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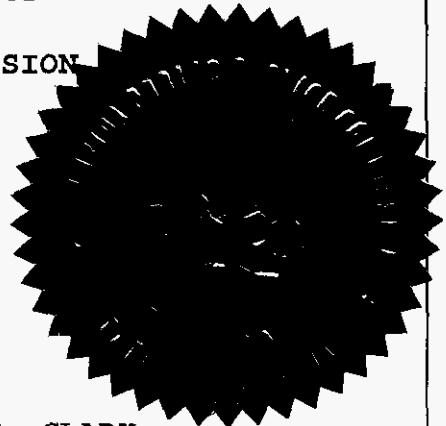
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of : DOCKET NO.
: 950495-WS
Application for a rate increase and :
Increase in service availability charges :
By SOUTHERN STATES UTILITIES, INC., for :
Orange-Osceola Utilities, Inc., in :
Osceola County, and in Bradford, Brevard, :
Charlotte, Citrus, Clay, Collier, Duval, :
Highlands, Lake, Lee, Marion, Martin, :
Nassau, Orange, Osceola, Pasco, Putnam, :
Seminole, St. Johns, St. Lucie, Volusia, :
and Washington Counties. :

SEVENTH DAY - LATE EVENING SESSION

VOLUME 30

Pages 3393 through 3430



PROCEEDINGS: HEARING

BEFORE: CHAIRMAN SUSAN F. CLARK
COMMISSIONER J. TERRY DEASON
COMMISSIONER JULIA L. JOHNSON
COMMISSIONER DIANE K. KIESLING
COMMISSIONER JOE GARCIA

DATE: May 7, 1996

TIME: Commenced at 7:00 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: PEGGY L. OWENS, RMR, RPR

APPEARANCES:

(As heretofore noted.)

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WITNESSES

NAME

PAGE NO.

GREGORY SHAFER

Continued Cross Examination	3396
by Mr. Twomey	
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Redirect Examination by Ms. Capeless	3424

	EXHIBITS		
	NUMBER	ID.	ADMTD.
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3	196		3427
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P R O C E E D I N G S

(Transcript continues from Volume 29.)

GREGORY SHAFER

resumed the stand on behalf of Southern States Utilities, and having been previously duly sworn, testified as follows:

CONTINUED CROSS EXAMINATION

BY MR. TWOMEY:

Q You believe utilities always will do that?

A Well, I believe they always should.

MR. TWOMEY: Madam Chair, I have an exhibit I would like to have identified, please.

CHAIRMAN CLARK: The next number is Exhibit 197.

(Exhibit No. 197 identified.)

MR. TWOMEY: Did you say 197?

CHAIRMAN CLARK: Yes.

MR. TWOMEY: Thank you. I apologize, Madam Chairman. Once again I neglected to mark the page numbers sequentially. These are a list of their collection of pages taken from documents made available by your water and wastewater staff pursuant to subpoena duces tecum to Mr. Hill.

And they are taken from the work papers of your staff who conducted the staff management audit

1 of SSU.

2 MS. CAPELESS: I object to Mr. Twomey
3 asking any questions about this document, Madam
4 Chairman. It is irrelevant and totally beyond the
5 scope of Mr. Shafer's testimony.

6 MR. TWOMEY: Mr. Shafer just suggested that
7 utilities would --

8 CHAIRMAN CLARK: Should.

9 MR. TWOMEY: Should, I think he said
10 initially they will look at the -- irrespective of
11 whether he said will or should -- they will look at
12 the compliance record and the level of improvements
13 necessary to improve a system to make it profitable
14 on an individual basis.

15 And if I'm allowed to ask the questions, I
16 would suggest to you that this document will show
17 that SSU utility in question had a history of failing
18 to do precisely that; and that some of the systems,
19 it is in part why we are dealing with troubled
20 utilities with this system.

21 CHAIRMAN CLARK: Mr. Twomey, I think it is
22 beyond the scope of his testimony. He isn't
23 testifying as to what SSU has done. He is testifying
24 as to his goals and objectives with respect to the
25 rate design in general. He is not providing

1 testimony as to what SSU has done or has not done.

2 MR. TWOMEY: But Madam Chairman, this is an
3 SSU rate case. We are not talking about -- he is not
4 talking in isolation. This is an SSU rate case.

5 CHAIRMAN CLARK: I don't disagree with
6 that, Mr. Twomey, but just because it is an SSU rate
7 case doesn't mean this is the appropriate witness to
8 ask these questions of.

9 MR. TWOMEY: I would like to proffer this
10 exhibit.

11 CHAIRMAN CLARK: Okay.

12 MR. TWOMEY: I will attempt to find another
13 witness that is more appropriate.

14 CHAIRMAN CLARK: Would you give me a title
15 for this whole thing?

16 MR. TWOMEY: Work papers from staff
17 management studies audit of SSU.

18 BY MR. TWOMEY:

19 Q You say finally, Mr. Shafer, it will look
20 at the resulting rate levels after any needed
21 improvements and how those rates relate to existing
22 levels across the utility; correct?

23 A That's correct.

24 Q Shouldn't a utility always do that when it
25 attempts to -- when it is looking to acquire a

1 system?

2 A Let's just say that if I were the owner of
3 a utility that is something I would look at.

4 Q Now, you suggest, I think, on line 13, you
5 say on the other hand if the utility has in place
6 some variation of average rates the ability to cost
7 average may change the utility's decision making
8 equation. A facility that is undesirable on a stand
9 alone basis may be more attractive if costs can be
10 sufficiently diluted company wide to make the
11 addition of the number of customers in question cost
12 effective. That's your statement, correct?

13 A That's correct.

14 Q And by that statement aren't you directly
15 saying, Mr. Shafer, that an undesirable facility, the
16 acquisition of an undesirable facility may become
17 acceptable if you can dilute the undesirable
18 characteristics and costs of that facility across the
19 broader base of customers?

20 A The statement says what it says.

21 Q Isn't that what you said, Mr. Shafer? Yes
22 or no?

23 A Yes, that's what is there.

24 Q Now, are you suggesting to this Commission,
25 Mr. Shafer, that it is a good policy, it is a good

1 procedure for this Commission to adopt that would
2 encourage a utility to acquire undesirable
3 facilities?

