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March 22, 1999

Ms. Blanca S. Bayó, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0870

RE: Docket No.971065-SU

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of Direct Testimony of Hugh Larkin, Jr. for filing in the above-referenced docket.

Please indicate receipt of filing by date-stamping the attached copy of this letter and returning it to this office. Thank you for your assistance in this matter.

Sincerely,

Stephen C. Burgess
Deputy Public Counsel

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PPSC-RECORDS/REPORTING

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for rate)
increase in Pinellas County)
by Mid-County Services,)
Inc.)
_____)

Docket No. 971065-SU

DIRECT TESTIMONY OF
HUGH LARKIN, JR.
Witness for the Citizens of the State of Florida

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DOCUMENT NUMBER-DATE

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1 DIRECT TESTIMONY OF HUGH LARKIN, JR.
2 ON BEHALF OF THE CITIZENS OF FLORIDA
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 971065-SU

5 Introduction

6 Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

7 A. My name is Hugh Larkin, Jr. I am a Certified Public Accountant licensed in the States of
8 Michigan and Florida and the senior partner in the firm of Larkin & Associates, Certified
9 Public Accountants, with offices at 15728 Farmington Road, Livonia, Michigan 48154.

10
11 Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES.

12 A. Larkin & Associates is a Certified Public Accounting and Regulatory Consulting firm.
13 The firm performs independent regulatory consulting primarily for public service / utility
14 commission staffs and consumer interest groups (public counsels, public advocates,
15 consumer counsels, attorneys general, etc.). Larkin & Associates has extensive experience
16 in the utility regulatory field as expert witnesses in over 400 regulatory proceedings,
17 including numerous water and sewer, gas, electric and telephone utilities.

18
19 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE FLORIDA PUBLIC SERVICE
20 COMMISSION?

21 A. Yes, I have testified before the Florida Public Service Commission on numerous

1 occasions. My qualifications as an expert on utility regulatory matters have been accepted
2 by this Commission.

3 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

4 A. The purpose of my testimony is to respond to the protest by Mid-County Services, Inc. to
5 the Proposed Agency Action (PAA) Order No. PSC-98-0524-FOF-SU in Docket No.
6 971065-SU.

7
8 Q. HOW WILL YOUR TESTIMONY BE ORGANIZED?

9 A. My testimony will respond to the Company's witnesses who are sponsoring testimony in
10 opposition to the Commission's PAA. I am also recommending that the Commission
11 change its overall rate of return in the Proposed Agency Action to reflect the current
12 authorized range of return on common equity authorized by the Commission on July 6,
13 1998 in Docket No. 980006-WS, Order No. PSC-98-0903-FOF-WS.

14
15 Used and Useful

16 Q. WHAT IS YOUR UNDERSTANDING OF THE STAFF'S RECOMMENDATION
17 AND THE COMMISSION'S ADOPTION OF STAFF'S RECOMMENDATION IN
18 THE PROPOSED AGENCY ACTION RELATED TO THE USED AND USEFUL
19 CALCULATION?

20 A. The Staff recommended, and the Commission adopted, an approach to calculating the
21 used and useful percentage which applies a consistent utilization of data in calculating the
22 percentage of plant which is used and useful. The Staff recommendation utilizes a recent

1 historical approach in determining the used and useful percentage which is consistent in
2 the use of data. This approach is fair to both the Company and the ratepayers. The recent
3 historical approach used by the Staff determines what flow data was used by the Florida
4 Department of Environmental Protection (FDEP) in issuing an operating permit for the
5 plant in question. As pointed out in the Staff analysis, the flow data utilized by the FDEP
6 is chosen by the plant owners and operators themselves. In other words, the flow data is
7 not a choice made by the FDEP, rather, it is a choice of design flows chosen by the plant
8 owners and operators themselves.

9
10 Q. WHY IS THAT IMPORTANT?

11 A. It is important because the operator and owner of the plant chooses the flow data which,
12 in its opinion, represents the operating characteristics of the plant. In other words, if the
13 operator thought that the annual average daily flow was the most important statistic in the
14 design and operation of the plant, and felt that the FDEP should permit the plant to
15 operate based on that designed flow, then the plant owners and operators would choose
16 that statistic as a basis for the operation of the plant. If, on the other hand, they felt that
17 the maximum monthly average daily flow were the most relevant data on which the plant
18 should be permitted, then they would have chosen that statistic in order to determine the
19 basis upon which the FDEP should allow the plant to operate.

