

1 BEFORE THE
2 FLORIDA PUBLIC SERVICE COMMISSION

3 In the Matter of

4 Application for rate increase in Brevard:
5 Charlotte/Lee, Citrus, Clay, Duval,
6 Highlands, Lake, Marion, Martin, Nassau,
7 Orange, Osceola, Pasco, Putnam, Seminole:
8 Volusia, and Washington Counties by
9 SOUTHERN STATES UTILITIES, INC.; Collier:
County by MARCO SHORES UTILITIES
(Deltona); Hernando County by SPRING
HILL UTILITIES (Deltona); and Volusia
County by DELTONA LAKES UTILITIES
(Deltona)

: DOCKET NO. 920199-WS

10
11 FIRST DAY - EVENING SESSION

12 VOLUME III

13 Pages 320 through 482

14 PROCEEDINGS:

FINAL HEARING

15 BEFORE:

CHAIRMAN THOMAS M. BEARD
COMMISSIONER BETTY EASLEY
COMMISSIONER SUSAN F. CLARK

16
17 DATE: **RECEIVED**
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Friday, November 6, 1992

18 TIME: NOV 12 1992

Commenced at 9:30 a.m.
Adjourned at 4:40 p.m.

19 PLACE: ~~Florida Public Service Commission~~

FPSC, Hearing Room 106
101 East Gaines Street
Tallahassee, Florida 32399

20
21 REPORTED BY:

JOY KELLY, CSR, RPR
22 SYDNEY C. SILVA, CSR, RPR
23 PAMELA A. CANELL
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and
24 LISA GIROD JONES, RPR, CM

25 APPEARANCES:

(As heretofore noted.)

FLORIDA PUBLIC SERVICE COMMISSION

DOCUMENT NUMBER-DATE

13250 NOV 10 1992

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P R O C E E D I N G S

(Transcript follows in sequence from Volume II.)

COMMISSIONER EASLEY: Does anybody object if we get started and at least get this witness on and going? In that case, call your next witness.

MR. McLEAN: Commissioner, there's one preliminary matter we might be able to deal with. You'll recall exhibit number -- the DORP exhibit.

COMMISSIONER EASLEY: I believe that was 23.

MR. McLEAN: Exactly. I think so. Commissioner Clark asked a question about whether it's been updated.

Commissioner, it has been updated. I am satisfied with the exhibit as it appears in the record because whatever probative value it has, it has updated or otherwise.

COMMISSIONER CLARK: I would be interested to know, are there any more cases since 1985 that either granted or denied -- would you give me an updated copy? I mean you're satisfied, but I'm not.

MR. McLEAN: Okay.

MS. BEDELL: Commissioners, I think it's Exhibit No. 25 that we're talking about.

COMMISSIONER EASLEY: I'm sorry. 25. You're right.

MR. McLEAN: I may have drawn as objection

1 from opposing counsel about substituting as an exhibit.
2 Rather than deal with that objection, I'm happy with
3 the record as it is. If you Commissioners want
4 something more, I just happen to have it right here.

5 COMMISSIONER EASLEY: You brought your tuba
6 and your music, did you, Mr. McLean?

7 COMMISSIONER CLARK: Let's have it. Can we
8 mark it as an exhibit?

9 COMMISSIONER EASLEY: Let's mark it as an
10 additional exhibit and then we won't have to worry
11 about objections to substitution. How is that?

12 And I'm going to show it under Mr. Phillips as
13 this witness. OPC, may I show is sponsoring this one?

14 MR. McLEAN: Yes, ma'am. You may.

15 COMMISSIONER EASLEY: Thank you so much.
16 It'll be Exhibit 27 and it is the "Update of Excerpt
17 from DORP," D-O-R-P.

18 And without objection or do you want time to
19 look at it, Mr. Hoffman?

20 MR. HOFFMAN: Just a moment.

21 COMMISSIONER EASLEY: Surely. (Pause)
22 (Exhibit No. 27 marked for identification.)

23 MR. HOFFMAN: Commissioner Easley, we don't
24 have any question.

25 In response to Commissioner Clark's question

1 about other cases, I happen to have one of them. Could
2 I get mine identified as Exhibit 28 and have it entered
3 into the record?

4 COMMISSIONER EASLEY: 28. Would you please
5 give a copy of it to Mr. McLean, and we'll see if he
6 has any objection to your updated case.

7 MR. McLEAN: Doesn't he have a witness to
8 sponsor it?

9 COMMISSIONER EASLEY: I haven't the foggiest
10 idea, Mr. McLean. You can ask the questions when --

11 COMMISSIONER CLARK: I'll tell you what, you can
12 put this on my nickel and we'll have this witness --

13 MR. McLEAN: Let's put it on your nickel.

14 COMMISSIONER CLARK: We can show it as a
15 Commission.

16 COMMISSIONER EASLEY: All right. You want
17 both of them that way?

18 COMMISSIONER CLARK: That would be fine.

19 (Exhibit No. 28 marked for identification.)

20 COMMISSIONER EASLEY: 27 and 28 will be shown
21 as Commission-sponsored exhibits. For the order of
22 finding them in the record, however, we'll identify
23 them as coming in when Mr. Phillips did, so that we at
24 least can find them. 90 FPSC 7.73 identified as
25 Exhibit 28 and without objection -- without objection,

1 entered into evidence. 27 and 28 are in.

2 (Exhibit Nos. 27 and 28 received into evidence.)

3 COMMISSIONER CLARK: Mr. Hoffman, do you know
4 if this became a final order?

5 MR. HOFFMAN: No, I don't. I'd have to check
6 that.

7 COMMISSIONER CLARK: Why don't you let me know?

8 MR. HOFFMAN: I will.

9 COMMISSIONER EASLEY: When you do, let's just
10 update Exhibit 28 instead of having Exhibit 29. As long
11 as we're interrupted, and I can get -- while I'm getting
12 the Chairman caught up here, did we get the answer to the
13 stipulation on the Issues 21, 55, 76 and 98?

14 MR. HOFFMAN: We can stipulate to those four
15 issues that we discussed earlier on.

16 MR. McLEAN: So can we.

17 COMMISSIONER EASLEY: And Staff was proposing
18 it, so I think we got it.

19 CHAIRMAN BEARD: Assuming Staff can, so they're
20 done.

21 MR. McLEAN: There is one point of
22 clarification on the last one. It's a rate design
23 issue. It is one of those wherein which we say, "Be
24 our guest. We don't join in, but we don't object."

25 CHAIRMAN BEARD: I think that was my point

1 earlier, that you may not stipulate, but you don't
2 oppose stipulation.

3 MR. McLEAN: Yes, sir. That is true of the last
4 one, and the other three we enthusiastically join in.

5 CHAIRMAN BEARD: Enthusiastically?

6 MR. McLEAN: They were our numbers.

7 CHAIRMAN BEARD: Okay.

8 COMMISSIONER EASLEY: Maybe we need to look back
9 at then. And in the meantime, we're ready for Mr. Phillips.

10 CHAIRMAN BEARD: Okay.

11 BERT T. PHILLIPS

12 called as a witness on behalf of Southern States
13 Utilities, Incorporated and, having been duly sworn,
14 testified as follows:

15 DIRECT EXAMINATION

16 BY MR. HOFFMAN:

17 Q Mr. Phillips, have you been sworn?

18 A Yes, I have.

19 Q Would you please state your name and business
20 address?

21 A Bert Phillips, 1000 Color Place, Apopka,
22 Florida.

23 Q Mr. Phillips, did you prepare and cause to be
24 filed prefiled direct testimony and prefiled rebuttal
25 testimony on behalf of Southern States Utilities, Inc.

1 in this proceeding?

2 A Yes, I did.

3 Q Do you have any changes or revisions to your
4 direct testimony or your rebuttal testimony?

5 A No, I do not.

6 Q If I were to ask you the same questions
7 contained in your direct testimony and rebuttal
8 testimony today, would your answers be the same?

9 A Yes, they would.

10 Q Mr. Chairman, we would ask that Mr. Phillips'
11 prefiled direct and prefiled rebuttal testimony be
12 inserted into the record as though read.

13 CHAIRMAN BEARD: It will be so inserted.

14 Q Mr. Phillips, have you prepared or attached
15 any exhibits to your direct testimony?

16 A Yes, I have

17 Q Could you please identify them?

18 A It would be Exhibits BTP-1 and BTP-2.

19 Q And you have no exhibits appended to your
20 prefiled rebuttal testimony?

21 A That is correct.

22 MR. HOFFMAN: Mr. Chairman, could we have a
23 number for Mr. Phillips --

24 CHAIRMAN BEARD: Those will be identified as
25 Exhibit No. 29.

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MR. HOFFMAN: Thank you.

CHAIRMAN BEARD: Composite attached.

(Exhibit No. 29 marked for identification.)

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Bert T. Phillips and my business
3 address is 1000 Color Place, Apopka, Florida
4 32703.

5 Q. WHAT IS YOUR POSITION WITH SOUTHERN STATES
6 UTILITIES, INC. AND DELTONA UTILITIES, INC.?

7 A. I am Chairman and President of Southern States
8 Utilities, Inc. and Deltona Utilities, Inc.
9 These companies were legally merged on July 15,
10 1992. Therefore, hereinafter I will refer to
11 them collectively as "Southern States". I also
12 serve as Chairman and President of Lehigh
13 Utilities, Inc. ("Lehigh").

14 Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND?

15 A. I hold a Bachelor of Science degree in marine
16 engineering from the United States Merchant
17 Marine Academy and a Masters in Business
18 Administration from the University of Idaho. I
19 also have attended numerous schools, seminars,
20 conferences, workshops and short courses on
21 utility management and engineering over the past
22 30 years which were sponsored by various
23 professional associations, universities and
24 engineering firms.

25 Q. PLEASE DESCRIBE YOUR EXPERIENCE IN THE UTILITY

1 **INDUSTRY.**

2 A. I have served as Chairman and President of
3 Southern States since February 1, 1990. I also
4 have held the same positions with Lehigh since
5 its acquisition by Topeka Group Incorporated
6 ("Topeka") in 1991. I am currently the Group
7 Vice President of Minnesota Power responsible for
8 water resource operations and President of
9 Topeka. As explained by Arend J. Sandbulte,
10 Topeka is a subsidiary of Minnesota Power & Light
11 Company ("Minnesota Power"). Topeka, the first
12 tier parent of Southern States, was created to
13 carry out Minnesota Power's diversification
14 efforts. Prior to taking my current position
15 with Southern States, I held various managerial
16 positions over a fourteen year period with
17 Minnesota Power, a diversified electric utility
18 located in Duluth, Minnesota. Prior to my
19 employment by Minnesota Power, I held various
20 engineering and plant superintendent positions
21 with Electric Boat Company, Aerojet Nuclear
22 Corporation and Metropolitan Edison Company over
23 an additional fourteen year period.

24 Q. **TO WHAT TRADE AND/OR PROFESSIONAL ORGANIZATIONS**
25 **DO YOU BELONG?**

1 A. I am a director of both the National Association
2 of Water Companies ("NAWC") and the Florida Water
3 Works Association as well as a member of the
4 American Water Works Association ("AWWA"). Both
5 the NAWC and AWWA concentrate on issues of public
6 interest which impact investor-owned utilities
7 and their customers. For instance, the cost of
8 complying with federal and state regulatory
9 requirements are passed through to our customers.
10 The NAWC and AWWA participate actively in state
11 regulatory arenas to provide regulators with
12 customer rate-impact and environmental impact
13 information. Through this participation,
14 regulations may be moderated so as to reflect
15 more reasonable risk and economic impact
16 assessments. These organizations also provide a
17 valuable resource for information sharing in
18 areas such as new technology, new system designs,
19 new solutions to water quality problems, water
20 conservation, etc. The NAWC, like Southern
21 States, has an unwavering and uncompromising
22 commitment to participate in any and all matters
23 that pose a threat to the safety and quality of
24 drinking water. Through our participation in
25 these organizations, Southern States and our

1 customers have an additional voice in federal and
2 state affairs affecting our customers.

3 **Q. HAVE YOU EVER TESTIFIED BEFORE THE FLORIDA PUBLIC**
4 **SERVICE COMMISSION?**

5 A. Yes. I testified before the Florida Public
6 Service Commission in 1990 in support of the
7 request for a rate increase of Southern States
8 and United Florida Utilities Corporation in
9 Docket No. 900329-WS. As the Commission is
10 aware, United Florida Utilities Corporation was
11 merged into Southern States Utilities, Inc. on
12 April 1, 1992. I also have submitted pre-filed
13 direct testimony on behalf of Lehigh in Docket
14 No. 911188-WS.

15 **Q. PLEASE DESCRIBE YOUR RESPONSIBILITIES AS CHAIRMAN**
16 **AND PRESIDENT OF SOUTHERN STATES.**

17 A. I oversee the management of all aspects of
18 Southern States' business operations including
19 the utility operations, finance, engineering,
20 administration, legal, ratemaking and customer
21 service areas. I also am responsible for
22 Southern States' long range strategic planning.

23 **Q. PLEASE DESCRIBE SOUTHERN STATES' FILING IN THIS**
24 **CASE.**

25 A. On May 11 and June 17, 1992, Southern States

1 filed tariff changes for rate relief designed to
2 increase annual water and wastewater revenues in
3 the amount of \$5,064,353 and \$3,601,165,
4 respectively (a total of \$8,665,518). The filing
5 was prepared in accordance with the Commission's
6 minimum filing requirements and other applicable
7 rules. The filing is based on an historic test
8 year consisting of the twelve months ended
9 December 31, 1991. This test year coincides with
10 Southern States' 1991 fiscal year.

11 Q. WHEN DID SOUTHERN STATES' SYSTEMS LAST OBTAIN
12 RATE RELIEF?

13 A. Volume I, Book 1, pages 4 through 6 of the MFRs
14 identifies the docket number and date of the last
15 Commission rate order for each water and
16 wastewater system included in this docket. A
17 review of these pages reveals that it has been
18 as much as 22 years since Southern States has had
19 rate relief (exclusive of indexing and/or
20 pass-throughs) on certain systems. Southern
21 States' last general rate filing for 32 of the
22 systems included in this proceeding was rejected
23 by the Commission in Order No. 24715 in Docket
24 No. 900329-WS. On January 6, 1992, Southern
25 States appealed the Commission's decision to the

1 First District Court of Appeals. The appeal was
2 denied by the First District Court of Appeals on
3 July 16, 1992. Southern States is contemplating
4 an appeal to the Florida Supreme Court at the
5 time of submission of this pre-filed testimony.
6 On June 25, 1992, Southern States filed a test
7 year letter concerning our Marco Island water and
8 wastewater systems, thus initiating the rate case
9 process for the two systems which had been
10 included in Docket No. 900329-WS but which are
11 not included in this proceeding. The test year
12 request was approved by the Commission by letter
13 dated July 7, 1992 and Docket No. 920655-WS has
14 been assigned to that proceeding.

15 **Q. WHAT ARE THE CAUSES FOR SOUTHERN STATES' RATE**
16 **FILING?**

17 **A.** As I just indicated, it has been as much as 22
18 years since Southern States has obtained rate
19 relief for certain systems. Therefore, by the
20 estimated effective date of new rates in this
21 proceeding, some existing rates will have been
22 in effect for approximately 23 years.

23 Such rates are inadequate as a result of new and
24 amended regulatory requirements and ongoing
25 increases in the costs incurred to provide

1 continued safe, efficient and sufficient service
2 to our customers. Despite recent aggressive
3 efforts to achieve new economies in the rendition
4 of service, Southern States' current rates are
5 not adequate to permit recovery of our costs,
6 never mind any return on the rate base of
7 approximately \$57 million for the 127 systems
8 included in this filing.

9 Q. IS IT TRUE THAT SOUTHERN STATES HAS MADE MORE
10 THAN \$50 MILLION (NET OF CIAC) IN CAPITAL
11 INVESTMENTS IN UTILITY ASSETS SINCE THE LAST RATE
12 ORDERS FOR THE SYSTEMS INCLUDED IN THIS FILING?

13 A. Yes. Southern States has invested a total of
14 approximately \$25 million in the water and \$25
15 million in the wastewater systems included in
16 this filing since rates were last established.

17 Q. I SHOW YOU EXHIBIT 29 (BTP-1) UNDER COVER PAGE
18 ENTITLED "MAJOR ADDITIONS PLACED IN SERVICE IN
19 1990 AND 1991." WAS THIS EXHIBIT PREPARED BY YOU
20 OR UNDER YOUR DIRECTION AND SUPERVISION?

21 A. Yes, it was.

22 Q. COULD YOU BRIEFLY DESCRIBE THIS EXHIBIT?

23 A. This exhibit identifies a number of the more
24 significant capital investment projects which
25 Southern States placed in service in 1990 and

1 1991 alone as well as the approximate cost of
2 such projects. Many of these improvements were
3 necessary to meet increasingly stringent
4 Environmental Protection Agency or Florida
5 Department of Environmental Regulation ("DER")
6 standards. Other capital improvement projects
7 were undertaken to ensure reliability of service,
8 to compensate for deteriorating water source
9 conditions or to achieve a common goal maintained
10 by the State of Florida and Southern States -- to
11 protect our environment so that generations to
12 come may enjoy its current treasures. For
13 instance, the costs identified in this exhibit
14 for Deltona wastewater system improvements
15 represent costs incurred to stop the discharge of
16 effluent into Lake Monroe, a practice carried out
17 by the former owner of Deltona Utilities, Inc.
18 which had generated a consent order from the DER.
19 In cooperation with the DER and the local water
20 management district, and in compliance with the
21 terms of the consent order, Southern States
22 successfully eliminated this discharge prior to
23 November 1, 1990. Effluent from the Deltona
24 wastewater system now meets DER public access
25 requirements and now is 100% reusable.

1 Q. WHAT WAS THE RATE OF RETURN EXPERIENCED BY
2 SOUTHERN STATES FOR THE FISCAL YEAR ENDED
3 DECEMBER 31, 1991?

4 A. The rates of return for the fiscal year ended
5 December 31, 1991 were 3.07% for the water system
6 and 1.74% for the wastewater system. This is
7 equivalent to a negative return on equity of -
8 7.07% and -10.18%, respectively. These returns
9 will not allow Southern States to remain viable
10 much less attract capital to finance capital
11 investments and operate the systems. We fear
12 that customers ultimately would bear the brunt of
13 these returns if the requested rate relief is not
14 granted to Southern States. For example, as the
15 Commission is aware, in December of 1984 the
16 financial situation of Deltona Utilities, Inc.
17 ("Deltona") was such that the only funding which
18 lenders would provide to enable Deltona to
19 finance construction and operate its facilities
20 came at a high price. The lenders secured
21 above-market interest rates from Deltona and
22 included other stringent terms in the bond
23 documents, all of which were favorable to the
24 lenders. As the Commission is aware, the courts
25 confirmed that utility customers must pay for

1 such interest and other debt related costs in
2 rates.

3 Q. WHAT IS THE RETURN ON EQUITY REQUESTED BY
4 SOUTHERN STATES IN THIS PROCEEDING?

5 A. The requested return on equity for water and
6 wastewater operations combined is 12.83%. Scott
7 Vierima will discuss how this return was
8 determined. Joseph P. Cresse and Helena Loucks
9 will discuss how we propose to recover this
10 return in customer rates.

11 Q. PLEASE IDENTIFY THE OTHER WITNESSES WHO WILL
12 TESTIFY IN THIS PROCEEDING ON BEHALF OF SOUTHERN
13 STATES AND THE TOPICS THEY WILL ADDRESS.

14 A. The following is a list of the witnesses who will
15 provide direct testimony in this proceeding. Of
16 course, additional witnesses may be required to
17 address issues not contemplated in our pre-filed
18 direct testimony which subsequently may be raised
19 by the Staff of the Public Service Commission
20 (Staff) or intervenors in this proceeding.

21	<u>Witness</u>	<u>Topics</u>
22	Arend J. Sandbulte	-Minnesota Power Overview and Goals in Florida
23		
24	Bert T. Phillips	-Overview of Filing
25	Forrest L. Ludsen	-Administrative and General

1		Expenses
2		-Application of the
3		Commission's O & M
4		Benchmark Guideline
5		-Impact of Commission's 1988
6		Management Audit Review
7		-Allocations of Common Costs
8	Charles K. Lewis	-Cost of Service
9	Scott W. Vierima	-Cost of Capital
10	Bruce E. Gangnon	-Taxes
11		-FASB 106: Post Retirement
12		Benefits
13	Charles L. Sweat	-Quality of Service
14		-Unaccounted For Water
15		-Impact of Commission's 1988
16		Management Audit on
17		Operations
18		-Customer Complaints received
19		by the Commission during the
20		Test Year
21	Gerald C. Hartman	-Used and Useful Utility
22		Property
23		-Margin Reserve
24		-Depreciation Life of R.O.
25		Permeators

1 Gary S. Morse -Used and Useful Utility
2 Property

3 -Margin Reserve

4 Joseph P. Cresse -Rate Design (Theory and
5 Justification)

6 Helena Loucks -Rate Design (Mechanics)

7 Q. PLEASE DESCRIBE THE SCOPE OF YOUR TESTIMONY IN
8 THIS PROCEEDING.

9 A. I will discuss the present management of Southern
10 States, describe Southern States' current
11 corporate goals and philosophy and provide a
12 brief overview of Southern States' filing in this
13 proceeding. I also will briefly describe certain
14 benefits which are offered to Southern States'
15 customers, including high quality water and
16 wastewater service consistent with regulatory
17 requirements at the lowest possible cost.
18 Southern States is a professional utility with
19 the personnel and resources which enable it to
20 provide such service. However, applicable
21 federal, state and local laws, rules, ordinances
22 and regulations have been and continue to be
23 expanded and revised considerably. These new and
24 revised laws, rules, etc., inevitably increase
25 Southern States' operations and maintenance

1 expenses and often the level of capital
2 investments which are required.