4 A I don't believe that I have said that is a
5 good outcome or a bad outcome; simply, a possible
6 outcome given the circumstances identified there.

7 Q Can you give me one circumstance under
8 which a utility, any utility, should be encouraged to
9 acquire undesirable facilities?

10 A I suppose that there are -- can be goals
11 and objectives beyond economic goals and objectives
12 that would lead to that conclusion.

13 Q Do you agree with the notion, Mr. Shafer,
14 there is no free lunch?

15 A Yes, I do.

16 Q Okay. Now, irrespective of whether it is
17 desirable for the Commission to adopt such a policy
18 or not, don't you agree with me that if a utility is
19 encouraged or is allowed to purchase or acquire
20 undesirable facilities and dilute the cost of that
21 acquisition across other systems, that the other
22 systems' customers necessarily have to pay?

23 A I don't know that on a case by case or
24 situation by situation that outcome would be always
25 true, but it is certainly a possibility. If it were

1 to be a common, frequently occurring practice at some
2 point that would be true.

3 Q Okay. I want to go back and finish your
4 discussion. You say at Page 23, line 9, after
5 discussing the microeconomic considerations, that if
6 those rates are at the high end of the utility's
7 current rate continuum, and the potential for
8 positive return on investment is slight, the utility
9 will most likely not make the investment.

10 And my question to you is why would you
11 want -- why would any sane business want to make an
12 acquisition in which the potential for positive
13 return on investment is slight?

14 A It may do so again to achieve goals that
15 are not economic.

16 Q When you "again" your discussion of utility
17 accountability on Page 23, line 20, aren't you
18 listing the way -- don't you believe, Mr. Shafer,
19 that is really the way utilities should be regulated,
20 that they should make acquisition adjustments, I mean
21 acquisition decisions?

22 A I'm sorry.

23 Q Okay, I'm sorry. You say one thing that I
24 have not yet mentioned is utility accountability.
25 The Commission desires the utility to be a prudent

1 and efficient business operation, and pricing
2 decisions may influence the utility's behavior
3 regarding accountability and prudence. All other
4 factors being equal, the Commission would choose a
5 rate structure that forced the utility to make every
6 investment decision and managerial decision the most
7 cost effective one. The most effective way to do
8 that is to force the utility to look at these
9 decisions as they relate to the cost and benefits of
10 the particular service area, rather than on a total
11 company basis where individual investment decisions
12 oftentimes appear immaterial.

13 Aren't you stating that is the, isn't that
14 the rational way for a utility regulatory agency to
15 force its regulated utility to operate?

16 A I think what I'm saying there is that in
17 order to achieve a particular outcome, there is a
18 best way to do that. And in this case the outcome
19 being accountability, the best way to get to
20 accountability would be through, as described there,
21 decisions related to or pricing that more closely
22 relates to individual decisions being made.

23 Q Right. But don't you agree generally that
24 the elements, the factors that go into utility
25 accountability are inconsistent for the most part

1 with rate averaging?

2 A There is a degree of inconsistency there,
3 yes.

4 Q In discussing your alternatives, the option
5 one is the rate structure that is in existence now,
6 right, under interim rates, essentially? You start
7 that discussion on Page 25.

8 A Correct. That is what has been described
9 as a modified stand alone rate structure.

10 Q Okay. And you recognize that on Page 26
11 there is some level of subsidy involved, right? In
12 fact you show that --

13 A That's correct.

14 Q -- that that particular option has
15 currently no more than 6.91 percent of subsidy;
16 right?

17 A For water service areas, that's correct.

18 Q And 16.7 percent for wastewater, right?

19 A Correct.

20 Q Okay. Do you have any view on whether
21 those levels of subsidy are fair or not, given your
22 definition of fairness?

23 A On the face of it, just looking at those
24 percentages without knowing a great amount of detail
25 about all of the particular service areas involved,

1 they seem within reason.

2 Q Okay. The second rate option you described
3 on Page 27 is stand alone rates, right?

4 A That's correct.

5 Q Okay. It still adopts the company's
6 proposal in this case of assigning 40 percent revenue
7 responsibility to the basic facility charge and 60 to
8 the gallonage charge; correct?

9 A That's correct.

10 Q Okay. Now, the option three, the modified
11 stand alone rate structure with minimum involves the
12 notion of making sure that certain customers pay a --
13 have a floor of rates that is a minimum beyond which
14 they cannot go lower, irrespective of what their cost
15 of service is; is that correct?

16 A That's correct.

17 Q Okay. And you seem to suggest that the
18 minimum gallonage charge, you don't suggest it, you
19 state, don't you, at line 13 Page 27, the minimum
20 gallonage charge is a conservation or resource
21 protection measure to prevent the usage component
22 from being priced abnormally low; and thereby,
23 encouraging reckless water usage, is that right?

24 A That's correct.

25 Q What do you mean by "reckless water

1 usage"?

2 A I would say that throwing a garden hose on
3 the top of a mobile home in order to keep it cool in
4 the heat of the summer is reckless water usage.

5 Q Okay. So that is one of the things, that
6 kind of behavior, is one of the things that we are
7 seeking to avoid by rate structure adopted in this
8 case?

9 A That's one of the things that I would be
10 concerned about if I was a decision maker.

11 Q Okay. But if you were a decision maker or
12 in this case advising a decision maker, could you
13 more definitively define "reckless water consumption"
14 either in gallonage usage per month or some other
15 objective standard?

16 A I believe that there are rules of thumb
17 that the Commission has used in the past relating to
18 monthly consumption based on household
19 characteristics of a particular service area.

20 Q Could you name one, Mr. Shafer? Are you
21 familiar with those?

22 A I'm sorry, name one what?

23 Q Yes, sir. Can you describe those objective
24 standards I just asked you about which you said the
25 Commission has used in the past?

1 A In my experience with staff-assisted rate
2 cases, we have typically capped wastewater usage at
3 6,000 gallons.

4 Q Yes, sir, but isn't it true that a 6,000
5 gallon cap for wastewater purposes is to not to
6 prevent reckless water usage, but better to define
7 what percentage or what amount on average of water
8 usage in a system goes to wastewater treatment?