20
21 The basis on which the utility chose to request a permit from the FDEP is an important
22 decision. It tells the Florida Department of Environmental Protection what statistic the

1 Company's plant operators feel is the most important in determining the way the plant
2 should operate. It is clear that the utility controls the determination of the permitting of
3 the plant and determines what statistic is used by the FDEP in issuing the operating
4 permit.

5
6 Q. WHAT EFFECT DOES THIS HAVE ON THE USED AND USEFUL
7 CALCULATION?

8 A. I believe the Staff has correctly determined that when making a used and useful
9 calculation, the data used in determining the used and useful percentage should be based
10 on the same statistical information. In other words, if the Company chose the annual
11 average daily flow as the basis for obtaining a permit from the FDEP, then that average
12 annual daily flow should form the basis of determining what percentage of the plant is
13 used and useful.

14
15 Q. WHAT RECOMMENDATION IS THE COMPANY MAKING REGARDING USED
16 AND USEFUL?

17 A. The Company is recommending that the Commission use a mix and match approach in
18 determining used and useful. The Company is recommending that the average annual
19 daily flow be used as the denominator while the maximum monthly average daily flow be
20 used as the numerator. This self-apparent mismatch results in a used and useful ratio
21 which is unfair, as well as inaccurate. The numerator must be based on the same
22 measurement as the denominator in order to obtain a fair result. Suppose, for example,

1 the Commission reversed the mismatch and based the numerator on the average annual
2 flow, but based the denominator on the maximum daily flow. Such a mismatch would
3 unfairly and inaccurately understate the used and useful ratio, and the utility would
4 justifiably complain.

5
6 As it is, however, the utility is seeking a self-serving mismatch merely because it results in
7 a higher percentage of used and useful. The Staff's approach, on the other hand, is proper
8 because it is consistent in its use of data. It utilizes average annual daily flow capacity of
9 the plant as the denominator and actual average daily flow in the test year as the
10 numerator. This consistent use of data assures a more accurate result, because the
11 equation is consistent in its use of statistical information.

12
13 Used and useful is a regulatory concept based on actual plant statistical data. As such,
14 used and useful should be determined on a basis that takes into consideration normal or
15 average uses throughout the historical period of time. To utilize only statistical data
16 which will result in the absolute highest used and useful percentage is not fair to the
17 ratepayers. It assigns plant capacity which will, in fact, be utilized by other customers in
18 the future.

19
20 Q. COMPANY WITNESS SEIDMAN ARGUES THAT THE USED AND USEFUL
21 PERCENTAGE DETERMINED BY THE STAFF IS LOWER THAN THE
22 PERCENTAGE UTILIZED IN THE LAST RATE CASE. WOULD YOU PLEASE

1 COMMENT?

2 A. As pointed out in Company Witness Seidman's testimony, on page 14, lines 11 through
3 13, in the last rate case "...the parties stipulated to a used and useful percentage..." It is
4 my understanding that stipulations have no precedential value in any future hearing.
5 Therefore, the fact that the used and useful percentage was a stipulated percentage that
6 used a particular methodology would have no precedential value in any future docket.
7 Additionally, it would be appropriate for the Commission to adopt a more reasoned
8 approach to calculating the used and useful percentage, as recommended by the Staff.

9
10 Q. THE COMPANY WITNESS ALSO INDICATES THAT THE NUMBER OF
11 EQUIVALENT RESIDENTIAL CONNECTIONS HAVE INCREASE SINCE THE
12 LAST RATE CASE, AND BASED ON THE INCREASE, IT IS UNREASONABLE TO
13 CONCLUDE THAT THE USED AND USEFUL PERCENTAGE SHOULD NOT BE
14 INCREASED FROM THE LAST RATE CASE.

15 A. I believe that the witness is placing reliance upon a stipulated percentage where both the
16 plant capacity was lower because of limits placed on it by the FDEP and a calculation was
17 stipulated to. It is my understanding that the FDEP had limited the plant capacity to a
18 800,000 gpd average annual daily flow. The current permit has increased that to 900,000
19 gpd based on the new permit. This increase in capacity is a result of the changing of the
20 permit rather than any change in the actual capacity of the plant. Further, it is my
21 understanding that the plant can actually qualify for a 1.1 million gpd permit if the
22 Company chose to. The new used and useful calculation should consider this change in

1 the permitted capacity and the true capacity, rather than merely being based on an
2 argument that ERCs have increased from the last case.

