

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

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of:

DOCKET NO. 20200139-WS

APPLICATION FOR INCREASE IN
WATER AND WASTEWATER RATES IN
CHARLOTTE, HIGHLANDS, LAKE, LEE,
MARION, ORANGE, PASCO, PINELLAS,
POLK, AND SEMINOLE COUNTIES, BY
UTILITIES, INC. OF FLORIDA.

_____ /

VOLUME 2
PAGES 170 - 433

PROCEEDINGS: HEARING

COMMISSIONERS
PARTICIPATING: CHAIRMAN GARY F. CLARK
COMMISSIONER ART GRAHAM
COMMISSIONER JULIE I. BROWN
COMMISSIONER ANDREW GILES FAY
COMMISSIONER MIKE LA ROSA

DATE: Tuesday, February 2, 2021

TIME: Commenced: 10:45 a.m.
Concluded: 4:58 p.m.

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

REPORTED BY: DEBRA R. KRICK
Court Reporter

APPEARANCES: (As heretofore noted.)

PREMIER REPORTING
114 W. 5TH AVENUE
TALLAHASSEE, FLORIDA
(850) 894-0828

| | | |
|----|---------------------------------------|------|
| 1 | I N D E X | |
| 2 | WITNESSES | |
| 3 | NAME : | PAGE |
| 4 | PATRICK C. FLYNN | |
| 5 | Prefiled Direct Testimony inserted | 175 |
| | Examination continued by Ms. Pirrello | 192 |
| 6 | Further Examination by Mr. Friedman | 208 |
| 7 | DEBORAH D. SWAIN | |
| 8 | Examination by Mr. Friedman | 211 |
| | Prefiled Direct Testimony inserted | 214 |
| 9 | Examination by Ms. Morse | 220 |
| | Examination by Mr. Trierweiler | 245 |
| 10 | | |
| | ANDREA C. CRANE | |
| 11 | | |
| | Examination by Ms. Morse | 251 |
| 12 | Prefiled Direct Testimony inserted | 256 |
| | Examination by Mr. Friedman | 308 |
| 13 | Examination by Mr. Trierweiler | 332 |
| 14 | DAVID J. GARRETT | |
| 15 | Prefiled Direct Testimony inserted | 348 |
| 16 | | |
| 17 | | |
| 18 | | |
| 19 | | |
| 20 | | |
| 21 | | |
| 22 | | |
| 23 | | |
| 24 | | |
| 25 | | |

| 1 | EXHIBITS | | |
|----|----------|---|-------------|
| 2 | NUMBER: | | ID ADMITTED |
| 3 | 189 | OPC Cross Exhibit 28 - UIF's Response to OPC's POD No. 40 | 210 |
| 4 | | | |
| 5 | 190 | OPC Cross Exhibit 14 - UIF's Response to OPC's Interrogatory No. 49 | 243 244 |
| 6 | | | |
| 7 | | | |
| 8 | | | |
| 9 | | | |
| 10 | | | |
| 11 | | | |
| 12 | | | |
| 13 | | | |
| 14 | | | |
| 15 | | | |
| 16 | | | |
| 17 | | | |
| 18 | | | |
| 19 | | | |
| 20 | | | |
| 21 | | | |
| 22 | | | |
| 23 | | | |
| 24 | | | |
| 25 | | | |

1 PROCEEDINGS

2 (Transcript follows in sequence from
3 Volume 1.)

4 CHAIRMAN CLARK: I believe we've got everybody
5 on the line, I assume my court reporter is here,
6 and I believe we left off OPC questioning Mr.
7 Flynn, OPC, you are still up.

8 Thank you, Debbie.

9 MR. FRIEDMAN: Could I ask a question before
10 we get started, please?

11 CHAIRMAN CLARK: Yes.

12 MR. FRIEDMAN: I am not sure -- I'm not sure
13 whether I moved Mr. Flynn's prefiled testimony into
14 the record, and if I did not, I would like to ask
15 that I do so, if somebody is keeping score there.

16 CHAIRMAN CLARK: Mr. Friedman, I actually
17 think I mentioned that to staff a minute ago. I
18 said, I think I may have missed one earlier, that
19 must have been it, so yes, we will move his
20 prefiled testimony into the record.

21 MR. FRIEDMAN: Thank you.

22 Whereupon,

23 PATRICK C. FLYNN

24 was recalled as a witness, having been previously duly
25 sworn to speak the truth, the whole truth, and nothing

1 but the truth, was examined and testified as follows:

2 (Whereupon, prefiled direct testimony of

3 Patrick C. Flynn was inserted.)

4

5

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for an increase in water and
wastewater rates in Charlotte, Highlands, Lake,
Lee, Marion, Orange, Pasco, Pinellas, Polk,
and Seminole Counties by Utilities, Inc. of Florida

Docket No. 20200139-WS

DIRECT TESTIMONY

OF

PATRICK C. FLYNN

on behalf of

Utilities, Inc. of Florida

1 **Q. Please state your, name profession and address.**

2 A. My name is Patrick C. Flynn. I am Vice-President of Utilities, Inc. of Florida. My business
3 address is 200 Weathersfield Ave., Altamonte Springs, Florida, 32714.

4 **Q. State briefly your educational background and experience.**

5 A. I am a 1978 graduate of the University of Virginia with a Bachelor of Arts degree in
6 Environmental Science. All told, I have over 41 years of experience in the water,
7 wastewater and reclaimed water industry. During that time, I have held various managerial
8 and executive positions with increasing levels of responsibility including all aspects of
9 facility operations, personnel management, capital and operating budget preparation and
10 execution, fleet administration, rate case support, and interface with multiple regulatory
11 bodies and their staffs. In 2012, I was appointed by Governor Scott to serve on the Study
12 Committee on Investor-Owned Water and Wastewater Utility Systems. I have been a
13 licensed water and/or wastewater treatment operator in the states of South Carolina,
14 Florida, Louisiana, and Maryland.

15 **Q. Have you previously appeared and presented testimony before any regulatory
16 bodies?**

17 A. Yes, I have presented testimony in multiple rate setting dockets in Florida and South
18 Carolina.

19 **Q. On whose behalf are you presenting this testimony?**

20 A. I am presenting this testimony and appearing on behalf of Utilities, Inc. of Florida (UIF),
21 which is the applicant for a rate increase in the present docket.

22 **Q. What is the purpose of your direct testimony?**

23 A. The purpose of my direct testimony is to present information supporting the additional
24 engineering information required by Commission Rule 25-30.440, its proposed program to
25 replace aging infrastructure, and the many proforma capital projects including in the filing.

1 **Q. Has UIF developed a plan for replacement of aging infrastructure?**

2 A. Yes, it is well known that aging water and wastewater infrastructure is a problem throughout
3 Florida and the nation. Over the past ten-years UIF has invested more than \$90 million in
4 Florida's water and wastewater systems to better serve our customers in a safe reliable
5 manner. These investments have not only led to improved service to our customers but have
6 provided jobs and economic growth in our service territories. Water is essential
7 infrastructure to every residential and business customer. In fact, without the provision of
8 dependable water service, businesses would fail. Additionally, UIF employs approximately
9 100 people within the State of Florida. Further, it is estimated that the number of reported
10 water main breaks across the country is more than 240,000 per year. There are undoubtedly
11 many more that are not reported. There are many examples of chronic water main failures
12 in systems across Florida including most recently in Miami, Ft. Lauderdale, and Sarasota.
13 The direct cost of these leaks nationwide adds up to \$2.6 billion per year. Also, the total cost
14 to the economy is not limited to the cost of the lost water. Beyond households, all economic
15 activities, from hospitals and schools to factories and farms, depend on reliable access to safe
16 water. In addition, the capital outlay needed to replace or repair failed infrastructure leads to
17 job creation and thereby positively impacts the local and state economy.

18 **Q. Can you describe UIF's water and wastewater systems?**

19 A. The UIF customer base is comprised of 22 water systems supporting more than 36,000
20 customers in eight counties and 18 wastewater systems serving more than 33,000 wastewater
21 connections spread over nine counties. Systems vary in size from as little as 43 customers
22 in a water-only system to as many as 20,000 customers in a large water and sewer system.
23 Water systems may contain simple single- or multi-well production facilities with wellhead
24 treatment and hydro-pneumatic tanks for pressure regulation. Others may contain ground

1 storage tanks with high service pumps and additional treatment technology in addition to
2 water production assets. Three water systems are distribution networks only with water
3 supplied by a third party. Seven wastewater systems rely on a third party to provide treatment
4 and disposal. Eleven of the systems include wastewater treatment plants and disposal systems
5 that vary by capacity, complexity, age of assets and effluent disposal methods. Much of the
6 original underground infrastructure dates from the 1960s, 1970s and 1980's. UIF has invested
7 heavily over time to replace significant quantities of its linear assets, including complete
8 replacement of distribution networks in 11 systems and partial replacements in five others.

9 **Q. How has the organizational structure of UIF changed in the last few years?**

10 A. UIF formerly consisted of 12 separate operating companies with 16 different rate structures
11 that were consolidated into a single entity under Utilities, Inc. of Florida on January 1, 2016.
12 Subsequently, a consolidated rate structure and tariff were established in Docket 20160101-
13 WS that established uniform water and wastewater rates that became effective in September
14 2017.

15 **Q. What has UIF done to enhance customer service in the last few years?**

16 A. UIF has taken several steps to improve the customer experience in the past two years. First,
17 we added a Director of External Affairs to our organization who has enhanced our
18 community engagement efforts and elevated our dialogue with our customers as well as all
19 other stakeholders. Additionally, we began interacting with customers on several social
20 media platforms including Facebook, Twitter and Google. Social media offers the means to
21 inform customers of helpful information and provide timely notice of service interruptions
22 using the communications methods that many customers prefer. This also offers an
23 opportunity to answer customer questions in an informal and welcoming manner. In 2019

1 UIF, in concert with the other Corix Group of Companies, rolled out our MyUtilityConnect
2 customer engagement portal and mobile app to allow customers easier access to usage,
3 billing, payment, conservation tips and service interruption information. The
4 MyUtilityConnect platform was designed to offer convenience and control to our customers
5 to access and update their account data anytime, anywhere and on any device, all while
6 keeping things simple and user-friendly. After one year, UIF has had an adoption rate of
7 nearly 50% of the customer base. UIF intends to continue improving the customer experience
8 within MyUtilityConnect by creating opportunities for more seamless transactions including
9 setting up payment arrangements and turning on and off service within our service areas.

10 **Q. How has UIF planned for the replacement of assets that have exceeded or are**
11 **approaching the end of their service lives?**

12 A. UIF directed Kimley-Horn and Associates (K-H) to develop an initial five-year capital
13 improvement plan for water distribution and wastewater collection/transmission system
14 assets. The purpose of the plan is to identify infrastructure replacement projects that need to
15 be accomplished during the next five years. This document will guide UIF in its capital
16 expenditure decision making process that will address its objective of continuously
17 improving the condition of its infrastructure and thereby provide a durable and reliable level
18 of service to its customers. Development of the 5-year plan included an analysis of UIF's
19 existing water and wastewater infrastructure that identified assets that are approaching the
20 end of their service life. UIF's asset management plan offers the means to prioritize the
21 timely replacement of critical infrastructure, primarily linear assets, but vertical assets as
22 well. The results of the analysis were used to produce a detailed five-year replacement
23 schedule with an estimated cost of each project. The 5-year schedule is intended to guide

1 capital project investments for water and wastewater infrastructure. The five-year plan was
2 developed through risk analysis of infrastructure combined with UIF staff input. Risk
3 analysis was based on probability of failure, which is the likelihood of an asset to fail, and
4 consequence of failure, which is the magnitude of the potential consequences. A 5-year
5 Capital Improvement Plan (CIP) schedule was developed to meet anticipated infrastructure
6 needs for UIF's systems based on this assessment. The 5-year project costs are shown in
7 2019 dollars. A detailed breakdown and figure for each project is included in the report from
8 K-H attached as Exhibit PCF-46.

9 **Q. Are you sponsoring any other exhibits?**

10 A. Yes, I am sponsoring multiple exhibits. For each of Exhibits PCF-1 through PCF-45, I have
11 provided a brief description of the project scope, the justification for the project, the placed-
12 in-service date for those projects that have been completed, the planned completion date
13 for those projects that are ongoing, and the total project expenditure. I have attached
14 supporting documentation to each exhibit in those instances where the documentation is
15 currently available.

16 **Q. Were you responsible for preparing MFR Volume III which consists of the additional
17 engineering information required by Commission Rule 25-30.440?**

18 A. Yes. That information was compiled by me or by my staff under my direct supervision and
19 control.

20 **Q. Can you provide a description of each proforma capital project?**

21 A. Yes, the following information describes the scope of each project, its estimated cost, the
22 actual or estimated placed in service date, and the exhibits associated with each one.

23 **PCF-1 Cypress Lakes I&I Investigation:** Jet clean and video inspect approximately

24 18,000 LF of 8" PVC gravity sewer main and manholes in zones 1 and 2 of the Cypress

1 Lakes collection system to locate and evaluate pipe deficiencies and to remove
2 accumulated solids deposited in manhole and pipe inverts - \$50,000 including tipping
3 fees of \$7,500. The solids will be disposed of at the county landfill. This project is
4 scheduled to be completed by September 30, 2020. The project's cost will be deferred
5 and amortized over 10 years.

6 **PCF-2 Eagle Ridge LS 3 & 8 Rehabilitation:** Remove and replace corroded guide rails,
7 bottom ells, pipe and fittings, then coat the wet well walls at two lift stations to protect the
8 concrete from further degradation - \$81,890. The check valves, isolation valves and
9 associated piping will be relocated to above ground to facilitate access to them. The two
10 valve vaults have no drain port and thus hold rain and groundwater. The project is slated
11 to be completed by September 30, 2020.

12 **PCF-3 Eagle Ridge SCADA RTU Installation:** Install remote telemetry units and
13 associated hardware and software at 13 lift stations and at the Eagle Ridge and Cross Creek
14 WWTP's. The project will interface with the existing Florida SCADA network and IT
15 infrastructure to offer real time operational data during both normal and abnormal
16 conditions and thereby reduce the risk of sanitary sewer overflows, surcharged gravity
17 mains, and property damage caused by wastewater backups - \$229,000. The project was
18 initiated at the urging of FDEP following the experiences gained from Hurricane Irma in
19 2017. The project is scheduled to be completed by July 1, 2020.

20 **PCF-4 Eagle Ridge Eng. Site Improvements:** Engineering services in support of the
21 replacement of the perimeter fence and gates, removal of invasive species and installation
22 of native landscaping materials in conformance with Lee County's land use ordinances.
23 Services include providing CEI during construction and coordination with Lee County staff
24 and the Eagle Ridge HOA - \$130,000. This project will be completed by July 1, 2020.

25 **PCF-5 Eagle Ridge Site Improvements:** Obtain setback variance for the previously

1 constructed EQ tank; removal of all invasive trees and shrubs from the plant site;
2 installation of a 9-foot high decorative fence on three sides and 8' chain link fence on the
3 west side of the perimeter to replace the 1984 fence material; replace two access gates on
4 the north and west sides; add landscaping buffer on all four sides; and add a drip irrigation
5 system. The project is designed to meet Lee County's land development ordinance
6 specifications and reflects input from the Eagle Ridge community - \$657,000. The project
7 is scheduled to be completed by June 30, 2020.

8 **PCF-6 Labrador WWTP Master Plan:** Develop master plan for the removal and
9 replacement of the three treatment trains, digestors, filter clear well, chlorine contact tank
10 and process blowers that are nearing the end of their service life - \$41,000. The project is
11 scheduled to be completed by August 31, 2020.

12 **PCF-7 Longwood SCADA RTU Installation:** Install remote telemetry units at 13 lift
13 stations in the Longwood collection system and interface with the existing Florida SCADA
14 network and equipment - \$122,024. This project was completed in January 2020.

15 **PCF-8 LUSI Engineering of Crescent Bay Raw Water Main:** Design, permitting and
16 construction of a raw water main connecting the existing Crescent Bay well with the CR
17 561 WTP to maximize the use of an underutilized well to meet peak water demand driven
18 by growth - \$70,000. This capital project is scheduled to be completed by October 31, 2020
19 or when construction of the raw water main is completed.

20 **PCF-9 LUSI Crescent Bay Raw Water Main:** Construction of an 8" raw water main
21 connecting Crescent Bay well with the CR 561 WTP. The project includes directional
22 drilling 1,000 LF under a body of water and 4,000 LF of pipe installation through the
23 Crescent West and Lake Crescent Hills neighborhoods to connect to an existing 18" raw
24 water main - \$486,514. This project is to be completed by October 31, 2020.

25 **PCF-10 LUSI Lake Groves Sulfuric Acid Storage Tank Replacement:** Replace existing

1 sulfuric tank and associated piping with corrosion and UV resistant materials that can
2 withstand a concentration of 93% sulfuric acid that is used in the treatment of groundwater
3 produced by Well 3- \$54,303. This project was completed in April 2020.

4 **PCF-11 LUSI Hydrochloric Acid Storage Tank Relocation:** Relocate a 1,000-gallon acid
5 storage tank and spill containment vessel to the exterior of the Lake Groves chemical
6 storage building to prevent rapid corrosion of metal components and equipment inside the
7 building - \$29,992. This project was completed in March 2020.

8 **PCF-12 LUSI Lake Groves RAS Pump Replacement:** Replace two Wilo dry pit RAS
9 pumps on north and south train that have reached the end of their service life with 2.3 Hp
10 Flygt pumps - \$43,000. The installation of the replacement pumps is scheduled to be done
11 by March 31, 2021.

12 **PCF-13 LUSI Barrington WWTP Improvements:** Install a plant lift station, emergency
13 generator, automatic transfer switch, EQ pumps and controls, 200 square foot field office
14 and process control lab following the acquisition of the facilities in 2019. The project
15 components address items not included in the original plant design that are needed to meet
16 operating permit requirements and to provide the means to dispose of the treated effluent
17 during power outages - \$47,000 in engineering services plus \$333,000 in construction costs
18 for a total of \$380,000. This project is planned to be completed by December 2020.

19 **PCF-14 Mid-County Master Lift Station:** Provide a preliminary design report (PDR)
20 reflecting a comprehensive evaluation of the treatment facilities. Provide engineering
21 design, permitting, bidding services and construction monitoring services regarding the
22 replacement of the master lift station including the wet well, pumps, piping, controls and
23 gravity sewer main on the plant site. This includes the construction of the master lift station,
24 gravity sewer mains, force main and appurtenances, then decommissioning and demolition
25 of the original lift station - \$1,766,115. The project is scheduled to be completed by

1 December 31, 2020. The project reflects the recommendations and conclusions of a
2 Preliminary Design Report (PDR) mandated by the Florida Department of Environmental
3 Protection (DEP) that identified imminent failure of the arched wall wet well at the existing
4 master station. Additionally, the pumping capacity is insufficient during wet weather in
5 keeping the inlet pipes from becoming surcharged resulting in solids deposition that
6 reduces the hydraulic capacity of the mains.

7 **PCF-15 Mid-County Generators at LS 4 and LS 7:** Provide emergency power at two
8 critical lift stations to prevent sanitary sewer overflows caused by a loss of normal power
9 - \$145,000. The project scope includes placement of generators, automatic transfer
10 switches, subbase fuel storage tanks and electrical components. A non-exclusive utility
11 easement was obtained from Pinellas County in which to place the generator at LS 7. This
12 project is projected to be completed by August 1, 2020.

13 **PCF-16 Mid-County Curlew Creek I&I Remediation:** Video inspect 6,500 LF of gravity
14 sewer main and manholes in select areas; replace a section of gravity sewer main off
15 Pepperwood Dr. that had collapsed; install permanent sheeting around two manholes
16 adjacent to a stormwater canal to prevent structural failure of the manholes; line 6,500 LF
17 of clay pipe with Cured-in-Place Pipe (CIPP) materials in various locations to reduce points
18 of entry of groundwater and runoff; rehabilitate 36 manholes; install fiberglass liners in
19 three manholes; and install top hat liners in 30 laterals - \$634,302. This is one of multiple
20 capital projects designed to locate and stifle the impact of excess infiltration on the
21 collection and treatment facilities. This project is scheduled to be completed by October
22 31, 2020.

23 **PCF-17 Mid-County Headworks:** Replace a static screen, dewatering screw, and metal
24 platform that are badly corroded and at end of their service life. Installed will be a 3mm
25 center flow screen; screenings compactor; grit removal equipment, and control panel sized

1 to meet peak influent flow characteristics - \$3,046,000. This project is scheduled to be
2 completed by March 31, 2021. The new equipment will be installed on the west side of the
3 South Plant in coordination with the new master lift station construction and with the
4 planned upgrade of the treatment process to Membrane Bioreactor (MBR) technology in
5 2022.

6 **PCF-18 Mid-County Lift Station #10 FM Relocation:** Design and permit the relocation of
7 a portion of the LS 10 FM impacted by an FDOT road improvement project in the US 19
8 North right-of-way - \$55,750. The design is scheduled to be completed by December 31,
9 2020. Construction of the force main will be identified in a separate future capital project
10 once the bidding process has been completed. FDOT has indicated their project will
11 commence in 2021, which triggers the need to complete the construction of the new force
12 main in advance of FDOT's construction schedule.

13 **PCF-19 Pennbrooke Diffuser Replacement:** Replace all diffusers and drop pipes in the
14 Pennbrooke WWTP aeration basins - \$33,420. The project was completed in March 2020.

15 **PCF-20 Sandalhaven SCADA Installation:** Install remote telemetry units at 13 lift stations
16 and interconnect to existing SCADA equipment in Florida. Provide real time status of lift
17 stations and archive of alarm conditions- \$128,000. This project is scheduled to be
18 completed by March 31, 2021.

19 **PCF-21 Sandalhaven I&I Investigation:** Video inspect 8,000 LF of primarily VCP gravity
20 sewer mains and manholes to identify the location and severity of groundwater and surface
21 runoff entry points to the collection system - \$57,000. The project is slated to be done by
22 February 2021. Correcting all deficiencies, if any, identified within the scope of this project
23 will be addressed in a subsequent capital project.

24 **PCF-22 Sanlando Wekiva WWTP Improvements:** Remove and replace process blowers
25 and air header; travelling bridge filters; and storage building; relocate belt press; upgrade

1 sodium hypochlorite storage capacity; replace sodium aluminate storage tank; renew plant
2 operating permit; mill and resurface roadway; replace facility entrance gate; and demolish
3 and remove all decommissioned tanks and equipment - \$6,112,000. This project is
4 scheduled to be substantially completed by December 31, 2020 as required by the terms of
5 an open Consent Order issued by FDEP. This reflects the replacement of various treatment
6 components that are well past their expected service life, are inadequate to treat wet
7 weather flows, and/or lack adequate redundancy when one unit is out of service for
8 maintenance.

9 **PCF-23 Sanlando Wekiva Headworks:** Design, permitting, bidding, and CEI services in
10 support of the construction of headworks improvements; the replacement of a Vulcan step-
11 screen with twin center flow screens that offer operational redundancy and higher capture
12 rate of screenings; manual bar screen; enhanced flow monitoring; increased peak flow
13 capacity of 6 mgd; overflow piping that directs flow to the EQ tank; installation of an
14 emergency bypass pump; and upsized transfer piping connecting the headworks to the three
15 treatment trains - \$186,715 for engineering services plus \$2,563,285 in construction costs
16 for a total of \$2,750,000. The project is scheduled to be completed by December 31, 2020.
17 The original step-screen became jammed during wet weather peak flow resulting in a large
18 overflow of raw wastewater and subsequent issuance of a Consent Order by FDEP that
19 mandates plant improvements that increase capacity and redundancy.

20 **PCF-24 Sanlando Well Panel Replacements:** Remove and replace control panels, electric
21 meter bases and associated electrical equipment at five water supply wells. The original
22 1970's vintage panels have reached the end of their service life, are not compliant with the
23 National Electric Code; and are difficult to find replacement parts due to their age -
24 \$74,500. Estimated completion date is September 30, 2020.

25 **PCF-25 Sanlando Power Line FM & WM Replacement:** Engineering design, permitting,

1 utility easement acquisition; and construction of 5,000 LF of water transmission main (AC
2 pipe) and 5,000 LF of force main (AC pipe) that are at the end of their service life;
3 abandonment of existing force main and water main; and coordination with the design and
4 construction of the plant headworks and future replacement of the L2 and L3 force mains
5 - \$187,000 in engineering plus \$3,575,250 in construction costs for a total of \$3,762,250.
6 This project is scheduled to be done by December 31, 2020.

7 **PCF-26 Sanlando Engineering F5/C1/L2 FM Replacements:** Engineering, permitting,
8 bidding services and CEI services associated with the replacement of three critical force
9 mains that have reached the end of their service life and have a high consequence of failure.
10 - \$194,500. The design, permitting and bidding tasks will be completed by December 31,
11 2020 with construction of the replacement force mains to occur before the end of 2021.
12 Construction costs will be captured under a separate capital project.

13 **PCF-27 Sanlando I&I Corrections, Phase 4:** Jet clean and video inspect 94,000 LF of VCP
14 gravity sewer main and manholes to locate and evaluate pipe deficiencies, then fix those
15 deficiencies with CIPP liner or open cut construction methods to reduce groundwater and
16 surface runoff from entering the collection system - \$1,996,092. This project is scheduled
17 to be completed by October 31, 2020.

18 **PCF-28 Sanlando EE Williamson Utility Relocations:** Relocate water main and sewer
19 main within the EE Williamson Rd. R/W that are in conflict with a Seminole County road
20 improvement project - \$440,026. Construction is scheduled to be completed in advance of
21 Seminole County's roadway project but no later than December 31, 2021.

22 **PCF-29 Sanlando Lift Station Mechanical Rehabilitation:** Remove and replace bottom
23 elbows, discharge piping, valves and fittings at multiple lift stations that have reached the
24 end of their service life and to restore the functionality and reliability of each lift station's
25 design pumping capacity - \$540,000. The project is to be completed by December 31, 2020.

1 **PCF-30 Sanlando FM Modeling and Development of CIP:** Evaluate the hydraulic capacity
2 of the Sanlando force main network west of I-4 and develop a capital improvement plan
3 for their replacement or upgrade of force mains found to be bottlenecks to maintain level
4 of service to customers - \$83,500. This project was completed in January 2020.

5 **PCF-31 Sanlando GST Remediation:** Remediate deficiencies in the interior of three
6 finished water ground storage tanks; replace interior access ladders with corrosion resistant
7 materials in three other GST's - \$181,000. This project is scheduled to be completed by
8 November 30, 2020 when seasonal peak demand has passed allowing for each tank to be
9 removed from service in turn and refurbished without affecting level of service to the
10 Sanlando customers.

11 **PCF-32 Tierra Verde I&I Remediation:** Video inspect 64,300 LF of gravity sewer main
12 and 253 manholes using Red Zone technology; geolocate all manholes; remove
13 accumulated solids throughout the collection system including 3,000 LF of 18" pipe on
14 Pinellas Bayway Blvd.; clean and line 300 LF of tuberculated DIP passing through conflict
15 structures - \$165,000. This project is scheduled to be completed by November 30, 2020.

16 **PCF-33 Tierra Verde FM & GSM Replacement:** Replace 1,500 LF of 10" FM between
17 LS 4 and a receiving manhole; line 400 LF of 8", 12" and 24" gravity sewer pipe, install
18 two doghouse manholes to resolve conflicts with an FDOT road improvement project; and
19 replace 4" electrical conduit and conductors supplying power to LS 4 - \$551,000.

20 **PCF-34 Tierra Verde LS 4 Replacement:** Design, permit and construct a relocated LS 4,
21 a converted manhole, as a standard duplex station that meets standard design criteria and
22 to establish reliable service - \$80,542 for engineering services plus \$828,440 for
23 construction for a total of \$908,982. The project is scheduled to be done by December 31,
24 2021.

25 **PCF-35 UIF – Buena Vista Well Improvements:** Replace well pump assembly at Well 2,

1 clean and inspect well casing; replace hydro tank and piping at Well 3; and make minor
2 improvements to well house - \$95,000. This project is scheduled to be completed by
3 August 31, 2020.

4 **PCF-36 UIF – Orangewood Well 1 Improvements:** Remove and replace worn out well
5 pump assembly, well head and discharge piping; replace the 5,000-gallon hydro tank with
6 an ASME code tank; and replace the 1989 emergency generator and automatic transfer
7 switch - \$165,000. The project is scheduled to be completed by July 31, 2020. An internal
8 inspection of the hydro tank identified significant loss of metal indicating a high risk of
9 failure of this pressure vessel. Additionally, the well pump was worn out and the generator
10 was difficult to maintain due to its age.

11 **PCF-37 UIF – Seminole County SCADA Installation:** Install remote telemetry units at 10
12 lift stations in the Weathersfield and Ravenna Park collection systems - \$94,476. This
13 project was completed in January 2020.

14 **PCF-38 UIF – Summertree Chlorine Dioxide Pilot Study:** Examine the efficacy of using
15 chlorine dioxide as a post-treatment method of reducing the accumulation of nitrogen
16 compounds in the distribution system. This reflect the varying water quality and age of
17 water supplied by Pasco County Utilities through a bulk water agreement. A six-month test
18 period will be used to optimize treatment, obtain DEP approval of a change in treatment
19 methods and provide opinion of probable cost to implement the treatment method
20 permanently - \$52,000. The project is scheduled to be completed by December 31, 2020.

21 **PCF-39 UIF – Summertree I&I Investigation:** Video inspect and/or smoke test 9,400 LF
22 of VCP gravity sewer main and manholes in Pointe West that are riddled with hammer taps
23 in the oldest section of Summertree - \$27,000. A separate capital project will be developed
24 to address the deficiencies.

25 **PCF-40 UIF – Golden Hills Galvanized Pipe Replacement:** Remove and replace about

1 2,000 LF of 2” galvanized iron pipe from three cul-de-sacs that are highly tuberculated and
2 corroded after 50+ years of service. They are prone to spring leaks indicating they have
3 exceeded their expected service life. Eighteen service lines and some isolation valves will
4 also be replaced. The project also includes replacing two 3-way hydrants that are leaking,
5 and because of their age and model, repair parts are not available - \$75,160. The project
6 will be completed by August 1, 2020.

7 **PCF-41 UIF – Golden Hills Water Main Relocation:** Relocate 1,350 LF of 6” water main
8 and appurtenances that were in conflict with a Marion County stormwater improvement
9 project - \$154,764. This project was completed in January 2020.

10 **PCF-42 UIF – Little Wekiva Generator:** Engineering design, permitting, purchase and
11 installation of a 40Kw emergency generator and automatic transfer switch at the Little
12 Wekiva WTP to maintain water service when normal power is interrupted - \$94,437. This
13 will improve the level of service to all 61 customers in the system by reducing the
14 frequency, duration and inconvenience of loss of water pressure when normal power is lost
15 during storm events. The project will be completed by June 30, 2020.

16 **PCF-43 UIF – Park Ridge Generator:** Engineering design, permitting, purchase and
17 installation of a 60Kw emergency generator and automatic transfer switch at the Park Ridge
18 WTP to maintain the provision of water service when normal power is interrupted -
19 \$99,137. This will improve service to the customers by reducing the frequency, duration
20 and inconvenience of loss of water pressure when normal power is lost during storm events.
21 The project will be completed by June 30, 2020.

22 **PCF-44 UIF – Ravenna Park I&I Remediation:** Video inspect 11,600 LF of VCP gravity
23 sewer main and manholes in Ravenna Park and Lincoln Heights to identify pipe
24 deficiencies and then apply CIPP, sectional liners and open cut methods to remediate them
25 - \$651,568. This project will be completed by October 31, 2020.

1 **PCF-45** UIF – Weathersfield Northwestern Bridge Crossing: Design, permitting and
2 bidding services to replace the 6” water main that crosses the Little Wekiva River on
3 Northwestern Drive in coordination with a Seminole County bridge replacement project -
4 \$22,000. The project is currently scheduled to be completed by August 31, 2021 but is
5 dependent on the county’s construction schedule.

6 **Q. Do the capital costs noted in Exhibits PCF-1 through PCF-45 include capitalized time**
7 **and interest incurred during construction?**

8 A. No, interest that has accrued or will accrue on the borrowed capital used to construct each
9 capital project must be added to each project reflecting the cost of capital, the amount of
10 capital required for each project, and the duration of the project’s construction period.
11 Additionally, the amount of capitalized time spent by UIF employees in conjunction with
12 each project must also be added to the project cost.

13 **Q. Were these Exhibits prepared by you and your staff under your supervision and**
14 **control?**

15 A. Yes, they were.

16 **Q. Does that conclude your direct testimony?**

17 A. Yes, it does.

1 CHAIRMAN CLARK: All right. OPC, you are up.

2 MS. PIRRELLO: Thank you, Mr. Chairman.

3 EXAMINATION (continued)

4 BY MS. PIRRELLO:

5 Q Mr. Flynn, if you could turn to CEL Exhibit
6 127?

7 A Yeah, which one is that related to?

8 Q PCF-33.

9 A Hang on a minute. Okay.

10 Q Are you there?

11 A Yes. Please go ahead.

12 Q Okay. Could you please go to page 24?

13 A This is a 21-page exhibit.

14 Q Updated PCF-33, CEL 127?

15 A Oh, the update. Okay, stand by. That's -- we
16 got them back and forth so I want to make sure I have it
17 correct. Correct. Page -- page 24?

18 Q Yes, sir.

19 A Okay.

20 Q So this is the contract for PCF-33, is that
21 correct?

22 A Correct.

23 Q And before we broke for lunch, you stated that
24 you didn't issue a notice to proceed in this -- for this
25 project because it wasn't necessary; is that correct?

1 A That was my recollection. I am looking here
2 as to whether we actually had one generated. Okay, no,
3 I did not -- yeah, I did not provide one for this
4 particular project.

5 Q Okay. And in Section A of this contract it
6 states: The contract documents include the agreement,
7 addenda, contractor's bid, notice to proceed, the bonds,
8 the general conditions, the supplemental conditions and
9 the specifications listed in the index to the project
10 manual; is that correct?

11 A Correct.

12 Q Okay. For this next line of questions, you
13 don't need to pull up the exhibit. I am just referring
14 to what you sent in these projects in your narrative
15 direct testimony, okay?

16 A Okay.

17 Q So with regard to PCF-6, on direct you
18 testified that this project was scheduled to be
19 completed by August 31st, 2020, correct?

20 A I believe so.

21 Q So that's no longer true, is it?

22 A No, we delayed the completion.

23 Q On direct, you testified that PCF-8 was
24 scheduled to be completed by October 31st, 2020,
25 correct?

1 A I am sorry, which one was that, please?

2 Q **Eight. It's on page eight, line 18.**

3 A Yeah, that's -- that was -- that was correct.

4 Q **And that's no longer true, is it?**

5 A No, it's not.

6 Q I would like to refer you to your direct
7 **testimony, page eight, line 24. Could you read the**
8 **second sentence starting with this?**

9 A Marty?

10 MR. FRIEDMAN: Yeah.

11 THE WITNESS: Talking about direct? I am
12 sorry -- I am sorry, which exhibit was that one?

13 BY MS. PIRRELLO:

14 Q **Not the exhibit, sir. Just your direct**
15 **testimony, page eight, line 24.**

16 A Oh, okay. Go ahead.

17 Q **Could you read the sentence starting with**
18 **this?**

19 A This -- this project is to be completed by
20 October 31st, 2020.

21 Q **And that sentence is referring to PCF-9, is**
22 **that correct?**

23 A Yes.

24 Q **And that sentence is no longer true, is it?**

25 A That's correct. It will be later.

1 Q On direct, you testified that PCF-13 was
2 scheduled to be completed by December of 2020, correct?

3 A Correct, that's what it says.

4 Q But that's no longer true, is it?

5 A No, it will be completed later this year.

6 Q On direct, you testified that PCF-14 was
7 scheduled to be completed by December 31st, 2020,
8 correct?

9 A Correct.

10 Q But that's no longer true, is it?

11 A No, we -- we will complete it later this year.

12 Q On direct, you testified that PCF-16 was
13 scheduled to be completed by October 31st, 2020,
14 correct?

15 A That's what the schedule was, correct.

16 Q And that's no longer true?

17 A No, it's wrapping up next month.

18 Q On direct, you testified that PCF-17 was
19 scheduled to be completed by March of 2021, correct?

20 A Correct.

21 Q So that's no longer true, is it?

22 A No, it will be completed in September or
23 October.

24 Q On direct, you testified that PCF-23 was
25 scheduled to be completed by December 21st, 2020; is

1 **that correct?**

2 A Correct.

3 **Q That's no longer true, is it?**

4 A No, we finish that up in September, October
5 2021.

6 **Q On direct, you testified that PCF-24 was**
7 **estimated to be completed by September 30th of 2020,**
8 **correct?**

9 A Correct.

10 **Q And that's no longer true, is it?**

11 A That was completed end of fourth quarter.

12 **Q On direct, you testified that PCF-25 was**
13 **scheduled to be completed by December 31st, 2020,**
14 **correct?**

15 A Correct.

16 **Q And that's no longer true, is it?**

17 A Correct, it will be completed in about two or
18 three months.

19 **Q Okay. On direct, you testified that PCF-31**
20 **was scheduled to be completed by November -- by November**
21 **30th, 2020, is that correct?**

22 A Correct.

23 **Q But isn't it true that this project has been**
24 **paused?**

25 A I am sorry, what's the question again, please?

1 **Q Isn't it true that this project has been**
2 **paused?**

3 A Correct. We waited for the high season to
4 pass so we could get the contractor remobilized. He
5 remobilized in January.

6 **Q So isn't it true that there is no known**
7 **completion date for this project?**

8 A The completion date will be this quarter, by
9 the end of March.

10 **Q Isn't it true that UIF has not provided**
11 **documentation to the Commission staff or OPC of that**
12 **date?**

13 A Regarding PCF-31?

14 **Q Yes.**

15 A Right. So in my rebuttal testimony, I offered
16 some information regarding the reasons for the pause in
17 the project and the impact on the schedule, and the
18 estimated completion date for the project looks like the
19 factors I identified.

20 **Q On direct, you testified that PCF-32 was**
21 **scheduled to be completed by November 30th, 2020,**
22 **correct?**

23 A Correct.

24 **Q But that's no longer true, is it?**

25 A Actually, it's -- it's been completed. It was

1 completed, I think, in January or December, either
2 December of last year or this past month.

3 Q So it was not true that the project was
4 completed by November 30th?

5 A That's correct.

6 Q On direct, you testified that PCF-35 was
7 scheduled to be completed by August 31st of 2020,
8 correct?

9 A Correct.

10 Q But that's no longer true, is it?

11 A Correct. It was finished last year, late in
12 the year.

13 Q On direct, you testified that PCF-38 was
14 scheduled to be completed by December 31st of 2020, is
15 that correct?

16 A Correct.

17 Q But that's no longer true, is it?

18 A That's correct. We are going to finish it up
19 in March.

20 Q I would like to refer you to your direct
21 testimony, page 16, line 25.

22 A Okay.

23 Q Could you please read the sentence starting
24 with this?

25 A This project will be completed by October 31,

1 2020.

2 Q And you are referring to PCF-44, correct?

3 A Correct.

4 Q That's no longer true, is it?

5 A No. It's wrapping up this month.

6 Q So subject to check, would you agree that
7 we've just identified 15 projects of 45 requested for
8 which UIF did not accurately identify the completion
9 date when you filed your direct testimony?

10 A That is correct. Those were scheduled dates,
11 and all those projects, it's important to understand the
12 full complexity and timing of issues that affect the
13 completion schedule, and so, of course, that's what I
14 provided in my rebuttal testimony.

15 MS. PIRRELLO: I have no more questions, Mr.
16 Chairman.

17 CHAIRMAN CLARK: Thank you.

18 Okay, let's move to staff.

19 MR. TRIERWEILER: Staff has no questions.

20 CHARIMAN CLARK: Commissioners?

21 Commissioner Brown.

22 COMMISSIONER BROWN: Thank you, Mr. Chairman.

23 I have a question regarding the investigation
24 projects, starting with Cypress Lake I&I.

25 THE WITNESS: Yes.

1 COMMISSIONER BROWN: So I am assuming -- so in
2 your PCF-1, it says that the total project costs
3 are 50,000. Does that amount also include the
4 tipping of the 7,500?

5 THE WITNESS: Does that include -- I am sorry,
6 what was the last word?

7 COMMISSIONER BROWN: Does that include the
8 7,500 that you say in your direct testimony for
9 tipping in the --

10 THE WITNESS: It included that tipping cost,
11 right, the disposal of solids and so on.

12 COMMISSIONER BROWN: Well, will there be --
13 after you identify any deficiencies in the piping,
14 will there be any type of additional proforma
15 project thereafter?

16 THE WITNESS: Yes. In fact, recently the
17 report generated from that investigation identified
18 some locations where there were deficiencies to be
19 addressed, and, in fact, those are underway. We
20 have a contractor working on those deficiencies.

21 There weren't a whole lot of them. It wasn't
22 a significant -- it wasn't a huge dollar amount,
23 but it was certainly not the case that I had
24 information in time for rebuttal testimony for
25 submittal to quantify what that amount would be.

1 COMMISSIONER BROWN: So you are not including
2 that in your base rate case proceeding.

3 THE WITNESS: That is correct.

4 COMMISSIONER BROWN: Would you be requesting
5 that in your SWIM program being asked for?

6 THE WITNESS: Yes. Whatever -- whatever
7 methodology is available to us in the future to
8 recover that investment certainly we would
9 appreciate the opportunity, whether it's SWIM, or a
10 limited proceeding, or a full general rate case in
11 the future, or whatever methodology we choose.

12 COMMISSIONER BROWN: Thank you, Mr. Flynn.

13 Another one you have on page 11 of your direct
14 testimony, and this could possibly be in your
15 rebuttal, but the Sandalhaven I&I investigation
16 slated to be done in February, that's also -- I am
17 assuming there is going to be a subsequent capital
18 project thereafter?

19 THE WITNESS: Yes, I would expect so. We --
20 we certainly believe some of the older sections of
21 that system have clay pipe, and most likely are
22 places where excess I&I is occurring in some level.
23 And once we discover where those are, we will able
24 to move forward with the deficiency correction
25 effort.

1 COMMISSIONER BROWN: And how are you going to
2 seek cost recovery for that proforma project -- the
3 investigation?

4 THE WITNESS: Yeah. Similar to Cypress Lakes,
5 the discussion we just had, it's going to be a
6 future proceeding that would offer an opportunity
7 to recover that investment.

8 COMMISSIONER BROWN: And do you have an idea
9 of what the proforma cost for that additional
10 project would be?

11 THE WITNESS: I do not. We don't have enough
12 information from our investigation to -- to pinpoint
13 how much it's going to be at this point.

14 COMMISSIONER BROWN: Thank you.

15 And lastly, poor Summertree, we are all
16 familiar with Summertree, the I&I investigation, you
17 cite a separate capital project to be developed
18 thereafter. Are you under way with that project?

19 THE WITNESS: We are, we have --

20 COMMISSIONER BROWN: I'm sorry, I can't hear
21 you that well.

22 THE WITNESS: Part of the condo portion of the
23 neighborhood, and those deficiency corrections are
24 underway. The Insituform is the prime contractor
25 doing that work.

1 COMMISSIONER BROWN: And do you know the cost
2 of that additional capital project? And are you --

3 THE WITNESS: That one -- Summertree, I think,
4 is going to be in the neighborhood of \$364,000, all
5 total, everything in.

