

971663-WS

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

FLORIDA CITIES WATER COMPANY  
WATER & WASTEWATER OPERATIONS  
Docket No. 97 \_\_\_\_ -WS  
TESTIMONY OF MICHAEL MURPHY

Q. Please state your name and business address.  
A. Michael E. Murphy, 4837 Swift Road, P.O. Box 21597,  
Suite 100, Sarasota, Florida 34231.  
Q. By whom are you employed and in what capacity?  
A. I am employed by Florida Cities Water Company (FCWC or  
the Company) as Vice President and Chief Financial  
Officer.  
Q. How long have you served in that capacity?  
A. Since May, 1994.  
Q. Would you describe your education and business  
background?  
A. My resume is attached as Exhibit \_\_\_\_ (MM-1).  
Q. Have you previously testified before the Commission?  
A. Yes. In Barefoot Bay Docket 951258-WS.  
Q. What is the purpose of your testimony?  
A. The purpose of my testimony is to present certain of  
the legal expenses incurred by FCWC related to the  
charges brought by the U. S. Environmental Protection  
Agency (EPA) (the charges) and the litigation filed by  
the U.S. Department of Justice (DOJ) (the litigation)  
against FCWC, the method of recovery of those legal

Note:  
exhibits marked  
as Exh. 11 at 8/98  
hearing

1 expenses that FCWC proposes to use, the rate case  
2 expenses associated with this proceeding and the  
3 surcharges FCWC proposes to collect from its  
4 customers. Also, I will sponsor the following  
5 exhibits filed in this proceeding on behalf of FCWC:  
6 FLORIDA CITIES WATER COMPANY, LEGAL EXPENSES, Exhibit  
7 \_\_\_\_\_(MM-2) "Legal Expenses Schedule",  
8 FLORIDA CITIES WATER COMPANY, RECOVERY OF LEGAL  
9 EXPENSES, RATE CASE EXPENSE RECOVERY SCHEDULE, Exhibit  
10 \_\_\_\_\_(MM-3) "Rate Case Expense Schedule" and  
11 FLORIDA CITIES WATER COMPANY, RECOVERY OF LEGAL  
12 EXPENSES & RATE CASE EXPENSES, PROPOSED SURCHARGE  
13 RATES & REVENUES SCHEDULE, Exhibit \_\_\_\_\_(MM-4) "Rate  
14 Schedule".

15 **LEGAL EXPENSES**

16 Q. Why has FCWC filed this application for recovery of  
17 legal expenses and proposed water and wastewater  
18 surcharge rates?

19 A. The necessity for filing this application for recovery  
20 of legal expenses and proposed surcharge rates arises  
21 from the fact that FCWC incurred \$3,826,210 of legal  
22 expenses related to the charges and the litigation  
23 filed against FCWC. The chronology and details of  
24 the charges and litigation are presented by Mr. Gerald  
25 Allen and Mr. Gary Baise.

1 Q. What is the purpose of the Legal Expenses Schedule,  
2 Exhibit \_\_\_\_\_ (MM-2)?

3 A. The Legal Expenses Schedule summarizes and categorizes  
4 the legal expenses related to the above referenced  
5 charges and litigation.

6 Q. What time periods are presented on the Legal Expenses  
7 Schedule?

8 A. The Legal Expenses Schedule reflects costs incurred  
9 from 1991 through the conclusion of the litigation.

10 Q. Did FCWC pay these legal expenses?

11 A. Yes.

12 Q. How were these legal expenses recorded on the books of  
13 FCWC during the period 1991 through 1997?

14 A. The legal expenses incurred have been expensed "below  
15 the line".

16 Q. Of the total legal expenses of \$3,826,210 how much is  
17 FCWC seeking to recover through a surcharge from all  
18 its customers regardless of rate jurisdiction?

19 A. As covered by Mr. Allen in his testimony, FCWC is  
20 seeking to recover \$3,589,368 from all rate  
21 jurisdictions.

22 Q. Of the net legal expenses of \$3,589,368 how much is  
23 FCWC seeking to recover from its customers in the  
24 Florida Public Service Commission (PSC) rate  
25 jurisdictions, North Ft. Myers Wastewater, South Ft.

1 Myers Wastewater, Ft. Myers Water and Barefoot Bay  
2 Water and Wastewater?

3 A. FCWC is seeking to recover \$2,265,833 from the PSC  
4 jurisdiction, namely those customers in Lee and  
5 Brevard Counties.

6 **Financial Effect of Requested Penalties on FCWC**

7 Q. Were the financial penalties requested by DOJ  
8 financially significant to FCWC?

9 A. Yes. In fact the penalty amounts claimed by the DOJ  
10 were of such a financial magnitude that FCWC clearly  
11 would not have been able to pay such amounts if the  
12 court had found FCWC liable, therefore, the financial  
13 integrity of the Company was in jeopardy.