3
4 In conclusion, I agree with the Staff's use of consistent data in determining the used and
5 useful percentage, as adopted in the Commission's PAA. Moreover, the use of 900,000
6 gpd, instead of 1.1 million, greatly benefits the utility and results in a used and useful
7 percentage that is imminently fair to Mid-County.

8
9 Margin Reserve

10 Q. WHAT MARGIN RESERVE CALCULATION DO YOU SUPPORT?

11 A. It is my position, and the position of the Office of Public Counsel, that a margin reserve
12 component should not be added to the capacity requirements in calculating the used and
13 useful percentage of plant. Having stated the position of the Office of Public Counsel and
14 myself in regard to this issue on numerous occasions in the past, the Commission has
15 permitted a margin reserve in most instances that I am aware of.

16
17 If a margin reserve is allowed, the Staff's approach to calculating the margin reserve
18 appears to be the most reasoned approach. It is not based upon a hypothetical 20%
19 increase, which the Company is requesting. It is based upon the statistical analysis of past
20 growth using a linear regression analysis. This statistical analysis, in my opinion, is more
21 realistic than the arbitrary 20% addition approach utilized by the Company. The Staff's
22 approach calculates a statistical growth rate which takes into consideration both time and

1 customers. It is more accurate than an average growth rate. The Staff then allows an 18-
2 month customer growth rate and annualizes that by the average residential annual
3 gallonage consumption. Allowing the Company a margin reserve based on 18-month
4 growth in customers is far superior to arbitrarily concluding that a 20% increase for
5 margin reserve is appropriate.

6
7 Q. DIDN'T THE COMPANY'S WITNESS STATE THAT, IN HIS OPINION, IT WOULD
8 TAKE FIVE YEARS TO CONSTRUCT ADDITIONAL PLANT CAPACITY?

9 A. Yes, he did, but this misses the entire point of the Commission's jurisdiction. The
10 Commission is charged with the responsibility of assuring that reasonably incurred costs
11 are equitably distributed among the various customers for whom those costs are incurred.
12 An eighteen month margin reserve does not prevent a utility from earning a return on plant
13 held for customers who will be added after the eighteen month period; rather, it merely
14 allots a fair portion of the cost to those specific customers for whom the plant is being
15 held. The utility will receive a return on, and a return of, its entire investment.

16
17 Further, I believe Mr. Seidman may be overstating the time needed to construct new plant
18 facilities. It has been my experience that electric utilities can construct major power plant
19 additions in less time than five years. It is unlikely that an increase in capacity in sewage
20 plant would take as long as five years to construct, given the fact that many of these
21 facilities are pre-engineered and off-the-shelf type purchases. Even if five years was an
22 accurate estimate of the time period to obtain approval, permits and construct a

1 wastewater facility, there is no reason that a utility should not plan that facility and obtain
2 permits several years prior to the necessity to construct the facility. Under the Company's
3 theory, the utility should run out of capacity and then have five years to plan, construct
4 and obtain permits for any addition to the wastewater treatment facility. Clearly, the
5 burden of this lack of prior planning and analysis of probable growth should not be placed
6 upon the ratepayer. It is the responsibility of the utility to anticipate future needs prior to
7 current capacity being fully utilized.

8
9 Imputation of CIAC Against Margin Reserve

10 Q. THE COMPANY WITNESS HAS TAKEN EXCEPTION TO THE COMMISSION
11 IMPUTING CIAC AGAINST THE MARGIN RESERVE. WOULD YOU PLEASE
12 DISCUSS THAT ISSUE?

13 A. Company Witness Seidman discusses the imputation of CIAC against the margin reserve
14 on pages 19 and 20 of his direct testimony. In that testimony, on page 19, he states,
15 "Imputation of CIAC against investment in margin reserve is a mismatch of investment
16 and contribution from different accounting periods." It appears to me that Witness
17 Seidman's testimony is at odds with both the Commission's view of margin reserve and
18 his own testimony. In his own testimony, at page 17, he indicates that the margin reserve
19 component of used and useful wastewater treatment plant should be the equivalent of five
20 years annual growth. The margin reserve is, in his opinion and in the opinion of the
21 Commission, an addition to used and useful capacity necessary to serve some future
22 annual growth. The Commission has the view that the margin reserve should be sufficient

1 to serve customer growth for 18-months past the end of the test year. The Commission
2 then concludes that it is appropriate to match that future capacity utilization with the
3 average CIAC, which the Company will receive as a result of that additional capacity
4 being utilized.