6 COMMISSIONER BROWN: That's significant. And
7 are you seeking recovery in this base rate case
8 proceeding?

9 THE WITNESS: So that include -- that
10 information and quantification is included in my
11 rebuttal testimony.

12 COMMISSIONER BROWN: Okay. Thank you for the
13 clarification. That's all.

14 CHARIMAN CLARK: Thank you, Commissioner
15 Brown.

16 Commissioner Fay.

17 COMMISSIONER FAY: Thank you, Mr. Chairman.

18 My question is on page five of your direct. I
19 will just give you a second to turn there. You
20 mentioned on here -- we had -- we had the customer
21 hearing that we attended and had a lot of feedback
22 there, and I know this is -- we are getting into a
23 lot of the technical aspects of the projects, but I
24 was trying to get a better understanding. You put
25 in here that you had an adoption rate of 50 percent

1 of your, essentially your -- your consumer program
2 MyUtilityConnect, and I didn't -- I didn't see in
3 your direct if that was arguably a good adoption
4 rate, a bad adoption rate, I didn't know if you had
5 anything to compare that to, if you could provide a
6 little context to that?

7 THE WITNESS: Chris Snow, who is going to be a
8 rebuttal witness, might be better able to elucidate
9 on that. I would say that over the course of the
10 launch period, and thereafter, we saw extended
11 growth of sign-ups to MyUtilityConnect. And in
12 discussions we had during the review of that
13 information, it was apparent to me that that was a
14 significant success rate in signing people up,
15 greater than what was expected. So I hope that
16 answered your question.

17 COMMISSIONER FAY: Yeah, it does. I mean, it
18 seems like a significant rate, but I will -- I will
19 also ask Mr. Snow just to see if he has got any
20 additional context for it. I appreciate it.

21 That's all I had, Mr. Chair. Thank you?

22 CHARIMAN CLARK: Thank you, Commissioner Fay.

23 Other questions from Commissioners?

24 Commissioner La Rosa.

25 COMMISSIONER LA ROSA: Thank you, Mr.

1 Chairman. And thank you, Mr. Flynn.

2 Mr. Flynn, you just pointed out a few
3 projects, quite a bit that were delayed, and I know
4 you gave kind of a brief overview. Can you do a
5 little deeper, and is there a consistency amongst
6 the projects for the purpose of -- of being
7 delayed?

8 THE WITNESS: No, sir. There is a variety of
9 reasons for any one project's delay. Sometimes its
10 driven by third-party schedules with respect to the
11 kind of other aspects of the -- example of Tierra
12 Verde lift station force main relocation, the
13 wrapup of the project was -- was partially driven
14 by the completion of a Florida DOT project building
15 their bridge and roundabout in Tierra Verde that
16 delayed the last element of that project -- of our
17 project being completed, which was raising the
18 manhole to finish grade once the roundabout was
19 constructed.

20 So that's just one aspect. It could be
21 delivery of equipment. It could be a function of
22 permitting delays at the county level. It could be
23 a function of highway project -- other highway
24 project issues that cause delays or delay pulling
25 the trigger in our project. Sometimes it advances

1 of the schedule as well. It works in both
2 directions.

3 COMMISSIONER FAY: Okay. Going to a part of
4 your testimony on page five, you specify a
5 five-year plan, I guess, when identifying, you
6 know, major projects. Why -- why five years? Why
7 is, you know, looking at your infrastructure, is --
8 would things change for that timeframe if either
9 decreased or increased?

10 THE WITNESS: The five years is just a planet
11 horizon -- a planet horizon timeframe. It's
12 essentially identifying to what degree of precision
13 we can identify and quantify and analyze
14 information that's available to us in the near
15 term.

16 Certainly, we have an aspect of looking at
17 even longer term issues, and as we gain information
18 from our fieldwork where we could add data that
19 flows into our database helps us better formulate
20 decisions on when to replace assets, where, to what
21 degree. That's an ongoing unending process, but
22 it's nothing that's magical about five years.
23 That's just the level of knowledge we have on the
24 near-term for project development and project
25 scheduling and scope of work.

1 COMMISSIONER FAY: All right. Very good.

2 Thank you, Chairman.

3 CHAIRMAN CLARK: Thank you, Commissioner La
4 Rosa.

5 Commissioner Brown.

6 COMMISSIONER BROWN: Thank you.

7 One last question I forgot to -- I know you
8 are so involved in the operations of the day-to-day
9 company, the sister management company that we
10 talked about WSC -- CS?

11 THE WITNESS: WSC.

12 COMMISSIONER BROWN: Okay, sorry. Can you
13 talk about the new contract that -- are there
14 expanded services? I know that you have a new
15 external affairs person in-house at UIF. Is there
16 any additional offerings that the company, the
17 sister is company is providing?

18 THE WITNESS: I am not really quite sure I can
19 answer that adequately. Water Service Corporation,
20 WSC for short, essentially has witness Deason
21 talked about, it's just a mechanism by which we
22 aggregate the back office expenses associated with
23 supporting operations, and it's just a mechanism
24 for accounting purposes to track and allocate those
25 resources in a fair and consistent way across all

1 the subsidiaries.

2 Does that answer your question?

3 COMMISSIONER BROWN: So, yeah, it's more
4 accounting and not operations and out in the field
5 dealing with customers on a day-to-day basis other
6 than --

7 THE WITNESS: Yeah, WSC has no -- no hands-on
8 with operations, with assets, with facilities.
9 That's operations' responsibility.

10 COMMISSIONER BROWN: Thank you.

11 CHAIRMAN CLARK: Thank you, Commissioner
12 Brown.

13 Other Commissioners have questions?

14 All right, Mr. Friedman, redirect?

15 MR. FRIEDMAN: Thank you, I have a couple of
16 questions.

17 FURTHER EXAMINATION

18 BY MR. FRIEDMAN:

19 **Q Mr. Flynn, are notices to proceed required in**
20 **all of your projects?**

21 **A** No, they are not.

22 **Q And -- so not receiving and having a notice to**
23 **proceed, you are still able to complete projects in a --**
24 **in a timely manner?**

25 **A** Yes, that's correct. We do that frequently.

1 **Q Are there instances where you have a notice to**
2 **proceed but it's not fully signed but the parties**
3 **operate as if it is?**

4 A Yes, that is the case.

5 **Q Am I correct that sometimes you have a project**
6 **that the documentation doesn't include signatures by --**
7 **by the -- by both the contractor and the company but**
8 **everybody is proceeding as if it was?**

9 A That's correct. Yes. Essentially it's a
10 formality in many cases reflecting what's customary for
11 large projects -- large projects. However, in many,
12 many cases, our contractors are ones who have worked for
13 us before, they've identified their -- their consistency
14 professionalism, their ability to execute the projects
15 in a timely and professional way. We have a lot of
16 trust in those contractors. We wouldn't invite them to
17 bid on our projects if we didn't have a high comfort
18 level with them typically. So we are not -- we are not
19 typically at risk, or any project at risk of not having
20 been completed because of a lack of the notice to
21 proceed being executed.

22 **Q Or -- or in another form documents in the**
23 **construction contract?**

24 A That's correct.

25 **Q Notwithstanding the delays that the Public**

1 Counsel so tediously brought out, is it still true, in
2 your opinion, that all these projects will be completed
3 by the end of 2021?

4 A Yes, that's correct.

5 Q And you are confident of that?

6 A Yes, I am.

7 MR. FRIEDMAN: We have no further questions.
8 Thank you.

9 CHAIRMAN CLARK: All right. Any exhibits?

10 MS. PIRRELLO: Mr. Chairman, I would like to
11 move Exhibit 189 into the record.

12 CHAIRMAN CLARK: Okay. So ordered.

13 (Whereupon, Exhibit No. 189 was received into
14 evidence.)

15 CHARIMAN CLARK: Anyone else?

16 All right. Mr. Friedman, you may call your
17 next witness.

18 THE WITNESS: Thank you very much.

19 CHAIRMAN CLARK: Good afternoon, Ms. Swain.

20 Would you please raise your right hand and affirm
21 the statement?

22 Whereupon,

23 DEBORAH D. SWAIN

24 was called as a witness, having been first duly sworn to
25 speak the truth, the whole truth, and nothing but the

1 truth, was examined and testified as follows:

2 THE WITNESS: I do.

3 CHARIMAN CLARK: Thank you.

4 Mr. Friedman.

5 MR. FRIEDMAN: Thank you very much, Mr.
6 Chairman.

7 EXAMINATION

8 BY MR. FRIEDMAN:

9 Q Ms. Swain, would you state your name and your
10 business address?

11 A Yes. My name is Deborah Swain. I am with
12 Milian, Swain & Associates at 2025 SW 32nd Avenue,
13 Miami, Florida.

14 Q And, Ms. Swain, did you prefile direct
15 testimony in this case?

16 A Yes, I did.

17 Q And if I asked you questions in your prefiled
18 direct testimony, would your answers be the same?

19 A Yes, they would.

20 Q So you have no changes or corrections in your
21 prefiled testimony?

22 A I do not have any changes in my prefiled
23 testimony, but I do have some corrections in my Exhibit
24 DDS-1.

25 Q And what would that be?

1 A Most of the corrections that I had were just
2 several things that came up during discovery. One I
3 pointed out in my rebuttal. Others, I pointed out in
4 discovery staff Interrogatory 99, 102 and 110. But
5 there is one that was a correction of a deficiency by
6 Mr. Seidman that required that there be an I&I -- an
7 excess I&I adjustment for Summertree, and I failed to
8 make that adjustment in the MFRs.

9 So it's actually a correction to DDS-1, page
10 42, lines 42 and 43, and DDS-1 is Exhibit 48 in this
11 case. And it's just two numbers that are required
12 because there is no -- no other way to know the I&I
13 adjustment for Summertree without me having done this
14 calculation.

15 So the -- hold on, I am sorry. I thought I
16 had it right there. So on page 42, line 42, purchased
17 wastewater should be an adjustment that reduces the
18 expense 29,828, and purchased power, which is the
19 following line, 43, should be an adjustment to reduce
20 purchased water by \$432.

21 **Q How many exhibits did you sponsor?**

22 A Two.

23 **Q And would you give a brief summar of what they**
24 **are?**

25 A Yes.

1 DDS-1 is the MFR Volume 1, and I sponsored all
2 the schedules in that, the E schedules, which witness
3 Deason sponsored, and then the F schedules are Mr.
4 Seidman. And DDS-2 is just the reconciliation between
5 the MFRs and the annual report.

6 MR. FRIEDMAN: All right. Mr. Chairman, I
7 would like to ask that Ms. Swain's prefiled direct
8 testimony be admitted into the record as though
9 read.

10 CHAIRMAN CLARK: Without objection, so
11 ordered.

12 (Whereupon, prefiled direct testimony of
13 Deborah D. Swain was inserted.)

14
15
16
17
18
19
20
21
22
23
24
25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for an increase in water and
wastewater rates in Charlotte, Highlands, Lake,
Lee, Marion, Orange, Pasco, Pinellas, Polk,
and Seminole Counties by Utilities, Inc. of Florida

Docket No. 20200139-WS

DIRECT TESTIMONY

OF

DEBORAH D. SWAIN

on behalf of

Utilities, Inc. of Florida

1 **Q. Please state your, name profession and address.**

2 A. My name is Deborah D. Swain. I am Vice President of Milian, Swain & Associates, Inc. and
3 head up the firm's finance, accounting and management team. My business address is 2025
4 SW 32nd Ave., Suite 110, Miami, Florida 33145.

5 **Q. State briefly your educational background and experience.**

6 A. I have a Bachelor of Science degree in Accounting from Florida State University. I have over
7 35 years of experience in utility management, accounting, finance, rate regulation, rate design
8 and system development. I have prepared and supervised cost of service studies for over 300
9 water and wastewater systems, calculated revenue deficiencies and revenue requirements,
10 and designed rates.

11 **Q. Have you previously appeared and presented testimony before any regulatory bodies?**

12 A. I have prepared and presented expert testimony in the areas of regulatory accounting, rate
13 regulation and utilities in general, before various federal, state, county, courts and regulatory
14 agencies, including the Florida Public Service Commission, Collier, Hillsborough, St. Johns
15 and Washington Counties, the Circuit Court in Palm Beach County, the Town of Jupiter, the
16 City of Miami, and the US Bankruptcy Court.

17 **Q. On whose behalf are you presenting this testimony?**

18 A. I am presenting this testimony and appearing on behalf of Utilities, Inc. of Florida (UIF), the
19 applicant for rate increase in the present docket.

20 **Q. What is the purpose of your direct testimony?**

21 A. The purpose of my direct testimony is to present information supporting the financial basis
22 for UIF's request to increase its rates and charges as presented in the MFRs, to provide
23 supporting schedules to show the basis for the requested rates and charges.

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

25 A. Yes, I am sponsoring two exhibits. Exhibit DDS-1 contains MFR Volume I – Financial, Rate

1 and Engineering (except the F schedules that were prepared and sponsored by Mr. Seidman).
2 Exhibit DDS-2 are the reconciliation schedules.

3 **Q. Were these Exhibits prepared by you and your staff?**

4 A. Yes they were. As is customary, they were prepared from financial information provided to
5 my staff and me by UIF.

6 **Q. Are there any particular explanations you want to make with regard to the MFRs?**

7 A. Yes, I will point out several about which I would like to elaborate.

8 Rate Base

9 (1) Non-Used and Useful (NUU): Although the MFRs present consolidated financial
10 information, adjustments for NUU required system-based calculations. These adjustments
11 pertained to Plant, Accumulated Depreciation, CIAC, Amortization of CIAC, Depreciation
12 Expense, and Property Tax Expense. The applicable MFR schedules include sections detailing
13 information per applicable system for those plant accounts to which a NUU adjustment was
14 made.

15 (2) Proforma Plant Retirements: Certain proforma plant additions required retirement of
16 replaced plant. In the 2015 rate case, we estimated the amount of the retirement as 75% of the
17 new project cost across the board. In this case we calculated the original plant cost for retirements
18 applying the Handy Whitman index, which is consistent with the methodology used by UIF
19 when it records the retirement on its accounting records. We also made adjustments to retire
20 CIAC in an equal amount for retired contributed plant.

21 (3) Working Capital: UIF does not maintain its own unique bank accounts, requiring that
22 cash transactions be recorded through intercompany accounts. Initially I determined that the
23 intercompany receivable and payable accounts should be included in working capital as they are
24 not interest bearing, and not included otherwise in rate base nor capital structure. However, the
25 overall magnitude as compared to total rate base was so significant, we then performed a review

1 of the accounts to determine if a particular intercompany receivable or payable account could be
2 identified to be included in working capital. Unfortunately, it was not possible to isolate a
3 specific account. I then reviewed other utilities to determine if there was a reasonable cash
4 balance amount that should be included instead. There are two cases I determined could be used
5 to develop a presumed cash amount as the cash balance was an issue in both of those cases.
6 These cases were KW Resorts Utilities Corp., Order No. PSC-17-0091-FOF-SU and Order
7 No. PSC-2018-0446-FOF-SU. In both of those cases, the actual operating cash account
8 balance was approximately \$900,000. The Commission determined that a balance of
9 \$317,978 would be allowed in both of those cases. In the 2015 test year case, this balance
10 represented 2% of gross plant allowed, and in the 2017 test year case, this amount was
11 1.65% of gross plant. I have made an adjustment to increase the cash balance to 2% of
12 requested gross plant, resulting in an adjustment of \$5,381,581 allocated to water and
13 sewer based on gross plant.

14 Operating Expenses

15 Excess Unaccounted for Water (EUW) and I&I Adjustments: In order to make
16 adjustments for system experiencing EUW and excess I&I, we used details for each
17 applicable system for purchased water, purchased wastewater, chemicals and power.

18 Current and Deferred Income Taxes

19 Excess Deferred Tax Liability as a result of the Tax Cuts and Jobs Act (TCJA): UIF performed
20 an analysis to record the adjustment to deferred taxes as a result of a reduced tax rate due to the
21 TCJA, creating a new liability account. The balance has not yet been amortized, so I am
22 proposing a proforma adjustment to commence amortization. The protected balance would be
23 amortized over a 20.51-year period, representing the remaining depreciation life of the
24 associated assets. The unprotected portion would be amortized over a 10-year period.

25 The MFRs incorporate these adjustments. The amortization is shown as a reduction to the current

1 income tax provision, which reduces revenue requirement. The unamortized balance is included
2 in the capital structure as a zero cost capital component.

3

4 **Q. Does that conclude your direct testimony?**

5 A. Yes, it does.

1 BY MR. FRIEDMAN:

2 Q Ms. Swain, would you give a brief summary of
3 your direct testimony, please?

4 A Yes. Thank you.

5 The purpose of my direct testimony is to
6 present information supporting the financial basis for
7 UIF's request as presented in the minimum filing
8 requirements, as I mentioned with the exception of the E
9 and the F schedules. I subsequently identified
10 corrections that I just mentioned to you. E schedules
11 were prepared by me, or under my direction, based on
12 information provided by the utility, and were prepared
13 in accordance with Commission rules.

14 My testimony also explains that, although the
15 MFRs present a consolidated picture of UIF, certain
16 aspects, such as non-used and useful and excess
17 unaccountable water and inflow and infiltration are
18 specific to individual systems. For this reason, I had
19 to modify the MFR schedules to be able to show system --
20 the system specific information.

21 I also note that I included an allowance for
22 an estimated cash balance to be added to my working
23 capital calculation since UIF does not maintain its own
24 bank accounts, and all the cash transactions are
25 actually recorded through intercompany accounts.

1 **engineering schedules in this case except for Exhibit F**
2 **to the filing, correct?**

3 A I am sorry, I didn't understand your question,
4 but I am not sponsoring the F schedules, which are the
5 engineering schedules in Volume 1 of the MFRs.

6 Q **I am sorry, yes, I did misspeak. I said**
7 **except for the engine-- except for the F schedules. So**
8 **you are sponsoring the financial and rate schedules in**
9 **this case, the MFR schedules?**

10 A I am also not sponsoring the E schedules. Mr.
11 Deason is the sponsor of the E schedules, and those are
12 the rate schedules.

13 Q **All right. So your direct testimony presented**
14 **the company's revenue requirement and accounting**
15 **adjustments then, correct?**

16 A Correct.

17 Q **Okay. And with regard to rate base items,**
18 **your testimony provided a brief explanation for non-used**
19 **and useful plant, proforma plant requirements and**
20 **working capital, correct?**

21 A Yes.

22 Q **And your discussion of working capital related**
23 **to the amount of cash that should be reflected in rate**
24 **base, correct?**

25 A Yes. That's right.

1 Q Okay. So turning to CEL Exhibit 48, which is
2 the MFR document, MFR 1. And just for reference, that's
3 also OPC's cross Exhibit No. 29.

4 A Okay.

5 Q All right. Isn't it true that the company is,
6 in this case, advertising a water utility cash balance
7 of \$2,355,199 as shown on Schedule A-3, page five of the
8 MFRs?

9 A Yes, that's right.

10 Q And isn't it true -- isn't it also true that
11 the company is proposing to include a sewer utility cash
12 balance of 3,061,123, as shown on Schedule A-3, page
13 five of the MFRs?

14 A Yes, that's right.

15 Q In your direct prefiled testimony at page
16 four, isn't it true you testified that UIF records many
17 transactions through intercompany accounts, and you
18 attempted, quote, "to determine if a particular
19 intercompany receivable or payable account could be
20 identified to be included in working capital," end
21 quote?

22 A I -- yes. What I was explaining is that
23 the -- I was hoping I would find a single intercompany
24 account that was associated with a particular company,
25 and therefore, be able to tie it to a particular bank

1 account, but I couldn't. It's because they use their --
2 for years now, they have been using one account for all
3 the intercompany transactions regardless of which entity
4 has -- has paid the bill, or received the cash -- or the
5 name on the bank account.

6 So at the time I prefiled my testimony, I was
7 not able to distinguish that, and sequentially I found
8 the reason is that they use the same account for any of
9 the entities.

10 **Q Okay. So -- so the bottom line is you are not**
11 **able to isolate specific accounts for the intercompany**
12 **receivable, or receivable or payable accounts, correct?**

13 A At the time -- at the time, no, but since
14 then, the -- the company has actually consolidated all
15 of the intercompany receivables and payables into a
16 single account. And by the company, I mean the entire
17 corporation. And it was always used that way, it just
18 had the not been recorded that way, and it was a little
19 bit confusing for the observer to see three different
20 accounts, intercompany accounts that sort of implied
21 that they had three different purposes, but they didn't.
22 They used one at one point, they used another at another
23 point, and they used finally one, and then they
24 consolidated them all the into one account.

25 **Q Okay. At the time of your filing of your**

1 direct testimony, they were not specific accounts, is
2 that correct?

3 A I am sorry, say that again.

4 Q I was just reasking the question just to
5 isolate it to the time that you filed your prefiled
6 testimony, because I believe you -- you -- and correct
7 me if I'm wrong, you started talking about things that
8 happened after your testimony.

9 A Yes. Yes. I am just explaining,
10 unfortunately at the time that I filed this, it was not
11 possible to isolate a specific account as to how the
12 receivables and the payables were used by individual
13 companies.

14 Q Okay. Well, on direct, isn't it true you
15 testified the company's cash claimed in this case is
16 based on two percent of the company's requested gross
17 plant?

18 A Yes. That's -- that's right. The -- when I
19 looked at the intercompany accounts, and just for
20 explanation -- and this is in my testimony -- using a
21 balance sheet approach, any -- any assets and
22 liabilities that are not interest bearing, these are
23 interest earned or interest paid, are eligible to be
24 considered included in working capital, and -- however,
25 we had never done that, and my company has filed the

1 rate cases for Utilities, Inc. for quite a while, and we
2 have never done that.

3 But the -- I ended up deciding that it was too
4 big a number to throw in right now, so I looked at two
5 other cases where cash was specifically considered, and
6 based on those cases, I estimated that the -- or
7 proposed that a balance of two percent of gross plants
8 be added to working capital to represent cash.

9 Q Okay. So the answer to my yes or no question
10 was yes, is that correct?

11 A Yes.

12 Q Okay. And isn't it true, in your testimony
13 you rationalize that methodology using the two percent
14 of the company's requested gross plant reference to two
15 KW Resort Utilities cases?

16 A Yes.

17 Q And specifically --

18 A Oh, I was going to say, and that's
19 specifically because those two cases, cash was an issue
20 in the case, and it -- so it was specifically addressed
21 by the Commission and by -- and looked at by Public
22 Counsel in those two cases.

23 Q So specifically, you testified that you could
24 use Order No. PSC-2017-0091-FOF-SU and Order No.
25 PSC-2018-0446-FOF-SU to develop a presumed cash amount,

1 correct?

2 A Yes, that's what I pointed to.

3 Q And isn't it true you testified that in the
4 2017 order, KW order I just referenced, KW was permitted
5 to include \$317,978 of cash in its working capital
6 claim?

7 A Yes. And I -- and I also point out that that
8 represented two percent of gross plant.

9 Q Exactly. So you calculated that the -- that
10 that dollar figure, the 317,000-dollar figure was two
11 percent of KW Resort's gross plant in that -- in that
12 docket, correct?

13 A Right.

14 Q And turning to that 2017 order, which also
15 references OPC's cross No. 12 on OPC's list of exhibits,
16 isn't it true that the reason the Commission authorized
17 the amount of \$317,978 cash and working capital in that
18 case was because that was the actual 13-month average
19 cash balance?

20 A No. The actual cash balance was nearly
21 \$900,000, and the OPC proposed that it -- that was an
22 excessive amount of cash and that the balance allowed
23 should be something less than that. 317,000 was one of
24 the accounts I believe, the operating account, but not
25 the other cash accounts that were not interest bearing,

1 so it's -- no, it's not the balance of cash. It was the
2 balance that was approved by the Commission based on OPC
3 arguments.

4 **Q Okay. Well, going to page 32 of that order.**

5 **A** I don't have that order.

6 MR. FRIEDMAN: Is it the one with --

7 MS. MORSE: It's OPC cross No. 12. I am
8 sorry, do you have --

9 CHARIMAN CLARK: We appear blank but we are
10 still here, so proceed.

11 THE WITNESS: Marty, every time I hit 12, 28
12 comes up again.

13 MR. FRIEDMAN: Hit refresh.

14 THE WITNESS: I have refresh it, okay.

15 MR. FRIEDMAN: See if that does it.

16 THE WITNESS: All right.

17 MR. FRIEDMAN: Return.

18 THE WITNESS: Okay. Page --

19 BY MS. MORSE:

20 **Q Page 32 of that 2017 order is what I am asking**
21 **about.**

22 **A** All right. Okay.

23 **Q So on that page, under the heading cash, the**
24 **last -- the last two sentences there makes reference to**
25 **the 13-month average cash balance unavailable data from**

1 **2016, and references the number 317,978, correct?**

2 A The 13-month average cash balance used on
3 available data from 2016 during the timeframe was
4 317,000. We believe this balance is more reflective of
5 ongoing utility operations, and cash will be decreased
6 by 559,000. However, that -- what that means is that we
7 had cash of 870 -- we had cash of \$877,289, that was on
8 the books of KW, but only 317,000 was allowed, and that
9 is the 13-month average, looks like -- I believe it was
10 after the test year, after the test year-end. So the
11 cash balance went down is because the utility was doing
12 a huge amount of construction and depleted their cash
13 balance before they could get more funds in, and that's
14 what -- and that's what was used rather than the actual
15 cash balance during the test year.

16 **Q Please turn to Order No. 2018-0446, and that's**
17 **at OPC's cross No. 13, OPC's cross exhibit list No. 13.**

18 A All right, I am there.

19 **Q And the Commission didn't determine the**
20 **utility's cash allowance based on percentage of gross**
21 **plant in this case, did it?**

22 A No, it did not. Are you looking for at a page
23 in particular on this exhibits?

24 **Q I will eventually, but I am just asking you**
25 **that question, if you are aware of that, and you**

1 answered it. Thank you.

2 A Okay. I was just focusing on getting to the
3 right place, okay.

4 Q Okay. So I am going to reference for my next
5 question page 31 of that order, so isn't it true that
6 the Commission stated on page 31 of its order, quote:
7 "We agree with OPC that KWRU has not provided support of
8 its claim that \$911,826 -- 826 is the proper cash
9 balance needed for day-to-day operations. As such, the
10 total cash included in working capital will be held at
11 317,978, as suggested by OPC witness Shelton approved by
12 this Commission in the last rate case a year ago,"
13 period, end quote, correct?

14 A Yes, and -- and again, the Commission did not
15 allow the actual cash balance on the books. It allowed
16 a lower number. And for this case, I am -- I am
17 recommending the lower calculation, not the amount that
18 KW, for example, used in those rate cases for its
19 request, but what the Commission found; which, as you
20 can see, is a sizable reduction. It's about a third
21 whoof was on the books of the utility as legitimate, you
22 know, in their cash accounts.

23 Q So going to CEL No. 48, which is also OPC's
24 cross No. 31.

25 A Okay. You said Exhibit No. 48, which is my

1 MFRs?

2 Q Yes. And I don't think --

3 A Okay.

4 Q So --

5 MR. FRIEDMAN: It's in the cross exhibits,
6 Debbie.

7 THE WITNESS: Oh, the cross exhibits.

8 MR. FRIEDMAN: I am sorry. Stephanie, is that
9 cross Exhibit 31?

10 MS. MORSE: Yeah, it is 31. It was
11 cross-referenced on -- it was on both lists so I
12 just provided both numbers, whichever was easier
13 for her to access.

14 THE WITNESS: Okay. So I have my MFRs in
15 front of me here.

16 BY MS. MORSE:

17 Q Okay. My question is about Schedules A-17 and
18 A-18.

19 A Okay.

20 Q So --

21 A All right.

22 Q In UIF's current case, isn't it true that the
23 actual 13-month average cash balances for water and
24 sewer utilities were 32,412 and \$41,164, or a total for
25 both utilities of 73,576, as shown on Schedule A-18 page

1 **two?**

2 A Yes. Actually, that's what they had on their
3 books, but that's one of the corrections I had
4 identified in -- in one of the staff interrogatories. I
5 found when I looked at it, this is staff interrogatory
6 110, I found when I looked at it, there should only have
7 been one cash account, and it's pretty cash \$3,000.

8 There was a payment that was -- or excuse me,
9 money that was received into one of the parent company
10 accounts was incorrectly put on the books of the
11 utility, of UIF, and it shouldn't have been, and was
12 corrected subsequently. But what ended up happening is
13 by the end of the year it wasn't there anymore, but it
14 increased their 13-month average cash. So the numbers
15 should be just 3,000 total, \$3,000 total cash the books
16 on Schedule A-17 and any other subsequent schedule using
17 working capital.

18 **Q Okay. Is that for both utili -- for water and**
19 **sewer together?**

20 A Right. 3,000 total. That's all they have, is
21 petty cash at the UIF level.

22 **Q Okay.**

23 A And --

24 **Q And so -- I am sorry, I need to go back. I am**
25 **going to ask you another question about the KW cases.**

1 So in the 2018 KW order, the Commission
2 ordered the use of the same cash balance amount as had
3 been approved in the 2017 order, is that correct?

4 A I think -- I think -- I think it was the same
5 amount. I am not looking at the order in front of me,
6 but it was -- the 2017 would have been the same as the
7 2015.

8 Q Yes. Correct.

9 So, yeah, on page 20 -- I am sorry, 31 of the
10 2017 order near the bottom, it says -- the passage that
11 I read said, it suggested that it's approved -- as
12 approved by this Commission in the last rate case a year
13 ago, at the end of the page there, correct?

14 A Right, that's what it says. And I haven't
15 read this detail in a while.

16 Q That's okay. I am just confirming that I read
17 it correctly.

18 So isn't it true, then, in UIF's last rate
19 case, there was no cash balance included in working
20 capital?

21 A Correct.

22 Q Next I am going to turn to --

23 A I am sorry to interrupt you. Could you repeat
24 that? I may have misunderstood what you asked me.

25 Q My question was: Isn't it true, in UIF's last

1 **rate case, there was no cash balance included this**
2 **working capital?**

3 A Right, and I -- and I said no, but I am not --
4 I would think that we put the \$3,000 petty cash in
5 there. I mean, it's been the same for years, so I would
6 have had that, whatever was actually on the books as
7 cash.

8 **Q Okay. So the answer is yes?**

9 A You asked me -- I thought you asked me a
10 negative. I believe we included \$3,000 of petty cash in
11 the last rate case.

12 **Q Okay. Please now turn to CEL number -- I**
13 **guess staying on your MFRs, which is CEL 48, and this**
14 **will also be OPC's cross Exhibit 32 for ease of**
15 **reference, but I am turning to MFR Schedule B-3, page**
16 **one.**

17 A I am sorry, you said B, as in boy, three?

18 **Q Yes, B, as in boy, three, page one.**

19 A Okay. All right.

20 **Q And on this schedule, there is a series of**
21 **test year and proforma revenue adjustments, correct?**

22 A Right.

23 **Q And those adjustments weren't discussed**
24 **anywhere in your direct testimony, correct?**

25 A Correct, the description of what those

1 adjustments are contained in the MFR schedules, and the
2 only things I brought up in my testimony were anomalies,
3 or things that were out of the ordinary in the MFR
4 schedules.

5 **Q Okay. And then to your testimony, regarding**
6 **operating expenses, isn't it true the only expense**
7 **adjustments discussed in your direct testimony were for**
8 **excess unaccounted for water or infiltration or**
9 **outflow -- correction, and outflow or I&I, I am sorry.**

10 **A** I think I also mentioned something about an
11 annualized adjustment for salaries, but maybe not.
12 Yeah, everything else is explained in the MFRs. Again,
13 the only thing I have in my direct testimony are those
14 things that I saw in the minimum filing requirements
15 were a little unusual, like the I&I, the way that I had
16 to do it when we are doing a consolidated case, so I
17 explained that a bit just to help understand the MFRs
18 better.

19 **Q All right. But you did make several test year**
20 **and proforma adjustments to the actual test year results**
21 **in order to develop your recommended revenue increases**
22 **in this case, correct?**

23 **A** Yes, and they are detailed in the -- in my
24 DDS-1 Exhibit 48.

25 **Q Back to MFR Schedule B-3, which is again CEL**

1 48.

2 A Okay.

3 Q On pages one and two of Schedule 3 there are
4 several adjustments in addition to adjustments relating
5 to unaccounted for water and I&I, correct?

6 A Oh, yes, many.

7 Q Okay. And for example, isn't there an
8 adjustment for -- a chemical adjustment at MFR Schedule
9 B-3, page 3?

10 A I am sorry, I didn't hear the end of that,
11 after you said B-3.

12 Q Oh, page one.

13 A Uh-huh. Okay. And what's the question?

14 Q The question: Isn't there a chemical
15 adjustment that -- on that page?

16 A Oh, a chemical adjustment, yes, there sure is.

17 Q Okay. And going to page two of that document,
18 isn't it true there is additional revenue and expense
19 adjustments shown on that wage?

20 A Yes, along with the detailed explanation for
21 each one.

22 Q Okay. And in terms of a narrative
23 explanation, is that what you are testifying?

24 A Yeah -- well, I believe that the explanation,
25 for example, I have proforma adjustments for annualized

1 rate increases for purchased water and sewer, and I say
2 at the top of page two, starting on line three, Terre
3 Verde, City of St. Petersburg increase on October 1,
4 2019, January to September gallons 87,80 times, and then
5 I show a calculation of what the increase is and then
6 the number.

7 So I think that that is -- that provides an
8 explanation of the adjustment, and then during the
9 discovery process documentation that's requested and
10 provided.

11 **Q** Well, there are no other adjustments, so those
12 adjustments on page two include another chemical
13 adjustment, contractual services adjustments relating to
14 testing and grounds maintenance, office rental,
15 equipment rental, labor adjustments, telephone and truck
16 fleet adjustments, right?

17 A Yes.

18 **Q** Okay. But those weren't discussed in your
19 direct testimony, were they, in the narrative portion?

20 A No. No. The -- I referred to my exhibit to
21 be part of my -- what I am sponsoring, and the
22 explanation is what's required to fulfill the minimum
23 filing requirements.

24 **Q** Isn't it true the company included labor cost
25 increases in its revenue requirement?

1 A Yes.

2 Q And those labor cost increases were discussed
3 in your direct testimony?

4 A Correct. They were described in the -- in my
5 exhibit explaining how they were calculated.

6 Q And the company also included costs for
7 several additional employee positions, correct?

8 A Yes, four new employees.

9 Q So regarding those new employee positions,
10 isn't it true that none of those new employees were
11 actually hired?

12 A I don't know.

13 Q Well, I will turn to OPC's cross exhibit list
14 No. 15.

15 MS. MORSE: And, Mr. Chairman, this is also on
16 the CEL at 163. I am asking the witness to please
17 look at UIF's response to Interrogatory No. 138.

18 BY MS. MORSE:

19 Q Ms. Swain, will you please read that response
20 into the record?

21 A Response -- and by the way, I didn't prepare
22 this response. This was Mr. Deason, but the response
23 is: None of these proposed additional employees have
24 been hired yet. The projected annual salary and the
25 projected annual cost per position inclusive of the cost

1 of benefits and taxes is as follows. And what follows
2 is the schedule showing the projected costs associated
3 with those employees that are to be -- or at that time,
4 still to be hired. They had not been hired yet.

5 Q Okay. Thank you.

6 So I am going to go back to CEL Exhibit 48,
7 which is the MFR schedule, please.

8 A Yes.

9 Q This time to MFR Schedule C-8, C as in cat,
10 eight.

11 A Okay.

12 Q So at the bottom of the page there, you have
13 included a note that states, quote: "A parent debt
14 adjustment is not necessary. Utilities, Inc. (parent
15 company) imputes interest expense to each subsidiary
16 company, including Utilities, Inc. of Florida, based on
17 the capital structure of the consolidated group. This
18 intercompany interest is shown on Schedule C-3, line
19 eight," correct? Is that --

20 A Correct. Correct.

21 Q Okay. So exactly what interest of the parent
22 has been imputed to UIF?

23 A That is, yes, that -- that's referring to
24 interest -- the parent company's debt that has been
25 allocated to Utilities, Inc. of Florida based upon their

1 rate base compared to the rest of the entire
2 corporation.

3 **Q Isn't it true that UIF has no debt obligations**
4 **of its own, and all debt is provided by the parent?**

5 A Long-term debt, the answer is yes. Short-term
6 debt, no -- or excuse me, yes, short-term debt, for
7 example, accounts payable, et cetera. Long-term debt,
8 that's right. All the debt is incurred at the parent
9 level, not at the individual subsidiary or system level.

10 **Q Isn't it true that the debt imputed on MFR C-8**
11 **only relates to the debt obligations obtained by the**
12 **parent used to support the investments of UIF?**

13 A The -- it's the -- the debt is incurred by the
14 parent for any number of reasons. It's allocate to UIF
15 based upon its rate base.

16 **Q Okay.**

17 A I don't -- I don't -- I haven't read the debt
18 documents to know what the purpose of the original debt
19 was.

20 **Q Okay. That's fair.**

21 I am going to turn to OPC's cross Exhibit No.
22 35. Do you have that document?

23 A I am -- I am getting there. Okay, I am there.

24 **Q All right. And -- and you are familiar with**
25 **Rule 25-14.004, Florida Administrative Code, related to**

1 **the parent debt adjustment, correct?**

2 A Yes.

3 **Q In this case, did you not -- you didn't**
4 **actually calculate a parent debt adjustment, did you?**

5 A No, it wasn't necessary, as the note on C-8
6 says.

7 Usually what happens is that the sub -- a
8 subsidiary utility that files a rate case shows its
9 capital structure, and a portion that's equity
10 represents their equity ownership of their parent
11 company, and the subsidiary utility is not allowed to
12 earn an interest -- excuse me, an income tax expense
13 addition to the revenue requirement on that portion of
14 equity earnings that's associated with the parent where
15 the parent incurred the debt.

16 So generally what happens is, say if my
17 utility -- my utility has a 50-50 debt equity, of that
18 50 percent equity, the parent company has a 50-50 debt
19 equity, then they can only -- my utility can only earn
20 an income tax increase in its revenues on the 25
21 percent, which is 50 percent of the 50 percent. So
22 that's the focus of the parent debt adjustment, which
23 it's not necessary for Utilities, Inc. of Florida
24 because they don't -- we are not reporting the utility's
25 capital structure. The capital structure is that of the

1 parent company. So we are reporting the parent company,
2 their actual capital structure, and with the exception
3 of a deferred taxes and customer deposits that are
4 maintained on the -- on the utility's books.

5 **Q So you can't assure the Commission that your**
6 **imputation of interest will fulfill the requirements of**
7 **the parent debt adjustment if you didn't actually do the**
8 **required calculation, can you?**

9 A The parent debt adjustment and the -- and the
10 amount of interest allocated to a utility are really two
11 completely different things. The interest that the
12 company -- that the utility is allowed to earn is the
13 interest on debt on the capital structure that's
14 allocated to Utilities, Inc. of Florida.

15 So it may be a different number than what's on
16 the books of the utility because we do it differently
17 for the rate case than the parent company does it for
18 the allocation to the utility, but it's, therefore,
19 irrelevant. It's what the Commission allows in the
20 determination of capital structure and the overall rate
21 of return in this proceeding.

22 **Q So going back to your direct testimony, you**
23 **have a heading on page four titled "Current and Deferred**
24 **Income Taxes", correct?**

25 A Where -- where in my direct testimony are you

1 pointing me?

2 Q Page four.

3 A Okay. Okay, I am there.

4 Q You don't have any discussion there about
5 income taxes other than the excess deferred income
6 taxes, or EDIT, associated with the tax jobs and cuts
7 act correct?

8 A That's right. That's correct.

9 Q Isn't it true that UIF files its taxes as part
10 of a consolidated income tax group?

11 A Yes, they do.

12 Q Isn't it true the consolidated group did not
13 actually pay any taxes during the test year?

14 A I have no -- it's irrelevant for this case the
15 amount of income tax we get -- (inaudible) --

16 MS. MORSE: Chairman.

17 CHARIMAN CLARK: All right. We got somebody
18 is moving something somewhere, let's see if we can
19 find out the source of that and start over again,
20 okay?

21 THE WITNESS: I am sorry. What was I going to
22 say? Ask me the question again, I am sorry. Oh,
23 you asked me if --

24 BY MS. MORSE:

25 Q It's just a yes or no question. It was just a

1 **question --**

2 A You were asking me if the parent company paid
3 tax. I said I didn't know, and then I was explaining
4 that it's irrelevant because the income tax allowance
5 allowed in this case is going to be based upon the new
6 financial results of this case.

7 Q **Well, turning to OPC's cross Exhibit No. 14**
8 **regardless, OPC's cross Exhibit No. 14, and that's in**
9 **response to UIF's response to OPC's Interrogatory No.**
10 **49?**

11 A That's one of the cross exhibits?

12 Q **Cross Exhibit No. 14?**

13 MS. MORSE: And, Mr. Chairman, I would like to
14 identify this exhibit with a hearing exhibit
15 number. I believe we are at 190.

16 MS. CIBULA: Yes, 190.

17 THE WITNESS: Okay.

18 (Whereupon, Exhibit No. 190 was marked for
19 identification.)

20 BY MS. MORSE:

21 Q **The answer -- if you can read that question**
22 **and answer into the record, please, Ms. Swain?**

23 A Could you repeat which question and answer?

24 Q **I am sorry, it's OPC's Interrogatory No. 49.**

25 A 49. Okay. Okay. Please state how much was

1 actually paid to the IRS by the consolidated income tax
2 group in each of the past three years. Response: No
3 federal taxes were due and paid to the IRS for tax years
4 2016 to 2018.

5 Q Thank you.

6 So moving on to the excess deferred income
7 taxes in your direct testimony, and I am referring to
8 page four, you state that protected EDIT is being
9 amortized over a 20.51-year period and unprotected EDIT
10 over a 10-year period, correct?

11 A Correct.

12 Q In your direct testimony, you didn't provide
13 any discussion as to why you chose those time periods,
14 did you?

15 A Well, I did. I said the 20.51-year period
16 representing the remaining depreciation life of the
17 associated asset. The 10-year period I did not explain
18 in my direct testimony, that was not until my rebuttal.

19 Q Okay. Thank you.

20 MS. MORSE: Mr. Chair, I don't have any
21 further questions, but I would like to move Exhibit
22 No. 190 into the record.

23 CHAIRMAN CLARK: Without objection so ordered.

24 (Whereupon, Exhibit No. 190 was received into
25 evidence.)

1 CHAIRMAN CLARK: Thank you very much, Ms.
2 Morse.

3 Let's move to Staff.

4 EXAMINATION

5 BY MR. TRIERWEILER:

6 Q Good afternoon, Ms. Swain.

7 I am going to direct your attention to CEL
8 186. This is a one-page web page print from the Florida
9 Department of Revenue web page, has tax information
10 publication or, TIP across the top.

11 A I don't -- I don't have that, give me just a
12 minute so I can pull it up.

13 MR. WHARTON: Go into the documents.

14 MR. FRIEDMAN: Back to the cross-examination
15 documents, go to the very bottom and it says final
16 CEL.

17 MR. TRIERWEILER: Yes, CEL 186.

18 THE WITNESS: Staff hearing, I am sorry. I am
19 getting there. I am learning -- you have got to
20 teach each witness one at a time.

21 Okay, which exhibit? I am sorry, repeat which
22 one?

23 BY MR. TRIERWEILER:

24 Q 186.

25 A Okay. All right, I am there.

1 Q Are you familiar with this web page, the tax
2 information publication for Florida --

3 A Yes, I am.

4 Q Okay. And it's for Florida state corporate
5 income tax rates, is that correct?

6 A Yes. That's right.

7 Q Would you agree that the document indicates
8 the Florida State corporate income tax rate is expected
9 to increase to 5.5 percent on January 1st, 2022?

10 A Yes. That's right.

11 Q Assuming this expected change to the state
12 corporate income tax to 5.5 percent on January 1st,
13 2022, would a composite state corporate income tax rate
14 developed using a four-year period that incorporates a
15 4.458 percent rate for the months rates are expected to
16 be in effect in 2021, and incorporates a rate of 5.5
17 percent for the remainder of the four-year period, allow
18 the company the opportunity to earn the expected amount
19 of state corporate income tax expense over the four-year
20 period?

