

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Application for Increase  
in Wastewater Rates in Monroe  
County by KW Resort Utilities  
Corp. \_\_\_\_\_/

DOCKET NO. 070293-SU

Filed: December 17, 2007

**DIRECT TESTIMONY**

**OF**

**KIMBERLY H. DISMUKES**

**ON BEHALF OF  
OFFICE OF PUBLIC COUNSEL**

**CONFIDENTIAL**

**DECLASSIFIED**

*mm 7-14-08*

Respectfully Submitted,

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CONFIDENTIAL DN 10990-07  
FILED BY OPC TO BE TREATED AS  
CONFIDENTIAL PENDING RECEIPT OF  
REQUEST FOR CONFIDENTIALITY FROM  
COMPANY.

DOCUMENT NUMBER-DATE

10990 DEC 17 5 *mm*

FPSC-COMMISSION CLERK

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1 **I. Introduction**

2  
3 **Q. WHAT IS YOUR NAME AND ADDRESS?**

4 A. Kimberly H. Dismukes, 6455 Overton Street, Baton Rouge, Louisiana 70808.

5 **Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?**

6 A. I am a partner in the firm of Acadian Consulting Group, which specializes in the  
7 field of public utility regulation. I have been retained by the Office of the Public  
8 Counsel ("OPC") on behalf of the Citizens of the State of Florida to analyze the  
9 application of KW Resort Utilities, Corp. ("KWRU" or the "Company" or the  
10 "Utility") for increased rates for its wastewater system in Monroe County, Florida  
11 ("County").

12 **Q. DO YOU HAVE AN APPENDIX THAT DESCRIBES YOUR**  
13 **QUALIFICATIONS IN REGULATION?**

14 A. Yes. Appendix I, attached to my testimony, was prepared for this purpose.

15 **Q. DO YOU HAVE AN EXHIBIT IN SUPPORT OF YOUR TESTIMONY?**

16 A. Yes. Exhibit No. KHD-1 contains 16 schedules that support my testimony.

17 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

18 A. My testimony is organized into 10 sections. Section one is an introduction.  
19 Section two summarizes my recommendations. The background of the proceeding  
20 is discussed in section three, followed by an examination of the Company's  
21 affiliates in section four. Section five addresses the Company's agreements and  
22 transactions with Monroe County, Florida. Section six discusses adjustments to  
23 rate base. My recommended adjustments to the Utility's revenue and expenses are



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1 detailed in sections seven and eight, respectively. In section nine I discuss the  
2 Florida Public Service Commission ("FPSC") Staff's audit adjustments. Finally,  
3 in section ten I present the revenue requirement resulting from the adjustments  
4 that have been proposed by the Citizens' witnesses thus far in this proceeding.

5 **Q. WHO ARE THE WITNESSES FOR THE OPC IN THIS PROCEEDING?**

6 A. The Citizens are sponsoring two witnesses. I am testifying on revenue  
7 requirement issues. Mr. Andrew Woodcock is testifying on engineering issues.

8 **II. Summary of Recommendations**

9

10 **Q. WOULD YOU PLEASE SUMMARIZE YOUR RECOMMENDATIONS?**

11 A. Yes. Schedule 1 of my exhibit sets forth each of the adjustments that I  
12 recommend. As shown on this Schedule, the revenue requirement impact of  
13 these adjustments produces a rate reduction of \$827,062. This compares to the  
14 Company's requested rate increase of \$601,684.

15 My analysis indicates that the Company's expenses are overstated due in  
16 part to its relationship with its affiliates, inappropriate marks-ups for direct costs  
17 from affiliates, the overstatement of costs associated with the upgrade to  
18 Advanced Wastewater Treatment (AWT) at the South Stock Island facility,  
19 excessive travel charges from the owner of the Utility, inclusion of inappropriate  
20 public relations expenses and the inclusion of abnormally high expenses in the  
21 test year.

22 My examination also shows that the Company's rate base is overstated  
23 due to inappropriate charges to the South Stock Island facility and the AWT plant

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1 related to unsupported and undocumented payments to affiliates of the Utility. In  
2 addition, Mr. Woodcock has found the Company's treatment facilities to be only  
3 72.14% used and useful.

4 Test year revenue is understated because the Company failed to include  
5 revenue related to services provided to Monroe County and it understated rent  
6 revenue.

7 **III. Overview of Company Filing**

8  
9 **Q. WOULD YOU PLEASE PROVIDE A BRIEF SUMMARY OF THE**  
10 **PROPOSED RATE INCREASE IN THIS PROCEEDING?**

11 A. KWRU is a Class A Utility providing wastewater service to approximately 1,556  
12 customers in Key West, Florida. In the instant application the Company proposes  
13 to increase wastewater revenue by \$601,684, representing an increase of 58%.

14 According to the Company, KWRU has not sought full rate relief since  
15 1985. However, they have availed themselves of the Commission's pass-through  
16 and indexing increases. The Company's proposed test year is the historic year  
17 ending December 2006.

18 **Q. WHAT DOES THE COMPANY CLAIM ARE THE REASONS FOR THE**  
19 **REQUESTED RATE INCREASE?**

20 A. KWRU claims that its rate request is driven largely by four issues as detailed in  
21 Mr. Smith's pre-filed direct testimony.

22 First, KWRU recently resleeved their collection lines because of  
23 substantial infiltration. The Company claims the degradation had impacted the

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1 ability to properly treat effluent and utilize the treated effluent for reuse purposes.

2 According to the Company, the project was completed in early 2007 at a cost of  
3 approximately \$600,000.<sup>1</sup>

4 Second, the Company also began a project to refurbish the wastewater  
5 treatment plant because of the deterioration caused by the salt content in its  
6 environment. Construction began in 2006 and was slated to be completed by  
7 October 1, 2007.<sup>2</sup>

8 Third, the Company is also converting its facilities to Advanced Waste  
9 Treatment (AWT) at the request of Monroe County. The County has required all  
10 utilities operating in the Keys to convert to an AWT facility by 2010. The  
11 Company explains that the County has specifically requested it to convert prior to  
12 the 2010 deadline and has advanced it \$707,000 to complete the project before  
13 2010. Since much of the effort to convert to an AWT facility would be duplicated  
14 in the projects already undertaken, KWRU decided to undertake the conversion  
15 now.<sup>3</sup>

16 Fourth, the Company claims that increased operational costs, including  
17 significant staffing changes, will result from the change to AWT causing the need  
18 for additional revenue. The Company estimates the increased operating costs will  
19 amount to approximately \$288,625 per year.<sup>4</sup>

20  

---

<sup>1</sup> Smith Testimony, p. 3.

<sup>2</sup> Ibid., pp. 3-4.

<sup>3</sup> Ibid., p. 4-5.

<sup>4</sup> Ibid., p. 6.

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1 **Q. IS THE COMPANY PROPOSING ANY CHANGES TO ITS RATE**  
2 **STRUCTURE?**

3 A. Yes. KWRU requests to change its rate structure from a flat rate to a base facility  
4 charge and gallonage charge structure. The Company has been utilizing a flat rate  
5 charge for sewer service because it has been difficult to obtain water usage  
6 information from the water service provider Florida Keys Aqueduct Authority  
7 ("FKAA"). However, recently the Company has confirmed it will be able to  
8 obtain the necessary information to charge consumers using a base facility charge  
9 and a gallonage charge.<sup>5</sup>

10 **IV. Affiliate Transactions**

11  
12 **Q. WHY IS IT IMPORTANT TO CLOSELY EXAMINE AFFILIATE**  
13 **TRANSACTIONS?**

14 A. In a situation involving the provision of services between affiliated companies,  
15 the associated transactions and costs do not represent arms-length dealings. Cost  
16 allocation techniques and methods of charging affiliates should be frequently  
17 reviewed and analyzed to ensure that the company's regulated operations are not  
18 subsidizing the non-regulated operations. Because of the affiliation between  
19 KWRU and the affiliates that contribute to most of the expenses included on the  
20 books of KWRU, the arms-length bargaining of a normal competitive  
21 environment is not present in their transactions. Although each of the affiliated  
22 companies is supposedly separate, relationships between KWRU and its affiliates

---

<sup>5</sup> Ibid.

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1 are extremely close—all have common owners or are related by family members.

2 In the absence of regulation, there is no assurance that affiliate  
3 transactions and allocations will not translate into unnecessarily high charges for  
4 KWRU's customers. Even when the methodologies for pricing have been  
5 explicitly stated, close scrutiny of affiliate relationships is still warranted.  
6 Regardless of whether or not the Utility explicitly establishes a methodology for  
7 the allocation and distribution of affiliate costs, there is an incentive to  
8 misallocate or shift costs to regulated companies so that the unregulated  
9 companies can reap the benefits.

10 **Q. DOES THE COMMISSION HAVE ANY GUIDELINES WHICH**  
11 **CONTROL THE PRICING ARRANGEMENTS BETWEEN UTILITIES**  
12 **AND THEIR AFFILIATES?**

13 A. Yes. The Commission has expressed its opinion on affiliate transactions and the  
14 precedent that should be followed when examining affiliate transactions.

15 By their very nature, related party transactions require closer  
16 scrutiny. Although a transaction between related parties is not per  
17 se unreasonable, it is the utility's burden to prove that its costs are  
18 reasonable. Florida Power Corp. v. Cresse, 413 So. 2d 1187, 1191  
19 (Fla. 1982). This burden is even greater when the transaction is  
20 between related parties. In GTE Florida, Inc. v. Deason, 642 So.  
21 2d 545 (Fla. 1994) (GTE), the Court established that the standard  
22 to use in evaluating affiliate transactions is whether those  
23 transactions exceed the going market rate or are otherwise  
24 inherently unfair.<sup>6</sup>

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<sup>6</sup> In re: Investigation of rates of Aloha Utilities, Inc. in Pasco County for possible overearnings for the Aloha Gardens water and wastewater systems and the Seven Springs water system; Order No. PSC-01-1374-PAA-WS; Issued: June 27, 2001.

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1 Q. HAS THE COMPANY PRESENTED ANY TESTIMONY OR ANALYSIS  
2 TO SHOW THAT THE CHARGES FROM ITS AFFILIATES ARE  
3 CONSISTENT WITH THE GOING MARKET RATE?

4 A. No, it has not.

5 Q. WOULD YOU PLEASE DESCRIBE THE OWNERSHIP OF KWRU?

6 A. Yes. An organizational chart of the Company and its affiliates is shown on Schedule  
7 2 of my exhibit. As shown on Schedule 2 and explained in response to Citizens'  
8 Interrogatory 29: "WS Utility is the sole shareholder of KWRU." WS Utility, Inc.,  
9 holds the financing note of KWRU, and is owned by Mr. William L Smith, Jr.,<sup>7</sup>  
10 (70%), his daughter Mrs. Leslie Johnson (10%), and his sons Messrs. Barton  
11 Smith (10%) and Alexander Smith (10%).<sup>8</sup>

12 Q. WOULD YOU PLEASE PRESENT ALL BUSINESS INTERESTS AND  
13 AFFILIATE RELATIONSHIPS OF MR. WILLIAM SMITH, JR?

14 A. Yes. Mr. Smith owns several businesses. According to the Company's response to  
15 Citizens' Interrogatory 28, Mr. Smith is "an owner, partner, employee, stock  
16 holder, officer, director, secretary or treasurer" in each of the following  
17 companies. In addition, other companies are listed below where a family member  
18 is an owner and that company provides services to the Utility.

- 19           • KW Resort Utility Corporation (owned 100% by WS Utility, Inc.)  
20           • WS Utility, Inc. (70% ownership)  
21           • Green Fairways (100% ownership)  
22           • Key West Golf Club (Owned 78% by Gwen Smith, Mr. Smith's wife)  
23           • Keys Environmental, Inc. (100% owned by Chris Johnson, Mr. Smith's

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<sup>7</sup> Throughout this testimony, reference to Mr. Smith, Mr. William Smith, and Mr. William L. Smith, Jr., all refer to the same person—the owner of the Utility.

<sup>8</sup> Responses to Citizens' Interrogatories 7 and 29.



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- 1 son-in-law)
- 2 • Johnson Constructors (50% owned by Chris Johnson, son-in-law of Mr.
- 3 Smith)
- 4 • Smith, Hemmesch & Burke (partner)
- 5 • Benicia Partners, LLC (20.5% ownership)
- 6 • 900 Commerce (83%)
- 7 • Courtland Court (50% ownership)
- 8 • Smith & Kreisler (50% ownership)
- 9 • Antioch Golf, LLC (10% ownership)
- 10 • Rail Golf, LLC (65% ownership)
- 11 • Deer Creek Golf, LLC (75% ownership)
- 12 • Gulf County Land, LLC (33% ownership)
- 13 • Norcor Tradewinds, LLC (1% ownership)
- 14 • Norcor Caldwell, LLC (1% ownership)<sup>9</sup>
- 15

16 According to the Company, Green Fairways, Inc. ("Green Fairways")

17 provides management, construction and financing services for Deer Creek Golf

18 LLC, The Rail Golf LLC, Key West Golf Club, Benicia Partners LLC, Cortland

19 Court Partnership, 900 Commerce Partnership, and KW Resort Utilities, Corp.

20 Green Fairways has no ownership in any of these companies, but Mr. Smith

21 does.<sup>10</sup>

22 **Q. DO ANY OF THE ABOVE COMPANIES PROVIDE SERVICES TO**

23 **KWRU?**

24 **A.** Yes. According to the agreement between Green Fairways, Inc. and the Company,

25 Green Fairways owned 100% by Mr. Smith, provides "management, construction

26 and financing services" to KWRU.<sup>11</sup> Mr. Smith is also a partner and attorney for

27 the law firm Smith, Hemmesch & Burke, which sometimes provides legal

---

<sup>9</sup> Response to Citizens' Interrogatory 28, 29, and 76.

<sup>10</sup> Response to Citizens' Interrogatory 7.

<sup>11</sup> Ibid.

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services to the Utility.<sup>12</sup> In addition, Mr. Smith has an 83% ownership interest in 900 Commerce, from which the Utility purchased a generator in 2005.<sup>13</sup> Key West Golf Club ("KWGC"), 78% of which is owned by Mrs. Smith, provides administrative services to the Company. Keys Environmental, Inc. ("Keys Environmental" or "KEI") provides operations, maintenance, and repair services to the Utility and is owned by Mr. Chris Johnson (Mr. Smith's son-in-law).

**Q. ARE THE TRANSACTIONS BETWEEN THE COMPANY AND THESE AFFILIATES SIGNIFICANT?**

A. Yes. There are substantial transactions between the Company and its affiliates. The Utility has no employees. All functions associated with operating and managing it are performed by these affiliates—primarily KWGC and KEI. The table below depicts the charges to the Utility by each of these companies during the last three years.

<b>KWRU Affiliate Charges</b>			
<b>Affiliate</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Green Fairways	\$ 86,000	\$ 95,167	\$ 66,000
Key West Golf Club	71,140	120,802	120,437
Smith, Hemmesch, & Burke	19,748	-	-
Keys Environmental, Inc.	330,003	630,643	615,756
Johnson Constructors			100,496
<b>Total</b>	<b>\$506,891</b>	<b>\$ 846,612</b>	<b>\$ 902,689</b>

<sup>12</sup> Response to Citizen's Interrogatory 28.

<sup>13</sup> Responses to Citizen's Interrogatories 2 and 28.