3 **Q. COULD YOU BRIEFLY DESCRIBE THE CORPORATE GOALS**
4 **AND PHILOSOPHY OF SOUTHERN STATES' MANAGEMENT?**

5 **A.** Southern States' management is dedicated to
6 ensuring that our customers receive the highest
7 quality service at the lowest possible cost,
8 while meeting or exceeding regulatory
9 requirements. As the Commission recently
10 reaffirmed in its order approving the transfer
11 of Lehigh to the Southern States family of water
12 and wastewater utilities, Southern States has the
13 expertise and financial ability to provide
14 quality service to our customers throughout the
15 State. Unfortunately, as demonstrated in Exhibit
16 29 (BTP-1), we are in an era in which
17 significant capital investments are required and
18 cost increases are unavoidable for water and
19 wastewater utilities primarily due to increased
20 regulatory requirements. These investment
21 requirements and cost increases must inevitably
22 be reflected in higher rates.

23 **Q. HAVE THERE BEEN ANY ACKNOWLEDGMENTS BY COMMISSION**
24 **PERSONNEL OF THE INEVITABILITY OF HIGHER RATES**
25 **DUE TO INCREASED REGULATION?**

1 A. Yes, as Commissioner Betty Easley stated last
2 year in her presentation to the Southeast
3 Association of Regulatory Utility Commissioners:
4 "Florida really comprises four distinct unique
5 geographic and hydrologic makeup, and because of
6 the uniqueness we have seen the cost of water and
7 wastewater service for an average household reach
8 \$100 per month in some areas. Needless to say
9 this doesn't go over very well with people who
10 were used to paying nothing or \$10 per month back
11 home up north. And unfortunately, the water in
12 most parts of Florida where people want to live
13 isn't exactly Rocky Mountain quality."
14 Commissioner Easley continued to state that "a
15 major factor to be considered in approaching the
16 Financial Challenge of the water and wastewater
17 industry is to somehow gain customer acceptance
18 of the increased cost of service to meet state
19 and federal environmental requirements." We
20 agree with the Commissioner's statements and we
21 look forward to the participation of
22 representatives of the Commission and the Florida
23 Department of Environmental Regulation ("DER")
24 during customer meetings and at hearings in this
25 proceeding to perform the service Commissioner

1 Easley recommends:

2 . . . to help in explaining that major
3 capital expenditures are necessary to comply
4 with the health standards mandated by the
5 [Environmental Protection Agency] and the
6 Congress.

7 **Q. COULD YOU BRIEFLY DESCRIBE THE NEW HEALTH**
8 **STANDARDS MANDATED BY THE ENVIRONMENTAL**
9 **PROTECTION AGENCY AND CONGRESS TO WHICH**
10 **COMMISSIONER EASLEY WAS REFERRING?**

11 **A.** In 1986, Congress amended the Safe Drinking Water
12 Act to require the establishment of new drinking
13 water quality and treatment regulations. To
14 fulfill this requirement, the Environmental
15 Protection Agency ("EPA") developed new
16 regulations and "maximum contaminant levels" for
17 volatile organic chemicals, fluoride, surface
18 water treatment, total coliform bacteria,
19 radionuclides, additional synthetic organic and
20 inorganic chemicals, disinfectants and
21 disinfection by-products. The DER has
22 implemented and is aggressively enforcing new
23 regulations consistent with the federal laws and
24 EPA regulations. As I will discuss later in my
25 testimony, these new regulations not only have

1 significantly increased the capital requirements
2 and corresponding treatment costs of water
3 utilities but also have resulted in material
4 increases in the cost of testing for compliance
5 with maximum contaminant levels.

6 In addition, DER has enacted various new and
7 amended rules affecting the cost of Southern
8 States' wastewater operations, including new
9 sludge rules, rules regarding tertiary treatment
10 standards, etc. All of these statutory and rule
11 changes have increased Southern States' cost of
12 providing service to our customers.

13 **Q. CAN YOU OFFER ANY SUBSTANTIATION THAT THE LAWS**
14 **AND REGULATIONS YOU HAVE REFERRED TO ARE HAVING**
15 **THE ECONOMIC CONSEQUENCES YOU HAVE PORTRAYED?**

16 **A.** Certainly. A review of any number of periodicals
17 and trade journals will confirm that the Safe
18 Drinking Water Act and regulations enacted by the
19 states to enforce it are increasing the cost of
20 providing water and wastewater service throughout
21 the country. For instance, in the June 15, 1992
22 issue of Standard & Poor's Creditweek, it is
23 noted that:

24 S&P has revised its public financial
25 benchmarks for investor-owned water

1 utilities. The more stringent standards
2 were implemented as a result of S&P's
3 conclusion that credit risk has escalated
4 in the water utility industry in recent
5 years due to significant challenges related
6 to developing future water supplies and
7 assuring the quality of existing supplies .
8 . . Another major challenge for many water
9 utilities is the ongoing implementation of
10 the 1986 amendment to the Safe Drinking
11 Water Act (SDWA) of 1974. The SDWA
12 amendments are imposing more stringent water
13 quality standards relating to specific
14 levels of substances found in both surface
15 and groundwater supplies. Higher water
16 quality standards are contributing to
17 significant financing and regulatory
18 pressures for the industry.
19 Ongoing evolution of the Act is expected as
20 the Environmental Protection Agency (EPA)
21 continues to review contaminants that may
22 have an adverse impact on public health.
23 Currently, the more significant proposed and
24 anticipated rules are for testing and
25 monitoring contaminants in water supply,

1 radionuclides, and disinfection/disinfection
2 by-products. The EPA continues to
3 promulgate slowly these standards, largely
4 because of the time needed to review
5 pertinent information and data before
6 issuing additional standards.

7 Financial Stress

8 Unlike the Clean Air Act's impact on a
9 select number of electric utilities, SDWA
10 requires virtually the entire industry to
11 improve existing treatment and related
12 facilities. This will result in significant
13 capital additions on top of already
14 escalating spending on distribution
15 infrastructure. Financing these large rate-
16 base additions - which are nonrevenue-
17 producing assets - will be difficult.
18 Internal cash generation is weak, with low
19 depreciation rates (usually about 2% versus
20 around 3% for electric utilities), and low
21 authorized return on equity. As a result,
22 dependence on external financing and rate
23 relief requirements will intensify.
24 Moreover, low authorized returns may affect
25 the industry's ability to attract necessary

1 capital to develop new water supplies and
2 upgrade the quality of existing supplies.
3 Scott Vierima, Vice President of Finance and
4 Administration, will address the impact of these
5 laws and regulations on Southern States' cost of
6 capital. However, I will beat him to the punch
7 by quoting further from the article in Standard
8 & Poor's Creditweek (June 15, 1992), wherein the
9 perspective of potential lenders and other
10 capital providers can be gleaned. The article
11 continues:

12 Poor internal cash generation along with
13 modest demand growth of under 1% will
14 require state utility regulators to play an
15 even more significant role in the future
16 financial well-being of the industry.
17 Traditional ratemaking policy has not
18 provided sufficient credit support during
19 the construction cycle of the electric
20 industry over the past 15 years. To avoid
21 a repeat in the water industry, regulators
22 must be aware of the increased challenges
23 the industry faces. With large rate-base
24 additions, along with increasing nonrevenue-
25 producing assets to meet future and current

1 water needs and mandated water quality
2 standards, regulators will need to implement
3 innovative regulatory policy to allow for
4 reasonable financial protection measures.
5 Techniques to be considered to preclude
6 financial erosion include future test year,
7 automatic adjustment clauses (for large
8 expense items), allowing a cash return on
9 construction work in progress, higher
10 earnable returns, and increased depreciation
11 rates.

12 Q. I SHOW YOU EXHIBIT 29 (BTP-2) UNDER COVER PAGE
13 ENTITLED "WATER UTILITY BENCHMARKS REVISED -
14 STANDARD & POOR'S CREDITWEEK DATED JUNE 15,
15 1992." WAS THIS EXHIBIT PREPARED BY YOU OR UNDER
16 YOUR DIRECTION AND SUPERVISION?

17 A. Yes, it was.

18 Q. IS THIS THE ARTICLE FROM WHICH YOU HAVE JUST
19 QUOTED AT LENGTH?

20 A. Yes, it is.

21 Q. ARE THERE ANY OTHER REASONS WHY SOUTHERN STATES
22 HAS FILED ITS APPLICATION FOR RATE RELIEF.

23 A. Yes. As I previously noted, new laws and
24 regulations have been enacted at both the federal
25 and state levels which have dramatically

1 increased the level of investments Southern
2 States has been required to make in its water and
3 wastewater facilities. As a result of these
4 investments, the cost of staffing, operating and
5 maintaining the required additional facilities
6 and testing our water and effluent also have
7 increased dramatically.

8 Since it has been a number of years since the
9 cost of serving our water and wastewater
10 customers has been determined, millions of
11 dollars of investments and expenses have not been
12 recovered in the rates we have been charging our
13 customers. Southern States can no longer afford
14 to forego the required rate relief.

15 **Q. COULD YOU DESCRIBE SOME OF THE REASONS FOR**
16 **INCREASED INVESTMENTS AND EXPENSES YOU HAVE**
17 **MENTIONED IN FURTHER DETAIL?**

18 **A.** Yes, I would be glad to generally describe these
19 factors. Various other witnesses for Southern
20 States will provide additional details. First,
21 new and amended federal and state laws and
22 regulations require Southern States to perform
23 more tests of its water and effluent, and often
24 on a more frequent basis. The Florida Department
25 of Environmental Regulation ("DER") recently has

1 promulgated new rules concerning the
2 stabilization, removal and disposal of sludge.
3 In addition, DER rules require advanced
4 "tertiary" treatment of effluent to meet DER's
5 "public access" standard for effluent reuse.
6 Southern States is a strong advocate of public
7 access reuse water and is providing 100% public
8 access reuse at three systems and up to 88%
9 public access reuse at five other systems.
10 Public access reuse technologies reduce the need
11 to extract potable (drinking) water from the
12 underground aquifer system for irrigation
13 purposes, thus conserving potable water supplies.
14 In addition, Southern States utilizes spray
15 irrigation and percolation ponds to dispose of
16 effluent at virtually all of its remaining
17 wastewater systems. These methods of effluent
18 disposal also assist in recharging Florida's
19 aquifers and are considered "reuse" by regulatory
20 authorities. We believe these facts demonstrate
21 Southern States' commitment to satisfy the
22 State's, as well as Southern States' own,
23 conservation goals.

24 **Q. HAS SOUTHERN STATES' BEEN COMMENDED FOR ITS**
25 **CONSERVATION EFFORTS BY VARIOUS ORGANIZATIONS IN**

1 **THE PAST?**

2 A. Yes. Southern States recently has been commended
3 for its conservation efforts, including the
4 education of our customers in the benefits of
5 xeriscaping, by several organizations including
6 the American Water Works Association and the
7 National Xeriscape Council, Inc. In addition,
8 our Company sponsored a 4-H group from Florida
9 which won both state and national competitions
10 regarding conservation/xeriscaping programs. We
11 are very proud of these achievements.

12 Q. **IS THERE A PRICE TO BE PAID FOR THE COMPANY'S**
13 **CONSERVATION EFFORTS?**

14 A. Yes. Compliance with DER's tertiary treatment
15 requirements for public access reuse requires
16 Southern States' to make significant capital
17 investments in its wastewater facilities. In
18 addition, the reuse of effluent by former water
19 customers will reduce water sales thus decreasing
20 the sales base over which our fixed costs may be
21 spread. However, Southern States agrees with the
22 policy of the State of Florida and its regulatory
23 agencies that although the treatment process for
24 reuse is expensive, reuse frequently is both the
25 lowest cost alternative available for effluent

1 disposal and a cost-effective alternative to
2 depleting precious underground water sources.

3 Q. HAVE THERE BEEN OTHER CHANGES FOSTERED BY
4 REGULATORY REQUIREMENTS WHICH HAVE INCREASED THE
5 COST OF PROVIDING WATER AND WASTEWATER SERVICE?

6 A. Yes. Staffing requirements also have changed due
7 both to changes in DER regulations as well as
8 operational requirements (to meet higher demands
9 associated with growth) to satisfy the daily
10 needs of our customers. In addition, in
11 September 1988 the Commission issued a management
12 audit review (the "Audit Report") regarding
13 Southern States. Forrest Ludsen, Vice President
14 in charge of Customer Services, will describe the
15 Audit Report and its impact on Southern States in
16 detail. Generally, the Commission's Audit Report
17 recognized that as of September 1988, Southern
18 States had grown to such an extent that the
19 internal management practices and procedures
20 required a comprehensive overhaul. In short, the
21 Staff audit admonished Southern States by
22 recommending that it "act its size." The report
23 contains seventy-nine recommendations for changes
24 in Southern States' management practices and
25 procedures which are rated high, medium and low

1 priorities. As Mr. Ludsen indicates, after
2 careful consideration of the Audit Report
3 findings and negotiation with the staff of
4 modification to certain recommendations, Southern
5 States agreed with and has implemented all but
6 two of the Commission's recommendations. I feel
7 strongly that the audit findings and
8 recommendations were well-founded. After my
9 arrival at Southern States, I would have
10 implemented similar changes even had the Audit
11 Report never been issued. It also must be noted
12 that the import of Staff's 1988 recommendations
13 has increased with the more than doubling in size
14 of Southern States through the acquisition of
15 Deltona and United Florida Utilities Corporation
16 in 1989 and Lehigh in 1991.

17 **Q. COULD YOU BRIEFLY DESCRIBE THE IMPACT OF**
18 **IMPLEMENTING THE AUDIT RECOMMENDATIONS ON THE**
19 **CORPORATE STRUCTURE OF SOUTHERN STATES?**

20 **A.** In general, implementation of the recommendations
21 has created a more defined corporate structure
22 comprised of various new departments with clearly
23 delineated areas of specialization. Mr. Ludsen
24 will provide a detailed analysis of the costs and
25 benefits associated with the implementation of

1 the audit recommendations. This analysis is
2 important since many of these costs and benefits
3 are associated with administrative and general
4 ("A&G") matters. Mr. Ludsen's analysis also
5 confirms that the level of A&G expenses allocated
6 to each of our systems are reasonable for the
7 services provided to our employees and our
8 customers.

9 Q. ARE THERE ANY ADVANTAGES WHICH SOUTHERN STATES
10 OFFERS TO ITS CUSTOMERS IN MEETING THE COSTS OF
11 COMPLIANCE WITH THE LAWS AND REGULATIONS YOU HAVE
12 DESCRIBED WHICH MIGHT NOT BE AVAILABLE TO OTHER
13 CONSUMERS OF WATER AND WASTEWATER SERVICES IN
14 FLORIDA?

15 A. Yes. Our customers can expect to be served by a
16 professional utility company dedicated solely to
17 providing high quality utility service. Our
18 management goals and practices are not distracted
19 by the desire to sell lots or achieve short term
20 advantages. Rather, as confirmed by Mr. Arend
21 Sandbulte, Chief Executive Officer of our parent
22 company, Southern States is in the water and
23 wastewater utility business for the long haul.
24 Southern States represents a family of water and
25 wastewater providers that obtain tax, accounting,

1 billing, collections, customer service, payroll,
2 pensions and benefits and other administrative
3 and general services on a consolidated basis
4 primarily from one source. In addition to
5 benefits in efficiency, the size of this family
6 of utilities enables us to hire specialists who
7 concentrate their efforts on certain limited
8 fields of expertise and identify areas where
9 costs can be decreased or the quality of service
10 improved. In this way, Southern States is able
11 to, among other things, keep abreast of the
12 latest advances in water and wastewater treatment
13 technology, capitalize on cost-saving measures in
14 medical and health insurance as they arise,
15 reduce or otherwise minimize increases in the
16 cost of chemicals and other supplies through bulk
17 purchases made under a bidding process, better
18 monitor customer service orders and complaints so
19 as to identify problem areas more quickly and
20 increase customer satisfaction. In addition,
21 membership in the Southern States family of
22 utilities provides customers served by all of our
23 approximately 150 systems with immediate access
24 to considerable personnel resources during times
25 of emergency or unusual occurrences thereby

1 reducing both the response time as well as the
2 possibility that service to our customers ever
3 would be interrupted. Also, Southern States'
4 size has permitted us to develop a process by
5 which spare utility equipment and accessories
6 have been identified and may be made available to
7 any system in emergency situations with a minimum
8 amount of delay. This process often will
9 eliminate the waiting period for equipment to be
10 ordered from and delivered by a third-party
11 supplier thus further reducing the possibility of
12 service interruptions to Southern States'
13 customers. As an example, soon after Lehigh
14 joined the Southern States family of utilities,
15 we discovered that the Lehigh water system was
16 exceeding the standard for trihalomethanes. Due
17 to our equipment sharing process, we were able to
18 provide Lehigh with ammoniation equipment from
19 another plant to reduce the trihalomethane
20 problem on a temporary basis until new equipment
21 could be obtained from the manufacturer. Thus,
22 we were able to expedite the resolution of the
23 trihalomethane problem at Lehigh and restore
24 compliance with the state standard in the most
25 expeditious manner possible. These are all

1 significant reasons why we believe our customers
2 are benefitted by having Southern States as their
3 water and wastewater service provider.

4 **Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

5 **A. Yes, it does.**

- 1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.
- 2 A. My name is Bert T. Phillips and my business address
3 is 1000 Color Place, Apopka, Florida 32703.
- 4 Q. WHAT IS YOUR POSITION WITH SOUTHERN STATES
5 UTILITIES, INC. ("SOUTHERN STATES" OR THE
6 "COMPANY")?
- 7 A. I am Chairman and President of Southern States.
- 8 Q. ARE YOU THE SAME BERT T. PHILLIPS WHO PREVIOUSLY
9 SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING?
- 10 A. Yes, I am.
- 11 Q. PLEASE BRIEFLY DESCRIBE THE PURPOSE OF YOUR REBUTTAL
12 TESTIMONY.
- 13 A. I will address the proposed adjustments of Public
14 Counsel's witness Kimberly H. Dismukes regarding
15 certain dues paid by the Company to retain
16 membership in certain business and professional
17 organizations.
- 18 Q. DO YOU AGREE WITH MS. DISMUKES' PROPOSED ADJUSTMENT
19 TO REMOVE CHAMBER OF COMMERCE DUES AND ASSOCIATED
20 EXPENSES FROM THE COMPANY'S REVENUE REQUIREMENTS?
- 21 A. No, I do not. The chambers of commerce are active
22 voices in the business community which represent
23 the interests of Southern States and our customers
24 in a variety of ways. The most critical service
25 provided by the chambers is the representation of

1 our interests in opposition to tax increases on
2 business, and particularly utilities, which
3 repeatedly are being proposed in the Florida
4 legislature. For example, in return for the
5 Company's 1991 dues and related expenditures of less
6 than \$2,000, our interests were represented in
7 opposition to the 1991 legislative proposals to levy
8 a tax on water utility services and implement other
9 taxes or tax increases which would have increased
10 Southern States' cost of doing business. Of course,
11 if taxes are imposed on water utility service or are
12 otherwise applicable to Southern States, the Company
13 must pay these taxes and pass through the cost to
14 our customers. By assisting in the defeat of such
15 tax proposals, the chambers of commerce effectively
16 saved our customers a minimum of \$1,200,000 in 1991
17 (which represents the total gallons sold, in
18 thousands, by the Company in 1991 times \$.10, the
19 proposed tax).

20 The Florida Chamber of Commerce is involved in the
21 issue of health care. The Chamber seeks to insure
22 that any proposed mandated plan does not add to the
23 cost of goods or services of companies already
24 providing coverage.

25 The Chamber also is active in efforts to control

1 workers' compensation costs and abuses. Spiraling
2 workers' compensation costs directly impact our cost
3 of serving our customers.

4 In addition, membership in the chambers of commerce
5 insures that the Company is provided with
6 information, such as tax proposals, on a timely
7 basis so that our voice can be heard. This benefit
8 is achieved at both the state and local chamber
9 levels since county boards also have authority to
10 enact rules and ordinances which can increase
11 Southern States' cost of doing business and
12 ultimately, the rates we must charge our customers
13 for service.

14 For these reasons, our request to recover chamber
15 of commerce dues from ratepayers may be
16 distinguished from the facts apparently presented
17 to the Commission in Docket No. 810002-EU (cited by
18 Ms. Dismukes) where the utility apparently
19 identified no benefits which accrued to customers
20 from that utility's participation in a chamber of
21 commerce.

22 I also disagree with Ms. Dismukes' proposal to deny
23 Southern States recovery of dues paid to the Florida
24 Public Relations Association ("FPRA").