21 A It only would if we were going to file a rate
22 case in another four years, and I don't think we can
23 anticipate that that would be the case. I think it
24 would be more appropriate, and I know this is
25 contradictory to my reaction during my deposition, but I

1 think, upon reflection, it would be more appropriate to
2 go ahead and put the rate down that we expect to be in
3 place during the time the rates are in effect, which
4 would be the five-and-a-half percent, and hopefully the
5 utility doesn't have to come back for a rate increase if
6 we get that SWIM policy in place.

7 Q You do, however, accept that the current rate
8 today, and until January 1, 2022, is 4.458 percent?

9 A Yes, I do. That is the current rate.

10 Q Thank you.

11 Regarding AFUDC, is it your opinion that the
12 Commission cannot set an AFUDC rate in this case, and
13 that a separate petition must be filed to set an AFUDC
14 rate?

15 A No. No. I -- I understand that the PSC can
16 at its own, on its own, set an AFUDC rate. It does not
17 need to wait for a petition from the utility.

18 MR. TRIERWEILER: Thank you. I have nothing
19 further.

20 CHAIRMAN CLARK: All right. Commissioners, do
21 you have any questions?

22 Commissioner Fay.

23 COMMISSIONER FAY: Thank you, Mr. Chairman,
24 and thank you, Ms. Swain, for your -- your
25 testimony.

1 Ms. Morse asked you a number of questions
2 about your testimony related to the cash balance,
3 and I think those were some good questions to try
4 to get a, you know, for the Commission to get a
5 better understanding of this process.

6 What I am trying to figure out, not to
7 oversimplify it, but it seems like you sort of
8 backed out these numbers to -- to get to something
9 that could be used as a theory for this cash
10 balance, and I just want to get clarification.

11 It seems like even if you sort of use this
12 thought process that you put forward, you have got
13 different numbers, the two percent and the 1.65 of
14 the gross plant numbers out there. Is there a
15 reason you used the two percent and not the 1.65?

16 THE WITNESS: Well, of course it's a better
17 number, but, no, I -- I wouldn't normally even look
18 at doing this. I would have included the
19 intercompany accounts, especially as I learned more
20 and more about them, but it just was such a huge
21 number.

22 So I am talking about, I think 13 or \$14
23 million, and this is more in the neighborhood of
24 five-and-a-half that I am asking for, and I really
25 just tried to see if there was some way I could

1 make it comparable to something.

2 So why did I pick the two percent? Based upon
3 what the gross plant is for Utilities, Inc.,
4 compared to net plant and all those factors, I felt
5 the two percent was more appropriate.

6 The 1.65, to tell you the truth, I -- what
7 happened in the KW Resort case, and I was the
8 consultant for that, was devastating to the company
9 to have such a hit on its cash, but it was, you
10 know, peanuts for them that different in -- that
11 difference in percentage.

12 So the short answer is the two percent, I
13 felt, was reasonable when compared to the 13 or 14
14 million that I wasn't asking for for intercompany.

15 COMMISSIONER FAY: Okay. All right. I
16 appreciate the context.

17 I -- you know, to your point, the number is
18 bigger, but when you look at the timeline it's, you
19 know, one is a 2015 and one is a 2017, so it looks
20 like there is a lot of factors there that we have
21 to take into consideration when trying to figure
22 out what -- what number would be appropriate there,
23 so I appreciate the background.

24 Thank you. That's all I had, Mr. Chair.

25 CHARIMAN CLARK: Thank you, Commissioner Fay.

1 Other Commissioners have questions?

2 All right. Seeing none, redirect, Mr.
3 Friedman.

4 MR. FRIEDMAN: We have none. And that
5 concludes our, I think -- let me look. I think
6 that concludes our direct case, Mr. Chairman.

7 CHAIRMAN CLARK: All right. Thank you.
8 Any -- any exhibits?

9 MR. REHWINKEL: Mr. Chairman?

10 CHAIRMAN CLARK: Mr. Rehwinkel.

11 MR. REHWINKEL: Yes, before we leave Ms.
12 Swain's testimony, I am not going to make a motion
13 to strike, but I would like to ask the Commission
14 to disregard her testimony about the SWIM program.
15 She's not identified as a witness on Issue 41, nor
16 did she file any testimony on the SWIM program, but
17 she volunteered some testimony on that, which I
18 think is improper.

19 CHAIRMAN CLARK: Thank you, Mr. Rehwinkel.
20 Duly noted.

21 Ms. Morse, do you have any exhibits to file?

22 MS. MORSE: I am sorry, Mr. Chairman, what was
23 the question?

24 CHAIRMAN CLARK: Any exhibits?

25 MS. MORSE: Only the Exhibit 190, but I think

1 you already moved that in for me. Thank you.

2 CHAIRMAN CLARK: All right. Thank you very
3 much.

4 All right. I believe that concluded UIF. We
5 will move to the OPC witness Crane.

6 Ms. Crane, would you please raise your right
7 hand.

8 Whereupon,

9 ANDREA C. CRANE

10 was called as a witness, having been first duly sworn to
11 speak the truth, the whole truth, and nothing but the
12 truth, was examined and testified as follows:

13 THE WITNESS: Yes, I do.

14 CHAIRMAN CLARK: All right. Ms. Morse.

15 MS. MORSE: Thank you, Mr. Chairman.

16 EXAMINATION

17 BY MS. MORSE:

18 **Q Will you please state your name for the**
19 **record?**

20 A Yes. My name is Andrea C. Crane.

21 **Q Can you tell me on whose behalf you are**
22 **testifying today?**

23 A Yes. I am testifying on behalf of OPC.

24 **Q And are -- is OPC representing all the**
25 **customers of Utilities, Inc. of Florida?**

1 A They are.

2 Q Ms. Crane, did you cause to be prepared direct
3 testimony on November 13th, 2020, consisting of 52
4 pages?

5 A Yes.

6 Q Do you have any changes or corrections to make
7 to that testimony?

8 A No, I don't.

9 Q Ms. Crane, if I were to ask you the same
10 questions today as contained in your November 13th,
11 2020, prefiled direct testimony, would your answers be
12 the same today as they were in that prefiled testimony?

13 A They would.

14 Q And Ms. Crane, did you also cause to be
15 prepared Exhibit ACC-1 through ACC-3?

16 A Yes, I did.

17 Q Do you have any corrections or changes to
18 those exhibits?

19 A No, I don't.

20 Q Ms. Crane, did you prepare a summary of your
21 prefiled testimony?

22 A Yes, I did.

23 Q Would you give that summary to the Commission
24 at this time, please?

25 A Yes.

1 My testimony addresses the company's revenue
2 requirement, or the total amount of the revenue increase
3 that UIF requires. OPC is recommending a water increase
4 of \$1.13 million, or about 6.8 percent, instead of the
5 17 percent increase being requested by UIF. OPC's
6 recommendations result in a sewer increase of \$2.58
7 million, or 12.7 percent, well below the 32 percent
8 being requested by the company.

9 My revenue requirement reflects the proforma
10 plant adjustments being recommended by OPC witness Frank
11 Radigan, and the capital structure and cost of capital
12 recommendations of OPC witness David Garrett.

13 In addition, my testimony discusses several
14 other adjustments, such as the proposed disallowance of
15 the company's presumed cash balance adjustment, which
16 adds millions of dollars to the company's water and
17 sewer rate bases.

18 With regard to operating expenses, I recommend
19 adjustments relating to new employee positions, the
20 company's labor escalator, severance expenses, the
21 portion of incentive compensation that is tied to
22 financial metrics, nonqualified requirement plan costs,
23 lobbying costs, and costs related to a holiday party. I
24 have also made adjustments to depreciation expense and
25 property taxes -- property tax expense which are

1 consistent with the utility plant in service adjustments
2 being recommended by OPC.

3 With regard to EDIT, excess deferred income
4 taxes, I explained the broad discretion that the
5 Commission has with regard to the amortization of EDIT,
6 and I recommend that this regulatory liability be
7 returned to ratepayers over a period of five years
8 instead of over the 10 years being proposed by UIF.

9 Finally, I recommended that the Commission
10 utilize the current state income tax rate of 4.458
11 percent instead of the 5.5 percent being claimed by UIF.

12 In addition to revenue requirement issues,
13 there are also two policy issues that I discuss in my
14 testimony. The first is the allowance for funds used
15 during construction, or AFUDC. Since January 1, 2003,
16 the company has used an AFUDC rate of 9.03 percent,
17 which reflects the cost of equity of 11.75 percent, and
18 a cost of debt of 7.82 percent. In my testimony, I
19 discuss the fact that capital costs have fallen
20 dramatically since 2003, and it is important for the
21 Commission to update this rate in this case.

22 And finally, with regard to the company's
23 request to implement -- to implement the Sewer and Water
24 Improvement Mechanism, or SWIM, I explained why I
25 believe that this mechanism is not -- is unnecessary and

1 why it is poor regulatory policy. I also discuss the
2 fact that it will result in significant annual rate
3 increases to Florida ratepayers.

4 That concludes my summary.

5 CHAIRMAN CLARK: Ms. Morse?

6 MS. MORSE: I am sorry about that, Mr.
7 Chairman.

8 I was mentioning for the record that Exhibits
9 ACC-1 through ACC-3 are identified in the CEL as
10 Exhibits 87 through 89.

11 And, Mr. Chairman, I would like to move Ms.
12 Crane's November 13, 2020, testimony into the
13 record, please.

14 CHAIRMAN CLARK: All right. Show the
15 testimony entered.

16 (Whereupon, prefiled direct testimony of
17 Andrea C. Crane was inserted.)

18

19

20

21

22

23

24

25

1 to January 1989. From June 1982 to September 1987, I was employed by various Bell
2 Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the
3 Product Management, Treasury, and Regulatory Departments.

4

5 **Q. Have you previously testified in regulatory proceedings?**

6 A. Yes. since joining The Columbia Group, Inc., I have testified in over 400 regulatory
7 proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Florida,
8 Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York,
9 Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, Washington, West
10 Virginia and the District of Columbia. These proceedings involved gas, electric, water,
11 wastewater, telephone, solid waste, cable television, and navigation utilities. A list of
12 dockets in which I have filed testimony over the past five years is included in Exhibit
13 ACC-1.

14

15 **Q. Have you previously testified in regulatory proceedings in Florida?**

16 A. Yes. I filed testimony on behalf of the Office of Public Counsel (“OPC”) in the Peoples
17 Gas System base rate case, PSC Docket No. 20200051-GU.

18

19 **Q. What is your educational background?**

20 A. I received a Master of Business Administration degree, with a concentration in Finance,
21 from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a
22 B.A. in Chemistry from Temple University.

1 **II. PURPOSE OF TESTIMONY**

2 **Q. What is the purpose of your testimony?**

3 A. On July 13, 2020, Utilities, Inc. of Florida (“UIF” or “Company”) filed a Petition with
4 the Florida Public Service Commission (“Commission”) seeking a base revenue
5 increase of \$2,823,848, or approximately 17.0% over current revenues at present rates,
6 for its water utility. In addition, the Company requested a base rate increase of
7 \$6,529,383, or approximately 32.2%, for its sewer systems.

8 The Company’s filing is based on a historic Test Year ending December 31,
9 2019. UIF is also seeking to include in rate base capital projects anticipated to be
10 completed within 24 months of the end of the Test Year. In addition, the Company has
11 reflected certain pro forma operating expense adjustments in its filing. UIF is
12 requesting a return on equity of 11.75% and a capital structure consisting of 49.4%
13 common equity (excluding customer deposits and deferred income taxes). The
14 Company’s last base rate case was filed in Docket No. 20160101-WS and was based
15 on an historic 2015 Test Year. That case was resolved with a Commission Order on
16 September 25, 2017.

17 In addition to its request for base rate increases, the Company is also seeking
18 authorization to implement a Sewer and Water Improvement Mechanism (“SWIM”) to
19 recover the revenue requirement associated with certain capital projects between base
20 rate case filings.

21 The Columbia Group, Inc. was engaged by OPC to review the Company’s
22 Petition and to provide recommendations to the Commission regarding revenue
23 requirement issues. In addition, David Garrett is sponsoring testimony on behalf of

1 OPC regarding cost of capital and capital structure issues, and Frank Radigan is
2 sponsoring testimony on behalf of OPC regarding engineering issues, including pro
3 forma plant additions, non-used and useful plant, unaccounted-for water, and
4 Infiltration and Inflow (“I&I”).

5

6 **Q. What are the most significant issues in this rate proceeding?**

7 A. The most significant financial issues include the Company’s request to reflect in rates
8 significant capital expenditures projected over a two-year period and the Company’s
9 requested 11.75% return on equity. The Company is also seeking increases to its labor
10 costs, chemical costs, and certain other operating and maintenance expenses.

11

12 **III. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS**

13 **Q. Please provide a brief description of the Company.**

14 A. UIF provides water services to more than 36,000 customers in eight counties through
15 its 22 operating water systems. In addition, the Company provides sewer services to
16 approximately 33,000 customers through 18 wastewater systems located in nine
17 Florida counties. UIF provides water and/or sewer services in Charlotte, Highlands,
18 Lake, Lee, Marion, Orange, Pasco, Pinellas, Polk and Seminole Counties.

19 UIF receives shared supporting services from an affiliate, Water Services
20 Corporation (“WSC”), and certain corporate services from its parent company, Corix
21 Infrastructure, Inc. (“CII”). Costs from these entities are charged or allocated to UIF
22 pursuant to a Cost Allocation Manual, as discussed in the testimony of Mr. Elicegui.

23

1 **Q. What are your conclusions concerning the Company’s revenue requirement and**
2 **its need for rate relief?**

3 A. Based on my analysis of the Company’s filing and other documentation in this case,
4 my conclusions are as follows:

5 1. The twelve months ending December 30, 2019, is an acceptable Test Year to
6 utilize in evaluating the reasonableness of the Company’s claim.

7 2. As discussed in the testimony of Mr. Garrett, the Commission should authorize
8 a pro forma cost of equity of 9.5% for UIF, and a capital structure consisting of
9 50% long-term debt, 5% short-term debt, and 45% common equity. In addition,
10 other capital components that the Company included in capital structure, such
11 as customer deposits, tax credits, and deferred income taxes, should also be
12 included, resulting in an overall cost of capital of 6.73% (see Exhibit ACC-2,
13 Schedule 2 and Exhibit ACC-3, Schedule 2).¹

14 4. UIF’s Water Utility has a pro forma Test Year rate base of \$54.07 million and
15 pro forma operating income at present rates of \$2.82 million. Based on my
16 recommended adjustments and on Mr. Garrett’s recommended cost of capital,
17 the Commission should authorize a revenue increase of no more than \$1.13
18 million, or approximately 6.8%, for the water utility (see Exhibit ACC-2,
19 Schedule 1).

20 5. UIF’s Sewer Utility has a pro forma Test Year rate base of \$74.39 million and

¹ Exhibit ACC-2 contains my Water Revenue Requirement schedules. Schedule 1 and Schedule 25 are Revenue Requirement Summary Schedules, Schedules 2 to 7 are Rate Base Schedules, and Schedules 8 to 24 are Operating Income Schedules. Exhibit ACC-3 contains my Sewer Revenue Requirement schedules. Schedule 1 and Schedule 28 are Revenue Requirement Summary Schedules, Schedules 2 to 8 are Rate Base Schedules, and Schedules 9 to 27 are Operating Income Schedules.

1 pro forma operating income at present rates of \$3.15 million. Based on my
2 recommended adjustments and on Mr. Garrett's recommended cost of capital,
3 the Commission should authorize a revenue increase of no more than \$2.58
4 million, or 12.7%, for the sewer utility (see Exhibit ACC-3, Schedule 1).

5 6. The Commission should authorize a prospective allowance for funds used
6 during construction ("AFUDC") rate of no higher than 6.73% for the water and
7 sewer utilities.

8 7. The Commission should reject the Company's request to implement a "SWIM"
9 mechanism to recover the revenue requirement of certain capital projects
10 between base rate cases.

11

12 **Q. Are you in agreement with all of the components of the Company's revenue**
13 **requirement claim, other than those specifically discussed in your testimony?**

14 A. No, not necessarily. If a specific issue or methodology is not addressed in my
15 testimony, it does not necessarily mean that I support the Company's position on that
16 issue or ratemaking methodology. In addition to the adjustments recommended in my
17 testimony, there may be adjustments raised by other parties or Commission staff to this
18 proceeding that have merit and that should be adopted by the Commission. For this
19 reason, I have identified my calculated revenue deficiency as a maximum.

20 In addition, in some cases, the Company has utilized methodologies with which
21 I may disagree but which have been accepted by the Commission in the past, and which
22 I chose not to address in this testimony. Accordingly, the Commission should not
23 assume that OPC is necessarily in agreement with all issues that are not otherwise

1 addressed in my testimony.

2

3 **IV. COST OF CAPITAL AND CAPITAL STRUCTURE**

4 **Q. What is the cost of capital and capital structure that the Company is requesting**
5 **in this case?**

6 A. The Company is requesting an authorized return on common equity of 11.75%, and a
7 capital structure consisting of 49.4% common equity to total debt plus equity. The
8 capital structure also includes customer deposits, tax credits, and deferred income
9 taxes. Based on its proposed capital structure and cost rates, UIF is requesting an
10 overall authorized return of 7.89%, as shown below:

11

| | Percent | Cost | Weighted Cost |
|-------------------------------------|---------|--------|---------------|
| Long Term Debt | 41.59% | 5.78% | 2.40% |
| Short Term Debt | 4.59% | 4.04% | 0.19% |
| Common Equity | 45.07% | 11.75% | 5.30% |
| Customer Deposits | 0.17% | 2.00% | 0.00% |
| Tax Credits – Zero Cost | 0.05% | 0.00% | 0.00% |
| Accumulated DIT | 4.88% | 0.00% | 0.00% |
| Other Deferred Tax Liability – TCJA | 3.65% | 0.00% | 0.00% |
| Total | 100% | | 7.89% |

17

18 **Q. Is OPC recommending any adjustments to the Company's capital structure?**

19 A. Yes, as discussed by Mr. Garrett, OPC is recommending a capital structure that consists
20 of 50% long-term debt, 5% short-term debt, and 45% common equity. This
21 recommendation excludes the impact of customer deposits, tax credits and deferred
22 taxes. To determine OPC's overall cost of capital, I have included customer deposits,

1 tax credits, and deferred income taxes at the percentages proposed by UIF, and adjusted
2 the debt and equity components consistent with Mr. Garrett's recommendation.

3

4 **Q. What cost of equity is Mr. Garrett recommending?**

5 A. Mr. Garrett is recommending a cost of equity of 9.5%. OPC is not recommending
6 adjustments to any other capital cost rates.

7

8 **Q. What is the overall cost of capital that OPC is recommending in this case?**

9 A. OPC is recommending an overall cost of capital of 6.73%, based on the following
10 capital structure and cost rates:

| | Percent | Cost | Weighted Cost |
|---|---------|-------|---------------|
| 11 Long Term Debt | 45.63% | 5.78% | 2.64% |
| 12 Short Term Debt | 4.56% | 4.04% | 0.18% |
| 13 Common Equity | 41.06% | 9.50% | 3.90% |
| Customer Deposits | 0.17% | 2.00% | 0.00% |
| 14 Tax Credits – Zero Cost | 0.05% | 0.00% | 0.00% |
| Accumulated DIT | 4.88% | 0.00% | 0.00% |
| 15 Other Deferred Tax Liability – TCJA | 3.65% | 0.00% | 0.00% |
| 16 Total | 100% | | 6.73% |

17 This is the cost of capital that I have incorporated into my revenue requirement
18 schedules, as shown in Exhibit ACC-2, Schedule 2 for water and in Exhibit ACC-3,
19 Schedule 2 for sewer.

1 V. RATE BASE ISSUES

2 A. Post-Test Year Utility Plant-in-Service Additions

3 Q. **What Test Year did the Company utilize to develop its rate base claim in this**
4 **proceeding?**

5 A. The Company selected the Test Year ending December 31, 2019. In addition, the
6 Company included post-test year additions that are expected to be in-service within 24
7 months of the end of the Test Year.

8

9 Q. **How do the Company's 2020 and 2021 projected additions compare with the**
10 **Company's gross plant balances?**

11 A. For the water utility, the Company has included post-test year, pro forma additions of
12 \$4.06 million, or approximately 3.3% of the gross utility plant at the end of the Test
13 Year. For the sewer utility, the Company has included post-test year additions of
14 \$25.31 million, or approximately 19.3% of the gross utility sewer plant at the end of
15 the Test Year.

16

17 Q. **Is OPC recommending any adjustments to the post-test year utility plant-in-**
18 **service additions projected by UIF in its filing?**

19 A. Yes, OPC is recommending several adjustments as discussed in the testimony of Mr.
20 Radigan. UIF identified 45 post-test year projects for which it is requesting rate base
21 treatment in this case, designated PCF-1 through PCF-45 in UIF witness Flynn's
22 testimony. Most of these are capital projects or studies that the Company is proposing
23 to include in its utility plant-in-service claim. A few of these projects are studies that

1 the Company is proposing to include in its sewer utility working capital allowance.

2 Mr. Radigan has reviewed the post-test year projects included in the Company's
 3 filing, along with supporting documentation and bids for the various projects. He has
 4 also
 5 conducted an on-site visit of certain systems. As a result of his investigation, Mr.
 6 Radigan has identified three water projects that he recommends be excluded from the
 7 Company's rate base claim. The projects that Mr. Radigan recommends be excluded
 8 are the following:

| Project (Water) | PCF# | Amount in Filing |
|--|------|------------------|
| E.E. Williamson Utility Relocations | 28 | \$347,142 |
| Ground Storage Tank Deficiency | 31 | \$188,923 |
| Eng Northwestern Bridge WM Replacement | 45 | \$22,000 |
| | | |
| Total | | \$558,065 |

10
 11 In addition, Mr. Radigan has identified thirteen of UIF's sewer projects that he
 12 recommends be excluded from rate base in this case. As shown below, three of these
 13 sewer projects are composed of subparts that were separately accounted for in the
 14 accounting testimony of UIF witness Swain. In addition, Ms. Swain also included
 15 trucks for new employees in her pro forma plant adjustment. The sewer projects that
 16 OPC recommends be excluded from utility plant-in-service are the following:

| Project (Sewer) | PCF# | Amount in Filing |
|----------------------------------|------|------------------|
| Engineering WWTP Master Plan | 6 | \$40,636 |
| Barrington WWTP Cap Improvements | 13 | \$396,710 |
| PDR & Master Lift Station | 14 | \$382,847 |
| PDR & Master Lift Station | 14 | \$89,331 |
| PDR & Master Lift Station | 14 | \$195,252 |
| PDR & Master Lift Station | 14 | \$545,041 |

| | | |
|-------------------------------------|-----|--------------|
| PDR & Master Lift Station | 14 | \$665,728 |
| Curlew Creek I&K Improvements | 16 | \$664,201 |
| MC Headworks Improvements | 17 | \$3,186,839 |
| Eng Relocate LS 10 FM | 18 | \$58,139 |
| L/S RTU Installation -2020091 | 20 | \$135,490 |
| Const – Wekiva WWTF Headworks | 23 | \$2,901,907 |
| ENG – Wekiva WWTF Headworks | 23 | \$198,117 |
| ENG FS/C1/L2 FM | 26 | \$202,637 |
| E.E. Williamson Utility Relocations | 28 | \$115,714 |
| Lift Station Mechanical Rehab | 29 | \$560,469 |
| UIF CIP Analysis/Modeling | 30 | \$93,492 |
| FM / GSM Relocation | 33 | \$374,656 |
| FM / GSM Relocation | 33 | \$190,409 |
| FM / GSM Relocation | 33 | \$44,426 |
| Trucks for New Employees | N/A | \$95,000 |
| | | |
| Total | | \$11,137,041 |

1

2

The total recommended disallowance of \$11.13 million includes the elimination of the additional trucks related to new employees. As discussed later in this testimony, I am recommending that costs for these new employees be excluded from this case. In addition, it should be noted that one of these projects, PCF #28 - the E. F. Williamson Utility Relocations, includes investment in both the water and sewer utilities.

4

5

6

7

8

Q. Based on Mr. Radigan's review, what adjustments are you recommending to the Company's utility plant-in-service claims?

9

10

A. I am recommending several adjustments. First, I am recommending that the utility plant-in-service balances associated with the projects identified by Mr. Radigan be eliminated from the Company's utility plant-in-service claim. In addition, several of these projects have associated retirements that had been removed by UIF in its rate base claim. In order to develop my water and sewer utility plant-in-service adjustments, I

11

12

13

14

1 excluded the post-test year additions identified by Mr. Radigan, but added back the
2 associated retirements, since those retirements would presumably not take place until
3 and unless the associated plant addition is completed and placed into service. These
4 adjustments are shown in Exhibit ACC-2, Schedule 4 for water and in Exhibit ACC-3,
5 Schedule 4 for sewer.

6
7 **B. Non-Used and Useful Plant**

8 **Q. Is Mr. Radigan also recommending an adjustment to non-used and useful plant?**

9 A. Yes, he is. Non-used and useful plant is plant that has been completed but which the
10 Commission finds is not needed to serve existing customers, e.g., excess capacity in a
11 sewer treatment facility that was constructed to serve future anticipated load. The
12 Company quantified its non-used and useful plant and proposed a rate base reduction
13 for the associated amount. UIF included non-used and useful adjustments for three
14 sewer systems. Mr. Radigan is proposing adjustments to several additional systems,
15 based on previous findings of non-used and useful plant by the Commission.

16
17 **Q. Have you reflected Mr. Radigan's adjustments relating to non-used and useful
18 plant in your rate base recommendation?**

19 A. Yes, I have. All of the adjustments proposed by Mr. Radigan relate to the Company's
20 sewer systems. Hence, I have not reflected any adjustment related to non-used and
21 useful plant to the Company's rate base claim for its water systems. Mr. Radigan is
22 recommending that a percentage of Treatment and Disposal Plant investment be
23 excluded from several sewer systems. Therefore, on Exhibit ACC-3, Schedule 5, I

1 have reflected Mr. Radigan's non-used and useful adjustments related to the sewer
2 utility systems.

3

4 **Q. How did you quantify Mr. Radigan's adjustments?**

5 A. The percentage disallowances recommended by Mr. Radigan are the same percentages
6 that the Commission determined should be excluded in the Company's last base rate
7 case. In its schedules supporting the Company's claim for interim relief in this current
8 case, UIF quantified each of these disallowances. I compared the data from the interim
9 schedules to the non-used and useful adjustments included in the current filing to
10 quantify the impact of Mr. Radigan's adjustments. My recommended rate base
11 disallowance related to non-used and useful plant is shown in Exhibit ACC-3, Schedule
12 5.

13

14 **C. Reserve for Depreciation**

15 **Q. Are there other rate base adjustments associated with the projects that Mr.
16 Radigan is proposing to exclude from rate base?**

17 A. Yes, there are. In its filing, UIF made several adjustments to the reserve for
18 depreciation. First, it annualized the reserve for projects completed during the Test
19 Year. Second, it increased the reserve for one year of depreciation expense on post-
20 test year projects that were included in utility plant-in-service. Third, it reduced the
21 reserve to remove the accumulated depreciation associated with plant retirements. The
22 amount of the Company's reserve adjustment for these retirements matched the
23 Company's utility plant-in-service adjustment associated with retirements, so that the

1 same amount was deducted from utility plant-in-service and from the reserve.

2 Since I am reducing post-test year plant additions and associated retirements, it
3 is necessary to first eliminate the one year of depreciation expense that the Company
4 added to the reserve related to the utility plant-in-service additions that are the subject
5 of Mr. Radigan's adjustment. In addition, it is necessary to reduce the Company's
6 reserve adjustment associated with retirements, since I am assuming that at least some
7 of these retirements will not occur. My adjustments to the Company's depreciation
8 reserve are shown in Exhibit ACC-2, Schedule 5 for water and in Exhibit ACC-2,
9 Schedule 6 for sewer.

10

11 **D. Contributions in Aid of Construction**

12 **Q. Are you recommending any adjustments to Contributions in Aid of Construction**
13 **("CIAC") or the associated Accumulated Reserve?**

14 A. Yes, I am. Some of the projected plant retirements included in the Company's filing
15 were financed with CIAC. CIAC is a contra-account in that it reduces utility plant in
16 service. In addition, the CIAC amortization reserve similarly acts as an offset to the
17 depreciation reserve. To the extent that I added back retirements that have been funded
18 with CIAC, it is necessary to make corresponding adjustments to CIAC and the CIAC
19 amortization reserve. These adjustments are shown in Exhibit ACC-2, Schedule 6 for
20 water and in Exhibit ACC-2, Schedule 7 for sewer.

21

22 **E. Working Capital Adjustments**

23 **Q. How did the Company determine its working capital claim in this case?**

1 A. The Company first developed a working capital requirement based on the Balance
2 Sheet method, which has been used previously by this Commission. However, in
3 calculating this requirement, UIF excluded both receivables and payables related to
4 intercompany transactions. As described in the testimony of Ms. Swain, all of UIF's
5 cash transactions are recorded through intercompany accounts. Ms. Swain stated in
6 her testimony that she initially determined that the intercompany receivable and
7 payable should be included in working capital. However, the magnitude of the
8 intercompany transactions relative to rate base was so significant that Ms. Swain
9 conducted a detailed review of the associated intercompany transactions to determine
10 which, if any, should be included in working capital. As stated on page 4 of her
11 testimony, Ms. Swain concluded that "it was not possible to isolate a specific account"
12 that should be included in working capital. Ms. Swain then examined other cases to
13 determine if it was possible to derive an appropriate cash balance for UIF. Based on
14 two orders involving KW Resorts Utilities Corp., Ms. Swain made an adjustment to
15 include a cash balance based on 2% of rate base. This resulted in a "presumed cash
16 balance" adjustment of \$2,355,199 for the water utility and of \$3,061,123 for the sewer
17 utility.

18 In addition, UIF included unamortized rate case costs related to prior rate cases
19 as well as unamortized costs related to a generic investigation. The Company also
20 included unamortized costs related to Project Phoenix. Finally, UIF included additional
21 adjustments to its sewer utility working capital claim relating to unamortized costs for
22 three studies that were included in the capital projects discussed in Mr. Flynn's
23 testimony. The resulting total working capital claims included in UIF's filing are

1 \$4,151,132 for the water utility and \$5,551,167 for the sewer utility.

2

3 **Q. Are you recommending any adjustments to the Company's working capital**
4 **claims?**

5 A. Yes, I am recommending several adjustments. First, I am recommending that the water
6 and sewer working capital claims be reduced to eliminate the "presumed" cash balances
7 described by Ms. Swain. In addition, I am recommending that several of the studies
8 included in the sewer working capital claim be eliminated. Finally, I am recommending
9 that the Chlorine Dioxide Study costs be moved from the sewer working capital
10 allowance to the water working capital allowance.

11

12 **Q. Why are you recommending that the Commission reject the "presumed cash**
13 **balance" adjustment proposed by Ms. Swain?**

14 A. I am recommending that the presumed cash balance adjustment be eliminated because
15 the Company has not demonstrated that these balances are necessary for the provision
16 of safe and reliable utility service in Florida. These presumed cash balances are
17 calculated amounts based on another case that has no applicability to UIF. In the two
18 cases cited by Ms. Swain, the actual cash balance of KW Resorts Utilities, Inc. was
19 about \$900,000, or approximately three times the cash balance of \$317,978 authorized
20 by the Commission. In this case, the actual 13-month average cash balances were
21 \$32,412 and \$41,164 for the water and sewer utilities respectively, or less than 1.4%
22 of the presumed cash balances being claimed by the Company. This discrepancy calls
23 into question the relevance of relying upon the KW Resorts Utilities Corp. cases cited

1 by Ms. Swain. In addition, Ms. Swain admitted that she was unable to identify specific
2 intercompany accounts that should be included in the Company's working capital
3 claim. Therefore, Ms. Swain has not demonstrated that the presumed cash balances
4 based on the KW Resorts Utilities Corp. cases are appropriate for use in this case.

5 Moreover, the working capital balances excluding the presumed cash
6 adjustments are very much in line with the working capital allowances authorized in
7 the Company's last base rate case. If the presumed cash balances are excluded, the
8 Company's working capital claim (inclusive of unamortized regulatory costs and costs
9 for certain studies) is \$1,795,933 for the water utility and \$2,490,044 for the sewer
10 utility, for a total of \$4,285,977. In the last case, the Commission authorized a total
11 working capital allowance of \$4,160,764, which consisted of \$1,130,422 for water and
12 \$3,030,342 for sewer, suggesting that no additional "presumed cash balance"
13 adjustment is necessary in this case. Given that (1) the working capital allowance
14 exclusive of the presumed cash balance adjustment is consistent with the Commission's
15 finding in the prior case, (2) the fact that the Company was unable to identify
16 intercompany transaction cash balances that should be included in working capital, and
17 (3) the differences between this case and the KW Resorts Utilities Corp. cases, I
18 recommend that the Company's presumed cash balance adjustments be rejected. My
19 adjustment is shown in Exhibit ACC-2, Schedule 7 for water and in Exhibit ACC-3,
20 Schedule 8 for sewer.

21
22 **Q. Please describe the studies included in UIF's working capital claim.**

23 **A.** As stated previously, the Company has also included the costs for certain studies in its

1 working capital claim for the sewer utility. These include the following:

2

| Study | PCF# | Amount |
|--|---------|----------|
| Chlorine Dioxide Pilot Study – Summertree | 38 | \$52,000 |
| Smoke Testing / I&I Investigation, Cypress Lakes | 21 / 39 | \$89,328 |
| I&I Investigation, Cypress Lakes (1 Yr. Amortized) | 1 | \$45,000 |

3

4 Before discussing the merits of the Company's claim for these studies, a few clarifying
 5 comments are in order. First, while the Company has included the Chlorine Dioxide
 6 Pilot Study in its sewer utility working capital, I understand that this study actually
 7 relates to its water utility. Second, the Company's working capital claim includes
 8 \$89,328 for Smoke Testing/I&I Investigation in the Cypress Lakes system. However,
 9 Ms. Swain's workpapers indicate that this is actually two projects: a \$61,847 sewer
 10 Smoke Testing/I&I investigation in Sandalhaven (PCF #21 in Mr. Flynn's testimony)
 11 and a \$27,481 Smoke Testing/I&I investigation in Summertree (PCF #39 in Mr.
 12 Flynn's testimony). Third, UIF is proposing to amortize costs associated with the I&I
 13 Investment at Cypress Lakes over 10 years and has therefore included only the
 14 unamortized costs of \$45,000 in its working capital claim.

15

16 **Q. Are you recommending any adjustments to the various study costs included in the**
 17 **Company's working capital claim?**

18 **A.** Yes, I have reflected two adjustments, based on the recommendations of OPC witness
 19 Mr. Radigan. Mr. Radigan is recommending that the Smoke Testing/I&I investigation
 20 costs at the Sandalhaven system (PCF #21 in Mr. Flynn's testimony) and the Smoke

1 Testing/I&I investigation at Summertree (PCF #39) both be eliminated. His
2 recommendation is based on the Company's representation that future capital projects
3 will be implemented to correct any deficiencies identified in these investigations;
4 therefore, it is premature to include these study costs in rates at this time. Therefore, on
5 Exhibit ACC-3, Schedule 8, I have also removed these study costs in the amount of
6 \$89,328 from the sewer utility's working capital.

7

8 **Q. Have you also moved the Chlorine Dioxide Study from the sewer utility to the**
9 **water utility?**

10 A. Yes, I have. It is my understanding that this study relates to the water utility. Therefore,
11 I have eliminated these costs from the sewer utility's working capital claim and instead
12 included these costs in the working capital allowance for the water utility.

13

14 **Q. Based on your adjustments, what working capital allowances are you**
15 **recommending in this case?**

16 A. My working capital adjustments are shown in Exhibit ACC-2, Schedule 7 and in
17 Exhibit ACC-3, Schedule 8, for the water and sewer utilities respectively. Based on
18 the adjustments discussed above, I am recommending a working capital allowance of
19 \$1,847,933 for the water utility and of \$2,348,716 for the sewer utility, as shown on
20 my Rate Base Summary schedules, Exhibit ACC-2, Schedule 3 (water) and Exhibit
21 ACC-3, Schedule 3 (sewer).

1 F. **Rate Base Summary**

2 Q. **What is the total rate base that you are recommending for the water and sewer**
3 **utilities?**

4 A. As summarized on Exhibit ACC-2, Schedule 3 and Exhibit ACC-3, Schedule 3, I am
5 recommending a rate base of \$54,066,409 for the water utility and a rate base of
6 \$74,394,657 for the sewer utility.

7

8 VI. **OPERATING INCOME ISSUES**

9 Q. **How did the Company develop its pro forma revenue claim in this case?**

10 A. The Company's claim is based on its actual Test Year water and sewer revenue,
11 adjusted to remove certain accruals and surcharge revenues, and further adjusted to
12 reflect the water and sewer rates that are currently in effect.

13

14 Q. **How did the Company determine its Test Year operating and maintenance costs?**

15 A. The Company began with its actual 2019 Test Year costs per its books and records of
16 account. It then made a series of adjustments to reflect Test Year chemical usage, to
17 eliminate costs for excess unaccounted-for water and excess infiltration and inflow, and
18 to include expenses for the current rate case.

19 In addition to these Test Year adjustments, UIF also made a series of Pro Forma
20 Operating Expense adjustments. These included adjustments to purchased water and
21 sewer costs, labor costs, chemical costs, contractual services costs, office lease and
22 equipment rental costs, and truck fleet costs. In most cases, the Company provided no
23 description of its adjustment or no explanation as to why the adjustment was being

1 made in its filing. There is virtually no accounting testimony in support of any of the
2 Company's adjustments. In discovery, OPC asked the Company to provide a
3 description of each pro forma adjustment along with supporting workpapers and
4 calculations. However, in many cases, the information provided by the Company was
5 inadequate.

6 The Company bears the burden to support each pro forma adjustment in a rate
7 case application. Therefore, while we have conducted some discovery to elicit
8 additional information that would support the Company's pro forma adjustments, it is
9 the Company that bears the ultimate responsibility for justifying its expense claims in
10 a base rate case. As discussed in more detail below, UIF failed to meet this
11 responsibility in many cases. My operating income adjustments are summarized in
12 Exhibit ACC-2, Schedule 8 for the water utility and in Exhibit ACC-3, Schedule 9 for
13 the sewer utility.

14
15 **A. Labor Expense**

16 **Q. How did the Company develop its claim for labor-related costs?**

17 A. The Company began with its actual Test Year costs. It then made adjustments to salary
18 and wages and to Employee Pensions and Benefits to reflect a) a 3.75% labor increase
19 applied to all labor components and b) additional employees. The Company also
20 included an adjustment to telephone expense to reflect the impact of additional
21 employees. The Company's adjustments are shown on Schedule B-3, page 2 of the
22 filing.

1 **Q. Are you recommending any adjustment to the Company's labor cost claim?**

2 A. Yes, I am recommending adjustments to both the labor escalator and to the request for
3 additional employee expense.

4 **Q. Please explain your adjustment related to the labor escalator.**

5 A. While the Company included a 3.75% escalator to its labor costs, including salary and
6 wages and Pensions and Benefits, it did not describe the basis or provide sufficient
7 evidentiary support for this adjustment. Moreover, in response to various discovery
8 requests, the Company indicated that it generally budgeted for 3% annual increases.
9 UIF stated that WSC/UIF employees receive wage increases in April and that CII
10 employees generally receive increases in January.

11 Based on the information elicited through the OPC's interrogatories, I am
12 recommending that the labor escalation adjustment be limited to 3.0%. This annual
13 escalator would therefore reflect expected 2020 salary and wage costs. Any further
14 salary and wage adjustment would essentially reflect costs in 2021, more than 12
15 months beyond the Test Year in this case.

16 Moreover, while I have applied this recommended 3% escalator to all labor
17 costs, including Pensions and Benefits, employee benefits do not necessarily trend in
18 line with salary and wage increases. Therefore, it is entirely possible that some of the
19 overall labor costs may increase at a rate of less than 3.0%. Nevertheless, I have
20 followed the Company's methodology and applied the same escalator to all
21 components of Pension and Benefit costs. My recommended adjustments are shown
22 in Exhibit ACC-2, Schedule 9 for the water utility and in Exhibit ACC-3, Schedule 10

1 for the sewer utility.

2

3 **Q. Are you also recommending an adjustment to the Company's claim for costs**
4 **related to additional employees?**

5 A. Yes, I am. UIF included costs for several additional employees in its claim. I am
6 recommending that these costs be excluded from the Company's claim in this case.
7 While it may be appropriate to include post-test year price changes in the underlying
8 components of the Company's revenue requirement, it is inappropriate to reflect
9 additional "unit" costs, such as costs for additional employees, unless other adjustments
10 are made. The Company's actual Test Year costs reflect the costs, and employee base,
11 that were incurred during the Test Year to provide water and sewer utility. In fact,
12 according to UIF's response to OPC Interrogatory No. 138, none of these additional
13 employees have as yet been hired. The Company has not adjusted its water or sewer
14 sales to reflect post-test year growth in the system; therefore, it would be inappropriate
15 to include a change in the number of employees needed to supply utility service.

16

17 **Q. Has UIF experienced growth in customers over the past few years?**

18 A. Yes, it has. UIF has experienced growth of approximately 4% in customer counts from
19 December 2016 through the end of the Test Year for its water utility, and growth of
20 approximately 4.6% in its sewer utility.² Moreover, the Company experienced growth
21 during the Test Year of approximately 1.7% in the water utility and of 2.3% in the
22 sewer utility. However, UIF did not annualize revenues to reflect this Test Year growth

² UIF's Response to OPC's Interrogatory No. 4.

1 but instead based its revenue claim in this case on actual water and sewer sales and
2 customer counts during the Test Year. Therefore, actual growth that occurred during
3 the Test Year was not annualized in the Company's pro forma revenue claims in this
4 case. If the Commission accepts the Company's claim to include costs for additional
5 employees in its revenue requirement, then it should also make an adjustment to reflect
6 additional revenues related to customer growth. At a minimum, it should annualize the
7 actual growth that occurred during the Test Year.

8

9 **Q. What do you recommend?**

10 A. I recommend that the Commission eliminate the Company's claims associated with
11 new employees. This includes salary and wage costs, Pension and Benefit costs, and
12 additional telephone costs. My adjustments are shown in Exhibit ACC-2, Schedule 10
13 for water and in Exhibit ACC-3, Schedule 11, for sewer. In the alternative, if the
14 Commission accepts these additional employee costs, then it should also make an
15 adjustment to reflect additional revenues based on customer growth.

16

17 **B. Severance Expense**

18 **Q. Has the Company included any severance costs in its revenue requirement claim?**

19 A. Yes. According to its response to OPC's Interrogatory No. 15, the Company has
20 included \$57,000 of severance costs allocated from CII in its revenue requirement
21 claim. According to this response, there were no severance costs incurred by UIF or
22 allocated by WSC Shared Services in 2017-2019. However, costs were allocated from
23 CII in the Test Year.

1 **Q. Are you recommending any adjustment to these severance costs?**

2 A. Yes. I am recommending that these CII severance costs be disallowed, for two reasons.
3 First, since the Company provided no details regarding these severance costs, we do
4 not have any information about the nature of these severance costs, the number of
5 employees involved, or the underlying factors that resulted in these severance
6 payments. Therefore, the Company has not met its burden to demonstrate that these
7 costs are necessary to the provision of safe and reliable utility service, or that these
8 costs should otherwise be paid by Florida ratepayers. In addition, we do not know if
9 these costs are recurring costs. It appears from the Company's response that CII
10 severance costs were incurred in only one year. If these costs are non-recurring, then
11 it would be inappropriate to include them in prospective utility rates regardless of the
12 underlying factors that resulted in the costs being incurred. For both of these reasons,
13 I recommend that these severance costs be disallowed. My water adjustment is shown
14 in Exhibit ACC-2, Schedule 11 and my sewer adjustment is shown in Exhibit ACC-3,
15 Schedule 12.