1 In addition to these charges, the table below reflects the amounts paid to  
2 Green Fairways and Smith, Hemmesch, & Burke for construction management in  
3 prior years.  
4

Construction Management	Amount
Green Fairways Detention Center Mgmt Fee	\$ 32,198
Green Fairways SSI Project Mgmt Fee	75,000
Green Fairways SSI Project Mgmt Fee	226,180
Green Fairways SSI Project Mgmt Fee	11,281
Smith, Hemmesch, & Burke Legal Fee	25,000
Green Fairways AWT Mgmt Fee	111,375
<b>Total</b>	<b>\$ 481,034</b>

5  
6 **Q. LET'S DISCUSS EACH OF THESE COMPANIES SEPARATELY. WHAT**  
7 **PRODUCTS OR SERVICES ARE PROVIDED BY GREEN FAIRWAYS**  
8 **TO THE COMPANY?**

9 **A.** Green Fairways provides management services to the Company. It also provides  
10 management services to several other companies. In connection with the  
11 construction of the South Stock Island Project and the connection for the  
12 Detention Center, Green Fairways was paid to perform construction management  
13 services.

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1

2 **Q. WHAT COMPANIES DOES GREEN FAIRWAYS MANAGE BESIDES**  
3 **THE COMPANY?**

4 A. According to the Company's response to Citizens' interrogatories and the Staff  
5 Audit, Green Fairways provides services to the following companies.

6 Deer Creek Golf LLC  
7 Venetian Partners  
8 The Rail Golf LLC  
9 Key West Golf Club  
10 Benicia Partners LLC  
11 Portland Court  
12 Cortland Court Partnership  
13 900 Commerce Partnership<sup>14,15</sup>  
14

15 There are three employees of Green Fairways that assist in performing the  
16 management services for these companies. According to the Staff Audit, one  
17 person runs the golf courses, including Key West Golf Club, another person runs  
18 the office buildings, and Mr. Smith oversees all businesses.<sup>16</sup>

19 **Q. WHAT PRODUCTS OR SERVICES ARE PROVIDED BY SMITH,**  
20 **HEMMESCH & BURKE?**

21 A. This is a law firm operating in Illinois that charged the Company \$25,000 in 2002  
22 in connection with negotiating contracts for construction of the South Stock  
23 Island Project.  
24

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<sup>14</sup> Response to Citizens' Interrogatory 7.

<sup>15</sup> Staff Audit, p. 8.

<sup>16</sup> Ibid.

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1 Q. WHAT PRODUCTS OR SERVICES ARE PROVIDED BY 900  
2 COMMERCE?

3 A. In 2006, 900 Commerce sold the Company a generator for \$75,000. It does not  
4 appear that any services are provided to KWRU by this company.

5 Q WHY DID THE COMPANY PURCHASE A GENERATOR FROM 900  
6 COMMERCE?

7 A. According to the Company's response to Citizens' Interrogatory 2, the Company  
8 purchased a Kholer 750 KW generator from 900 Commerce on December 16,  
9 2005, and it sold a 150 KW Caterpillar generator for \$15,000 on July 31, 2006, to  
10 Key West Golf Club. The invoice for the 750 KW generator is reflected on  
11 Schedule 3. Also, as shown on this schedule, the Company's 2006 Annual Report  
12 shows that the Company sold a generator to KWGC for \$15,000 and the book  
13 value of the generator was \$25,500, for a loss of \$10,500. However, when asked  
14 about this in discovery the Company responded: 11/20/07 Supplement: "The  
15 Company's Annual Report does not report a loss on the disposal of the generator  
16 on its Income Statement."<sup>17</sup> While there may be no loss shown on the income  
17 statement, the Annual Report does in fact show that the asset was sold to an  
18 affiliate at less than book value. In response to Interrogatory 42, the Company  
19 explained why the generator was sold to KWCG:

20  
21 KWRU could no longer use its 200 KW generator to run our  
22 expanded vacuum system because it was inadequately powered.

---

<sup>17</sup> Response to Citizens' Interrogatory 42.

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1 KWGC purchased this generator at a fair market value of \$15,000  
2 to run its re-use irrigation system.<sup>18</sup>  
3

4 The Company explained the accounting entries were as follows:  
5

6 Investment: A decrease to plant in service of \$30,000; a decrease  
7 in accumulated depreciation of \$30,000; an increase in  
8 accumulated depreciation of \$15,000. This results in a net  
9 reduction to rate base of \$15,000.<sup>19</sup>  
10

11 **Q. WHAT DO YOU RECOMMEND WITH RESPECT TO THE**  
12 **TREATMENT OF THE SALE AND PURCHASE OF THESE**  
13 **GENERATORS?**

14 A. I recommend that the Commission treat the sale of the generator to KWGC as if it  
15 was sold at net book value. This ensures that ratepayers are not harmed by the  
16 affiliate transaction. Therefore, accumulated depreciation should be increased by  
17 \$10,500.

18 **Q. WHAT PRODUCTS OR SERVICES HAVE BEEN PROVIDED TO THE**  
19 **UTILITY BY JOHNSON CONSTRUCTORS?**

20 A. Johnson Constructors provided construction services to the Utility in 2006 when  
21 it permitted and constructed the clarifier at the AWT project.<sup>20</sup> Mr. Chris Johnson  
22 owns 50% of Johnson Constructors with his father Mr. Jim Johnson who owns  
23 50%.<sup>21</sup> According to the Company, "[o]n October 27, 2006 KWRU paid  
24 \$34,408.80 directly to Johnson Constructors on an invoice to Green Fairways for  
25 work performed for the Utility. The check, payable to both Green Fairways and

---

<sup>18</sup> Ibid.

<sup>19</sup> Ibid.

<sup>20</sup> Supplemental Response to Citizens' Interrogatory 7.

<sup>21</sup> Response to Citizens' Interrogatory 76.



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1 Johnson Constructors has been previously provided. There have been no other  
2 direct charges by Johnson Constructors to KWRU or payment by KWRU to  
3 Johnson Constructors.”<sup>22</sup> However, as discussed in greater detail below, Green  
4 Fairways billed KWRU for \$31,887 and \$34,200 on December 11, 2006 and  
5 November 6, 2006 for services performed by Johnson Constructors in connection  
6 with the AWT.<sup>23</sup>

7 **Q. WHAT PRODUCTS OR SERVICES ARE PROVIDED BY KEY WEST**  
8 **GOLF CLUB?**

9 A. Key West Golf Club provides management, accounting, and customer service  
10 functions to KWRU.<sup>24</sup> In response to Citizens’ Interrogatory 7, the Company  
11 stated that: “Key West Golf Course/Club does not own any companies, and only  
12 provides limited services to KWRU.”<sup>25</sup>

13 There are three employees of KWGC who provide services to the  
14 Company. These are Doug Carter, Gillian Sheifert, and Judi Irizarry. According  
15 to the Utility’s MFRs, Mr. Carter, KWGC General Manager, spends  
16 approximately 30% of his time on Utility work. He oversees the daily operations  
17 of KWRU. In this capacity he has daily contact with KEI and Mr. Smith and also  
18 has responsibility for new customer contracts and management of capital projects.  
19 Ms. Seifert, KWGC Chief Financial Officer, oversees all accounting functions for  
20 the Utility. Ms. Seifert spends approximately 50% of her time on utility matters.

---

<sup>22</sup> Response to Citizens’ Interrogatory 77.

<sup>23</sup> Response to Citizens’ POD 3.

<sup>24</sup> Responses to Citizens’ Interrogatories 7 and 29. During 2004, 2005, and 2006, Mrs. Smith owned 75% of KWGC.

<sup>25</sup> Response to Citizens’ Interrogatory 7.

1 Ms. Irizarry acts as the Customer Service Manager for the Utility, but is paid by  
2 the golf club. Ms. Irizarry manages utility accounting, performs daily banking  
3 tasks, performs filing and record keeping tasks associated with new connections,  
4 and does field service coordination with the service company, KEI. Ms. Irizarry  
5 spends almost<sup>26</sup> 100% of her time on utility matters.<sup>27</sup>

6 **Q. ARE YOU RECOMMENDING ANY ADJUSTMENTS TO CHARGES**  
7 **FROM KWGC?**

8 A. During the test year KWGC paid bonuses to its employees in the amount of  
9 \$12,038.<sup>28</sup> Part of the bonuses were for year-end bonuses and the remainder are  
10 characterized as EDU bonuses and are paid for each customer that is connected to  
11 the system. I do not believe that it is appropriate to pass these bonuses on to  
12 customers. The EDU bonuses are clearly designed to enhance the Company  
13 revenue and therefore benefits the stockholders. In addition, the Company pays  
14 KWGC a management fee of \$8,000 a month. Any bonuses paid to employees of  
15 the golf course should be covered in this fee.

16 **Q. WHAT PRODUCTS OR SERVICES ARE PROVIDED BY KEYS**  
17 **ENVIRONMENTAL, INC.?**

18 A. Keys Environmental, Inc. ("KEI" or "Keys Environmental") provides operational  
19 services to KWRU. This company essentially operates the plant and performs  
20 related maintenance services for the sewer treatment plant and collection system.

---

<sup>26</sup> In her deposition, Ms. Irizarry explained that when she performs banking and post office errands on behalf of the Utility she also performs the same task for the golf club.

<sup>27</sup> MFRs, Volume IV.

<sup>28</sup> Ibid.

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1 Mr. Christopher Johnson is president of KEI and is the son-in-law of KWRU  
2 President William Smith.

3 Key's Environmental, Inc. was started by Mr. Smith's son-in-law to  
4 service KWRU. The offices of KEI are located in the Utility owned trailer for  
5 which it pays the Utility \$24,000 annually. Key's Environmental also uses all of  
6 the Company's owned vehicles for which it pays no lease fees, but does pay for  
7 its gasoline and for vehicle maintenance. Key's Environmental bills the Utility  
8 for all purchases of supplies, chemicals, and sludge hauling.

9 The Key's Environmental contract indicates that the following services  
10 will be provided to the Company: periodic inspections and minor maintenance to  
11 keep the system in good condition; daily inspection of pumping stations;  
12 preventative maintenance programs; monitoring the collection systems, including  
13 lift stations, manholes, gravity lines, manholes, reclaimed water lines, meters,  
14 control panels, pumps, blowers and related equipment. The contract also states  
15 that KEI will do sampling and testing. Key's Environmental is also supposed to  
16 be responsible for customer complaints and handle all service disconnections.  
17 Keys Environmental is also responsible for pumping and hauling sewage at  
18 specific rates set forth in the contract and for jet rodding of sewer lines at a cost of  
19 \$1.00 per linear foot or \$100.00 per hour for on-site services such a pump station  
20 maintenance.

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1           The contract also provides for meter reading, answering services and  
2           dispatch services. Finally, the contract states that Keys Environmental will  
3           supervise and inspect new customer tie-ins.

4   **Q.   DOES THE CONTRACT SPECIFY HOW KEI IS COMPENSATED FOR**  
5           **ITS SERVICES OTHER THAN THE EXTRA ITEMS JUST**  
6           **MENTIONED?**

7   A.   No, it does not. However, there is a provision in the contract for compensation.  
8           Unfortunately, the amounts in the contract are blank. There appears to be no  
9           written arrangement between K W Resort Utilities, Corporation and KEI for the  
10          amount of compensation that KEI will be paid for operating and maintaining the  
11          Company's wastewater system. Such an open-ended arrangement would be  
12          unlikely in an arm's length arrangement and should be considered imprudent in  
13          the instant situation.

14   **Q.   DOES KEYS ENVIRONMENTAL HAVE ITS OWN EMPLOYEES?**

15   A.   Yes, it does. According to the Staff Audit, the contract between the Company and  
16          KEI requires that two full time operators and a manager work a minimum of eight  
17          hours a day on weekdays and two hours a day on weekends. In his deposition,  
18          Mr. Johnson testified that:

19               We have parttimers and fulltimers. Fulltime staff, including  
20               myself, six fulltime, a parttime administrator, 16 hours a week, and  
21               we have an instrument calibration technician who is very limited.  
22               We calibrate about two times a year. We call him in from time to  
23               time to troubleshoot.<sup>29</sup>  
24

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<sup>29</sup> Smith Deposition, p. 6.

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1 Q. IS THERE A CLEAR LINE OF DEMARCATION BETWEEN THE  
2 UTILITY AND KEYS ENVIRONMENTAL?

3 A. No, there is not. For all intents and purposes Keys Environmental functions as if it  
4 were the Utility. There are several facts that indicate that any distinction between  
5 the Utility and KEI is minor.

6 First, Keys Environmental uses all of the vehicles owned by the Utility,  
7 but pays no lease fee for their use. Since the Utility has no employees it is  
8 questionable why the vehicles are even owned by the Utility.

9 Second, Keys Environmental rents the Utility's trailer that is located at the  
10 sewer site but no employees of either the Utility or Key West Golf Club occupy  
11 the trailer.

12 Third, Mr. Doug Carter, who is the General Manager of the Utility and  
13 also works for the golf course, said in his deposition that he supervises Mr.  
14 Johnson, president of Keys Environmental, on certain utility issues.<sup>30</sup>

15 Fourth, Mr. Smith stated in his deposition that to the best of his knowledge  
16 all expenses of KEI are reflected on the books of the Utility.<sup>31</sup>

17 Fifth, the Utility pays a portion of Mr. Johnson's credit card bills where it  
18 is determined that the expenses relate to utility business.

19 Sixth, Mr. Johnson has approved payment to vendors that were paid by the  
20 Utility in connection with the purchase of a vehicle owned by the Utility.<sup>32</sup>

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<sup>30</sup> Carter Deposition, p. 19.

<sup>31</sup> Smith Deposition, p. 31.

<sup>32</sup> Response to Citizens' POD 28.

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1 Q. WHAT EXPENSES RELATED TO KEI WERE RECORDED ON THE  
2 BOOKS OF THE COMPANY DURING THE TEST YEAR?

3 A. During the test year, as shown on Schedule 4, KWRU recorded charges of  
4 \$615,756 from KEI. KEI charged the Utility \$630,643 in 2005 and \$330,003 in  
5 2004. The expenses charged to the Company during the test year include  
6 \$19,472 charged to sludge disposal, \$42,947 charged to chemicals, \$80,800  
7 charged to materials and supplies, \$384,588 charged to contractual services-other  
8 and \$1,866 charged to miscellaneous expenses.

9 Q. DO YOU HAVE ANY CONCERNS ABOUT THE CHARGES FROM KEI  
10 THAT ARE SHOWN ON THE BOOKS OF THE COMPANY?

11 A. Yes, I have several concerns. First, it appears that KEI is including a certain  
12 percentage mark-up on materials and supplies and chemicals that it purchases on  
13 behalf of the Company. This matter was discussed in the confidential portion of  
14 Mr. Johnson's deposition. Also, in response to Citizens' POD 28 the Company  
15 provided an invoice from KEI with a notation suggesting that certain charges are  
16 marked up over cost. Specifically, the invoice stated: "Pass Thru to KWRU No  
17 Mark-up Auto Accessory. KEI has 0 tangible property." I've attached this invoice  
18 as Schedule 5 of my exhibit. In response to a Staff Audit Request the Company  
19 provided additional workpapers for the electricity, chemicals and contract hauling  
20 expenses included in its proforma adjustment for the AWT. This workpaper,  
21 which is included as page 5 of Schedule 5, shows that the Company has included  
22 a 30% mark-up on chemicals and sludge hauling services provided by KEIs. In



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1 addition, the Company produced the invoice for chemicals that are included in  
 2 test year expenses. Rather than submit the actual invoice from the vendor, the  
 3 Company supplied the handwritten invoices from KEI with no supporting back up  
 4 documentation. All of this information strongly suggests that KEI charges the  
 5 Company more than it costs KEI to purchase the supplies. In my opinion, this is  
 6 inappropriate. For all intents and purposes KEI is the Utility and performs only  
 7 minor services for other entities. In addition, these services are a function of the  
 8 services it provides to the Utility. If KWRU purchased the chemicals and moved  
 9 the sludge, the Commission would not permit it to mark-up its expenses by more  
 10 than the actual costs. Because KEI is an affiliated party and is essentially an arm  
 11 of the Utility, I recommend that all mark-ups be disallowed.