5
6 However, according to Mr. Seidman's testimony, he views margin reserve as currently
7 utilized and currently necessary for the service of current customers, while at the same
8 time indicating that the reserves should be calculated considering future growth. This
9 seems to be entirely inconsistent with his theory that there is an accounting mismatch
10 between the addition of margin reserve to used and useful capacity and the calculation of
11 imputed CIAC against that margin reserve.

12
13 It is clear that the appropriate view is that of the Commission. We are dealing with
14 hypothetical growth in the future when we add margin reserve to used and useful capacity;
15 therefore, it is also appropriate to use hypothetical CIAC which would be received as a
16 result of that capacity actually becoming used and useful. Rather than the Commission
17 being wrong as to the proper matching of accounting periods, the Company's witness is
18 wrong as to what period the CIAC is attempting to match against the investment.

19
20 Q. MR. SEIDMAN CLAIMS THAT IF CIAC IS IMPUTED AGAINST MARGIN
21 RESERVE, THEN THE COMPANY WILL NOT RECEIVE A RETURN ON ITS
22 INVESTMENT. WOULD YOU PLEASE RESPOND?

1 A. Yes. If the Company has investments made in plant which will not be utilized until some
2 future period, it has the authority to record an allowance for funds prudently invested
3 (AFPI). AFPI allows a carrying cost to be recorded on that unutilized or non-used or
4 useful plant until it is actually used to serve customers. AFPI allows the Company to
5 properly match the carrying cost with the customers that the plant will actually serve. To
6 include a margin reserve which would be utilized to service future customers in current
7 rates without offsetting that amount by CIAC would result in current customers
8 subsidizing future customers who will receive service from the plant. It should also be
9 kept in mind that CIAC actually returns all or part of the utility's investment in plant to the
10 utility. Future customers will make that contribution to the utility, not current customers.
11 Additionally, it is the Company's choice to include margin reserve in the ratemaking
12 process. The Company could choose to exclude margin reserve in rates and instead
13 accumulate AFPI on the related plant.

14
15 The current customer is only utilizing the capacity as calculated in the actual flows during
16 the test year. The addition of margin reserve allows for future customer additions. To
17 require a current customer to pay the carrying charge for a plant that will be utilized to
18 service a future customer creates intergenerational inequity. In other words, current
19 customers are subsidizing plant utilized by future customers. The proper way to fund
20 current investment that will be utilized in a future period is through AFPI, not through the
21 creation of a phony margin reserve based on an exorbitant number of future customers
22 without the imputation of CIAC in order to give the Company a current cash return. The

1 Company's approach is inequitable to current customers. It shifts the risk of the plant not
2 actually being utilized at any point in the future from the Company to current customers.
3 The risk of determining what capacity plant should be constructed and when it will be
4 utilized is a risk that should be borne by the Company and its stockholders who earn a
5 "risk premium" on their investment. Current customers do not plan, construct nor operate
6 wastewater facilities; they have no knowledge of what amount of capacity would be
7 utilized at any point in time. To include any margin which causes current ratepayers to
8 pay a rate of return on plant which is not utilized specifically for their own service results
9 in current ratepayers bearing the risk of paying a cash return for plant which may not be
10 utilized by future customers and for which they themselves receive no service. This is
11 clearly not the purpose or intent of regulation.

12
13 Q. WHEN DISCUSSING IMPUTING CIAC RELATED TO THE MARGIN RESERVE
14 ON PAGE 20 OF HIS TESTIMONY, MR. SEIDMAN STATES: "THE RESULT IS
15 THAT THE UTILITY IS DENIED THE OPPORTUNITY TO EVER EARN A
16 RETURN ON ITS INVESTMENT." DO YOU AGREE WITH THAT STATEMENT?

17 A. No, I do not. One need only look at the Commission's discussion of CIAC and the margin
18 reserve associated with that CIAC to conclude that the Company is not harmed. In fact,
19 in most instances, the Company will earn more than its authorized rate of return under a
20 scenario where margin reserve is included without a CIAC offset.

21
22 Q. WOULD YOU PLEASE EXPLAIN?