25 The objectives of the FPRA are to promote the

1 highest standards of professional ethics; exchange
2 knowledge, trends, ideas and innovation; and provide
3 new and direct channels of communication. The FPRA
4 provides services and programs dedicated to
5 improving the professional competence of its
6 members. The Public Relation News, an international
7 weekly for public relations, public administration
8 and communication executives defines "Public
9 Relations" as the management function which (1)
10 evaluates public attitudes, (2) identifies the
11 policies and procedures of an individual or an
12 organization with the public interest and (3) plans
13 and executes a program of action to educate the
14 public. In addition to the basic obligation of
15 Southern States to be able to communicate
16 effectively with our customers, certain water
17 management districts now are requiring Southern
18 States to educate our customers in water
19 conservation techniques and the water supply
20 problems Florida now faces -- and will face in the
21 future if appropriate steps to conserve water are
22 not taken now by our customers as well as the
23 industry. In addition, in her speech to SEARUC
24 which I referred to in my direct testimony,
25 Commissioner Easley identifies the need for all

1 entities involved in the industry to educate
2 customers regarding the costs of providing water and
3 wastewater service in Florida. For reasons such as
4 these, the Company has obtained membership in the
5 FPRA so that appropriate Company personnel are
6 trained in the most effective communication
7 techniques available, with emphasis on the
8 customer's needs. In this way, we can fulfill the
9 obligations I have referred to in the most effective
10 manner possible without having to engage in "hit or
11 miss" type communications with our customers. The
12 messages we must send to our customers are too
13 important to risk them not being understood. Also,
14 the two individuals who participate as active
15 members of the FPRA are able to share the
16 communications techniques they have learned with
17 other Company personnel, particularly the Speakers
18 Bureau (consisting of approximately 20 employees)
19 which made more than 50 presentations in 1991
20 regarding the benefits and techniques of general
21 conservation and Xeriscaping," a highly praised
22 water conservation technique. For these reasons,
23 I strongly disagree with Ms. Dismukes' allegation
24 at page 41, lines 16 through 19 of her testimony
25 that "it appears that the purpose of [FPRA] is to

1 support the public relations efforts of its members
2 which largely benefits stockholders not ratepayers."
3 Southern States' relationship with the chambers of
4 commerce as well as the FPRA benefit our customers
5 as much as, and I would argue more than, our
6 shareholders.

7 Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

8 A. Yes, it does.

1 Q (By Mr. Hoffman) Mr. Phillips, do you have a
2 summary of your testimony?

3 A Yes, I do.

4 Q Could you please provide it?

5 A Yes.

6 This filing represents all 127 Southern
7 States Utility systems under FPSC jurisdiction, with
8 the exception of Marco Island and Lehigh. Marco Island
9 system has been filed and accepted and hearing is
10 scheduled for March, '89. Lehigh system, of course,
11 was heard last week.

12 We believe this filing is responsive to
13 concerns expressed by the Commission in Docket
14 900329-WS, that the Company file all systems so that a
15 full determination of rate of return could be made.
16 This filing is for an historical test year ended
17 December 31, 1991. The Company chose such a filing in
18 order to make this case as straightforward and
19 nonsubjective as possible when filing 127 systems under
20 the requirements of the Minimum Filing Requirements.

21 To date, we have answered approximately 1500
22 interrogatories, including subparts, and responded to
23 almost 1,000 docket requests in this docket.

24 It has been as much as 22 years since Southern
25 States has obtained rate relief in certain systems.

1 During this period we have invested approximately
2 \$50 million to meet regulatory, quality of service and
3 growth requirements. Our customers are served by a
4 professional utility concerned solely with providing
5 utility service. Our management focus is not
6 distracted by the desire to sell lots or achieve
7 short-term advantage. We are in this business for the
8 long haul.

9 Southern States' customers receive operation,
10 maintenance, environmental compliance, tax, accounting,
11 finance billing, collection, customer service, payroll,
12 purchasing, legal and other administrative and general
13 services on an efficient, consolidated basis.

14 In addition to efficiency, our size enables us
15 to employ specialists to further identify areas where
16 costs can be reduced or quality of service improved.

17 Southern States has experienced a negative
18 return on equity of 7.07% on water systems and 10.18%
19 on wastewater systems for the test year, and is at this
20 time not even recovering the cost of its debt. It is
21 our Company's goal to provide the highest quality
22 service at the lowest reasonable cost. It is
23 essential, in order to achieve and sustain this goal,
24 that Southern States be allowed to earn its authorized
25 return on its prudent investments and recoup it's

1 prudently incurred expenses.

2 Failing to do this, we will be unable to
3 attract or retain the necessary investors, nor will we
4 be able to secure low-cost long-term debt in order to
5 provide stable low rates and high quality service.

6 MR. HOFFMAN: Does that conclude your summary?

7 WITNESS PHILLIPS: Yes, it does.

8 MR. HOFFMAN: Mr. Phillips is available for
9 cross.

10 COMMISSIONER EASLEY: Mr. Jones?

11 MR. JONES: We would like to wait and cross
12 after Public Counsel.

13 COMMISSIONER EASLEY: All right. Mr. McLean.

14 CROSS EXAMINATION

15 BY MR. McLEAN:

16 Q Afternoon, Mr. Phillips. Harold McLean with
17 the Public Counsel.

18 A Afternoon, Mr. McLean.

19 Q It falls our lot to argue mostly about
20 Chamber of Commerce dues this morning. I've got a few
21 questions for you about that subject.

22 A I had hoped we could talk salaries.

23 Q All right. I don't think so, not with my
24 examination anyway.

25 Would you look to Page 6 of your rebuttal

1 testimony. The general problem here is that Southern
2 States incurs some measure of expenses for Chamber of
3 Commerce dues, and we don't object to that. We just
4 object to your making your customers pay for it.
5 That's pretty much the state of our disagreement, don't
6 you think?

7 A Yes, sir.

8 Q All right. Now, Page 6, I'm trying to get
9 beginning point for exactly where our disagreement is.
10 As I read your testimony, beginning the sentence there
11 that says "Southern States' relationship with the
12 Chambers of Commerce, as well as FPRA, benefit our
13 customers as much as" -- and I would argue more than --
14 "our shareholders." And that seems to me to concede
15 the point, at least to some extent, that did does, in
16 fact, benefit the shareholders.

17 A To some extent, that's correct.

18 Q Okay, and I'm looking at the point because we
19 certainly don't disagree with whatever portion of the
20 expenses you think should be borne by shareholders, so
21 what I'm searching for is the point on the range
22 between the two extremes that represents our point of
23 disagreement. What portion of the dues do you think
24 ought to be borne by the shareholders?

25 A The Chamber of Commerce, which I think is --

1 we are aware, certainly of past Commission rulings on
2 the order of Chamber of Commerce dues, and I think we,
3 frankly, have been unable to come up with any utility
4 that posed any oral argument or offered any
5 "testimony," I guess is the term, to defend their
6 position.

7 I think the Chamber of Commerce is a unique
8 organization that is -- I shouldn't say exclusively,
9 but largely focused on the cost of doing business and
10 holding down the cost of doing business. I cite in my
11 testimony a number of examples recently that have
12 proposed legislation to impose a ten-cent a
13 1,000-gallon tax on water in the state. That would
14 have cost Southern States customer a \$1,200,000 a year.
15 The Chamber of Commerce, among other bodies, were
16 influential in seeing that that did not become law.

17 COMMISSIONER CLARK: Let me ask you a
18 question along those lines. What about customers in
19 your area that might agree with you, might agree that
20 that is an appropriate charge to be added with water,
21 should they have to pay for your Chamber of Commerce
22 dues?

23 WITNESS PHILLIPS: That's a good question. I
24 -- yes, I believe they should.

25 COMMISSIONER CLARK: You understand that's --

1 WITNESS PHILLIPS: I think in the opinion of
2 our customers, customer surveys we've taken, there's no
3 appetite for tax increases of any stripe, particularly
4 in the government -- in the population. I use that
5 merely as an example of holding down medical costs and
6 costs of medical insurance, the workmen's compensation
7 costs. Those are key activities of the Chamber of
8 Commerce, all of which are cost to us and passed
9 through to our customers. And we feel it's responsible
10 on our part to participate and do what we can to try
11 to, you know, reduce costs to our customers. It's part
12 of the covenant for regulated business.

13 COMMISSIONER CLARK: So the customers that
14 may disagree with your stand on a particular issue
15 should still have to pay the cost of your lobbying to
16 promote that stand?

17 WITNESS PHILLIPS: Well, I don't see a -- yes.

18 Q (By Mr. McLean) Mr. Phillips, I want to go
19 back to my question. I have some questions about that
20 general area. But my question is specifically about
21 our point of disagreement. And I read what you say on
22 Page 6, and I have the impression that you believe, by
23 your words there, that some of the benefit is, in fact,
24 borne by the shareholders. My question to you is: Do
25 you believe that some of the costs should be borne by

1 the shareholders?

2 A In the specific to the Chamber of Commerce,
3 no. I think we better go on the preponderance of their
4 activities and who the increased costs effect. As you
5 know, these cost-of-doing-business things are
6 pass-through types of costs of which the Company and
7 the shareholders make no return, but it does affect the
8 cost of service to our customers.

9 Q So what you're saying is that despite the
10 fact that you say, at Page 6, that the customers -- I'm
11 sorry, that the shareholders do benefit from these
12 dues, you don't believe that any part of the costs
13 should be borne by them, at least with respect to the
14 Chamber?

15 A It is my position that they should not.

16 Q All right, sir.

17 So our point of disagreement is for the whole
18 works, not just for a portion of it, is that correct?

19 A Yes.

20 COMMISSIONER EASLEY: Let me ask the
21 follow-up question, since -- Mr. McLean, you are
22 getting ready to leave that area, aren't you?

23 MR. MCLEAN: Yes, ma'am.

24 COMMISSIONER EASLEY: Okay.

25 MR. MCLEAN: Not the area of chamber dues,

1 but the area --

2 COMMISSIONER EASLEY: That specific area.

3 MR. McLEAN: -- the area that he may disagree
4 in part with us.

5 COMMISSIONER EASLEY: All right. Then the
6 next question, I would think, would be if we disagree
7 with you, and agree with Public Counsel, that if the
8 shareholders benefit, the shareholders should also bear
9 some of the cost, how would you recommend that we
10 apportion that sharing?

11 A If I was to pick a number, I would say 50/50.

12 COMMISSIONER EASLEY: Thank you.

13 Q (By Mr. McLean) Mr. Phillips, I've arranged
14 for you to be handed an exhibit.

15 MR. McLEAN: And, Mr. Chairman, when it comes
16 your way, may I have it marked for identification?

17 COMMISSIONER BEARD: Exhibit number will be
18 30.

19 COMMISSIONER EASLEY: Mr. Chariman, you're
20 ruining a precedent I've been trying to set. I won't
21 number them until I get them. That's why he
22 mentioned --

23 COMMISSIONER BEARD: It's not No. 30. Now
24 it's No. 30.

25 COMMISSIONER EASLEY: That's right. Thank

1 you.

2 COMMISSIONER BEARD: I would not want to ruin
3 a precedent.

4 COMMISSIONER EASLEY: Thank you. Mr.
5 Chariman.

6 (Exhibit 30 is marked for identification.)

7 Q (By Mr. McLean) Mr. Phillips, Exhibit No.
8 30 appears to be portion of a Commission order, would
9 you agree?

10 A It would appear so, yes.

11 Q Would you agree, sir, that Page 85, which is
12 the last page of your exhibit, indicates that this
13 particular utility, which is TECO, was not able to
14 recover the chambers of commerce listed there. The
15 dues for chambers of commerce because the Company
16 requested that it not be allowed?

17 A Those were the words there. Of course, I
18 have no knowledge of what led up to the Company's
19 request, although, I have reason to believe that the
20 Company did not offer any evidence to support the
21 benefits to the shareholders.

22 Q Okay. So what --

23 A Excuse me. I'm not finished, sir. For
24 membership in the chamber of commerce.

25 Q So what you're saying that is that Southern

1 States wants to be something of a leader in the field,
2 then, by offering evidence on the point; is that
3 correct?

4 A That would be correct.

5 Q All right, sir. I've arranged for you to be
6 handed a second exhibit, which I'll ask the Chairman to
7 mark for identification, please.

8 COMMISSIONER BEARD: Exhibit 31. That
9 exhibit, for the record, would be identified as Order
10 No. 11307, and this Exhibit 31 would be identified as
11 Order No. 18551.

12 (Exhibit 31 is marked for identification.)

13 Q (By Mr. McLean) If you will, Mr. Phillips,
14 first of all, does this appear to be an order of the
15 Florida Public Service Commission?

16 A Yes, it appears to be.

17 Q Would you turn -- partial order, I'm sorry.
18 Would you turn to page the third page of your exhibit
19 and look to Paragraph 9, please, sir. Does that seem
20 to be a disallowance of the chamber of commerce dues
21 sought by St. John Service Company?

22 A Yes, it does. But I, likewise, have no
23 evidence of what argument was raised in defense of
24 chamber of commerce dues and of the benefit to the
25 customers.

1 Q Would you look at the immediately preceding
2 page where it says "stipulations" and agree with me
3 that Item 9 seems to be --

4 A I'm sorry, sir, which page?

5 Q I'm sorry. The second page of that exhibit,
6 yes, sir. And the second page appears to be a
7 stipulation; is that correct? Let me rephrase the
8 question. The Item No. 9 appears to be included within
9 the stipulations; is that correct?

10 A Yes.

11 COMMISSIONER EASLEY: Mr. Phillips, how do
12 you know those are dues in Item No. 9? I'm not
13 questioning, I just want to know how you know?

14 A I don't. I'm guilty of assuming,
15 Commissioner. I have a \$400 payment to the chamber of
16 commerce --

17 COMMISSIONER EASLEY: Yeah, that's what I was
18 curious about. It does say "\$400 payment." I'm
19 assuming that someplace we know what that's for.

20 COMMISSIONER CLARK: Mr. McLean, can you --
21 I think that Commissioner Easley has brought up a good
22 point. Do you know what that \$400 payment is in there?

23 MR. McLEAN: I do not.

24 COMMISSIONER CLARK: Okay.

25 Q (By Mr. McLean) Mr. Phillips, I've handed

1 you yet a third exhibit on a similar subject.

2 MR. McLEAN: Mr. Chairman, may I have it
3 marked?

4 COMMISSIONER BEARD: It will be Exhibit No.
5 32.

6 (Exhibit 32 is marked for identification.)

7 Q (By Mr. McLean) It appears to be a partial
8 order of the Florida Public Service Commission.

9 A Yes, sir, that's correct.

10 MR. McLEAN: Mr. Chariman, may I refer to it
11 as Order No. 9864.

12 COMMISSIONER BEARD: That will be good.

13 MR. McLEAN: Thank you, sir.

14 Q (By Mr. McLean) Turn to the second page, if
15 you will. Look to paragraph, which is No. 9, and if
16 you will, follow with me through the middle of
17 paragraph, I'm going to read to you: "Membership in
18 certain organizations, however, tends either to build
19 the image of the company, or is for the purpose of
20 engaging in lobbying activities. Neither of these
21 activities should be borne by ratepayers; therefore, we
22 have removed the allowable expenses due associated with
23 the US Chamber of Commerce and the Florida Chamber of
24 Commerce." Did I read correctly, sir?

25 A That's correct.

1 Q All right, sir --

2 A But again I have no -- evidently I do not
3 know upon what arguments were raised in defense to the
4 chamber of commerce dues, and upon, therefore, on what
5 evidence the Commission based its decision.

6 Q Of course. But you're not suggesting that
7 they entered a decision in the absence of evidence, are
8 you?

9 MR. HOFFMAN: Objection. Mr. Chairman, I
10 think this is kind of getting out of hand. I think --
11 we'll stipulate that these Commission orders say what
12 they say when read in their entirety. And I think it's
13 inappropriate for Mr. Phillips, or anyone else, to be
14 speculating on what the Commission intended, or what
15 they did or did not say in their orders. I don't think
16 this is evidence.

17 MR. McLEAN: It's Mr. Phillips' continuing
18 position that the -- apparently that he doesn't know
19 whether the Commission had evidence before it. All I
20 asked him is if he thinks they ordered something in the
21 absence of evidence. I intend to address that specific
22 point with the next exhibit, where the Commission has a
23 word or two to say on that point.

24 COMMISSIONER BEARD: Why don't you go ahead
25 to the next exhibit and let's see what we've got.

1 MR. McLEAN: Thank you, sir. (Pause)

2 COMMISSIONER EASLEY: Of course, we could
3 wait for the witness to say he thinks we don't do
4 anything based on the record.

5 COMMISSIONER BEARD: I think he wasn't going
6 to say that. We'll identify this as Exhibit No. 33 and
7 it will be identified as Order No. 10306.

8 (Exhibit 33 is marked for identification.)

9 Q (By Mr. McLean) This, Mr. Phillips, appears
10 to be in order dealing with Florida Power and Light
11 Company; is that correct?

12 A That's correct.

13 Q Would you look to Page 27, which is the
14 second page of your exhibit where it begins, where it
15 says "Witness Talon?"

16 A Yes.

17 Q Would you read that sentence, sir, and see if
18 you think the Commission was dealing with some evidence
19 presented by Witness Talon?

20 MR. HOFFMAN: Objection. I think that's an
21 unfair question. I think it would require Mr. Phillips
22 to read the order in its entirety, and the order speaks
23 for itself, and probably the record and the transcript
24 supporting the order speaks most clearly.

25 MR. McLEAN: I think if there are elements of

1 this Order which are inconsistent with those, I have
2 suggested to the witness that Mr. Hoffman has adequate
3 opportunity to show that to be the case. It seems to
4 me easier to give you a portion of the Order than it
5 does to give you what probably would be a hundred-page
6 order.

7 COMMISSIONER BEARD: See, I guess --

8 MR. McLEAN: I think what the Commission is
9 saying here is not genuinely in issue in terms of this
10 objection. If Mr. Hoffman says that this order does
11 not represent what the Commission said, then so be it.
12 We can meet that objection by presenting the whole
13 evidence into the record -- the whole order in the
14 record.

15 COMMISSIONER BEARD: Well, you all help me
16 out because I'm just not smart enough to figure all
17 this out, but we've got a part of the order that I can
18 read and I know what it says. And I'm not sure what
19 we're doing here with the witness commenting on what
20 the Order says because, quite frankly, I'm not one of
21 the five listed, but I don't think they really care
22 what he thinks of their order, but the Order says what
23 it says.

24 MR. McLEAN: The witness says that the
25 Commission has entered a decision about chamber of

1 commerce never having been presented with evidence on
2 the point.

3 My first thesis is that I don't think the
4 Commission does business that way. The second is that
5 at least this fourth exhibit shows that it considered
6 evidence on the point.

7 COMMISSIONER EASLEY: I'm sorry. Maybe I
8 misunderstood, Mr. McLean.

9 COMMISSIONER BEARD: Yeah, me too.

10 COMMISSIONER EASLEY: I thought what he was
11 doing was qualifying his answer to your question saying
12 that's what the order said but he didn't know what
13 evidence we were presented with. Did I misunderstand?

14 MR. McLEAN: I don't know.

15 COMMISSIONER CLARK: I can say I did hear him
16 say that he was presenting it to the Commission, his
17 underlying rationale for including it, and he's aware
18 of the fact that the Commission has disallowed it
19 before, but he's not aware that they were presented
20 evidence that would support including it; is that
21 right?

22 WITNESS PHILLIPS: That's correct or what
23 that evidence was.

24 MR. McLEAN: And particularly Exhibit 33 at
25 least recites by the Commission that they did consider

1 evidence on the point, so to that extent is my belief
2 that the witness is mistaken in this exhibit --

3 COMMISSIONER EASLEY: Mr. McLean, we are
4 talking past each other.

5 COMMISSIONER BEARD: Wait. I'm sorry. Go
6 ahead.

7 COMMISSIONER EASLEY: I don't think --

8 COMMISSIONER BEARD: You're trying to say
9 that he said something didn't say. He said he has no
10 knowledge. He wasn't there. He can read the Order,
11 and I guess in this instance, he can read the Order and
12 the words, and if the words say that were presented
13 something, they were presented something.

14 I don't need his expert witness and testimony
15 on what this Order says because I can read it, and I
16 think these other two Commissioners were paying
17 attention based on their comments. And I don't want to
18 avoid, you know, this opportunity for you all to go
19 back and forth on this, but I understand your position
20 and his. And I don't think they're inconsistent, quite
21 frankly.

22 MR. McLEAN: The witness says in his rebuttal
23 testimony that he agrees that the Commission has
24 removed it before. But if you look at Page 3, Line 18,
25 he says "where the Utility apparently identified no

1 benefits which accrued to customers from that Utility's
2 participation in the Chamber of Commerce," and it's
3 correct.

4 COMMISSIONER BEARD: Okay. So, now --

5 MR. McLEAN: The fourth says "that the
6 Utility did, in fact, identify those benefits," and I
7 say that that gives rise to the presumption that the
8 Commission was presented with no evidence; however, I
9 think we've beat the point to death.

10 COMMISSIONER BEARD: Yes.

11 MR. McLEAN: I'm certainly ready to move on.

12 COMMISSIONER BEARD: Good.

13 COMMISSIONER EASLEY: Thank you.

14 COMMISSIONER CLARK: Let me ask you a
15 question, Mr. Phillips. Do you know any case where the
16 Commission has allowed chamber of commerce dues?