16

17 **C. Incentive Compensation Award Expense**

18 **Q. Does the Company offer any incentive compensation awards to its employees or**
19 **officers?**

20 A. According to the Company's response to OPC's Interrogatory No. 17, "[s]ome non-
21 officer employees may receive deferred compensation incentives based on regional
22 KPIs and/or manager evaluation of operational performance." This response indicates
23 that during the Test Year, UIF had 15 non-officers participate for a total of \$92,500,

1 and WSC Shared Services had 25 non-officers for a total of \$45,605, approximately
2 22% of which was allocated to UIF.

3 With regard to executives and officers, the Company's response to OPC's
4 Interrogatory No. 18 states that some WSC/UIF and CII executives/officers participate
5 in an Employee Incentive Plan ("EIP") program. A description of this program was
6 provided in UIF's response to OPC's Interrogatory No. 18. The Company further
7 stated that a long-term incentive program ("LTIP") also exists for the executive
8 management team and select senior leaders at CII. The CII LTIP is a 3-year cash
9 payout program based on company performance. No other details of the LTIP were
10 provided in response to this interrogatory. The Company indicated that in the Test
11 Year, approximately \$244,000 of WSC/UIF costs were allocated or charged to UIF
12 relating to executives and officers. The Company was also allocated \$49,935 in
13 deferred compensation incentive costs from CII in the Test Year, according to the
14 Company's response to OPC's Interrogatory No. 11. However, this incentive
15 compensation is identified as "deferred short term compensation," so there may be
16 additional amounts associated with the LTIP that have not been identified by UIF.
17 Moreover, UIF did not provide a copy of the LTIP so we do not know what criteria are
18 used to make these long-term incentive awards.

19

20 **Q. What descriptive information did UIF provide in response to OPC's discovery,**
21 **which sought a description of each incentive compensation program, the**
22 **performance criteria or factors used to determine awards, and the amount**
23 **included in the Company's claim?**

1 A. UIF only provided details of the EIP; it did not provide the requested descriptive
2 information about the LTIP. According to UIF, the first objective of the EIP is to
3 “provide eligible employees with an annual incentive as an integral component of their
4 total annual compensation package while furthering the annual performance of the
5 Company with a view to maximizing shareholder value.” OPC Interrogatory No. 18
6 (emphasis added) While most employees in non-regulated business operations
7 participate in the EIP, only executive positions in the regulated sectors are eligible to
8 participate. Awards are based on company, business unit, and personal performance;
9 the relative impact of each factor depends upon each employee’s position. The more
10 senior positions, such as the regulated positions eligible to participate, are heavily
11 weighted toward company performance rather than business unit or personal
12 performance. In addition, in order for any award to be made, the company must achieve
13 a targeted level of return on investment and must be free from any code red safety or
14 environmental incidents. Seventy percent of the company performance metric is based
15 on financial performance measures.

16

17 **Q. Are you recommending any adjustment to the Company’s claim for incentive**
18 **compensation award costs?**

19 A. Yes. I am recommending that the incentive compensation award costs that are tied to
20 financial metrics, or which do not otherwise benefit ratepayers, be recovered from the
21 Company’s shareholders, and denied for recovery in this case. Regulatory commissions
22 frequently disallow incentive compensation costs tied to financial metrics on the basis
23 that such metrics benefit shareholders, but may not benefit, and may even harm,

1 ratepayers. Awarding incentive compensation based on financial metrics is
2 inconsistent with a utility's mandate to provide safe and reliable utility service at the
3 lowest reasonable cost.

4

5 **Q. How did you quantify your adjustment?**

6 A. The Company has provided very limited information about its incentive compensation
7 programs. However, based on the information provided for the EIP, we know that this
8 program is heavily weighted toward financial metrics, at least for regulated company
9 participants who must hold executive positions in order to participate. Based on the
10 information provided by UIF and received to date, I am unable to quantify exactly how
11 much of the Company's incentive compensation awards are based on financial metrics,
12 since the actual award criteria vary by employee level. Given the overall EIP's
13 objective to maximize shareholder value and the overall requirement that certain
14 financial metrics must be achieved prior to any awards being made, I am
15 recommending an adjustment to eliminate 50% of the incentive compensation costs
16 identified by the Company. Moreover, as noted above, there may be additional costs
17 associated with the LTIP that are embedded in the Company's claim. If so, a further
18 disallowance may be appropriate. My water utility adjustment is shown in Exhibit
19 ACC-2, Schedule 12 and my sewer utility adjustment is shown in Exhibit ACC-3,
20 Schedule 13.

21

22 **D. Payroll Tax Expense**

23 **Q. In addition to the Labor, Severance, and Incentive Compensation adjustments**

1 **discussed above, did you make corresponding adjustments relating to payroll tax**
2 **expense?**

3 A. Yes, on Exhibit ACC-2, Schedule 13, I have made a corresponding water utility payroll
4 tax adjustment, to reflect the impact on payroll taxes of my recommended adjustments
5 to eliminate costs for new employee positions, to reduce the Company's annual labor
6 cost escalator, to eliminate severance costs, and to eliminate 50% of incentive
7 compensation award costs. A similar sewer utility payroll tax adjustment is shown in
8 Exhibit ACC-3, Schedule 14. My payroll tax adjustments reflect the statutory payroll
9 tax rate of 7.65%.

10

11 **E. Non-Qualified Retirement Benefits Expense**

12 **Q. Does the Company provide any non-qualified retirement benefits to its**
13 **employees?**

14 A. Yes, it does. These non-qualified plans provide supplemental retirement benefits for
15 key executives that are in addition to the normal retirement programs provided by the
16 Company. By offering a non-qualified plan, a company is able to provide additional
17 benefits to highly paid officers and executives that cannot be provided under "qualified"
18 plans, which limit the amount of compensation that can be considered for purposes of
19 determining pension benefits. The current compensation limit is \$285,000. In addition,
20 non-qualified plans allow a company to avoid rules and regulations that apply to
21 qualified plans, e.g., rules that prohibit discrimination among employees with regard to
22 retirement benefits. Non-qualified plans generally do not need to meet the requirements
23 of the Employee Retirement Income Security Act ("ERISA"). Non-qualified plans also

1 do not qualify for the more favorable tax treatment that is available to qualified
2 retirement plans under the Internal Revenue Service ("IRS") Tax Code.

3

4 **Q. How much did the Company incur in the Test Year relating to non-qualified**
5 **retirement plans?**

6 A. As shown in the Company's response to OPC's Interrogatory No. 11, UIF incurred
7 non-qualified retirement plan costs of \$26,853 and was allocated approximately 22%
8 of the total WSC costs of \$127,203.

9

10 **Q. Do you believe that these costs should be included in utility rates?**

11 A. No, I do not. These benefits are generally available to a very small group of officers
12 and other executives, who are generally well compensated. Moreover, the individuals
13 that receive non-qualified retirement plan benefits also receive the normal retirement
14 plan benefits offered by the Company as well. Ratepayers are already paying rates that
15 include retirement benefits for these officers and other key personnel based on the IRS
16 limits. However, I do not believe that ratepayers, some of whom may not have any
17 retirement plans, should be required to pay utility rates that reflect an excessive level
18 of retirement benefit costs from these non-qualified retirement plans. Just as the IRS
19 has determined that these costs should not be eligible for favorable tax treatment, the
20 Commission should also determine that these costs should not be recoverable from
21 regulated ratepayers. If UIF wants to provide additional retirement benefits to select
22 officers and executives, then shareholders, not ratepayers, should fund these excess
23 benefits. Therefore, I recommend that the Commission disallow the Company's claim

1 for non-qualified retirement plan costs. My adjustment is shown in Exhibit ACC-2,
2 Schedule 14, for the water utility and in Exhibit ACC-3, Schedule 15, for the sewer
3 utility.

4
5 **F. Truck Fleet Expense**

6 **Q. Did the Company also include incremental truck fleet costs in its revenue
7 requirement claim?**

8 A. Yes, it did. As shown in UIF's filing at Exhibit B-3, page 2, the Company included
9 incremental truck fleet costs of \$6,931 for the water utility and of \$6,362 for the sewer
10 utility in its claim. The Company indicated on that schedule that this adjustment
11 represented an "Increase in exp to reflect increase of assigned truck fleet (3.8%)".
12 However, it did not provide supporting documentation for these costs, explain why
13 these additional costs are necessary, or explain the 3.8% reference. In its response to
14 OPC's Interrogatory No. 136, the Company indicated that these costs relate to
15 incremental expenses associated with the new trucks that are being acquired for the
16 new employees being requested in this case. Since I am recommending that costs
17 related to additional employees be excluded, I have made an adjustment to remove
18 these additional truck fleet costs from my revenue requirement. At Exhibit ACC-2,
19 Schedule 15, I have made a water utility adjustment. A corresponding sewer
20 adjustment is shown in Exhibit ACC-3, Schedule 16.

21
22 **G. Lobbying Expense**

23 **Q. Has the Company included lobbying costs in its revenue requirement claim?**

1 A. Yes. In OPC's Interrogatory No. 34, we asked the Company to identify, for each
 2 organization for which dues or membership expenses are included in the filing, any
 3 portion of dues or membership fees that are directed toward lobbying activities by the
 4 organization, and to state if those amounts have been excluded from the Company's
 5 revenue requirement claim. In response, the Company initially identified a total of
 6 \$75,859 associated with lobbying efforts, as shown below:

| Organization | Amount | Lobbying Information |
|---|----------|-----------------------------|
| Florida Chamber of Commerce | \$3,000 | State Lobbying |
| Gunster, Yoakley, Stewart, P.A. | \$60,972 | State Lobbying |
| Florida Rural Water Association | \$560.00 | State Lobbying |
| National Association of Water Companies | \$11,677 | Registered Federal Lobbyist |

8

9 In response to OPC Interrogatory No. 140, UIF clarified that not all of these costs were
 10 related to lobbying activities. Instead, UIF stated that only \$45,827 of lobbying costs
 11 were included in the Test Year.

12

13 **Q. Is it appropriate to recover lobbying costs from regulated ratepayers?**

14 A. No, it is not. Lobbying costs are not necessary for the provision of safe and adequate
 15 utility service. Moreover, the lobbying activities of a regulated utility may be focused
 16 on policies and positions that enhance shareholders but may not benefit, and may even
 17 harm, ratepayers. Regulatory agencies generally disallow costs involved with
 18 lobbying, since most of these efforts are directed toward promoting the interests of the
 19 utilities' shareholders rather than its ratepayers. Ratepayers have the ability to lobby
 20 on their own through the legislative process if they so choose. Moreover, lobbying

1 activities have no functional relationship to the provision of safe and adequate utility
2 service. If the Company were immediately to cease contributing to these types of
3 efforts, utility service would not be disrupted. Clearly, these costs should not be borne
4 by ratepayers. At Exhibit ACC-2, Schedule 16, I have made an adjustment to remove
5 these costs from the water utility. I made a similar adjustment at Exhibit ACC-3,
6 Schedule 17, for the sewer utility. I have allocated my adjustments based on the
7 allocation percentages for dues and memberships provided in the Company's response
8 to OPC's Interrogatory No. 33.

9
10 **H. Holiday Party Expense**

11 **Q. Are you recommending any other operating expense adjustments?**

12 A. Yes. I am recommending that costs for the annual Holiday social event be borne by
13 shareholders instead of ratepayers. These costs were identified in UIF's response to
14 OPC's Interrogatory No. 38. While these costs are modest, such costs are not necessary
15 to the provision of safe and adequate utility service. Allowing the Company to recoup
16 these costs from ratepayers sends the wrong message about the types of costs that
17 should be included in regulated rates. While hosting an annual employee holiday party
18 is a nice corporate gesture, these costs should clearly be borne by shareholders. My
19 adjustments are shown in Exhibit ACC-2, Schedule 17, and in Exhibit ACC-3,
20 Schedule 18, for the water and sewer utilities respectively.

21
22 **I. Depreciation and Amortization Expense**

23 **Q. How did the Company develop its depreciation expense claim in this case?**

1 A. The Company's depreciation expense claim is based on actual depreciation expense
2 booked during the twelve months ending December 31, 2019, adjusted for certain
3 reclassifications and corrections. The Company then made adjustments to remove
4 depreciation expense associated with non-used and useful plant. UIF made additional
5 adjustments to annualize depreciation expense for plant additions made during the Test
6 Year, to include depreciation on post-test year plant additions, and to remove
7 depreciation associated with post-test year plant retirements. In addition to these
8 depreciation expense adjustments, the Company also made an adjustment to
9 amortization expenses related to the retirements that were funded with CIAC.

10

11 **Q. Are you recommending any adjustment to the Company's depreciation or**
12 **amortization expense claims?**

13 A. Yes. I am recommending several adjustments. First, with regard to both the water and
14 sewer utilities, I have made adjustments to eliminate depreciation expense on the post-
15 test year plant additions that Mr. Radigan recommends be excluded from rate base. In
16 addition, I have increased depreciation expense to reflect depreciation on retirements
17 associated with these projects. Since Mr. Radigan is recommending that certain
18 projects be excluded from rate base, I am assuming that the associated retirements will
19 not take place, and therefore it is necessary to add back the depreciation expense
20 associated with these retirements. Finally, I have made an adjustment to remove the
21 amortization expense on CIAC associated with the retirements that are being added
22 back to rate base. My adjustments for the water utility are shown in Exhibit ACC-2,
23 Schedule 18, and my adjustments for the sewer utility are shown in Exhibit ACC-3,

1 Schedule 19.

2 Additionally, I have made an adjustment to remove depreciation expenses on
3 the incremental non-used and useful plant that I discussed earlier in the Rate Base
4 section of my testimony. Since Mr. Radigan is recommending a larger non-used and
5 useful sewer adjustment than the adjustment included in the Company's filing, it is
6 necessary to make a corresponding adjustment to depreciation expense. My sewer
7 adjustment to depreciation expense associated with non-used and useful plant is shown
8 in Exhibit ACC-3, Schedule 20.

9

10 **J. Property Tax Expense**

11 **Q. How did the Company develop its property tax expense claim in this case?**

12 A. The Company began with its actual Test Year property tax expense. It then made an
13 adjustment to remove property taxes on non-used and useful plant and to reflect
14 incremental property taxes on net post-test year plant additions. The Company used
15 composite millage rates adjusted for certain payment discounts to quantify its water
16 and sewer adjustments.

17

18 **Q. What adjustments are you recommending to the Company's property tax expense
19 claims?**

20 A. I am not recommending any adjustment to the millage rates used by the Company.
21 However, since I am recommending certain reductions to utility plant-in-service, it is
22 necessary to make corresponding reductions to property tax expense. Therefore, at
23 Exhibit ACC-2, Schedule 19, I have made an adjustment to remove property tax

1 expense associated with OPC's recommended water utility plant adjustments. A
2 similar adjustment for the sewer utility is shown in Exhibit ACC-3, Schedule 21. In
3 addition, in Exhibit ACC-3, Schedule 22, I have made an adjustment to property taxes
4 consistent with Mr. Radigan's non-used and useful plant adjustment for the sewer
5 utility.

6 **K. Excess Deferred Income Tax Amortization Expense**

7 **Q. What are deferred income taxes?**

8 A. Deferred income taxes are taxes that have been collected from ratepayers but have not
9 yet been paid by the utility, due to differences in the tax treatment utilized by regulatory
10 commissions and taxing authorities, including the IRS. The cumulative difference
11 between the taxes that that have been collected from ratepayers and the taxes paid is
12 known as accumulated deferred income taxes ("ADIT").

13
14 **Q. How is ADIT treated for ratemaking purposes?**

15 A. ADIT is reflected as an adjustment to rate base. Accumulated deferred income taxes
16 that have been collected from ratepayers but not yet paid by the Company are used to
17 reduce rate base, while accumulated deferred taxes that have been paid but not yet
18 collected from ratepayers are rate base additions.

19 **Q. What are excess deferred income taxes?**

20 A. Excess deferred income taxes are the difference between the accumulated deferred
21 income tax liability booked at a prior income tax rate and the accumulated deferred
22 income tax liability booked at current income tax rates. Since the Company's last base

1 rate case, Congress passed the Tax Cut and Jobs Act of 2017, which reduced the federal
2 income tax rate from 35% to 21%. UIF's ADIT balance was based on the expectation
3 that the Company's future income would be taxed at the prior federal income tax rate
4 of 35%. Instead, commencing with Calendar Year 2018, the Company's income is
5 now taxed at 21%. The difference represents taxes that were collected from ratepayers
6 but will never be paid, assuming the 21% rate remains in effect.

7

8 **Q. How are excess deferred income taxes treated for ratemaking purposes?**

9 A. There are two types of excess deferred income taxes – protected and unprotected.
10 Protected excess deferred income taxes relate to deferred taxes associated with plant-
11 related balances, primarily related to accelerated depreciation methodologies
12 (including bonus depreciation) that were permissible for tax purposes, but which were
13 not reflected for ratemaking purposes. Protected excess deferred income taxes are
14 required to be returned to ratepayers using the Average Rate Assumption Method
15 (“ARAM”) or an alternate method such as the Reverse South Georgia Method
16 (“RSGM”), which generally provides that the excess deferred taxes cannot be flowed-
17 through to ratepayers more rapidly than the average remaining life of the underlying
18 property that gave rise to the deferred taxes. UIF is proposing to return the protected
19 excess deferred income taxes of \$5,287,412 to ratepayers over a period of 21.5 years.

20 Unprotected excess deferred taxes relate to differences between the tax and
21 ratemaking treatments afforded other types of costs, such as pension and benefit costs,
22 regulatory costs, and costs for which the Company accrues a reserve. Unprotected
23 deferred taxes can be flowed-through for ratemaking purposes over any “reasonable”

1 period. The Company has approximately \$360,233 of unprotected excess deferred
2 income taxes, which it is proposing to return to ratepayers over 10 years.

3 As shown on Schedule C-2, page 1, the Company has included amortization of
4 excess deferred income taxes as a pro forma adjustment associated with its requested
5 rate increase, instead of as an adjustment to the Test Year operating income.

6

7 **Q. Are you recommending any adjustment to the Company's proposed amortization**
8 **expense claims associated with excess deferred federal income taxes?**

9 A. Yes, I am recommending two adjustments. First, I am recommending that the
10 unprotected excess deferred income taxes be returned to ratepayers over a period of 5
11 years, instead of over the 10-year period proposed by UIF. In addition, I am
12 recommending that the amortization be reflected as a Test Year adjustment, prior to the
13 determination of the required revenue increase.

14

15 **Q. Why did the Company propose a 10-year amortization period for the return of**
16 **unprotected excess deferred income taxes?**

17 A. The Company stated in its response to OPC's Interrogatory No. 44 that the use of a 10-
18 year amortization was "Commission precedent" and cited Commission Order No. PSC-
19 2019-0076-FOF-GU. That order involved Florida Public Utility Company ("FPUC") –
20 Gas, and can be distinguished from UIF in at least two respects. First, in the FPUC
21 case, the unprotected excess deferred income tax balance was a deferred tax asset, i.e.,
22 these were amounts that ratepayers owed to the Company. Therefore, the period of
23 time selected to amortize that asset had a much different impact on ratepayers than in

1 this case where the unprotected excess tax balance is a regulatory liability. The second
2 key distinction is that in the FPUC case, the amount of the protected excess deferred
3 taxes was about three times as large as the balance of unprotected deferred income
4 taxes. In the case of UIF, the unprotected balance is relatively small, only \$360,233 or
5 about 7% of the protected balance of \$5,287,412.

6
7 **Q. What do you recommend?**

8 A. I recommend that the Commission require UIF to return unprotected excess deferred
9 federal income tax balances to ratepayers over a 5-year period. Given the relatively
10 small balance to be returned, my recommendation will allow ratepayers to receive their
11 refunds sooner without causing undue rate shock when this amortization ends in five
12 years. Moreover, given the financial difficulties that many Floridians are experiencing
13 as a result of the pandemic, a five-year amortization period will provide at least some
14 small additional relief to ratepayers during these difficult times. Accordingly, I have
15 made an adjustment for the water utility in Exhibit ACC-2, Schedule 20, and an
16 adjustment for the sewer utility in Exhibit ACC-3, Schedule 23, to reflect a five-year
17 amortization period.

18 In addition, rather than showing the excess deferred tax amortization as a
19 component of the proposed revenue increase, I have included this amortization as an
20 adjustment to operating income at present rates. While this recommendation is largely
21 presentational, I believe that reflecting the excess deferred income tax amortization as
22 an adjustment at present rates is appropriate since the amount of the amortization is
23 fixed regardless of the overall revenue increase that is ultimately authorized by the

1 Commission.

2

3 **L. State Income Tax Expense**

4 **Q. What state tax rate did the Company utilize in its revenue requirement**
5 **calculation?**

6 A. The Company utilized a state income tax rate of 5.5%, as shown in Schedule C-2 to the
7 filing.

8

9 **Q. Are you recommending any adjustment to the Company's claim for state income**
10 **taxes?**

11 A. Yes, in addition to the income tax adjustments that result from my other operating
12 expense adjustments, I am also recommending that a state income tax rate of 4.458%
13 be used to determine the Company's revenue requirement. On September 12, 2019,
14 the Florida Department of Revenue announced a reduction in the state corporate
15 income tax rate from 5.5% to 4.458% for tax years beginning in 2019, 2020, and 2021.
16 While the state income tax rate is currently projected to revert to the rate of 5.5%
17 effective January 1, 2022, there is a possibility that the reduction in the tax rate will be
18 extended. Therefore, I recommend that the Commission utilize a state income tax rate
19 of 4.458% in determining the Company's revenue requirement. My adjustment is
20 shown in Exhibit ACC-2, Schedule 21 for the water utility and in Exhibit ACC-3,
21 Schedule 24 for the sewer utility.

1 **M. Interest Synchronization**

2 **Q. Have you adjusted the pro forma interest expense for income tax purposes?**

3 A. Yes, I have made this adjustment at Exhibit ACC-2, Schedule 22 for the water utility
4 and at Exhibit ACC-3, Schedule 25 for the sewer utility. It is consistent (synchronized)
5 with my recommended rate base and with the capital structure and cost of capital
6 recommendations of Mr. Garrett. The rate base and cost of capital being recommended
7 by OPC in this case result in a higher pro forma interest expense for the Company's
8 water utility and in a lower pro forma interest expense for the Company's sewer utility.
9 Since interest expense is an income tax deduction for state and federal tax purposes,
10 OPC's adjustments will result in a decrease to income taxes and in an increase to
11 operating income for the water utility. For the sewer utility, OPC's recommendations
12 will result in an increase to income taxes and in a decrease to operating income.

13

14 **N. Revenue Multiplier**

15 **Q. What is the composite income tax factor that you have reflected in your schedules?**

16 A. My schedules are based on an income tax factor of 24.52%, which includes a state
17 income tax rate of 4.458% and a federal income tax rate of 21%. The calculation of
18 this rate is shown in Exhibit ACC-2, Schedule 23 for the water utility and in Exhibit
19 ACC-3, Schedule 26 for the sewer utility. My revenue multiplier, which is shown in
20 Exhibit ACC-2, Schedule 24 and in Exhibit ACC-3, Schedule 27 for the water and
21 sewer utilities respectively, reflects these corporate income tax rates. In addition, the
22 revenue multiplier also includes the regulatory assessment of 4.5%, resulting in a
23 revenue multiplier of 1.3873.

1 **VII. REVENUE REQUIREMENT SUMMARY**

2 **Q. What is the result of the recommendations contained in your testimony?**

3 A. My adjustments indicate a revenue deficiency at present rates of no more than
4 \$1,129,866 for the water utility, as summarized on Exhibit ACC-2, Schedule 1. This
5 recommendation reflects revenue requirement adjustments of \$1,693,982 to the
6 Company's claimed revenue deficiency of \$2,823,848. My recommendations would
7 result in an overall water revenue increase of no more than approximately 6.8%. In
8 addition, my recommended sewer adjustments indicate a revenue deficiency at present
9 rates of no more than \$2,577,689, as summarized on Exhibit ACC-3, Schedule 1. This
10 recommendation reflects revenue requirement adjustments of \$3,951,694 to the
11 Company's claimed revenue deficiency of \$6,529,383. My recommendations would
12 result in an overall sewer revenue increase of no more than approximately 12.7%.

13

14 **Q. Have you quantified the revenue requirement impact of each of your**
15 **recommendations?**

16 A. Yes, at Exhibit ACC-2, Schedule 25, I have quantified the revenue requirement impact
17 of each of the rate of return, rate base, and expense recommendations contained in this
18 testimony relating to the water utility. Similar information is provided in Exhibit ACC-
19 3, Schedule 28, for the sewer utility.

20

21 **VIII. OTHER ISSUES**

22 **A. Allowance for Funds Used During Construction**

23 **Q. What is an allowance for funds used during construction ("AFUDC")?**

1 A. AFUDC is a financing cost that is added to the capital costs of a project in order to
 2 compensate a utility for the costs of financing a project during its construction period.
 3 The AFUDC is added to the direct capital costs of the project and included in rate base
 4 once the project is completed and serving customers, either as part of a subsequent base
 5 rate case or under the provision that permits the inclusion of plant additions completed
 6 within 24 months of the end of the Test Year.

7

8 **Q. Are there restrictions on the amount of AFUDC that can be accrued by utilities?**

9 A. Generally, there are certain limitations on the types of projects that can accrue AFUDC.
 10 There are often minimum construction periods and/or capital costs that must be met
 11 before a project can accrue AFUDC. In addition, there are often formulas used in order
 12 to determine the AFUDC rate that can be applied to eligible plant.

13

14 **Q. Is there a Florida statute governing AFUDC?**

15 A. Yes, I understand that in Florida, AFUDC is governed by Rule 25-30.116, Florida
 16 Administrative Code (“F.A.C.”) (“the AFUDC Rule”). According to the AFUDC Rule,
 17 projects eligible to accrue AFUDC generally include those that have construction
 18 periods exceeding sixty days and have capital costs in excess of \$5,000. The AFUDC
 19 Rule also dictates the formula that shall be used to determine AFUDC, as follows:

20 (a) the most recent 12-month average embedded cost of capital, except
 21 as noted below, shall be derived using all sources of capital and adjusted
 22 using adjustments consistent with those used by the Commission in the
 23 Company’s last base rate case.

24 (b) The cost rates for the components in the capital structure shall be the
 25 midpoint of the last allowed return on common equity, the most recent
 26

1 12-month average cost of short term debt and customer deposits and a
 2 zero cost rate for deferred taxes and all investment tax credits. The cost
 3 of long term debt and preferred stock shall be based on end of period
 4 cost. The annual percentage rate shall be calculated to two decimal
 5 places.

6
 7 (c) A company that has not had its equity return set in a rate case shall
 8 calculate its return on common equity by applying the most recent water
 9 and wastewater equity leverage formulas.

10
 11 Rule 25-30.116(2)(a)-(c), F.A.C.
 12

13 **Q. What is the current AFUDC rate being used by UIF?**

14 A. According to Schedule A-15 of the Company's filing, the current AFUDC rate is
 15 9.03%. Moreover, this rate has been utilized since January 1, 2003.

16

17 **Q. Are you recommending any prospective adjustment to the AFUDC rate for UIF**
 18 **projects?**

19 A. Yes, I am recommending that the AFUDC rate be reduced to reflect the cost of capital
 20 authorized by the Commission in this case. The current AFUDC rate of 9.03% is
 21 excessive. Even with the Company's cost of equity claim of 11.75%, the overall cost
 22 of capital being claimed in this case is only 7.89%, well below the 9.03% AFUDC rate
 23 being used by UIF. In addition, OPC is recommending a cost of equity that is well
 24 below the 11.75% being claimed by UIF; therefore, a reasonable AFUDC rate is even
 25 lower than the Company's claimed cost of capital. The current AFUDC rate is causing
 26 Florida ratepayers to pay rates that are significantly higher than necessary. Moreover,
 27 since AFUDC is recovered over the life of the underlying asset, the high AFUDC rates
 28 that have been in place for the past 18 years not only impacted ratepayers in the past,

1 but will continue to negatively impact ratepayers in the future as the associated plant
2 is depreciated over its remaining life, currently estimated at more than 20 years. By
3 way of comparison, the 20-year U.S. Government Bond rate was 5.05% in January
4 2003, but had fallen to 1.43% by October 2020 - a decline of approximately 72%. In
5 addition, it appears from Order No. PSC-04-0262-PAA-WS in Docket No. 20031006-
6 WS that the debt rate reflected in the 9.03% AFUDC rate is based on a cost of long-
7 term debt of 7.82% and on no short-term debt, yet in this case the Company's long-
8 term debt cost has fallen to 5.78% and the capital structure also contains short-term
9 debt at a rate of 4.04%. In spite of the significant decline in capital costs over the past
10 twenty years, UIF has continued to accrue AFUDC at the same rate of 9.03%, and to
11 embed high financing costs into the Company's rate base. This has improperly and
12 negatively impacted the rates paid by Florida ratepayers and has embedded
13 unnecessarily high financing costs in rate base.

14

15 **Q. What do you recommend?**

16 A. I recommend that the Commission order UIF to reduce its AFUDC rate to reflect the
17 capital cost components authorized in this case. Based on Mr. Garrett's
18 recommendation, this would result in an AFUDC rate of 6.73%.

19

20 **Q. Do you have any additional comments?**

21 A. Yes. In addition to reducing the AFUDC rate prospectively, I recommend that the
22 Company should be required to demonstrate that the AFUDC rate used by the
23 Company since its last base rate case has been in compliance with the Rule 25-30.116,

1 F.A.C. In the event that the Company has not complied with the Rule, then the
2 Commission should also adjust the Company's Test Year rate base to reflect
3 investment based on an AFUDC rate that is in compliance with the statute.

4

5 **B. Sewer and Water Improvement Mechanism**

6 **Q. Please describe the Company's proposed Sewer and Water Improvement**
7 **Mechanism ("SWIM").**

8 A. As described in Mr. Deason's testimony, UIF devised a new mechanism it refers to as
9 a "SWIM" by which it proposes the Commission allow the Company to recover the
10 revenue requirement associated with capital projects between base rate case filings.
11 The revenue requirement passed through to ratepayers would include the return on
12 investment using the equity and debt components of the cost of capital approved in the
13 prior rate case, Commission-authorized depreciation rates, and federal and state income
14 taxes. The Company proposes to make annual filings in conjunction with the annual
15 index and pass-through filings. It appears that the Company envisions
16 contemporaneous recovery of this investment, i.e., rate adjustments would be based on
17 projected investment. The Company is also proposing an annual true-up to reflect
18 actual replacement costs, actual index revenues, and over or under recovered balances
19 for the prior year.

20

21 **Q. Does the Company propose an earnings test as part of its "SWIM" proposal?**

1 A. Although details of the Company’s proposal are vague, incomplete, and inadequate for
2 purposes of a thorough analysis, it does not appear that the Company is proposing an
3 earnings test as part of its proposed SWIM.

4

5 **Q. What is the rationale for the Company’s proposed “SWIM”?**

6 A. According to the Company’s Application for Increase in Rates at page 4, the proposed
7 SWIM would allow the Company to accelerate the replacement of infrastructure and
8 treatment plant to “proactively respond to the growing concerns regarding aging
9 infrastructure and treatment plant reliability and safety.” UIF further claims that
10 without the so-called SWIM, “UIF’s rate of returns would deteriorate over time,” and
11 purportedly require more frequent rate filings.

12

13 **Q. Has the Company provided the details of a proposed infrastructure replacement
14 program as part of its filing in this case?**

15 A. No, it has not. The Company has actually provided very little testimony on its SWIM
16 plan, which would constitute a major regulatory policy change in the recovery of capital
17 investment. UIF claims it plans to file two years of program detail in each annual filing;
18 however, the Company failed to include any project descriptions whatsoever as part of
19 this base rate case. In response to discovery, the Company stated that that it did not
20 plan to restrict recovery to certain infrastructure projects, but instead planned to apply
21 the SWIM to virtually all capital projects contained in its five-year capital program.³
22 Therefore, the SWIM, as proposed by UIF, is actually not an accelerated replacement

³ UIF’s Response to Staff’s Interrogatory No. 4.

1 program – it would simply be a new scheme for recovering alleged capital costs without
2 having to comply with the authorized regulatory analysis and review process.

3 **Q. What factors should the Commission consider as it considers the proposed**
4 **SWIM?**

5 A. The Commission should consider whether such a mechanism is necessary in order for
6 the Company to meet its service obligations. Replacing aging infrastructure and
7 ensuring safety and reliability are not new concepts for a regulated utility. These are
8 functions that are integral to the provision of safe and reliable utility service. The
9 investment proposed by UIF that would be recovered through the proposed SWIM
10 surcharge is not incremental investment – it is the normal, routine investment that is
11 required in order to maintain regulated water and sewer utilities. Moreover, system
12 integrity and reliability are not new concepts for the Company or for the Commission.
13 Rather, ensuring reliability is an integral part of managing any utility system. The
14 regulatory compact provides that in exchange for being granted a monopoly franchise
15 area, a utility will provide safe and reliable utility service at reasonable rates. The
16 obligation to provide safe and reliable service is a cornerstone of the utility's
17 obligations. Thus, the concept of undertaking system integrity projects, when required,
18 is not new or novel. Rather, this is a fundamental obligation of any regulated utility
19 company. In addition, the utility has the obligation to demonstrate that all investment
20 is prudent and necessary. Permitting recovery of investment between base rate case
21 filings provides an incentive for the Company to maximize expenditures knowing that
22 dollar-for-dollar recovery is assured.

1 While there may be changes in certain rules and regulations with regard to
2 system integrity over the years, UIF has always had, and continues to have, an
3 obligation to operate its business in a safe and reliable manner. This has not changed.
4 UIF has not shown why an alternative recovery mechanism is necessary in order to
5 undertake those investments necessary to provide safe and reliable utility service. From
6 a cost recovery prospective, investments are either necessary in order to meet the
7 Company's service obligation or they are not. The level of investment necessary to
8 ensure a utility meets its service obligations to its ratepayers should be determined
9 pursuant to the base rate case methodology that has traditionally and historically been
10 used by the Commission to determine whether a given utility may recover its cost of
11 service.

12
13 **Q. Does the Company already have the ability to include future projects in regulated**
14 **rates?**

15 A. Yes, it does. Pursuant to Florida Statutes, UIF has the ability to include in rate base
16 capital projects that will be completed and placed into service within 24 months of the
17 end of the Test Year. This already provides a significant benefit to UIF and its
18 shareholders.

19

20 **Q. What is the impact on shareholders of the Company's proposed SWIM, i.e.,**
21 **surcharge mechanism?**

22 A. Contrary to economic theory and good ratemaking practice, the proposed surcharge
23 mechanism would increase shareholder return while significantly reducing risk.

1 Shareholder return is directly proportional to the amount of investment made by the
2 utility. Since shareholders benefit from every investment dollar that is spent by a
3 utility, UIF's proposed surcharge mechanism would increase overall return to
4 shareholders and accelerate recovery of that return. UIF provided no evidentiary
5 support of how the SWIM scheme would benefit its ratepayers.

6 Pursuant to the current ratemaking mechanism, future plant additions are only
7 included in rate base, and therefore in utility rates, if they are reviewed in a base rate
8 case and if the Commission finds that the investment is prudent and reasonable and
9 likely to go into service within 24 months of the end of the Test Year. Between general
10 base rate cases, plant that is booked to utility plant-in-service is not reflected in utility
11 rates until the Company's next base rate case. However, under UIF's proposal,
12 ratepayers would bear higher costs sooner, as a result of the proposed SWIM
13 mechanism. If the SWIM scheme is adopted, ratepayers will pay an additional charge
14 each year, even if the Company is earning within its authorized rate of return earnings
15 range. From a financial perspective, these are serious detriments to ratepayers.

16
17 **Q. Would the Company's proposal to implement the proposed SWIM shift additional**
18 **risk onto ratepayers?**

19 **A.** Yes, it would. The Company's proposed mechanism would shift risk from
20 shareholders, where it properly belongs, to ratepayers without any commensurate
21 reduction in the Company's return on equity. The SWIM scheme would reduce
22 shareholder risk in two ways. First, since the SWIM would accelerate recovery,
23 shareholders would no longer have to wait for a general base rate case to receive a

1 return on this investment. Nor would shareholders have to wait for a general base rate
2 case in order to begin recovery of depreciation and income taxes associated with the
3 investment. Second, given the true-up included in the SWIM proposal, recovery of,
4 and on, this investment would be guaranteed. Under traditional ratemaking,
5 shareholders are awarded a risk-adjusted return on equity and given the opportunity,
6 but not a guarantee, to earn this return. Under the true-up process proposed by UIF as
7 part of its SWIM scheme, shareholders would be guaranteed to recover both the return
8 on this investment as well as the return of this investment. This guarantee results from
9 the fact that any shortfalls would be charged to ratepayers in a subsequent period
10 through a true-up process. Depending on design, this mechanism could eliminate all
11 shareholder risk associated with recovery of projects funded through the proposed
12 SWIM until the time that such projects are rolled into rate base in a subsequent base
13 rate case.

14

15 **Q. Will adoption of the proposed SWIM mitigate the need for base rate cases?**

16 A. No. The Company suggests that its SWIM scheme could delay the need to file a full
17 base rate case to recover this investment; however, UIF has not included any stay-out
18 provision as part of its SWIM proposal. Moreover, a full rate case allows the
19 Commission and other parties the opportunity to examine all components of a utility's
20 revenue requirement, as well as its operations, in a comprehensive manner, unlike the
21 SWIM contrivance which would not only result in single-issue ratemaking, but would
22 further result in overall annual increases to be paid by customers.

23

1 **Q. What do you recommend with regard to the Company's proposed SWIM plan?**

2 **A.** I recommend that the Commission reject UIF's SWIM strategy. Utilities have a basic
3 obligation to provide safe and reliable utility service. Investment related to meeting
4 this obligation should be recovered through the traditional rate case process. The
5 Company's proposal is overly broad regarding the types of projects that would qualify
6 for recovery under the SWIM scheme and fails to adequately explain why a new
7 recovery mechanism is necessary. The Company's proposal would increase costs to
8 ratepayers and shift significant risk from shareholders to customers. For all these
9 reasons, I recommend that the proposed SWIM be rejected by the Commission.

10

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

12 **A.** Yes, it does.

1 MS. MORSE: With that, Mr. Chairman, Ms. Crane
2 is available for cross-examination.

3 CHARIMAN CLARK: Mr. Friedman. Can't hear
4 you, Mr. Friedman.

5 MR. FRIEDMAN: Can you hear me now?

6 CHAIRMAN CLARK: Now we got you, sir.

7 MR. FRIEDMAN: (Inaudible).

8 EXAMINATION

9 BY MR. FRIEDMAN:

10 Q Good afternoon, Ms. Crane.

11 Is this --

12 A Good afternoon.

13 Q Is this your first water and wastewater case
14 that you have worked on in Florida, is it not?

15 A It is.

16 Q And I am correct, am I not, that the last
17 water and wastewater case you worked anywhere in the
18 country was in Kentucky in 2016, five years ago?

19 A That's the last testimony that I filed. I
20 don't recall whether there was a case after that that
21 was settled, but that's certainly the last case in which
22 I filed direct testimony. Some of the case are settled
23 prior to testimony being filed.

24 Q And even though you are new to water and
25 wastewater regulation in Florida, you didn't spend much

1 time looking at the prior orders of the Commission other
2 than the prior UIF order, did you?

3 A No, I didn't spend a lot of time looking at
4 prior orders other than the UIF order.

5 Q You comment in your testimony about the
6 inadequacy of the information that's included in the
7 initial filing, did you not?

8 A I did.

9 Q And isn't it true that you did not look at any
10 other PSC rate filings in order to consider whether they
11 suffered the same perceived deficiency?

12 A Well, I didn't look at any other water
13 filings. I was familiar with some of the other utility
14 filings.

15 It's my understanding that many of the other
16 water companies as well are very small companies and not
17 on the order of magnitude of UIF, so I am not sure that
18 they are relevant. But, no, I do not go in and look at
19 all the individual water and wastewater filings that
20 were made.

21 Q Did you even look at the last MFRs that UIF
22 filed in the 2016 case?

23 A I believe did I.

24 Q And did you notice that it had the same
25 explanations in the MFRs that the current one does?

1 A I would say that they were very similar to
2 what was filed here. I would disagree that there were
3 explanations in all the MFRs. I think in many cases,
4 there were, in fact, no explanations in the MFRs. There
5 were simply numbers. But, yes, I would agree that they
6 were similar.

7 Q And were, like was asked of Ms. Swain earlier,
8 when there were adjustments made in the MFRs, weren't
9 there explanations to those adjustments in the MFRs
10 themselves but not in her testimony?

11 A Well, no, there were -- there were
12 identifiers, but for the most part, there was not an
13 explanation. It would tell you what the adjustment was,
14 chemicals, labor, new employees, et cetera, but there
15 was no information about how those adjustments were
16 calculated, why those adjustments were necessary. You
17 know, there was nothing to support the adjustment in
18 terms -- there was nothing to give the Commission
19 information about whether or not that was a reasonable
20 number.

21 So, yes, the numbers were there, and there was
22 a title there on each line, but in many -- practically
23 -- in fact, in most of those situations, there was no
24 real explanation as to why the company was proposing
25 that adjustment.

1 Q Did you just hear the numerous times that
2 counsel for OPC asked Ms. Swain that exact question and
3 she cited to the MFRs, for instance, on the wastewater
4 explanation in the MFR, did you hear that question?

5 A I did. I was actually kind of surprised to
6 hear her answer, because while it's true that in some
7 cases -- I am looking at, for example, the Schedule B-3
8 that she was talking about. It's true that in some --
9 in some places, for example, the proforma adjustments
10 for annualizing rate increases, it does talk about the
11 specific systems and the amount of time that the
12 annualization adjustment is being made, et cetera.

13 But if you go down, I mean, there is things
14 like, you know, the employees, annualized rent for
15 office lease. Well, we don't know, you know, how that
16 number was determined. We don't know when that lease
17 was taken out. We don't know what the terms of that
18 lease are.

19 Adjustments to salary and wages, there is one
20 number for additional employees and then another number
21 for benefits and pensions. But we don't know how many
22 employees that represents. We don't know what the
23 salaries and wages are. We don't know why those
24 employees are necessary.

25 Similarly, when she talks about the labor

1 costs annualizing 2020 increase, she says it's to
2 annualize the 2020 increase. There is no -- there is
3 nothing there to tell me what that percentage increase
4 was, and how those numbers were adjusted, and whether or
5 not they include unfilled positions or not.

6 So I have to respectfully disagree with --
7 with Ms. Swain that there were full explanations
8 provided in the MFRs, because I just don't see it -- I
9 just don't see it. And I don't see how the Commission
10 could make an informed decision based on solely what was
11 provided in the MFRs.

12 **Q Weren't the MF -- weren't the MFR schedules**
13 **and the explanations that were given or not given**
14 **consistent with the MFR form?**

15 A Yeah. I am not making any representation as
16 to whether your filing meets the legal requirements for
17 a minimum filings requirement, I mean, I presume it
18 does. But I am just -- I am just, as an expert witness,
19 testifying as to whether or not I think you provided
20 sufficient information to explain those numbers to the
21 Commission -- and to your ratepayers, by the way -- as
22 to where this increase is coming from.

23 There is a lot of numbers here. You filed a
24 lot of pages with a lot of numbers, but I don't think
25 you filed a lot of explanation as to why this increase

1 is necessary, and what's underlying those numbers.