1 A. On page 10 of the Commission's PAA, the Commission discusses the imputation of the
2 CIAC related to the margin reserve. The Commission states that its calculation of the
3 margin reserve would add \$50,733 to the rate base. This would represent the margin
4 reserve associated with the addition of 109 ERCs. The Commission's calculations
5 determine that these additional ERCs would be added in the next 1.5 years. According to
6 the Commission's calculations the Company, during that same period of time, would
7 collect CIAC in the amount of \$135,220. This is 166% greater than the margin reserve
8 which the Commission states is necessary to service additional customers in the next 18
9 months. If the 109 ERCs are added ratably over the next 18 months, the Company would
10 have collected all of the margin reserve of \$50,733 in the first seven months after rates are
11 established. After that point, every new customer added decreases the Company's
12 investment, as determined by the Commission during the test year. The utility is still
13 earning at the level that the Commission established seven months earlier, but its
14 investment is decreasing each and every month after, so it is earning in excess of the
15 authorized rate of return in each accounting period after the first seven months. If rates
16 are never reestablished, the Company continues to over-earn because the investment is
17 overstated by the amount in excess of margin reserve. Consequently, Mr. Seidman's
18 statement that the utility will be denied the opportunity to ever earn a return on its
19 investment is blatantly incorrect. In fact, it will over earn based on the test period on
20 which rates are established. The ratepayer will never receive credit for the additional
21 CIAC until the next rate case. That additional CIAC will always flow to the benefit of the
22 Company and its stockholders.

1 Under Mr. Seidman's scenario, the utility would have an additional \$50,000 of investment
2 earning a rate of return after the Company has fully recovered its investment, then the
3 utility would continue to earn on that additional \$50,000 up until the time rates are
4 reestablished.

5
6 Curlew Road, US-19 and Belcher Road Main Relocation

7 Q. WOULD YOU PLEASE DISCUSS THE PROJECT RELATED TO THE CURLEW
8 ROAD, US-19 AND BELCHER ROAD MAIN RELOCATION WHICH MR. WENZ
9 DESCRIBES IN HIS TESTIMONY AS NON-CONTROVERSIAL?

10 A. In his direct testimony, on page 8, Company Witness Wenz describes this as a non-
11 controversial adjustment. His adjustment, which he describes as more or less a correction
12 of a mistake, effectively includes all construction work in progress in plant in service as if
13 it had been in service since January 1, 1996. Mr. Wenz describes the entire amount of
14 construction work in progress of \$296,659 as the cost associated with the relocation of
15 the Curlew Road, US-19 and Belcher Road main project.

16
17 As Schedule 1 of Exhibit___(HL-1), I have included the Company's schedule from its
18 MFRs which details the amounts associated with the \$296,659 of construction work in
19 progress. As can be seen by an examination of the details of that schedule, the entire
20 amount of \$296,659 is not associated with the Curlew Road, US-19 and Belcher Road
21 main relocation. Only \$195,891 of the amount is associated with that project. These
22 amounts are shown on lines 2 and 3 of the schedule and are explained in the description of

1 the projects on the same line numbers in the description at the bottom of the page. The
2 other projects, which comprise the remaining \$100,768, are not identified as being
3 associated with the relocation project. Thus, I assume these are capital expenditures for
4 normal repair and replacement projects. If this is correct, then these projects should be
5 either included as a test year average balance or totally excluded from the rate base for
6 1996 because: (1) they were not in service and did not provide benefit to the ratepayer;
7 and (2) they represent on-going replacement and repairs which would normally occur in
8 any accounting period.

9
10 Replacement and repair projects take place on an ongoing basis, and are regularly in some
11 phase of the process. Each phase in the process is reflected by the appropriate accounting
12 entry. A test year generally should be limited to the transactions of a particular 12-month
13 period and is intended to be representative of a company's ongoing operations. Any given
14 test year is likely to have a certain amount of CWIP related to various projects before they
15 are closed to plant-in-service. Unless there is a compelling reason to do otherwise, the
16 average balance of CWIP is more representative of the operations associated in an average
17 test year (just as revenue from an average number of customers is used, rather than year-
18 end; CIAC collections are on an average basis, rather than year-end).

19
20 Accordingly, since the utility has not identified any valid reason to treat the \$100,768 in a
21 special way, it should have been treated as CWIP is normally treated. This CWIP should
22 either have been excluded from rate base and allowed AFUDC, or it should have been

1 included as an average, rather than year-end, basis.