14 Q. Why do you feel the financial integrity of the  
15 Company was in jeopardy?

16 A. The financial penalties requested by the DOJ were so  
17 substantial that FCWC would not have been able to fund  
18 the claims and would have probably been forced into  
19 bankruptcy.

20 Q. Isn't it presumptuous to think that the DOJ would have  
21 wanted to put the Company out of business?

22 A. Not necessarily, the DOJ's financial witness testified  
23 that the Company was financially capable of paying a  
24 fine of \$7,500,000. The only way for the Company to  
25 fund a penalty of that magnitude would be to borrow

1 funds. However, based on my experience, I do not  
2 believe the Company's lenders, banks and insurance  
3 companies, are interested in financing non-cash flow  
4 activities. They require that debt investment  
5 generate cash flow for repayment. They do not lend  
6 upon expenses which do not generate revenues.  
7 Likewise equity capital (like the Company's  
8 shareholders) are not inclined to invest for the  
9 payment of expenses with no potential repayment.

10 Q. Since the Complaint, as amended, and penalty as sought  
11 therein were ultimately directed towards only three of  
12 FCWC's systems, why does FCWC propose that the legal  
13 expenses be allocated to all FCWC customers?

14 A. As indicated above, the penalties requested by the DOJ  
15 were of such magnitude that payment of the penalties  
16 would have been extremely difficult, if not impossible  
17 and all FCWC systems, water and wastewater, would have  
18 been adversely and materially effected.

19 Q. Please clarify how all FCWC systems would have been  
20 adversely affected?

21 A. These DOJ proposed financial penalties represented a  
22 possible financial calamity to FCWC. Although the  
23 allegations in the Complaint were local in nature, the  
24 financial effects would have been system wide. The  
25 initial investigation and Complaint was only directed

1           towards the North Ft. Myers Wastewater system.  
2           However, the penalty sought of \$34 million would of  
3           necessity had to be borne by FCWC not just that one  
4           system. At the time of the original Complaint the  
5           North Ft. Myers Wastewater system had annual operating  
6           revenues of \$1,464,917 and operating income of  
7           \$313,430. This system could not financially support  
8           a significant penalty. Although the charges might  
9           have been localized, the financial impacts to FCWC  
10          were not.

11   Q.    Is FCWC seeking recovery of the legal expenses from  
12          all its customers, both water and wastewater,  
13          regardless of the FCWC system providing service.

14   A.    Yes.

15   Q.    Why is FCWC seeking recovery from all its customers?

16   A.    At one time or another all of FCWC's wastewater  
17          systems were under investigation by the DOJ and  
18          consequently legal expenses were sustained by all.  
19          Ultimately only three wastewater systems were targeted  
20          in the amended Complaint and penalties sought.  
21          However the claims made by the DOJ were so substantial  
22          as compared to the size of the systems that the  
23          financial integrity of FCWC was in jeopardy. At the  
24          time of the amended Complaint the annual operating  
25          revenues and operating incomes of those systems

1            totaled \$3,284,921 and \$596,408, respectively. It is  
2            recognized that there is a close relationship between  
3            the level of service provided to customers and a  
4            company's financial health. The future viability of  
5            the entire Company, including its water systems, was  
6            at stake. All customers were in peril of being  
7            adversely impacted by the litigation. Because of  
8            this, FCWC proposes that all FCWC customers, water and  
9            wastewater, share in the expenses incurred by FCWC in  
10           defending the allegations of the DOJ and litigation,  
11           using some rational method that is simply applied.

12           **RATE CASE EXPENSES**

13    Q.    What is the purpose of the Rate Case Expense Schedule,  
14           Exhibit \_\_\_\_\_ (MM-3)?

15    A.    The Rate Case Expense Schedule shows an estimated  
16           amount for certain expenses that will be incurred  
17           during this proceeding (rate case expenses).

18    Q.    Is FCWC seeking the recovery of rate case expenses  
19           incurred in this proceeding?

20    A.    Yes. However, the actual amount of rate case expense  
21           will not be known until the conclusion of this  
22           proceeding. FCWC requests that it be allowed to file  
23           a schedule of the actual appropriate expenses incurred  
24           plus an estimate to complete this rate proceeding  
25           immediately prior to hearing.

1           **SURCHARGE RATES**

2    Q.    What is the purpose of the Rate Schedule, Exhibit  
3           \_\_\_\_\_ (MM-4)?

4    A.    The Rate Schedule develops the proposed surcharge  
5           rates that would generate the revenue required to  
6           recover the legal expenses discussed earlier (the  
7           Surcharge).