9 A That's correct.

10 Q Okay. Would you agree with me that a 6,000
11 gallon cap for a wastewater rate calculation has
12 nothing to do with reckless water usage?

13 A That is most likely correct.

14 Q And I don't mean to ask this question too
15 often, but I don't think I've got an answer yet. Can
16 you give me any other definition, aside from the
17 water hose on the mobile home roof definition of
18 reckless water usage?

19 A Okay. Frequently in cases we look at the
20 average consumption for a particular service area.
21 And it can vary depending on the characteristics of
22 that service area. A possible definition of reckless
23 would be something that exceeded that average
24 consumption level by some large amount.

25 Q Do you have -- you mean exceeded average

1 consumption by a certain percentage?

2 A I don't have a particular percentage to
3 define that, but I mean it would again kind of depend
4 on the characteristics of the particular service
5 area.

6 Q I see.

7 A I think that, I suppose that reckless usage
8 is in the eye of the beholder. From personal
9 experience, I have a household of four with a
10 relatively large size lot, and my average water
11 consumption is in the neighborhood of 10,000 gallons
12 or less per month. So you know, my definition is
13 something that would exceed that on a regular basis
14 by some significant amount.

15 Q Let me ask you this: You've already agreed
16 with me, have you not, that marginal costs sends the
17 most efficient -- economically efficient -- price
18 signal in terms of consumptive behavior, right?

19 MS. CAPELESS: Objection, that's asked and
20 answered.

21 MR. TWOMEY: I don't think I asked it
22 exactly like that.

23 CHAIRMAN CLARK: I thought you admitted
24 that you had asked it.

25 MR. TWOMEY: Well, maybe I did.

1 BY MR. TWOMEY:

2 Q Given that you did that, Mr. Shafer, are
3 you suggesting to me that a price that was based upon
4 marginal costs could be considered to be abnormally
5 low, as you used that term?

6 A It could be considered to be abnormally low
7 again to the extent that it goes against goals that
8 the Commission may be wanting to achieve that are not
9 economic goals, such as conservation.

10 Q Would by definition those goals, whatever
11 they would be, have to be economically inefficient?

12 A I think there are goals that the Commission
13 may have that are clearly adverse to the best
14 economic solution.

15 Q But if you force -- if you force somebody
16 to pay a minimum gallonage charge that was higher,
17 pardon me, if you forced somebody to pay a minimum
18 gallonage charge for whatever reasons and goals that
19 exceeded the true cost of providing that service,
20 isn't it true that you would be placing in effect an
21 economic inefficiency that would cause them to
22 consume less water than they otherwise would -- than
23 they otherwise would if they were charged the true
24 cost of providing service at a marginal cost?

25 A It would be economically efficient, but you

1 would be achieving another goal.

2 Q What other goal is that?

3 A They would use less than what they would
4 otherwise use.

5 Q Now, isn't the corollary, Mr. Shafer, that
6 if you charged a person more than their cost and they
7 use less, isn't the necessary economic conclusion
8 that if you charge somebody less than their cost they
9 will use more than they otherwise would?

10 A That's certainly a possible result.

11 Q Isn't that a very likely result?

12 A It would be a likely result. It would
13 depend again on price elasticities.

14 Q Right. And doesn't that necessarily have
15 an anti-conservation result?

16 A It could, yes.

17 Q Was that, yes, it could; or it could, yes?

18 A It is late in the day.

19 MR. TWOMEY: That's all I have. Thank you,
20 Mr. Shafer, for your time.

21 CHAIRMAN CLARK: Mr. Feil.

22 MR. FEIL: Thank you, Madam Chairman.

23 **REDIRECT EXAMINATION**

24 BY MR. FEIL:

25 Q Mr. Shafer, if I could refer you to Page 3,

1 line ten of your testimony. I just wanted to request
2 some clarification with regard to your statement
3 there. You say the Commission has always recognized
4 the necessity of providing adequate financial
5 coverage of such standards.

6 My question pertains to the term you use
7 there, "recognized". Did you mean to say that the
8 Commission has observed or that the Commission has
9 taken action to insure the necessity of providing
10 adequate financial coverage?

11 A I believe the Commission has taken the
12 necessary actions to provide that coverage.

13 Q Okay, thank you. Do you believe that a
14 utility must have adequate earnings to comply with
15 regulatory standards?

16 A I don't know that is necessarily true, but
17 it would certainly be more likely.

18 Q All right. Do you believe that if the
19 utility's investment and plant needed to meet
20 regulatory standards is not recovered through rates,
21 then regulatory compliance is at least at risk?

22 A Repeat that, please.

23 Q Sure. Do you believe that if a utility's
24 investment in plant that is needed to meet regulatory
25 standards is not recovered through rates, then

1 regulatory compliance is at risk?

2 A Yes, I believe that is possible.

3 Q Okay. Thank you. If an investment in
4 plant --

5 COMMISSIONER GARCIA: Excuse me. By that
6 you would mean that -- don't you think that argument
7 is inverse? In other words, doesn't that go back on
8 itself, anyway? I mean, if we give them the money
9 they can comply with regulations; if we don't give
10 them the money, they will violate the law or
11 regulations?

12 WITNESS SHAFER: Yeah, I guess that.

13 COMMISSIONER GARCIA: They have an
14 obligation, regardless what this Commission decides,
15 to comply with regulations, do they not?

16 WITNESS SHAFER: That's correct.

17 BY MR. FEIL:

18 Q But if the utility's earnings are
19 insufficient to comply with regulation it makes
20 compliance more difficult; is that correct?

21 A That's very likely, yes.

22 Q Okay. If a utility is required to make an
23 investment in plant by regulations, and the utility
24 cannot build the plant any smaller or any differently
25 than it has in order to meet the regulatory

1 requirements, and the rates are not sufficient for
2 the utility to recover its costs for that compliance,
3 do you again believe that compliance is at risk?

4 A I'm sorry, could you repeat it one more
5 time?

6 Q I will try to do that. If a utility's
7 investment in plant is required by regulations, and
8 the utility cannot build the plant in any smaller
9 size or any differently than it has and still meet
10 the regulatory requirement, and the rates on that
11 investment are not sufficient to allow the utility to
12 earn cost of its investment or recover the cost of
13 its investment, do you believe that regulatory
14 compliance would be at risk?