2
3 Key-Man Life Insurance

4 Q. WOULD YOU PLEASE DISCUSS THE KEY-MAN LIFE INSURANCE ISSUE?

5 A. The Staff removed \$3,983 from allocated expenses for various insurance costs, which the
6 Staff properly concluded should be paid for by stockholders. Company Witness Wenz
7 claims that the Staff has the wrong dollar amount, and that the amount which should have
8 been excluded is only \$1,876. I have included as Schedule 2 to Exhibit ___ (HL-1) the
9 Staff calculation of the allocated expenses. It seems clear that the Staff has examined the
10 total Company insurance expense and has shown the allocation percentage to Mid-
11 County. Staff appears to have calculated the correct dollar amount. Mr. Wenz has
12 presented no evidence which controverts the Staff calculation of the items which should be
13 excluded from above-the-line expenses. I, therefore, recommend that the Commission
14 exclude the full \$3,983, which I believe the Staff correctly excluded from cost allocated to
15 ratepayers.

16
17 Allocation of Common Costs

18 Q. COMPANY WITNESS WENZ HAS TAKEN EXCEPTION TO THE COMMISSION'S
19 ADOPTION OF THE STAFF'S RECOMMENDED ALLOCATION METHODOLOGY
20 FOR COMMON COSTS. WOULD YOU PLEASE DISCUSS THAT ISSUE?

21 A. Mr. Wenz discusses the allocation methodology recommended by Mid-County on pages
22 10 through 13 of his direct testimony. Mr. Wenz provides no additional evidence which

1 refutes the Commission's concern regarding this allocation methodology. Essentially, Mr.
2 Wenz's testimony argues that this is the way the Company has done it in other
3 jurisdictions, and this is the way we have done it in other utilities in the State of Florida;
4 therefore, the Commission should ignore the Staff's analysis which clearly shows that this
5 allocation methodology results in an unfair and substantial increase in an allocated cost to
6 the customers of Mid-County.

7
8 The Company witness fails to refute the Staff's contention that counting each apartment
9 or mobile home resident as a customer clearly overstates the customer equivalence when
10 converted to ERCs or compared to consumption on a customer basis. The Staff's analysis
11 shows that Mid-County is unique in its customer base. It contains more master metered
12 customers than the other entities in Florida. Therefore, the customer equivalent allocation
13 methodology which the Commission has accepted for other sister companies of Mid-
14 County results in a distortion when applied in the Mid-County rate case. It is not enough
15 for the Company to contend that the Commission has used this methodology elsewhere. It
16 is not enough for the Company to contend that it is used in other jurisdictions. It is
17 incumbent upon the Company to show that its proposed allocation methodology results in
18 a fair allocation of expenses to Mid-County customers when compared to the
19 Commission's accepted ERC allocation methodology. The Company has failed to do that.
20 It cannot be permitted to just argue that you have accepted this elsewhere, we've used it
21 elsewhere, therefore you ought to accept it. The Commission must focus on a results
22 oriented methodology and compare that methodology to what other similarly situated

1 utilities would be allocated under similar circumstances. The Staff analysis clearly shows
2 that the methodology proposed by Mid-County results in over-allocation of expense to
3 this utility and is the primary underlying basis for the increase requested in this docket. It
4 is my opinion that the Staff analysis justifies the allocation it made, which is the one
5 adopted by the Commission in the PAA. Consistent with the Staff analysis, the
6 Commission should reject the Company's protest of the PAA as it relates to the allocation
7 of parent company costs.

8
9 Rate Case Expense

10 Q. ON PAGE 13 OF MR. WENZ'S TESTIMONY, HE REQUESTS AN INCREASE IN
11 RATE CASE EXPENSE. WHAT IS YOUR POSITION ON THIS REQUESTED
12 INCREASE IN RATE CASE EXPENSE?

13 A. It is my position that the Commission should deny any increase in rate case expense over
14 that authorized in the PAA. It is not clear from Mr. Wenz's testimony, since no detail was
15 provided, where the cost increases are being incurred. The Commission authorized the
16 amortization of \$94,959 of rate case expense in the PAA issued April 16, 1998.

17 According to Mr. Wenz's testimony, on page 13, line 22, the Company's schedules
18 include the amortization of \$151,779 of rate case expense. This is \$56,820 higher than the
19 amount authorized in the PAA.

20
21 Q. WHY SHOULD THE INCREASE BE DENIED?

