9 **revenues that will be produced by KW Resort's additional**  
10 **investments?**

11 A. Yes. This will result in a better matching and would be consistent with  
12 good ratemaking policy and previous decisions of the Commission and the  
13 Florida Supreme Court.

14  
15 **Q. How should this be accomplished?**

16 A. The amount of test year revenue should be increased to properly account  
17 for the amount of revenue that will be generated at existing rates due to  
18 increased customer usage. This will better indicate the amount of any  
19 revenue deficiency that may exist at existing rates. Once the correct test  
20 year revenue requirements are determined, the utility's new rates should  
21 be set using the new, current-billing-period billing determinants to  
22 generate the amount of revenues needed to afford a reasonable  
23 opportunity for KW Resort to recover its reasonable and prudent operating

1 costs and to earn its authorized rate of return on its prudent investments.

2

3 **Q. If there is credible evidence that the gallonage of wastewater treated**  
4 **and billed by KWRU is likely to be greater in 2017 than in 2016,**  
5 **should the Commission take that evidence into account when setting**  
6 **KWRU's rates in this case?**

7 A. Yes. This is particularly important in this instance because the new Phase  
8 II rates will likely not be implemented until March or April of 2017, which  
9 should be contemporaneous with KWRU's new WWTP coming on line to  
10 serve customers. Accordingly, greater usage in 2017, when the new plant  
11 that is driving the need for new rates is actually on line and providing  
12 service, strongly indicates that rates should be based on such greater  
13 usage. Otherwise, in my opinion, KWRU's rates would likely not be fair,  
14 just, and reasonable.

15

16 **Q. Have you quantified these adjustments to account for increased**  
17 **customer usage?**

18 A. No. The purpose of my testimony is to address the policy reasons for  
19 making the needed adjustments. The quantifications are supported in the  
20 testimony of Witness Patricia Merchant, who is testifying on behalf of the  
21 Citizens of the State of Florida, represented by their Public Counsel.

22

23

1 **Q. Please state the main conclusions of your testimony.**

2 A. The Florida Public Service Commission has a longstanding regulatory  
3 policy of establishing rates on appropriate test years, and this policy  
4 recognizes the need to match the utility's investment, expenses, and  
5 revenues in those test years in order to ensure that the rates approved by  
6 the PSC recover the costs incurred during the period or periods in which  
7 those rates will be in effect. I refer to this principle as the "matching  
8 principle." Where a utility is experiencing significant growth in investment  
9 and expenses to serve growth in customers' demands for service, as is  
10 the case with KWRU in this proceeding, it is critical that this matching  
11 principle be followed in order to ensure, to the maximum extent possible,  
12 that the utility's rates are fair, just, and reasonable.

13 In conclusion, I strongly recommend that the Commission apply the  
14 matching principle in this case to ensure that KW Resort's rates are fair,  
15 just, and reasonable.

16

17 **Q. Does this conclude your testimony?**

18 A. Yes, it does.

19

## Terry Deason\*



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### **Professional Experiences:**

- The Radey Law Firm, Special Consultant, 2007 - Present
- Florida Public Service Commission, Commissioner, 1991 - 2007
- Florida Public Service Commission, Chairman, 1993 - 1995, 2000 - 2001
- Office of the Public Counsel, Chief Regulatory Analyst, 1987 - 1991
- Florida Public Service Commission, Executive Assistant to the Commissioner, 1981 - 1987
- Office of the Public Counsel, Legislative Analyst II and III, 1979 - 1981
- Ben Johnson Associates, Inc., Research Analyst, 1978 - 1979
- Office of the Public Counsel, Legislative Analyst I, 1977 - 1978
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### **Professional Associations and Memberships:**

- National Association of Regulatory Utility Commissioners (NARUC), 1993 - 1998,  
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- National Association of Regulatory Utility Commissioners (NARUC) 2002 *Member,*  
*Rights-of-Way Study*
- Nuclear Waste Strategy Coalition, 2000 - 2006, *Board Member*
- Federal Energy Regulatory Commission (FERC) South Joint Board on Security  
*Constrained Economic Dispatch, 2005 - 2006, Member*
- Southeastern Association of Regulatory Utility Commissioners, 1991 - 2006, *Member*
- Florida Energy 20/20 Study Commission, 2000 - 2001, *Member*
- FCC Federal/State Joint Conference on Accounting, 2003 - 2005, *Member*
- Joint NARUC/Department of Energy Study Commission on Tax and Rate  
*Treatment of Renewable Energy Projects, 1993, Member*
- Bonbright Utilities Center at the University of Georgia, 2001, *Bonbright Distinguished Service*  
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- Eastern NARUC Utility Rate School - Faculty Member



**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Application for Increase )  
In Wastewater Rates in Monroe ) DOCKET NO. 150071-SU  
County By K W Resort Utilities )  
Corp. ) FILED: September 14, 2016  
\_\_\_\_\_)

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a true and correct copy of the foregoing was furnished to the following, by electronic delivery, on this 14th day of September, 2016.

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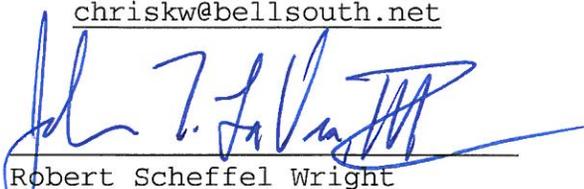
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