15 A I believe the financial health of the
16 utility may be at risk, again, as indicated earlier.
17 The utility has the obligation to comply, regardless
18 of the financial resources. And certainly if those
19 financial resources are absent, then the ability of
20 the utility to comply comes into question.

21 Q Okay. Let me ask this, then: Do you
22 believe that at least the minimum amount of
23 investment for the utility to comply with regulations
24 should be recovered through rates?

25 A I goes I would be more comfortable with

1 specific situations; but in general, I would agree
2 that is a possible outcome.

3 Q Okay. Thank you. Do you believe that the
4 decisions of the Commission influence a utility
5 company's decision to build plant?

6 A (No response.)

7 Q Would you like me to repeat the question?

8 A Yes, the first part.

9 Q Do you believe that the decisions of the
10 Commission, Florida Commission, influence the utility
11 company's decision to build plant?

12 A I certainly believe that the Commission's
13 decisions can influence the utility's decisions.

14 Q And you believe that the PSC should
15 encourage utilities through their decisions to build
16 plant in the most economic fashion?

17 A To the extent that they can do that without
18 sacrificing other objectives that they may wish to
19 achieve, then I believe that would be appropriate,
20 yes.

21 Q Mr. Twomey asked you a number of questions
22 regarding marginal costs and unit costs. I don't
23 want to rehash all of that ground, but I would like
24 to ask one question directly; and you alluded this,
25 but I don't think you made this statement.

1 Do you believe that it is economically
2 efficient to conserve water in terms of reducing the
3 long-term costs of treating and providing water?

4 A If by conserving you can reduce the long-
5 term costs, then certainly your pricing outcome may
6 reflect that.

7 Q As a general proposition wouldn't you
8 consider a utility that is consistently losing money
9 to be a troubled utility?

10 A I guess my definition of a troubled utility
11 is one that causes me trouble. And you know, a prime
12 example of that -- I don't mean to be facetious --
13 but a prime example of that is a recent situation
14 where we had a utility who had not paid their power
15 bill, and we began getting phone calls shortly after
16 lunch on a Friday afternoon.

17 Clearly, this is a troubled utility. And
18 it goes well beyond whether or not the utility is
19 earning a fair rate of return. And these are the
20 kinds of catastrophic events that face small
21 utilities routinely.

22 Yes, I'm sure that the fact that their
23 earnings are suppressed leads directly to these
24 problems, but I believe that you can have an earning
25 short fall in the short run without necessarily

1 created a troubled utility.

2 COMMISSIONER GARCIA: But from your
3 experience that wouldn't be the case in Southern
4 States, correct? You rarely have the case on
5 Southern States own utilities where you are in fear
6 that they are going to close down or let the power be
7 cut off?

8 WITNESS SHAFER: I can only presume that to be
9 true because typically the complaints from Southern
10 States would not come through my office; but in general,
11 yes, I would agree with that characterization.

12 COMMISSIONER GARCIA: That would also mean
13 that because Southern States Utilities don't have those
14 problems, as you define problems, that it would be good
15 for you for Southern States to own utilities? In your
16 definition of problem.

17 WITNESS SHAFER: I suppose in the context of
18 this conversation, yes, it would be good.

19 COMMISSIONER GARCIA: I think it is a chit in
20 Southern States' behalf that from a regulatory
21 perspective Southern States small utilities give us less
22 of a problem than the Class C utilities usually do?

23 WITNESS SHAFER: Yeah, I think in general that
24 is true.

25 COMMISSIONER GARCIA: This case wouldn't be a

1 good example.

2 WITNESS SHAFER: I was just thinking about the
3 customer service hearings.

4 COMMISSIONER GARCIA: Right.

5 CHAIRMAN CLARK: Mr. Shafer, while he is
6 interrupted, Mr. Twomey asked you some questions that I
7 just would like some clarification on. There can be
8 instances where a small utility is one that is having
9 difficulty meeting its bills and having difficulty
10 operating on its own. But if you combine it with other
11 systems it will no longer have difficulties, but it will
12 neither be subsidized by them, too.

13 Let me give you a specific example. I'm
14 thinking, I may be wrong, you should probably clarify it
15 for me, it seems to me Jacksonville Suburban acquired
16 one such facility where that particular facility was
17 being to have to put in another well. It was in a
18 coastal region. If they had put in the other well it
19 would have created significant financial impact on those
20 customers. But by combining them, you had a win-win
21 situation, because there was extra capacity in one of
22 the acquiring facilities, and they were able to
23 eliminate a capital investment. I will admit -- I
24 believe they were adjacent areas, were they not?

25 A I'm not familiar with the specifics, but it

1 sounds to me like it could have been an
2 interconnection situation; and certainly, yes, under
3 those circumstances that would be a win-win
4 situation.

5 CHAIRMAN CLARK: Mr. Twomey, I will let you
6 go back and follow up on that.

7 MR. TWOMEY: Okay, I just want to ask you a
8 question really.

9 CHAIRMAN CLARK: Yes. That would be --

10 MR. FEIL: Objection.

11 MR. TWOMEY: I don't mean to be rude by
12 this, but doesn't what you just stated in terms of
13 the facts you remember necessarily mean that they
14 were interconnected if they avoided the, I mean, is
15 that what you remember?

16 CHAIRMAN CLARK: That they could be inter-
17 connected.

18 MR. TWOMEY: No, if they, by joining
19 together they avoided the necessity for drilling a
20 new well?

21 CHAIRMAN CLARK: Not that it is testimony,
22 but I would concede I think that was the relevant
23 issue with that case.

24 MR. TWOMEY: I was just curious. Thank
25 you.

1 BY MR. FEIL:

2 Q Mr. Shafer, in response to a question Mr.
3 Twomey asked you, you said that when costs are
4 imposed on a utility, the costs are in turn imposed
5 on the customers. Do you recall that?

6 A Yes.

7 Q On Page 11, beginning at line 22 of your
8 testimony, you refer to other agencies involved with
9 environmental compliance and speculate that they may
10 be less concerned about rate levels.