12 While I do not have the precise amount for the expenses included in the  
 13 test year, I am providing a conservative estimate. I am assuming that KEI marked  
 14 up the amount of chemicals and sludge hauling expenses by 30% in the test year.  
 15 To remove this mark-up, I recommend that the Commission disallow \$33,826  
 16 from test year chemicals, materials and supplies, and sludge hauling expenses, as  
 17 shown in the table below. Citizens are requesting additional discovery on this  
 18 matter.

Account	Expenses Marked Up by KEI			
	Expense Amount	Adjustments	Net Amount after Prior Adjustments	Mark-up Disallowance
Chemicals	\$ 50,763	\$ (16,480)	\$ 34,283	\$ 7,913
Sludge Hauling	\$ 19,472	\$ (7,819)	\$ 11,653	\$ 2,690
Materials and Supplies	\$ 103,361	\$ (2,739)	\$ 100,622	\$ 23,224
<b>Total</b>	<b>\$ 173,596</b>	<b>\$ (27,038)</b>	<b>\$ 146,558</b>	<b>\$ 33,826</b>

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2 Q. WHAT IS YOUR NEXT CONCERN ABOUT KEYS ENVIRONMENTAL  
3 AND THE AMOUNTS CHARGED TO THE COMPANY?

4 A. I have concerns about the hook-up fees charge by KEI to customers of the Utility.  
5 It is unclear exactly what functions are being performed for this service. Even Mr.  
6 Smith and Mr. Johnson were unclear about how the cost of performing hook-ups  
7 and inspections were handled by the Utility. Mr. Smith discussed this in his  
8 deposition as follows:

9 Q. Thank you very much. I appreciate that. I want to move on to  
10 hookup fees and talk a little bit about that. What I understand is  
11 hookup fees are \$450 per connection for EDU?

12  
13 A. Didn't he say \$150?

14  
15 Q. I thought hookup fees to connect, the charge is \$450 per  
16 customer.

17  
18 A. I thought the testimony was \$50. Do you have notes on this?

19  
20 Q. I guess we can get to that.

21  
22 A. That will give you an idea of my knowledge.

23  
24 Q. Or mine.

25  
26 A. Okay.

27  
28 Q. Whatever the fee is, is Keys Environmental responsible for  
29 making sure these customers are hooked up?

30  
31 A. Yes.

32  
33 Q. Does Keys Environmental collect the connection fee from the  
34 customer?

35  
36 A. I don't know that. I believe KWRU collects the money.

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Q. As far as you know, would that money be recorded on the books of KWRU?

A. I believe it would be.

Q. Would you be able to --

A. But, I may be in error.

Q. Do you know what Keys Environmental, then, is paid for their service by the utility for this?

A. The management fee plus there was a list of other things. There are inspection fees. So long as you are refreshing his recollection, refresh mine, too.

MR. BURGESS: Marty, this is interrogatories, in response to Interrogatory 72.

Q. (BY MR. BURGESS) I will show it to you.

MR. BURGESS: Ralph, I have given Mr. Smith a copy of Interrogatory 72.

A. All right.

Q. (BY MR. BURGESS) It is \$450?

A. \$450 is what that answer says. I presume my staff got it right.

Q. I am sure they did. Is that an increase from what was charged in 2005 or prior years?

A. It said it was. If it said it was, it was.

Q. Do you know why it increased from \$350 to \$450 in '06?

A. It took more time, more effort. You heard Mr. Johnson explain what he had to do. There are 4 or 5 site visits.

Q. What I am trying to understand is, in the process how this works its way out into the account, both the cost to do it and the amount that is paid by the customer. I will get to the specific question. I am trying to understand, is it money collected by

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1 KWRU for the entire amount and treated as or how is it treated, or  
2 is it collected by Keys Environmental, and how is the expense  
3 associated with it paid by KWRU?

4  
5 A. I don't know the answer to that question.

6  
7 Q. So you wouldn't be able to lead me through an  
8 examination of how the money is collected?

9  
10 A. That is correct, I wouldn't be able to.

11  
12 Q. Do you know whether that hookup fee is approved by the  
13 Florida Public Service Commission?

14  
15 A. I have been advised it was.

16  
17  
18 Q. So therefore, has the increase been approved by the Florida  
19 Public Service Commission?

20  
21 A. I do not know.<sup>33</sup>

22  
23 The above exchange indicates that Mr. Smith is not clear on how these  
24 costs are recovered and recorded on the Company's book.

25 Mr. Johnson was also unclear on the question as set forth below.

26 Q. When a customer seeks to connect to KWRU system --  
27 let's say somebody right now that is currently on septic. Is  
28 Keys Environmental responsible for seeing to it that the  
29 connection is performed properly and is done consistent  
30 with requirements, environmental requirements and the  
31 requirements of KWRU?

32  
33 A. Yes.

34  
35 Q. How are you reimbursed for that particular service?  
36 Do you charge the customer that hooks up individually, and  
37 they pay Keys Environmental or do you charge KWRU, or  
38 is there some means for you to get paid for that service?

39  
40 A. We are billing the customer directly.

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<sup>33</sup> Smith Deposition, pp. 32-35.

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Q. How much do you charge?

A. \$100 per hour.

Q. Has that changed recently?

A. It did change. There was a period before where we are not being paid by the hour. We were being paid based on a percentage of work done. The utility advised us that it would be better or a more consistent way with the Public Service Commission to charge based on \$100 an hour hourly wage. We switched at some point in time, yes.

Q. Physically, as it is happening --and I am a customer seeking to connect into the system. So I run a lateral. Is that something that Keys Environmental will perform for a fee, actually putting in the lateral?

A. No, no. We don't do construction work.

Q. It's all private?

A. Yes.

Q. You had said that the switch to an hourly fee was something that, it was your understanding, the Public Service Commission encouraged?

A. It was not my idea.

Q. Do you know whether the hourly fee and how you do it is approved by the Public Service Commission?

A. I don't know.<sup>34</sup>

**Q. DID THE STAFF'S AUDIT ADDRESS THIS ISSUE CONCERNING THE HOOK-UP FEES CHARGED BY KEYS ENVIRONMENTAL?**

A. Yes, it did. The Staff Audit indicated that the contract with Keys Environmental included a provision for connecting customers. The Staff Audit, however, noted

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<sup>34</sup> Smith Deposition, pp. 11-15.

25

1       that the functions performed by KEI might be more extensive than what is set  
2       forth in the contract.

3               I agree with the Staff Audit in that the contract between the Company and  
4       KEI clearly specifies that KEI is responsible for overseeing and inspecting new  
5       customer connections. However, as explained in Mr. Johnson's deposition, Keys  
6       Environmental does not perform any construction associated with the hook-ups.  
7       Because the contract specifically provides for added compensation for other  
8       functions performed by KEI, like jet rodding the sewer lines and sludge hauling, I  
9       recommend that the Commission treat the functions of inspecting and hooking up  
10      customers as part of the contract for which Keys Environmental is paid a  
11      significant management fee.

12             Therefore, I recommend that the \$252,690 in connection charges booked  
13      to plant in service be removed. The accumulated depreciation related to these  
14      additions is \$10,983 and the depreciation expense is \$3,021.<sup>35</sup>

15   **Q.   DID THE STAFF'S AUDIT ADDRESS ANY ADJUSTMENTS RELATED**  
16   **TO KEYS ENVIRONMENTAL?**

17   A.   Yes. According to the Staff Audit, several items charged by KEI to the Company  
18      were incorrectly recorded as expenses by the Company. First, a charge of  
19      \$1,313<sup>36</sup> for lab testing should be removed as the contract with Key's  
20      Environmental provides for sampling and testing. Therefore, this amount is  
21      already recovered in the monthly fee charged by KEI to the Company. In

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<sup>35</sup> Staff Audit, p. 11, 91.33% of Staff's adjustment.

<sup>36</sup> Ibid., Staff Audit p. 11.



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1 addition, \$15,000<sup>37</sup> in sewer hook-up fees should have been capitalized to plant in  
2 service, account 363 Services to Customers, rather than expensed. Therefore, I  
3 removed \$15,000 in sewer hook-up fees.

4 In addition, the Staff auditors identified \$51,663<sup>38</sup> of plant items which  
5 were expensed which may be more appropriately capitalized. According to the  
6 Staff Audit, the Utility did not respond to Staff's request for justification of these  
7 expenses. My review of the list of these costs indicates that additional information  
8 would be needed to determine if the amounts should be capitalized or expensed.  
9 In the absence of that information being provided by the Company, I recommend  
10 that the entire amount be capitalized as plant in service. Therefore, I have  
11 increased plant in service by \$51,663<sup>39</sup> and reduced test year expenses by  
12 \$51,663.

13 The Staff Audit also identified two items included in the expense accounts  
14 for which the utility will be reimbursed by third parties: a bill for \$2,082 for  
15 damage to a pit vacuum that will be recovered from Waste Management who  
16 caused the damage, and a bill for \$995 for Oceanside Marina that is to be  
17 reimbursed by Monroe County.<sup>40</sup> I concur with Staff that these items should be  
18 removed from the expense accounts. As shown on Schedule 1, I have removed  
19 these expenses from the test year.

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<sup>37</sup> Ibid.

<sup>38</sup> Ibid.

<sup>39</sup> Adjustments would also need to be made for accumulated depreciation and depreciation expense.

<sup>40</sup> Staff Audit, p. 11.

1   **Q.    DO YOU RECOMMEND ANY DISALLOWANCE OF COSTS CHARGED**  
2       **TO THE COMPANY BY GREEN FAIRWAYS?**

3   A.    Yes. The Company failed to provide adequate documentation supporting the  
4       management fee paid to Green Fairways. Mr. Smith could not produce any  
5       timesheets in support of the amount of time that he spends managing the Utility  
6       versus the numerous other companies that he owns or operates through Green  
7       Fairways. Even assuming that Mr. Smith spends 50% of his time managing the  
8       Utility, his salary equates to an annualized salary of \$120,000, which appears  
9       excessive given the amount of time that Mr. Smith spends at the Utility's  
10      headquarters in Key West. Even while in Key West, Mr. Smith spends time  
11      managing the Key West Golf Course.

12               While Mr. Smith undoubtedly spends time on the phone with utility-  
13      related employees when he is not in town (which is approximately once a month)  
14      I find it difficult to believe that he spends 50% of his time on utility business  
15      given the fact that he is a managing partner of a law firm and owns numerous  
16      other businesses. Furthermore, Mr. Smith has most likely been spending more  
17      time recently on utility matters due to the rate case and other issues that should  
18      subside now that most customers have hooked up to the system. If Mr. Smith  
19      maintained time records it would be easier to determine how much time he  
20      typically spends on utility business. In the absence of documentation supporting  
21      the ongoing time spent by Mr. Smith on utility matters, I recommend that the  
22      Commission remove 50% of Mr. Smith's management fee, or \$30,000, under the

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1 assumption that on a going forward basis, Mr. Smith will spend less time on  
2 utility matters and there has been no demonstration that the \$60,000 is reasonable.

3 **Q. IS THERE PRECEDENT FOR DISALLOWING COSTS WHEN A**  
4 **UTILITY FAILS TO PROVIDE THE NECESSARY DOCUMENTATION**  
5 **TO SUPPORT THE REQUESTED COST?**

6 A. Yes. In Palm Coast Utility Corporation's ("Palm Coast" or "PCUC") most recent  
7 rate case, the Commission disallowed costs charged by an affiliate because Palm  
8 Coast failed to provide adequate documentation justifying the costs included in  
9 the test year. The Commission found:

10 OPC witness Dismukes proposed two adjustments related to  
11 affiliate transactions. The first adjustment relates to administrative  
12 services provided by PCUC's parent (ITT). Ms. Dismukes testified  
13 that the Commission should disallow expenses in the amount of  
14 \$21,201. She testified that the utility failed to justify this expense  
15 and refused to provide on a timely basis the information needed to  
16 evaluate the reasonableness of the charge.

17  
18 Ms. Dismukes' second adjustment related to charges from ITT  
19 Community Development Corporation. During 1995, ITT  
20 Community Development Corporation began providing accounts  
21 payable processing services to PCUC. This function was  
22 previously provided by the utility. She argued that the utility  
23 provided no justification for the change, other than a memo saying  
24 that "per agreement between Jim Perry of PCUC and myself there  
25 will be [a] monthly fee of \$ 1000 for accounting services provided  
26 to PCUC." Further, the utility provided no information concerning  
27 how the fee was determined or that it is cost effective for ITT  
28 Community Development Corporation to provide this service. She  
29 proposed a \$10,564 reduction to expenses, due to the absence of  
30 supporting documentation.<sup>41</sup>  
31

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<sup>41</sup> Florida Public Service Commission, Order PSC-96-1338-FOF-WS, November 7, 1996.

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1           Although the utility made several arguments attempting to rebut the  
2           recommendations of OPC's witness, the Commission disagreed and found the  
3           utility did not provide sufficient support to determine if the charges were  
4           reasonable.

5           We believe that the record does not provide sufficient support to  
6           determine what administrative services are provided under the ITT  
7           Community Development Corporation agreement and whether  
8           those transactions exceeded the market rate.... Further, we do not  
9           believe that water and wastewater customers should be required to  
10          pay for charges and R&D assessments to ITT headquarters to  
11          cover the funding of international research and development and  
12          the costs of ITT corporate administrative and commercial  
13          services.<sup>42</sup>  
14

15          The Commission went on to explain that the utility has the burden of proof  
16          to prove that its costs are reasonable. The Commission also explained how this  
17          case differed from the GTE Florida case where the court established the standard  
18          for related party costs and prices.

19          It is the utility's burden to prove that its costs are reasonable.  
20          *Florida Power Corp. v. Cresse*, 413 So.2d 1187, 1191 (1982). This  
21          burden is even greater when the purchase is between related  
22          parties. In *GTE Florida Inc. v. Deason*, 642 So.2d 545 (Fla. 1994),  
23          the Court established that when affiliate transactions occur, that  
24          does not mean that "unfair or excessive profits are being generated,  
25          without more." The standard established to evaluate affiliate  
26          transactions is whether those transactions exceed the going market  
27          rate or are otherwise inherently unfair. The evidence in the GTE  
28          Florida case indicated that its related party costs were no greater  
29          than they would have been had services and supplies been  
30          purchased elsewhere.

31          The facts in this case differ from those established in the GTE  
32          Florida case. The distinction is that in the GTE Florida case, there  
33          was evidence in the record that showed that the utility's cost was

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<sup>42</sup> Ibid.

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1 equal to or less than what an arms-length transaction would have  
2 been. Other than the testimony provided by Mr. Seidman that  
3 either of the above charges are reasonable, PCUC did not provide  
4 any documentation to support these costs. As such, we find that the  
5 utility has essentially failed to prove the prudence of these charges.

6  
7 We find that the utility failed to meet its burden to justify its costs.  
8 Accordingly, we have reduced affiliate charges by \$ 25,412  
9 (\$31,765 less 20% non-used and useful) and then allocated 59.63%  
10 to water and 40.37% to wastewater.<sup>43</sup>

11 **V. Monroe County Issues**

12  
13 **Q. COULD YOU PLEASE DESCRIBE THE PROJECT REFERRED TO AS**  
14 **THE SOUTH STOCK ISLAND PROJECT?**

15 A. KWRU and Monroe County entered into an agreement whereby KWRU would  
16 expand its central sewer system into South Stock Island by constructing a  
17 wastewater collection system. In addition, the Utility would convert its system to  
18 comply with the state's mandate that all wastewater treatment meet the Advanced  
19 Wastewater Treatment (AWT) standards.