17 WITNESS PHILLIPS: In Florida, of course.

18 COMMISSIONER CLARK: Excuse me?

19 WITNESS PHILLIPS: In Florida, of course.

20 COMMISSIONER CLARK: That's correct.

21 WITNESS PHILLIPS: Look across these 48 or
22 50 states, there are instances where they are allowed,
23 but, no, I'm not aware of any in Florida, nor was I
24 aware, I guess, of until we had made our argument, what
25 evidence was presented. And I know we personally feel

1 it's wothwhile, it's largely to the benefit of our
2 customers. We don't, as our records will show, we
3 don't engage in the golf outings and the mixers and try
4 to pass those kinds of costs through to our customers;
5 but to do the dues, to be a member, to participate in
6 the agenda and the items to be addressed, we think
7 there is a large potential benefit to our customers.

8 COMMISSIONER CLARK: Okay.

9 Q (By Mr. McLean) Mr. Phillips, will you turn
10 to Page 2 of your rebuttal testimony. I'm sorry, Line
11 15 it says "by assisting in the defeat of such tax
12 proposals, the Chamber of Commerce effectively saved
13 the customers money," and so forth. To whom did they
14 go to defeat that tax proposal or those tax proposals
15 as the case may be?

16 A Give might one second, please?

17 Q Yes, sir. (Pause)

18 A The information I have is not specific other
19 than it says to the Legislature.

20 Q To the Legislature. Look down to Page Line
21 22, if you would, please. The --

22 A Of what sir?

23 Q Page 2, Line 22 of your rebuttal testimony.
24 "The Chamber seeks to ensure that any proposed mandated
25 plan." Who would do the proposing?

1 A Again, my information is general and it says
2 legislative question must be addressed.

3 Q Now, look to the last line on that page, Page
4 25. Follow with me: "The Chamber is active in efforts
5 to control workers' compensation costs and abuses."
6 Would that also be an effort expressed before the
7 Legislature?

8 A I don't believe so. Some of that is policy
9 with the agency regulating workmans' compensation. Yes,
10 I'm sure some of it probably is legislative initiative.

11 Q Do you know which agency regulates workmans'
12 compensation?

13 A No, I don't.

14 Q It would be a state agency, wouldn't it?

15 A I certainly believe so.

16 Q On Line 7, there are these words: "On a
17 timely basis, so that our voice can be heard." First
18 of all, you're speaking of Southern States' voice,
19 correct?

20 A Our voice in speaking in the best interest
21 our customers, yes.

22 Q All right, sir. And where would the voice be
23 heard?

24 A The voice would be heard by Southern States
25 at Chamber meetings and when the Chamber is putting

1 together its agenda, and from thereafter, provides an
2 effective means. The Chamber's voice is heard in
3 Tallahassee at rulemaking sessions, wherever.

4 Q And at tax proposals; is that correct?

5 A Correct.

6 Q All right. And my understanding is the
7 legislature normally proposes taxes; is that also
8 correct?

9 A That's my understanding also.

10 Q Unfortunately, not exclusively, but certainly
11 primarily.

12 And you also say that a benefit is achieved
13 at both the state and local chamber levels since county
14 boards also have authority to enact rules. That,
15 presumably, is an opportunity for Southern States to
16 have its view heard through the Chamber before the
17 authorities, such as county boards; is that correct?

18 A That's correct.

19 Q If you will, contrast the activities that
20 we've just been discussing with activities known as
21 lobbying.

22 A I would draw a differentiation, I guess, with
23 the intent and the benefit to the customers. We're not
24 doing this for our narrow self-interest. These are
25 pase-through types of things. Of course, there are

1 exceptions to all rules, but in vast majority of cases
2 we remember the Chamber because it's very active in
3 controlling and holding down the cost of doing
4 business, and we think that benefits our customers.

5 Q So these efforts, although they take place,
6 perhaps, before or at least to persuade the
7 Legislature, should be allowed by the Commission
8 because they're of some benefit to ratepayers; is that
9 right?

10 A They're of considerable benefit to
11 ratepayers.

12 Q Do you know if the Commission has taken that
13 -- made that distinction in its examination of lobbying
14 expenses in general?

15 A I know the Commission disallows lobbying
16 expenses. I don't know if they've taken that
17 differentiation into account.

18 Q All right, sir. Let's leave the area and
19 look to another disagreement we have, and that is over
20 the level of participation of your various employees in
21 acquisition effort.

22 Do you recall, Mr. Phillips, telling me in
23 your deposition, I asked you a question about the
24 extent to which Ms. Karla Teasley participates in the
25 acquisition effort. Do you remember that question?

1 A I believe so. I thought you were addressing
2 condemnation efforts or condemnation cases. My
3 recollection, I remember the question concerning
4 condemnation. I don't have a clear recollection of you
5 asking me about acquisition.

6 Q All right, sir. We'll get the deposition in
7 just a moment. I have a couple of general questions.
8 Who is --

9 A I'm not -- I'll accept your statement that I
10 said that.

11 Q Okay. You may have to accept my recollection
12 of your answer as well then. My question to you was to
13 what extent -- I think it's a fair summation of my
14 question is, to what extent does Ms. Teasley
15 participate in acquisitions. And I think your answer
16 was, "Well, I don't know but I could tell if I looked
17 at her timesheet." Do you recall that answer?

18 A I think that's not exactly my words.
19 Certainly, if it were my words, maybe it wasn't my
20 intent. What I meant to say, I thought your question
21 was directed to precisely -- or not precisely -- but
22 what amount of time on a weekly timesheet basis or on
23 an average basis Ms. Teasley spends on acquisitions and
24 I didn't have that number. That I would have to go to
25 timesheets. I know what her role is with regard to

1 acquisitions, that it's fairly minimal; that she's our
2 general counsel and that she will review contractual
3 documents. It's a relatively small de minimis part of
4 her total activity, which includes our entire Legal
5 Department, Human Resources Department, Communications
6 Department, Information Services Department.

7 Q Pardon me just a moment.

8 Mr. Phillips, we went to -- first of all, do
9 you have the exhibit that was just passed the out?

10 A I have got so many papers in front of me
11 right now. Is this K. O. Teasley timesheets, '91?

12 Q Yes, sir.

13 MR. McLEAN: Mr. Chariman, may we have that
14 item marked for identification.

15 COMMISSIONER BEARD: Exhibit No. 34. Short
16 title will be Teasley Timesheet for '91.

17 (Exhibit 34 is marked for identification.)

18 Q (By Mr. McLean) Mr. Phillips, we, at the
19 office of Public Counsel, made some effort to determine
20 by looking at Ms. Teasley's timesheets, to determine
21 how much time she spent on acquisition, and didn't meet
22 with much success. Can you help us out? You have the
23 timesheets in front of you. Can you point us to
24 information on the timesheets that we could rely upon
25 to make that distinction?

1 A Looking at the three examples I have, I see
2 no charges to acquisition. On the surface that doesn't
3 surprise me, with the exception of Lehigh, which we, at
4 Southern States, were not heavily involved in as much
5 as it went over the \$1 million limit where we have the
6 lead, and it was largely handled by our Corporate
7 Development Department in Duluth. We have not made any
8 acquisitions since '89. We didn't make any in '90,
9 '91; have not made any in '92.

10 Q All right. I want to ask you a question
11 about that. You were in the room earlier when Mr.
12 Sandbulte testified that the point of the threshold is
13 \$1 million. If it's more than \$1 million, management
14 in Minnesota participates, and if less than --

15 A Yeah. It's kind of loose, but that's the
16 point where the lead passes off between myself or Mr.
17 McDonald up in that Topeka Group or Minnesota Power,
18 I'm sorry.

19 Q All right, sir. Thank you, sir.

20 MR. McLEAN: No further questions.

21 COMMISSIONER EASLEY: Mr. Haag wanted to
22 be --

23 COMMISSIONER BEARD: I'm sorry. That's
24 correct.

25 MR. HAAG: No cross.

1 COMMISSIONER BEARD: Staff?

2 CROSS EXAMINATION

3 BY MS. SUMMERLIN:

4 Q Okay. Mr. Phillips, on Page 22 of your
5 direct testimony, Lines 6 through 9. Are you there?

6 A Yes, I am.

7 Q You make a statement, and I quote "Southern
8 States is a strong advocate of public access reuse
9 water and is providing 100% public access reuse at
10 three systems and up to 88% public access reuse at five
11 other systems." Could you tell us the names of these
12 systems?

13 A Yes, I can. Amelia Island, University
14 Shores, Deltona Lakes, Marco Island, Venice Gardens,
15 and Lehigh.

16 Q Okay. Can you define for us exactly what you
17 mean by that term "public access reuse water"?

18 A Yes. Although, as you know, there's several
19 type of reuse; public access is the highest level of
20 treatment. Requires tertiary filters on the plant, but
21 essentially it produces an effluent, although it is not
22 potable water, it can be used on things, such as golf
23 courses, right-of-ways, where people will come in
24 contact with it. There's a lower level of treatment
25 where the area must be fenced off and is nonproductive.

1 We're very supportive of public access since it saves
2 -- the aquifer in effect, really benefits -- it also
3 benefits our water customers that this potable water is
4 not going to be used for these uses and that we can
5 effectively aid in recharging the aquifer.

6 A This wastewater would otherwise, you know,
7 typically be disposed of into surface waters and,
8 therefore, be wasted to salt water.

9 Q Okay, thank you. On Page 25 of your direct
10 testimony, you -- and actually on Page 24, also, you
11 discuss some of the recommendations that were included
12 in the Commission's management audit that was done
13 September of '88?

14 A Yes, ma'am.

15 Q And you say that Southern States has agreed
16 with and implemented all but two of the Commission's
17 recommendations?

18 A Yes.

19 Q Can you tell us which are the two that were
20 not?

21 A Yes, I can. They're Item No. 11, which was
22 "Develop procedures and check lists for acquisitions."
23 I think our disagreement there was we don't believe
24 acquisitions can quite be relegated to a form --
25 filling out a form. It's an art more than a science.

1 We're very comfortable that we have the appropriately-
2 schooled people, we have the internal procedures and
3 checks, and that we strongly felt we did not need any
4 other procedures developed to evaluate acquisitions.

5 The second one was Item 18, which was a call
6 for routine reviews of gallonage versus revenue. And I
7 think our dispute at that time was over the frequency
8 of doing that. We do, in fact, review those things on
9 a regular basis, but the disagreement was over the
10 rigorousness.

11 Q What exactly was the problem with coming up
12 with procedures for acquisitions?

13 A It was our feeling that they were
14 unnecessary; that our procedures and level of expertise
15 was sufficient, we didn't need -- we didn't feel that
16 additional procedures in, frankly, a nonregulated area,
17 were warranted.

18 Q In your rebuttal testimony, you talk about
19 the fact that the Company feels that or believes that
20 the Commission should allow recovery of membership dues
21 in the Florida Public Relations Association?

22 A That's correct.

23 Q And isn't the primary purpose of that
24 association to enhance the image of businesses? And
25 wouldn't that be the primary benefit to Southern

1 States?

2 A I think, honestly, we've got to look past
3 what might be the primary function of the Public
4 Relations Association. I mean, that's a terrible title
5 to look for to try to get included in costs. I think
6 it's largely a victim of its title.

7 We have very limited public relations
8 activity. I think we've offered in our testimony -- we
9 have a communications department, that's only two
10 people. We have a Speakers Bureau of 50 people. We
11 need to go out and meet with our customers.

12 We have a conservation program we have
13 developed, we've won awards for it, we want to present
14 that. We want to encourage conservation. We want to
15 help our customers to understand our billing and our
16 necessity for rates. This, we find, is a very
17 effective tool, it's local, it's in Florida, it doesn't
18 really require a lot of travel. Because it's public
19 relations, they do address presentation speaking
20 skills, and that's what we use it for. So I think,
21 we'd really have to -- we're asking the Commission to
22 look past merely the title of that organization, but
23 the use we put our membership in that to.

24 COMMISSIONER CLARK: How much money are we
25 talking about? Excuse me, I haven't read Ms. Dismukes'

1 testimony, how much money are we talking about here?

2 WITNESS PHILLIPS: I don't believe I have Ms.
3 Dismukes' -- it's a couple hundred dollars, I believe,
4 I might be wrong.

5 COMMISSIONER CLARK: It's the principle of
6 the thing, right?

7 COMMISSIONER EASLEY: I do hope it's more
8 than that.

9 WITNESS PHILLIPS: Are we speaking of Chamber
10 dues or --

11 COMMISSIONER CLARK: No, the Public Relations
12 dues. Page 3 on rebuttal, Florida Public Relations
13 Association. Anybody know?

14 WITNESS PHILLIPS: Oh, I'm sorry. I didn't
15 know you were waiting. \$600 roughly.

16 COMMISSIONER CLARK: Right. Per year? Is
17 that an annual figure?

18 WITNESS PHILLIPS: I believe so.

19 COMMISSIONER CLARK: Thank you.

20 Q (By Ms. Summerlin) Isn't it true that the
21 Company has training for all of those individuals that
22 are sent to the Public Relations Association already in
23 the Company or within the Company?

24 A Not for the particular individuals that
25 belong -- who are two, which is our entire

1 Communications Department. They are, in fact, the
2 people who are the trainers of our Speakers Bureau, who
3 have put together our award-winning conservation
4 program.

5 So it's not like we have 50 people
6 participating, it's just that it's two people, it's
7 narrowly focused, and largely they use that activity in
8 putting together customer presentations. And we have
9 inhouse publications both for our employees, and
10 customer newsletters and the skills -- unfortunately
11 it's called the Public Relations Association, that's
12 where we get those skills to put forward effective
13 newsletters, presentations, et cetera.

14 MS. SUMMERLIN: Staff has no further
15 questions.

16 COMMISSIONER CLARK: Let me ask a question.

17 WITNESS PHILLIPS: Yes, ma'am.

18 COMMISSIONER CLARK: This Association, are
19 there any costs beyond the \$600 paid for them to take
20 training that they in turn pass on to the other
21 employees?

22 WITNESS PHILLIPS: Other than the direct
23 costs of the membership and attending of the meetings?

24 COMMISSIONER CLARK: Yeah. Well, tell me
25 about that. How often do they meet?

1 WITNESS PHILLIPS: I don't know.

2 COMMISSIONER CLARK: Well, here's what I'm
3 trying to find out. It seems to me that what you're
4 suggesting is the title of this Association is a
5 misnomer, that it is more like training or education
6 you get in the area that you were responsible for in
7 the Company?

8 WITNESS PHILLIPS: Yeah, I'm sorry, I didn't
9 mean to say, it's not a misnomer. But I think we're
10 just asking the Commission to look past the name, and
11 look at the use we put our membership in that
12 organization to, and it's not public relations.

13 COMMISSIONER CLARK: And I'm trying to find
14 out do your membership dues cover the access to all of
15 the offerings this Association makes that you believe
16 are beneficial? I mean, it seems to me --

17 WITNESS PHILLIPS: To the best of my
18 knowledge, yes. There's a magazine, periodicals,
19 seminars that --

20 COMMISSIONER CLARK: And the seminars are
21 free as long as you are a member?

22 WITNESS PHILLIPS: You pay your own expenses,
23 but the membership covers that.

24 COMMISSIONER CLARK: And they receive
25 training there in their area of their expertise?

1 WITNESS PHILLIPS: Yes.

2 COMMISSIONER CLARK: In the same way it may
3 be an engineer might belong to an Association and by
4 virtue of that membership he has access to training and
5 seminars?

6 WITNESS PHILLIPS: I think that's an
7 excellent analogy.

8 COMMISSIONER CLARK: All right.

9 MS. SUMMERLIN: Staff didn't have any further
10 questions.

11 CHAIRMAN BEARD: Redirect?

12 MR. HOFFMAN: Thank you, Mr. Chairman.

13 REDIRECT EXAMINATION

14 BY MR. HOFFMAN:

15 Q Mr. Phillips, one question. Mr. Sandbulte,
16 in response to some questions by Mr. McLean from Public
17 Counsel, referred questions to you concerning salaries
18 and potential bonuses.

19 MR. MCLEAN: Object. Beyond the scope of
20 cross.

21 MR. HOFFMAN: I agree, it is beyond the scope
22 of cross, Mr. Chairman; but, if the Commission wants
23 further information, I think Mr. Phillips is the one
24 with the most specific information on that issue.

25 MR. MCLEAN: That's puts me in the position --

1 MR. HOFFMAN: He was identified by Mr.
2 Sandbulte as such.

3 CHAIRMAN BEARD: Does the Commission wish any
4 further information at this time?

5 COMMISSIONER EASLEY: The only trouble with
6 "at this time" is it may make it a little bit difficult
7 to get it if we need it later.

8 COMMISSIONER CLARK: Mr. Chairman, let's let
9 him ask the question and then you can do recross.

10 CHAIRMAN BEARD: Okay.

11 Q (By Mr. Hoffman) Mr. Phillips, my question
12 essentially was if you can provide any further
13 information on the questions pertaining to salaries and
14 particularly bonuses.

15 A Yes, I can.

16 Q Would you do so?

17 A Yes. I'm afraid I don't have that exhibit in
18 front of me. If someone could hand it to me, it would
19 be helpful. I can speak to it.

20 I believe Mr. Sandbulte -- I believe the sum
21 was \$62,000, and there was an assumption that that
22 represented a bonus payment. And I think that's not
23 the proper way to classify those payments; and I think
24 it would be helpful to the Commission if I briefly
25 could explain our compensation system, which is a bit

1 unusual, and where the bulk of those payments came
2 from.

3 I'm assuming -- we have a typical merit
4 incentive payroll system. I believe most of the larger
5 utilities regulated by the Commission use a similar
6 one, it is a basic matrix with different levels of
7 performance and position and salary grade.

8 What Southern States does differently is for
9 performance, we have five levels of performance:
10 unacceptable, marginal, fully competent, excellent and
11 outstanding. And typically, you know, each, depending
12 on what category an employee falls into, they get a
13 progressively higher percentage increase.

14 What Southern States does differently is the
15 base -- the pay adjustment that's built into your
16 salary from then forward is capped at the fully
17 adjustable rating. The extra percentages for being
18 excellent or an outstanding performer are paid to the
19 employees in lump sums. We do this for two reasons:
20 We find the employee -- it's 1 or 2% of salary, if you
21 looked, those are not big numbers, 3 or 4 but the
22 employee appreciates having the money all in one time,
23 it seems like more than a few more bucks every
24 paycheck, if you will.

25 But I think, more importantly, it emphasizes

1 that an employee must earn their exceptional and
2 outstanding rating ever year. It is not built into
3 your salary. It doesn't carry on year for year where,
4 because you got 6% for being outstanding one year,
5 that's not 6% every year going forward.

6 We think it actually saves the customers some
7 money, it incentivises our employees. If you look at
8 the exhibit you have now, there is the employees'
9 names, and then there's two columns, "BEX," one is
10 "BIN."

11 Q Excuse me, Mr. Phillips, are you referring to
12 the exhibit which has been marked as Exhibit No. 23?

13 A Yes.

14 Q Thank you.

15 A Those amounts in the column marked "BIN" are
16 really, that is the capped payment.

17 COMMISSIONER CLARK: That is the what?

18 MR. PHILLIPS: That is the payment of the
19 lump sum amounts for a normal merit adjustment. For
20 instance, I believe in this year we had a total payroll
21 of 4.2% for merit increases; 3.5 of that was paid out
22 as built into your salary for performance levels up to
23 fully competent; the remaining .7% was disbursed as
24 lump sums to those individuals who earned it.

25 CHAIRMAN BEARD: Now, let me get square on

1 what you just said, okay? All the employees have
2 basically their base salary. And then you had 4.1% or
3 .2%, whatever it was, that your total amount that you
4 were going to increase salaries, either through your
5 quote/unquote "normal merit increase" or some lump for
6 being excellent or outstanding?

7 WITNESS PHILLIPS: That's correct, 4.2, I
8 believe for this year.

9 CHAIRMAN BEARD: Okay. So now you got
10 roughly 3.5% that is distributed to the employees.
11 Does some of that 3.5% get distribute to the
12 unsatisfactory employees?

13 WITNESS PHILLIPS: A unsatisfactory employee
14 will not receive a raise. A marginal employee might
15 receive a nominal 1% and a reprimand, but he would
16 probably receive a small increase.

17 CHAIRMAN BEARD: He would receive 1% and a
18 reprimand, okay.

19 WITNESS PHILLIPS: On unsatisfactory, it's a
20 reprimand -- perhaps "reprimand" is strong.
21 Unsatisfactory, assuming that's the first time that
22 person ever heard they were unsatisfactory, and that
23 should not be because we try to communicate with our
24 employees on a regular basis, that's our intent, on
25 their performance. You get two unsatisfactories in a

1 row and you're history.

2 Not much better with marginal. Marginal is a
3 warning that you've got to get better or you likewise
4 will be separated from the Company. But we have
5 typically given a small, it's a 1% type of increase, to
6 those individuals. Fully competent individual, and
7 this year, would get 3.5.

8 CHAIRMAN BEARD: Can I if --

9 WITNESS PHILLIPS: I'm sorry. Somebody who
10 was, for instance, outstanding, would get 3.5 added to
11 their base salary and receive a lump sum payment
12 amounting to 2% of their salary. Where ordinarily they
13 would have gotten just a 5% increase or a 5.5% increase
14 in the normal scheme of things that would carry over
15 year-for-year, here the only thing that carries over
16 year-for-year is the 3.5 for being fully competent.