11 Are you aware of whether or not other
12 agencies are required to look at costs before they
13 implement regulations? Specifically, I'm referring
14 to DEP, HRS, water management districts.

15 A I'm not aware of any requirements that they
16 have in that regard.

17 Q The Commission is required to look at costs
18 prior to implementing rules, though, is it not?

19 A I don't know if it is required, but it
20 certainly does as part of economic regulation.

21 Q Okay, thank you. You have testified in
22 response to some of the questions that Mr. Twomey has
23 asked you regarding price elasticity. Would you
24 agree that price elasticity is a concept that is
25 applied and should be applied in utility rate

1 making?

2 A I think application of price elasticity has
3 its place in utility regulation. It has always been
4 an area that has been difficult to quantify and
5 identify with any degree of confidence.

6 Q Generally speaking, would you agree that
7 elasticity concept suggests, for example, on one side
8 of the spectrum that if rates go up consumption
9 generally will go down?

10 A I think to be more correct, elasticity
11 would be the degree to which consumption would be
12 effected by changes in price.

13 Q Were you listening this morning when
14 Mr. Hansen was testifying and stated that customers
15 in his area have reduced consumption as a result of
16 past rate increases?

17 A I will accept that. I don't recall that
18 specifically.

19 Q Would you agree that if the Commission
20 increases rates without examining elasticity and
21 adjusting consumption for elasticity the resulting
22 rates would be noncompensatory?

23 A I would agree there is a danger that that
24 may be true.

25 Q Let me ask another question on another

1 subject matter. Regardless of rate structure, isn't
2 it correct the PSC will review the prudence of
3 investments that a utility makes?

4 A Say that again, please.

5 Q Regardless of the rate structure that a
6 utility has, the PSC will review the prudence of the
7 investments that the utility makes.

8 A It makes every effort to do that, yes.

9 Q Do you believe that the standard of
10 prudence should vary from one water utility -- let me
11 restate that. Do you believe that the standard of
12 prudence should vary from one water utility to the
13 next water utility or that should be a uniform
14 standard of prudence?

15 A I guess I'm not really sure what you mean
16 by uniform standard of prudence.

17 Q Well, do you believe that one utility
18 should be held to a higher standard of prudence?

19 A No.

20 MR. FEIL: Thank you. I have nothing
21 further.

22 CHAIRMAN CLARK: Commissioners. Redirect.

23 COMMISSIONER DEASON: I have a question.

24 Mr. Shafer, on Page 30 of your testimony, at the
25 bottom of that page, lines 23 and 24, you are talking

1 about the option one. You indicate that it gives no
2 consideration to revenue stability.

3 I was wondering if you could just elaborate
4 some on that. Why do you think that particular
5 structure gives no consideration to revenue
6 stability?

7 WITNESS SHAFER: That would be the modified
8 stand alone. I guess when I conceive of revenue
9 stability, I am thinking in terms of the allocation
10 between the base facility charge and the gallonage
11 charge, and also whether or not there would be any kind
12 of minimum consumption charge.

13 And since that rate structure is kind of a
14 status quo, I guess what I was trying to say is it gives
15 no additional consideration to revenue stability beyond
16 what the status quo is.

17 COMMISSIONER DEASON: Would it be more
18 accurate to say it gives no additional consideration?

19 WITNESS SHAFER: Yeah, yes.

20 COMMISSIONER DEASON: Because it is a base
21 facility charge with a gallonage charge structure.

22 WITNESS SHAFER: Correct. To the extent you
23 have a base facility charge there is going to be a more
24 stable component of the rate structure. So in that
25 sense any rate structure that has base facility and

1 gallonage charge construct has a degree of revenue
2 stability.

3 I guess the statement in regard to that
4 particular rate structure was that since that is what is
5 in place that proposal would not change that in any
6 way.

7 COMMISSIONER DEASON: Is it your opinion that
8 a uniform rate structure has more rate stability than a
9 modified stand alone rate structure, or does it depend
10 upon the relationship between the base facility charge
11 and the gallonage charge as percentage of revenue
12 derived from each component?

13 WITNESS SHAFER: That's correct. You know, to
14 the extent that going from the status quo to a uniform
15 rate structure that would have a higher level of
16 revenues allocated to base facility, then you would have
17 a more revenue stable rate structure.

18 COMMISSIONER DEASON: So it is really a
19 question of the allocation between base facility and
20 gallonage charge, as opposed to whether it is uniform or
21 stand alone?

22 THE WITNESS: Primarily yes. And then again,
23 also, whether the usage component has a minimum.

24 COMMISSIONER DEASON: Okay. Thank you.

25 MR. FEIL: Can I ask one follow-up question to

1 that?

2 CHAIRMAN CLARK: Yes.

3 BY MR. FEIL:

4 Q So you are saying uniform rates has no role
5 in revenue stability, Mr. Shafer?

6 A What I'm saying is that the degree to which
7 it has a role in revenue stability would depend
8 largely on whether there is any kind of change in the
9 allocation between, of the revenue requirement,
10 between the base facility and gallonage charge.

11 Q Well, if the allocation was the same
12 percentage-wise, modified stand alone rates to
13 uniform, which would have the greater revenue
14 stability, uniform rates or modified stand alone
15 rates?

16 A That would be difficult for me to say
17 without some quantitative analysis.

18 Q Would you agree that a uniform rate would
19 provide more rate stability as opposed to revenue
20 stability?

21 A Can you tell me the difference, please?

22 Q That the rates themselves would be less
23 subject to wide variation in terms of percentage?

24 A That would be true between service
25 territories.

1 Q Could you explain your answer, true between
2 service territories? I don't understand.

3 A Well, I guess I don't understand the
4 question, but, you know, I'm saying rate variation --

5 Q I didn't mean between service territories.
6 My question is regarding rate stability.

7 MR. TWOMEY: I object, Madam Chairman.
8 This is a little bit beyond the scope of what
9 Commissioner Deason was inquiring on. It seems to be
10 reopening a new area of cross examination.

11 MR. FEIL: I will leave it at that.

12 CHAIRMAN CLARK: Redirect.

13 MS. CAPELESS: Thank you.

14 **REDIRECT EXAMINATION**

15 BY MS. CAPELESS:

16 Q Mr. Shafer, which agency has the primary
17 responsibility for setting rates which are just, fair
18 and reasonable?