22 A. The Company's protest, in this instance, seeks to reargue issues that the Commission has

1 decided in the past or has concluded, based on an analysis, that such costs are
2 inappropriate for ratepayers to pay. The Company protested the Staff's disallowance of
3 insurance cost, but provided no evidence that the Staff calculations were in error. The
4 Company stated Staff has the wrong insurance cost. The Staff received their information
5 from the Company, so if it is in error, the Company was at fault. The issues related to
6 used and useful calculations, margin reserve and imputed CIAC are included in the PAA
7 based on prior Commission precedent. For the Company to reargue those issues, and
8 attempt to charge ratepayers for the expense associated with its rearguing, is egregious.
9 The issues related to CWIP are factual in nature and could have been determined or
10 clarified through a conference with the Staff as to the proper treatment that the Staff
11 intended. In any case, it is clear that CWIP, which Mr. Wenz claims is related to the
12 relocation of water mains, is in large part related to normal repair and replacement
13 projects which should not be included in the rate base.

14
15 Finally, the issue of the common cost allocation methodology does not provide the
16 Commission with any additional information. Mr. Wenz just reargues the Company
17 methodology, restating facts already known to the Commission. The Commission knew
18 the Company used this methodology in other water company cases within the state. The
19 Commission analyzed that fact and determined that it was not appropriate to use the same
20 methodology for this particular utility. The Commission knew the Company used this
21 methodology in other states; that fact has little or no impact in the State of Florida.

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This case was entirely unnecessary, given the invalidity of almost all of the issues raised by the Company. The only two issues raised by Mid-County that merit any serious consideration are (1) the CWIP treatment for the road widening projects and (2) the key man insurance.

My understanding is that from the start, the Staff has been willing to accept Mid-County's proposed treatment for the CWIP associated with the road-widening. Since its intervention, the Office of Public Counsel likewise has been willing to accept Mid-County's proposed treatment (despite some legitimate counter arguments that can be raised) of the CWIP that is shown to be part of the road-widening projects.

My understanding is that from the start, Staff has been willing to examine any evidence that the insurance expense sought by Mid-County is in compliance with the concerns raised by the audit exception. The Public Counsel also has been willing to concede the issue that if Mid-County shows that the customers would be the beneficiaries of insurance proceeds, then they should bear the premiums. Thus far, however, Mid-County has made no such demonstration.

The point is that there was never a need for a hearing for Mid-County to obtain a favorable resolution to these two issues.

1 The only reason this case is proceeding to a hearing is for Mid-County to pursue two
2 other major issues: (1) margin reserve/CIAC imputation, and (2) allocation of common
3 costs. As shown earlier in this testimony, as well as in the Staff analysis, both of these
4 issues are meritless. The cost for Mid-County to pursue these meritless issues, therefore,
5 should be borne by the utility, rather than its customers.

6
7 To request an increase in rate case expense of over 50% of that authorized by the
8 Commission without raising substantial issues or presenting new evidence attempts to
9 unjustly place the burden upon ratepayers. In addition, it should be pointed out that the
10 Company's MFRs had to be resubmitted because they did not meet the filing requirements
11 of the Commission Staff. This additional expense has, in part, been allowed by the
12 Commission, even though, in my mind, this is an expense which should be borne by the
13 Company's stockholders due to the failure of the Company to provide the proper
14 documentation as required in the minimum filing requirements.

15
16 In addition, it should also be pointed out that the rate case expense allowed by the
17 Commission in the PAA of \$94,959 includes additional rate case expense from the prior
18 docket in the amount of \$44,753. The additional rate case expense in the prior docket
19 was incurred as a result of a protest filed by a developer, Suntech, Inc. The developer's
20 protest was limited to the service availability charges. In other words, the developer's
21 protest was self-centered, it related to the developer's ability to sell future lots within the
22 service territory of Mid-County. However, the additional rate case expense is now being

1 placed upon the current ratepayers who receive no benefit from Suntech's protest. Thus,
2 the Commission's determination of rate case expense in the PAA was eminently fair to the
3 Company. It allowed the Company to recover rate case expense incurred by a developer
4 who had a vested interest in future development not related to providing service to the
5 current customers. The future development would also add to the customer growth, while
6 having no affect on cost incurred to service the customers on-line when those rates were
7 established. To summarize, I would recommend that the Commission not allow any
8 increase in rate case expense beyond that authorized in the PAA.