17 CHAIRMAN BEARD: So, if I am the outstanding
18 employees, which I obviously would be. (Laughter) And
19 I got 5.5, I have to assume that there are some that
20 didn't do quite as good --

21 WITNESS PHILLIPS: That's correct.

22 CHAIRMAN BEARD: -- in order for you to get a
23 lump average across the Company of 4.1 or 4.2?

24 WITNESS PHILLIPS: That's correct.

25 CHAIRMAN BEARD: Okay. Would you have the

1 information available now or, if not, provide a
2 late-filed exhibit for I think, this is 1991 that we
3 have the numbers for, is that correct?

4 WITNESS PHILLIPS: Yes, that's correct.

5 CHAIRMAN BEARD: Okay. If you could, could
6 you provide for me the percentage of employees that
7 were classified as unsatisfactory, marginal, fully
8 competent, excellent and outstanding?

9 WITNESS PHILLIPS: I certainly will,
10 Commissioner. I would like to add in this exhibit, I
11 counted the names, and there are 55 names total in
12 here. We have approximately 450 employees. We're very
13 selective about excellent and outstanding ratings. So
14 we are looking at about one out of eight as rated
15 excellent or outstanding.

16 CHAIRMAN BEARD: So the 55 names represent
17 those two top categories?

18 WITNESS PHILLIPS: That would be correct.

19 CHAIRMAN BEARD: Okay. And then you would
20 need to get for me the information, and I really would
21 like a breakdown of all five categories, if you can do
22 that?

23 WITNESS PHILLIPS: Yes. We certainly have
24 that information available.

25 CHAIRMAN BEARD: Being an ex scientist, I get

1 fascinated by bell-shaped curves and those kind of
2 things, you know.

3 COMMISSIONER EASLEY: You said being a rocket
4 scientist.

5 CHAIRMAN BEARD: No, ex. Ex scientist. I
6 never claim to be a rocket scientist, just a school
7 teacher. And let's call that Late-Filed Exhibit,
8 Exhibit No. 35. And a short title would be "Percent in
9 Performance Categories."

10 (Late-filed Exhibit No. 35 identified.)

11 CHAIRMAN BEARD: I'm sorry, go ahead,
12 Commissioner.

13 COMMISSIONER CLARK: Mr. Phillips, one of the
14 things that Florida Power Company does is it ties
15 bonuses to --

16 WITNESS PHILLIPS: I'm sorry, Commissioner
17 would you -- I missed the first part of your --

18 COMMISSIONER CLARK: One of the things
19 Florida Power Corporation does with respect to bonuses
20 is it ties it to the performance of the Company as a
21 whole, whether or not they've earned a good rate of
22 return. Do you do that in this case?

23 WITNESS PHILLIPS: For some people in this
24 case, if you will let me explain. And at this point in
25 time we're doing it for all other employees, but this

1 goes back to '91.

2 COMMISSIONER CLARK: The Company has to be
3 earning a good return before you will even look at
4 bonuses for them. Is that what you said --

5 WITNESS PHILLIPS: I would like to
6 differentiate, if I could, bonuses, which we do have
7 some bonuses, I'll fully admit. From what I have been
8 talking about, which is merely receiving merit pay in a
9 lump sum.

10 COMMISSIONER CLARK: All right. But this
11 merit pay is not tied to the performance of the Company
12 as a whole?

13 WITNESS PHILLIPS: No, it's based on
14 individual performance.

15 COMMISSIONER CLARK: Okay. I don't need to
16 know any more then.

17 COMMISSIONER EASLEY: I do. There are
18 several pages in here that have the word "Bonuses, 1992
19 Bonuses for '91 Performances," that's on page 1. And
20 page 6 of 10, "1991 Bonuses for 1990." Whose
21 handwriting is that, do you know?

22 WITNESS PHILLIPS: No. It appears to be the --

23 COMMISSIONER EASLEY: Do you know whether
24 that was --

25 WITNESS PHILLIPS: No, I don't know.

1 COMMISSIONER EASLEY: I assume this was
2 produced by the Company as this response to an
3 interrogatory.

4 Would you assume that that information was
5 written by whoever wrote Appendix 28-A, Page 9 of, or
6 you just don't know?

7 WITNESS PHILLIPS: I just don't know whether
8 it's the same handwriting that is down here on the --

9 COMMISSIONER EASLEY: So tell me the difference
10 then between a bonus and a lump-sum-merit-pay amount?

11 WITNESS PHILLIPS: If a hypothetical person,
12 employee, was excellent, and under our matrix, if that
13 employee received a 4% salary adjustment, I think it
14 would be relatively noncontroversial. What we do,
15 speaking hypothetically, is if the salary -- if the
16 salary -- percentage increase were a fully capable,
17 fully competent employee is 3, that's all we give an
18 exceptional employee as far as increasing their base.
19 Rather than giving them a 4% increase, we'll give an
20 excellent employee a 3% base increase and a 1% lump
21 sum. That makes the employee whole. And they've
22 gotten a 4% increase in their income for that year. It
23 adds value to the customers because going into next
24 year, that 1% isn't there anymore, that employee is --

25 COMMISSIONER EASLEY: I understand your

1 concept of the merit additive, for want of calling it a
2 bonus at this point. Tell me what a bonus is.

3 WITNESS PHILLIPS: A bonus, and as I say, we
4 do have some bonuses --

5 COMMISSIONER EASLEY: Those are the ones I
6 want to know what they are.

7 WITNESS PHILLIPS: Commissioner, if you'll
8 look at the same exhibit, 23, if you'll look to the --
9 I won't count the pages, but there's a page marked
10 confidential, incentive compensation.

11 COMMISSIONER EASLEY: They're all marked
12 confidential.

13 WITNESS PHILLIPS: I'm sorry, I guess they
14 all are. Page 1 of 5 --

15 COMMISSIONER EASLEY: 1 of 10, that's a short
16 one?

17 WITNESS PHILLIPS: Looks like that; it's got
18 my signature on it.

19 COMMISSIONER EASLEY: Your signature on it.
20 Oh, okay. There are two -- that's 28-B, Page 1 of 5.
21 Got it.

22 WITNESS PHILLIPS: I apologize.

23 COMMISSIONER EASLEY: That's all right. Go
24 ahead.

25 WITNESS PHILLIPS: This is our incentive

1 compensation or bonus program, if you will.

2 For the purposes of this case, it is -- well,
3 still, it is available to very few people in the
4 Company. I believe it's ten. I could count them, but
5 it's --

6 COMMISSIONER EASLEY: Mr. Phillips, let me
7 shortcut you because you're going way beyond what I
8 think I need to know.

9 This document doesn't tell me, and you're not
10 headed in the road, I don't think, of telling me, the
11 difference between -- you said you all have bonuses.

12 WITNESS PHILLIPS: Yes.

13 COMMISSIONER EASLEY: The difference between
14 a bonus and the 2% lump sum added to somebody who gets
15 3.5 as a merit increase. What do I have to do to
16 qualify for a bonus?

17 WITNESS PHILLIPS: Two ways, Commissioner:
18 Either you're one of the ten people who are in this --
19 covered by this plan --

20 COMMISSIONER EASLEY: All right.

21 WITNESS PHILLIPS: Or you're an employee not
22 covered who we feel has rendered exceptional and
23 extraordinary service --

24 COMMISSIONER EASLEY: Okay.

25 WITNESS PHILLIPS: -- in terms of -- and

1 we've had employees who have worked 60-hour weeks for
2 months at end. We don't feel that our -- even with an
3 outstanding rating, that that would adequately
4 compensate employees for that level of effort. And in
5 those cases, and they're rare, their records would be
6 available, we do grant bonuses.

7 COMMISSIONER EASLEY: So the distinction
8 you're making and want us to see, I gather --

9 WITNESS PHILLIPS: Yes.

10 COMMISSIONER EASLEY: -- is that a bonus is
11 something, number one, only a few people have access to
12 and, number two, takes something reasonably
13 extraordinary, and they should not be eligible for the
14 merit increase.

15 And the merit increase, which is a lump sum
16 instead of a bonus, is done to reduce the amount for
17 which the Company or the ratepayers or anybody else who
18 is paying payroll taxes and payroll expense would be
19 liable for in going-forward years because the base
20 salary is not increased by the amount of that lump sum.

21 WITNESS PHILLIPS: In the going-forward
22 years.

23 COMMISSIONER EASLEY: In the going forward
24 years.

25 WITNESS PHILLIPS: And the lump such seems to

1 have more of an incentive effect on the employees in
2 getting that X number of hundred dollars in one piece
3 to do something with.

4 COMMISSIONER EASLEY: Okay. I think I've got
5 the distinction.

6 CHAIRMAN BEARD: Well, I want to clarify,
7 because I hear some talking by each other, or my ears
8 don't work.

9 Any and every employee in the Company who
10 performs in a fully competent manner in this particular
11 year, that is to say fully competent, excellent, or
12 outstanding, would have received a 3.5% merit increase
13 that continues in future years because it's a part of
14 their base salary?

15 WITNESS PHILLIPS: That's correct.

16 CHAIRMAN BEARD: And any employee that worked
17 time and a half, in the ensuing year, that three and a
18 half would have worked that time and a half for them as
19 well?

20 In other words if they increase by base
21 salary -- I assume some of these employees are hourly,
22 right?

23 WITNESS PHILLIPS: That's correct.

24 CHAIRMAN BEARD: Okay. So if you increase my
25 salary by 3.5%, and I work time and a half, it's

1 impacted by that 3.5%, right?

2 WITNESS PHILLIPS: Yes, for every hour
3 worked.

4 CHAIRMAN BEARD: And that's on a
5 going-forward basis and it sticks with me as long as
6 I'm with the Company and don't do something really
7 stupid to get it reduced.

8 WITNESS PHILLIPS: Correct.

9 CHAIRMAN BEARD: Okay. Now --

10 WITNESS PHILLIPS: Maintains your position
11 within salary grades.

12 CHAIRMAN BEARD: Within grade and range. I'm
13 familiar with those concepts.

14 Now, in addition to that, any employee in the
15 Company, all employees in the Company are eligible if
16 they perform in an outstanding or excellent manner, for
17 a merit-lump amount that they receive on a one-time
18 basis at the end of have year for performance during
19 that year.

20 WITNESS PHILLIPS: That's correct.

21 CHAIRMAN BEARD: So if I were an outstanding
22 employee, I could get my 3.5%, plus I could get 2% in a
23 lump payment?

24 WITNESS PHILLIPS: That's correct.

25 CHAIRMAN BEARD: In addition to that, there

1 are ten employees in the Company who can receive a
2 bonus.

3 I'll get to the others in a minute --

4 WITNESS PHILLIPS: There are ten employees
5 covered by this formal program.

6 CHAIRMAN BEARD: And what do those ten
7 employees have to do to get a bonus?

8 WITNESS PHILLIPS: May I refer to the
9 document, sir?

10 CHAIRMAN BEARD: Sure. You can refer to the
11 encyclopedia.

12 WITNESS PHILLIPS: Okay. We establish goals,
13 and the bonus amounts are calculated. And in most of
14 these cases it's formal, but it's rather cumbersome, I
15 won't try to explain it. But, for instance, we
16 established goals in the area of key organizational
17 goals and financial performance. And the opportunity
18 for bonus for an additional pay for these few people,
19 the officers and senior management, is based upon the
20 number of the key organizational goals we've achieved,
21 such things as operating within the overall O&M budget,
22 completing capital budget projects within schedule and
23 budget, things of this nature. And the second
24 component is targeted financial results.

25 CHAIRMAN BEARD: Okay, now, if I'm one of

1 those ten employees and my performance has been
2 determined during this year to be fully competent and
3 no more --

4 WITNESS PHILLIPS: Yes.

5 CHAIRMAN BEARD: -- consequently, I do not
6 receive a merit lump.

7 WITNESS PHILLIPS: That's correct.

8 CHAIRMAN BEARD: But the goals of the Company
9 have been achieved, then I would, in fact, receive my
10 bonus.

11 WITNESS PHILLIPS: Yes, you would receive a
12 bonus under this program in addition to your --

13 CHAIRMAN BEARD: Because it's based on group
14 performance as opposed to individual?

15 WITNESS PHILLIPS: It's based on group
16 corporate performance.

17 CHAIRMAN BEARD: Okay. Now, if I were an
18 employee that's not one of those ten, I would
19 ultimately have to have performed in an outstanding
20 manner, gotten my merit lump increase and then above
21 and beyond that done something so extraordinary that
22 the corporate officers determine that I deserve, even
23 in addition to that, a bonus?

24 WITNESS PHILLIPS: That's correct. This is a
25 handful of people literally.

1 CHAIRMAN BEARD: You couldn't be a fully
2 competent employee of the Company and no more -- not
3 counting the ten people, I'm not talking about that
4 now, and receive a bonus because, obviously, you would
5 not even have performed in an outstanding manner at
6 that stage?

7 WITNESS PHILLIPS: That's correct.

8 CHAIRMAN BEARD: Okay.

9 COMMISSIONER CLARK: Did I hear you say that
10 you could be among the top ten and not receive an
11 outstanding or excellent and still get a bonus?

12 CHAIRMAN BEARD: Yes.

13 WITNESS PHILLIPS: Under the -- because the
14 excellent -- and the bonus for the ten people is based
15 on joint corporate goals; basically return, targeted
16 financial results, and the internal customer-focused
17 results, staying within budget and doing things of that
18 nature, achieving a safety target.

19 CHAIRMAN BEARD: What I would like for you to
20 do for me, on that Late-Filed Exhibit 35, when we
21 talked about the percent in each performance category.

22 WITNESS PHILLIPS: Yes.

23 CHAIRMAN BEARD: If you would, as a breakout
24 of that, I would like to see the ten employees that
25 fall under this bonus plan during 1991 and what

1 categories they were ranked. I don't need names, but I
2 want how many were outstanding, how many were
3 excellent, and how many were fully competent, that kind
4 of thing, on those ten as well.

5 WITNESS PHILLIPS: I understand.
6 Commissioner, do you want them by name or just number
7 of employees?

8 WITNESS PHILLIPS: I could care less about
9 names. I'm strictly interested in, you know, how many
10 of the ten were outstanding and how many were
11 excellent, et cetera.

12 COMMISSIONER EASLEY: Just make sure they're
13 identified separately from the other employees'
14 breakdown.

15 CHAIRMAN BEARD: Commissioner, did you
16 understand the difference between the bonus and the
17 merit and corporate goals versus individual?

18 COMMISSIONER CLARK: Well, geez, I don't
19 know, I was looking at that -- the exhibit, and how you
20 compute the bonuses for those ten people. And I
21 thought I understood you had to be outstanding or
22 excellent on an individual basis before you could even
23 participate in the bonus, but that is incorrect, right?

24 WITNESS PHILLIPS: For these -- that's
25 correct.

1 COMMISSIONER CLARK: Okay.

2 CHAIRMAN BEARD: For those ten.

3 WITNESS PHILLIPS: For these ten people.

4 COMMISSIONER CLARK: I think I do.

5 CHAIRMAN BEARD: Okay.

6 COMMISSIONER EASLEY: But if one of those ten

7 who can participate in the group bonus had not received

8 the outstanding or whatever --

9 CHAIRMAN BEARD: Excellent.

10 COMMISSIONER EASLEY: -- excellent. You

11 would not have gotten the 2% on the 3.5% that everybody

12 else got?

13 WITNESS PHILLIPS: That's correct.

14 COMMISSIONER EASLEY: Okay.

15 CHAIRMAN BEARD: Okay.

16 COMMISSIONER EASLEY: You know, what's scary

17 is I'm beginning to understand this stuff.

18 CHAIRMAN BEARD: You, too, can be a personnel

19 director.

20 COMMISSIONER EASLEY: I have been a personnel

21 director.

22 MR. HOFFMAN: Mr. Chairman, may I follow up

23 with one question for clarification, because I --

24 CHAIRMAN BEARD: Go ahead.

25 MR. HOFFMAN: I've become a little confused.

1 Q (By Mr. Hoffman) Mr. Phillips, could you
2 turn, on Exhibit 23, we've been discussing the 1991
3 Incentive Compensation Plan, to Page 4 of 5?

4 COMMISSIONER EASLEY: Which?

5 MR. HOFFMAN: Appendix 28-B, Page 4 of 5. It
6 is the next to last page, Commissioner.

7 COMMISSIONER EASLEY: Thank you

8 Q (Mr. Hoffman) Mr. Phillips, I read this page,
9 and I come out with the understanding that for one to
10 qualify for a bonus under this plan, one has to be
11 outstanding or excellent.

12 MR. McLEAN: I don't suppose a leading
13 objection would carry much weight?

14 COMMISSIONER CLARK: I thought that was the
15 standpoint --

16 COMMISSIONER EASLEY: Not a tad. You ought
17 to just leave him alone.

18 WITNESS PHILLIPS: I believe Mr. McLean is
19 going to be surprised.

20 No, that's not correct.

21 COMMISSIONER EASLEY: Say that again.

22 WITNESS PHILLIPS: No, that's not correct.

23 WITNESS PHILLIPS: In order for --

24 MR. McLEAN: I'll withdraw the objection.

25 (Laughter)

1 CHAIRMAN BEARD: Now, Mr. Hoffman objects.

2 MR. HOFFMAN: Commissioner, let me quote Mr.
3 McLean from the Lehigh case. "You can't lead if you
4 don't know where you're going."

5 COMMISSIONER EASLEY: You're asking to strike
6 his testimony, are you, Mr. Hoffman?

7 MR. HOFFMAN: No.

8 CHAIRMAN BEARD: Okay. How about now that
9 you've said no, why don't you explain? At the risk of
10 interfering between two attorneys, go ahead.

11 WITNESS PHILLIPS: If you'll -- on the plan,
12 if you will turn to Page 1 of that plan.

13 COMMISSIONER EASLEY: Which is Page 1 of 5,
14 Appendix 28-B.

15 WITNESS PHILLIPS: Yes. It says "Southern
16 States Utility Services Incentive Compensation Plan."

17 COMMISSIONER EASLEY: 2 of 5, right?

18 WITNESS PHILLIPS: Okay. Yes. 2 of 5 --
19 it's typed "1," but, yes, 2 of 5, ma'am.

20 COMMISSIONER EASLEY: Right.

21 WITNESS PHILLIPS: Up at the top, there are
22 three components only for these ten people: One being
23 the contributions to the goals that I mentioned and
24 those change, those are developed and changed every
25 year. And each of these are independent.

1 The second one is achieving the target
2 financial results of the Company.

3 And I would draw your attention to the third
4 one. Now, that's individual performance. For these
5 ten individuals, when I spoke of the -- they're
6 excluded from the group I had previously spoke of,
7 which is all other people who get the -- the lump-sum
8 merit increase.

9 These people -- these ten people get their
10 lump-sum merit increase, if they're excellent or
11 outstanding, under this plan under Component 3. So,
12 yes, it is possible that an employee can be -- that's
13 fully competent or even less. And although they will
14 certainly not get Component 3 of the plan, they are
15 still eligible to participate in Components 1 and 2.

16 CHAIRMAN BEARD: Let me ask one clarifying
17 question based on that answer.

18 If I am one of these ten people, can I
19 participate -- obviously, I can participate in that
20 3.5% portion. Can I participate in the merit lump and
21 the bonus?

22 WITNESS PHILLIPS: The merit lump, you
23 participate through this plan. You're not in both.
24 It's through this plan.

25 CHAIRMAN BEARD: Okay.

1 COMMISSIONER EASLEY: That I misunderstood
2 because that was the question I thought I had asked.

3 CHAIRMAN BEARD: Okay. So let me back up.

4 We know what the other guys are doing. They
5 got three and a half and two. So now I'm one of the
6 ten. I got my three and a half because I was fully
7 competent.

8 WITNESS PHILLIPS: Yes, sir.

9 CHAIRMAN BEARD: Okay. And then -- and this
10 was for 1991, I'm one of the ten.

11 WITNESS PHILLIPS: Yes, sir.

12 CHAIRMAN BEARD: Okay. And let's assume that
13 we achieved all our goals, we hit all our financial
14 targets, and I was a really, really good employee. So
15 I got all of my either 20%, if I was a VP, or my 33 and
16 a third if I was one of the others, if there's not a VP
17 in that plan. What percentage increase, lump increase,
18 would I have received?

19 WITNESS PHILLIPS: We do our merit
20 adjustments for all employees except these ten -- no,
21 for all employees, on January 1. So there would be a
22 -- and if you're one of these ten -- assuming you were
23 at least competent, you would get just the three and a
24 half and no more. The rest of the employees, at that
25 date, will also get, if they're eligible for this

1 lump-sum merit, will get a lump-sum merit at that time
2 as well.

3 CHAIRMAN BEARD: Okay. But it's January 1st,
4 I'm one of the ten, I've got my three and a half and
5 I'm excellent, I'm outstanding, whatever the top
6 category is --

7 WITNESS PHILLIPS: If you're outstanding, you
8 would get a 3.5% increase. Because of the time lag to
9 calculate these numbers and results, this plan is
10 payable on April 1 of the year. Knowing Al, it's April
11 Fools day, but that's the date that it is.

12 CHAIRMAN BEARD: Okay.

13 WITNESS PHILLIPS: But you wouldn't receive
14 your additional increment for being excellent until
15 April 1, because it's all wrapped up in this one plan.

16 CHAIRMAN BEARD: I'm not worried about when I
17 got it. I want to know how much I'm going to get.

18 WITNESS PHILLIPS: You're going to get three
19 and a half into your base and 2% as a lump sum.

20 CHAIRMAN BEARD: Based on my excellence.

21 WITNESS PHILLIPS: Based on your individual
22 performance.

23 CHAIRMAN BEARD: Okay. Now, how much am I
24 going to get based on the fact that we hit the
25 financial targets and the corporate goals?