8    Q.    What time period was used in the preparation of the  
9           Rate Schedule?

10   A.    The Rate Schedule is based upon active customers as of  
11           September 30, 1997

12       **Allocation Method**

13   Q.    Please describe the allocation method utilized on the  
14           Rate Schedule.

15   A.    While the number of customers provides the general  
16           basis for allocation, FCWC believes that meter size  
17           needs to be considered in the allocation. Using meter  
18           size as a factor reflects the fact that a customer  
19           receiving service from a 1 inch meter places a  
20           greater demand on the system than a customer receiving  
21           service from a 5/8 inch meter. FCWC's current rate  
22           structure for water and wastewater service recovers  
23           fixed costs through a fixed monthly base facility  
24           charge for each meter size weighted by an AWWA 5/8  
25           inch meter equivalent factors. It is logical to

1 recover the fixed costs in this proceeding in a  
2 similar method. Therefore, FCWC applied the AWWA  
3 meter weighting factors to the number of customers in  
4 each class and in each meter size category. This  
5 resulted in the number of weighted customers, which  
6 becomes the denominator in the surcharge calculation  
7 that will be discussed later in this testimony. We  
8 have attempted to arrive at the lowest common  
9 denominator for cost allocation. A 5/8 inch meter is  
10 that lowest common denominator. From there we can  
11 equate single family residential customers with multi-  
12 family or commercial customers. For example using the  
13 AWWA meter weighting factors, a customer that has a 1  
14 inch meter is equivalent to 2 and 1/2 customers that  
15 have a 5/8 inch meter. This logic is easily seen in  
16 the fact that a multifamily unit typically has a  
17 larger service meter which is required to serve more  
18 than one residential dwelling.

19 Q. How does an allocation method based upon a water meter  
20 size relate to a wastewater customer?

21 A. A standard wastewater rate making practice is to  
22 equate a wastewater customer to a water meter size  
23 and/or water consumption. Since wastewater flows are  
24 not typically metered at the collection site (ie. the  
25 customer's home or business) it is reasonable to

1 allocate to wastewater customers based upon the water  
2 meter size. Like a water customer, a wastewater  
3 customer with a larger water meter will typically  
4 generate larger wastewater flows. Therefore using the  
5 AWWA factors are appropriate.

6 **Recovery Period**

7 Q. What cost recovery period was chosen for this  
8 proposal?

9 A. The recovery period that was chosen and used in the  
10 Rate Schedule is ten years.

11 Q. Why was a period of ten years chosen?

12 A. The ten year cost recovery period was selected because  
13 it is not overly burdensome to the ratepayers and  
14 also allows the utility to recover the costs over a  
15 reasonable period. The ten year cost recovery period  
16 is also discussed by Mr. John McClellan in his  
17 testimony.

18 Q. Over what period of time should the rate case expenses  
19 be recovered?

20 A. In order to be consistent with the ten year  
21 amortization period of the surcharge rate, a ten year  
22 amortization period for the recovery of rate case  
23 expenses would be reasonable and less confusing for  
24 all parties; FCWC, the PSC, and most importantly  
25 FCWC's customers.

1 Q. Do you have any other comments regarding the ten year  
2 recovery period?

3 A. Yes. Based on the current number of customers, the  
4 costs of including rate case expenses, will be  
5 recovered in ten years as presented on the Rate  
6 Schedule. However, since customer growth will be a  
7 factor, although not currently known, the Surcharge  
8 would be accumulated and then discontinued by FCWC  
9 once the costs have been recovered.

10 **Rate Schedule**

11 Q. Please describe the Rate Schedule, Exhibit \_\_\_(MM-4).

12 A. Page 1, rows 1-8, summarizes the additional revenue  
13 requested by category: Legal Expenses, Rate Case  
14 Expenses, and Total; and calculates the respective  
15 surcharge rates. In addition, page 1 of the Rate  
16 Schedule summarizes the number of customers and  
17 weighted customers (as previously discussed based on  
18 AWWA 5/8 inch meter equivalent weighting factors) from  
19 each of FCWC's PSC and non PSC jurisdictional  
20 divisions and operations. While this proceeding  
21 pertains to the PSC jurisdictions and related  
22 requested revenues, legal expenses will be allocated  
23 to all FCWC customers in the same consistent manner.  
24 It is necessary to segregate total FCWC customers  
25 into customers under PSC and Non-PSC jurisdictions

1 so that the legal expenses can be properly allocated  
2 to the PSC and non-PSC jurisdictional customers.  
3 Page 2 calculates the requested Surcharge by meter  
4 size as discussed later.

5 Q. How were PSC jurisdictional customers allocated legal  
6 expenses?

7 A. PSC jurisdictional customers were allocated 63.13% of  
8 total legal expenses based upon the ratio of weighted  
9 customers in the PSC jurisdictions to the total FCWC  
10 weighted customers (49,443/78,324).