2 That's -- that's my -- that was my concern. There is
3 nothing to show me where these numbers come from.

4 **Q Okay. So you think that way that the Public**
5 **Service Commission set forth in the requirement in the**
6 **MFRs is not sufficient, is that what you are saying?**

7 A No, I didn't say that at all. I think that
8 the information that's provided here is -- is probably
9 necessary for a rate increase, or for a rate change, but
10 I don't think it provides -- I don't think it is
11 sufficient, no, to provide full explanation and
12 justification for the rate increases that you are asking
13 for here. I mean, a 32 percent sewer increase, that's a
14 pretty significant rate increase, and based on the
15 explanations I have seen, no, I don't think that that's
16 sufficient.

17 **Q So if it was only a 10-percent rate increase,**
18 **you would be okay with it?**

19 A No, I probably wouldn't be okay with it for 10
20 percent either, because what I have seen generally in
21 other cases is the people explain their proforma
22 adjustments. There is test year, and then there is a
23 series of proforma adjustments, and those proforma
24 adjustments are generally explained and justified and in
25 many cases supported with underlying workpapers for each

1 adjustment. None of that was provided for here.

2 **Q If this is your first water and wastewater**
3 **case in Florida, how do you know what's required?**

4 A Again, you are -- I never said --
5 (Multiple speakers.)

6 **Q I am sorry, go ahead. I am sorry to**
7 **interrupt.**

8 A I never said that the company did not provide
9 what was legally required. I am not an attorney, and I
10 assume that you did provide what was legally required or
11 we wouldn't be here today at the evidentiary hearing.

12 What I am saying is to the Commission, and
13 they can all look at this data themselves and see it,
14 does this provide sufficient justification for the
15 magnitude of the rate increase that you are requesting
16 in this case? Do you really know why they are
17 requesting new employees? Do you know why they are
18 requesting, you know, increases in chemical costs? Do
19 you know how they determined their proforma revenues?

20 I think in many cases the answer to that is
21 no. And that's why we had so much discovery in this
22 case, in my view, because a lot of the information that
23 would have helped us to analyze the filing was, in fact,
24 not provided with the filing, and therefore, we were
25 forced to undergo an extensive discovery process in

1 order to elicit information from the company.

2 Q And you are familiar that the staff does an
3 audit in connection with rate cases, does it not?

4 A It does.

5 Q Okay. And then since you mentioned it, isn't
6 the opportunity for you or staff to obtain explanations
7 on adjustments or other numbers in the MFRs by
8 discovery, isn't that normally the way that is handled?

9 A No. The way it's normally handled is the
10 company justifies its case, because the company
11 generally bears -- or always bears the burden of proof.
12 So the way it's generally handled, in my -- in my
13 experience, is that the company files an application
14 that justifies, or at least the company feels it has
15 justified its -- its rate request.

16 There is always the need for additional
17 discovery. However, in many cases, there is quite a bit
18 of information filed with the application, including an
19 explanation of each proforma adjustment to the test
20 year, which minimizes or reduces the need to undertake
21 additional discovery.

22 In this case, it was just the opposite, there
23 were five pages of accounting testimony filed on the
24 direct case. And by the way, there is -- there are only
25 going to be five pages discussed on the rebuttal

1 testimony too, because that was all that was filed on
2 the accounting side. There was one Q&A on the SWIM
3 filed in the direct case.

4 So in my view -- I mean, the Commission is
5 going to make up its own mind whether you supported your
6 case or not. I am here to give them my expert opinion
7 that at least with regard to your initial application
8 you had not.

9 **Q And how can you say that that's in your**
10 **experience that you experienced elsewhere but not in**
11 **Florida, correct, that's not necessarily the way we do**
12 **things here in Florida?**

13 A Well, I have -- I have testified here -- as I
14 say, I have never testified in Florida before. I have
15 testified in 19 states, plus the District of Columbia.
16 I have been testifying for over 30 -- 30 years, and I
17 have also testified in several other Corix cases, I
18 might add. So I do have some -- although those
19 companies were probably before you acquired them, so I
20 do have, though, a fairly broad experience testifying
21 for a long period of time in a lot of states in -- with
22 regard to a lot of companies.

23 **Q But that doesn't necessarily mean that Florida**
24 **does things the way other states does it, is it?**

25 MS. MORSE: Objection to form. I am going to

1 object here. This is getting to be, I think,
2 unnecessarily argumentative. I think you have made
3 your point.

4 CHARIMAN CLARK: Sustained.

5 THE WITNESS: I am sorry, am I supposed to
6 answer?

7 CHAIRMAN CLARK: No, the objection was
8 sustained. I am sorry.

9 MR. FRIEDMAN: I couldn't hear the objection.
10 I didn't understand it.

11 CHARIMAN CLARK: I am sorry.

12 MR. FRIEDMAN: Is there an objection?

13 MS. MORSE: Mr. Chair, did you have a
14 question?

15 CHAIRMAN CLARK: No. Mr. Friedman, Ms. Morse
16 objected. I sustained the objection. I didn't say
17 it loud enough. I repeated it again, and
18 apparently we still have confusion.

19 Any questions?

20 MR. FRIEDMAN: All right. Thank you, I will
21 move on then.

22 CHAIRMAN CLARK: Thanks.

23 BY MR. FRIEDMAN:

24 **Q I have just a couple of questions about**
25 **working capital.**

1 A Okay.

2 **Q Doesn't the parent company need cash to**
3 **operate?**

4 A Sure. They do -- every company does need cash
5 to operate, and some companies get it -- get sufficient
6 cash purely from their revenue stream in order to meet
7 their expenses, so the timing of when they get that cash
8 is also important, but absolutely they need cash.

9 **Q All right. And cash is reflected in the**
10 **balance sheet, is it not?**

11 A It is.

12 **Q And you would agree, would you not, that**
13 **Florida uses the balance sheet approach to determine the**
14 **amount of working capital to be included in rate base?**

15 A I would. I -- I am sorry, I would.

16 **Q Okay. What is your understanding of the**
17 **definition of working capital used in the balance sheet**
18 **approach?**

19 A Well, it is -- it's -- it's basically
20 short-term liabilities and assets that are needed to
21 operate the business. You know, it's -- it's things
22 that, like prepayments, inventory, cash, to the extent
23 there is cash required, all of those other balance sheet
24 items that basically are not included in -- in your,
25 like, plant in service categories.

1 **Q** **Okay. Am I correct that you don't believe**
2 **that cash should be included in the determination of**
3 **rate base?**

4 A That -- I -- no. Cash -- to the extent that
5 there is a cash requirement, then, yes, I think it
6 should be included. In fact, you know, in many cases,
7 there is cash included in my rate base recommendation.
8 Sometimes -- some companies, as I mentioned earlier
9 actually file a negative cash balance, and that gets
10 deducted from rate base. But certainly there is usually
11 cash, either positive or negative reflected in rate pays
12 base, the problem is there has to be some basis for the
13 amount of that cash.

14 **Q** **All right. So you don't disagree --**

15 A I am sorry, did I miss the question?

16 MS. MORSE: What was the question.

17 BY MR. FRIEDMAN:

18 **Q** **I am just trying -- I thought you said**
19 **something different in your deposition is all, and**
20 **that's why I looked perplexed. Did you not make a**
21 **contrary statement in your deposition?**

22 A I don't think so. You can point me to my
23 deposition. I have it here. If you think I did, I am
24 happy to explain, you know, why I don't think what I
25 have said is inconsistent with my deposition.

1 **Q Okay. Why are you recommending that the**
2 **Commission deny UIF's request for proforma expense for**
3 **additional employees?**

4 A For several reasons. They didn't discuss why
5 they need these employees. They weren't on board during
6 the test year. In fact, they are still not on board
7 right now. So in my mind, it's not a known and
8 measurable change to the historic test year.

9 **Q You said on board. If you are on board during**
10 **the test year, it wouldn't be a proforma adjustment**
11 **then, would it?**

12 A No, it wouldn't, unless they were, you know,
13 there was some expansion of the particular position, or
14 salary level, or something like that. No, but the point
15 is many times during the test year you have employees
16 that are added during the test year. There is still a
17 proforma adjustment for new employees to annualize that
18 portion of the salary that was not actually incurred
19 during the test year. So if you brought somebody on
20 board July 1, your test year may only reflect six months
21 rather than 12 months of the salary, and therefore, you
22 would need a post test year adjustment for that new
23 employee position.

24 **Q Okay. So you don't have a disagreement with a**
25 **proforma for employees if it's supported with some**

1 **testimony?**

2 A Well, that's a rather broad statement. I
3 would -- I don't have a problem with some proforma
4 adjustments for new employees if it's supported with
5 testimony, provided that the company supports the fact
6 that the employee position is needed, the employee is
7 either hired -- was either hired already during the test
8 year or shortly to be hired. And it also depends on the
9 timing. I mean, if the company said, yeah, I am going
10 to hire a new employee in 2022, in my view, that would
11 not be appropriate to include in this revenue
12 requirement regardless of the need for that employee.
13 It's simply too far past the end of the test year.

14 **Q But did I understand you correctly, so if an**
15 **employee is hired in the middle of the test year, you**
16 **believe it would be appropriate to annualize their**
17 **salary?**

18 A Well, generally, I would say yes. I mean,
19 obviously I guess there could be a situation where they
20 brought somebody on board for a position that you felt
21 was not appropriate to charge the ratepayers. In that
22 particular case -- I mean, let's say I brought in, you
23 know, someone who was going to work on business
24 development for, you know, a new unregulated venture or
25 something. In that case, maybe I would recommend

1 disallowance. But as long as you brought on someone who
2 was working on your, you know, regulated business, then
3 generally I would recommend that that salary be
4 annualized.

5 **Q Let's move on to lobbying expenses.**

6 **On page 32 of your prefiled testimony, you**
7 **have a table there listing four organizations. Do I**
8 **understand you correctly that merely because these**
9 **organizations to be lobbying that their expenses should**
10 **be excluded?**

11 A Not all of their expenses. Their lobbying
12 expenses should be excluded. And just to clarify that
13 tabling, though, the only expenses I did exclude were a
14 portion of the Gunster -- and I hope I am saying that
15 right -- firm's expenses, because the company in -- the
16 company originally identified these as lobbying costs.
17 I asked another question in follow-up and said, are all
18 of these lobbying costs? And then you came back and you
19 said, oh, no, no, they are not lobbying costs. The only
20 lobbying costs are the Gunster costs, and that was only
21 45,000 of the 50,000.

22 So my adjustment is only limited to the 45,000
23 of the 60,000 for Gunster. The rest, I did not disallow
24 in my revenue requirement. But I do believe that all
25 lobbying costs should be disallowed, and it's even

1 broader than that, because a lot of times an
2 organization like the National Association of Water
3 Companies, they have a very limited view of lobbying.
4 So they will -- they will -- they will quantify their
5 lobbying as being very small, but they will be out doing
6 external affairs and other sort of informal advocacy
7 work that, in my view, also should not be charged to
8 ratepayers. So anything that is either called lobbying,
9 or really is lobbying with another name I believe should
10 be disallowed.

11 **Q But you haven't recommended disallowing the**
12 **other three, only the portion of the Gunster?**

13 **A** I am sorry, I missed the beginning of your
14 question.

15 **Q So if I understand what you just said**
16 **correctly, that you are not recommending disallowance of**
17 **the expenses of all four of those organizations, but**
18 **just a portion of the Gunster?**

19 **A** That's right.

20 **Q Okay. On incentive compensation, prior to**
21 **preparing your prefiled testimony, did you research any**
22 **prior PSC orders to determine how this commission has**
23 **historically dealt with incentive programs?**

24 **MS. MORSE:** Objection, asked and answered.

25 **CHAIRMAN CLARK:** I couldn't understand --

1 MR. FRIEDMAN: I am sorry, what was the
2 objection.

3 MS. MORSE: The objection was asked and
4 answered.

5 MR. FRIEDMAN: On incentive compensation?

6 MS. MORSE: No, on her research of prior
7 orders. You already went through an extensive
8 question and answer about whether she researched
9 prior orders in Florida.

10 MR. FRIEDMAN: I'm just -- I'm asking her what
11 she's done with compensation. All she's got to say
12 is question or no.

13 CHAIRMAN CLARK: Mr. Friedman, I don't know if
14 anybody -- is anyone else having a problem
15 understanding Mr. Friedman? Okay, I'm getting --
16 everybody is nodding their head, Mr. Friedman. We
17 are going to have to make some adjustments.

18 MR. FRIEDMAN: I am going to speak up. I
19 apologize. I was sitting back.

20 CHARIMAN CLARK: No problem.

21 MR. FRIEDMAN: I apologize. Is this any
22 better?

23 CHAIRMAN CLARK: Would you repeat your
24 question that you asked Ms. Crane for me, please?

25 MR. FRIEDMAN: Prior to preparing her

1 testimony on incentive compensation, did she do any
2 research of prior PSC orders to determine how the
3 Commission has historically treated incentive
4 compensation?

5 CHAIRMAN CLARK: And, Ms. Morse, you objected
6 to that based on the grounds that it has been asked
7 and answered?

8 MS. MORSE: Yes, I did, because of his
9 extensive questioning about whether she researched
10 any prior orders whatsoever prior to in the -- in
11 earlier colloquy.

12 CHAIRMAN CLARK: I think this one goes a
13 little beyond that, so overruled.

14 You may answer the question.

15 THE WITNESS: Okay. Not before I prepared my
16 testimony, other than reading the UIF order from
17 that case, I have since taken a look at a couple of
18 other decisions, but not -- not before I filed my
19 testimony.

20 BY MR. FRIEDMAN:

21 **Q Thank you.**

22 **I have got a couple of questions about the**
23 **excess deferred income tax amortization?**

24 **A Okay.**

25 **Q It's the same question I just asked.**

1 **Did you -- did you review how the PSC has**
2 **historically handled the amortization of excess deferred**
3 **taxes in other cases?**

4 A Well, I was familiar with the Peoples Gas
5 case, because I worked in that case, and I was familiar
6 with the cases that the company had cited with regard to
7 the 10-year amortization in its testimony, and of
8 course, I distinguished those cases from this case in my
9 prefiled testimony.

10 **Q And so did you object to the use of 10 years**
11 **with the Peoples Gas?**

12 A I am going to tell you the absolute truth. I
13 can't remember what we did in Peoples Gas because --
14 because I just don't remember. Once these cases are
15 over I am on to the next one, so I would have to refresh
16 my recollection whether that was an issue or not in the
17 Peoples Gas case.

18 **Q And in doing that, did you see any cases that**
19 **had other than 10 percent in Florida?**

20 A Well, the case -- the cases that I looked at
21 were the cases that the company pointed out in its
22 testimony. And as I indicated, in those cases, the EDIT
23 was a regulatory liability, not a regulatory -- I mean,
24 it was a regulatory asset, not a regulatory liability,
25 as it is in this case, so they were clearly

1 distinguishable from this cases because, in those cases,
2 the ratepayers owed the company money, and in this case,
3 the company owes the ratepayers money.

4 **Q So it sounds like to me that you don't want to**
5 **do a fair if it's good for the goose, it's good for the**
6 **gander argument?**

7 A Oh, no, I think it's totally fair, because you
8 are getting 21-and-a-half years before you have to give
9 us back all the rest of the money that -- that you are
10 holding on to the -- the other accumulated deferred
11 income taxes. So we are already -- you are already
12 doing pretty well with that.

13 In addition to that, anything you don't give
14 us back, gets to put in -- you get to essentially get it
15 in, you know, rate base reflection. So I think you are
16 doing pretty well in that regard. I mean, I would love
17 to get all of our -- all of our money back prior to
18 21-and-a-half years, but -- so I think the company is
19 already sort of benefiting from those funds, more so
20 than ratepayers.

21 **Q Now we are talking about just the excess**
22 **deferred income tax amortization --**

23 A Right.

24 **Q -- so it's my understanding that if it's a**
25 **benefit to the customers, you think it should be**

1 **amortized over a shorter period, but if it's to the**
2 **benefit of the utility, it should be amortized over a**
3 **longer period?**

4 A Well, there is two things I will say, and I
5 will explain that.

6 First of all, with regard to the EDIT, it was
7 the excess -- you said we are only talking about excess
8 deferred income taxes. It is the excess deferred income
9 taxes, the protected excess deferred income taxes ed
10 that are, in fact, being held by the company and slowly
11 dribbled out to us over 21-and-a-half years. So that --
12 that is the other piece of EDIT that I was referring to,
13 that's 21-and-a-half years.

14 With regard to the -- the unprotected, that is
15 the only piece that this Commission has discretion over.
16 And frankly, I think that there are many reasons for
17 giving that back to ratepayers as soon as possible.
18 First of all, it is our money. Second of all, you do
19 have complete discretion over that, whereas you have no
20 discretion over protected excess deferred income taxes.
21 We are in the middle of a terrible pandemic, which is
22 reeking havoc with the economy, not only of Florida but
23 probably of -- of the country, and probably of the
24 world. And I think any help that you could give to
25 ratepayers in that regard would be welcome.

1 You are also proposing, although, I hope you
2 don't get it, but you are proposing a 32 percent rate
3 increase for sewer and a 17 percent rate increase for
4 water, both of which are really significant rate
5 increases. And so even under my recommendation, I am
6 still proposing that sewer customers get a 12.7 percent
7 rate increase. That's an incredibly high rate increase
8 given current economic conditions.

9 So I think when the Commission looks at
10 everything over all the, I think my approach is a
11 balanced recommendation.

12 **Q And I guess that answers my simple question,**
13 **which was, why is it -- why is it that you use one**
14 **amortization period when it benefits the customers and a**
15 **different one when it benefits the utility?**

16 A Well, I think I have just explained why I
17 chose in this particular case to use a five-year
18 amortization period. If you would like me to explain
19 it, you know, again, I will. But I would love to get --
20 I would love to get those protected excess deferred
21 taxes back a lot sooner too, but I don't have any choice
22 with regard to those.

23 **Q Wouldn't you agree that aging water and**
24 **wastewater infrastructure is a serious problem in this**
25 **state?**

1 A I think aging infrastructure -- I haven't done
2 a study in the state, but in general, I think aging
3 infrastructure has always been a problem for utilities,
4 and that's why they are expected to replace those as
5 needed, you know, in the normal course of business.
6 That's -- that's your key responsibility for all of the
7 utilities, is to keep up their infrastructure.
8 Absolutely.

9 Q And do you have live in Ft. Lauderdale?

10 A I do.

11 Q Okay. Then you keep up with, do you not, all
12 the instances of water and wastewater line breaks in Ft.
13 Lauderdale of late?

14 A I -- I absolutely do. I am -- I am detouring
15 around those sewer construction projects all the time.

16 Q And wouldn't you agree that the Commission
17 should encourage water and wastewater utilities to be
18 proactive in addressing aging infrastructure?

19 A Oh, I think they are proactive. I mean, as I
20 have said, I think the problem in Ft. Lauderdale is
21 unfortunately the amount of money that we paid in our
22 bills wasn't being used for infrastructure, it was being
23 syphoned off and used for other things. I mean, that's
24 the problem.

25 But I think the I -- I think all regulatory

1 commissions have an obligation to make sure that the
2 utility -- that the rates that are set by those
3 commissions are sufficient in order for the utility,
4 through the normal rate-making process, to replace its
5 infrastructure when necessary. I mean, providing safe
6 and adequate utility service is -- is key. I mean,
7 that's why -- that's why you are in business.

8 **Q Are you familiar with the GRIP program that**
9 **this commission approved for gas utilities?**

10 A I have certainly read your rebuttal testimony
11 with regard to the GRIP. I don't have firsthand know --
12 I am sorry, I don't have firsthand knowledge of it, but
13 I have read your testimony.

14 I am sorry, is there a question?

15 **Q No, I am looking at my notes. I am sorry.**

16 A Okay. Sorry. I can't see you, so that's
17 why --

18 **Q Can you see me now?**

19 A No, I -- I can't see you, so I am not sure
20 what you are doing.

21 **Q I apologize, can nobody see me?**

22 **CHAIRMAN CLARK: Don't fret, Mr. Friedman, we**
23 **can still see you. You are fine. You haven't gone**
24 **anywhere.**

25 **MR. FRIEDMAN: I'm sure you probably would**

1 rather not.

2 That's all I have got.

3 THE WITNESS: Okay. Thank you.

4 CHAIRMAN CLARK: All right. Thank you very
5 much, Mr. Friedman.

6 Staff?

7 EXAMINATION

8 BY MR. TRIERWEILER:

9 **Q Good afternoon, Ms. Crane.**

10 A Good afternoon.

11 **Q Staff has three questions for you.**

12 **The first is: Regarding the amortization of**
13 **unprotected deferred income taxes over five years as**
14 **opposed to 10 years, in your opinion, will using a**
15 **five-year amortization as opposed to the 10-year**
16 **amortization for unprotected deferred income taxes**
17 **create a cash flow problem for UIF?**

18 A No.

19 **Q Can you provide any financial metrics that**
20 **indicate a five-year amortization will not cause a cash**
21 **flow problem for UIF?**

22 A I -- I haven't seen any evidence presented by
23 the company that it would create a cash flow problem.
24 And looking at the magnitude of the adjustment, I don't
25 believe that given the -- the fact that we just heard,

1 in fact, that cash is managed for the entire corporation
2 in this one big account somewhere, what you are talking
3 about here on a -- on an annual revenue requirement
4 basis -- now, this is a revenue requirement number --
5 it's about \$280,000 for sewer and -- I'm looking at my
6 schedules -- \$177,000 for water. So I find it hard to
7 believe that that -- those two adjustments would create
8 any kind of a serious cash flow problem for UIF.

9 **Q But can you provide any financial metric?**

10 A I have not done a study to determine what --
11 in terms of the rating agency metrics is what I presume
12 you are talking about, and I haven't done any kind of a
13 study to determine what the specific cash flow
14 implications of that from a credit metrics would be.

15 I am not sure that it would be that easy to do
16 given the fact that UIF doesn't manage even its own
17 cash, as we've heard. So, you know, presumably the
18 credit agencies are looking at the entire corporate
19 structure when they are making, you know, their
20 decisions, and so I am not even sure how I would go
21 about doing that calculation.

22 **Q Thank you.**

23 **In response to Staff's Sixth Set of**
24 **Interrogatories No. 109, which is CEL 122 -- you may not**
25 **need to go to it -- UIF Witness Swain stated: The ratio**

1 of cash to rate base was an appropriate indicator to
2 derive a presumed cash balance. Do you agree?

3 A No, I don't agree. I think that the -- the
4 cash balance is more closely related to the operating
5 expenses, and specifically it's related to the -- to the
6 difference between the time when expenses are
7 incurred -- or actually when they are paid, not when
8 they are incurred, when they are paid by the utility and
9 the time that the utility receives revenues from its
10 customers. I mean, they are kind of the appropriate
11 metrics with regard to the need for cash.

12 And in addition, if you look at the -- the two
13 cases that the Commission -- or that the company had
14 cited, where the Commission had ordered the \$317,000 of
15 cash working capital that we discussed earlier, in those
16 cases, the Commission didn't use a percent of plant or
17 rate base, or utility plant. That two percent was
18 simply the company's calculation based on the dollar
19 amount that had been approved in those cases and the
20 dollar amount of the rate base in those cases. So they
21 made the calculation. They said, oh, it's two percent,
22 so let's do two percent here.

23 But the Commission, there is absolutely no
24 evidence that I saw the Commission took rate base into
25 account, or plant in service into account at all when it

1 made that determination. In fact, it looked at actual
2 cash. You know, in the first case, it looked at actual
3 cash balances subsequent, though, to the test year,
4 because of the construction project that was going on.
5 And then in the second case, it basically said, let's
6 just keep with what we ordered a year ago. So they
7 didn't look at -- they didn't look at a rate base or
8 plant in service, so, no, I don't think they are related
9 at all.

10 **Q Thank you.**

11 MR. TRIERWEILER: Staff has nothing further.

12 CHAIRMAN CLARK: All right. Commissioners,
13 any questions for Ms. Crane?

14 Commissioner -- we will start with
15 Commissioner Fay, center square.

16 COMMISSIONER FAY: Thank you, Mr. Chairman. I
17 am hopefully going to ask Commissioner Brown's
18 question before she gets to ask it, so I will give
19 it a go. Thank you, Ms. Crane, for your testimony.

20 So starting on page 47 of your testimony, you
21 talk about the SWIM program and I think the record
22 discusses a little bit about this -- the program
23 being unusual compared to another gas program. So
24 despite sort of that -- that debate, I am trying to
25 get a better understanding if this is something

1 that may be applied in other jurisdictions and
2 maybe something that you -- you have seen before
3 since it sounds like you have a descent amount of
4 expertise outside of Florida.

5 And then maybe additionally to that, just help
6 me understand, is -- are there -- you know, based
7 on your testimony, it seems that there are even --
8 even if applied, there are still no benefits to
9 applying the increases in sort of a stepped format,
10 because I think there is arguments in rate-making
11 that if it's all done in one rate case, the rate
12 impact would be more significant than if it's
13 spread out. So if you could maybe answer those two
14 questions for me.

15 THE WITNESS: Okay. Sure.

16 First of all, the -- in my view, the SWIM is
17 unusual but not unique. I have seen something
18 called the distribution system improvement charge,
19 which some companies have, which is a mechanism
20 whereby the revenue requirement -- the revenue
21 requirement of certain capital projects can be
22 charged to ratepayers between base rate cases.

23 In those cases that I have seen, generally
24 what happens is the companies come in with a very
25 detailed capital program of, you know, specific

1 mains or other infrastructure that needs to be
2 replaced. They are required to pretty much
3 demonstrate that, for whatever reason, they can't
4 do that within the normal rate-making process
5 because, as I indicated, obviously infrastructure
6 replacement is probably, you know, job number --
7 job function number one of the utility.

8 But if for some reason they can't do that
9 within the normal rate-making process, I have seen
10 commissions allow for this DSIC, distribution
11 system improvement charge. They would come in with
12 a complete set of projects telling everybody what
13 they want to do, budgets for each project,
14 timeframes, et cetera.

15 And under that type of scenario, I am aware
16 of, I think, a couple of northeastern states that
17 do have this distribution system improvement
18 charge. I believe in some cases there may be rate
19 case stay-out requirements as well; that if you
20 put -- you know, if you are going to use the --
21 this mechanism, then you can't also come back in
22 for a rate case. So there is a lot of -- a lot
23 that goes into these mechanisms in the few states
24 where they have been authorized.

25 As to your second question, I would -- I would

1 agree with you that rate shock is a concern, in
2 that, you know, generally we -- we advocate for a
3 rate gradualism to avoid rate shock, and there has
4 been some testimony in this case in rebuttal that
5 if the SWIM is authorized, there would be -- or
6 there could be -- there could be fewer rate cases
7 and a reduction in rate case costs.

8 Well, you know, there is no guarantee of that
9 whatsoever. Now, if the Commission wanted to, you
10 know, approve a SWIM mechanism but require that
11 there be a five-year stay-out so that ratepayers
12 weren't hit twice, you know, maybe -- maybe that
13 would be something that would be interesting; but
14 the fact of the matter is that you could be dealing
15 with very significant increases relating to a SWIM
16 mechanism on top of fairly frequent rate increases
17 as well, base rate increases.

18 So, you know, at this -- at this point, I -- I
19 don't think there is enough evidence to suggest
20 that ratepayers really would benefit from a SWIM
21 mechanism. I think -- I think in all likelihood
22 they would sort of get hit twice, and you would
23 have -- you would have annual increases. I mean,
24 you would have annual increases. That's a sure --
25 that's, like, a sure thing, so...

1 COMMISSIONER FAY: Yeah, I appreciate the
2 clarification, because it does seem, you know,
3 if -- if spread out, that that debate is relevant.
4 I think, just to clarify in your testimony, you are
5 saying if there was this stay-out, then that
6 argument would prove true. If there is not, then
7 it's hard to say that it would be any better, so I
8 appreciate your answers. Thanks so much.

9 THE WITNESS: And I think, if I could just
10 add, it would have to be a significant stay-out.
11 You know, some companies call 18 months or two
12 years a stay-out. And to me, that's just kind of a
13 normal rate case cycle, so it would have to be a
14 significant stay-out.

15 Thank you.

16 COMMISSIONER FAY: Yep, thank you for your
17 answers.

18 CHARIMAN CLARK: Thank you, Commissioner Fay.
19 Commissioner Brown.

20 COMMISSIONER BROWN: Thank you. And I
21 appreciate your testimony, Ms. Crane, and the
22 detail that you provided in your -- your testimony,
23 it was very, very thorough, and it really kind of
24 elucidated some areas.

25 Going back to Commissioner Fay's question --

1 yes, he did ask my question, but your response --
2 your response, I do want to focus a little on that
3 SWIM program.

4 In those few states that have some type of
5 mechanism for distribution replacement repair, is
6 it -- was it codified by statute, by rule, or just
7 by order, or by settlement?

8 THE WITNESS: You know, I don't know the
9 answer to that. You know, I just -- I just don't
10 know if there was enabling legislation or not. So
11 I am sorry, I don't know.

12 COMMISSIONER BROWN: And that is relevant as
13 well, just because I am not -- I am not certain
14 really of the authority. I mean, we -- we can do
15 what we want, but whether we have the authority to
16 do it under Florida law, that's just one area that
17 I am interested in. And you do have an extensive
18 background too, looking at your resume.

19 And in those -- those mechanisms, is it
20 typical to have a substantial stay-out provision
21 when -- when the company -- when a company comes in
22 and files a distribution replacement repair plan
23 with the Commission?

24 THE WITNESS: Yeah, you know, I am just -- I
25 am trying to think about the two or three. I think

1 there -- I think there is a stay-out in -- in a
2 couple of those. I mean, I don't know. I can't
3 recall now specific timing, or whether they all had
4 them or not. I mean, I would have to do some more
5 research on that, but, I mean, five years is
6 sticking in my mind, but I am not sure -- I am not
7 sure if I am really recalling correctly.

8 COMMISSIONER BROWN: I don't see a benefit to
9 states -- the states that you are at least
10 generally familiar with that have authorized it.
11 Has there been a benefit to that mechanism in
12 addition to a base rate case or -- or just a
13 benefit?

14 THE WITNESS: Yes. That's -- that's an
15 interesting question, because I am not an engineer.
16 And, you know, engineers think that -- if you ask
17 an engineer and you ask a financial person, you may
18 very well get two different answers because my
19 focus is generally on, you know, safe and reliable
20 service, but I am trying to keep costs down to
21 ratepayers. Sometimes the engineers feel like cost
22 should be a secondary consideration. So to them,
23 you know, to be replacing infrastructure may, you
24 know, may, in fact, be more of a benefit than the
25 ratepayers would initially perceive.

1 I -- so, you know, I am not aware of any
2 specific engineering type of benefit, and I
3 certainly don't think there has been a financial
4 benefit in the states in which I am -- in which I
5 testify, but an engineer might give you a different
6 answer.

7 I mean, obviously, every dollar that goes into
8 the ground, whether it goes into the ground, you
9 know, through the base rate process or whether it
10 would go in through some sort of a SWIM mechanism
11 and then later transferred into -- into base rates,
12 but every dollar is a benefit to shareholders. I
13 mean, every dollar of rate base that -- every
14 incremental dollar of rate base means that the next
15 time the company comes in for a rate increase, they
16 can ask for a larger dollar return on investment,
17 even if the overall cost of capital doesn't change,
18 the fact that their rate base now has grown means
19 that they are going to earn more dollars and,
20 therefore, their shareholders are going to be
21 better off.

22 So -- and this is not unique to water.
23 Electric, gas, they are all -- they are all really
24 trying to build their rate bases now across the
25 board. And so, you know, I think you just have to

1 be very, very careful to make sure that this isn't
2 being driven by the need for earnings. And until
3 you see that there is a dramatic engineering
4 infrastructure failure that needs to be addressed
5 and can't be addressed in the base rate case
6 process, you know, I think that the -- I think all
7 the regulatory commissions should be -- should be
8 very hesitant to -- to support these kind of
9 mechanisms which will only increase rates.

10 COMMISSIONER BROWN: And, you know, the way I
11 look at it, we have a storm protection cost
12 recovery mechanism that was put into law recently,
13 and it was in addition to base rates because
14 Florida is prone to extreme weather like
15 hurricanes. And so it was -- over the years, we
16 developed and we had very robust storm hardening
17 programs, and those, of course, were recovered
18 through base rates, and now it's a clause. This is
19 something that I kind of analogize to that, but
20 based on history.

21 And I am sorry I am not trying to testify here
22 for you, but I was trying to get more insight from
23 your experiences on that SWIM, and whether it's a
24 clause or a settlement or a law.

25 Finally, regarding the Corix, you really

1 combed through a lot of the utility's request.
2 You -- you recommend a disallowance of the Corix
3 severance cost, can you elaborate a little bit more
4 on that?

5 THE WITNESS: Sure.

6 Initially, it was because the company really
7 hadn't justified it in my view. I mean, there
8 is -- there is nothing at all. If I hadn't asked
9 the question about severance, you know, we would
10 never know that it was even included in their
11 revenue requirement. So I was curious about
12 whether or not there -- there were amounts for
13 severance embedded in there, and -- and there were.

14 And I am just trying -- I am trying to recall
15 the timing, and how much went in my testimony, and
16 whether or not more information -- I believe more
17 information actually came out in rebuttal
18 testimony, and then we did a round of discovery in
19 rebuttal testimony, and we found out that some of
20 these severance payouts are really significant. I
21 mean, I think there were two -- over the past three
22 years, I think there were two that were, like,
23 close to \$1 million. So I mean, this is not -- you
24 know this is not Andrea Crane who gets severed
25 because I have become redundant and, you know, they

1 are giving me a month's salary. These -- these
2 were very significant payments probably for very
3 top officers or executives of the company. Not all
4 of them. Not all of them by any means, but some.

5 So my concerns here were more that the company
6 had not, in my view, sufficiently supported these
7 costs. As, you know, some of them may be
8 legitimate, but certainly some of them raised a red
9 flag once we began to dig in -- dig into them. But
10 again, by the time of my testimony, my direct
11 testimony was done, it was simply because they
12 hadn't provided sufficient justification.

13 COMMISSIONER BROWN: Thank you, Ms. Crane.
14 You have been a very detailed witness, and I
15 appreciate your testimony on behalf of the citizens
16 of Florida.

17 THE WITNESS: Thank you.

18 CHAIRMAN CLARK: Thank you, Commissioner
19 Brown.

20 Any other Commissioners have questions?

21 Commissioner La Rosa.

22 COMMISSIONER LA ROSA: Thank you, Chairman.
23 And thank you, Ms. Crane, for your testimony. Some
24 of the questions my colleagues have answered have
25 been really great questions, you have done a great

1 job answering them.

2 Just kind of quick follow-up to some of the
3 commentary in the recent questions with other
4 states that have maybe alternative, or similar type
5 programs that utilities have -- have asked for that
6 the folks are asking for today in the SWIM program,
7 is it fair to say that those states have similar
8 infrastructure as the state of Florida in the sense
9 of old and infrastructure needing replacement
10 and/or diversity in the size of those states?

11 THE WITNESS: Yeah. I mean, I would -- I
12 would -- I would gather that some of them are --
13 that have it are actually quite a bit older than
14 yours. You know, I am thinking, like,
15 Pennsylvania, which is actually my home state
16 originally, their -- their infrastructure is
17 probably actually older than yours. And so I think
18 in some of those states there, that -- that is an
19 issue, but, you know, certainly you have, I am
20 sure, aging infrastructure as well.

21 COMMISSIONER LA ROSA: Okay. All right. Very
22 good. Thank you.

23 Thank you, Chairman.

24 CHARIMAN CLARK: Thank you, Commissioner La
25 Rosa.

1 All right. Any other questions from
2 Commissioners?

3 All right. Where does that leave us?
4 Redirect, OPC? No volume, OPC.

5 MS. MORSE: Yeah, I am here, Mr. Chairman.

6 No, I don't have any further questions. And I
7 think Ms. Crane's exhibits are already in the
8 record in the CEL. I don't know if I need to move
9 them in.

10 CHAIRMAN CLARK: Not if they are already in
11 the CEL, we are good to go.

12 Any other exhibits from anybody?

13 All right. I believe that concludes Ms.
14 Crane's testimony for the day. Thank you very
15 much.

16 THE WITNESS: Thank you.

17 CHAIRMAN CLARK: We are going to take a
18 five-minute --

19 MS. MORSE: May she be excused, Chair?

20 CHAIRMAN CLARK: Yes. Yes, who's -- someone
21 has -- Ms. Crane?

22 THE WITNESS: Thank you.

23 (Witness excused.)

24 (Whereupon, prefiled direct testimony of David
25 Garrett was inserted.)

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for increase in water and
wastewater rates in Charlotte, Highlands, Lake,
Lee, Marion, Orange, Pasco, Pinellas, Polk, and
Seminole Counties, by Utilities, Inc. of Florida

DOCKET NO. 20200139-WS

DIRECT TESTIMONY**OF****DAVID J. GARRETT****ON BEHALF OF THE FLORIDA OFFICE OF PUBLIC COUNSEL**

J. R. Kelly
Public Counsel

A. Mireille Fall-Fry
Office of Public Counsel
c/o The Florida Legislature
111 West Madison Street, Room 812
Tallahassee, FL 32399-1400

Attorneys for the Citizens
of The State of Florida

TABLE OF CONTENTS

| | | |
|-------|--|----|
| I. | INTRODUCTION | 1 |
| II. | EXECUTIVE SUMMARY | 2 |
| | A. Overview..... | 2 |
| | B. Response to Mr. D’Ascendis’ Testimony..... | 8 |
| | C. FL ROE Formula | 10 |
| III. | LEGAL STANDARDS AND THE AWARDED RETURN..... | 12 |
| IV. | GENERAL CONCEPTS AND METHODOLOGY..... | 22 |
| V. | RISK AND RETURN CONCEPTS | 24 |
| VI. | DISCOUNTED CASH FLOW ANALYSIS | 32 |
| | D. Stock Price | 32 |
| | E. Dividend..... | 34 |
| | F. Growth Rate..... | 35 |
| | 1. The Various Determinants of Growth..... | 36 |
| | 2. Reasonable Estimates for Long-Term Growth | 39 |
| | 3. Qualitative Growth: The Problem with Analysts’ Growth Rates | 43 |
| | 4. Long-Term Growth Rate Recommendation | 48 |
| | G. Response to Mr. D’Ascendis’ DCF Model..... | 50 |
| VII. | CAPITAL ASSET PRICING MODEL ANALYSIS | 51 |
| | A. The Risk-Free Rate | 52 |
| | B. The Beta Coefficient..... | 53 |
| | C. The Equity Risk Premium..... | 55 |
| | D. Response to Mr. D’Ascendis’ CAPM Analysis..... | 63 |
| VIII. | OTHER COST OF EQUITY ISSUES..... | 66 |
| | 1. Non-Price Regulated Model | 66 |
| | 2. Small Size Premium..... | 67 |
| IX. | COST OF EQUITY SUMMARY..... | 70 |
| X. | CAPITAL STRUCTURE | 73 |

LIST OF EXHIBITS

| | |
|----------------|---|
| Exhibit DJG-1 | Curriculum Vitae |
| Exhibit DJG-2 | Proxy Group Summary |
| Exhibit DJG-3 | DCF Stock Prices |
| Exhibit DJG-4 | DCF Dividend Yields |
| Exhibit DJG-5 | DCF Terminal Growth Determinants |
| Exhibit DJG-6 | DCF Final Results |
| Exhibit DJG-7 | CAPM Risk-Free Rate |
| Exhibit DJG-8 | CAPM Betas |
| Exhibit DJG-9 | CAPM Implied Equity Risk Premium Calculation |
| Exhibit DJG-10 | CAPM Equity Risk Premium Results |
| Exhibit DJG-11 | CAPM Final Results |
| Exhibit DJG-12 | Cost of Equity Summary |
| Exhibit DJG-13 | Market Cost of Equity |
| Exhibit DJG-14 | Utility Awarded Returns vs. Market Cost of Equity |
| Exhibit DJG-15 | Competitive Industry Debt Ratios |
| Exhibit DJG-16 | Proxy Group Debt Ratios |
| Exhibit DJG-17 | Appendices |
| Appendix A: | Discounted Cash Flow Model Theory |
| Appendix B: | Capital Asset Pricing Model |

1 **I. INTRODUCTION**

2 **Q. STATE YOUR NAME AND OCCUPATION.**

3 A. My name is David J. Garrett. I am a consultant specializing in public utility regulation. I
4 am the managing member of Resolve Utility Consulting PLLC.

5
6 **Q. SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL
7 EXPERIENCE.**

8 A. I received a B.B.A. with a major in Finance, an M.B.A., and a Juris Doctor from the
9 University of Oklahoma. I worked in private legal practice for several years before
10 accepting a position as assistant general counsel at the Oklahoma Corporation Commission
11 in 2011. At the commission, I worked in the Office of General Counsel in regulatory
12 proceedings. In 2012, I began working for the Public Utility Division as a regulatory
13 analyst providing testimony in regulatory proceedings. After leaving the commission, I
14 formed Resolve Utility Consulting PLLC, where I have represented various consumer
15 groups and state agencies in utility regulatory proceedings, primarily in the areas of cost of
16 capital and depreciation. I am a Certified Depreciation Professional with the Society of
17 Depreciation Professionals. I am also a Certified Rate of Return Analyst with the Society
18 of Utility and Regulatory Financial Analysts. A more complete description of my
19 qualifications and regulatory experience is included in my curriculum vitae.¹

¹ Exhibit DJG-1.

1 **Q. DESCRIBE THE PURPOSE AND SCOPE OF YOUR TESTIMONY IN THIS**
2 **PROCEEDING.**

3 A. I am testifying on behalf of the Florida Office of Public Counsel (“OPC”) in response to
4 the application for a rate increase filed by Utilities, Inc. of Florida (“UIF” or the
5 “Company”). Specifically, I address the cost of capital and fair rate of return for UIF in
6 response to the direct testimony of Company witness Dylan W. D’Ascendis.

7 **II. EXECUTIVE SUMMARY**

A. Overview

8 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION.**

9 A. I recommend the Commission authorize a return on equity of 9.5%. I also recommend the
10 Commission impute a capital structure consisting of 50% long-term debt, 5% short-term
11 debt, and 45% common equity.

12

13 **Q. EXPLAIN THE CONCEPT OF THE “WEIGHTED AVERAGE COST OF**
14 **CAPITAL.”**

15 A. The term “cost of capital” refers to the weighted average cost of all types of components
16 within a company’s capital structure, including debt and equity. Determining the cost of
17 debt is relatively straight-forward. Interest cost rates on bonds are contractual, derived,
18 “embedded costs” that are generally calculated by dividing total interest payments by the
19 book value of outstanding debt. In contrast, determining the cost of equity is more
20 complex. Unlike the known contractual cost of debt, there is no explicit “cost” of equity;
21 thus, the cost of equity must be estimated through various financial models. The overall

1 weighted average cost of capital (“WACC”) includes the cost of debt and the estimated
 2 cost of equity. It is a “weighted average,” because it is based upon the Company’s relative
 3 levels of debt and equity, or “capital structure.” Companies in the competitive market often
 4 use their WACC as the discount rate to determine the value of capital projects, so it is
 5 important that this figure be closely estimated. The basic WACC equation used in
 6 regulatory proceedings is presented as follows:

7 **Equation 1:**
 8 **Weighted Average Cost of Capital**

9
$$WACC = \left(\frac{D}{D + E} \right) C_D + \left(\frac{E}{D + E} \right) C_E$$

where: *WACC* = *weighted average cost of capital*
 D = *book value of debt*
 C_D = *embedded cost of debt capital*
 E = *book value of equity*
 C_E = *market-based cost of equity capital*

10 Thus, the three components of the weighted average cost of capital include the following:

- 11 1. Cost of Equity
 12 2. Cost of Debt
 13 3. Capital Structure

14 The term “cost of capital” is necessarily synonymous with the “weighted average cost of
 15 capital,” and the terms are used interchangeably throughout this testimony.