1 WITNESS PHILLIPS: The maximum achievable,
2 assuming you're a vice president, if we exceeded all --
3 exceeded all financial goals, far exceeded, actually,
4 is the way it's worded, over 110% of goals, you would
5 receive 8%. If we achieved all seven of our goals, of
6 our organizational goals, you would receive an
7 additional 8%. If you were outstanding in individual
8 performance, you would receive 4%.

9 So the maximum award -- assuming -- exceeding
10 all financial goals, achieving all corporate goals, and
11 being an outstanding performer, would be a 20% bonus to
12 these ten people.

13 CHAIRMAN BEARD: Okay. That's the answer I
14 wanted to know.

15 COMMISSIONER EASLEY: Redirect?

16 MR. HOFFMAN: Nothing further.

17 MR. McLEAN: Actually -- oh, I'm sorry, just
18 looking for my turn on the stuff that was beyond the
19 scope of cross.

20 COMMISSIONER EASLEY: Oh, I beg your pardon.
21 I forgot.

22 CHAIRMAN BEARD: Recross.

23 COMMISSIONER EASLEY: Recross.

24

25

REXCROSS EXAMINATION

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BY MR. McLEAN:

Q Mr. Phillips, turn from the back of your exhibit, please, probably be the easiest way to get to Page 3 of 5.

A Three pages in, Mr. McLean?

Q Yes, sir. It's Page 3 of 5; it's marked down there on the right-hand side.

As I understand this, you're identifying here at the bottom of the page, target, "targeted financial results," one of which is 6.6 return on equity. Is that correct?

A That's correct. We didn't achieve it.

Q And the second one, you did achieve it, did you?

A Did not achieve it.

Q Did not achieve it.

The second one is 549,000 from water/wastewater, in LP gas operations, correct?

A Correct.

Q Now, what is the 4.1 million after-tax income? Do you know what that is? (Pause)

A Not in any particular -- I mean, that goes back a couple of years as to how we came up with the -- with that target.

Q Okay. Well the \$549,000 is identified as net

1 income. Is that typical net income from all of the
2 water, wastewater, LP and gas operations?

3 A Unfortunately, that's typical, and it's even
4 worse now.

5 Q Okay. Well, I'm a little confused as to how
6 you can have net income of 549 and then an after tax
7 income of 1.4 million.

8 A One is the operational income and, I guess,
9 the other is you must look at other income.

10 Q Would you suppose that you looked
11 specifically to the gain on St. Augustine Shores to get
12 to that?

13 A That certainly was -- is what that business
14 was worth to our shareholders.

15 Q Okay. I want to ask you something about
16 those shareholders, because it seems to me like all
17 this exemplary performance which you attempt to reward
18 in these two plans does accrue in some measure to the
19 benefit of the shareholders. Wouldn't you agree with that?

20 A I'm sorry. Would you say all of the
21 exemplary performance? I certainly would not agree
22 with that.

23 Q There might be some omissions, but in large
24 part doesn't exemplary performance accrue to the
25 benefit of the shareholders of this Company?

1 A Not at all.

2 Q How so?

3 A An employee who was acting in an exceptional
4 and outstanding manner certainly is beneficial to the
5 customers.

6 Q I'm not suggesting exclusive benefit to the
7 shareholders. I'm suggesting that it has some benefit
8 to the customers, is that right? Do you agree with
9 that?

10 A I don't necessarily think so. To me the real
11 -- since the payroll cost is a pass-through kind of a
12 cost, the shareholders don't benefit from it. I really
13 see the vast majority of that accruing to the benefit
14 of the customers.

15 Q Okay. So if the Company reaches its budgeted
16 ROE, it's targeted financial results, you're saying
17 that's not of benefit to the shareholders?

18 A Well, we're talking about an outstanding
19 employee. Outstanding is based on individual
20 performance. There's -- you're mixing an apple and an
21 orange. Achieving targeted financial results is not
22 part of our merit adjustment program, or the
23 percentage. That's based purely on individuals' effort
24 and performance.

25 Q I want to mix these two plans together, and I

1 have the notion that what these two plans do is reward
2 employees who go a bit or a lot beyond and above the
3 call of their normal duty. Is that a fair
4 representation?

5 A And/or -- and achieve extraordinary results.

6 Q Yes, sir, and my question --

7 A To the benefit of, well, yes, to the benefit,
8 largely, of the customers.

9 Q Well, my question to you is, is it of any
10 benefit whatsoever to the shareholders?

11 A If your question is directed toward the first
12 two components of the Incentive Compensation Plan, that
13 which we have a relatively small -- ten is the number
14 we're using in employees -- I would think certainly
15 achieving targeted financial results for that portion,
16 that is a benefit to the shareholders.

17 With regard to achieving our organizational
18 goals, motor vehicles accidents, safety, staying within
19 budget, getting projects done, I think that is almost
20 exclusively to the benefit of the customers.

21 Q So you'll give the customers a refund somehow
22 if they don't run into as many people with their
23 trucks, is that how it works?

24 A No, we won't have as high insurance rates.

25 Q Exactly.

1 A And, therefore, our operating costs going
2 forward will be lower, and in future rate cases, they
3 will enjoy that benefit.

4 Q How about before the future rate cases?

5 A There wouldn't be -- before the future rate
6 cases, I'm sure you know as well as I do. Assuming we
7 have no other costs increasing, which also is not the
8 case. We have a number of costs that increase every
9 year, and if there's a savings in something like
10 vehicle insurance, which is more than offset by things
11 like the increased rules for sludge disposal, which
12 have about doubled this year and yet is not in this
13 case.

14 Q All right. So to the extent that you are
15 willing to concede that the shareholders enjoy any
16 benefit whatsoever, as de minimis as that benefit is in
17 your testimony, where is the attending cost to them?
18 Where do they pay for it?

19 A Well, certainly with a negative return on
20 equity, the shareholders are paying for it now, sir.

21 Q But it's not in this plan, is it?

22 A To have a negative return on equity?

23 Q This plan assigns the costs of all the
24 benefits that you have described in the plan. It
25 assigns all those costs to the ratepayers; isn't that

1 correct? Because I don't see where shareholders pay
2 any part of this.

3 A No. We didn't achieve our financial goals,
4 so it wasn't -- no component of that was paid.

5 Q You didn't pay any bonuses because you didn't
6 achieve your financial goals, correct?

7 A It's a three-component program. That
8 component for financial goals was not met, no bonuses
9 were paid.

10 Q What kind of bonus did --

11 A No bonus attributable to that portion of the
12 plan was paid.

13 Q Does anything in this entire exhibit imply
14 that you paid compensation for performance which was
15 above and beyond the call of general daily duties?
16 Isn't that what this plan is all about?

17 A I'm sorry. Would you repeat it one more
18 time, Mr. McLean?

19 Q Sure.

20 Doesn't both these plans stand for the notion
21 that employees who perform more than adequately ought
22 to be rewarded somehow?

23 A That's correct.

24 Q Now, if you include -- isn't it true that all
25 the expenses that you incurred in rewarding that sort

1 of behavior is going to be borne by the shareholders --
2 I'm sorry, by the ratepayers?

3 A The expenses being the salary increases? The
4 actual amounts?

5 Q Yes, sir.

6 A Well, as I explained, I think it's arguable
7 that achieving financial results, that one portion of
8 this particular plan does benefit shareholders, and
9 I'll freely admit that. The individual performance, as
10 well as achieving the corporate goals, is to the
11 benefit of our shareholders -- customers. I'm doing
12 it, too.

13 Q Is there any money reflected in the test year
14 with which the Company intends to reward something
15 above adequate performance?

16 A In the test year. Yeah. I forget the
17 percentage that's in there. I seem to recall we have
18 about a 5% total payroll increase if you separate out
19 the progression adjustments for new employees who were
20 brought up to bring them into the matrix, in grade.
21 And our licensing program where we -- it's a
22 pay-for-knowledge program primarily for our field
23 workers, as they get additional licenses, we pay them
24 --

25 Q Let me interrupt you, Mr. Phillips.

1 A Can I finish my answer?

2 Q No, sir, I didn't ask that question.

3 A Yes, you did.

4 Q All right, then I move --

5 CHAIRMAN BEARD: It's a great dance, but the
6 music is over.

7 WITNESS PHILLIPS: I apologize.

8 Q (By Mr. McLean) Exhibit No. 23: Does that
9 exhibit represent expenses which you incurred during
10 the test year to award performance which is beyond
11 adequate performance?

12 A We use the term "fully competent." Yes.

13 Q Thank you, sir.

14 Now, to the extent that money is reflected in
15 the test year, don't you presume the same level of
16 exemplary performance in all future years for which
17 these rates are in effect?

18 A The level of -- certainly the percentage --
19 I'm not sure I understand the question. The salary
20 increase amounts, of course, vary annually, based on
21 economic --

22 COMMISSIONER EASLEY: Could I try it, Mr.
23 McLean?

24 MR. McLEAN: Yes, ma'am.

25 COMMISSIONER EASLEY: One of the reasons that

1 you have the lump sum at the end of your merit increase
2 is because it costs less to not have it repeated and
3 included in the base in the forward years, right?

4 (Pause)

5 Wasn't that the answer you gave me a little
6 bit ago?

7 WITNESS PHILLIPS: Yes, potentially, yes,
8 that's correct.

9 COMMISSIONER EASLEY: Okay. I think the
10 gist, if I understand what Mr. McLean is asking you is,
11 if it's a one-time shot and doesn't get included in the
12 salary base, why should it be included in the rate case
13 so that it continues to increase when the salary base
14 doesn't?

15 Am I at least close, Mr. McLean?

16 MR. McLEAN: Yes, particularly with respect
17 to the marginal part of it --

18 COMMISSIONER EASLEY: Well, even if --

19 (Simultaneous conversation)

20 COMMISSIONER EASLEY: You don't even have to
21 worry about the marginal, just forget the numbers
22 because it assumes that the same number of people will
23 qualify for the same amount of merit lump sum every
24 year in the out years, doesn't it?

25 WITNESS PHILLIPS: Yes, it does, with 40, 50

1 employees, we're assuming the percentage of people in
2 the excellent and outstanding range will be about the
3 same year after year.

4 MR. McLEAN: No further questions. Thank
5 you.

6 COMMISSIONER EASLEY: Thank you.

7 CHAIRMAN BEARD: The witness may step down.

8 MS. SUMMERLIN: Commissioners, Staff would
9 like to have a couple of questions. We didn't have a
10 chance to talk about this either, this exhibit.

11 CHAIRMAN BEARD: Okay.

12 MS. SUMMERLIN: We just have a couple.

13 CHAIRMAN BEARD: Please.

14 RE CROSS EXAMINATION

15 BY MS. SUMMERLIN:

16 Q Mr. Phillips, would you agree that these are
17 tough economic times --

18 A Today?

19 Q -- in general?

20 A Yes.

21 Q Are you aware that the State employees, the
22 great majority of State employees haven't received a
23 raise for three years?

24 A Including benefits or just direct
25 compensation?

1 Q The great majority of State employees, in
2 general, have not received a raise in three years. I'm
3 asking if you're aware of that.

4 A Yes, I'm aware of that.

5 Q How that does Southern States justify an
6 across-the-board increase of 3.5% for all employees
7 except unsatisfactory employees in light of these kinds
8 of facts?

9 A Well, I certainly can sympathize with
10 employees of the State of Florida, nor do I personally
11 condone things like a salary freeze for three years
12 running.

13 We are in a competitive market, we at
14 Southern States; we invest a lot of money in our
15 employees, particularly operators, which we have to
16 train and we have to retain after we have trained them.
17 We were losing operators. We were spending customers'
18 money training people, and as soon as they got their
19 licenses, they were leaving. We have to compete
20 primarily with county government, who, in my
21 experience, has not been subjected to pay freezes for
22 the last three years.

23 Likewise, for our professional people,
24 although it's a thin job market, there are jobs
25 available out there for good qualified people. We feel

1 in order to retain our people and to keep them
2 motivated, that we do have to pay a competitive salary.

3 I believe this is addressed a number of times
4 in the audit which you had earlier asked me about, the
5 necessity for us to attract and retain qualified
6 people.

7 We must be competitive with salary. We think
8 we have, based on industry standards and surveys we
9 have taken, we are competitive and we're in the water,
10 wastewater industry nationwide, and particularly in the
11 Southeast.

12 Q Who sets these goals for the Company, this
13 incentive plan that you have been talking about?

14 A The financial goal, I do. I approve as I
15 approve the whole plan. But I approve the financial
16 goal in consultation with Mr. Sandbulte.

17 With regard to those corporate performance
18 goals, we have a number of employee teams working in
19 each of these areas to achieve these things. They
20 propose goals to me for the coming year, and we go
21 through a very iterative process so I can be assured
22 they are challenging; that's challenging,
23 not-easy-to-attain goals that we set.

24 Q How many people could conceivably qualify for
25 an up to a 20% bonus?

1 A Five.

2 Q Five?

3 A Five.

4 Q Okay. You mentioned earlier something about
5 the pass-through nature of salary costs. Is that what
6 you said earlier?

7 A Well, not a pass-through but the fact that
8 it's an expense item. And, you know, that the
9 shareholders assume we've budgeted right, and we come
10 in on budget that the -- you know, the shareholder,
11 there is no benefit. It's -- you're aware of the
12 mechanism as well as I am. We don't try to inflate our
13 budget and then come under it. We have lean-type
14 budgets, especially in a situation where we're losing
15 money like we are now.

16 MS. SUMMERLIN: No further questions. Thank
17 you.

18 CHAIRMAN BEARD: The witness may step down.
19 (Witness Phillips excused.)

20

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21 CHAIRMAN BEARD: For those that don't know
22 it, we will not be working tomorrow. I do that at the
23 risk of everybody's animosity, but we won't work
24 tomorrow. However, I can promise you we will finish by
25 Saturday evening, being next Saturday. And if that

1 means we're wearing our "jammies" until 2:00 in the
2 morning, that's exactly what we'll do. And I think you
3 can count on working late on Monday, and based on how
4 we do on Monday will determine how late we work on
5 Tuesday.

6 Now, we're not done today. I just was
7 letting people know so if you have to make
8 arrangements. I thought I had gotten the word out, but
9 I guess I hadn't done it officially.

10 Now, we're going to take a break and when we
11 come back, the next witness.

12 Yes, sir?

13 MR. HOFFMAN: Mr. Chairman, we would move
14 Composite Exhibit 29.

15 CHAIRMAN BEARD: Thank you. Without
16 objection.

17 MR. McLEAN: Mr. Chairman, we move 30 through
18 34.

19 CHAIRMAN BEARD: Without objection.

20 (Exhibit Nos. 29, 30, 31, 32, 33 and 34
21 received into evidence.)

22 MR. HOFFMAN: One further item, Mr. Chairman.
23 Commissioner Clark had asked me whether or
24 not Order No. 23143, which is Exhibit 28, had been
25 challenged? We have the consummating order. There was

1 no petition filed challenging that, and so we'll
2 provide a copy of that, and I guess I would suggest
3 that we append it to Exhibit 28.

4 COMMISSIONER EASLEY: Yes.

5 CHAIRMAN BEARD: Okay.

6 MR. HOFFMAN: Thank you.

7 CHAIRMAN BEARD: Mr. Hoffman?

8 - - - - -

9 BRUCE E. GANGNON

10 was called as a witness on behalf of Southern States
11 Utilities, Inc. and Deltona Utilities, Inc. and, having
12 been duly sworn, testified as follows:

13 DIRECT EXAMINATION

14 BY MR. HOFFMAN:

15 Q Mr. Gangnon, have you been sworn?

16 A Yes, I have.

17 Q All right, sir. Would you please state your
18 name and business address?

19 A Bruce E. Gangnon, G-a-n-g-n-o-n, 30 West
20 Superior Street, Duluth, Minnesota 55802.

21 Q Mr. Gangnon, did you prepare and cause to be
22 filed prefiled direct testimony and prefiled rebuttal
23 testimony on behalf of Southern States Utilities, Inc.?

24 A Yes, I did.

25 Q Do you have any changes or revisions to

1 Q Do you have any changes or revisions to
2 either your direct testimony or your rebuttal
3 testimony?

4 A Yes, I do. On my direct testimony,
5 Page 3, Line 9, after "Book 1 of 4," insert,
6 "W-C-1."

7 On Line 10, delete the word "pension" and
8 insert the word "provision."

9 Q Provision?

10 A "Provision," p-r-o-v-i-s-i-o-n.

11 Line 11, delete "with W-C-1," insert "W-C-7."

12 Line 13 delete "W-C-7," insert "S-C-1."

13 Q Do you have any further changes to your
14 direct testimony?

15 A No, I don't.

16 Q All right, sir. Do you have any revisions to
17 your rebuttal testimony?

18 A No, I do not.

19 Q With those revisions, Mr. Gangnon, if
20 I were to ask you the same questions as contained in
21 your prefiled direct testimony and your prefiled
22 rebuttal testimony, would your answers be the
23 same?

24 A Yes, they would.

25 MR. HOFFMAN: Mr. Chairman, I would ask that

1 Mr. Gangnon's prefiled direct testimony and rebuttal
2 testimony be inserted into the record as though
3 read.

4 CHAIRMAN BEARD: They will both be so
5 inserted.

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1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. My name is Bruce E. Gangnon. My business address
3 is Minnesota Power, 30 West Superior Street, Duluth,
4 MN 55802.

5 Q. WHAT IS YOUR POSITION WITH MINNESOTA POWER?

6 A. I serve as Assistant Corporate Controller for
7 Minnesota Power.

8 Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

9 A. I received a Bachelor's Degree in Accounting and
10 Business Administration from the University of
11 Minnesota - Duluth in 1968. I received my
12 certificate as a Certified Public Accountant in
13 1972. In addition, I have attended a number of
14 schools, seminars, conferences, workshops and short
15 courses on various tax and accounting issues
16 sponsored by various professional associations,
17 universities and accounting firms.

18 Q. HOW LONG HAVE YOU BEEN EMPLOYED IN THE UTILITY
19 INDUSTRY AND WHAT POSITIONS HAVE YOU HELD?

20 A. I have been employed in the following accounting
21 management positions by Minnesota Power since 1975.
22 1975-1977: Manager - Audit Tax; 1978-1990:
23 Manager, Taxes; 1991 - May 1992: Director of
24 Corporate Accounting; and May 1, 1992 to Present:
25 Assistant Corporate Controller.

1 Q. TO WHAT TRADE AND/OR PROFESSIONAL ORGANIZATIONS DO
2 YOU BELONG?

3 A. I am a member of the Minnesota Society of Certified
4 Public Accountants and the Edison Electric Institute
5 Taxation Committee.

6 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE A PUBLIC
7 UTILITIES COMMISSION?

8 A. Yes. I have testified before the Florida Public
9 Service Commission.

10 Q. WHAT ARE YOUR RESPONSIBILITIES AS ASSISTANT
11 CORPORATE CONTROLLER?

12 A. As Assistant Corporate Controller, I am responsible
13 for the tax, accounting systems and procedures,
14 external and internal reporting functions and
15 accounting research for Minnesota Power,
16 subsidiaries and related entities.

17 Q. PLEASE OUTLINE THE SCOPE OF YOUR TESTIMONY IN THIS
18 PROCEEDING.

19 A. I will testify with respect to the Company's tax
20 matters, in the cost of service and will sponsor
21 Schedules C-1 and C-7 contained in Volume I, Book
22 1 of 4 and Schedules C-1 through C-11 in Volume II,
23 Book 7 of 11 except for the Topeka Group, Inc.
24 Schedule C-9 on pp. 0042 & 0044 in said book of the
25 Minimum Filing Requirements ("MFRs") filed in this

1 case, Exhibit ____ (FLL-1). I will also testify
 2 regarding issues related to the adoption of
 3 Statement of Financial Accounting Standards No. 106,
 4 "Employers Accounting for Post-Retirement Benefits
 5 other than Pensions" (SFAS 106).