20 **Q. DID MONROE COUNTY PROVIDE FUNDING FOR THIS PROJECT?**

21 A. Yes. Essentially there were two arrangements, one for the design of the project,  
22 the other for the construction of the project. For the design phase of the project,  
23 Monroe County simply reimbursed KWRU for its costs to prepare the plans,  
24 permits, and bids.

25 The funding arrangement for the construction phase of the project,  
26 however, is more complicated. Monroe County agreed to fund the construction of

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<sup>43</sup> Ibid.

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1 the project. KWRU agreed to repay Monroe County using the capacity reservation  
2 fees it collects from the new connections to the system. Therefore, ultimately the  
3 ratepayers have contributed to the cost of the project.

4 **Q. EXACTLY HOW DID MONROE COUNTY FUND THE**  
5 **CONSTRUCTION OF THE SOUTH STOCK ISLAND PROJECT?**

6 A. During the construction phase, KWRU paid its vendors and then submitted the  
7 required information to Monroe County for reimbursement.<sup>44</sup> Where the amounts  
8 were supported, Monroe County reimbursed the Company for the amounts paid to  
9 its vendors.

10 **Q. WOULD YOU PLEASE EXPLAIN THE PROCESS OF KWRU**  
11 **REPAYING MONROE COUNTY?**

12 A. In its response to Citizens' interrogatories, the Company provided the following  
13 description of the process of repaying Monroe County:

14 As prescribed by the Agreement, \$2,700 per EDU is collected from  
15 the customer. Of this amount, \$2,100 is repaid to the County and  
16 \$600 is retained by the Company. In October 2006, the County  
17 funded the remaining uncollected amount of \$707,000 as an  
18 additional refundable advance as the County assumed the  
19 collection of the \$2,700 per EDU. Under this agreement the  
20 Company "collects" the \$2,700 per EDU in 3 ways:

- 21 1. The customer pays the Utility \$2,700 per EDU directly to  
22 KWRU; the Company records the receipt of CIAC of \$2,700  
23 Per EDU, reducing Advances by the same amount and pays the  
24 County the \$2,700 per EDU collected;
- 25 2. The County provides a grant of \$2,700 per EDU and pays  
26 KWRU directly; the Company records \$2,700 as CIAC  
27 received, reducing Advances by the same amount. KWRU then  
28 pays the County the \$2,700 per EDU collected;

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<sup>44</sup> Response to Citizens' Interrogatory 82.

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1                   3. The Customer signs a Consent and Agreement to pay the  
2                   County the \$2,700 per EDU over a period of time through the  
3                   customers property tax bill and the customer or the County  
4                   notifies the Company that the required connection fee is paid;  
5                   the Company records \$2,700 as CIAC received, reducing  
6                   Advances by the same amount. No cash is received by the  
7                   Company or paid to the County.<sup>45</sup>

8                   In summary, the capacity of the South Stock Island Project is for 1,500  
9                   EDUs, \$2,100 of the \$2,700 capacity reservation fee is remitted to Monroe  
10                  County as repayment for the construction of the vacuum collection system, and  
11                  \$600 of the capacity reservation fee collected from customers is retained by the  
12                  Company in order to fund the conversion to AWT. However, the responsibility  
13                  for collecting the connection fees now lies with Monroe County as it advanced  
14                  \$707,000 to KWRU for the AWT portion of the fee the Company expected to  
15                  receive from new customers.<sup>46</sup>

16   **Q.    HAVE CUSTOMERS DELAYED CONNECTING TO THE SYSTEM?**

17   A.    According to the Company, "All customers were supposed to be connected to the  
18           system within two years, however, considerable balking by customers and lax  
19           enforcement by Monroe County have delayed these connections."<sup>47</sup> Of the 1,500  
20           EDUs that are supposed to be connected, only 761 had connected as of October 3,  
21           2007.<sup>48</sup>

22   **Q.    HAS THE COMPANY ADDRESSED THESE CUSTOMER DELAYS?**

23   A.    The Company sent 30-day connection notices to residents of South Stock Island

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<sup>45</sup> Response to Citizens' Interrogatory 79.

<sup>46</sup> Ibid.

<sup>47</sup> MFRs, Schedule F-6.

<sup>48</sup> Response to Staff's Audit Request 14.

1 and notified the Monroe County Attorney that the notices had been delivered. The  
2 following table demonstrates the notices sent by KWRU:

KWRU 30-Day Connection Notices			
Date	Number of Notices	Cost	Method
11/30/2003	825	\$559.54	Island Advertising
4/5/2005	118	\$529.86	
3/17/2005	70	\$306.49	
3/27/2006	21	\$420.00	Monroe County Sherriff's Office
4/16/2006	3	\$225.00	Anderson Process Service

Source: Response to Citizens' Interrogatory 89.

3

4 **Q. ARE THERE ISSUES INVOLVING THE CONSTRUCTION OF THE**  
5 **SOUTH STOCK ISLAND COLLECTION SYSTEM AND MONROE**  
6 **COUNTY WHICH YOU BELIEVE SHOULD BE EXAMINED AS PART**  
7 **OF THIS RATE PROCEEDING?**

8 A. Yes. Monroe County and KWRU have entered into several agreements in which  
9 the County has agreed to fund the construction of certain projects to be  
10 constructed by the Company. Therefore, it is important to examine the  
11 transactions between these two parties. In addition, KWRU's South Stock Island  
12 Project has been the source of many customer complaints, prompting a grand jury  
13 investigation.



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**Q. PLEASE DISCUSS THE PARTICULARS OF THE AGREEMENTS GOVERNING THE CONSTRUCTION OF THE SOUTH STOCK ISLAND PROJECT.**

A. There are two agreements that provide for the expansion of KWRU's central sewer system into South Stock Island and conversion of its system to Advanced Wastewater Treatment (AWT) levels. On December 19, 2001, KWRU and the County entered into a "Reimbursement Contract," whereby the County agreed to reimburse KWRU no more than \$199,300 for the preparation of engineering plans for the South Stock Island Project, which was budgeted as follows:

• Survey	\$35,000
• Design and Permitting	\$94,750
• Bidding	\$16,750
• Construction Administration and Certification	\$46,800
• Reimbursable Expenses Including Prints and Application Fees	\$ 6,000 <sup>49</sup>

Also, KWRU agreed to employ the Weiler Engineering Corporation or a similarly professionally qualified Professional Engineering firm.<sup>50</sup>

On July 31, 2002, KWRU and the County signed the Capacity Reservation and Infrastructure Contract. This contract provided that: "As consideration for the purchase the County agrees to fund the Utility's construction of the wastewater collection system on South Stock Island, in an amount not to exceed \$4,606,000,

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<sup>49</sup> Reimbursement Contract, paragraph 2(b).

<sup>50</sup> Ibid., paragraph 1.

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1       pursuant to the plans dated May 30, 2002 from Weiler Engineering  
2       Corporation.”<sup>51</sup> The construction costs were allocated as follows:

3	• Collection System Infrastructure	\$3,500,000
4	• Contingency Amount	\$ 380,000
5	• Engineering and Engineering Inspection	\$ 279,000
6	• Construction Administration and Legal Fees	\$ 347,000
7	• Testing	\$ 100,000 <sup>52</sup>

8               In a letter signed by Mr. Smith written to Mr. Danny Kolhage on  
9       November 1, 2002, the construction administration and legal fee portion of the  
10       budget is further allocated as \$300,000 for construction administration and  
11       \$47,000 for legal fees.<sup>53</sup>

12              KWRU agreed to repay the County from the capacity reservation fees it  
13       would collect from customers connecting to the Stock Island Project.<sup>54</sup> The  
14       agreement provides that of the \$2,700 reservation fee KWRU collects from new  
15       customers, KWRU would retain \$600 to cover the incremental costs of converting  
16       its wastewater treatment facilities to AWT.<sup>55</sup> The contract also states the  
17       following:

18              Utility agrees not to add the construction cost funded by the  
19       County to its cost basis utilized by the Public Service Commission  
20       to calculate a reasonable return on invested capital. Utility further  
21       agrees not to use the advances in calculating any impact fees,  
22       connection charges, or any like charges imposed on the Utility’s

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<sup>51</sup> Capacity Reservation and Infrastructure Contract, paragraph 1.A.

<sup>52</sup> Ibid., paragraph 1.B.

<sup>53</sup> Letter from Mr. William L. Smith, Jr., to Mr. Danny L. Kolhage, March 16, 2004, in response to the Draft Audit Report of Monroe County, Exhibit K.

<sup>54</sup> Ibid., paragraph 4.

<sup>55</sup> Ibid., paragraph 5.

1 customers, i.e., that the advances will be applied as a credit against  
2 such fees otherwise charged.<sup>56</sup>

3 This contract was amended on December 9, 2003, in order to provide an  
4 alternative for property owners who were experiencing a hardship paying the  
5 connection fees. The Monroe County Board of Commissioners adopted an  
6 ordinance that would allow property owners to pay 5% of the connection fee and  
7 finance the remainder of the \$2,700 per EDU over a period of up to 20 years.<sup>57</sup>

8 Finally, on October 8, 2004, the County Attorney certified a Contract  
9 Change Request for a change to the Capacity Reservation and Infrastructure  
10 Contract. The change calls for an additional \$53,225 to provide sewer lines to  
11 Hurricane Hole Marina, Stock Island. The Change Order is attached as Schedule 6  
12 of Exhibit KHD-1.<sup>58</sup>

13 **Q. DID KWRU RECEIVE REIMBURSEMENT FROM THE COUNTY FOR**  
14 **ALL COSTS FOR THE SOUTH STOCK ISLAND PROJECT?**

15 A. No, it did not. As shown in the table below, Monroe County reimbursed KWRU  
16 for 92% of the requested reimbursement amount.

17

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<sup>56</sup> Ibid., paragraph 6.

<sup>57</sup> Amendment Number One to KW Resort Utilities Corporation Capacity Reservation and Infrastructure Contract, paragraph E.

<sup>58</sup> Response to Citizens' Interrogatory 91.

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1

South Stock Island Project Amounts Reimbursed by Monroe County			
	Submitted Invoice Amount	Amount Paid by Monroe County	Difference
<b>Reimbursement Contract</b>			
MC001	\$ 35,000	\$ 35,000	\$ -
MC005	94,750	94,750	-
MC007	16,750	16,750	-
MC0021	46,800	46,800	-
<b>Total</b>	<b>\$193,300</b>	<b>\$193,300</b>	<b>\$ -</b>
<b>Capacity Reservation and Infrastructure Contract</b>			
SSI001	\$ 250,531	\$ 250,531	\$ -
SSI002	295,255	295,255	-
SSI003	344,809	344,809	-
SSI004	345,808	345,808	-
SSI005	752,877	752,877	-
SSI006	607,312	607,312	-
SSI007	141,802	141,802	-
SSI008	115,310	115,310	-
SSI009	461,960	461,960	-
SSI010	323,047	129,480	
		155,541	(38,026)
SSI011	445,521	137,038	(308,483)
SSI012	153,024	148,951	(4,073)
<b>Total</b>	<b>\$4,237,256</b>	<b>\$3,886,674</b>	<b>\$(350,582)</b>
<b>Hurricane Hole Marina</b>			
SSI013 Amended	\$53,225	\$53,225	\$ -
<b>South Stock Island Project Total</b>	<b>\$4,483,781</b>	<b>\$4,133,199</b>	<b>\$(350,582)</b>

2

3

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1   **Q.   WHAT WERE THE REASONS WHY MONROE COUNTY DID NOT**  
2       **REIMBURSE ALL THE COSTS SUBMITTED BY KWRU?**

3   A.   The primary reason was that the Company could not produce documentation for  
4       the amounts requested. The County withheld \$308,483 from KWRU Invoice  
5       SSI011 because of lack of support. In a letter dated February 26, 2004, to Mr.  
6       William Smith, Clerk of Court Mr. Danny L. Kolhage explained,

7               The adjustment of \$308,483.00 represents all of the payments  
8               made to your firm pursuant to the contract under the budget  
9               category Construction Administration and Legal.

10              As you are aware, during the conduct of the audit being performed  
11              by my office, no documentation has been presented to the auditors  
12              that would allow us to make a determination that the expenses in  
13              this category were made for purposes authorized by the contract.  
14              The County Attorney's office concurs with this action.

15              In addition, the County did not reimburse KWRU \$4,073 for sod and  
16       repairs to E. Laurel Avenue as submitted on Invoice SSI012.<sup>59</sup> On Invoice  
17       SSI010, Monroe County did not reimburse \$38,026, and provided no explanation  
18       for the shortage.

19   **Q.   DID KWRU AND MONROE COUNTY ENGAGE IN ANOTHER**  
20       **PROJECT?**

21   A.   Yes. This project is commonly referred to as the Detention Center Project as  
22       governed by the Utility Agreement of August 16, 2001.

23   **Q.   WHAT ARE THE SPECIFIC PROVISIONS OF THE UTILITY**  
24       **AGREEMENT?**

---

<sup>59</sup> Responses to Citizens' PODs 65 and 66.

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1 A. According to the agreement, the County agreed to the following:

- 2 • Pay \$1,225,800 in capacity reservation fees,
- 3 • Convey two lift stations,
- 4 • Construct and convey another lift station and sewer main,
- 5 • Purchase wastewater treatment services for the Detention Center and other
- 6 public buildings, and
- 7 • Purchase reuse water for the Detention Center.

8  
9 In return for the County's reservation fees and contributed property,  
10 KWRU agreed to construct a reuse line to the Detention Center and offsite  
11 facilities to connect the lift station at the Detention Center to the Central Sewage  
12 System.<sup>60</sup>

13 The capacity reservation fees were to be deposited into an interest bearing  
14 escrow account at a federally insured financial institution (Republic Bank) and  
15 then transferred to the Utility according to the agreement's escrow terms.<sup>61</sup>  
16 Additionally, if Monroe County chose to decommission its existing treatment  
17 plant, KWRU agreed to contribute up to \$10,000 toward the costs.<sup>62</sup>

18 **Q. HOW MUCH DID KWRU RECEIVE FROM MONROE COUNTY PER**  
19 **THE UTILITY AGREEMENT OF AUGUST 16, 2001?**

20 A. The Company received three payments of \$408,600 each and booked them to  
21 CIAC. The first payment was received April 30, 2002, the second on March 31,  
22 2003, and the third on March 31, 2004.<sup>63</sup>

23 **Q. HOW MUCH DID KWRU EXPEND ON THE DETENTION CENTER**  
24 **PROJECT?**

---

<sup>60</sup> Utility Agreement, dated August 16, 2001, paragraphs 1 and 3.

<sup>61</sup> Ibid., paragraph 7(a).

<sup>62</sup> Ibid., paragraph 4.

<sup>63</sup> Response to Interrogatory 66 and Staff Audit Workpapers, Binder 3.

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1 A. According to the Company's response to Citizens' discovery, the Company spent  
2 \$356,247.<sup>64</sup> I have prepared Schedule 7 detailing the costs of the Detention  
3 Center Project.

4 **Q. DID KWRU EXPLAIN HOW IT USED THE FUNDS RECEIVED BY THE**  
5 **COUNTY AFTER THE DETENTION CENTER WAS COMPLETED?**

6 A. In the deposition of Mr. Smith, Citizens inquired how these funds were used.  
7 According to Mr. Smith, the funds that were not used for the detention center and  
8 jail were used for either the South Stock Island Project or general maintenance.

9  
10 Q. Let me back up. I want to go back to Mr. Carter's answers,  
11 some of Mr. Carter's answers. I got the impression from  
12 what Mr. Carter said -- correct me if my impression is  
13 wrong -- that the amount of money that was calculated  
14 exceeded the total expenditure necessary to make that  
15 connection.

16  
17 A. Correct.

18  
19 Q. What I want to talk about is the amount by which the  
20 funding from the County was going, for the 450 EDUs  
21 were going to be used for.