19 A The Public Service Commission.

20 Q If rates are set which are just, fair and
21 reasonable, do you believe that in some cases
22 abandonments may be avoided?

23 A That's likely, yes.

24 Q Is that the role the Commission plays in
25 preventing abandonment?

1 A Yes.

2 Q Is an efficient way to protect the health,
3 safety, and welfare of the citizens of Florida with
4 regard to water issues for the environmental and
5 economic agencies to work in concert on those water
6 issues?

7 A I believe that to be true.

8 Q Are you familiar with the memorandums of
9 understanding the Commission has with the DEP and the
10 five water management districts?

11 A I'm aware of them.

12 Q Is this the primary reason that these
13 memorandums of understanding were entered into?

14 A Yes, that the agencies would attempt to
15 work in concert.

16 Q Thank you. Does the viability of a utility
17 in the sense of being a healthy financial viable
18 system, financially viable system, benefit the
19 customers as a whole?

20 A Yes.

21 Q What effect can an unstable revenue stream
22 have on the quality of service that a utility
23 provides its customers?

24 A To the extent that the unstable revenue
25 stream affects the ability, the utility's ability to

1 secure financing in a negative way, that could
2 ultimately lead to quality of service problems.

3 Q Mr. Shafer, can you recall any Class C
4 utilities which have uniform rates?

5 A I cannot think of any Class C utilities
6 that are comprised of more than one service area that
7 have uniform rates at this time.

8 Q Okay. How about with respect to Class A
9 utilities in Florida, are you aware of any other than
10 SSU that has a form of uniform rates?

11 A Not that I'm aware of.

12 Q Are you familiar with Jacksonville Suburban
13 or what used to be called Jax Suburban is now United
14 Water Florida?

15 A Yes.

16 Q Do you know what kind of rate structure
17 they have?

18 A No, I sure don't.

19 Q Okay. Commissioner Deason asked you about
20 revenue stability under option one. Could the
21 resulting disparity in rates such as high gallonage
22 rates result in revenue instability?

23 A Yes, to the extent that the customers
24 altered their consumption.

25 Q Since the time you've prepared testimony in

1 this case have you discussed the issues of this case
2 with other staff members?

3 A No.

4 Q Have you attended any meetings on this
5 case?

6 A No.

7 MS. CAPELESS: Thank you. That's all I
8 have.

9 CHAIRMAN CLARK: Exhibits.

10 MS. CAPELESS: Staff moves --

11 COMMISSIONER GARCIA: Real quick.

12 CHAIRMAN CLARK: No, you've missed your
13 chance.

14 COMMISSIONER GARCIA: Mr. Shafer -- call
15 that vote any moment now. Mr. Shafer I wanted to ask
16 you, in your experience with this company has SSU
17 ever abandoned a facility that it has taken over?

18 THE WITNESS: I'm not aware that they've done
19 that.

20 COMMISSIONER GARCIA: Thank you.

21 CHAIRMAN CLARK: From now on when that person
22 calls up and says that the power is going to be cut off
23 you can have them call Commissioner Garcia. Go ahead.

24 MS. CAPELESS: Staff moves Exhibit 196.

25 CHAIRMAN CLARK: 196 will be entered in the

1 record without objection.

2 (Exhibit No. 196 admitted.)

3 CHAIRMAN CLARK: I don't think we can take up
4 Mr. Williams at this time.

5 (Discussion off the record.)

6 CHAIRMAN CLARK: I think we are all getting a
7 little tired.

8 MR. HOFFMAN: Madam Chairman, before we
9 conclude if I could I think we have a stipulation
10 concerning Mr. Vierima's rebuttal testimony and his
11 exhibits. We will put the Commissioners on notice.

12 CHAIRMAN CLARK: Great. That's good. We will
13 start tomorrow at 9:00 a.m. With Mr. Williams.

14 MR. FEIL: Just so we are clear on the order
15 of witnesses after Mr. Williams, we will continue on
16 with the regular order of witnesses, starting with
17 Mr. Harvey and then the other subpoenaed witnesses
18 listed on Page 11.

19 CHAIRMAN CLARK: Mr. Twomey, when are we going
20 to take up Judge Mann?

21 MR. TWOMEY: He will be here -- he is driving
22 up tomorrow morning. He will be here mid-morning.

23 CHAIRMAN CLARK: Okay. Then what we will do
24 is we will take up Mr. Williams. Mr. Carter is next for
25 you.

1 MR. TWOMEY: We won't have Mr. Carter.

2 CHAIRMAN CLARK: Then we will go through
3 Mr. Williams, and then we will move to Mr. Harvey.

4 MR. FEIL: Yes, ma'am.

5 CHAIRMAN CLARK: We will continue on with
6 SSU's rebuttal witness until we are ready to take up
7 Judge Mann. Okay.

8 MR. TWOMEY: Thank you.

9 MR. FEIL: Thank you.

10 CHAIRMAN CLARK: Would it be more appropriate
11 to have a time certain for him like after lunch?

12 MR. TWOMEY: I expect it probably would,
13 Chairman Clark.

14 CHAIRMAN CLARK: Why don't you let me know
15 tomorrow if we need to do anything specific.

16 MR. TWOMEY: I will. Thank you.

17 CHAIRMAN CLARK: The hearing is adjourned
18 until 9:00 a.m. tomorrow morning.

19 (Thereupon, the hearing adjourned at 7:50 p.m.
20 to reconvene May 8, 1996 at 9:00 a.m.)

21 - - - - -

22 (Transcript continues in sequence in Volume
23 31.)

24

25

DOCKET 950495-WS
EXHIBIT NO. 197
CASE NO. 96-04227

10.(H) SSU Should Implement A Cost Comparison Program So That The Actual Costs Incurred For Each System Acquired Would Be Compared To the Original Anticipated Costs.

Company Response:

Company AGREES with this recommendation.

"Cost comparison will be conducted on all new acquisitions. This cost comparison will, however, at times be several years after the acquisition as many known capital improvement expenditures are not projected to be necessary until 2-3 years after acquiring a system."