16

1 **Q. DESCRIBE THE RELATIONSHIP BETWEEN THE COST OF EQUITY,**
2 **REQUIRED RETURN ON EQUITY (“ROE”), EARNED ROE, AND AWARDED**
3 **ROE.**

4 A. While “cost of equity,” “required ROE,” “earned ROE,” and “awarded ROE” are
5 interrelated factors and concepts, they are all technically different from each other. The
6 financial models presented in this case were created as tools for estimating the “cost of
7 equity,” which is synonymous to the “required ROE” that investors expect based on the
8 amount of risk inherent in the equity investment. In other words, the cost of equity from
9 the company’s perspective equals the required ROE from the investor’s perspective.

10 The “earned ROE” is a historical return that is measured from a company’s
11 accounting statements, and it is used to measure how much shareholders earned for
12 investing in a company. A company’s earned ROE is not the same as the company’s cost
13 of equity. For example, an investor who invests in a risky company may *require* a return
14 on investment of 10%. If the company used the same estimates as the investor, then the
15 company will estimate that its *cost* of equity is also 10%. If the company performs poorly
16 and the investor *earns* a return of only 7%, this does not mean that the investor required
17 only 7%, or that the investor will not still require a 10% return the following period. Thus,
18 the cost of equity is not the same as the earned ROE.

19 Finally, the “awarded” return on equity is unique to the regulatory environment; it
20 is the return authorized by a regulatory commission pursuant to legal guidelines. As
21 discussed later in this testimony, the awarded ROE should be based on the utility’s *cost* of
22 equity. The relationship between the terms and concepts discussed thus far could be
23 summarized in the following sentence: If the awarded ROE reflects a utility’s cost of

1 equity, then it should allow the utility to achieve an earned ROE that is sufficient to satisfy
2 the required return of its equity investors. Thus, the “required” or “expected” return from
3 an investor’s standpoint is not simply what the investor wishes he could get. Likewise, the
4 expected return of a utility investor has nothing to do with what the investor “expects” the
5 ROE awarded by a regulatory commission to be. Rather, the expected return/cost of equity
6 is estimated through objective, mathematical financial modeling based on risk.

7
8 **Q. DESCRIBE THE COMPANY’S POSITION REGARDING ITS COST OF**
9 **CAPITAL IN THIS CASE.**

10 A. In this case, Mr. D’Ascendis proposes an awarded return on equity of 11.75% for the
11 Company.² Mr. D’Ascendis relies on the Discounted Cash Flow (“DCF”) Model, the
12 Capital Asset Pricing Model (“CAPM”), and other models in making his recommendation.

13
14 **Q. SUMMARIZE YOUR ANALYSES AND CONCLUSIONS REGARDING THE**
15 **COMPANY’S COST OF EQUITY.**

16 A. Analysis of an appropriate awarded ROE for a utility should begin with a reasonable
17 estimation of the utility’s cost of equity capital. In estimating the Company’s cost of
18 equity, I performed a cost of equity analysis on a proxy group of utility companies with
19 relatively similar risk profiles. Based on this proxy group, I evaluated the results of the
20 two most common financial models for calculating cost of equity in utility rate

² Direct Testimony of Dylan W. D’Ascendis, p. 5, line 7.

1 proceedings: the CAPM and DCF Model. Applying reasonable inputs and assumptions to
2 these models indicates that the Company's estimated cost of equity is approximately 6%.³

3
4 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATION TO THE COMMISSION.**

5 A. Pursuant to the legal and technical standards guiding this issue, the awarded ROE should
6 be based on, or reflective of, the utility's cost of equity. As I explain in more detail below,
7 the Company's estimated cost of equity is approximately 6%. However, these legal
8 standards do not mandate the awarded ROE be set exactly equal to the cost of equity.
9 Rather, in *Federal Power Commission v. Hope Natural Gas Co.*,⁴ the U.S. Supreme Court
10 ("Court" or "Supreme Court") found that, although the awarded return should be based on
11 a utility's cost of capital, it also indicated that the "end result" should be just and
12 reasonable. If the Commission were to award a return equal to the Company's estimated
13 cost of equity of 6%, it would be accurate from a technical standpoint, and it would also
14 significantly reduce the excess wealth transfer from ratepayers to shareholders that would
15 otherwise occur if the Company's proposal were adopted. I recommend, however, the
16 Commission award an ROE to the Company's shareholders that is remarkably higher than
17 the UIF's actual cost of equity in this case. Specifically, I recommend an awarded ROE of
18 9.5%.

³ Exhibit DJG-12.

⁴ See *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). Here, the Court states that it is not mandating the various permissible ways in which the rate of return may be determined, but instead indicates that the end result should be just and reasonable. This is sometimes called the "end result" doctrine.

1 The ratemaking concept of “gradualism,” though usually applied from the
2 customer’s standpoint to minimize rate shock, could also be applied to shareholders. An
3 awarded return as low as 6% in any current rate proceeding would represent a substantial
4 change from the “status quo,” which as I prove later in this testimony, involves awarded
5 ROEs that clearly exceed market-based cost of equity for utilities. However, while
6 generally reducing awarded ROEs for utilities would move awarded returns closer to
7 market-based costs and reduce part of the excess transfer of wealth from ratepayers to
8 shareholders, I believe it is advisable to do so gradually. One of the primary reasons the
9 Company’s cost of equity is so low is because the Company is a very low-risk asset. In
10 general, utility stocks are low-risk investments because movements in their stock prices are
11 relatively involatile. If the Commission were to make a significant, sudden change in the
12 awarded ROE anticipated by regulatory stakeholders, it could have the undesirable effect
13 of notably increasing the Company’s risk profile and would arguably be at odds with the
14 *Hope Court’s* “end result” doctrine. An awarded ROE of 9.5% represents a good balance
15 between the Supreme Court’s indications that awarded ROEs should be based on cost,
16 while also recognizing that the end result must be reasonable under the circumstances. An
17 awarded ROE of 9.5% also represents a gradual move toward the Company’s market-based
18 cost of equity, and it would be fair to the Company’s shareholders because 9.5% is over
19 300 basis points above the Company’s market-based cost of equity. Nonetheless, it is clear
20 that the Company’s proposed ROE of 11.75% is excessive and unreasonable, as further
21 discussed below.

B. Response to Mr. D'Ascendis' Testimony

1 **Q. PLEASE PROVIDE AN OVERVIEW OF THE PROBLEMS YOU HAVE**
2 **IDENTIFIED WITH MR. D'ASCENDIS' TESTIMONY REGARDING COST OF**
3 **EQUITY AND THE AWARDED ROE.**

4 A. Mr. D'Ascendis proposes a return on equity of 11.75%.⁵ Mr. D'Ascendis'
5 recommendations are based on the CAPM, DCF Model, and other models. However,
6 several of his key assumptions and inputs to these models violate fundamental, widely-
7 accepted tenants in finance and valuation, while other assumptions and inputs are simply
8 unrealistic. The key areas of concern are summarized as follows:

9 **1. Terminal Growth Rate**

10 In his DCF Model, Mr. D'Ascendis' average long-term growth rate applied to the
11 Company exceeds the long-term growth rate for the entire U.S. economy. In fact, Mr.
12 D'Ascendis' projected growth rates for his proxy companies are as high as 14%,⁶ which is
13 more than three times the projected U.S. GDP growth. It is a fundamental concept in
14 finance that, in the long run, a company cannot fundamentally grow at a faster rate than the
15 aggregate economy in which it operates; this is especially true for a regulated utility with
16 a defined service territory. Thus, the results of Mr. D'Ascendis' DCF Model are upwardly
17 biased and are not reflective of current market conditions.

⁵ Direct Testimony of Dylan W. D'Ascendis, p. 5, line 7.

⁶ Exhibit DWD-2, Sch. 3.

1 **2. Equity Risk Premium**

2 Mr. D'Ascendis' estimate for the Equity Risk Premium, the single most important
3 factor in estimating the cost of equity and a key input to the CAPM, is 11.94%.⁷ This
4 estimate is significantly higher than the estimates reported by thousands of experts across
5 the country. Thus, Mr. D'Ascendis' CAPM cost of equity estimate is overstated,
6 unsupported, and unreasonable.

7 **3. Non-Price Regulated Model**

8 In addition to conducting the CAPM and DCF model on the proxy group of utility
9 companies, Mr. D'Ascendis also used a non-price regulated proxy group.⁸ This approach
10 is flawed because the risk inherent in the non-regulated proxy group is higher than that of
11 the utility proxy group. Moreover, this model suffers from the same overestimated equity
12 risk premium and risk-free rate as Mr. D'Ascendis' CAPM for the proxy group of regulated
13 utilities.

14
15 **Q. WOULD THE RESULT OF ANY OF MR. D'ASCENDIS' COST OF EQUITY**
16 **MODELS BE REASONABLE FOR UIF'S AWARDED ROE IN THIS CASE?**

17 A. Yes. Mr. D'Ascendis DCF Model produced a median result of 9.44%.⁹ Although I do not
18 agree with some of the inputs to his DCF Model, nor do I agree that it produces a reasonable

⁷ Exhibit DWD-2, Sch. 5.

⁸ See Direct Testimony of Dylan W. D'Ascendis, pp. 35-37.

⁹ Exhibit DWD-2, Sch. 3.

1 estimate for UIF's cost of equity, a 9.4% ROE would nonetheless be a reasonable result
2 for UIF's awarded return on equity in this case.

C. FL ROE Formula

3 **Q. PLEASE DESCRIBE THE RESULTS OF THE FLORIDA ROE LEVERAGE**
4 **GRAPH ("FL ROE") FORMULA.**

5 A. Using UIF's common equity ratio of 49.39%, the result of the FL ROE formula would be
6 9.69%.¹⁰

7
8 **Q. WOULD YOU RECOMMEND THE COMMISSION USE THIS FORMULA TO**
9 **DETERMINE UIF'S AUTHORIZED ROE?**

10 A. No. There are several reasons why I think using this formula to determine the awarded
11 ROE is problematic. First, applying this formula runs the risk of being at odds with the
12 standards set forth in the legal cases governing this issue. As discussed further below in
13 my testimony, the U.S. Supreme Court is clear that the awarded ROE should be based on
14 the utility's cost of equity and should be commensurate with returns on investments in
15 other enterprises having corresponding risks, among other standards. In my opinion, the
16 FL ROE formula cannot produce a result that ensures conformance with these standards.
17 This is because the formula does not measure the cost of equity, and there is no input to
18 the formula to account for market risk, or the effect that market risk would have on UIF.

¹⁰ Formula: $ROE = 6.05\% + (1.8 / \text{equity ratio})$.

1 Second, I do not believe the FL ROE formula adds any marginal value to the
2 analytical process beyond the CAPM and DCF Model. The CAPM has been widely relied
3 upon for decades by analysts, managers, investors, and academics in the financial
4 community and in utility rate cases. The CAPM itself is also a formula; however, it is one
5 that was designed to estimate the cost of equity, and it directly accounts for market risk.
6 For these reasons, the CAPM is aligned with the legal standards governing this issue. The
7 DCF Model is another model and formula that has been widely relied upon in the finance,
8 investment, and regulatory industry for decades to help make investment decisions and
9 estimate cost of equity. I would strongly recommend to the Commission to rely on the
10 CAPM and DCF Model as valuable tools to indicate a utility's cost of equity, and then base
11 the awarded ROE on that cost of equity estimate.

12
13 **Q. DO YOU BELIEVE THE FL ROE FORMULA WOULD PRODUCE A**
14 **REASONABLE RESULT FOR UIF'S AUTHORIZED ROE IN THIS CASE?**

15 **A.** No. Using the CAPM and DCF Model in this case indicates that UIF's cost of equity is
16 much lower than 9.69%, as further discussed in my testimony.

1 **III. LEGAL STANDARDS AND THE AWARDED RETURN**

2 **Q. DISCUSS THE LEGAL STANDARDS GOVERNING THE AWARDED RATE OF**
3 **RETURN ON CAPITAL INVESTMENTS FOR REGULATED UTILITIES.**

4 A. In *Wilcox v. Consolidated Gas Co. of New York*,¹¹ the U.S. Supreme Court first addressed
5 the meaning of a fair rate of return for public utilities. The Court found that “the amount
6 of risk in the business is a most important factor” in determining the appropriate allowed
7 rate of return.¹² Later in two landmark cases, the Court set forth the standards by which
8 public utilities are allowed to earn a return on capital investments. In *Bluefield Water*
9 *Works & Improvement Co. v. Public Service Commission of West Virginia*,¹³ the Court
10 held:

11 A public utility is entitled to such rates as will permit it to earn a return on
12 the value of the property which it employs for the convenience of the
13 public . . . but it has no constitutional right to profits such as are realized or
14 anticipated in highly profitable enterprises or speculative ventures. The
15 return should be reasonably sufficient to assure confidence in the financial
16 soundness of the utility and should be adequate, under efficient and
17 economical management, to maintain and support its credit and enable it to
18 raise the money necessary for the proper discharge of its public duties.

19 In *Federal Power Commission v. Hope Natural Gas Company*,¹⁴ the Court expanded on
20 the guidelines set forth in *Bluefield* and stated:

¹¹ *Wilcox v. Consolidated Gas Co. of New York*, 212 U.S. 19 (1909).

¹² *Id.* at 48.

¹³ *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-93 (1923).

¹⁴ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (emphasis added).

1 From the investor or company point of view it is important that there be
 2 enough revenue not only for operating expenses *but also for the capital*
 3 *costs of the business*. These include service on the debt and dividends on
 4 the stock. By that standard the return to the equity owner should be
 5 commensurate with returns on investments in other enterprises having
 6 corresponding risks. That return, moreover, should be sufficient to assure
 7 confidence in the financial integrity of the enterprise, so as to maintain its
 8 credit and to attract capital.

9 (Emphasis added). The cost of capital models I have employed in this case are in
 10 accordance with the foregoing legal standards.

11
 12 **Q. IS IT IMPORTANT THAT THE AWARDED RATE OF RETURN BE BASED ON**
 13 **THE COMPANY'S ACTUAL COST OF CAPITAL?**

14 A. Yes, it is. The *Hope* Court makes it clear that the allowed return should be based on the
 15 actual cost of capital. Under the rate base rate of return model, a utility should be allowed
 16 to recover all its reasonable expenses, its capital investments through depreciation, and a
 17 return on its capital investments sufficient to satisfy the required return of its investors.
 18 The "required return" from the investors' perspective is synonymous with the "cost of
 19 capital" from the utility's perspective. Scholars agree that the allowed rate of return should
 20 be based on the actual cost of capital:

21 Since by definition the cost of capital of a regulated firm represents
 22 precisely the expected return that investors could anticipate from other
 23 investments while bearing no more or less risk, and since investors will not
 24 provide capital unless the investment is expected to yield its opportunity
 25 cost of capital, the correspondence of the definition of the cost of capital
 26 with the court's definition of legally required earnings appears clear.¹⁵

¹⁵ A. Lawrence Kolbe, James A. Read, Jr. & George R. Hall, *The Cost of Capital: Estimating the Rate of Return for Public Utilities* 21 (The MIT Press 1984).

1 The models I have employed in this case closely estimate UIF's true cost of equity. If the
2 Commission sets the awarded return based on my lower, and more reasonable rate of
3 return, it will comply with the U.S. Supreme Court's standards, allow the Company to
4 maintain its financial integrity, and satisfy the claims of its investors. On the other hand,
5 if the Commission sets the allowed rate of return much *higher* than the true cost of capital,
6 it arguably results in an inappropriate transfer of wealth from ratepayers to shareholders.

7 As Dr. Morin notes:

8 [I]f the allowed rate of return is greater than the cost of capital, capital
9 investments are undertaken and investors' opportunity costs are more than
10 achieved. Any excess earnings over and above those required to service
11 debt capital accrue to the equity holders, and the stock price increases. In
12 this case, the wealth transfer occurs from ratepayers to shareholders.¹⁶

13 Thus, it is important to understand that the *awarded* return and the *cost* of capital are
14 different but related concepts. The two concepts are related in that the legal and technical
15 standards encompassing this issue require that the awarded return reflect the true cost of
16 capital. On the other hand, the two concepts are different in that the legal standards do not
17 mandate that awarded returns exactly match the cost of capital. Awarded returns are set
18 through the regulatory process and may be influenced by a number of factors other than
19 objective market drivers. The cost of capital, on the other hand, should be evaluated
20 objectively and be closely tied to economic realities. In other words, the cost of capital is
21 driven by stock prices, dividends, growth rates, and — most importantly — it is driven by
22 risk. The cost of capital can be estimated by financial models used by firms, investors, and
23 academics around the world for decades. The problem is, with respect to regulated utilities,

¹⁶ Roger A. Morin, *New Regulatory Finance* 23-24 (Public Utilities Reports, Inc. 2006) (1994).

1 there has been a trend in which awarded returns fail to closely track with actual market-
2 based cost of capital as further discussed below. To the extent this occurs, the results are
3 detrimental to ratepayers and the state's economy.

4
5 **Q. DESCRIBE THE ECONOMIC IMPACT THAT OCCURS WHEN THE**
6 **AWARDED RETURN STRAYS TOO FAR FROM THE U.S. SUPREME COURT'S**
7 **COST OF EQUITY STANDARD.**

8 A. As discussed further in the sections below, Mr. D'Ascendis' recommended awarded ROE
9 is much higher than UIF's actual cost of capital based on objective market data. When the
10 awarded ROE is set far above the *cost* of equity, it runs the risk of violating the U.S.
11 Supreme Court's standards that the awarded return should be *based on the cost of capital*.
12 If the Commission were to adopt the Company's position in this case, it would be
13 permitting an excess transfer of wealth from UIF's Florida customers to Company
14 shareholders. Moreover, establishing an awarded return that far exceeds the true cost of
15 capital effectively prevents the awarded returns from changing along with economic
16 conditions. This is especially true given the fact that regulators tend to be influenced by
17 the awarded returns in other jurisdictions, regardless of the various unknown factors
18 influencing those awarded returns. This is yet another reason why it is crucial for regulators
19 to focus on the target utility's actual *cost* of equity, rather than awarded returns from other
20 jurisdictions. Awarded returns may be influenced by settlements and other political factors
21 not based on true market conditions. In contrast, the true cost of equity as estimated
22 through objective models is not influenced by these factors but is instead driven by market-
23 based factors. If regulators rely too heavily on the awarded returns from other jurisdictions,

1 it can create a cycle over time that bears little relation to the market-based cost of equity.

2 In fact, this is exactly what we have observed since 1990.

3
4 **Q. ILLUSTRATE AND COMPARE THE RELATIONSHIP BETWEEN AWARDED**
5 **UTILITY RETURNS AND MARKET COST OF EQUITY SINCE 1990.**

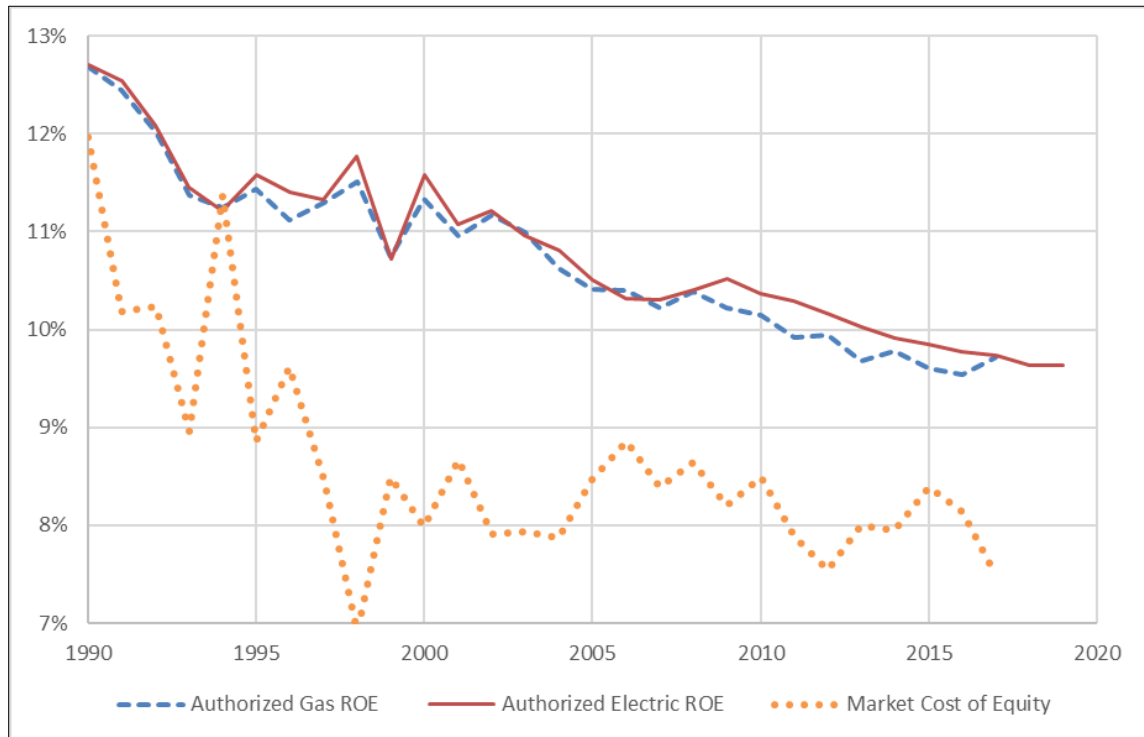
6 A. As shown in the figure below, awarded returns for public utilities have been above the
7 average required market return since 1990.¹⁷ Because utility stocks are consistently far
8 less risky than the average stock in the marketplace, the cost of equity for utility companies
9 is *less* than the market cost of equity. This is a fact, not an opinion. The graph below
10 shows two trend lines. The top line is the average annual awarded returns since 1990 for
11 U.S. regulated utilities. The bottom line is the required market return over the same period.
12 As discussed in more detail later in my testimony, the required market return is essentially
13 the return that investors would require if they invested in the entire market. In other words,
14 the required market return is essentially the cost of equity of the entire market. Since it is
15 undisputed (even by utility witnesses) that utility stocks are less risky than the average
16 stock in the market, then the utilities' cost of equity must be less than the market cost of
17 equity.¹⁸ Thus, awarded returns (the solid line) should generally be *below* the market cost
18 of equity (the dotted line), since awarded returns are supposed to be based on true cost of
19 equity.

¹⁷ See Exhibit DJG-14.

¹⁸ This fact can be objectively measured through a term called "beta," as discussed later in the testimony. Utility betas are less than one, which means utility stocks are less risky than the "average" stock in the market.

1
2

Figure 1:
Awarded ROEs vs. Market Cost of Equity

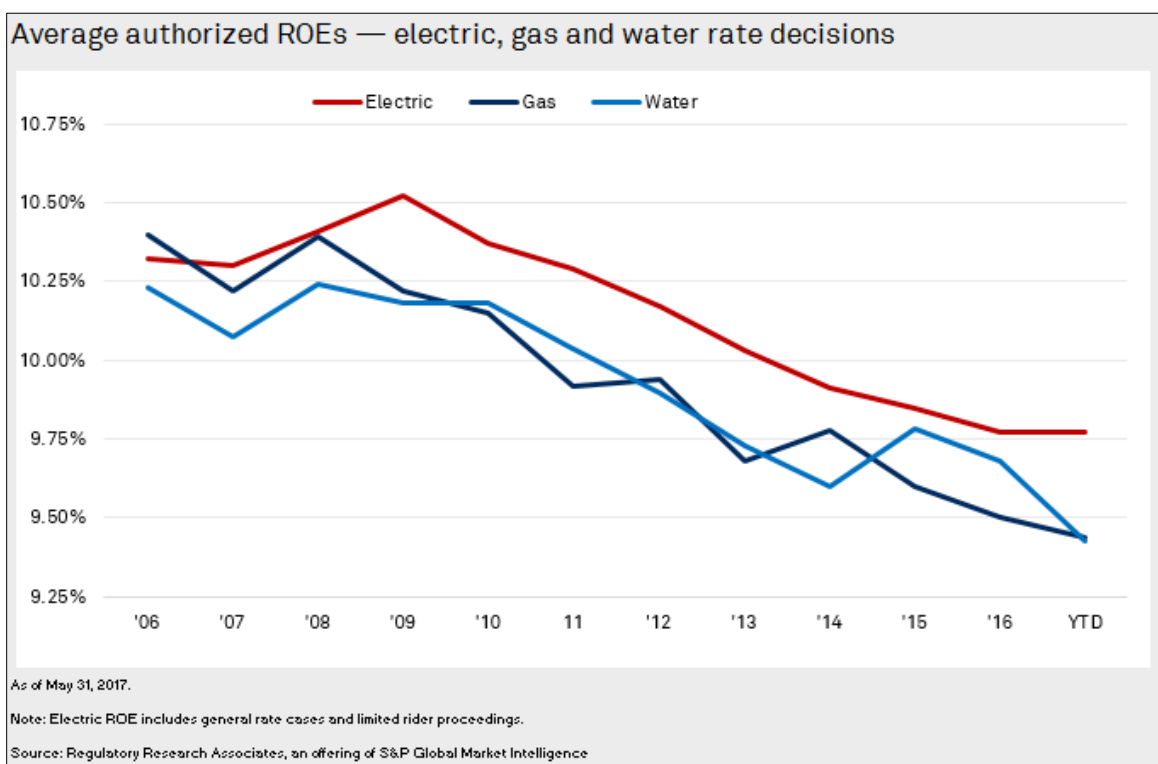


3 Because utility stocks are less risky than the average stock in the market, utility cost of
 4 equity is *below* market cost of equity (the dotted line in this graph). However, as shown in
 5 this graph, awarded ROEs have been consistently *above* the market cost of equity for many
 6 years. As shown in the graph, since 1990 there was only one year in which the average
 7 awarded ROE was below the market cost of equity — 1994. In other words, 1994 was the
 8 year that regulators awarded ROEs that were the closest to utilities' market-based cost of
 9 equity. In my opinion, when awarded ROEs for utilities are below the market cost of
 10 equity, they more closely conform to the standards set forth by *Hope* and *Bluefield* and
 11 minimize the excess wealth transfer from ratepayers to shareholders.

1 **Q. DOES THIS CONCEPT ALSO APPLY TO REGULATED WATER UTILITIES?**

2 A. Yes. Like regulated electric and gas utilities, water utilities are also less risky than the
3 average stock in the market portfolio. We can objectively measure this fact through water
4 utility betas.¹⁹ As shown in the graph below, the average authorized ROEs for water
5 utilities have generally tracked with those of gas utilities.

6 **Figure 2:**
7 **Awarded ROEs vs. Market Cost of Equity**



8 Comparing this graph with the preceding graph, we can see that authorized ROEs for water
9 utilities have also exceeded the market cost of equity. Again, the cost of equity for a

¹⁹ See Exhibit DJG-8. The concept of beta will be discussed further in my testimony; however, since the average beta of the proxy group is less than 1.0, we have an objective way to determine that if UIF were publicly traded, the return required by its equity investors would be less than the return required on the market portfolio.

1 regulated utility, including water utilities, should be below the market cost of equity. In
2 2017, the average authorized ROE for water utilities was approximately 9.4%.²⁰ As
3 demonstrated later in my testimony, the current required return on the market portfolio (or
4 market cost of equity) is approximately 7.5% (and perhaps even lower).²¹ Thus, regardless
5 of where the awarded ROE is set in this case, any reasonable estimate for UIF's cost of
6 equity should be below 7.5%.

7
8 **Q. HAVE OTHER ANALYSTS COMMENTED ON THIS NATIONAL**
9 **PHENOMENON OF AWARDED ROES EXCEEDING THE MARKET-BASED**
10 **COST EQUITY FOR UTILITIES?**

11 A. Yes. In his article published in Public Utilities Fortnightly in 2016, Steve Huntoon
12 observed that even though utility stocks are less risky than the stocks of competitive
13 industries, utility stocks have nonetheless outperformed the broader market.²² Specifically,
14 Huntoon notes the following three points which lead to a problematic conclusion:

- 15 1. Jack Bogle, the founder of Vanguard Group and a Wall Street
16 legend, provides rigorous analysis that the long-term total return for
17 the broader market will be around 7 percent going forward. Another
18 Wall Street legend, Professor Burton Malkiel, corroborates that 7
19 percent in the latest edition of his seminal work, *A Random Walk*
20 *Down Wall Street*.

²⁰ S&P Global Market Intelligence, *Water Rate Case Activity: How It Ebbs and Flows*, June 23, 2017.
<https://www.spglobal.com/marketintelligence/en/news-insights/research/water-rate-case-activity-how-it-ebbs-and-flows>

²¹ See Exhibit DJG-13.

²² Steve Huntoon, "Nice Work If you can Get It," Public Utilities Fortnightly (Aug. 2016).

1 2. Institutions like pension funds are validating [the first point] by
2 piling on risky investments to try and get to a 7.5 percent total return,
3 as reported by the Wall Street Journal.

4 3. Utilities are being granted returns on equity around 10 percent.²³

5 In a follow-up article analyzing and agreeing with Mr. Huntoon’s findings, Leonard
6 Hyman and William Tilles found that utility equity investors expect about a 7.5% annual
7 return.²⁴

8 Other scholars have also observed that awarded ROEs have not appropriately
9 tracked with declining interest rates over the years, and that excessive awarded ROEs have
10 negative economic impacts. In a 2017 white paper, Charles S. Griffey stated:

11 The “risk premium” being granted to utility shareholders is now higher than
12 it has ever been over the last 35 years. Excessive utility ROEs are
13 detrimental to utility customers and the economy as a whole. From a
14 societal standpoint, granting ROEs that are higher than necessary to attract
15 investment creates an inefficient allocation of capital, diverting available
16 funds away from more efficient investments. From the utility customer
17 perspective, if a utility’s awarded and/or achieved ROE is higher than
18 necessary to attract capital, customers pay higher rates without receiving
19 any corresponding benefit.²⁵

20 It is interesting that both Mr. Huntoon and Mr. Griffey use the word “sticky” in their articles
21 to describe the fact that awarded ROEs have declined at a much slower rate than interest
22 rates and other economic factors resulting in a decline in capital costs and expected returns
23 on the market. It is not hard to see why this phenomenon of sticky ROEs has occurred.
24 Because awarded ROEs are often based primarily on a comparison with other awarded

²³ *Id.*

²⁴ Leonard Hyman & William Tilles, “Don’t Cry for Utility Shareholders, America,” *Public Utilities Fortnightly* (October 2016).

²⁵ Charles S. Griffey, “When ‘What Goes Up’ Does Not Come Down: Recent Trends in Utility Returns,” *White Paper* (February 2017).

1 ROEs around the country, the average awarded returns effectively fail to adapt to true
2 market conditions, and regulators seem reluctant to deviate from the average. Once utilities
3 and regulatory commissions become accustomed to awarding rates of return higher than
4 market conditions actually require, this trend becomes difficult to reverse. Nevertheless,
5 the fact is that utility stocks are *less risky* than the average stock in the market, and thus,
6 awarded ROEs should be less than the expected return on the market. However, that is
7 rarely the case. “Sooner or later, *regulators may see the gap between allowed returns and*
8 *cost of capital.*”²⁶

9
10 **Q. SUMMARIZE THE LEGAL STANDARDS GOVERNING THE AWARDED ROE**
11 **ISSUE.**

12 A. The Commission should strive to move the awarded return to a level more closely aligned
13 with the Company’s actual, market-derived cost of capital while keeping in mind the
14 following legal principles:

- 15 **1. Risk is the most important factor when determining the awarded return. The**
16 **awarded return should be commensurate with those on investments of**
17 **corresponding risk.**

18 The legal standards articulated in *Hope* and *Bluefield* demonstrate that the Court
19 understands one of the most basic, fundamental concepts in financial theory: the more
20 (less) risk an investor assumes, the more (less) return the investor requires. Since utility
21 stocks are very low risk, the return required by equity investors should be relatively low. I

²⁶ Leonard Hyman & William Tilles, “Don’t Cry for Utility Shareholders, America,” *Public Utilities Fortnightly* (October 2016) (emphasis added).

1 have used financial models in this case to closely estimate UIF's cost of equity, and these
2 financial models account for risk. The public utility industry is one of the least risky
3 industries in the entire country. The cost of equity models confirm this fact in that they
4 produce relatively low cost of equity results. In turn, the awarded ROE in this case should
5 reflect the fact that UIF is a low-risk firm.

6 **2. The awarded return should be sufficient to assure financial soundness under**
7 **efficient management.**

8 Because awarded returns in the regulatory environment have not closely tracked market-
9 based trends and commensurate risk, utility companies have been able to remain more than
10 financially sound, perhaps despite management inefficiencies. In fact, the transfer of
11 wealth from ratepayers to shareholders has been so far removed from actual cost-based
12 drivers that even under relatively inefficient management a utility could remain financially
13 sound. Therefore, regulatory commissions should strive to set the awarded return for a
14 regulated utility at a level based on accurate market conditions to promote prudent and
15 efficient management and minimize economic waste.

16 **IV. GENERAL CONCEPTS AND METHODOLOGY**

17 **Q. DISCUSS YOUR APPROACH TO ESTIMATING THE COST OF EQUITY IN**
18 **THIS CASE.**

19 A. While a competitive firm must estimate its own cost of capital to assess the profitability of
20 competing capital projects, regulators determine a utility's cost of capital to establish a fair
21 rate of return. The legal standards set forth above do not include specific guidelines
22 regarding the models that must be used to estimate the cost of equity. Over the years,
23 however, regulatory commissions have consistently relied on several models. The models

1 I have employed in this case have been the two most widely used and accepted in regulatory
2 proceedings for many years. These models are the Discounted Cash Flow Model (“DCF
3 Model”) and the Capital Asset Pricing Model (“CAPM”). The specific inputs and
4 calculations for these models are described in more detail below.

5
6 **Q. PLEASE EXPLAIN WHY MULTIPLE MODELS ARE USED TO ESTIMATE THE**
7 **COST OF EQUITY.**

8 A. The models used to estimate the cost of equity attempt to measure the return on equity
9 required by investors by estimating several different inputs. It is preferable to use multiple
10 models because the results of any one model may contain a degree of imprecision,
11 especially depending on the reliability of the inputs used at the time of conducting the
12 model. By using multiple models, the analyst can compare the results of the models and
13 look for outlying results and inconsistencies. Likewise, if multiple models produce a
14 similar result, it may indicate a narrower range for the cost of equity estimate.

15
16 **Q. PLEASE DISCUSS THE BENEFITS OF CHOOSING A PROXY GROUP OF**
17 **COMPANIES IN CONDUCTING COST OF CAPITAL ANALYSES.**

18 A. The cost of equity models in this case can be used to estimate the cost of capital of any
19 individual, publicly-traded company. There are advantages, however, to conducting cost
20 of capital analysis on a “proxy group” of companies that are comparable to the target
21 company. First, it is better to assess the financial soundness of a utility by comparing it to
22 a group of other financially sound utilities. Second, using a proxy group provides more
23 reliability and confidence in the overall results because there is a larger sample size.

1 Finally, the use of a proxy group is often a pure necessity when the target company is a
2 subsidiary that is not publicly traded. This is because the financial models used to estimate
3 the cost of equity require information from publicly-traded firms, such as stock prices and
4 dividends.

5
6 **Q. DESCRIBE THE PROXY GROUP YOU SELECTED IN THIS CASE.**

7 A. In this case, I chose to use the same proxy group used by Mr. D'Ascendis. There could be
8 reasonable arguments made for the inclusion or exclusion of a particular company in a
9 proxy group; however, the cost of equity results are influenced far more by the underlying
10 assumptions and inputs to the various financial models than the composition of the proxy
11 groups.²⁷ By using the same proxy group, we can remove a relatively insignificant variable
12 from the equation and focus on the primary factors driving the Company's cost of equity
13 estimate in this case.

14 **V. RISK AND RETURN CONCEPTS**

15 **Q. DISCUSS THE GENERAL RELATIONSHIP BETWEEN RISK AND RETURN.**

16 A. Risk is among the most important factors for the Commission to consider when
17 determining the allowed return. Thus, it is necessary to understand the relationship
18 between risk and return. There is a direct relationship between risk and return: the more
19 (or less) risk an investor assumes, the larger (or smaller) return the investor will demand.
20 There are two primary types of risk: firm-specific risk and market risk. Firm-specific risk

²⁷ See Exhibit DJG-2.

1 affects individual companies, while market risk affects all companies in the market to
2 varying degrees.

3
4 **Q. DISCUSS THE DIFFERENCES BETWEEN FIRM-SPECIFIC RISK AND**
5 **MARKET RISK.**

6 A. Firm-specific risk affects individual companies, rather than the entire market. For example,
7 a competitive firm might overestimate customer demand for a new product, resulting in
8 reduced sales revenue. This is an example of a firm-specific risk called “project risk.”²⁸
9 There are several other types of firm-specific risks, including: (1) “financial risk” — the
10 risk that equity investors of leveraged firms face as residual claimants on earnings; (2)
11 “default risk” — the risk that a firm will default on its debt securities; and (3) “business
12 risk” — which encompasses all other operating and managerial factors that may result in
13 investors realizing less than their expected return in that particular company. While firm-
14 specific risk affects individual companies, market risk affects all companies in the market
15 to varying degrees. Examples of market risk include interest rate risk, inflation risk, and
16 the risk of major socio-economic events. When there are changes in these risk factors, they
17 affect all firms in the market to some extent.²⁹

18 Analysis of the U.S. market in 2001 provides a good example for contrasting firm-
19 specific risk and market risk. During that year, Enron Corp.’s stock fell from \$80 per share
20 and the company filed bankruptcy at the end of the year. If an investor’s portfolio had held

²⁸ Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 62-63 (3rd ed., John Wiley & Sons, Inc. 2012).

²⁹ See Zvi Bodie, Alex Kane & Alan J. Marcus, *Essentials of Investments* 149 (9th ed., McGraw-Hill/Irwin 2013).

1 only Enron stock at the beginning of 2001, this irrational investor would have lost his or
2 her entire investment by the end of the year due to assuming the full exposure of Enron’s
3 firm-specific risk (in that case, imprudent management). On the other hand, a rational,
4 diversified investor who invested the same amount of capital in a portfolio holding every
5 stock in the S&P 500 would have had a much different result that year. The rational
6 investor would have been relatively unaffected by the fall of Enron because his portfolio
7 included about 499 other stocks. Each of those stocks, however, would have been affected
8 by various *market* risk factors that occurred that year, including the terrorist attacks on
9 September 11th, which affected all stocks in the market. Thus, the rational investor would
10 have incurred a relatively minor loss due to market risk factors, while the irrational investor
11 would have lost everything due to firm-specific risk factors.

12

13 **Q. CAN INVESTORS EASILY MINIMIZE FIRM-SPECIFIC RISK?**

14 A. Yes. A fundamental concept in finance is that firm-specific risk can be eliminated through
15 diversification.³⁰ If someone irrationally invested all their funds in one firm, they would
16 be exposed to all the firm-specific risk *and* the market risk inherent in that single firm.
17 Rational investors, however, are risk-averse and seek to eliminate risk they can control.
18 Investors can essentially eliminate firm-specific risk by adding more stocks to their
19 portfolio through a process called “diversification.” There are two reasons why
20 diversification eliminates firm-specific risk. First, each stock in a diversified portfolio

³⁰ See John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 179-80 (3rd ed., South Western Cengage Learning 2010).

1 represents a much smaller percentage of the overall portfolio than it would in a portfolio
2 of just one or a few stocks. Thus, any firm-specific action that changes the stock price of
3 one stock in the diversified portfolio will have only a small impact on the entire portfolio.³¹

4 The second reason why diversification eliminates firm-specific risk is that the
5 effects of firm-specific actions on stock prices can be either positive or negative for each
6 stock. Thus, in large diversified portfolios, the net effect of these positive and negative
7 firm-specific risk factors will be essentially zero and will not affect the value of the overall
8 portfolio.³² Firm-specific risk is also called “diversifiable risk” because it can be easily
9 eliminated through diversification.

10
11 **Q. IS IT WELL-KNOWN AND ACCEPTED THAT, BECAUSE FIRM-SPECIFIC**
12 **RISK CAN BE EASILY ELIMINATED THROUGH DIVERSIFICATION, THE**
13 **MARKET DOES NOT REWARD SUCH RISK THROUGH HIGHER RETURNS?**

14 A. Yes. Because investors eliminate firm-specific risk through diversification, they know they
15 cannot expect a higher return for assuming the firm-specific risk in any one company.
16 Thus, the risks associated with an individual firm’s operations are not rewarded by the
17 market. In fact, firm-specific risk is also called “unrewarded” risk for this reason. Market
18 risk, on the other hand, cannot be eliminated through diversification. Because market risk
19 cannot be eliminated through diversification, investors expect a return for assuming this
20 type of risk. Market risk is also called “systematic risk.” Scholars recognize the fact that

³¹ See Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 64 (3rd ed., John Wiley & Sons, Inc. 2012).

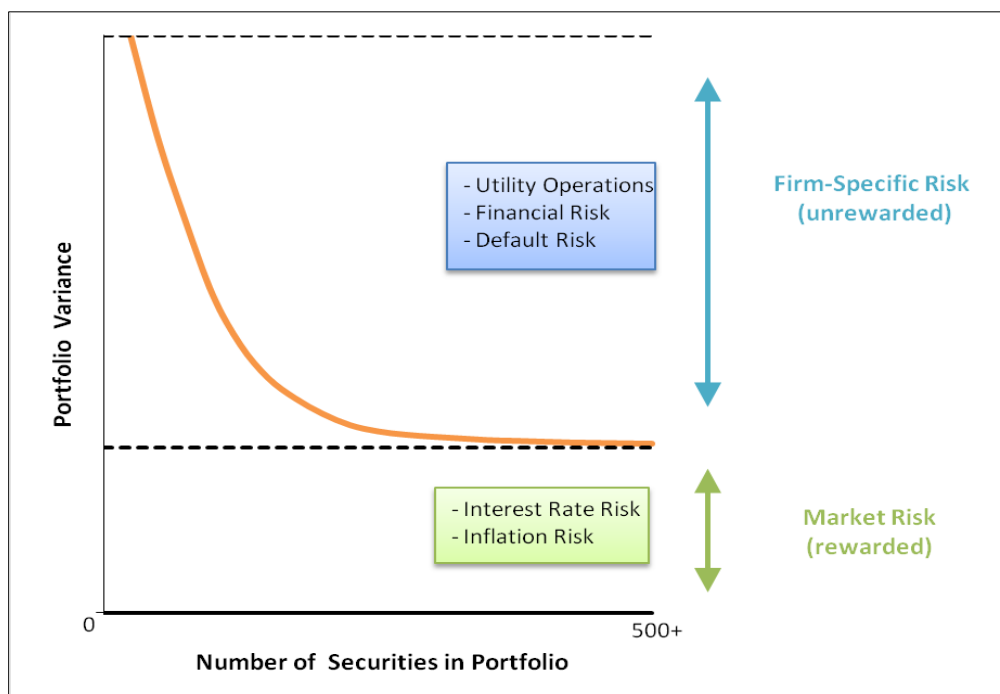
³² *Id.*

1 market risk, or “systematic risk,” is the only type of risk for which investors expect a return
 2 for bearing:

3 If investors can cheaply eliminate some risks through diversification, then
 4 we should not expect a security to earn higher returns for risks that can be
 5 eliminated through diversification. Investors can expect compensation *only*
 6 for bearing systematic risk (i.e., risk that cannot be diversified away).³³

7 These important concepts are illustrated in the figure below. Some form of this figure is
 8 found in many financial textbooks.

9 **Figure 3:**
 10 **Effects of Portfolio Diversification**



11 This figure shows that as stocks are added to a portfolio, the amount of firm-specific risk
 12 is reduced until it is essentially eliminated. No matter how many stocks are added,

³³ See John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 180 (3rd ed., South Western Cengage Learning 2010).

1 however, there remains a certain level of fixed market risk. The level of market risk will
2 vary from firm to firm. Market risk is the only type of risk that is rewarded by the market
3 and is thus the primary type of risk the Commission should consider when determining the
4 allowed return in this case.