11 Q. How was the monthly Surcharge rate of \$0.42 (\$0.382  
12 legal expenses and \$0.034 rate case expense recovery  
13 for a 5/8 inch meter ) calculated as shown on page 1,  
14 row 10?

15 A. These rates were calculated by dividing the requested  
16 monthly recovery of legal expenses and rate case  
17 expenses by FCWC's PSC total weighted customers as  
18 follows: [legal,  $\$18,882/49,443 = \$0.382$ ] + [rate  
19 case,  $\$1,667/49,443 = \$0.034$ ] = \$0.42 [rounded].

20 Q. Are Non-PSC jurisdictional customers being allocated  
21 a similar amount of legal expenses?

22 A. Yes. Non-PSC jurisdictional customers will receive  
23 the same monthly surcharge of \$0.38. Added to this  
24 amount will be the cost of the rate case in each  
25 separate non-PSC jurisdiction.

1 Q. How were the remaining Surcharge rates, based on total  
2 costs, determined for the other meter sizes?

3 A. The remaining Surcharge rates were determined by  
4 applying the AWWA meter weighting factors as shown on  
5 page 2 . These are the same meter equivalent factors  
6 used in the PSC annual report and represent the demand  
7 flows that can pass through a given meter size  
8 compared to a 5/8 inch meter. For example, the 1 inch  
9 meter surcharge rate was determined by multiplying the  
10 5/8 inch meter surcharge rate times 2.5 ( $\$0.42 \times 2.5$   
11  $= \$1.05$ . FCWC has utilized these AWWA factors in all  
12 of its recent rate case applications and the PSC has  
13 utilized these same factors in all of their Final Rate  
14 Orders to FCWC.

15 **Typical Surcharge Rates**

16 Q. What would the monthly Surcharge be for a typical  
17 residential water or wastewater customer under the  
18 proposed Surcharge rate structure?

19 A. Given the fixed amount to be recovered over a ten year  
20 period, a typical residential customer would be  
21 charged \$0.42 monthly for each water or wastewater  
22 service. In other words, if a customer has water and  
23 wastewater service, they would be charged a total of  
24 \$0.84 per month for up to ten years.

25 Q. How does this compare to a current typical residential

1 bill (5/8 inch meter) in Barefoot Bay and Ft. Myers?

2 A. As follows:

3		Barefoot	South	North
4		<u>Bay</u>	<u>Ft Myers</u>	<u>Ft Myers</u>
5	Typical Water and			
6	Wastewater Bill:	\$51.69	\$48.48	\$74.55
7	Proposed Surcharge			
8	Water and Wastewater:	<u>\$ 0.84</u>	<u>\$ 0.84</u>	<u>\$ 0.84</u>
9	Proposed Water and			
10	Wastewater Bill			
11	with Surcharge:	<u>\$52.53</u>	<u>\$49.32</u>	<u>\$75.39</u>

12 **Regulatory Assessment Fees**

13 Q. Has the Company considered the Florida Public Service  
14 Commission (the Commission) regulatory assessment fee  
15 in the calculation of the Surcharge?

16 A. No. The Surcharge does not include a gross-up for the  
17 Commission's 4.5% regulatory assessment fee.

18 Q. Why?

19 A. The Company does not know if the Commission will  
20 consider the Surcharge subject to its fee. If the  
21 Commission does consider the surcharge subject to its  
22 fee, then the Surcharge as calculated must be  
23 increased by the 4.5% regulatory assessment fee.

24 **Accounting Treatment**

25 Q. What accounting treatment is FCWC requesting from the

1 Commission regarding the recovery of legal expenses?

2 A. The legal expenses were expensed "below the line",  
3 meaning that the expenses were not included in  
4 operating income, so it is important that no matter  
5 what accounting treatment is allowed by the Commission  
6 that the recovery of the Surcharge relating to the  
7 legal expenses not affect net operating income.

8 Q. Do you have a recommended accounting treatment ?

9 A. Yes. We recommend that the total legal expenses to be  
10 recovered be recorded as a regulatory asset and  
11 included in Rate Base. This regulatory asset would  
12 then be amortized over a ten year period. As the  
13 Surcharge is collected it would be recorded as a  
14 revenue which would be off-set by the amortization of  
15 the regulatory asset. Only the unamortized regulatory  
16 asset would remain in rate base.

17 Q. Do you have anything further to add regarding your  
18 testimony?

19 A. Yes. This testimony supports Exhibit \_\_\_\_ (MM-2),  
20 Exhibit \_\_\_\_ (MM-3), and Exhibit \_\_\_\_ (MM-4) as filed  
21 in this case. However, my testimony may be modified  
22 at the hearing so as to address or be consistent with  
23 any stipulations, testimony, or other changed  
24 circumstances occurring prior to the hearing.

25 Q. Does that conclude your testimony?

1 A. Yes, it does.