FLORIDA PUBLIC SERVICE COMMISSION
DOCKET
NO. 950495 EXHIBIT NO. 197
COMPANY/
WITNESS:
DATE: 4/23/96

11.(H) SSU Should Implement A Written Procedure Which Formalizes Existing Check Lists And Sets Forth Specific Instructions For System Acquisitions.

Company Response:

Company DISAGREES with this recommendation for the following reasons:

"Due diligence and contract check lists which define information needed to make acquisition decisions are in place. Specific review activities and responsibilities are assigned by functional area, and all findings consolidated and documented centrally. Acquisition responsibilities are centralized with SSU President and Vice-President, and procedures "manual" format is not appropriate."

197

The Process By Which Newly Acquired Systems Are Evaluated Leaves The Company At Risk For Costly Undiscovered Defects.

During the evaluation of a system for potential acquisition, Southern States must look carefully for hidden defects which need to be considered in the offering price. A defect may manifest itself as a problem with the facilities, a need for plant expansion, an inaccurate estimate of rate base, a contingent liability, or other such difficulty. In earlier years, more of the systems acquired were in poor operating condition and more likely to contain a hidden defect. However, as recently as 1985, SSU acquired a group of systems that produced several hidden defects which were substantial. Consequently, an unanticipated expenditure of several hundred thousand dollars was required to correct the defects. This situation must be avoided in future acquisitions.

While the Company has improved its general procedures for the acquisition process, including the development of "check lists," and accounting and engineering audits for major acquisitions, they still lack a formal program for comparing the actual costs incurred with the costs anticipated at the time of purchase. Such a cost analysis program will highlight weaknesses in the process and thereby protect the Company and ratepayers.

Each public utility is obligated to carefully evaluate a potential acquisition to assure that it will not be a detriment to the existing ratepayers. Similarly, the acquired customers should benefit from being purchased, often by receiving improved or more reliable service. Finally, the utility as an investor, must avoid making an imprudent investment which might be disallowed for ratemaking purposes.

At the same time, management must also avoid spending a disproportionate amount of effort or funds while reviewing and auditing a potential purchase. Having made the acquisition, there must be an after the fact measurement of whether all is proceeding as planned. That should always include a comparison of the actual cost incurred for a facility versus the anticipated costs. This assists management in refining the acquisition process.

10.(H) SSU Should Implement A Cost Comparison Program So That The Actual Costs Incurred For Each System Acquired Would Be Compared To The Original Anticipated Costs.

This will provide a formal comparison of management actions versus their plans.

11.(H) SSU Should Implement A Written Procedure Which Formalizes Existing Check Lists And Sets Forth Specific Instructions For System Acquisitions.

The existing check lists require that the users possess an extensive knowledge of each step itemized, whereas the proposed written procedures should assume that the users have a very limited knowledge. It is also essential that some provision be made to ensure that the procedures are periodically updated to reflect the lessons learned from each new acquisition.

12.(M) SSU Should Have The Parent Company Perform An Operational Audit Of All System Acquisition Procedures.

This will assist management to identify specific areas for further improvement.

Company Name SSU

Item No. 1

Auditor's Initials _____

FIELD

W/P Ref. _____

(1) ISSUE (Is there a point of discussion, debate, or dispute?)

Quality of pre-purchase estimates of improvements

Duplicates # 9

This issue s/B rolled in w/ other acq. issues

NO FINDING

(2) CONDITION (What is happening?)

Frequently encounter "surprises" once they get into systems.

(3) STANDARD/CRITERIA (How is it supposed to work?)

(4) EFFECT (What has happened or could happen due to variance between (2) & (3)?)

(5) CAUSE (Why has a variation occurred?)

Old systems have poor or non-existent plans.

(6) RECOMMENDATION (What steps will correct the problem?)

Ask Parent Corp to perform operational audit of SSU procedures.
Begin maintaining a record of actual - v. - projected costs for upgrading

NOTES:

REFERENCES:

		No.	Page No.			No.	Page No.				
Interview	<input checked="" type="checkbox"/>	Document	<input type="checkbox"/>	<u>5</u>	<u>4</u>	Interview	<input type="checkbox"/>	Document	<input type="checkbox"/>	<u>24</u>	<u>3</u>
Interview	<input checked="" type="checkbox"/>	Document	<input type="checkbox"/>	<u>5</u>	<u>5</u>	Interview	<input type="checkbox"/>	Document	<input type="checkbox"/>	_____	_____
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Interview	<input checked="" type="checkbox"/>	Document	<input type="checkbox"/>	<u>31</u>	<u>7</u>	Interview	<input type="checkbox"/>	Document	<input type="checkbox"/>	_____	_____

(If required, use attachments keyed to numbers 1 thru 6.)

RECOMMENDATION No. _____ (Final Report)
CHAPTER No. _____

Poor Condition of Systems Acquired

5-4 5-4

Corder - New acquisitions; most in bad shape. No records or manuals. Have to guess.

Acquisition problems: Not told of budget to upgrade.

He doesn't look at plants before purchase. Method of determining flows are based on pumps + time clocks. Inadequate. Often field staff is told SSU cannot afford their request.

6-5

Aaron - Acquisition Problems:

Sometimes get "surprises" when they purchase systems; older plants, especially non-DEP plants, have very poor, if any plans.

24-3

Boyd - Previous acquisitions have been in "disasterous" condition. He feels they are not buying the bad ones anymore. He checks potential acquisitions in his area + gives his suggestions to Donnie Crandell. Donnie follows through on plans to upgrade systems, once acquired.

31-7

Aaron (attached)

Aaron
Acquisitions

Q. Quality of problem estimates?
Physical items usually quite viable: know costs of these items.

DER requirements?
Aaron gets records of inspections & letters to DER

Aaron admitted SSU has bought "a few" dogs (not more than 5-6). Reason low price, procedure not filed.
Industrial utilities is worse; maybe bought because of low price. No other significant ones. More than \$100,000 (a very "significant" amount) has been spent on it.

COVER SHEET

FOR

SOUTHERN STATES UTILITIES, INC.

NAME: Chas Sweat

DATE OF INTERVIEW: 10/30/87

TITLE: Chief Executive Officer

DATE OF WRITE-UP: 10/30/87

LOCATION: Apopka

SUMMARY OF THE INTERVIEW: (In 25 words or less.)