5
6 **Q. DESCRIBE HOW MARKET RISK IS MEASURED.**

7 A. Investors who want to eliminate firm-specific risk must hold a fully diversified portfolio.
8 To determine the amount of risk that a single stock adds to the overall market portfolio,
9 investors measure the covariance between a single stock and the market portfolio. The
10 result of this calculation is called “beta.”³⁴ Beta represents the sensitivity of a given
11 security to the market as a whole. The market portfolio of all stocks has a beta equal to
12 one. Stocks with betas greater than one are relatively more sensitive to market risk than
13 the average stock. For example, if the market increases (decreases) by 1.0%, a stock with
14 a beta of 1.5 will, on average, increase (decrease) by 1.5%. In contrast, stocks with betas
15 of less than one are less sensitive to market risk, such that if the market increases
16 (decreases) by 1.0%, a stock with a beta of 0.5 will, on average, only increase (decrease)
17 by 0.5%. Thus, stocks with low betas are relatively insulated from market conditions. The
18 beta term is used in the CAPM to estimate the cost of equity, which is discussed in more
19 detail later.³⁵

³⁴ *Id.* at 180-81.

³⁵ Though it will be discussed in more detail later, Exhibit DJG-8 shows that the average beta of the proxy group was less than 1.0. This confirms the well-known concept that utilities are relatively low-risk firms.

1 **Q. ARE PUBLIC UTILITIES CHARACTERIZED AS DEFENSIVE FIRMS THAT**
2 **HAVE LOW BETAS, LOW MARKET RISK, AND ARE RELATIVELY**
3 **INSULATED FROM OVERALL MARKET CONDITIONS?**

4 A. Yes. Although market risk affects all firms in the market, it affects different firms to
5 varying degrees. Firms with high betas are affected more than firms with low betas, which
6 is why firms with high betas are riskier. Stocks with betas greater than one are generally
7 known as “cyclical stocks.” Firms in cyclical industries are sensitive to recurring patterns
8 of recession and recovery known as the “business cycle.”³⁶ Thus, cyclical firms are
9 exposed to a greater level of market risk. Securities with betas less than one, on the other
10 hand, are known as “defensive stocks.” Companies in defensive industries, such as public
11 utility companies, “will have low betas and performance that is comparatively unaffected
12 by overall market conditions.”³⁷ In fact, financial textbooks often use utility companies as
13 prime examples of low-risk, defensive firms. The figure below compares the betas of
14 several industries and illustrates that the utility industry is one of the least risky industries
15 in the U.S. market.³⁸

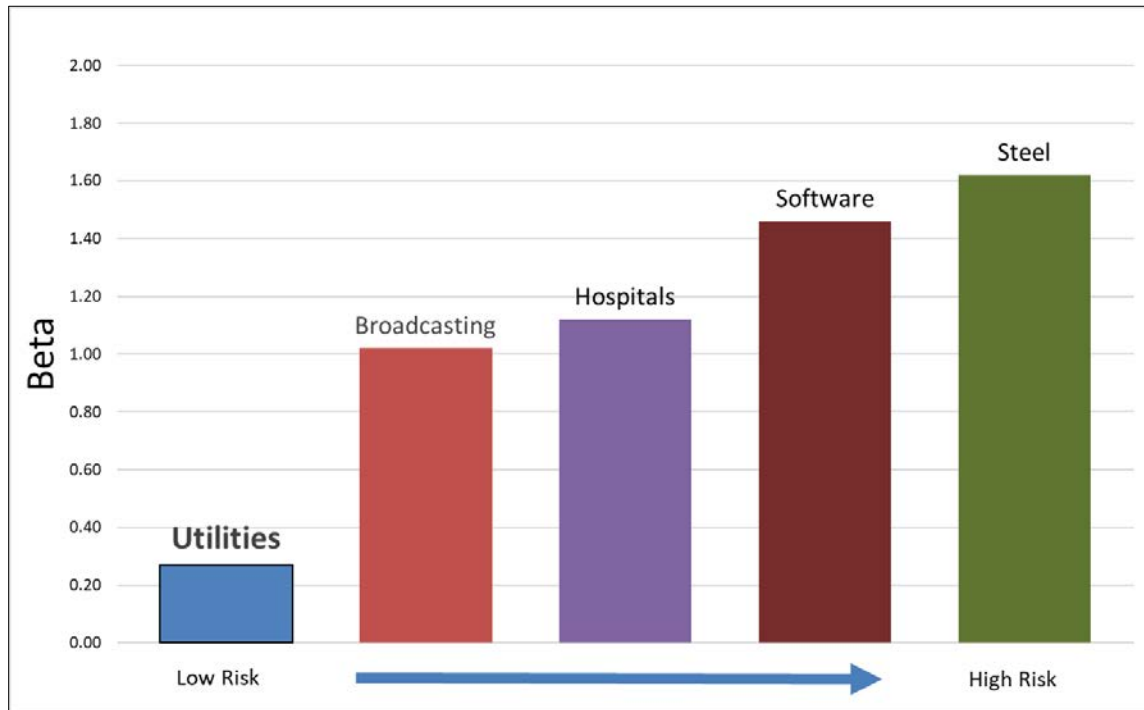
³⁶ See Zvi Bodie, Alex Kane & Alan J. Marcus, *Essentials of Investments* 382 (9th ed., McGraw-Hill/Irwin 2013).

³⁷ *Id.* at 383.

³⁸ See Betas by Sector (US) available at <http://pages.stern.nyu.edu/~adamodar/> (2018). (After clicking the link, click “Data” then “Current Data” then “Risk / Discount Rate” from the drop down menu, then “Total Beta by Industry Sector”). The exact beta calculations are not as important as illustrating the well-known fact that utilities are very low-risk companies. The fact that the utility industry is one of the lowest risk industries in the country should not change from year to year.

1
2

Figure 4:
Beta by Industry



3 The fact that utilities are defensive firms that are exposed to little market risk is
4 beneficial to society. When the business cycle enters a recession, consumers can be assured
5 that their utility companies will be able to maintain normal business operations and provide
6 safe and reliable service under prudent management. Likewise, utility investors can be
7 confident that utility stock prices will not widely fluctuate. So, while it is recognized and
8 accepted that utilities are defensive firms that experience little market risk and are relatively
9 insulated from market conditions, this fact should also be appropriately reflected in the
10 Company's awarded return.

1 **VI. DISCOUNTED CASH FLOW ANALYSIS**

2 **Q. DESCRIBE THE DISCOUNTED CASH FLOW (“DCF”) MODEL.**

3 A. The Discounted Cash Flow (“DCF”) Model is based on a fundamental financial model
4 called the “dividend discount model,” which maintains that the value of a security is equal
5 to the present value of the future cash flows it generates. Cash flows from common stock
6 are paid to investors in the form of dividends. There are several variations of the DCF
7 Model. These versions, along with other formulas and theories related to the DCF Model
8 are discussed in more detail in Exhibit DJG-17, Appendix A. For this case, I chose to use
9 the Quarterly Approximation DCF Model.

10 11 **Q. DESCRIBE THE INPUTS TO THE DCF MODEL.**

12 A. There are three primary inputs in the DCF Model: (1) stock price; (2) dividend; and (3) the
13 long-term growth rate. The stock prices and dividends are known inputs based on recorded
14 data, while the growth rate projection must be estimated. I discuss each of these inputs
15 separately below.

D. Stock Price

16 **Q. HOW DID YOU DETERMINE THE STOCK PRICE INPUT OF THE DCF** 17 **MODEL?**

18 A. For the stock price (P_0), I used a 30-day average of stock prices for each company in the
19 proxy group.³⁹ Analysts sometimes rely on average stock prices for longer periods (e.g.,

³⁹ Exhibit DJG-3.

1 60, 90, or 180 days). According to the efficient market hypothesis, however, markets
2 reflect all relevant information available at a particular time, and prices adjust
3 instantaneously to the arrival of new information.⁴⁰ Past stock prices, in essence, reflect
4 outdated information. The DCF Model used in utility rate cases is a derivation of the
5 dividend discount model, which is used to determine the current value of an asset. Thus,
6 according to the dividend discount model and the efficient market hypothesis, the value for
7 the “P₀” term in the DCF Model should technically be the current stock price, rather than
8 an average.

9
10 **Q. WHY DID YOU USE A 30-DAY AVERAGE FOR THE CURRENT STOCK PRICE**
11 **INPUT?**

12 A. Using a short-term average of stock prices for the current stock price input adheres to
13 market efficiency principles while avoiding any irregularities that may arise from using a
14 single current stock price. In the context of a utility rate proceeding, there is a significant
15 length of time from when an application is filed, and testimony is due. Choosing a current
16 stock price for one particular day could raise a separate issue concerning which day was
17 chosen to be used in the analysis. In addition, a single stock price on a particular day may
18 be unusually high or low. It is arguably ill-advised to use a single stock price in a model
19 that is ultimately used to set rates for several years, especially if a stock is experiencing

⁴⁰ See Eugene F. Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, Vol. 25, No. 2 *The Journal of Finance* 383 (1970); see also John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 357 (3rd ed., South Western Cengage Learning 2010). The efficient market hypothesis was formally presented by Eugene Fama in 1970 and is a cornerstone of modern financial theory and practice.

1 some volatility. Thus, it is preferable to use a short-term average of stock prices, which
2 represents a good balance between adhering to well-established principles of market
3 efficiency while avoiding any unnecessary contentions that may arise from using a single
4 stock price on a given day. The stock prices I used in my DCF analysis are based on 30-
5 day averages of adjusted closing stock prices for each company in the proxy group.⁴¹

E. Dividend

6 **Q. DESCRIBE HOW YOU DETERMINED THE DIVIDEND INPUT OF THE DCF**
7 **MODEL.**

8 A. The dividend term in the Quarterly Approximation DCF Model is the current quarterly
9 dividend per share. I obtained the most recent quarterly dividend paid for each proxy
10 company.⁴² The Quarterly Approximation DCF Model assumes that the company
11 increases its dividend payments each quarter. Thus, the model assumes that each quarterly
12 dividend is greater than the previous one by $(1 + g)^{0.25}$. This expression could be described
13 as the dividend quarterly growth rate, where the term “g” is the growth rate and the
14 exponential term “0.25” signifies one quarter of the year.

⁴¹ Exhibit DJG-3. Adjusted closing prices, rather than actual closing prices, are ideal for analyzing historical stock prices. The adjusted price provides an accurate representation of the firm’s equity value beyond the mere market price because it accounts for stock splits and dividends.

⁴² Exhibit DJG-4. Nasdaq Dividend History, available at <http://www.nasdaq.com/quotes/dividend-history.aspx>.

1 **Q. DOES THE QUARTERLY APPROXIMATION DCF MODEL RESULT IN THE**
2 **HIGHEST COST OF EQUITY IN THIS CASE RELATIVE TO OTHER DCF**
3 **MODELS, ALL ELSE HELD CONSTANT?**

4 A. Yes. The DCF Model I employed in this case results in a higher DCF cost of equity
5 estimate than the annual or semi-annual DCF Models due to the quarterly compounding of
6 dividends inherent in the model. In essence, the Quarterly Compounding DCF Model I
7 used results in the *highest* cost of equity estimate, all else held constant.

8

9 **Q. ARE THE STOCK PRICE AND DIVIDEND INPUTS FOR EACH PROXY**
10 **COMPANY A SIGNIFICANT ISSUE IN THIS CASE?**

11 A. No. Although my stock price and dividend inputs are more recent than those used by Mr.
12 D'Ascendis, there is not a statistically significant difference between them because utility
13 stock prices and dividends are generally quite stable. This is another reason that cost of
14 capital models such as the CAPM and the DCF Model are well-suited to be conducted on
15 utilities. The differences between my DCF Model and Mr. D'Ascendis' DCF Model are
16 primarily driven by differences in our growth rate estimates, which are further discussed
17 below.

F. Growth Rate

18 **Q. SUMMARIZE THE GROWTH RATE INPUT IN THE DCF MODEL.**

19 A. The most critical input in the DCF Model is the growth rate. Unlike the stock price and
20 dividend inputs, the growth rate input must be estimated. As a result, the growth rate is
21 often the most contentious DCF input in utility rate cases. The DCF model used in this

1 case is based on the constant growth valuation model. Under this model, a stock is valued
 2 by the present value of its future cash flows in the form of dividends. Before future cash
 3 flows are discounted by the cost of equity, however, they must be “grown” into the future
 4 by a long-term growth rate. As stated above, one of the inherent assumptions of this model
 5 is that these cash flows in the form of dividends grow at a constant rate forever. Thus, the
 6 growth rate term in the constant growth DCF model is often called the “constant,” “stable,”
 7 or “terminal” growth rate. For young, high-growth firms, estimating the growth rate to be
 8 used in the model can be especially difficult, and may require the use of multi-stage growth
 9 models. For mature, low-growth firms such as utilities, however, estimating the terminal
 10 growth rate is more transparent. The growth term of the DCF Model is one of the most
 11 important, yet apparently most misunderstood aspects of cost of equity estimations in
 12 utility regulatory proceedings. Therefore, I have devoted a more detailed explanation of
 13 this issue in the following sections, which are organized as follows:

- 14 (1) The Various Determinants of Growth
- 15 (2) Reasonable Estimates for Long-Term Growth
- 16 (3) Quantitative vs. Qualitative Determinants of Utility Growth:
 17 Circular References, “Flatworm” Growth, and the Problem with
 18 Analysts’ Growth Rates
- 19 (4) Growth Rate Recommendation

20 1. The Various Determinants of Growth

21 Q. DESCRIBE THE VARIOUS DETERMINANTS OF GROWTH.

22 A. Although the DCF Model directly considers the growth of dividends, there are a variety of
 23 growth determinants that should be considered when estimating growth rates. It should be
 24 noted that these various growth determinants are used primarily to determine the short-

1 term growth rates in multi-stage DCF models. For utility companies, it is necessary to
2 focus primarily on long-term growth rates, which are discussed in the following section.
3 That is not to say that these growth determinants cannot be considered when estimating
4 long-term growth; however, as discussed below, long-term growth must be constrained
5 much more than short-term growth, especially for young firms with high growth
6 opportunities. Additionally, I briefly discuss these growth determinants here because it
7 may reveal some of the source of confusion in this area.

8 1. Historical Growth

9 Looking at a firm's actual historical experience may theoretically provide a good
10 starting point for estimating short-term growth. However, past growth is not always a good
11 indicator of future growth. Some metrics that might be considered here are historical
12 growth in revenues, operating income, and net income. Since dividends are paid from
13 earnings, estimating historical earnings growth may provide an indication of future
14 earnings and dividend growth. In general, however, revenue growth tends to be more
15 consistent and predictable than earnings growth because it is less likely to be influenced by
16 accounting adjustments.⁴³

17 2. Analyst Growth Rates

18 Analyst growth rates refer to short-term projections of earnings growth published
19 by institutional research analysts such as Value Line and Bloomberg. A more detailed

⁴³ See Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 279 (3rd ed., John Wiley & Sons, Inc. 2012).

1 discussion of analyst growth rates, including the problems with using them in the DCF
2 Model to estimate utility cost of equity, is provided in a later section.

3 3. Fundamental Determinants of Growth

4 Fundamental growth determinants refer to firm-specific financial metrics that
5 arguably provide better indications of near-term sustainable growth. One such metric for
6 fundamental growth considers the return on equity and the retention ratio. The idea behind
7 this metric is that firms with high ROEs and retention ratios should have higher
8 opportunities for growth.⁴⁴

9
10 **Q. DID YOU USE ANY OF THESE GROWTH DETERMINANTS IN YOUR DCF**
11 **MODEL?**

12 A. No. Primarily, these growth determinants discussed above would provide better
13 indications of short to mid-term growth for firms with average to high growth
14 opportunities. However, utilities are mature, low-growth firms. While it may not be
15 unreasonable on its face to use any of these growth determinants for the growth input in
16 the DCF Model, we must keep in mind that the stable growth DCF Model considers only
17 *long-term* growth rates, which are constrained by certain economic factors, as discussed
18 further below.

⁴⁴ *Id.* at 291-292.

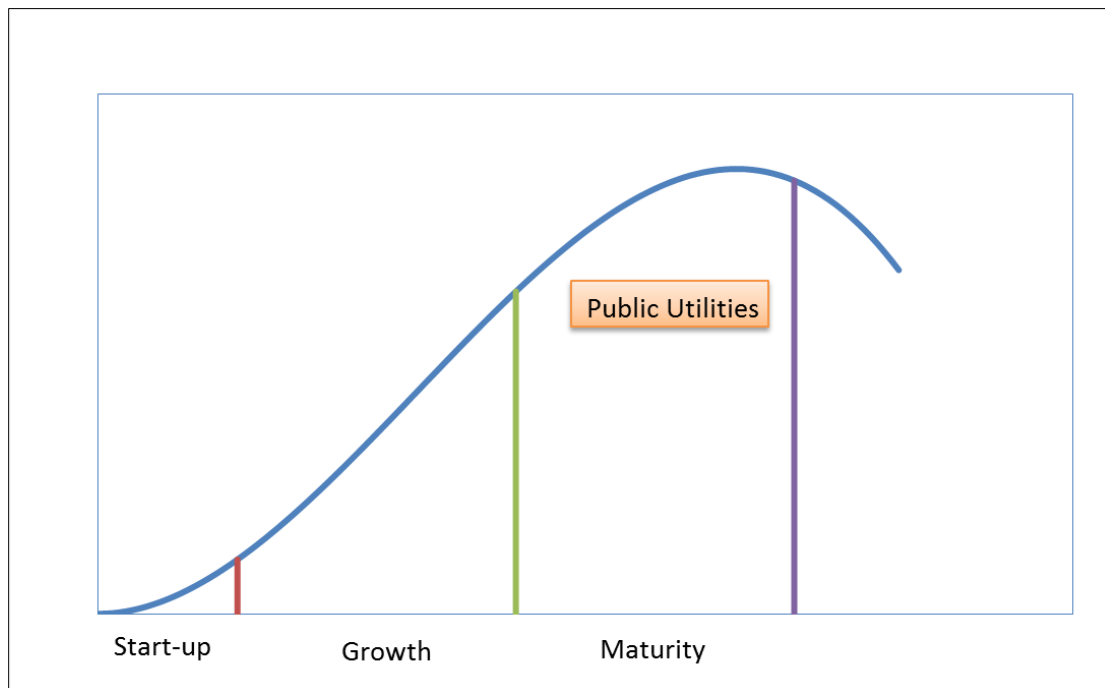
2. **Reasonable Estimates for Long-Term Growth**

Q. **DESCRIBE WHAT IS MEANT BY LONG-TERM GROWTH.**

A. In order to make the DCF a viable, practical model, an infinite stream of future cash flows must be estimated and then discounted back to the present. Otherwise, each annual cash flow would have to be estimated separately. Some analysts use “multi-stage” DCF Models to estimate the value of high-growth firms through two or more stages of growth, with the final stage of growth being constant. However, it is not necessary to use multi-stage DCF Models to analyze the cost of equity of regulated utility companies. This is because regulated utilities are already in their “terminal,” low growth stage. Unlike most competitive firms, the growth of regulated utilities is constrained by physical service territories and limited primarily by the customer and load growth within those territories.

The figure below illustrates the well-known business/industry life-cycle pattern.

Figure 5:
Industry Life Cycle



1 In an industry's early stages, there are ample opportunities for growth and profitable
2 reinvestment. In the maturity stage however, growth opportunities diminish, and firms
3 choose to pay out a larger portion of their earnings in the form of dividends instead of
4 reinvesting them in operations to pursue further growth opportunities. Once a firm is in
5 the maturity stage, it is not necessary to consider higher short-term growth metrics in multi-
6 stage DCF Models; rather, it is sufficient to analyze the cost of equity using a stable growth
7 DCF Model with one terminal, long-term growth rate. Because utilities are in their
8 maturity stage, their real growth opportunities are primarily limited to the population
9 growth within their defined service territories, which is usually less than 2%.

10
11 **Q. IS IT TRUE THAT THE TERMINAL GROWTH RATE CANNOT EXCEED THE**
12 **GROWTH RATE OF THE ECONOMY, ESPECIALLY FOR A REGULATED**
13 **UTILITY COMPANY?**

14 A. Yes. A fundamental concept in finance is that no firm can grow forever at a rate higher
15 than the growth rate of the economy in which it operates.⁴⁵ Thus, the terminal growth rate
16 used in the DCF Model should not exceed the aggregate economic growth rate. This is
17 especially true when the DCF Model is conducted on public utilities because these firms
18 have defined service territories. As stated by Dr. Damodaran:

⁴⁵ See generally Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 306 (3rd ed., John Wiley & Sons, Inc. 2012).

1 “If a firm is a purely domestic company, either because of internal
 2 constraints . . . or external constraints (such as those imposed by a
 3 government), the growth rate in the domestic economy will be the limiting
 4 value.”⁴⁶

5 In fact, it is reasonable to assume that a regulated utility would grow at a rate that is *less*
 6 than the U.S. economic growth rate. Unlike competitive firms, which might increase their
 7 growth by launching a new product line, franchising, or expanding into new and developing
 8 markets, utility operating companies with defined service territories cannot do any of these
 9 things to grow. Gross domestic product (“GDP”) is one of the most widely used measures
 10 of economic production and is used to measure aggregate economic growth. According to
 11 the Congressional Budget Office’s Budget Outlook, the long-term forecast for nominal
 12 U.S. GDP growth is 3.9%, which includes an inflation rate of 2%.⁴⁷ For mature companies
 13 in mature industries, such as utility companies, the terminal growth rate will likely fall
 14 between the expected rate of inflation and the expected rate of nominal GDP growth. Thus,
 15 UIF’s terminal growth rate is realistically between 2% and 4%.

16
 17 **Q. IS IT REASONABLE TO ASSUME THAT THE TERMINAL GROWTH RATE**
 18 **WILL NOT EXCEED THE RISK-FREE RATE?**

19 A. Yes. In the long term, the risk-free rate will converge on the growth rate of the economy.
 20 For this reason, financial analysts sometimes use the risk-free rate for the terminal growth

⁴⁶ *Id.*

⁴⁷ Congressional Budget Office – The 2019 Long-Term Budget Outlook p. 54,
<https://www.cbo.gov/publication/55331>.

1 rate value in the DCF model.⁴⁸ I discuss the risk-free rate in further detail later in this
2 testimony.

3
4 **Q. PLEASE SUMMARIZE THE VARIOUS LONG-TERM GROWTH RATE**
5 **ESTIMATES THAT CAN BE USED AS THE TERMINAL GROWTH RATE IN**
6 **THE DCF MODEL.**

7 A. The reasonable long-term growth rate determinants are summarized as follows:

- 8 1. Nominal GDP Growth
- 9 2. Real GDP Growth
- 10 3. Inflation
- 11 4. Current Risk-Free Rate

12 Any of the foregoing growth determinants could provide a reasonable input for the terminal
13 growth rate in the DCF Model for a utility company, including UIF. In general, we should
14 expect that utilities will, at the very least, grow at the rate of projected inflation. However,
15 the long-term growth rate of any U.S. company, especially utilities, will be constrained by
16 nominal U.S. GDP growth.

⁴⁸ Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 307 (3rd ed., John Wiley & Sons, Inc. 2012).

1 **3. Qualitative Growth: The Problem with Analysts' Growth Rates**

2 **Q. DESCRIBE THE DIFFERENCES BETWEEN “QUANTITATIVE” AND**
3 **“QUALITATIVE” GROWTH DETERMINANTS.**

4 A. Assessing “quantitative” growth simply involves mathematically calculating a historic
5 metric for growth (such as revenues or earnings) or calculating various fundamental growth
6 determinants using various figures from a firm’s financial statements (such as ROE and
7 the retention ratio). However, any thorough assessment of company growth should be
8 based upon a “qualitative” analysis. Such an analysis would consider specific strategies
9 that company management will implement to achieve a sustainable growth in earnings.
10 Therefore, it is important to begin the analysis of UIF’s growth rate with this simple,
11 qualitative question: How is this regulated utility going to achieve a sustained growth in
12 earnings? If this question were asked of a competitive firm, there could be several answers
13 depending on the type of business model, such as launching a new product line, franchising,
14 rebranding to target a new demographic, or expanding into a developing market. Regulated
15 utilities, however, cannot engage in these potential growth opportunities.

16
17 **Q. WHY IS IT ESPECIALLY IMPORTANT TO EMPHASIZE REAL,**
18 **QUALITATIVE GROWTH DETERMINANTS WHEN ANALYZING THE**
19 **GROWTH RATES OF REGULATED UTILITIES?**

20 A. While qualitative growth analysis is important regardless of the entity being analyzed, it is
21 especially important in the context of utility ratemaking. This is because the rate base rate
22 of return model inherently possesses two factors that can contribute to distorted views of
23 utility growth when considered exclusively from a quantitative perspective. These two

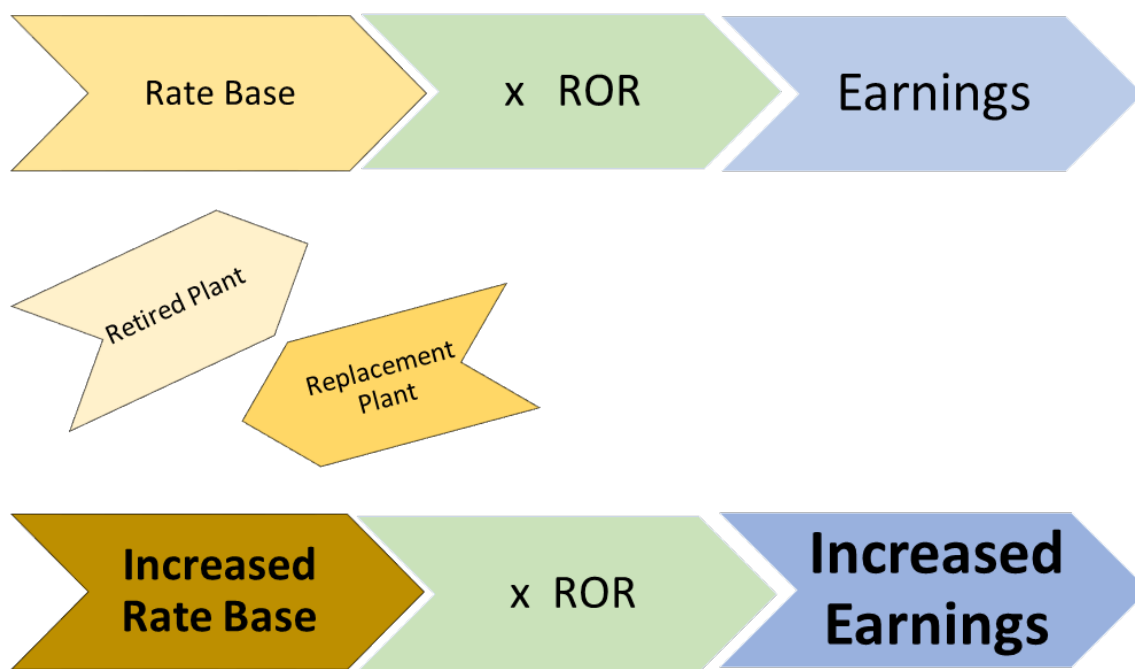
1 factors are (1) rate base and (2) the awarded ROE. I will discuss each factor further below.
2 It is important to keep in mind that the ultimate objective of this analysis is to provide a
3 foundation upon which to base the fair rate of return for the utility. Thus, we should strive
4 to ensure that each individual component of the financial models used to estimate the cost
5 of equity are also “fair.” If we consider only quantitative growth determinants, it may lead
6 to projected growth rates that are overstated and ultimately unfair, because they result in
7 inflated cost of equity estimates.

8
9 **Q. HOW DOES RATE BASE RELATE TO GROWTH DETERMINANTS FOR**
10 **UTILITIES?**

11 A. Under the rate base rate of return model, a utility’s rate base is multiplied by its awarded
12 rate of return to produce the required level of operating income. Therefore, increases to
13 rate base generally result in increased earnings. Thus, utilities have a natural financial
14 incentive to increase rate base. In short, utilities have a financial incentive to increase rate
15 base regardless of whether such increases are driven by a corresponding increase in
16 demand. Under these circumstances, utilities have been able to increase their rate bases by
17 a far greater extent than what any concurrent increase in demand would have required. In
18 other words, utilities “grew” their earnings by simply retiring old assets and replacing them
19 with new assets. If the tail of a flatworm is removed and regenerated, it does not mean the
20 flatworm actually grew. Likewise, if a competitive, unregulated firm announced plans to
21 close production plants and replace them with new plants, it would not be considered a real
22 determinant of growth unless analysts believed this decision would directly result in
23 increased market share for the company and a real opportunity for sustained increases in

1 revenues and earnings. In the case of utilities, the mere replacement of old plant with new
 2 plant does not increase market share, attract new customers, create franchising
 3 opportunities, or allow utilities to penetrate developing markets, but may result in short-
 4 term, quantitative earnings growth. This “flatworm growth” in earnings was merely the
 5 quantitative byproduct of the rate base rate of return model, and not an indication of real,
 6 fair, or qualitative growth. The following diagram illustrates this concept.

7 **Figure 6:**
 8 **Analysts’ Earnings Growth Projections: The “Flatworm Growth” Problem**

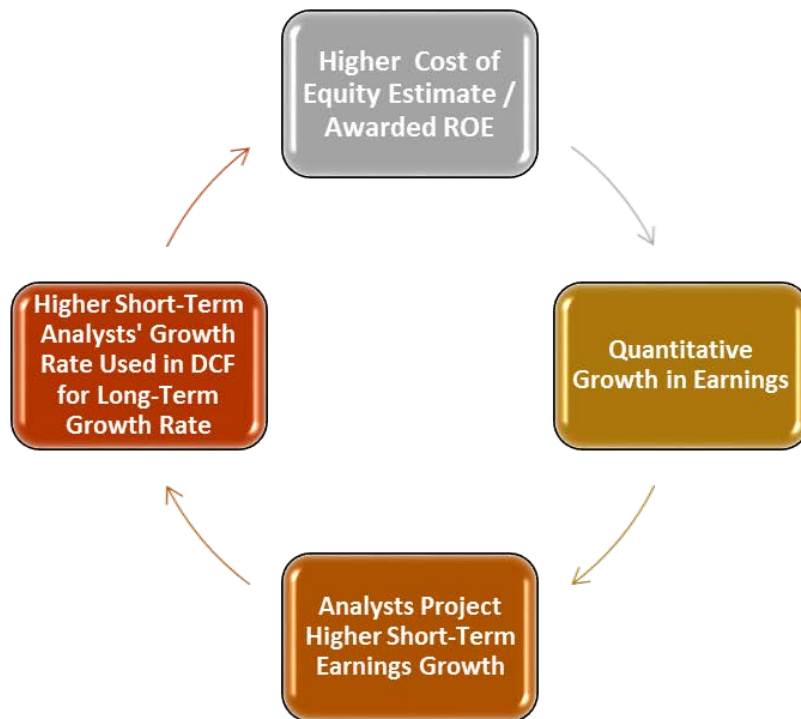


9 Of course, utilities might sometimes add new plant to meet a modest growth in customer
 10 demand. However, as the foregoing discussion demonstrates, it would be more appropriate
 11 to consider load growth projections and other qualitative indicators, rather than mere
 12 increases to rate base or earnings, to attain a fair assessment of growth.

1 **Q. PLEASE DISCUSS THE OTHER WAY IN WHICH ANALYSTS' EARNINGS**
2 **GROWTH PROJECTIONS DO NOT PROVIDE INDICATIONS OF FAIR,**
3 **QUALITATIVE GROWTH FOR REGULATED UTILITIES.**

4 A. If we give undue weight to analysts' projections for utilities' earnings growth, it will not
5 provide an accurate reflection of real, qualitative growth because a utility's earnings are
6 heavily influenced by the ultimate figure that all this analysis is supposed to help us
7 estimate: the awarded return on equity. This creates a circular reference problem or
8 feedback loop. In other words, if a regulator awards an ROE that is above market-based
9 cost of capital (which is often the case, as discussed above), this could lead to higher short-
10 term growth rate projections from analysts. If these same inflated, short-term growth rate
11 estimates are used in the DCF Model (and they often are by utility witnesses), it could lead
12 to higher awarded ROEs; and the cycle continues, as illustrated in the following figure:

1 Figure 7:
2 **Analysts' Earnings Growth Projections: The "Circular Reference" Problem**



3 Therefore, it is not advisable to simply consider the quantitative growth projections
4 published by analysts, as this practice will not necessarily provide fair indications of real
5 utility growth.

6
7 **Q. ARE THERE ANY OTHER PROBLEMS WITH RELYING ON ANALYSTS'**
8 **GROWTH PROJECTIONS?**

9 A. Yes. While the foregoing discussion shows two reasons why we cannot rely on analysts'
10 growth rate projections to provide fair, qualitative indicators of utility growth in a stable
11 growth DCF Model, the third reason is perhaps the most obvious and indisputable. Various
12 institutional analysts, such as Zacks, Value Line, and Bloomberg, publish estimated
13 projections of earnings growth for utilities. These estimates, however, are *short-term*

1 growth rate projections, ranging from 3 – 10 years. Many utility ROE analysts, however,
2 inappropriately insert these short-term growth projections into the DCF Model as *long-*
3 *term* growth rate projections. For example, assume that an analyst at Bloomberg estimates
4 that a utility’s earnings will grow by 7% per year over the next 3 years. This analyst may
5 have based this short-term forecast on a utility’s plans to replace depreciated rate base (i.e.,
6 “flatworm” growth) or on an anticipated awarded return that is above market-based cost of
7 equity (i.e., “circular reference” problem). When a utility witness uses this figure in a DCF
8 Model, however, it is the *witness*, not the Bloomberg analyst that is testifying to the
9 regulator that the utility’s earnings will qualitatively grow by 7% per year over the *long-*
10 *term*, which is an unrealistic assumption.

11 **4. Long-Term Growth Rate Recommendation**

12 **Q. DESCRIBE THE GROWTH RATE INPUT USED IN YOUR DCF MODEL.**

13 A. I considered various qualitative determinants of growth for UIF, along with the maximum
14 allowed growth rate under basic principles of finance and economics. The following chart
15 shows the various long-term growth determinants discussed in this section.⁴⁹

⁴⁹ Exhibit DJG-5.

1
2

Figure 8:
Terminal Growth Rate Determinants

| Terminal Growth Determinants | Rate |
|------------------------------|-------------|
| Nominal GDP | 3.9% |
| Real GDP | 1.9% |
| Inflation | 2.0% |
| Risk Free Rate | 1.5% |
| Highest | 3.9% |

3 For the long-term growth rate in my DCF model, I selected the maximum, reasonable long-
4 term growth rate of 3.9%, which means my model assumes that the Company's qualitative
5 growth in earnings will match the nominal growth rate of the entire U.S. economy over the
6 long run.

7

8 **Q. PLEASE DESCRIBE THE FINAL RESULTS OF YOUR DCF MODEL.**

9 A. I used the Quarterly Approximation DCF Model discussed above to estimate the
10 Company's cost of equity capital. I obtained an average of reported dividends and stock
11 prices from the proxy group, and I used a reasonable terminal growth rate estimate for the
12 Company. Applying this model, my DCF cost of equity estimate for the Company is
13 approximately 6%.⁵⁰

⁵⁰ Exhibit DJG-6.

G. Response to Mr. D'Ascendis' DCF Model

1 **Q. MR. D'ASCENDIS' DCF MODEL YIELDED MUCH HIGHER RESULTS. DID**
2 **YOU FIND ANY ERRORS IN HIS ANALYSIS?**

3 A. Yes, I found several errors. Mr. D'Ascendis' DCF Model produced a median cost of equity
4 of 9.44%.⁵¹ The results of Mr. D'Ascendis' DCF Model are overstated primarily because
5 of a fundamental error regarding his growth rate inputs.

6
7 **Q. DESCRIBE THE PROBLEMS WITH MR. D'ASCENDIS' LONG-TERM**
8 **GROWTH INPUT.**

9 A. Mr. D'Ascendis used long-term growth rates in his proxy group as high as 14%,⁵² which
10 is more than three times higher than the projected, long-term nominal U.S. GDP growth
11 (approximately 4.0%). This means Mr. D'Ascendis' growth rate assumption violates the
12 basic principle that no company can grow at a greater rate than the economy in which it
13 operates over the long-term, especially a regulated utility company with a defined service
14 territory. Furthermore, Mr. D'Ascendis used short-term, quantitative growth estimates
15 published by analysts. As discussed above, these analysts' estimates are inappropriate to
16 use in the DCF Model as long-term growth rates because they are estimates for short-term
17 growth. For example, Mr. D'Ascendis incorporated a 14% long-term growth rate for SJW
18 Group ("SJW"), which was reported by Yahoo! Finance.⁵³ This means that an analyst from

⁵¹ Exhibit DWD-2, Sch. 3.

⁵² *Id.*

⁵³ *Id.*

1 Yahoo! Finance apparently thinks that SJW’s earnings will quantitatively increase by 14%
2 each year over the next *several* years. However, it is Mr. D’Ascendis, not the Value Line
3 analyst, who is suggesting to the Commission that SJW’s earnings will grow by three times
4 the amount of U.S. GDP growth every year for many decades into the future.⁵⁴ This
5 assumption is simply not realistic, and it contradicts fundamental concepts of long-term
6 growth. The growth rate assumptions used by Mr. D’Ascendis for many of the proxy
7 companies suffer from the same unrealistic assumptions.⁵⁵

8 **VII. CAPITAL ASSET PRICING MODEL ANALYSIS**

9 **Q. DESCRIBE THE CAPITAL ASSET PRICING MODEL.**

10 A. The Capital Asset Pricing Model (“CAPM”) is a market-based model founded on the
11 principle that investors expect higher returns for incurring additional risk.⁵⁶ The CAPM
12 estimates this expected return. The various assumptions, theories, and equations involved
13 in the CAPM are discussed further in Exhibit DJG-17, Appendix B. Using the CAPM to
14 estimate the cost of equity of a regulated utility is consistent with the legal standards
15 governing the fair rate of return. The U.S. Supreme Court has recognized that “the amount
16 of *risk* in the business is a most important factor” in determining the allowed rate of

⁵⁴ *Id.* Technically, the constant growth rate in the DCF Model grows dividends each year to “infinity.” Yet, even if we assumed that the growth rate applied to only a few decades, the annual growth rate would still be too high to be considered realistic.

⁵⁵ *Id.*

⁵⁶ William F. Sharpe, *A Simplified Model for Portfolio Analysis* 277-93 (Management Science IX 1963); see also John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 208 (3rd ed., South Western Cengage Learning 2010).

1 return,⁵⁷ and that “the return to the equity owner should be commensurate with returns on
2 investments in other enterprises having corresponding *risks*.”⁵⁸ The CAPM is a useful
3 model because it directly considers the amount of risk inherent in a business and directly
4 measures the most important component of a fair rate of return analysis: Risk.

5
6 **Q. DESCRIBE THE INPUTS FOR THE CAPM.**

7 A. The basic CAPM equation requires only three inputs to estimate the cost of equity: (1) the
8 risk-free rate; (2) the beta coefficient; and (3) the equity risk premium. Each input is
9 discussed separately below.

A. The Risk-Free Rate

10 **Q. EXPLAIN THE RISK-FREE RATE.**

11 A. The first term in the CAPM is the risk-free rate (R_F). The risk-free rate is simply the level
12 of return investors can achieve without assuming any risk. The risk-free rate represents the
13 bare minimum return that any investor would require on a risky asset. Even though no
14 investment is technically void of risk, investors often use U.S. Treasury securities to
15 represent the risk-free rate because they accept that those securities essentially contain no
16 default risk. The Treasury issues securities with different maturities, including short-term
17 Treasury Bills, intermediate-term Treasury Notes, and long-term Treasury Bonds.

⁵⁷ *Wilcox*, 212 U.S. at 48 (emphasis added).

⁵⁸ *Hope Natural Gas Co.*, 320 U.S. at 603 (emphasis added).

1 **Q. IS IT PREFERABLE TO USE THE YIELD ON LONG-TERM TREASURY BONDS**
2 **FOR THE RISK-FREE RATE IN THE CAPM?**

3 A. Yes. In valuing an asset, investors estimate cash flows over long periods of time. Common
4 stock is viewed as a long-term investment, and the cash flows from dividends are assumed
5 to last indefinitely. As a result, short-term Treasury bill yields are rarely used in the CAPM
6 to represent the risk-free rate. Short-term rates are subject to greater volatility and thus can
7 lead to unreliable estimates. Instead, long-term Treasury bonds are usually used to
8 represent the risk-free rate in the CAPM. I considered a 30-day average of daily Treasury
9 yield curve rates on 30-year Treasury bonds in my risk-free rate estimate, which resulted
10 in a risk-free rate of 1.51%.⁵⁹

B. The Beta Coefficient

11 **Q. HOW IS THE BETA COEFFICIENT USED IN THIS MODEL?**

12 A. As discussed above, beta represents the sensitivity of a given security to movements in the
13 overall market. The CAPM states that in efficient capital markets, the expected risk
14 premium on each investment is proportional to its beta. Recall that a security with a beta
15 greater (less) than one is more (less) risky than the market portfolio. An index such as the
16 S&P 500 Index is used as a proxy for the market portfolio. The historical betas for publicly
17 traded firms are published by various institutional analysts. Beta may also be calculated
18 through a linear regression analysis, which provides additional statistical information about
19 the relationship between a single stock and the market portfolio. As discussed above, beta

⁵⁹ Exhibit DJG-7.

1 also represents the sensitivity of a given security to the market as a whole. The market
2 portfolio of all stocks has a beta equal to one. Stocks with betas greater than one are
3 relatively more sensitive to market risk than the average stock. For example, if the market
4 increases (decreases) by 1.0%, a stock with a beta of 1.5 will, on average, increase
5 (decrease) by 1.5%. In contrast, stocks with betas of less than one are less sensitive to
6 market risk. For example, if the market increases (decreases) by 1.0%, a stock with a beta
7 of 0.5 will, on average, only increase (decrease) by 0.5%.

8
9 **Q. DESCRIBE THE SOURCE FOR THE BETAS YOU USED IN YOUR CAPM**
10 **ANALYSIS.**

11 A. I used betas recently published by Value Line Investment Survey. The beta for each proxy
12 company is less than 1.0, and the average beta for the proxy group is only 0.76.⁶⁰ Thus,
13 we have an objective measure to prove the well-known concept that utility stocks are less
14 risky than the average stock in the market. While there is evidence suggesting that betas
15 published by sources such as Value Line may actually overestimate the risk of utilities (and
16 thus overestimate the CAPM), I used the betas published by Value Line in the interest of
17 reasonableness.⁶¹

⁶⁰ Exhibit DJG-8.

⁶¹ See Appendix B for a more detailed discussion of raw beta calculations and adjustments.

C. The Equity Risk Premium

1 **Q. DESCRIBE THE EQUITY RISK PREMIUM.**

2 A. The final term of the CAPM is the equity risk premium (“ERP”), which is the required
3 return on the market portfolio less the risk-free rate ($R_M - R_F$). In other words, the ERP is
4 the level of return investors expect above the risk-free rate in exchange for investing in
5 risky securities. Many experts agree that “the single most important variable for making
6 investment decisions is the equity risk premium.”⁶² Likewise, the ERP is arguably the
7 single most important factor in estimating the cost of capital in this matter. There are three
8 basic methods that can be used to estimate the ERP: (1) calculating a historical average;
9 (2) taking a survey of experts; and (3) calculating the implied ERP. I will discuss each
10 method in turn, noting advantages and disadvantages of these methods.

11 **1. HISTORICAL AVERAGE**

12 **Q. DESCRIBE THE HISTORICAL EQUITY RISK PREMIUM.**

13 A. The historical ERP may be calculated by simply taking the difference between returns on
14 stocks and returns on government bonds over a certain period of time. Many practitioners
15 rely on the historical ERP as an estimate for the forward-looking ERP because it is easy to
16 obtain. However, there are disadvantages to relying on the historical ERP.