22  
23 A. Yes.

24  
25 Q. Can you tell me what it was going to be used for, the  
26 differential?

27  
28 A. It was mostly construction on Stock Island, maintenance of  
29 the plant, things of that nature.

30  
31 Q. There wasn't a specific separate project, or anything, that it  
32 was ear-marked toward?

33  
34 A. No.

35

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<sup>64</sup> Response to Interrogatory 85.

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1 Q. It was general construction and maintenance needs?

2  
3 A. Correct.<sup>65</sup>

4  
5 **Q. WERE THERE PROVISIONS IN THE UTILITY AGREEMENT THAT**  
6 **INDICATED THAT PROPERTY WOULD BE CONVEYED TO THE**  
7 **COMPANY?**

8 A. Yes, as described above. However, when asked if the Utility received any  
9 property, plant, or equipment from Monroe County, KWRU provided the  
10 following response, "In accordance with the Laws of the State of Florida, no  
11 public property was transferred to the Utility."<sup>66</sup> This response is consistent with  
12 Mr. Smith's deposition where he indicated that although the contract provided for  
13 the conveyance of property, no such transaction took place.

14 However, it is important to note that in the Company's response to the  
15 Monroe County Audit signed by Mr. Smith, it states, "...the Utility agreed to take  
16 over and manage the operations of the lift stations and assume their operating and  
17 maintenance expenses."<sup>67</sup>

18 It is not clear why or how this service is being provided to the County free  
19 of charge. Apparently, the service is provided by Keys Environmental, Inc. when  
20 it services the other lift stations owned by the Utility. I question whether it is  
21 appropriate for the Utility to provide this service to the County at the expense of  
22 its general ratepayers.

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<sup>65</sup> Smith Deposition, pp. 41-42.

<sup>66</sup> Response to Citizens' Interrogatory 85.

<sup>67</sup> Letter from Mr. William L. Smith, Jr., to Mr. Danny L. Kolhage, March 16, 2004, in response to the Draft Audit Report of Monroe County, p.3.



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1    **Q.    ARE THERE ANY OTHER SIGNIFICANT ISSUES WITH THE**  
2    **PROJECTS BETWEEN KWRU AND MONROE COUNTY?**

3    A.    Yes. In the summer of 2003, citizens of Stock Island began filing complaints with  
4    the Florida State Attorney General's Office. In addition, complaints were received  
5    from County Commissioners. The complaints alleged that the costs to the  
6    residents of Stock Island to connect to the new sewer system were in reality much  
7    higher than the Monroe County Board of County Commissioners (BOCC) told  
8    them their costs would be when the project began. In addition, residents claimed  
9    that the increase of the hook-up charges was because the engineering plans were  
10    changed without the knowledge or approval of the BOCC. State Attorney Mark  
11    Kohl ordered an investigation of the project and the complaints, which was  
12    presented to a grand jury at the culmination of the fall term in 2004.<sup>68</sup>

13   **Q.    WHAT DID THE GRAND JURY FIND?**

14   A.    The grand jury investigation found the following:  
15        1.    Contrary to the provisions in the Capacity Reservation and Infrastructure  
16            Contract, the County Engineer did not inspect all of the work for completion  
17            prior to the approval of invoices for payment;<sup>69</sup>  
18        2.    The County did not recover \$147,000 KWRU paid to John L. London,  
19            former Monroe County Commissioner, as provided for in the contract;<sup>70</sup>

---

<sup>68</sup> Final Report of the 2004 Fall Term Grand Jury of the Sixteenth Judicial Circuit of the State of Florida,  
p. 3.

<sup>69</sup> Ibid., p. 5.

<sup>70</sup> Ibid., p. 6.

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- 1           3.    The BOCC Commissioners were negligent for failing to evaluate and assess  
2           the financial burden of the many fees and additional costs property owners  
3           must bear with the new system;<sup>71</sup>
- 4           4.    The BOCC's process for reviewing KWRU's construction plans appeared to  
5           be flawed;<sup>72</sup>
- 6           5.    The Stock Island Project was funded 100% with taxpayer money; however,  
7           the infrastructure would remain property of the Utility. Also the new system  
8           was to serve 1,500 EDUs, but the grand jury's consultant determined the  
9           capacity would only be 850 EDUs;<sup>73</sup>
- 10          6.    Under the Utility Agreement, public property and equipment were again  
11          being conveyed to a private entity;<sup>74</sup> and
- 12          7.    Based on the findings of the County's March 19, 2004, internal audit,  
13          performed at the request of the Monroe County Clerk of the Circuit Court,  
14          the County was found to be negligent and/or incompetent in their control of  
15          public funds;<sup>75</sup>
- 16               a.   Contrary to the contract, no escrow agent or agreement was put in  
17               place, and KWRU had sole discretion of the reserved capacity funds;
- 18               b.   Upon the audit department's recommendation, the County withheld  
19               \$308,483 in construction and legal fees because of the Utility's failure  
20               to provide supporting documentation for these fees. KWRU paid these

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<sup>71</sup> Ibid., p. 7.

<sup>72</sup> Ibid., p. 8

<sup>73</sup> Ibid., p. 10.

<sup>74</sup> Ibid.

<sup>75</sup> Ibid., p. 11-12.

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1 fees to Smith, Hemmesch & Burke and Green Fairways, Inc. Both are  
2 affiliates of the Utility: KWRU's President William Smith is a partner  
3 of Smith, Hemmesch & Burke and the president of Green Fairways,  
4 Inc.

5 **Q. WHAT WERE THE FINDINGS OF THE COUNTY'S INTERNAL AUDIT**  
6 **OF THE BOCC?**

7 A. The internal audit conclusions include the following:

- 8 1. Section 7 of the Utility Agreement requires the use of an escrow agent for  
9 the capacity reservation fees paid by Monroe County for the Detention  
10 Center project, however, no agent was ever assigned or used.
- 11 2. There were two instances where KWRU withdrew money from the  
12 Detention Center escrow account to pay for work performed on the South  
13 Stock Island Expansion Project. These amounts were subsequently  
14 reimbursed to KWRU under the Capacity Reservation and Infrastructure  
15 Contract.
- 16 3. The auditors concluded that the Utility Agreement is ambiguous as to how  
17 the capacity reservation funds paid by Monroe County for the Detention  
18 Center project were to be used by KWRU.
- 19 4. E.T. MacKenzie charged KWRU for two mobilization costs associated with  
20 the Capacity Reservation and Infrastructure Contract, however, no separate  
21 construction phases occurred. During interviews the auditors conducted with  
22 the county engineer, the engineer stated the costs appeared reasonable.

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1           5.    The Utility had not remitted to the County the fees that it collected under the  
2               Capacity Reservation and Infrastructure Contract.

3           6.    The engineering firm URS recommended an audit of the construction phase  
4               be performed to confirm the fees charged for construction administration  
5               and legal fees were consistent with the services performed since KWRU  
6               could not provide the supporting documentation.

7           7.    The auditors found that both the Utility Agreement and the Capacity  
8               Reservation and Infrastructure Contract have unusual provisions that need  
9               monitoring.

10   **Q.    WHAT IS THE NATURE OF THE PAYMENTS TO FORMER BOCC**  
11       **COMMISSIONER MR. JOHN L. LONDON FOR SERVICES PROVIDED**  
12       **TO THE COMPANY?**

13   A.    The Grand Jury investigation into the contracts between Monroe County and  
14       KWRU revealed that monthly payments of \$2,500 were made to Mr. John  
15       London from November 1998 to October 2003, totaling \$147,500.<sup>76</sup> Mr.  
16       London's term on the BOCC expired in October 1998.<sup>77</sup>

17               According to the Company's response to Citizens Interrogatory 64, Mr.  
18       London received a total of \$160,000 from KWRU from 1998 to 2004. According  
19       to KWRU, "Mr. London served as liason (sic) between Monroe County and the  
20       Utility in its efforts to expand operations to South Stock Island."<sup>78</sup>

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<sup>76</sup> Final Report of the 2004 Fall Term Grand Jury of the Sixteenth Judicial Circuit of the State of Florida,  
p. 6.

<sup>77</sup> Monroe County BOCC Response to the 2004 Fall Term Grand Jury, p. 7.

<sup>78</sup> Response to Citizens' Interrogatory 64.

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1 Q. HOW WERE THE PAYMENTS TREATED ON THE COMPANY'S  
2 BOOKS?

3 A. According to the Company's response to Citizens' Interrogatory 64, \$32,500 of  
4 the payments was capitalized to plant accounts and \$127,500 was expensed.

5 Q. CAN THE COMPANY PROVIDE DOCUMENTATION SUPPORTING  
6 THE PAYMENTS TO MR. LONDON?

7 A. No. The Company stated, "No invoices are associated with this oral agreement for  
8 \$2,500 per month with Mr. London (now deceased) for his assistance in  
9 negotiations with Monroe County...."<sup>79</sup>

10 Q. DO YOU BELIEVE THAT CUSTOMERS SHOULD BE CHARGED FOR  
11 THE AMOUNT PAID TO MR. LONDON THAT REMAINS  
12 CAPITALIZED ON THE COMPANY'S BOOKS?

13 A. No, I do not. First, the Company has not provided any support for the amounts  
14 charged by Mr. London. There were no written contracts between the Company  
15 and Mr. London nor were there any invoices from Mr. London to the Company.  
16 Second, the Company has not demonstrated that ratepayers received any benefits  
17 from the amounts paid to Mr. London. Third, the Company has not shown that the  
18 amounts should have been capitalized as opposed to expensed. Therefore, I  
19 recommend that the Commission remove the \$32,500 charges to plant in service  
20 of which \$27,500 was charged to franchises and \$5,000 was charged to force  
21 mains.

22 Q. BASED ON YOUR ANALYSIS OF THE CONTRACTS BETWEEN KWRU

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<sup>79</sup> Response to Staff Audit Request 3.

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1           AND   MONROE   COUNTY,   DO   YOU   RECOMMEND   ANY  
2           ADJUSTMENTS TO PLANT?

3    A.    Yes. I recommend that the Commission remove from plant in service the \$10,000  
4           expended by the Utility to decommission the County's treatment facility. This  
5           money appears to have been spent to decommission a treatment plant that was not  
6           owned by KWRU. Therefore, the expenditure of these funds should not be  
7           charged to the Company's customers. Consequently, I recommend that plant in  
8           service be reduced by \$10,000. If the Company can demonstrate that the cost to  
9           decommission the plant for Monroe County was not capitalized to plant in  
10          service, then this adjustment would not be necessary.

11                 Another adjustment to plant in service should be made for the charges  
12           from the legal firm White and Case. The invoices provided in response to Staff  
13           Audit Request 3 clearly show these services were provided to the Utility in  
14           connection with responding to the Monroe County Audit Report. I do not believe  
15           that these costs should have been capitalized and therefore should not be included  
16           in rate base. Moreover, the cost to the Utility to defend itself against Monroe  
17           County should be borne by stockholders, not ratepayers. In total, \$27,230 was  
18           charged to the Utility. Therefore, I recommend that plant in service be reduced by  
19           \$27,500 with corresponding adjustments to accumulated depreciation and  
20           depreciation expense.

21                 Next, I recommend that all charges from Green Fairways be removed from  
22           the capitalized cost of the South Stock Island Project. Although these fees were

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1       supposed to be for management of the project, the invoices from Weiler  
2       Engineering indicate that they also provided management and oversight of the  
3       construction of the project. Green Fairways charged KWRU \$32,198 as a  
4       management fee<sup>80</sup> and \$301,180 for administration of the South Stock Island  
5       Project.<sup>81</sup> However, when asked in connection with the Monroe County Audit for  
6       work completion logs for Green Fairways, the auditors for Monroe County noted  
7       that the logs “were completed by the engineering firm and consisted of daily work  
8       reports of approximately one page per work day.”<sup>82</sup> It does not appear that Green  
9       Fairways administered the project; instead, this function appears to have been  
10      performed by the engineering firm. Consequently, these costs should not be  
11      passed on to ratepayers as they received no benefit from them. Therefore, I  
12      recommend that \$333,378 be removed from plant in service as well as the  
13      associated adjustments to accumulated depreciation and depreciation expense as  
14      set forth on Schedule 1.

15             In addition, the \$25,000 legal fee for Smith, Hemmesch & Burke for its  
16      claimed negotiation of contracts for the South Stock Island Project should also be  
17      removed. According to the Monroe County Audit Report, the Company could not  
18      provide supporting documentation for this charge. The adjustments that I  
19      recommend are shown on Schedule 1.

20      **Q.    ARE THERE OTHER CHARGES THAT WERE BOOKED TO THE**  
21      **SOUTH STOCK ISLAND PROJECT THAT YOU BELIEVE SHOULD BE**

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<sup>80</sup> Staff Audit Request 3.

<sup>81</sup> Ibid.

<sup>82</sup> Audit Report of Monroe County Contracts with KW Resort Utilities, March 19, 2004, Exhibit R.

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1        **REMOVED?**

2        A.     Yes. There are two other charges capitalized to plant for the South Stock Island  
3               Project that I believe should not be charged to ratepayers. The first is \$422 for an  
4               advertisement in the Key West Citizen which should have been expensed. The  
5               second is \$8,602 in moving expenses for Mr. Chris Johnson.<sup>83</sup> I do not believe  
6               that the cost to move Mr. Chris Johnson is an appropriate expense to be  
7               capitalized to the SSI plant. The adjustments resulting from this recommendation  
8               are shown on Schedule 1.

9        **VI. Other Rate Base Adjustments**

10

11       **Q.     HAVE YOU INCORPORATED THE USED AND USEFUL**  
12               **RECOMMENDATION FROM CITIZENS' WITNESS ANDREW**  
13               **WOODCOCK INTO YOUR CALCULATIONS?**

14       A.     Yes. As shown on Schedule 1, removing costs associated with non-used and  
15               useful plant reduced plant in service by \$1,324,595 and test year expenses by  
16               \$6,929.<sup>84</sup>

17       **Q.     WOULD YOU PLEASE ADDRESS THE COMPANY'S PROPOSED**  
18               **PROFORMA ADJUSTMENT TO PLANT?**

19       A.     Yes. KWRU proposes to add \$1,139,707 to its plant due to the conversion to  
20               AWT. In his testimony, Mr. Smith explained that KWRU undertook the  
21               conversion to AWT earlier than the state's 2010 deadline at the request of Monroe  
22               County. In addition, the Utility is refurbishing its plant and to perform these

---

<sup>83</sup> Response to Staff Audit Request 3.

<sup>84</sup> An adjustment may also be needed for the associated CIAC.



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1 projects together would be more efficient, cost effective, and reduce duplications  
2 of effort.

3 According to Mr. Smith, the conversion began in 2006 and was expected  
4 to be completed by October 1, 2007.<sup>85</sup> However, that deadline has been extended  
5 to January 2008.<sup>86</sup> The original estimates of the projects were \$426,650 for the  
6 refurbishment portion<sup>87</sup> and \$792,350 for the AWT upgrade.<sup>88</sup> With the project  
7 extension, the cost is expected to increase by approximately \$220,000.<sup>89</sup>

8 **Q. HAS THE COMPANY BEEN ABLE TO PROVIDE SUPPORT FOR ALL**  
9 **OF ITS PROJECTED CAPITAL ADDITIONS?**

10 A. Citizens requested documentation in its POD 3:

11 Please provide all documents supporting the pro-forma plant  
12 additions/improvements to Plant in Service, including but not  
13 limited to: invoices, budgets, projection basis, quotes, budget  
14 requisitions, monthly payment requests for all projects, signed  
15 contracts, all bids for each project either completed or still under  
16 construction, and any requirements of the DEP for the proposed  
17 plant additions.