Explanation of the acquisition "surprises"
SSU has made.

INTERVIEW DETAILS: (Notes expanded to narrative format.)

Q. I understand that there have been quite a few systems acquired in very poor condition, with a few bad surprises. Can you tell me about them?

A. Keystone was in poor condition but we were aware of major problems. Actually we have had to spend fewer \$'s fixing up than we projected. Probably \$100,000 less. We have spent our orig. fix-up \$'s, but more will be spent. We appeared before the Commission a few weeks ago + it looks like cust. will receive a refund of some of \$ put in escrow. He believes Commission panel (Bunter + Wilson) were pleased w/ SSU fix-up. Above the ground there were no surprises at Keystone. But below the ground some lines were even smaller than anticipated. To do some of orig. intent, we would have to bore pipe under major highway. We have come up with less expensive approach; building a new plant.

By DAK

COVER SHEET

FOR

SOUTHERN STATES UTILITIES, INC.

NAME: Tom Kravitz

DATE OF INTERVIEW: 11/2/87

TITLE: Vice Chairman of Board

DATE OF WRITE-UP: 11/2/87

LOCATION: Miami Office

SUMMARY OF THE INTERVIEW: (In 25 words or less.)

Discussed system acquisition "surprises" (hidden defects)

+ how to avoid them.

INTERVIEW DETAILS: (Notes expanded to narrative format.)

Q. *Clas. Sweat has explained to me some the "surprises" in systems acquired. What are some of the most worrisome surprises?*

A. *C I A C "skeletons in closet" (hidden problems w/ developer contracts) Underground defects. Rate base accuracy.*

Q. *Do you write many escape clauses into the contracts? Do you have an "arsenal" of clauses to use?*

A. *Some; not much. It depends on the situation we face. We always insert that the PSC must approve transfer.*

Q. *Do you have written check lists to be sure you have covered everything before you sign the contract?*

A. *Yes*

Q. How can you avoid future surprises?

A. We have a Magnolia Valley acquisition pending now + we found out PSC is doing a CIAC audit.

We don't want any surprises that adversely impact our cost. But we have to be careful. There is always the potential for having underground surprises; maybe even leadpipes; just to mention a hypothetical. We always try to touch base with DER + PSC.

A. Zephyr Shores

Here we had a surprise, in that rate base was not what their numbers indicated. We relied on their numbers. It is just not earning the ROR on a rate base of some \$80-100,000. PSC made a disallowance.

Operationally it won't be a prob. if we expand.

Q. How many surprises have there been? 15?

A. There are probably 15 that, w/ hindsight, I wish we hadn't bot. But it is in the range of 5 to 15 depending on what you call a surprise. Probably 5 were surprises in the true sense.

Industrial Utilities (Marion Co.)

This was a surprise. South 40 STP gave us some surprises. We were receiving some bad effluent. There was an ice cream factory + other commercial. But we were not able to figure out who was sending the problem effluent. It cost us \$10,000 for an eng. study to narrow it down to the plating comp. We have sent them the bill; + hope they pay it.

There we probably ^{had} some add'l \$15,000 of surprises plus a plant expansion of \$60-70,000. We should be able to collect about \$40-50,000 of C.I.R.S. from developers + the balance will be our investment. Surprized at plant cost.

Salt Springs (Marion Co.)

We were surprised at the cost of land for effluent disposal.

Citrus Park (Marion Co)

We bot 20 acres adjacent to plant for \$350,000 for a 100,000 GPD STP + \$100,000 for a lift sta. site. We only spent \$400,000 for all the ^{Marion Co.} utilities in the first place.

So we had a \$500,000 surprize in Marion County.

We entered into a ^{DER} consent agreement 2 days after purchase.

COVER SHEETFORSOUTHERN STATES UTILITIES, INC.

NAME: Donnie Crandell DATE OF INTERVIEW: 11/2/87
 TITLE: Vice Pres. Development DATE OF WRITE-UP: 11/2/87
 LOCATION: Apogee Office

SUMMARY OF THE INTERVIEW: (In 25 words or less.)

*Discussed system acquisition "surprises" (hidden defects)
 + how to avoid them.*

INTERVIEW DETAILS: (Notes expanded to narrative format.)

Q I have discussed w/ Chas. Sweat + T. Kravitz "acquisition" surprises. -
 What are some of the most worrisome?

A. I am mostly concerned about the financial end of it. Making
 sure we have accurate info on rate base + CIAC. At Amelia
 Island they expensed some items that S/H/B capitalized.
 Engineering improvement cost estimating is very difficult.

We now are performing "due diligence audits" especially on some
 of larger deals. We've spent about \$ 1/4 million w/ auditors
 + engineers on Deltona. Since Minn. Power + he have been
 involved there haven't been any "surprises" to speak of.

Q. What about the use of escape clauses or contingencies?

A. We've made good use of that aspect, especially in larger
 transactions. Sometimes we require the seller to

continue to operate it til the regulatory agency grants approval. Then we have a right of final inspection.

Sometimes we take the assets "as is".

Something new we have been doing for 6 or 7 months is to give seller a down payment at time of closing + then hold back the balance until rate base is proven + approved by the regulatory agency.

Q Do you have a written check list.

A: Yes, we have extensive check offs to follow. Be glad to get you a copy if needed.

By DAK

COVER SHEET

FOR

SOUTHERN STATES UTILITIES, INC.

NAME: Aaron Polchowick

DATE OF INTERVIEW: 11/2/87

TITLE: General Manager

DATE OF WRITE-UP: 11/2/87

LOCATION: Apogee

SUMMARY OF THE INTERVIEW: (In 25 words or less.)

Discusser's system acquisition "surprises" (hidden defects) + how to avoid them

INTERVIEW DETAILS: (Notes expanded to narrative format.)

Q: Chas Sweet has explained some of the "surprises" in systems acquired. What are some of the most worrisome?

A: Most problems are obvious. But you are concerned about the condition of the various equipment. While it may appear to be operating well, it may have hidden defects.

Also, be sure to obtain the analysis of the well water. If they do not have test results, we have it analyzed.

Q/A Yes he has a check list for operational concerns. He will give to Judy Kimball to send to me.