⁶² Elroy Dimson, Paul Marsh & Mike Staunton, *Triumph of the Optimists: 101 Years of Global Investment Returns* 4 (Princeton University Press 2002).

1 **Q. WHAT ARE THE LIMITATIONS OF RELYING SOLELY ON A HISTORICAL**
2 **AVERAGE TO ESTIMATE THE CURRENT OR FORWARD-LOOKING ERP?**

3 A. As I mentioned, many investors use the historic ERP because it is convenient and easy to
4 calculate. What matters in the CAPM model, however, is not the actual risk premium from
5 the past, but rather the current and forward-looking risk premium.⁶³ Some investors may
6 think that a historic ERP provides some indication of what the prospective risk premium
7 is; however, there is empirical evidence to suggest the prospective, forward-looking ERP
8 is actually *lower* than the historical ERP. In a landmark publication on risk premiums
9 around the world, *Triumph of the Optimists*, the authors suggest through extensive
10 empirical research that the prospective ERP is lower than the historical ERP.⁶⁴ This is due
11 in large part to what is known as “survivorship bias” or “success bias” — a tendency for
12 failed companies to be excluded from historical indices.⁶⁵ From their extensive analysis,
13 the authors make the following conclusion regarding the prospective ERP:

14 The result is a forward-looking, geometric mean risk premium for the
15 United States . . . of around 2½ to 4 percent and an arithmetic mean risk
16 premium . . . that falls within a range from a little below 4 to a little above
17 5 percent.⁶⁶

18 Indeed, these results are lower than many reported historical risk premiums. Other noted
19 experts agree:

⁶³ John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 330 (3rd ed., South Western Cengage Learning 2010).

⁶⁴ Elroy Dimson, Paul Marsh & Mike Staunton, *Triumph of the Optimists: 101 Years of Global Investment Returns* 194 (Princeton University Press 2002).

⁶⁵ *Id.* at 34.

⁶⁶ *Id.* at 194.

1 The historical risk premium obtained by looking at U.S. data is biased
2 upwards because of survivor bias. . . . The true premium, it is argued, is
3 much lower. This view is backed up by a study of large equity markets over
4 the twentieth century (*Triumph of the Optimists*), which concluded that the
5 historical risk premium is closer to 4%.⁶⁷

6 Regardless of the variations in historic ERP estimates, many leading scholars and
7 practitioners agree that simply relying on a historic ERP to estimate the risk premium going
8 forward is not ideal. Fortunately, “a naïve reliance on long-run historical averages is not
9 the only approach for estimating the expected risk premium.”⁶⁸

10

11 **Q. DID YOU RELY ON THE HISTORICAL ERP AS PART OF YOUR CAPM**
12 **ANALYSIS IN THIS CASE?**

13 A. No. Due to the limitations of this approach, I primarily relied on the ERP reported in expert
14 surveys and the implied ERP method discussed below.

15 **2. EXPERT SURVEYS**

16 **Q. DESCRIBE THE EXPERT SURVEY APPROACH TO ESTIMATING THE ERP.**

17 A. As its name implies, the expert survey approach to estimating the ERP involves conducting
18 a survey of experts including professors, analysts, chief financial officers and other
19 executives around the country and asking them what they think the ERP is. Graham and
20 Harvey have performed such a survey since 1996. In their 2018 survey, they found that

⁶⁷ Aswath Damodaran, *Equity Risk Premiums: Determinants, Estimation and Implications – The 2015 Edition* 17 (New York University 2015).

⁶⁸ John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 330 (3rd ed., South Western Cengage Learning 2010).

1 experts around the country believe the current ERP is 4.4%.⁶⁹ The IESE Business School
 2 conducts a similar expert survey. Their 2020 expert survey reported an average ERP of
 3 5.6%.⁷⁰

4 **3. IMPLIED EQUITY RISK PREMIUM**

5 **Q. DESCRIBE THE IMPLIED EQUITY RISK PREMIUM APPROACH.**

6 A. The third method of estimating the ERP is arguably the best. The implied ERP relies on
 7 the stable growth model proposed by Gordon, often called the “Gordon Growth Model,”
 8 which is a basic stock valuation model widely used in finance for many years.⁷¹ This model
 9 is a mathematical derivation of the DCF Model. In fact, the underlying concept in both
 10 models is the same: The current value of an asset is equal to the present value of its future
 11 cash flows. Instead of using this model to determine the discount rate of one company, we
 12 can use it to determine the discount rate for the entire market by substituting the inputs of
 13 the model. Specifically, instead of using the current stock price (P_0), we will use the current
 14 value of the S&P 500 (V_{500}). Instead of using the dividends of a single firm, we will
 15 consider the dividends paid by the entire market. Additionally, we should consider
 16 potential dividends. In other words, stock buybacks should be considered in addition to

⁶⁹ John R. Graham and Campbell R. Harvey, *The Equity Risk Premium in 2018*, at 3 (Fuqua School of Business, Duke University 2014), copy available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3151162.

⁷⁰ Pablo Fernandez, Pablo Linares & Isabel F. Acin, *Market Risk Premium used in 59 Countries in 2018: A Survey*, at 3 (IESE Business School 2018), copy available at <http://www.valumonics.com/wp-content/uploads/2017/06/Discount-rate-Pablo-Fern%C3%A1ndez.pdf>. IESE Business School is the graduate business school of the University of Navarra. IESE offers Master of Business Administration (MBA), Executive MBA and Executive Education programs. IESE is consistently ranked among the leading business schools in the world.

⁷¹ Myron J. Gordon and Eli Shapiro, *Capital Equipment Analysis: The Required Rate of Profit* 102-10 (Management Science Vol. 3, No. 1 Oct. 1956).

1 paid dividends, as stock buybacks represent another way for the firm to transfer free cash
 2 flow to shareholders. Focusing on dividends alone without considering stock buybacks
 3 could understate the cash flow component of the model, and ultimately understate the
 4 implied ERP. The market dividend yield plus the market buyback yield gives us the gross
 5 cash yield to use as our cash flow in the numerator of the discount model. This gross cash
 6 yield is increased each year over the next five years by the growth rate. These cash flows
 7 must be discounted to determine their present value. The discount rate in each denominator
 8 is the risk-free rate (R_F) plus the discount rate (K). The following formula shows how the
 9 implied return is calculated. Since the current value of the S&P is known, we can solve
 10 for K : The implied market return.⁷²

11 **Equation 2:**
 12 **Implied Market Return**

13
$$V_{500} = \frac{CY_1(1+g)^1}{(1+R_F+K)^1} + \frac{CY_2(1+g)^2}{(1+R_F+K)^2} + \dots + \frac{CY_5(1+g)^5 + TV}{(1+R_F+K)^5}$$

where: V_{500} = current value of index (S&P 500)
 CY_{1-5} = average cash yield over last five years (includes dividends and buybacks)
 g = compound growth rate in earnings over last five years
 R_F = risk-free rate
 K = implied market return (this is what we are solving for)
 TV = terminal value = $CY_5(1+R_F)/K$

14 The discount rate is called the “implied” return here because it is based on the current value
 15 of the index as well as the value of free cash flow to investors projected over the next five
 16 years. Thus, based on these inputs, the market is “implying” the expected return; or in
 17 other words, based on the current value of all stocks (the index price) and the projected
 18 value of future cash flows, the market is telling us the return expected by investors for

⁷² See Exhibit DJG-9 for detailed calculation.

1 investing in the market portfolio. After solving for the implied market return (K), we
2 simply subtract the risk-free rate from it to arrive at the implied ERP.

3 **Equation 3:**
4 **Implied Equity Risk Premium**

5
$$\text{Implied Expected Market Return} - R_F = \text{Implied ERP}$$

6 **Q. DISCUSS THE RESULTS OF YOUR IMPLIED ERP CALCULATION.**

7 A. After collecting data for the index value, operating earnings, dividends, and buybacks for
8 the S&P 500 over the past six years, I calculated the dividend yield, buyback yield, and
9 gross cash yield for each year. I also calculated the compound annual growth rate (g) from
10 operating earnings. I used these inputs, along with the risk-free rate and current value of
11 the index to calculate a current expected return on the entire market of 7.5%.⁷³ I subtracted
12 the risk-free rate to arrive at the implied equity risk premium of 6.0%.⁷⁴ Dr. Damodaran,
13 arguably one of the world's leading experts on the ERP, promotes the implied ERP method
14 discussed above. Using variations of this method, he calculates and publishes his ERP
15 results each month. Dr. Damodaran's *highest* ERP estimate for October 2020 using several
16 implied ERP variations was 5.8%.⁷⁵

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ <http://pages.stern.nyu.edu/~adamodar/>

1 **Q. WHAT ARE THE RESULTS OF YOUR FINAL ERP ESTIMATE?**

2 A. For the final ERP estimate I used in my CAPM analysis, I considered the results of the
 3 ERP surveys, the implied ERP calculations discussed above, and the estimated ERP
 4 reported by Duff & Phelps.⁷⁶ The results are presented in the following figure:

5 **Figure 9:**
 6 **Equity Risk Premium Results**

| | |
|-----------------------------|-------------|
| IESE Business School Survey | 5.6% |
| Graham & Harvey Survey | 4.4% |
| Duff & Phelps Report | 6.0% |
| Damodaran (highest) | 5.8% |
| Damodaran (COVID Adjusted) | 5.0% |
| Garrett | 6.0% |
| Average | 5.5% |
| Highest | 6.0% |

7 While it would be reasonable to select any one of these ERP estimates to use in the CAPM,
 8 I conservatively selected the *highest* ERP estimate of 6.0% to use in my CAPM analysis.
 9 All else held constant, a higher ERP used in the CAPM will result in a higher cost of equity
 10 estimate.

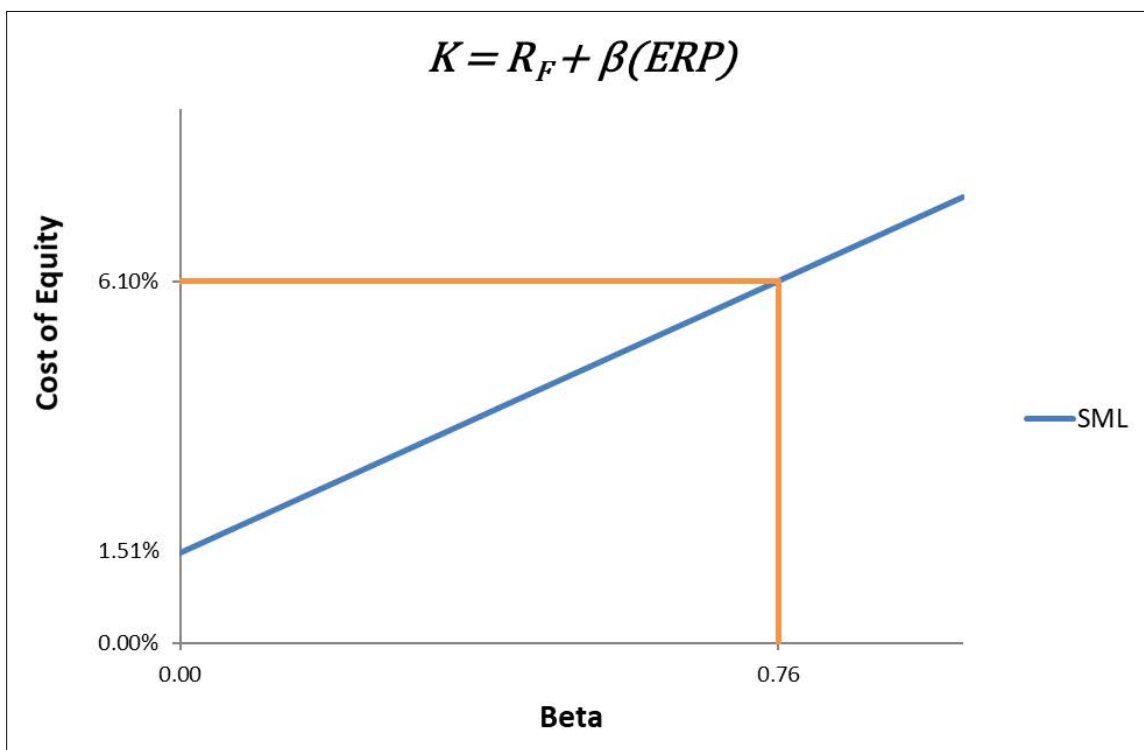
⁷⁶ See also Exhibit DJG-10.

1 **Q. PLEASE EXPLAIN THE FINAL RESULTS OF YOUR CAPM ANALYSIS.**

2 A. Using the inputs for the risk-free rate, beta coefficient, and equity risk premium discussed
 3 above, I estimate that the Company's CAPM cost of equity is 6%.⁷⁷ The CAPM can be
 4 displayed graphically through what is known as the Security Market Line ("SML"). The
 5 following figure shows the expected return (cost of equity) on the y-axis, and the average
 6 beta for the proxy group on the x-axis. The SML intercepts the y-axis at the level of the
 7 risk-free rate. The slope of the SML is the equity risk premium.

8
 9

Figure 10:
 CAPM Graph



⁷⁷ Exhibit DJG-11.

1 The SML provides the rate of return that will compensate investors for the beta risk of that
2 investment. Thus, at an average beta of 0.76 for the proxy group, the estimated CAPM
3 cost of equity for the Company is about 6%.

D. Response to Mr. D'Ascendis' CAPM Analysis

4 **Q. MR. D'ASCENDIS' CAPM ANALYSIS YIELDS CONSIDERABLY HIGHER**
5 **RESULTS. DID YOU FIND SPECIFIC PROBLEMS WITH MR. D'ASCENDIS'**
6 **CAPM ASSUMPTIONS AND INPUTS?**

7 A. Yes. The median result of Mr. D'Ascendis' various CAPM evaluations is 10.63%,⁷⁸ which
8 is considerably higher than my estimate. The main problem with Mr. D'Ascendis' CAPM
9 cost of equity result stems primarily from his estimate of the ERP. In addition, his input
10 for the risk-free rate is overestimated.

11
12 **Q. DID MR. D'ASCENDIS RELY ON A REASONABLE MEASURE FOR THE ERP?**

13 A. No, he did not. Mr. D'Ascendis used an ERP estimate of 11.94% in his CAPM.⁷⁹ The
14 ERP is one of three inputs in the CAPM equation, and it is one of the most single important
15 factors for estimating the cost of equity in this case. As discussed above, I used three
16 widely accepted methods for estimating the ERP, including consulting expert surveys,
17 calculating the implied ERP based on aggregate market data, and considering the ERPs
18 published by reputable analysts. The highest ERP found from my research and analysis is

⁷⁸ Exhibit DWD-2, Sch. 5.

⁷⁹ *Id.*

1 only 6.0%.⁸⁰ This means that Mr. D'Ascendis' ERP estimate is more than twice as high
2 as the highest reasonable ERP I could either find or calculate. And, as noted, it is also
3 considerably higher than that of reputable analysts.

4
5 **Q. PLEASE DISCUSS AND ILLUSTRATE HOW MR. D'ASCENDIS' ERP**
6 **COMPARES WITH OTHER ESTIMATES FOR THE ERP.**

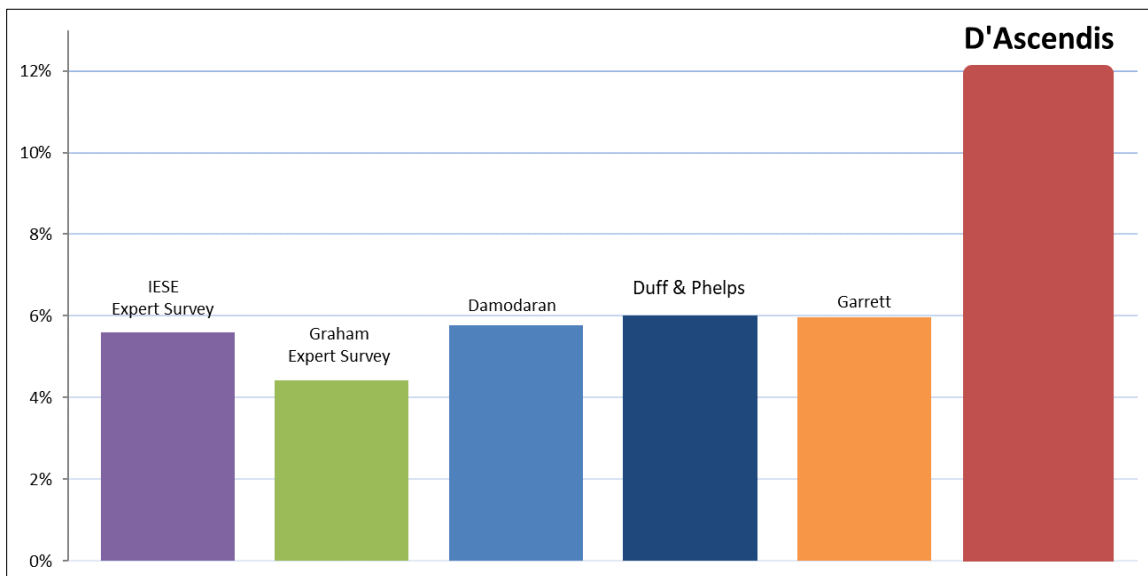
7 A. As discussed above, Graham and Harvey's 2018 expert survey reports an average ERP of
8 4.4%. The 2020 IESE Business School expert survey reports an average ERP of 5.6%.
9 Similarly, Duff & Phelps recently estimated an ERP of 6.0%. The following chart
10 illustrates that Mr. D'Ascendis' ERP estimate is far out of line with industry norms.⁸¹

⁸⁰ Exhibit DJG-10.

⁸¹ See Exhibit DJG-10. The ERP estimated by Dr. Damodaran is the highest of several ERP estimates under varying assumptions.

1
2

Figure 11:
Equity Risk Premium Comparison



3 When compared with other independent sources for the ERP (as well as my estimate),
4 which do not have a wide variance, Mr. D'Ascendis' ERP estimate is clearly not within
5 the range of reasonableness. As a result, his CAPM cost of equity estimate is overstated
6 and unreliable.

7

8 **Q. DID MR. D'ASCENDIS OVERESTIMATE HIS RISK-FREE RATE INPUT TO**
9 **THE CAPM?**

10 A. Yes. The current yield on 30-year Treasury bonds is only about 1.5%.⁸² Mr. D'Ascendis,
11 however, uses a risk-free rate of 2.03% in his CAPM.⁸³ All else held constant, a higher

⁸² Exhibit DJG-7.

⁸³ Exhibit DWD-2, Sch. 5.

1 risk-free rate will result in a higher CAPM cost of equity estimate. Thus, Mr. D'Ascendis'
2 CAPM cost of equity estimate is overstated.

3
4 **VIII. OTHER COST OF EQUITY ISSUES**

5 **Q. DO YOU HAVE A RESPONSE TO OTHER COST OF EQUITY ISSUES RAISED**
6 **BY MR. D'ASCENDIS?**

7 A. Yes. Mr. D'Ascendis conducted a cost of equity model on a group of companies that are
8 neither utility companies nor regulated. In addition, Mr. D'Ascendis suggests that UIF's
9 relatively small size should have an effect on its cost of equity.

10 **1. Non-Price Regulated Model**

11 **Q. PLEASE DESCRIBE MR. D'ASCENDIS' NON-PRICE REGULATED MODEL?**

12 A. In addition to conducting the CAPM and DCF model on the proxy group of utility
13 companies, Mr. D'Ascendis also used a non-price regulated proxy group.⁸⁴

14
15 **Q. DO YOU AGREE WITH THE RESULTS OF THIS MODEL?**

16 A. No, I do not. In fact, I disagree with the entire premise of the model. There are three
17 important reasons why the Commission should completely disregard this analysis. First,
18 there is no marginal benefit received for conducting a CAPM and/or DCF Model on a
19 group of non-regulated, non-utility companies in this context. Typically, non-regulated,
20 competitive firms have higher levels of market risk than regulated utility companies. As a
21 result, their cost of equity estimates will be generally higher. Second, using a group of

⁸⁴ See Direct Testimony of Dylan W. D'Ascendis, pp. 35-37.

1 non-regulated, non-utility companies for a cost of equity analysis in a utility rate case does
2 not help in reaching a fair awarded ROE according to the standards set forth by the *Hope*
3 Court, which held that the “the return to the equity owner should be commensurate with
4 returns on investments in other enterprises having corresponding risks.”⁸⁵ Using a group
5 of non-regulated, non-utility companies will not indicate a required return on investments
6 that is *commensurate* with returns on investments of *corresponding risks*. Finally, Mr.
7 D’Ascendis’ non-price regulated model suffers from the same overestimated equity risk
8 premium and risk-free rate as Mr. D’Ascendis’ CAPM for the proxy group of regulated
9 utilities, as discussed above. For all of these reasons, the Commission should reject Mr.
10 D’Ascendis’ approach regarding the non-price regulated model.

11
12 **2. Small Size Premium**

13 **Q. PLEASE DESCRIBE MR. D’ASCENDIS’ POSITION REGARDING THE SIZE**
14 **PREMIUM.**

15 A. Mr. D’Ascendis suggests that UIF’s size should somehow have an increasing effect on its
16 cost of equity estimate.⁸⁶ Mr. D’Ascendis adds a 1% upward adjustment to reflect a small
17 size premium.⁸⁷

⁸⁵ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

⁸⁶ See Direct Testimony of Dylan W. D’Ascendis, pp. 38-42.

⁸⁷ *Id.* at p. 42, line18.

1 **Q. DO YOU AGREE WITH MR. D’ASCENDIS REGARDING THE SIZE PREMIUM**
2 **OR SIZE EFFECT?**

3 A. No, I do not. To the extent Mr. D’Ascendis is adjusting his CAPM result upward to account
4 for the “size effect” phenomenon, I disagree with his position because numerous studies
5 have shown that small cap stocks do not consistently outperform large-cap stocks. The
6 “size effect” phenomenon arose from a 1981 study conducted by Banz, which found that
7 “in the 1936 – 1975 period, the common stock of small firms had, on average, higher risk-
8 adjusted returns than the common stock of large firms.”⁸⁸ According to Ibbotson, Banz’s
9 size effect study was “[o]ne of the most remarkable discoveries of modern finance.”⁸⁹
10 Perhaps there was some merit to this idea at the time, yet, the size effect phenomenon was
11 short lived. Banz’s 1981 publication generated much interest in the size effect and spurred
12 the launch of significant new small cap investment funds. However, this “honeymoon
13 period lasted for approximately two years. . . .”⁹⁰ After 1983, U.S. small-cap stocks
14 actually underperformed relative to large cap stocks. In other words, the size effect
15 essentially reversed. In the more recent study, *Triumph of the Optimists*, the authors
16 conducted an extensive empirical study of the size effect phenomenon around the world.
17 They found that after the size effect phenomenon was discovered in 1981, it disappeared
18 within a few years:

⁸⁸ Rolf W. Banz, *The Relationship Between Return and Market Value of Common Stocks* 3-18 (Journal of Financial Economics 9 (1981)).

⁸⁹ 2015 Ibbotson Stocks, Bonds, Bills, and Inflation Classic Yearbook 99 (Morningstar 2015).

⁹⁰ Elroy Dimson, Paul Marsh & Mike Staunton, *Triumph of the Optimists: 101 Years of Global Investment Returns* 131 (Princeton University Press 2002).

1 It is clear . . . that there was a global reversal of the size effect in virtually
2 every country, with the size premium not just disappearing but going into
3 reverse. Researchers around the world universally fell victim to Murphy’s
4 Law, with the very effect they were documenting – and inventing
5 explanations for – promptly reversing itself shortly after their studies were
6 published.⁹¹

7 In other words, the authors assert that the very discovery of the size effect phenomenon
8 likely caused its own demise. The authors ultimately concluded that it is “inappropriate to
9 use the term ‘size effect’ to imply that we should automatically expect there to be a small-
10 cap premium;” yet, this is exactly what utility witnesses often do in attempting to
11 artificially inflate the cost of equity with a size premium. Other prominent sources have
12 agreed that the size premium is a dead phenomenon. According to Ibbotson:

13 The unpredictability of small-cap returns has given rise to another argument
14 against the existence of a size premium: that markets have changed so that
15 the size premium no longer exists. As evidence, one might observe the last
16 20 years of market data to see that the performance of large-cap stocks was
17 basically equal to that of small cap stocks. In fact, large-cap stocks have
18 outperformed small-cap stocks in five of the last 10 years.⁹²

19 In addition to the studies discussed above, other scholars have concluded similar results.

20 According to Kalesnik and Beck:

⁹¹ *Id.* at 133.

⁹² 2015 Ibbotson Stocks, Bonds, Bills, and Inflation Classic Yearbook 112 (Morningstar 2015).

1 Today, more than 30 years after the initial publication of Banz's paper, the
2 empirical evidence is extremely weak even before adjusting for possible
3 biases. . . . The U.S. long-term size premium is driven by the extreme
4 outliers, which occurred three-quarters of a century ago. . . . Finally,
5 adjusting for biases . . . makes the size premium vanish. If the size premium
6 were discovered today, rather than in the 1980s, it would be challenging to
7 even publish a paper documenting that small stocks outperform large
8 ones.⁹³

9 Thus, the size-effect phenomenon has been extinct for nearly 40 years, and it should have
10 no application in this case.

11 **IX. COST OF EQUITY SUMMARY**

13 **Q. PLEASE SUMMARIZE THE RESULTS OF THE CAPM AND DCF MODEL**
14 **DISCUSSED ABOVE.**

15 **A.** The following table shows the cost of equity results from each model I employed in this
16 case.⁹⁴

⁹³ Vitali Kalesnik and Noah Beck, *Busting the Myth About Size* (Research Affiliates 2014), available at https://www.researchaffiliates.com/Our%20Ideas/Insights/Fundamentals/Pages/284_Busting_the_Myth_About_Size.aspx (emphasis added).

⁹⁴ See Exhibit DJG-12.

Figure 12:
Cost of Equity Summary

| Model | Cost of Equity |
|-----------------------------|-----------------------|
| Discounted Cash Flow Model | 6% |
| Capital Asset Pricing Model | 6% |
| Average | 6% |

The cost of equity indicated by the results of the DCF Model and the CAPM is approximately 6%.

Q. IS THERE A MARKET INDICATOR THAT YOU CAN USE TO TEST THE REASONABLENESS OF YOUR COST OF EQUITY ESTIMATE?

A. Yes, there is. The CAPM is a risk premium model based on the fact that all investors will require, at a minimum, a return equal to the risk-free rate when investing in equity securities. Of course, the investors will also require a premium on top of the risk-free rate to compensate them for the risk they have assumed. If an investor bought every stock in the market portfolio, he would require the risk-free rate, plus the ERP discussed above. Recall that the risk-free rate plus the ERP is called the required return on the market portfolio. This could also be called the market cost of equity. It is undisputed that the cost of equity of utility stocks must be less than the total market cost of equity. This is because utility stocks are less risky than the average stock in the market. (We proved this above by showing that utility betas are less than one). Therefore, once we determine the market cost of equity, it gives us a “ceiling” below which UIF’s actual cost of equity must lie.

1 **Q. DESCRIBE HOW YOU ESTIMATED THE MARKET COST OF EQUITY.**

2 A. The methods used to estimate the market cost of equity are necessarily related to the
 3 methods used to estimate the ERP discussed above. In fact, the ERP is calculated by taking
 4 the market cost of equity less the risk-free rate. Therefore, in estimating the market cost of
 5 equity, I relied on the same methods discussed above to estimate the ERP: (1) consulting
 6 expert surveys; and (2) calculating the implied ERP. The results of my market cost of
 7 equity analysis are presented in the following table:⁹⁵

8 **Figure 13:**
 9 **Market Cost of Equity Summary**

| Source | Estimate |
|----------------------|-----------------|
| IESE Survey | 7.1% |
| Graham Harvey Survey | 5.9% |
| Damodaran | 7.3% |
| Garrett | 7.5% |
| Average | 7% |

10 As shown in this table, the average market cost of equity from these sources is only about
 11 7%. Therefore, it is not surprising that the CAPM and DCF Model indicate a cost of equity
 12 for the Company of only 6%. In other words, any cost of equity estimates for the Company
 13 (or any regulated utility) that is *above* the market cost of equity should be viewed as
 14 unreasonable (again, the cost of equity is a different concept than the awarded ROE).

⁹⁵ See Exhibit DJG-13.

X. CAPITAL STRUCTURE

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

Q. DESCRIBE IN GENERAL THE CONCEPT OF A COMPANY'S CAPITAL STRUCTURE.

A. "Capital structure" refers to the way a company finances its overall operations through external financing. The primary sources of long-term, external financing are debt capital and equity capital. Debt capital usually comes in the form of contractual bond issues that require the firm to make payments, while equity capital represents an ownership interest in the form of stock. Because a firm cannot pay dividends on common stock until it satisfies its debt obligations to bondholders, stockholders are referred to as "residual claimants." The fact that stockholders have a lower priority to claims on company assets increases their risk and the required return relative to bondholders. Thus, equity capital has a higher cost than debt capital. Firms can reduce their WACC by recapitalizing and increasing their debt financing. In addition, because interest expense is deductible, increasing debt also adds value to the firm by reducing the firm's tax obligation.

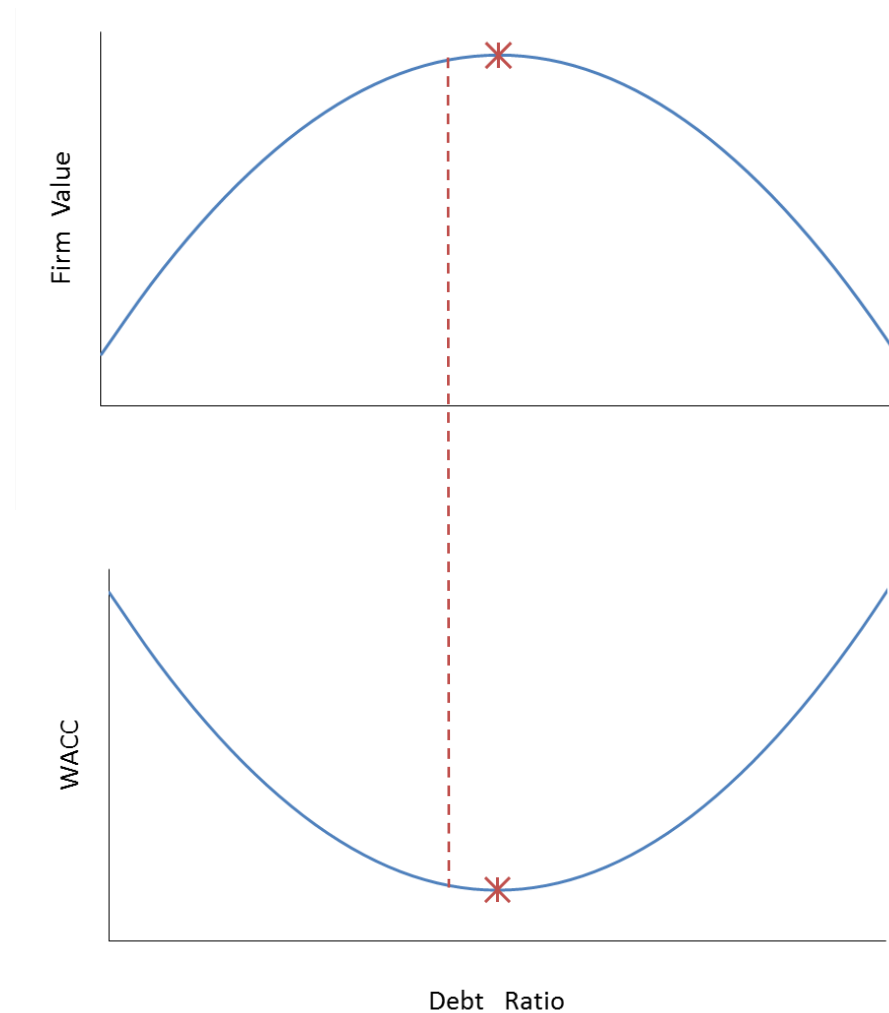
Q. IS IT TRUE THAT, BY INCREASING DEBT, COMPETITIVE FIRMS CAN ADD VALUE AND REDUCE THEIR WACC?

A. Yes, it is. A competitive firm can add value by increasing debt. After a certain point, however, the marginal cost of additional debt outweighs its marginal benefit. This is because the more debt the firm uses, the higher interest expense it must pay, and the likelihood of loss increases. This also increases the risk of non-recovery for both bondholders and shareholders, causing both groups of investors to demand a greater return

1 on their investment. Thus, if debt financing is too high, the firm's WACC will increase
2 instead of decrease. The following figure illustrates these concepts.

3
4

Figure 14:
Optimal Debt Ratio



5 As shown in this figure, a competitive firm's value is maximized when the WACC is
6 minimized. In both graphs, the debt ratio is shown on the x-axis. By increasing its debt
7 ratio, a competitive firm can minimize its WACC and maximize its value. At a certain
8 point, however, the benefits of increasing debt do not outweigh the costs of the additional

1 risks to both bondholders and shareholders, as each type of investor will demand higher
 2 returns for the additional risk they have assumed.⁹⁶

3
 4 **Q. DOES THE RATE BASE RATE OF RETURN MODEL EFFECTIVELY**
 5 **INCENTIVIZE UTILITIES TO OPERATE AT THE OPTIMAL CAPITAL**
 6 **STRUCTURE?**

7 A. No. While it is true that competitive firms maximize their value by minimizing their
 8 WACC, this is not the case for regulated utilities. Under the rate base rate of return model,
 9 a higher WACC results in higher rates, all else held constant. The basic revenue
 10 requirement equation is as follows:

11 **Equation 4:**
 12 **Revenue Requirement for Regulated Utilities**

$$13 \quad RR = O + d + T + r(A - D)$$

where: RR = revenue requirement
 O = operating expenses
 d = depreciation expense
 T = corporate tax
 r = **weighted average cost of capital (WACC)**
 A = plant investments
 D = accumulated depreciation

14 As shown in this equation, utilities can increase their revenue requirement by increasing
 15 their WACC, not by minimizing it. Thus, because there is no incentive for a regulated
 16 utility to minimize its WACC, a commission standing in the place of competition must
 17 ensure that the regulated utility is operating at the lowest reasonable WACC.

⁹⁶ See John R. Graham, Scott B. Smart & William L. Megginson, *Corporate Finance: Linking Theory to What Companies Do* 440-41 (3rd ed., South Western Cengage Learning 2010).

1 **Q. CAN UTILITIES GENERALLY AFFORD TO HAVE HIGHER DEBT LEVELS**
2 **THAN OTHER INDUSTRIES?**

3 A. Yes. Because regulated utilities have large amounts of fixed assets, stable earnings, and
4 low risk relative to other industries, they can afford to have relatively higher debt ratios (or
5 “leverage”). As aptly stated by Dr. Damodaran:

6 Since financial leverage multiplies the underlying business risk, it stands to
7 reason that firms that have high business risk should be reluctant to take on
8 financial leverage. It also stands to reason that firms that operate in stable
9 businesses should be much more willing to take on financial leverage.
10 Utilities, for instance, have historically had high debt ratios but have not
11 had high betas, mostly because their underlying businesses have been stable
12 and fairly predictable.⁹⁷

13 Note that the author explicitly contrasts utilities with firms that have high underlying
14 business risk. Because utilities have low levels of risk and operate a stable business, they
15 should generally operate with relatively high levels of debt to achieve their optimal capital
16 structure.

17
18 **Q. ARE THE CAPITAL STRUCTURES OF THE PROXY GROUP A SOURCE THAT**
19 **CAN BE USED TO ASSESS A PRUDENT CAPITAL STRUCTURE?**

20 A. Yes. However, while the capital structures of the proxy group might provide some
21 indication of an appropriate capital structure for the utility being studied, it is preferable to
22 also consider additional types of analyses. The average debt ratios of a utility proxy group
23 will likely be lower than what would be observed in a pure competitive environment. As

⁹⁷ Aswath Damodaran, *Investment Valuation: Tools and Techniques for Determining the Value of Any Asset* 196 (3rd ed., John Wiley & Sons, Inc. 2012).

1 I explain above, this is because utilities do not have a financial incentive to operate at the
2 optimal capital structure.

3
4 **Q. HOW CAN UTILITY REGULATORY COMMISSIONS HELP OVERCOME THE**
5 **FACT THAT UTILITIES DO NOT HAVE A NATURAL FINANCIAL INCENTIVE**
6 **TO MINIMIZE THEIR COST OF CAPITAL?**

7 A. While under the rate base rate of return model utilities do not have a natural financial
8 incentive to minimize their cost of capital, competitive firms, in contrast, can and do
9 maximize their value by minimizing their cost of capital. Competitive firms minimize their
10 cost of capital by including a sufficient amount of debt in their capital structures. They do
11 not do this because it is required by a regulatory body, but rather because their shareholders
12 demand it in order to maximize value. The Commission can provide this incentive to UIF
13 by acting as a surrogate for competition and setting rates consistent with a capital structure
14 that is similar to what would be appropriate in a competitive, as opposed to a regulated,
15 environment.

16 **Q. WHAT IS THE CAPITAL STRUCTURE MR. D'ASCENDIS PROPOSES FOR**
17 **THE COMPANY?**

18 A. Mr. D'Ascendis proposes a capital structures consisting of 45.58% long-term debt, 5.03%
19 short-term debt, and 49.39% common equity.⁹⁸

⁹⁸ Direct Testimony of Dylan W. D'Ascendis, p. 19, lines 18-22.

1 **Q. WHAT IS YOUR RECOMMENDED EQUITY RATIO?**

2 A. I recommend that the Commission authorize a capital structure consisting of 50% long-
3 term debt, 5% short-term debt, and 45% common equity.

4

5 **Q. PLEASE DESCRIBE YOUR APPROACH IN ASSESSING A FAIR CAPITAL**
6 **STRUCTURE FOR UIF.**

7 A. To analyze UIF's appropriate capital structure, I examined the debt ratios of competitive
8 industries as well as debt ratios of the proxy group. Based on either benchmark, the
9 Company's proposed capital structure is unreasonably weighted to equity.

10

11 **Q. WHAT ARE THE DEBT RATIOS OBSERVED IN COMPETITIVE INDUSTRIES?**

12 A. I found that there are currently more than 3,500 firms in U.S. industries with higher debt
13 ratios than that requested by UIF in this case.⁹⁹ Moreover, these firms have an average
14 debt ratio of greater than 60%.¹⁰⁰ The following figure shows a sample of these industries
15 with debt ratios higher than 55%.

⁹⁹ Exhibit DJG-15.

¹⁰⁰ Exhibit DJG-15.

1
2

Figure 15:
Industries with Debt Ratios Greater than 55%¹⁰¹

| Industry | # Firms | Debt Ratio |
|-------------------------------------|--------------|------------|
| Tobacco | 17 | 96% |
| Financial Svcs. | 232 | 95% |
| Retail (Building Supply) | 17 | 90% |
| Hospitals/Healthcare Facilities | 36 | 88% |
| Advertising | 47 | 80% |
| Retail (Automotive) | 26 | 79% |
| Brokerage & Investment Banking | 39 | 77% |
| Auto & Truck | 13 | 75% |
| Food Wholesalers | 17 | 70% |
| Bank (Money Center) | 7 | 69% |
| Transportation | 18 | 67% |
| Hotel/Gaming | 65 | 67% |
| Packaging & Container | 24 | 66% |
| Retail (Grocery and Food) | 13 | 66% |
| Broadcasting | 27 | 65% |
| R.E.I.T. | 234 | 64% |
| Retail (Special Lines) | 89 | 64% |
| Green & Renewable Energy | 22 | 64% |
| Recreation | 63 | 63% |
| Software (Internet) | 30 | 63% |
| Air Transport | 18 | 63% |
| Retail (Distributors) | 80 | 62% |
| Computers/Peripherals | 48 | 61% |
| Telecom (Wireless) | 18 | 61% |
| Farming/Agriculture | 31 | 61% |
| Cable TV | 14 | 60% |
| Computer Services | 106 | 60% |
| Beverage (Soft) | 34 | 60% |
| Telecom. Services | 67 | 60% |
| Trucking | 33 | 59% |
| Power | 52 | 59% |
| Office Equipment & Services | 22 | 58% |
| Chemical (Diversified) | 6 | 58% |
| Retail (Online) | 70 | 58% |
| Aerospace/Defense | 77 | 58% |
| Oil/Gas Distribution | 24 | 58% |
| Business & Consumer Services | 165 | 57% |
| Construction Supplies | 44 | 57% |
| Real Estate (Operations & Services) | 57 | 56% |
| Household Products | 127 | 56% |
| Environmental & Waste Services | 82 | 56% |
| Rubber& Tires | 4 | 56% |
| Total / Average | 2,215 | 66% |

¹⁰¹ Exhibit DJG-15.

1 Many of the industries shown here, like public utilities, are generally well-established with
2 large amounts of capital assets. The shareholders of these industries demand higher debt
3 ratios to maximize their profits. There are several notable industries that are relatively
4 comparable to public utilities (highlighted in the figure above). For example, Green and
5 Renewable Energy has an average debt ratio of 64% and Telecom Services has an average
6 debt ratio of 60%. These debt ratios are significantly higher than UIF's proposed debt ratio
7 of only 45%.

8 **Q. DID YOU ALSO LOOK AT THE DEBT RATIOS OF THE PROXY GROUP?**

9 A. Yes. According to the most recently reported data from Value Line, the average debt ratio
10 of the proxy group made up of similarly situated utilities is 50%.¹⁰²

11
12 **Q. WHAT IS YOUR RECOMMENDATION REGARDING UIF'S CAPITAL
13 STRUCTURE?**

14 A. In my opinion, UIF's proposed capital structure consists of an insufficient amount of debt,
15 especially since UIF's awarded ROE in this case will certainly be above its market-based
16 cost of equity, even if my recommendation is adopted. With an awarded ROE that is above
17 market-based costs, UIF's overall cost of capital can be reduced by replacing higher-cost
18 equity with lower-cost debt. I recommend the Commission apply a capital structure
19 consisting of a 50% long-term debt, 5% short-term debt, and 45% common equity. The
20 figure below summarizes my findings and puts my recommendation into perspective.

¹⁰² Exhibit DJG-16.

Figure 16:
Debt Ratio Comparison

| Source | Debt Ratio |
|---------------------------------|------------|
| Green & Renewable Energy | 64% |
| Telecom (Wireless) | 61% |
| Cable TV | 60% |
| Telecom. Services | 60% |
| Power | 59% |
| Proxy Group of Utilities | 50% |
| Garrett Proposal | 50% |
| Company's Proposal | 45% |

Based on these findings, UIF's proposed debt ratio is an outlier as being far too low, and if adopted, would result in an unreasonably high WACC for shareholders.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. I reserve the right to supplement this testimony as needed with any additional information that has been requested from the Company but not yet provided. To the extent I have not addressed an issue, method, calculation, account, or other matter relevant to the Company's proposals in this proceeding, it should not be construed that I agree with the same.

1 CHAIRMAN CLARK: Was someone trying to get our
2 attention? Yes. I am sorry. I think I am getting
3 the question.

4 All right. We are going to take five-minute
5 break, give the court reporter a minute to stretch
6 her hands, a quick restroom break. Let's be back
7 at 4:10.

8 Thank you.

9 (Brief recess.)

10 (Transcript continues in sequence in Volume
11 3.)

12

13

14

15

16

17

18

19

20

21

22

23

24

25

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

CERTIFICATE OF REPORTER

STATE OF FLORIDA)
COUNTY OF LEON)

I, DEBRA KRICK, Court Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorney or counsel connected with the action, nor am I financially interested in the action.

DATED this 16th day of February, 2021.



DEBRA R. KRICK
NOTARY PUBLIC
COMMISSION #HH31926
EXPIRES AUGUST 13, 2024