6 Q. WOULD YOU DESCRIBE THE SCHEDULES IN THE TAX SECTION
 7 THAT YOU ARE SPONSORING?

8	A. <u>Schedule No.</u>	<u>Title</u>
9	Volume I, Book 1 of 4	W-C-1 ↓ Reconciliation of Total Income
10	Tax	- Pension Provision
11	W-C-7 W-C-1	Summary of Accumulated Deferred
12		Income Taxes
13	S-C-1 W-C-7	Reconciliation of Total Income
14	Tax	Provision
15	S-C-7	Summary of Accumulated Deferred
16		Income Taxes
17	Volume II, Book 7 of 11	
18	C-1	Reconciliation of Total Income
19	Tax	Provision
20	C-1/A	Reconciliation of Total Income
21	Tax	Provision
22	C-2	State and Federal Income Tax
23	Calculation	- Current
24	C-2/A	State and Federal Income Tax
25	Calculation	- Current

1	C-3	Schedule of Interest in Tax
2	Expense	Calculation
3	C-4	Book/Tax Differences - Permanent
4	C-5	Deferred Income Tax Expense
5	C-6	Deferred Tax Balance Adjustments
6	C-7 (p. 1 of 3)	Accumulated Deferred Income
7	Taxes -	Summary
8	C-7 (p. 2 of 3)	Accumulated Deferred Income
9	Taxes -	State
10	C-7 (p. 3 of 3)	Accumulated Deferred Income
11	Taxes -	Federal
12	C-7A	Accumulated Deferred Income
13		Taxes - By Company
14	C-8 (p. 1 of 3)	Investment Tax Credits -
15		Analysis
16	C-8 (p. 2 of 3)	Investment Tax Credits - Company
17		Policies
18	C-8 (p. 3 of 3)	Investment Tax Credits - Section
19		46(f) Election
20	C-8/A	Investment Tax Credits -
21		Analysis
22	C-9 (pp. 1-2)	Parent Debt Information
23	C-10	Income Tax Returns
24	C-11	Miscellaneous Tax Information
25	Q.	WHAT DOES SCHEDULE C-1/A OF VOLUME , BOOK 1 OF 4 OF

- 1 **THE MFRS SHOW?**
- 2 A. Schedule C-1/A shows the computation of the parent
3 debt amount shown on Schedule C-1.
- 4 Q. **WHAT DOES SCHEDULE C-2/A OF VOLUME II, BOOK 7 OF 11**
5 **OF THE MFRS SHOW?**
- 6 A. Schedule C-2/A shows the detail of the adjustments
7 between the total per books and utility income.
- 8 Q. **WHAT DOES SCHEDULE C-7A OF VOLUME II, BOOK 7 OF 11**
9 **OF THE MFRS SHOW?**
- 10 A. Schedule C-7A shows the detail of accumulated
11 Deferred Income Taxes by timing difference and by
12 Company.
- 13 Q. **WHAT DOES SCHEDULE C-8/A OF VOLUME II, BOOK 7 OF 11**
14 **OF THE MFRS SHOW?**
- 15 A. Schedule C-8/A shows the detail of deferred ITC by
16 company.
- 17 Q. **WERE THOSE SCHEDULES PREPARED BY YOU OR UNDER YOUR**
18 **DIRECTION AND/OR SUPERVISION?**
- 19 A. Yes, they were.
- 20 Q. **WOULD YOU DESCRIBE THE BACKGROUND LEADING UP TO THE**
21 **ADOPTION OF SFAS NO. 106?**
- 22 A. The Financial Accounting Standards Board ("FASB"),
23 in February 1989, issued a draft of a proposed
24 statement concerning the recognition and measurement
25 of post-retirement benefits other than pensions

1 ("OPEB"). The draft proposed to change the
2 accounting for OPEBs from a pay-as-you-go method
3 (cash basis) to an accrual basis (recognizing the
4 expense when the employee earns the benefits). In
5 other words, the OPEBs would be recognized on a
6 company's financial statements when they are earned
7 (over the employee's working life similar to pension
8 benefits) and not when the benefits are paid. OPEBs
9 are benefits that the employee receives from the
10 employer when the employee retires and are made up
11 of medical care, dental care, life insurance and
12 other miscellaneous benefits. The purpose for the
13 accounting change was to disclose the large
14 liability that employers had for OPEBs which the
15 employee had earned but not recorded in the
16 company's financial statements. In December 1990,
17 after receiving comments from financial and
18 accounting professionals, the FASB adopted SFAS No.
19 106 which is generally effective for fiscal years
20 beginning after December 15, 1992.

21 **Q. DOES SFAS 106 APPLY TO UTILITY COMPANIES?**

22 **A.** Yes, SFAS 106 applies to all companies, including
23 utility companies who pay for all or part of their
24 retirees' OPEBs.

25 **Q. SHOULD THE COMMISSION ALLOW RECOVERY OF THE OPEB**

1 **EXPENSES IN ACCORDANCE WITH SFAS 106?**

2 A. Yes, the expense for OPEBs should be recovered as
3 the employee earns them and be paid for by the
4 ratepayers for whom the employee is performing
5 services rather than future ratepayers.

6 Q. **WILL THE COMPANY ADOPT SFAS 106 PRIOR TO CALENDAR**
7 **YEAR 1993?**

8 A. No, the Company intends to adopt SFAS 106 in 1993.

9 Q. **IF THE COMPANY IS NOT ADOPTING SFAS 106 UNTIL 1993,**
10 **WHY SHOULD THE OPEB EXPENSE BE ALLOWED IN THE RATE**
11 **CASE?**

12 A. The OPEB expenses should be allowed because they are
13 known costs that will be incurred when the final
14 rates in this docket are effective.

15 Q. **ARE THE OPEB EXPENSES INCLUDED IN THIS RATE CASE**
16 **BASED UPON AN ACTUARIAL STUDY?**

17 A. Yes.

18 Q. **DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?**

19 A. Yes, it does.

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1 Q. PLEASE STATE YOUR NAME, TITLE AND EMPLOYER.

2 A. My name is Bruce E. Gangnon. I am employed as
3 Assistant Corporate Controller for Minnesota Power.

4 Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS
5 PROCEEDING?

6 A. Yes, I filed direct testimony on July 22, 1992.

7 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

8 A. My rebuttal testimony will address certain
9 statements made and positions taken by Office of
10 Public Counsel witness Victoria A. Montanaro
11 regarding the appropriate ratemaking treatment for
12 Southern States Utilities, Inc.'s (the "Company")
13 test year expenses for other post-employment
14 benefits ("OPEBs"). It is my opinion that the
15 Commission should continue its policy of permitting
16 utilities to recover OPEBs earned and accrued
17 pursuant to Statement of Financial Accounting
18 Standard No. 106 ("SFAS 106").

19 Q. MS. MONTANARO OPPOSES RECOVERY OF SFAS 106 EXPENSES
20 CITING RULE 203 OF THE AICPA CODE OF PROFESSIONAL
21 CONDUCT WHICH PROVIDES THAT THE APPLICATION OF AN
22 ACCOUNTING STANDARD OR OTHER PRINCIPLE MAY NOT BE
23 APPROPRIATE IN "UNUSUAL CIRCUMSTANCES". DO
24 INTERPRETATIONS OF RULE 203 DISCUSS WHAT CONSTITUTE
25 "UNUSUAL CIRCUMSTANCES"?

1 A. Yes. The interpretations under Rule 203 Accounting
2 Principles found in AICPA Professional Standard
3 Volume II state:

4 "The question of what constitutes unusual
5 circumstances as referred to in Rule 203
6 is a matter of professional judgement
7 involving the ability to support the
8 position that adherence to a promulgated
9 principle would be regarded generally by
10 reasonable men as producing a misleading
11 result.

12 Examples of events which may justify
13 departure from a principle are new
14 legislation or the evolution of a new
15 form of business transaction. An unusual
16 degree of materiality or the existence of
17 conflicting industry practices are
18 examples of circumstances which would not
19 ordinarily be regarded as unusual in the
20 context of Rule 203."

21 **Q. WOULD APPLICATION OF SFAS 106 CONSTITUTE AN UNUSUAL**
22 **CIRCUMSTANCE UNDER RULE 203 OF THE AICPA CODE OF**
23 **PROFESSIONAL CONDUCT?**

24 A. No. The materiality of the SFAS 106 expenses
25 appears to be Ms. Montanaro's greatest area of

1 concern. However, as the interpretations I just
2 referred to confirm, materiality is not to be
3 considered an "unusual circumstance" under Rule
4 203.

5 Q. WOULD THE COMPANY BE ALLOWED TO CONTINUE TO USE THE
6 CASH OR "PAY-AS-YOU-GO" METHOD OF RECORDING OPEBS
7 FOR FINANCIAL STATEMENT PURPOSES?

8 A. No. The Company would have to record its OPEB
9 expenses for financial statement purposes, unless
10 the deferral provisions of SFAS 71 were to apply.

11 Q. WOULD THE COMPANY BE ALLOWED TO USE DEFERRAL
12 ACCOUNTING UNDER SFAS 71 FOR THE DIFFERENCE BETWEEN
13 THE PAY-AS-YOU-GO AND THE SFAS 106 AMOUNTS?

14 A. The Company would be able to use deferral
15 accounting, but only for a short period of time, as
16 noted by the staff in its recommendation in Docket
17 No. 910840-PU.

18 Q. DOES THE COMPANY AGREE WITH MS. MONTANARO'S
19 PROPOSAL THAT THE COMPANY RETAIN THE CASH BASIS
20 METHOD OF ACCOUNTING FOR SFAS 106 COSTS?

21 A. No, the Company finds Ms. Montanaro's position to
22 be unacceptable for the following reasons:

23 In the past, "pay-as-you-go" accounting was
24 considered generally accepted accounting for OPEBs
25 because they constituted a relatively minor cost

1 and the perceived difference between cash and
2 accrual accounting was not considered material.
3 Due to the high levels of medical cost inflation
4 experienced over the past decade, OPEB liabilities
5 are no longer immaterial. The Financial Accounting
6 Standards Board ("FASB") issued SFAS 106,
7 Employers' Accounting for Post-Retirement Benefits
8 Other Than Pensions, to require accrual accounting
9 for OPEBs primarily to recognize this fact. It
10 also is accepted fact that OPEBs are a form of
11 deferred compensation. As such, the costs should
12 be recognized over the active service life of the
13 employee to properly match and assess the full cost
14 of providing services with the periods such
15 services are earned.

16 **Q. WOULD THE CONTINUATION OF THE CASH OR "PAY-AS-YOU-**
17 **GO" METHOD OF RECOVERING OPEB EXPENSES HAVE ANY**
18 **IMPACT ON THE COMPANY OTHER THAN A MISMATCH OF**
19 **EXPENSE INCURRENCE AND BOOK RECOGNITION?**

20 **A. Yes.** If the Company did not recognize the full
21 SFAS 106 accrual in any given reporting period due
22 to regulatory denial of the recovery of such costs,
23 the Company would still be faced with the funding
24 question. A decision to fully fund the OPEB
25 obligation regardless of non-recovery would divert

1 the Company's credit capacity during a period when
2 water and wastewater utilities are straining
3 existing capital sources to fund mandated plant
4 additions, improvements and modifications. A
5 decision not to fund would create increased
6 uncertainty on the part of the Company's creditors
7 and investors with respect to the Company's ability
8 to service a rapidly increasing liability.
9 Prospective creditors and investors would include
10 that element of increased uncertainty in
11 establishing interest rates and equity return
12 expectations -- resulting in higher financing costs
13 for the Company.

14 **Q. MS. MONTANARO STATES THAT "THERE IS SIGNIFICANT**
15 **REASON TO BELIEVE THAT THE COMPANY MAY RESTRUCTURE**
16 **ITS BENEFIT PLAN TO REDUCE COSTS IN THE FUTURE."**
17 **IN SUPPORT OF THIS STATEMENT, SHE REFERS TO AN**
18 **ACTUARIAL STUDY PREPARED BY MILLIMAN AND ROBERTSON,**
19 **INC. WHICH SHOWS THREE ALTERNATIVES TO THE CURRENT**
20 **PLAN BEING STUDIED. DO YOU AGREE WITH MS.**
21 **MONTANARO'S ASSESSMENT?**

22 **A. No, I do not. The Company has been and will**
23 **continue to review costs so that it will be able to**
24 **provide high quality service at reasonable rates.**
25 **As part of this process of reviewing costs we are**

1 always looking at alternatives and cheaper
2 alternatives always will exist; however, as we
3 stated in response to several interrogatories,
4 there are no present plans to reduce either the
5 kinds or levels of post-retirement benefits now or
6 in the future. The current level of OPEBs have
7 been determined by the Company to be the level
8 necessary to assist the Company in attracting and
9 retaining qualified employees who can provide high
10 quality service to our customers. Also, Ms.
11 Montanaro's conclusion also seems to be based on a
12 suspicion that the Company will collect the funds
13 to cover the cost of OPEBs while trying to avoid
14 paying the OPEBs. Since the Company intends to
15 fund the OPEBs, and the Commission monitors the
16 Company's earnings, such suspicion is groundless.

17 **Q. MS. MONTANARO HAS EXPRESSED CONCERN THAT "SFAS 106**
18 **CALCULATIONS ARE INHERENTLY UNRELIABLE IN A RATE**
19 **SETTING ENVIRONMENT." DO YOU AGREE WITH THIS**
20 **STATEMENT?**

21 **A.** No, I do not. While the SFAS 106 calculations are
22 not the product of an exact process, the estimates
23 are sufficiently certain to be included in the
24 ratemaking process, as the Commission concluded in
25 the United Telephone rate case (Order No. PSC-92-

1 0708-FOF-TL). While I would not suggest that
2 actuarial estimates of future OPEBs will not
3 change, the calculations are the result of a number
4 of carefully researched and informed decisions,
5 made in consultation with independent experts, to
6 select appropriate assumptions and produce
7 reasonable results.

8 Q. MS. MONTANARO ALSO SUGGESTS THAT ADOPTION OF SFAS
9 106 FOR RATEMAKING PURPOSES WILL ASSIGN COSTS TO
10 TODAY'S RATEPAYERS THAT RELATE TO A PRIOR PERIOD.
11 IS THAT ACCURATE?

12 A. First, I must note that Ms. Montanaro's statements
13 in this regard constitute an admission that OPEBs
14 are a form of deferred compensation and, like any
15 other form of deferred compensation, should be
16 recognized over the active service life of the
17 employee. Second, the accumulated benefit
18 obligation ("APBO") which exists today was incurred
19 to provide utility service to previous and present
20 customers of the Company. Under the "pay-as-you-
21 go" method, there is no direct matching of
22 customers who pay the costs and the customers on
23 whose behalf the costs were incurred, i.e., a
24 customer who first received service in 1991 will be
25 assessed OPEBs paid to an employee who may have

1 retired in 1989. Therefore, conversion to the
2 accrual method actually would result in a more
3 appropriate matching of cost incurrence and utility
4 rates. As to previously incurred liabilities, the
5 Company believes, as did the FASB, that the
6 amortization of the APBO over twenty years is a
7 fair way to spread this liability.

8 **Q. MS. MONTANARO RECOMMENDS THAT THE COMMISSION USE**
9 **THE COMPANY'S COST OF CAPITAL AS THE DISCOUNT RATE**
10 **FOR RATEMAKING PURPOSES. DO YOU AGREE WITH THIS**
11 **RECOMMENDATION?**

12 **A.** No. The use of a discount rate for ratemaking
13 purposes which is different than that used for
14 financial statement purposes would only create an
15 unnecessary level of complication. Also, her
16 recommendation only has relevance to an unfunded
17 plan and it is the Company's intent to fund the
18 plan. Therefore, Ms. Montanaro's recommendation is
19 not relevant in this proceeding and should be
20 rejected.

21 **Q. DOES THAT COMPLETE YOUR REBUTTAL TESTIMONY?**

22 **A.** Yes, it does.

23

24

25

1 Q (By Mr. Hoffman) Mr. Gangnon, have you
2 prepared a summary of your testimony?

3 A Yes, I have.

4 Q Could you please provide it?

5 A I am sponsoring the tax schedules in the MFRs
6 which I believe to be appropriate. I'm also supporting
7 the adoption of SFAS 106 as a basis of recovery for
8 other postretirement benefits, OPEBs, and in the amount
9 proposed in the MFRs.

10 I believe that SFAS 106 should be adopted
11 because the OPEB expenses should be recovered as they
12 are earned by the employee and paid for by the
13 ratepayers for whom the services are performed. The
14 dollar amount is appropriate for the following reasons:

15 The level of benefits that were offered to
16 the employees after careful consideration of the
17 management and the Medical Plan Board of Governors.
18 The level of benefits and the costs having been
19 considered by management as part of an overall
20 compensation package needed to attract and retain
21 qualified employees. The benefits appear to be in line
22 with the other OPEB benefits offered by other Florida
23 companies that I'm aware of.

24 The Commission has adopted SFAS 106 in the
25 case of United Telephone, Florida Power, without

1 reduction or change to their substantive plan amounts.
2 Not allowing the recovery of the OPEBs in accordance
3 with the SFAS 106 may force the Company to reduce those
4 benefits when other utilities are not forced to do so,
5 which could cause us to lose qualified people and have
6 a harder time attracting them.

7 If we do not recover these costs and continue
8 the benefits levels and fund them to retain our employees,
9 this would divert credit capacity when we are straining
10 existing capital sources to fund plant additions,
11 improvements and modifications.

12 Also, the growth of the OPEB liability if we
13 don't fund would create uncertainty on the part of the
14 Company's creditors and investors, which would be used
15 to determine the interest rates and equity return
16 expectations resulting in higher financing costs.

17 Q Does that conclude your summary?

18 A Yes, it does.

19 MR. HOFFMAN: He's available for cross.

20 MR. JONES: I have nothing.

21 MR. McLEAN: Mr. Gangnon --

22 CHAIRMAN BEARD: Are you going to let Public
23 Counsel go first?

24 MR. HAAG: Correct.

25 CHAIRMAN BEARD: Okay.

CROSS EXAMINATION

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BY MR. McLEAN:

Q Mr. Gangnon, Harold McLean for the Citizens.

You reference SFAS 71 on Page 3 of your rebuttal testimony. And I would like you to tell the Commission, if you can, I suppose the fair way to put it is why do you mention SFAS 71 at that point?

A Because in her direct testimony Ms. Montanaro has made or implied that the Commission can continue to use the pay-as-you-go method for rates and that there would be no financial statement impact because the Company could merely defer on the balance sheet the difference between the pay-as-you-go methodology and the amounts computed under SFAS 106.

Q Okay. So what is the consequence, according to you, of what Ms. Montanaro suggests, at least in terms of the financial statement?

A In my opinion, based upon what I know in talking with outside CPAs and other consultants, that once we go beyond a short-term transition period where you could defer that amount on the balance sheet with assurance that those costs would be recovered from the ratepayers in the future, that we would not be -- that a company would not be able to create that regulatory asset on the balance sheet but would be forced, for financial statement

1 purposes, to expense the FAS 106 or the other
2 postretirement benefits on the basis of SFAS 106.

3 Q What consequence would that have?

4 A It would deteriorate the financial condition
5 of the Company and would make us appear as a poor
6 credit risk to our creditors.

7 Q Now, do you know whether the Financial
8 Accounting Standards Board has any plan to address that
9 specific problem within the foreseeable future?

10 A Yes. There is a meeting of the Emerging
11 Issues Task Force to address that specific issue on
12 November 19th of this month.

13 Q All right, sir. And they will consider the
14 exact problem that you just described to the
15 Commission, will they not?

16 A Yes, they will.

17 Q So far as we know.

18 Okay, now, when we were down at Lehigh, I
19 asked you about a hypothetical employee and I want to
20 ask you about the same hypothetical employee with one
21 or two changes. This one is going to retire a little
22 sooner than the last one did.

23 The employee has given faithful service to
24 the Company and so forth and retires, let us say, in
25 1980. And the Company contracted with that employee or

1 represented to that employee that that the employee
2 would have some OPEBs as he enjoyed his retirement
3 years, or as she did. And my questions to you, the
4 line of questions, was designed to discover whether the
5 liability that the Company believes it has to that
6 employee arose in times outside the test year.

7 So, let me pose the same line of questioning,
8 I suppose, I don't know whether you need me to identify
9 those for you. But do you believe that that expense --
10 that liability, I'm sorry -- was incurred outside the
11 test year?

12 A Yes.

13 Q And a question which Commissioner Clark posed
14 at that hearing, I believe, was designed to show that,
15 although the liability might have been incurred outside
16 the test year, the actual expense might be recorded in
17 the test year. Do you recall that question?

18 A Yes. Under the pay-as-you-go method, that is
19 exactly what happens. Because the OPEBs are expensed
20 for financial statement purposes when they're paid
21 rather than when they were earned or accrued.

22 Q For what purposes? I'm sorry, I wasn't
23 listening.

24 A The cash method, the pay-as-you-go, the method
25 that everyone has been on prior to the dissemination of

1 Financial Accounting Standards 106.

2 Q But now, irrespective of when the expense is
3 recorded, isn't it true that the liability arose in
4 times, in my hypothetical, earlier than the test
5 period?

6 A Yes. The same as it does with any mode of
7 deferred compensation.

8 Q Okay. Now, with respect to something that
9 the Utility had neglected to ask for, some expense that
10 they -- this is hypothetical -- that they had neglected
11 to ask for, let us say, in the year, let's say, 1989,
12 you are generally aware, I think, with the ratemaking
13 practices such that you can say whether that expense
14 would be recoverable in the test year, can't you? It
15 is the question: Can you recover out-of-period
16 expenses during the test year, essentially? Do you
17 know the answer to that question?

18 A I'm not sure I, with all you went through,
19 I'm not sure I really understand what the actual
20 question was.

21 Q Okay. The actual question is: If the Utility
22 incurs a liability outside the test year that is not
23 related to OPEBs, can it recover the expense just
24 because it suffers the expense or it records the
25 expense during the test year? (Pause)

1 A Well, I think the answer to that question is,
2 to a certain degree, dependent upon the method of
3 accounting that is used for recording that particular
4 expense.

5 Q Sir, I think it's your testimony that SFAS
6 106 changes accounting methodology such that this
7 Commission ought to allow the Utility to recognize
8 expenses which it incurs for liabilities, which it
9 clearly incurred in earlier periods. Is that right?

10 A Which is consistent with what is being done
11 now. All 106, SFAS 106, does is change the period at
12 which those are being recognized. We're switching from
13 an accrual method to a pay-as-you-go or cash method.
14 The nature of those expenses has not changed at all.

15 Q Exactly. And the time during which they were
16 incurred, the liability, if any, which was incurred,
17 that hasn't changed either as a result of 106, has it?
18 (Pause)

19 A Again, I think it goes back to the method of
20 accounting that you're talking about. If you're using
21 a cash method of accounting, under that method
22 "incurred" would be when paid. In an accrual basis of
23 accounting, "incurred" would be when the liability
24 attached.