18 KWRU's response was "The documents will be produced to the extent  
19 they exist." The Utility provided the following documents:

- 20 • Bid from Bob Lomrance for the clarifier foundation in the amount of  
21 \$144,600.  
22 • Bid from Keys Construction Services, Inc. for the clarifier foundation in  
23 the amount of \$148,200.  
24 • A proposal from Johnson Constructors for the clarifier foundation project.

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<sup>85</sup> Smith Testimony, p. 4.

<sup>86</sup> Response to Citizens' Interrogatory 56.

<sup>87</sup> Smith Testimony, p. 4.

<sup>88</sup> Ibid., p. 5.

<sup>89</sup> Response to Citizens' Interrogatory 56.

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- A contract from USFilter Davco Products for the clarifier and AWT conversion in the amount of \$954,800.
- Invoices from Green Fairways
- An invoice from JAS Corp.
- An invoice from Johnson Constructors
- An invoice from Keys Environmental, Inc.
- Notes on a fax from Keys Environmental, Inc.
- Checks written by Green Fairways.<sup>90</sup>

Citizens' relevant interrogatories and the Company's responses are included

below.

Interrogatory 38: Please provide the status of the plant projects under construction and included in the Company's test year. This status should include, but not be limited to the following: a discussion of the status of the addition; the original estimated date of completion, the current estimated date of completion, and the actual date of completion, if applicable; the status of the engineering and permitting efforts, if the plant addition has not been through the bidding process; the actual cost to complete the addition, the amount expended as of September 2007 if the addition is not complete, and the current estimate of the completed cost of the addition; a statement if any of the pro forma plant is required by the Florida Department of Environmental Protection, and explain why it is required.

Company's Response: The documents will be produced in response to OPC's Document Request.

11/20/07 Supplement: Documents responsive to this Interrogatory (and Document Request No. 56), in the form of Change Orders from US Filter/Davco, are being copied and will be produced.

Interrogatory 56: For purposes of this request please refer to the testimony of Mr. Smith, page 5. Please provide a detailed discussion of the status of the construction of the AWT improvements including updated costs estimates.

Company's Response: AWT project is scheduled to be complete Jan 1 2008, at a cost of \$1,204,600 extras to original contract

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<sup>90</sup> This amount includes payments to other contractors/subcontractors as well as the 10% management fee.

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1 (\$984,600) is approx. \$220,000, which includes \$100,000 in extra  
2 steel, \$100,000 extra sludge hauling and \$20,000 for  
3 demobilization. Also see attached.

4 Interrogatory 57: For purposes of this request please refer to the  
5 testimony of Mr. Smith, pages 3 and 4. Please provide a detailed  
6 discussion of the status of the refurbishment of the existing  
7 wastewater treatment facilities including updated costs estimates.

8 Company's Response: KWRU is in the midst of the AWT upgrade  
9 and expects to be complete by Jan 1, 2008.

10  
11 11/20/07 Letter from John Wharton: The answer has been clarified.  
12

13 11/20/07 Supplement: KWRU is in the midst of the AWT upgrade  
14 and expects to be complete by Jan 1, 2008. See Interrogatories No.  
15 38 and 56.

16 In its response to Interrogatory 56, the Company produced an attachment  
17 that contained change orders totaling \$139,470, which are provided in Schedule 8.

18 **Q. WHO IS THE CONTRACTOR ON THE PROJECT?**

19 A. According to the agreement for construction of the AWT, Green Fairways, Inc.  
20 and Johnson Constructors, LLC together are the "Contractor" on the project.  
21 Interestingly, the address for Johnson Constructors is shown as 6330 Front Street,  
22 Key West, Florida—the same address of KEI, which the Utility trailer housed at  
23 the wastewater treatment plant. According to the contract, the AWT conversion  
24 was to reach substantial completion by May 1, 2007.

25 **Q. WHAT CHANGES TO THE COMPANY'S PROFORMA ADJUSTMENT**  
26 **TO RATE BASE DO YOU RECOMMEND?**

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1 A. The Company is proposing to add \$1,139,707 to plant in service for the  
2 conversion to AWT.<sup>91</sup> As of November 2007, the cost of the project has increased  
3 to \$1,315,142.<sup>92</sup> I recommend several adjustments to the Company's proforma  
4 amount for the AWT upgrade.

5 First, I recommend that the Commission disallow the added costs  
6 associated with change orders from Davco as identified below. Upon examination  
7 of the Change Orders provided in response to Citizens' Interrogatory 56, it is  
8 evident that the change orders were due to the Utility's failure to have the permits  
9 in place to do the job as originally scheduled. The change orders reflect additional  
10 housing costs associated with the delayed project. The first request for a change  
11 order states: "We were originally suppose to start the job on 11/8/06. So we  
12 rented a house for \$3,300.00 a month. The customer was red tagged and could not  
13 pour the slab until the permits were done."<sup>93</sup> The Change Orders are duplicated  
14 on Schedule 8. The table below sets forth the amount of each change ordered  
15 resulting from the delay. The total of the Change Orders is \$13,547.

US Filter Davco Products Change Orders	
Change Order Number	Amount
1	\$3,667
2	\$1,360
3	\$1,360
4	\$1,360
5	\$5,800
Total	\$13,547

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<sup>91</sup> MFRs, Schedule A-3.

<sup>92</sup> Response to Citizens' POD 81.

<sup>93</sup> Response to Citizens' POD 56.

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1 I do not believe customers should have to pay for the Company's failure to  
2 properly secure the permits for the project. Therefore, I recommend removing  
3 \$13,547 from the proforma adjustment and the corresponding adjustments for  
4 accumulated depreciation and depreciation expense.

5 Second, I recommend that the Commission remove \$111,374 associated  
6 with Green Fairways's administration fee. The Utility has capitalized \$111,374 in  
7 Green Fairways management fees which includes \$100,094 paid in 2007 plus  
8 \$11,281 paid in 2006. Like the situation with the South Stock Island Project, it is  
9 not clear what services are being provided by Green Fairways, other than the  
10 submission of invoices to KWRU for payment. In addition, according to the  
11 contract for this project, the engineer – in this case, Weiler Engineering – is  
12 responsible for providing administration of the contract. Therefore, I recommend  
13 removing \$111,374 from the proforma plant adjustments and related adjustments  
14 to accumulated depreciation and depreciation expense.<sup>94</sup>

15 Third, it appears that Johnson Constructors and JAS Corp. were also  
16 providing some management services for the AWT Upgrade. There is also an  
17 affiliate relationship between Johnson Constructors and JAS Corp, as JAS Corp is  
18 owned by Jim Johnson (Chris Johnson's father). I do not believe ratepayers  
19 should pay for two supervisors. Therefore, I recommend all JAS Corporation and  
20 Jim Johnson charges relating to project supervision be removed from plant in  
21 service. Several of these charges relate to travel charges of Mr. Jim Johnson. The  
22 Company has not demonstrated that such costs should be borne by ratepayers.

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<sup>94</sup> Response to Citizens' Interrogatory 73.

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This results in a decrease of \$4,650 to plant in service and related adjustments to accumulated depreciation and depreciation expense. These charges are detailed in the table below.

JAS Corp		
10/2/2006	Management Services	2,000
10/2/2006	Per Diem	500
10/2/2006	Flight	198
10/16/2006	Flight	198
10/17/2006	Per Diem	100
10/18/2006	Auto Expense	13
10/19/2006	Auto Rental	111
10/22/2006	Flight	198
10/22/2006	Flight	198
10/23/2006	Per Diem	250
10/26/2006	Auto Expense	3
10/30/2006	Auto Expense	20
10/30/2006	Auto Rental	214
11/13/2006	Flight	198
11/17/2006	Per Diem	150
11/16/2006	Gasoline	9
11/17/2006	Auto Rental	289
	<b>Total</b>	<b>\$ 4,650</b>
Source: PODs 3, 7, and 73.		

Fourth, as shown on Schedule 9, there is a \$30,000 charge from Johnson Constructors for which there is no supporting documentation. It is not clear what services were provided for this amount. Absent supporting documentation for this charge, I recommend that it be removed from the cost of the AWT upgrade.

**Q. DO YOU HAVE OTHER ADJUSTMENTS TO RATE BASE?**

A. Yes. There is a possibility that an adjustment should be made to rate base for an acquisition adjustment. However, at the time of the filing of this testimony, the information necessary to examine this issue was outstanding in discovery.

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2 **VII. Revenue/Billing Issues**

3

4 **Q. HAVE YOU EXAMINED KWRU'S TEST YEAR REVENUE AND ITS**  
5 **PROPOSED RATE STRUCTURE CHANGES?**

6 A. Yes. According to Mr. William Smith's testimony, KWRU has historically billed  
7 its customers using flat rate charges because it was impossible to obtain water  
8 usage information from the Florida Keys Aqueduct Authority ("FKAA").  
9 However, that has recently changed and the Company is proposing to move to a  
10 Base Facility/Gallon Charge rate structure.

11 The number of bills according to the FKAA usage information is different  
12 from the number of bills KWRU has reported. In response to Citizens'  
13 Interrogatory 60, the Company explained this difference as follows:

14 The Utility has historically billed flat rates for all but commercial  
15 customers. With the FKAA information, certain customers which were flat  
16 rate billed, such as multifamily apartment units, have individually metered  
17 units as billed by FKAA. As a result, the number of residential customers,  
18 including individually metered apartment units, increased. Additionally,  
19 based on the FKAA data, meter sizes were updated to agree to what was  
20 being billed for commercial and multi-family bulk meters by FKAA. Also,  
21 some commercial establishments are being served by multiple meters  
22 which were being flat rate billed as a single meter.

23 In order to ensure consistency between test year revenue and the proposed  
24 rate design which contains different billing units, I adjusted test year revenue  
25 where possible using the FKAA billing data the Company proposes to use. As  
26 shown on Schedule 10, this adjustment increases test year revenue by \$158,151.

27 **Q. WHAT IS THE NEXT ADJUSTMENT TO TEST YEAR REVENUE THAT**

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1           **YOU RECOMMEND?**

2       A.     The second adjustment that I recommend relates to the trailer rent paid to the  
3           Company by Weiler Engineering Corporation. As discussed earlier, KWRU owns  
4           a trailer which Keys Environmental, Inc. and Weiler Engineering, Corp. occupy.  
5           During the test year, \$37,400 in rent was generated from the construction trailer.<sup>95</sup>  
6           In examining the billing summary the Company provided in response to Citizens  
7           Interrogatory 4, the rent charged to KEI has always remained constant at  
8           \$2,000/month. In contrast, since 2002, the rent charged to Weiler Engineering  
9           Corporation changed four times in five years. For some unknown reason, during  
10          the test year the monthly rent charged to Weiler Engineering Corporation went  
11          from \$1,750 to \$800. Without an explanation for the change in the monthly rent  
12          charged to Weiler Engineering Corporation, I recommend that the Commission  
13          adjust test year revenues to reflect that monthly rent of \$1,750 is paid by Weiler  
14          Engineering Corporation for the entire year. Accordingly, I recommend that test  
15          year revenue be increased by \$14,600. In addition, the Commission should be  
16          aware that Johnson Constructors, another affiliate, uses the same address as the  
17          Utility trailer, but no rent is paid by this entity.

18       **Q.     WHAT IS YOUR NEXT ADJUSTMENT TO TEST YEAR REVENUE?**

19       A.     The Company recorded \$19,624 of income below the line. According to the  
20           Company's response to Citizens' Interrogatory 74, this income was received from  
21           Monroe County to keep its lift stations and other portions of its wastewater

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<sup>95</sup> Company's MFRs, Schedule E-5.



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1 system clear and clean.<sup>96</sup> Since the Utility has no employees, this service is most  
2 likely provided by KEI. The person(s) that perform this service on behalf of the  
3 County would appear to be the same person(s) that maintains the Utility's lift  
4 stations. I have seen no documents which indicate that KEI keeps a record of the  
5 time it spends on servicing Monroe County lift stations versus the Utility lift  
6 stations. Consequently, in the absence of a showing that the cost of cleaning these  
7 lift stations has been excluded from the costs charged to the Company, the  
8 associated revenue/income should be recorded above the line for ratemaking  
9 purposes. Therefore, test year revenue should be increased by \$19,624.

10 **VIII. Expense Adjustments**

11  
12 **Q. HAVE YOU MADE ANY ADJUSTMENTS TO THE COMPANY'S TEST**  
13 **YEAR EXPENSES TO REMOVE ABNORMAL AND NON-RECURRING**  
14 **EXPENSES?**

15 A. Yes, I have. Schedule 11 details the analysis that I performed in developing the  
16 adjustment to test year expenses for abnormal and non-recurring levels of  
17 expense.

18 **Q. HAVE YOU DONE AN ANALYSIS THAT EVALUATES THE INCREASE**  
19 **IN EXPENSES INCLUDED IN THE TEST YEAR?**

20 A. Yes. I examined the level of the Company's expenses in the years 2002, 2003,  
21 2004, 2005, and 2006. This analysis is shown on Schedule 11. As depicted on this  
22 schedule, many of KWRU's expense categories experienced significant cost

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<sup>96</sup> Response to Citizens' Interrogatory 74.

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1 increases during this time period. As shown, sludge removal expenses increased  
2 by 36% in 2005 and another 252% in 2006. On average over the 5-year period  
3 2002 to 2006, these expenses increased by 33%. Likewise, chemical expenses  
4 have increased by 145% on average over the last five years, while materials and  
5 supplies increased by 22%, and contractual services – engineering increased by  
6 301% over the same time period. Schedule 11, shows the year-to-year and five  
7 year average of cost increases associated with each major expense account.

8 **Q. BEFORE YOU BEGIN A DISCUSSION OF THE SPECIFIC**  
9 **ADJUSTMENTS, WERE THERE ANY PARTICULAR EVENTS THAT**  
10 **COULD HAVE CAUSED THE COMPANY'S EXPENSES TO BE**  
11 **UNUSUALLY HIGH DURING THE TEST YEAR?**

12 **Begin Confidential**

13 A. Yes. On October 24, 2005, Key West was hit by Hurricane Wilma. According to  
14 the deposition of Mr. Johnson, this event caused significant costs to be incurred  
15 by Keys Environmental, which in turn caused significant cost increases to be  
16 incurred by the Utility at the tail end of 2005 and for several months during 2006.  
17 In his deposition, Mr. Johnson explained that the reason for the cost increases  
18 incurred by Keys Environmental was the repair and maintenance work caused by  
19 Hurricane Wilma.

20 Mr. Johnson explained the significance of this hurricane in his deposition:

21  
22 A. That was the big one for us. October 2005 was Wilma. That  
23 incapacitated our lift stations throughout the island. It necessitated  
24 crew to bring portable power via a trailer to the lift stations on  
25 around-the-clock basis.

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A. Other contract work could be a direct result, as I said earlier, of Wilma. Utilities in general, when systems come under stress such as a hurricane, they fail.

Q. Callouts: Is there any other factor other than Hurricane Wilma associated with activities from the hurricane?

A. The hurricane would explain a large percentage of that increase, as I said, requiring portable power supply on a twenty-four hour basis, to be trailing around. That is manhours upon manhours every day, including 7 o'clock at night, 10 o'clock at night, 5 in the morning, 3 in the morning. That didn't end until well into January.

Q. It looks like other outside work increased by about 50 percent from 2005 to 2006.

A. Yes. That would probably also been -- that other outside work is not necessarily non utility-related. It is work outside of the contract. So it could include work for KWRU above and beyond the contract. It could also include components of work for non utility entities.

Q. Do you have kind of a sense or notion as to why it increased by 50 percent from the year 2005 to 2006?

A. The hurricane was huge. Electrical systems underground, pumps burning up, everything related to that.

Q. Storm drain cleaning looks like it 15 increased by maybe 1000 percent.

A. Yes. Again, that was post hurricane. Hurricanes bring debris in. People wanted the debris out. There is opportunity there

...