9
10 Range of Return on Common Equity

11 Q. WHAT RECOMMENDATION ARE YOU MAKING TO THE COMMISSION IN
12 REGARDS TO THE RETURN ON COMMON EQUITY?

13 A. The Commission issued a new authorized range of return on common equity for water and
14 wastewater utilities on July 6, 1998, in Docket No. 980006-WS, Order No. PSC-98-0903-
15 FOF-WS. The range of return on common equity in that Order was a low of 8.57% to a
16 high of 9.85%, with a mid-point being 9.21%. The Commission should reflect the current
17 cost of capital in the capital structure of Mid-County. This is the current return on equity
18 which would allow the Company stockholders a fair rate of return in current market
19 conditions. It will reduce the overall rate of return authorized in the PAA from 9.34% to
20 8.91%. Again, this is an appropriate adjustment because it reflects the current authorized
21 rate of return on equity and reflects the Company's current cost for that component of
22 rates.

1

2 Q. DOES THAT CONCLUDE YOUR TESTIMONY?

3 A. Yes, it does.

Docket No. 971065-SU
 Exhibit _____ (HL-1)
 Schedule 1
 Witness Hugh Larkin, Jr.

Schedule of Construction Work in Progress

Company: Mid-County Services, Inc.
 Docket No.: 971065-SU
 Schedule Year Ended: 12/31/96
 Interim Final

Florida Public Service Commission
 Schedule: A-6
 Page 3 of 4
 Preparer: FPG

Line No.	Account Name	Cost
1	Collection Sewers -Force	10,000
2	Collection Sewers -Force	107,891
3	Collection Sewers -Force	88,000
4	Treatment & Disposal Equipment	24,000
5	Treatment & Disposal Equipment	21,904
6	Collection Sewers -Force	9,900
7	Collection Sewers -Force	12,584
8	Collection Sewers -Force	16,000
9	Treatment & Disposal Equipment	6,280
	Total	296,659
	Adjusted Average Balance	148,330

Description of Projects in Progress:

- 1 Replaced Prunket Village Force Main.
- 2 Relocate sanitary sewer lines along Curlew Road east of US-19.
- 3 Relocate sanitary sewer lines along Belcher Road.
- 4 Remove sand and grit from the WWTP tanks.
- 5 Replace existing office with pre fabricated unit and overlay entrance road to plant through Doral Mobile Home Park.
- 6 Clean and televisc portion of sewer lines impacted by telephone cable installation.
- 7 Replace broken sewer main in the 580 Mobile Home Park.
- 8 Replace broken sewer main serving Republic bank.
- 9 Replace valve, check valves and add emergency pump around to Spanish Pine L/S.

0010B

Docket No. 971065-SU
 Exhibit _____ (HL-1)
 Schedule 2
 Witness Hugh Larkin, Jr.

Exception No. 2**Subject: Allocated Miscellaneous Nonutility Expense**

Statement of Fact: The company recorded an allocation from the parent company of \$3,982.83 for 1996 Insurance Expense, Account No. 759. 43-15
2 p 2 U

Included in insurance expense are costs for life insurance policies for officers and key employees in which the company is the beneficiary. Also, included in insurance expense are costs for fiduciary policies protecting directors, officers, and pension funds.

Per NARUC, Class B, Account No. 426 Miscellaneous Nonutility Expense,

This account shall contain all expenses other than expenses of utility operations and interest expense. Items which are included in this account are . . . :

7. Life insurance on officers and employees where utility is beneficiary

Recommendation: The purpose of these policies is to protect the company and do not demonstrate a clear benefit to the ratepayers. The company should reclassify \$3,982.83 as scheduled below.

	<u>1996</u> <u>Ins. Expense</u>	<u>Allocation</u> <u>Rate</u>	<u>Debit</u>	<u>Credit</u>
Acct. No. 426 Miscellaneous Nonutility Exp			\$ 3,982.83	
Acct. No. 759 Insurance-Other				
43-15 2 p 2 U Keyman Life Insurance.	\$ 28,588.34	3.249%		\$ 928.94
Life Insurance	21,749.71	3.249%		706.73
Director/Officer Liability	53,495.28	3.249%		1,738.25
ESOP & Pensions	9,526.03	3.249%		309.53
Accidental/Death Travel	9,213.57	3.249%		299.38

**CERTIFICATE OF SERVICE
DOCKET NO. 971065-SU**

I HEREBY CERTIFY that a true and correct copy of the foregoing Direct Testimony of Hugh Larkin, Jr., has been furnished by U.S. Mail or *hand-delivery to the following parties, this 22nd day of March, 1999.

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