25 Q Okay. Let's change focus a bit and look at

1 the obligation itself. Is it true that Southern States
2 has what it believes some sort of obligation to pay
3 OPEBS to persons who have already retired and persons
4 who will retire?

5 A Yes.

6 Q Can they change that plan? (Pause)

7 A We can change it, in my understanding, and
8 I'm not a lawyer, my understanding that the plan can be
9 changed as to employees who are not retired, but not
10 for a retired employee.

11 Q Do you know if that is different from the
12 Utility's obligation to pay pensions to an employee?

13 MR. HOFFMAN: Mr. Chairman, I want to object.
14 I think we've gotten kind of far into questions which
15 ask Mr. Gangnon to provide legal opinions on what types
16 of legal obligations accrue with pensions as opposed to
17 OPEBS. (Pause)

18 CHAIRMAN BEARD: Did you hear the objection?

19 MR. McLEAN: No. But I think I can guess
20 what it was. For my response, I think whether that
21 particular thing can be changed is a matter of legal
22 judgment, so I think we're outside the bounds.

23 CHAIRMAN BEARD: Mr. McLean, you make it so
24 hard to rule on objections when you agree with them.

25 (Laughter)

1 MR. McLEAN: I know. It's hard to agree.

2 Mr. Gangnon, you have an exhibit I've
3 arranged for you to be handed.

4 Mr. Chairman, may we have that marked for
5 identification?

6 CHAIRMAN BEARD: Mark this as Exhibit No. 36.

7 And the short title will be "Retirement Benefits,
8 1-1-91." Will that do?

9 MR. McLEAN: Yes, sir.

10 (Exhibit No. 36 marked for identification.)

11 Q (By Mr. McLean) Mr. Gangnon, do you
12 recognize this as a late-filed exhibit which was
13 offered to your deposition which Staff --

14 A It is an attachment to one of my late-filed
15 exhibits, yes.

16 Q All right, sir. Would you look down to the
17 very last sentence on the exhibit?

18 A Yes.

19 Q All right, sir. Let me read it to you, read
20 with me if you will: "If at any time the Company
21 changes the provisions of the group life and medical
22 plan for active employees, such changes will also be
23 applicable to the retired employees."

24 Does that imply to you -- first of all, do
25 you who the author of this particular instrument is?

1 A It's the Benefits, Human Resources Department
2 of Southern States Utilities.

3 Q All right, sir. Without engaging into the
4 area of any sort of legal judgment, can you infer from
5 that sentence there that someone at least within the
6 Company is contemplating that it might be changed, that
7 the benefit -- that the group life medical plan could
8 be changed?

9 MR. HOFFMAN: Mr. Chairman, I'm going to object.
10 I think that calls for speculation on the witness's part
11 as to what some third party might do.

12 MR. McLEAN: I think anyone can read a
13 sentence and raise an inference from that sentence
14 which is something short of speculation. The sentence
15 is fairly clear to me. Why don't we see what the
16 witness says?

17 CHAIRMAN BEARD: Your question again was?

18 MR. McLEAN: Does the sentence at the bottom
19 of the page imply to you that someone in the Company
20 has at least thought about the possibility that the
21 plan might change? (Pause)

22 CHAIRMAN BEARD: Go ahead and answer the
23 question. I tell you what, let's ask this a different
24 way. Does this sentence at the bottom of this page
25 reserve the right for the Company to change the plan?

1 WITNESS GANGNON: Yes. And I think it's
2 fairly standard language in any plan that I'm aware of.

3 CHAIRMAN BEARD: So if this sentence reserves
4 the right to change the plan, then somewhere in the
5 continuum of time someone has thought about that
6 possibility?

7 WITNESS GANGNON: Yes. As I said, I think
8 it's a fairly standard provision in any plan.

9 CHAIRMAN BEARD: Yeah. I've seen them before
10 myself. Okay. I didn't think it was a controversial
11 item, I'm sorry.

12 Q (By Mr. McLean) Having read that, do you now
13 believe that the Company can change the plan?

14 MR. HOFFMAN: I think he's answered that
15 question.

16 COMMISSIONER CLARK: Yes. Can we stipulate
17 that in this case the Company can change its plan with
18 respect to OPEB benefits? I think that's fairly
19 standard. I mean, in every rate case I have been in so
20 far, the Company always reserves the right to change
21 its plan. And we know as sure as anything the costs
22 are going to be different next year than they are
23 today.

24 CHAIRMAN BEARD: Why even in state government
25 they change the plan.

1 MR. McLEAN: I'd like to stipulate and add
2 that that is true with respect to existing retiree and
3 as well as people who might retire. Now, I think
4 that's true.

5 WITNESS GANGNON: I would agree that we can
6 change it for existing employees, but I -- and again,
7 I'm not a lawyer, but I have been told by some people
8 that are knowledgeable in the area that even with a
9 welfare plan under ERISA that you can't make changes to
10 someone who has already retired. That's something they
11 have earned and already have a legal liability, you
12 know, a legal right to.

13 MR. McLEAN: Well, we can have the witness
14 testifying as a lawyer or we can have his counsel
15 objecting about it, but I don't think we can have both.

16 CHAIRMAN BEARD: He said he wasn't a lawyer
17 and you're right, you're not. And --

18 COMMISSIONER CLARK: And it was hearsay. I
19 mean, I think --

20 CHAIRMAN BEARD: Can we move on? I mean,
21 this is great, I'm fascinated.

22 MR. McLEAN: I don't think the record would
23 show we have a stipulation.

24 CHAIRMAN BEARD: We don't have a stipulation
25 then. We have a sentence in here, and we know what the

1 sentence says. No stipulation.

2 MR. McLEAN: Great.

3 Q (By Mr. McLean) Now, with respect -- I think
4 you make the argument that, unless allowed to fund the
5 OPEBs, the financial integrity of the Company might be
6 affected in some way; is that correct?

7 A Yes.

8 Q Okay. Now, with respect to the Company's
9 operations, about 35% of it, namely nonregulated
10 activities, are not really before the Commission; is
11 that right?

12 A Subject to check of the percentage, that's
13 true.

14 Q Yeah, roughly 35%?

15 A Well, I don't know how much of that is
16 nonregulated and how much of it is regulated by other
17 parties.

18 Q Good point. With respect to that the 35%
19 that is not regulated by the Commission, how do you
20 propose to protect the financial integrity of that
21 portion? (Pause)

22 A By filing rate cases with those regulatory
23 authorities.

24 Q And presumably you will seek to fund those as
25 well?

1 A Yes.

2 Q Do you know whether such filings have
3 actually been made?

4 A No, I do not.

5 Q All right, sir. Now, okay, just a last
6 question or two.

7 When did the Company formalize these plans,
8 the group life and medical plan? (Pause) Let me
9 strike the question.

10 Mr. Gangnon, I'm going to ask you essentially
11 the same question but I want to ask it a little bit
12 more correctly. When was a formal policy regarding
13 other postretirement benefits adopted by Southern
14 States? (Pause)

15 A January 1st, 1991.

16 Q Thank you, Mr. Gangnon. No further
17 questions. (Pause)

18 MR. HAAG: No cross.

19 CHAIRMAN BEARD: You guys get me out of
20 order. And if I don't go straight down the line, I get
21 so confused. I'm sorry.

22 Staff?

23 CROSS EXAMINATION

24 BY MS. BEDELL:

25 Q Good afternoon.

1 If the assets of a Company are acquired
2 through the purchase of assets, rather than through the
3 transfer of stock of the Company, do the tax attributes
4 follow the assets?

5 A No, they do not.

6 Q Okay. Do you know for the various systems
7 involved in this rate case, how they were acquired?

8 A That's kind of broad because that would go
9 back to the start of the Company, and we only acquired
10 it in 1984.

11 Q For those systems that have been purchased
12 since Minnesota Power acquired the Company.

13 A The only systems where we acquired them by
14 the purchase of stock would be Venice Gardens, the DUI
15 group of companies and Lehigh Utilities, that I'm aware
16 of. (Pause)

17 Those are the only ones that I'm aware of,
18 yes.

19 COMMISSIONER EASLEY: I'm sorry, what was the
20 second group?

21 WITNESS GANGNON: The Deltona group of
22 utilities, which is Deltona Utilities Seaboard.

23 COMMISSIONER EASLEY: You used initials,
24 didn't you?

25 WITNESS GANGNON: Yes, I did. DUI.

1 COMMISSIONER EASLEY: I just didn't
2 understand what you said. Thank you.

3 Q (By Ms. Bedell) Yesterday the Company filed
4 a broader position for Issue No. 11. And that position
5 states that "The CIAC-related deferred taxes should be
6 allocated on the basis of CIAC activity during the test
7 year," is that correct?

8 A Yes, that is true.

9 Q Could you explain what is meant by the "CIAC
10 activity during the test year"?

11 A That's the change in the CIAC accounts
12 between the end of the -- beginning of the year and the
13 end of the year.

14 Q Wouldn't a five-year average of CIAC activity
15 tend to level out fluctuations?

16 A Yes, it would.

17 Q And wouldn't you agree that that might be
18 more representative of the CIAC-related deferred taxes?

19 A I'm not sure I understand the question.

20 Q Well, basically, if you are going to allocate
21 CIAC, would it be more representative of the
22 CIAC-related deferred taxes to use a five-year average
23 as opposed to using one year?

24 A I assume you tied to the allocation of the
25 accumulated deferred amount?

1 Q Yeah. (Pause)

2 A Assuming that there are no wild or large
3 fluctuations in the CIAC activity, you should end up in
4 the same place using either methodology.

5 Q Can you tell me whether all of the CIAC
6 reflected in the MFRs has been taxed?

7 A No, CIAC would only be taxed from the year
8 1986 forward. So -- but the activity would have been
9 taxed, yes.

10 Q Is the amount of CIAC which has not been
11 taxed identified in the MFRs by system?

12 A Not to my knowledge, no.

13 Q Is that information that you might be able to
14 get for us?

15 A No, because we don't -- the tax records are
16 not kept by system. I can tell you how much CIAC had
17 been taxed each year, but we don't keep those records,
18 the tax records, by system.

19 Q Okay. Do you know the systems -- if you
20 don't have it by system, would you know -- well, would
21 you be able to provide us with a late-filed exhibit
22 showing the amount of CIAC which has not been taxed in
23 total, the total amount?

24 A Yes, I could show you the total which has
25 been taxed and which has not been taxed.

1 COMMISSIONER EASLEY: Is there -- before we
2 do that, if you don't keep it by system --

3 WITNESS GANGNON: The tax --

4 COMMISSIONER EASLEY: For tax purposes, you
5 got to have it some place, I would think, on a system
6 basis, or have a way to get there, I would think, or
7 even get to a percentage of the total CIAC based on the
8 system.

9 WITNESS GANGNON: That's what we tried to --
10 attempted to do with allocating it -- the deferred
11 taxes, based on the CIAC activity. And in that
12 activity is by system.

13 COMMISSIONER EASLEY: All right, I understand
14 now.

15 Okay, you want the late-filed to show the
16 total CIAC untaxed?

17 MS. BEDELL: Yes, ma'am.

18 CHAIRMAN BEARD: It will be Late-Filed 37.
19 And Mr. Gangnon you're clear on what's being asked for?

20 WITNESS GANGNON: Yes.

21 (Late-Filed Exhibit No. 37 identified.)

22 Q (By Ms. Bedell) Can you tell me whether the
23 gross-up has been collected for all the CIAC that's on
24 the books?

25 A Not on all of it.

1 Q And can you identify the amount that is not
2 subject to gross-up by system?

3 A Again, I would have -- I can show it total,
4 but not by system.

5 Q Isn't gross-up something that has to be
6 refunded to customers on a pro rata share when it is,
7 in fact, refunded?

8 A Yes.

9 Q So why would you not be able to give us the
10 information on the CIAC gross-up by system?

11 A I guess, I can't personally -- I'd have to
12 talk to Ms. Kimball, who does --

13 Q Is that a question we might ought to direct
14 to Ms. Kimball?

15 A Yes.

16 Q Are you aware that the Company had recently
17 had a gross-up refund?

18 A Yes, I am. We compute the gross numbers for
19 the gross-up, or for the pay back of that, but not, you
20 know, each system amount.

21 Q Okay. (Pause)

22 MS. BEDELL: If the Company won't object to
23 us addressing this question that's related to an issue
24 that Mr. Gangnon is assigned to, we will defer it.

25 MR. HOFFMAN: We don't object.

1 MS. BEDELL: Okay.

2 Q (By Ms. Bedell) Issue 54 addresses the
3 question of whether the portion of benefits related to
4 construction should be removed. Should the Commission
5 approve the accrual method for postretirement benefits?

6 A Yes.

7 Q If the Company is not going to adopt this
8 method until 1993, why should any portion of this pro
9 forma adjustment be added to plant that's built in 1991
10 or before?

11 A It shouldn't be.

12 MS. BEDELL: Okay. Before or during the
13 break, I put the Staff's composite exhibit out for
14 everyone. For those of you all that were at Lehigh,
15 it's probably a very familiar looking document. It
16 contains Mr. Gangnon's deposition, the late-filed
17 exhibits that went with the deposition and the
18 Actuarial Study.

19 Commissioner Easley, if we could have a
20 number for that?

21 COMMISSIONER EASLEY: Composite Exhibit 38.
22 Deposition of Gannon, 9-3-92, with attached
23 late-fileds, and the Actuarial Study of May 29, 1992.

24 MS. BEDELL: Commissioner Easley, I was also
25 informed during the break that that composite exhibit

1 is missing an errata sheet, which, if it's all right
2 with the parties, I'd like it provide on Monday.

3 COMMISSIONER EASLEY: All right.

4 MS. BEDELL: If the parties are willing to
5 stipulate this material into the record that's
6 identified as Exhibit 38, with the errata sheet, we
7 would waive any cross questions on FAS 106.

8 COMMISSIONER EASLEY: Mr. Hoffman?

9 MR. HOFFMAN: We have no objection.

10 COMMISSIONER EASLEY: Mr. McLean?

11 MR. McLEAN: No objection.

12 COMMISSIONER EASLEY: Parties? (Pause) It's
13 in.

14 (Exhibit No. 38 marked for identification.)

15 MS. BEDELL: I believe that concludes what we
16 need to do for Mr. Gangnon.

17 COMMISSIONER EASLEY: Commissioner?

18 COMMISSIONER CLARK: I don't have anything.

19 COMMISSIONER EASLEY: Redirect?

20 MR. HOFFMAN: Yes, ma'am.

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REDIRECT EXAMINATION

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BY MR. HOFFMAN:

Q Mr. Gangnon, earlier on today we stipulated into the record an Exhibit No. 22 which is the deposition of Victoria A. Montanaro, and I've given you a copy of that. Do you have that in front of you?

A Yes, I do.

Q If you would look in the back of that deposition, you will see that there are copies of two articles which have been identified as Deposition Exhibit 1 and Deposition Exhibit 2.

Do you have those in front of you?

A Yes, I do.

Q Have you had an opportunity to review those articles?

A Yes, I have.

Q Could you please give us your comments on those articles?

A Well the first article, which is entitled "Experts Get Tough with Your Retirement Plan," talks about how individuals should do retirement planning because of the fact that some companies may be cutting back on their benefit payments, including OPEBs, and that people should save more to cover their expenses in retirement.

1 The second article talks about cost curbs for
2 retiree health benefits, talking about a survey that a
3 particular consultant took; talk about changes in the
4 cost sharing between the Company and retirees and other
5 methods of reducing postretirement benefit costs. And
6 also it talks, later on, about the fact that apparently
7 41 people kind of stuck their head -- 41% of employers
8 stuck their head in the ground and tried to ignore the
9 issue.

10 Q Well, are there any conclusions that you draw
11 from these articles?

12 A I guess that, as we're all aware, there is a
13 lot of publicity out there about this issue. And,
14 again, I think that the articles reflect what's going
15 on in the real world. And I think that the OPEBs of
16 Southern States have to be addressed in that same
17 realm. They have to be taken as part of a total
18 compensation and benefit package, which is what
19 management and the Medical Plan Board of Governors at
20 Southern States tried to do in looking at this. And
21 those are why the alternatives were addressed in the
22 Actuarial Study.

23 MR. HOFFMAN: May I have a moment,
24 Commissioner?

25 COMMISSIONER EASLEY: Sure. (Pause)

1 Q (By Mr. Hoffman) Mr. Gangnon, would I be
2 correct if I stated that Southern States included the
3 total OPEB expenses and O&M costs in its MFRs?

4 A Yes, they did.

5 Q If a portion is capitalized, as the Company
6 agrees is appropriate, and the Company is not allowed
7 to recover the capitalized portion, in essence, you
8 will not be able to recover the entire OPEB expenses,
9 would it, or will it?

10 COMMISSIONER EASLEY: Or should it or could
11 it? (Laughter)

12 COMMISSIONER CLARK: Well, you've stumped him
13 on that.

14 WITNESS GANGNON: I'm not sure I understood
15 the question.

16 COMMISSIONER CLARK: I'm not sure I did
17 either.

18 Q (Mr. Hoffman) Let me try one more time.

19 If a portion of the OPEB expenses in the MFRs
20 are capitalized, and I think you have already testified
21 that you believe that that's appropriate --

22 A Yes.

23 Q With me so far?

24 A Yes.

25 Q -- and the Company is not allowed to recover

1 that capitalized portion, then the Company will not be
2 able to recover its entire OPEB expenses; follow? Is
3 that correct?

4 A Yes.

5 Q One more question.

6 If the Commission were to determine that the
7 level of OPEBs requested by the Company is reasonable,
8 in your opinion should the Company be able to recover
9 the entire expense, either through O&M or through
10 capitalized expenses, or as capitalized?

11 A As capitalized, yes.

12 Q My question was, if the Commission were to
13 determine that the level requested by Southern States
14 of OPEB expenses is reasonable, in your opinion should
15 the Company be able to recover 100% of that level of
16 expense, either through O&M or as capitalized? (Pause)

17 COMMISSIONER CLARK: Mr. Gangnon, what's
18 giving you trouble, because it seems to me --

19 COMMISSIONER EASLEY: I think you had already
20 answered it, had you not, just exactly the way he asked
21 it?

22 COMMISSIONER CLARK: Whichever we treat it,
23 whether we expense it or capitalized, you think we
24 should retain it?

25 Is that the gist of your question?

1 MR. HOFFMAN: Yes.

2 WITNESS GANGNON: Yes, ma'am.

3 MR. HOFFMAN: Thank you. That's all I have.

4 COMMISSIONER EASLEY: All right.

5 MR. McLEAN: Commissioner, I had asked
6 Mr. Sandbulte a question which he referred to Mr.
7 Gangnon, and it will take two minutes at the outside,
8 probably 30 seconds. Yes? No?

9 COMMISSIONER EASLEY: All right.

10 WITNESS GANGNON: I didn't know he could get
11 here that fast. (Laughter)

12 COMMISSIONER EASLEY: You got that right.

13 RECROSS EXAMINATION

14 BY MR. McLEAN:

15 Q The question concerns Exhibit 26, of which I
16 happen to have a copy.

17 A I think that's one of my late-fileds.

18 Q The question is, will you -- do you know
19 whether Southern States or whoever the acquiring party
20 was -- whoever the selling party was in this case -- do
21 you know whether they were compensated for their total
22 expense of sale outside of the deal which is presented
23 on this page?

24 A I am not -- now, I'm really confused. I
25 don't understand the question. I'm sorry.

1 Q They underwent, Southern States, or the
2 family of companies, apparently incurred some expenses
3 in dealing with this condemnation.

4 A Correct.

5 Q And I see an entry their for total expense of
6 sale, which is 1,400,000 and so forth?

7 A Right.

8 Q But my question is, I thought Mr. Sandbulte
9 referenced some arrangement or something whereby the
10 Company received an additional amount, an additional
11 compensation to compensate it for its costs.

12 A I believe what Mr. Sandbulte was alluding to
13 is that in some cases the condemnation award would be
14 -- would include, as part of the award, the value of
15 the system, plus expenses.

16 Q But so far as you know on this transaction
17 right here, any recovery of expenses is -- which
18 Southern States enjoyed, is reflected on this paper, is
19 that right?

20 A That is correct.

21 MR. McLEAN: Thank you, sir.

22 CHAIRMAN BEARD: Anything else? Witness is
23 excused.

24 (Witness Gangnon excused.)

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1 CHAIRMAN BEARD: Exhibits? Exhibits?

2 MS. BEDELL: Staff would move Exhibit No. 38.

3 CHAIRMAN BEARD: Without objection.

4 Public Counsel?

5 MR. McLEAN: Yes, sir, we had one --

6 CHAIRMAN BEARD: 36?

7 MR. McLEAN: Yes, sir.

8 CHAIRMAN BEARD: Very good. Without
9 objection?

10 (Exhibit Nos. 36 and 38 received into
11 evidence.)

12 CHAIRMAN BEARD: 9:00 Monday morning. Bring
13 your sleeping bags and your "jammies" and your softest
14 pillow. We're liable to be here a while on Monday;
15 make a little progress.

16 Thank you. Have a nice weekend.

17 (Hearing adjourned at 4:40 p.m., to reconvene
18 at 9:00 a.m., Monday, November 9, 1992, at the same
19 location.)

20 (Transcript continues in sequence in Volume V.)

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