Q. You talk about Wilma and the reason for the increase in expenses. Wilma was in October 2005?

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1 A. That is correct.

2

3 Q. Yet, these increase in expenses are occurring in 2006, is that  
4 correct?

5

6 A. Yes.

7

8 Q. Why? I guess you worked real hard in October, November  
9 and December, and there was a carryover into 2006? Is that why  
10 they increased that much?

11

12 A. Yes.<sup>97</sup>

13

14 **End Confidential**

15 **Q. WOULD IT BE APPROPRIATE TO INCLUDE IN TEST YEAR COSTS**  
16 **EXPENSES RELATED TO A HURRICANE?**

17 A. No, it would not. Because hurricanes and their associated damage are not  
18 incurred annually, it would be inappropriate to charge customers as if one of these  
19 events occurred every year.

20 **Q. WHEN WAS THE LAST TIME THAT ANOTHER HURRICANE HIT**  
21 **KEY WEST?**

22 A. According to the website <http://www.hurricanecity.com/city/keywest.htm> Key  
23 West was hit by Hurricane Irene on October 15, 1999 and did minor damage. This  
24 website also stated that Key West is affected by direct hits from hurricanes once  
25 every 7.16 years. Clearly, under these circumstances it would be inappropriate to  
26 include in test year expenses costs related to a hurricane that caused major  
27 damage and resulted in unusually high expenses.

28 **Q. WHERE THERE ANY OTHER EVENTS DURING THE TIME PERIOD**

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<sup>97</sup> Chris Johnson Deposition, pp. 55, 56, 59, 66, 67.

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1       **THAT YOU EXAMINED WHICH MAY HAVE IMPACTED EXPENSES**  
2       **THAT SHOULD BE ADDRESSED?**

3     A.    Yes. In 2003 the Company completed the construction of a new vacuum sewer  
4           collection system. As result of this, the Company anticipated adding  
5           approximately 1,500 new EDUs to its wastewater system. As a result, the  
6           Company experienced significant growth in EDUs in 2004, 2005, and 2006. In  
7           response to Staff Audit Request 18 and in response to Citizens' Interrogatory 72,  
8           the Company showed that in 2004 it added 337.23 EDUs, in 2005 it added 187.50  
9           EDUs and in 2006 it added another 151.80 EDUs. Therefore, where costs are  
10          variable I would expect the Company's expenses to increase with the addition of  
11          these customers.

12   **Q.    TAKING THESE FACTORS INTO CONSIDERATION, DO YOU HAVE A**  
13       **RECOMMENDATION ON WHICH EXPENSE ACCOUNTS SHOULD BE**  
14       **ADJUSTED DUE TO THEIR ABNORMAL NATURE?**

15   A.    Yes. I recommend that the following expenses be adjusted because test year  
16          expenses are abnormally high compared to the past four years.

- 17               • Sludge Removal
- 18               • Chemicals
- 19               • Materials and Supplies
- 20               • Contractual Services – Engineering
- 21               • Contractual Services – Other

22   **Q.    DID YOU ASK THE COMPANY WHY THESE EXPENSES INCREASED**

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1           **BETWEEN THESE YEARS?**

2       A.     Yes. Citizens requested that the Company provide an explanation for several of  
3           these expense increases. Also, the Company is required, as part of the MFR  
4           requirements, to explain increases in expense levels that are not explained by a  
5           change in the number of customers and the CPI-U. This information is supposed  
6           to be provided since the last rate case. If the applicant has not had a previous rate  
7           case, the information is to be provided for the year five years prior to the test year.

8       **Q.     WHAT WAS THE COMPANY'S RESPONSE CONCERNING WHY**  
9           **SLUDGE HAULING EXPENSES INCREASED SO SUBSTANTIALLY**  
10          **DURING THE TEST YEAR—FROM \$5,537 IN 2005 TO \$19,472 IN 2006?**

11      A.     In response to the requirements in the MFRs to explain the increase in sludge  
12           hauling costs, the Company stated: "Change in sludge disposal requirements."  
13           However, in the deposition of Mr. Johnson, when asked if sludge hauling  
14           requirements had changed in the last five years, Mr. Johnson stated: "The  
15           requirements are the requirements. They have not changed. What we have done  
16           is different, if that is what you are asking."<sup>98</sup> Citizens also asked the Company to  
17           explain the increase in these expenses in its Interrogatory 18 (a). In response to  
18           this interrogatory, the Company stated:

19                       See the Response to Audit Request No. 25. After removal of this  
20                       activity, (allowing for \$2,500 for normal activity) Sludge Removal  
21                       Expense increased by \$5,023, or 0.91%.  
22

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<sup>98</sup> Johnson Deposition, p. 10.

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1           The Company also explained in response to Interrogatory 18 that sludge  
2           hauling costs changed in the first quarter of 2005 and KWRU was no longer able  
3           to allow sludge to dry for 90 days on its drying beds. Consequently, the Company  
4           began hauling the sludge to a landfill in Miami.

5           In response to Staff Audit Request 25, the Company indicated that the  
6           invoice for \$11,412 was high compared to other months because of blower and  
7           diffuser problems at the plant and a high solids inventory that caused the Utility to  
8           haul an “inordinate” amount of solids to continue to operate the plant within DEP  
9           requirements.<sup>99</sup>

10           All of these responses indicate that the amount of sludge hauling expenses  
11           included in the test year are abnormally high.

12   **Q.   HOW MUCH DID SLUDGE REMOVAL EXPENSES INCREASE OVER**  
13   **THE LAST FIVE YEARS?**

14   A.   As shown on Schedule 11, annual sludge removal expenses increased on average  
15           by 33% over the last five years, with the increase from 2005 to 2006 at 252%. As  
16           shown on page 1 of this schedule, sludge removal expenses also increased  
17           significantly on a per customer basis. Examining the expenses on this basis will  
18           tend to reduce the impact of customer growth on expense levels (where relevant).  
19           In this case there would be some relationship between the amount of sludge  
20           processed and hauled and the number of customers. However, even accounting  
21           for this factor, sludge removal expenses decreased from \$8 a customer<sup>100</sup> in 2002

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<sup>99</sup> Response to Staff Audit Request 25.

<sup>100</sup> ERCs are used in the calculation which considers both the number of customers as well as volume.

1 to \$3 a customer in 2003, then increased to \$4 a customer in 2004, \$5 a customer  
2 in 2005 and to \$14 a customer in 2006. Clearly, the level of sludge expenses  
3 included in the test year is abnormal. Therefore, I recommend that the  
4 Commission reduce the level of test year sludge removal expenses.

5 **Q. DID THE STAFF AUDITOR FOR THE COMMISSION FIND THAT**  
6 **SLUDGE HAULING EXPENSES WERE UNUSUALLY HIGH DURING**  
7 **THE TEST YEAR?**

8 A. Yes. The Staff auditor found that the expenses during the test year appeared  
9 higher than normal. The following was contained in the Staff Audit:

10  
11 The utility recorded in Account 711 - Sludge Hauling, an expense  
12 to haul the sludge for \$11,411.82. This amount is for a total of  
13 66.62 tons. The other four charges in this account were for lower  
14 amounts. The utility explained that due to blower and diffusers  
15 problems at the plant and also to a high solids inventory, the utility  
16 had to haul an inordinate amount of solids to continue to operate  
17 within the DEP requirements. This charge is probably not  
18 recurring and may need to be amortized over five years. The yearly  
19 amortization would be \$2,282.36. The deferred amount would be  
20 \$9,129.46.<sup>101</sup>

21  
22 **Q. HOW DID YOU DETERMINE WHAT THE NORMAL LEVEL OF TEST**  
23 **YEAR SLUDGE HAULING EXPENSES SHOULD BE?**

24 A. Schedule 11 of my exhibit shows three alternatives for determining a reasonable  
25 on-going level of sludge hauling expenses. These three alternatives are to use a  
26 three year, four year, or five year average of expenses to determine a normal level  
27 of expenses. As shown, if a three year average is used, test year expenses should  
28 be reduced by \$7,819, if a four year average is used, test year expenses should be

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<sup>101</sup> Staff Audit, p. 30.



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1 reduced by \$9,033 and if a five year average is used, test year expenses should be  
2 reduced by \$8,994. Given that KWRU has been in the process of adding new  
3 customers during the last three years, I recommend using a 3-year period to  
4 determine a normal level of test year expenses. Therefore, test year expenses  
5 should be reduced by \$7,819. This amount is somewhat less than the amount  
6 developed by the Staff auditor, but reinforces that the amount of sludge hauling  
7 expense included in the test year is overstated.

8 **Q. DID YOU EXAMINE THE INCREASE IN CHEMICAL EXPENSES?**

9 A. Yes. As shown on Schedule 11, chemical expenses increased by 145% since  
10 2003. Chemical expenses increased by 64% in 2003, remained almost constant in  
11 2004, increased by 125% in 2005 and by 85% in 2006.

12 **Q. WHAT EXPLANATION HAS THE COMPANY GIVEN FOR THIS**  
13 **INCREASE IN EXPENSES?**

14 A. In the MFRs the Company indicated that chemical expenses increased due to  
15 "increased treatment requirement due to AWT standards."<sup>102</sup> This response  
16 however, appears to be geared toward the proposed 2006 increase in chemical  
17 expenses of \$112,341 associated with the AWT conversion.

18 In response to Citizens' Interrogatory 18, which asked the Company to  
19 explain the increase in chemical expenses from 2004 to 2006, the Company  
20 stated: "Documents responsive to this Interrogatory are being produced in  
21 response to the Request for Production of Documents." In response to this  
22 interrogatory, the Company produced copies of chemical bills received from its

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<sup>102</sup> MFRs, Schedule B-6.

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1 affiliate Keys Environmental. In addition, the Company explained in response to  
2 this interrogatory that chlorine prices have increased considerably and that more  
3 wastewater is being processed due to a significant increase in users in 2005-06.

4 In response to Interrogatory 49, which asked the Company to "[p]lease  
5 explain in detail why Chemical Expenses increased from \$3,773 in October to  
6 \$7,152 in November and to \$11,906 in December," the Company provided the  
7 following responses:

8 Initial Response: Our accountants did not break our supplies out of  
9 the "Chemical and Supply" categories. Please see 18 (c) for  
10 chemical amounts.

11  
12 11/20/07 Letter from John Wharton: The answer has been clarified.

13  
14 11/20/07 Supplement: Included in the General Ledger account  
15 901010000-Chemicals and Supplies are supplies other than  
16 chemicals. Invoices showing chemicals purchases have been  
17 provided in response to Interrogatory 18(c).<sup>103</sup>

18  
19 It would appear that the Company's explanation of the changes and  
20 increases in chemical expenses relate to something that affected supplies as  
21 opposed to chemicals. Regardless, the Company did not explain why the costs  
22 increased. In my opinion, if the Company booked more than just chemicals to  
23 this account, it should explain why the other expenses increased as well.

24 **Q. HAVE CHEMICAL EXPENSES INCREASED WHEN THE GROWTH OF**  
25 **CUSTOMERS IS TAKEN INTO CONSIDERATION?**

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<sup>103</sup> Response to Citizens' Interrogatory 49(a).

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1 A. Yes. As shown on page 1 of Schedule 11, chemical expenses increased from \$7  
2 per customer in 2002 to \$12 in 2003, then decreased to \$11 in 2004, increased to  
3 \$24 a customer in 2005 and then to \$36 a customer in 2006.<sup>104</sup>

4 **Q. DO YOU HAVE A RECOMMENDATION CONCERNING THE**  
5 **APPROPRIATE LEVEL OF CHEMICAL EXPENSE THAT SHOULD BE**  
6 **USED FOR THE 2006 TEST YEAR?**

7 A. Yes. As shown on Schedule 11, I recommend that test year chemical expenses be  
8 reduced by \$16,480. As with the case of sludge removal expenses, I recommend  
9 that the normal level of expenses be established using a three-year average.

10 **Q. WHAT IS THE NEXT ACCOUNT THAT YOU EXAMINED?**

11 A. The next account is the materials and supplies account which increased an  
12 average of 22% over the last five years and by 33% during the test year—  
13 increasing from \$77,678 in 2005 to \$103,361 in 2006. On a per customer basis  
14 materials and supplies increased from \$67 in 2005 to \$74 in 2006.

15 **Q. WHAT EXPLNATION HAS THE COMPANY GIVEN FOR THIS**  
16 **INCREASE?**

17 A. In the MFRs the Company indicated that materials and supplies expenses  
18 increased due to “system expansion and corrosive environment.”<sup>105</sup> Also, in  
19 response to Citizens’ Interrogatory 49, the Company gave the following reason  
20 for the increase in materials and supplies expenses:

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<sup>104</sup> ERCs are used in the calculation which considers both the number of customers as well as volume.

<sup>105</sup> MFRs, Schedule B-6.

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1 Material and supply expenses increase in July from June was  
2 mainly due to \$5,478 in office supplies which represent 2 years of  
3 a copier lease that was billed at the end of two years; to KWRU  
4 from Weiler Engineering on a copier lease in which KWRU agreed  
5 to share 50/50 with Weiler. The August to September increase of  
6 \$5,152 is due to \$8,636 repair of damaged valve pit in front of  
7 Hansen and Bringle, September. Vacuum repair for August was  
8 \$3,484 for after hours call outs.<sup>106</sup>

9  
10 In response to Citizens' Interrogatory 17, the Company also explained that  
11 the increase was due to the repair and maintenance of the vacuum collection  
12 system. Specifically, the Company stated:

13 In 2001, the Air Vac lift stations and the Vacuum collection system  
14 were not in service, so no expenses related to these activities were  
15 incurred. In 2006 \$40,000 and \$28,052 in repairs and maintenance  
16 costs were incurred respectively for these activities. Removing this  
17 \$68,052 in expenses not incurred in 2001 yields a net increase in  
18 materials and supplies from 2001 to 2006 of \$13,622, or 0.63%,  
19 well under the benchmark index.<sup>107</sup>

20  
21 The Company's response concerning the additional requirements  
22 associated with the Air Vac lift stations and the Vacuum collection system does  
23 satisfactorily account for the large increase between 2005 and 2006. These  
24 services are provided by the Utility's affiliate KEI.

25 However, with respect to the copier charges, I recommend removal of  
26 \$2,739 for the double charge on the copier lease, as I question how the copier is  
27 shared. If this copier is shared with KWRU as explained in the response to  
28 Citizens' Interrogatory 49, I question where the copier is located and which  
29 employees it is shared with, since the Utility has no employees. If the copier is  
30 located in the trailer owned by the Utility but leased to KEI and Weiler

---

<sup>106</sup> Response to Citizens' Interrogatory 49.

<sup>107</sup> Response to Citizens' Interrogatory 17.

1 Engineering, then the copier is most likely shared with KEI, not KWRU. It would  
2 be physically impossible for KWRU's employees to use the copier, since they do  
3 not exist. While it might be appropriate to disallow the entire cost, I have  
4 conservatively removed \$2,739 from test year expenses.

5 **Q. WHAT OTHER ADJUSTMENTS DO YOU RECOMMEND TO TEST**  
6 **YEAR EXPENSES?**

7 A. I recommend several adjustments for expenses which should not be borne by  
8 ratepayers. These are discussed below.

9 **Q. HAVE YOU MADE ANY ADJUSTMENT TO TRAVEL EXPENSES?**

10 A. Yes, I have. I have removed the entire \$19,106 in travel expenses for Mr. Smith  
11 that the Company had recorded in Account 775-Miscellaneous Expenses. The  
12 total travel expenses were broken down as \$6,000 paid to Green Fairways for 6  
13 months lodging and a total of \$13,106 for rental cars and airplane fuel. According  
14 to the Company, Mr. Smith's travel expenses are allocated on alternating months  
15 to the Utility and to Key West Golf Course. I have seen no explanation of why  
16 airplane fuel is allocated between the two Key West business ventures and not  
17 also among the Illinois businesses which are on the other end of Mr. Smith's  
18 Illinois to Florida Keys flights. For several reasons, I do not believe that these  
19 expenses should be borne by ratepayers.

20 As Mr. Smith's wife owns a house on Stock Island, I see no need for the  
21 Utility to be paying Mr. Smith's lodging expenses. Nor do I believe the Utility's  
22 ratepayers should be paying for rental cars or aviation fuel. Mr. Smith is a partner

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1 in multiple business ventures, in Key West, Illinois, and San Francisco. If Mr.  
2 Smith lived in the same city as this utility, ratepayers would not be asked to pay  
3 for his travel expenses. The fact that his primary home and other businesses are  
4 out of state should not cause any additional costs to be borne by the Company's  
5 customers.

6 In his deposition, Mr. Smith indicated that the \$1,000 in monthly lodging  
7 expenses were a holdover from a prior period when he paid lodging expenses. But  
8 he still did not believe that the \$6,000 of lodging expenses charged to customers  
9 should be removed:

10 Q. Just one other line of questioning. I am going to travel  
11 expenses. It says, a total of \$6000 was recorded for lodging  
12 expenses paid to Green Fairways. This was recorded for \$1000 a  
13 month, for January through November 2006. I thought you said  
14 you stayed at your wife's home.

15  
16 A. Yes.

17  
18 Q. How was that \$6000 calculated?

19  
20 A. It is a carryover from when I used to come down and stay in a  
21 hotel or stay at locations that was owned by Green Fairways.  
22 When my wife bought a house, it just continued, the lodging  
23 expense.

24  
25 Q. But the \$6000 should be removed, then?

26  
27 A. I don't think so.

28  
29 Q. Why?

30  
31 A. There are expenses for me to stay down here. It is not  
32 cheap.<sup>108</sup>  
33

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<sup>108</sup> Smith Deposition, pp. 52-3.

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I disagree. I recommend that these expenses be removed. The table below itemizes the expenses incurred by Mr. Smith and his wife to travel to Key West/Stock Island.

Smith Travel Charges 2006					
Date	Island City Flying Service	Lodging Driftwood #4	Reimburse Smith Airplane Fuel and Rental Car	Gwenn Smith Dinner	Total
01/2006	\$ 1,259	\$ 1,000			\$ 2,259
					\$ -
03/2006	\$ 195	\$ 1,000	\$ 2,690	\$ 249	\$ 4,134
03/2006			\$ 1,885		\$ 1,885
05/2006		\$ 1,000	\$ 3,578		\$ 4,578
06/2006	\$ 165				\$ 165
07/2006		\$ 1,000			\$ 1,000
09/2006		\$ 1,000			\$ 1,000
10/2006					\$ -
12/2006		\$ 1,000	\$ 2,623		\$ 3,623
	\$ 360	\$ 6,000	\$ 10,775	\$ 249	\$ 18,643
Source: Response to Citizens' POD 28 and Staff Audit Request 25.					

**Q. DID THE COMPANY SUPPLY INVOICES IN SUPPORT OF THE TRAVEL EXPENSES OF MR. SMITH?**

A. Attached as Schedule 12 is the support provided by the Company for Mr. Smith's travel expenses in response to Citizens' POD 28 and Staff Audit Request 25. As shown, there were no invoices or receipts associated with the amount paid to Mr. Smith for his \$6,000 of lodging expenses. In addition, in support of his fuel and rental car expenses, Mr. Smith provided hand written documents supporting

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1 charges for \$2,691, \$1,885, \$3,578, and \$2,623.<sup>109</sup> In addition, Mr. Smith  
2 submitted a hand written request for a \$249 charge related to a dinner apparently  
3 paid for by Mrs. Smith, shown on page 14 of this Schedule. Supporting  
4 documentation was provided for the three charges from Island City Flying  
5 Service, Inc.

6 **Q. HAS THE COMMISSION ALLOWED TRAVEL EXPENSES OF THIS**  
7 **NATURE IN PAST PROCEEDINGS?**

8 A. No, it has not. In a case involving BFF Corp. the Commission specifically  
9 disallowed travel costs for a utility owner to travel from Miami to Ocala. The  
10 Commission found:

11  
12 The utility requested \$ 6,800 annually for an officer's salary. This  
13 request was based on the owner's travel time from Miami to Ocala  
14 at an estimated 40 hours a year plus \$ 800 annually for travel,  
15 meals, and lodging and 20 hours a year for a review of the books  
16 and records. The hourly rate requested was \$ 100 per hour.

17  
18 We do not believe the customers of the utility should be  
19 responsible for the owner's travel time to and from work. We have  
20 allowed transportation expense in the past; however, this expense  
21 was for travel through the service area and to and from meetings  
22 with regulatory agencies and to utility related seminars. Therefore,  
23 we have disallowed the requested travel expenses for the owner of  
24 \$ 4,800.<sup>110</sup>

25  
26 **Q. ARE THERE ANY OTHER TRAVEL EXPENSES THAT YOU WOULD**  
27 **LIKE TO ADDRESS?**

---

<sup>109</sup> Responses to Citizens' POD 28 and Staff Audit Request 25.

<sup>110</sup> Florida Public Service Commission, Docket No. 010919-SU; Order No. PSC-02-0487-PAA-SU, April 8, 2002.



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1 A. Yes. There were several other expenses included in the travel category that  
2 deserve close scrutiny. They include expenses for reimbursements for the  
3 purchase of a vehicle for the Utility (that has no employees to drive them) that  
4 was driven to Key West from Illinois. I question these expenses for several  
5 reasons.

6 First, the Company has not demonstrated that it could not have purchased  
7 a similar vehicle without incurring the travel plus other costs incurred to drive this  
8 vehicle from Illinois to Stock Island. One invoice was for \$598 for which \$598  
9 was paid, another invoice was for \$445 for which \$500 was paid, and a third  
10 invoice for \$211 was paid in full. Another charge of \$500 was paid for personal  
11 services for finding the truck which was promised by WLS [William L. Smith].  
12 Interestingly, Mr. Chris Johnson approved the payment by the Utility for this  
13 service as well as the repairs on the vehicle driven from Illinois. There is a final  
14 charge in this account which I recommend be disallowed. The amount is \$716  
15 charged to KWRU by Chris Johnson for Southernmost Motel of \$677, a Utility  
16 lunch of \$17, and charges for an MSN dial up account that was cancelled of \$22.  
17 In total these charges amount to \$2,525.

18 **Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE \$21,631**  
19 **TRAVEL AND AUTO EXPENSES THAT YOU HAVE JUST DISCUSSED?**

20 A. I recommend that all of these expenses be disallowed. The amounts charged to  
21 the Utility by Mr. Smith are excessive and unsupported. Furthermore, as  
22 explained above, if Mr. Smith's primary residence were in Key West or Stock

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1 Island, these costs would not be incurred. In addition, the Company has provided  
2 no support for the dinner expense of \$249 for Mrs. Smith. Regarding the costs  
3 incurred to drive a vehicle from Illinois to Key West and the other miscellaneous  
4 charges of Mr. Chris Johnson, I recommend disallowance of these as well. The  
5 Company has not demonstrated that these expenses were incurred for the benefit  
6 of its customers.

7 **Q. WHAT IS YOUR RECOMMENDATION REGARDING TELEPHONE**  
8 **CHARGES?**

9 A. I recommend that the telephone charges not directly related to the Utility's  
10 business be removed from Account 775-Miscellaneous. The Utility has included  
11 \$13,814 in telephone charges in this account. Of this amount, only \$6,306 relates  
12 to Bellsouth charges for sewer customer service calls and for telephone service in  
13 KWRU's trailer. The remaining \$7,508 is for telephone charges for wireless  
14 services. These wireless services appear to be related to Mr. Bart Smith, Mr.  
15 Alexander Smith, and Ms. Leslie Johnson, all of whom are children of Mr. Smith.  
16 None of these children are employed by the Company or the affiliates that work  
17 for the Utility.

18 In addition, according to the Staff Audit, the remainder of these telephone  
19 charges are associated with Mr. Carter's cellular phone and telephone purchases.  
20 As Mr. Carter is employed by KWGC, any cellular phone charges should be  
21 charged to that Company. The Utility pays a management fee of \$8,000 a month  
22 to KWGC—Mr. Carter's cellular phone charges should be included as part of the

1 management fee. There should be no other costs charged to the Company  
2 associated with the management services provided by KWGC. Unfortunately,  
3 there are no contracts between the Company and KWGC which govern the  
4 services provided to the Company by this affiliate.<sup>111</sup> In the absence of a  
5 contractual arrangement which sets forth the costs to be charged to the Utility, I  
6 recommend that the charges for Mr. Carter's phone be disallowed.

7 In total, I recommend a disallowance of \$7,508 in miscellaneous expenses  
8 which have not been supported by the Company.

9 **Q. HAVE YOU MADE AN ADJUSTMENT TO THE COMPANY'S**  
10 **EXPENSES FOR POLITICAL CONTRIBUTIONS?**

11 A. Yes, I recommend that the Commission disallow \$1,023 in expenses incurred by  
12 the Company related to a fund raiser for Charlie Crist's gubernatorial campaign.  
13 As noted in the Staff Audit report, conformance with the NARUC Uniform  
14 System of Accounts (USOA) requires that these expenses be booked below-the-  
15 line and therefore should not be charged to ratepayers.

16 Commission Rule 25-30.115(1), Florida Administrative Code,  
17 requires water and wastewater utilities to maintain accounts and  
18 records in conformity with the 1996 National Association of  
19 Regulatory Utility Commissioners (NARUC) Uniform System of  
20 Accounts (USOA) adopted by the National Association of  
21 Regulatory Utility Commissioners. The USOA prescribes that  
22 "expenditures for the purpose of influencing public opinion with  
23 respect to the election or appointment of public officials... should  
24 be charged to Account 426, Miscellaneous Non-Utility Expense, a  
25 below-the-line account.  
26

---

<sup>111</sup> Response to Citizens' POD 29.

1 Consistent with the Staff's Audit Finding No. 16, I recommend that \$1,203 in  
2 expenses related to the fund raiser be booked below-the-line and not charged to  
3 ratepayers. The amounts are as follows: \$55 from Account 720-Materials and  
4 Supplies, \$63 from Account 775-Miscellaneous and \$1,085 from Account 760-  
5 Advertising.<sup>112</sup>

6 **Q. WHAT IS YOUR NEXT ADJUSTMENT?**

7 A. The next adjustment concerns the Company expenses for advertising/public  
8 relations expenses. According to the Company's response to Citizens'  
9 Interrogatory 20, the costs charged to advertising included:

10 The amounts included in account 760-Advertising were principally  
11 for the work of William Barry and are related to public relations  
12 rather than advertising. Certain public relations activities,  
13 including door hanging, letters to the editor, etc. were published,  
14 but there was no "advertising". The 2006 general ledger, as well as  
15 all other years, has itemization of charges (908310000 account  
16 number).<sup>113</sup>

17  
18 Most of the expenses included in the advertising account relate to charges  
19 from Mr. William Barry. Mr. Barry labels himself as a spokesperson for KW  
20 Resort Utilities Corporation. In his deposition, Mr. Barry explained that he "is a  
21 media consultant, that he does media relations and he is a spokesperson in the  
22 community."<sup>114</sup> He described his work with the Company as follows:

23 I am the spokesperson for the company. In that capacity,  
24 communicate with the press when they have questions or when we  
25 have press releases or when there is a presentation to be given to

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<sup>112</sup> Staff Audit, p. 33.

<sup>113</sup> Response to Citizens' Interrogatory 20.

<sup>114</sup> Barry Deposition, p. 3.

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1 the County Commission or public meeting concerning the utility  
2 company. I would do that on behalf of the company.<sup>115</sup>  
3

4 Although Mr. Barry is supposed to be an independent contractor and own  
5 his own company, he periodically writes letters on the letterhead of the Utility, as  
6 shown on Schedule 13. In one instance, Mr. Barry sent a letter in 2005 to the  
7 South Florida World Wildlife Fund responding to a radio interview Mr. Barry  
8 heard. The letter responds to a statement about the infrastructure needed to  
9 connect to the Utility's vacuum sewer system. The next document in the  
10 schedule is a press or news release which begins "My name is Bill Barry...." but  
11 is signed by Bill Smith, President of the Utility and addresses the political  
12 struggle for wastewater funds and the Utility's bid to provide service to other  
13 areas in the Florida Keys. The next letter is to Commissioner Dixie Spehar in  
14 defense of the instant rate increase request and its relationship to the AWT.  
15 Again the letter is on the letterhead of the Utility, but is signed by Mr. Barry.

16 In response to Citizens' Interrogatory 20, the Company provided examples  
17 of the work performed by Mr. Barry in his capacity as a spokesperson for the  
18 Utility. I have attached as Schedule 13 to my testimony several examples of the  
19 work product of Mr. Barry. As shown in this exhibit, the costs incurred by Mr.  
20 Barry are designed to enhance the public opinion of the Company.

21 Similar to the items discussed above, the documents contained in Schedule  
22 14 are designed to enhance the public's opinion of the Company. For example, as  
23 shown on page 1 of the schedule, the Company's newsletter "Customer Pipe

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<sup>115</sup> Ibid., p. 5.

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1 Line” attempts to persuade its readers that the Company has the lowest monthly  
2 sewer bill in Monroe County and the least expensive hook-up fees in the Keys.  
3 Page 5 is an opinion piece written by Mr. Barry that extols the benefits of the  
4 vacuum sewer system installed by KWRU: “Our Monroe County government  
5 leadership made the best choice for Stock Island property owners with their  
6 selection of a vacuum system. FCAA Executive Director Jim Reynolds (an  
7 engineer) also agree that a vacuum system can be an efficient and effective choice  
8 for wastewater collection.”

9 More recently, as shown on pages 11 and 12 of this schedule, Mr. Barry  
10 has attempted to refute though newspaper articles filings made in the rate case.  
11 Again, these are attempts to influence public opinion; unfortunately the  
12 information written by Mr. Barry is not always accurate.

13 **Q. WHAT HAS THE COMMISSION FOUND CONCERNING SPENDING**  
14 **RELATED TO PUBLIC RELATIONS?**

15 A. The Commission has typically disallowed expenses that are public relations  
16 oriented, finding that they benefit stockholders, not customers. When discussing  
17 the inclusion of membership dues and contributions in a utility’s test year  
18 expenses that are public relations oriented, the Commission found:

19 We acknowledge that some benefits may be accrued as a result of  
20 these expenses. However, we agree with OPC that costs related to  
21 contributions and membership dues, which are public relations  
22 oriented, should be disallowed. These costs serve to improve the  
23 image of the company, resulting in a direct benefit to the utility's  
24 shareholders, not to the customers. This treatment has been  
25 consistently applied by the Commission, as evidenced by Orders  
26 Nos. PSC-93-0301-FOF-WS at 19-20 and PSC 96-1320-FOF-WS

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1 at 151-153, which Orders were officially recognized in this  
2 proceeding.<sup>116</sup>  
3

4 In a large water and wastewater case involving Southern States Utilities,  
5 Inc., the Commission made several findings on what was appropriate to charge  
6 customers as it related to public relations-related expenses.

7 Mr. Ludsen disagreed with OPC that a public relations retainer is  
8 generally not a proper charge for rate case expense. Although he  
9 did not know specifics about the charge, Mr. Ludsen stated that the  
10 uniform rate investigation benefitted this case because of broader  
11 customer input. Mr. Ludsen did not think that SSU was trying to  
12 enhance its image, but instead trying to inform customers through  
13 brochures about the issues in the case.

14 When asked about legislative charges from the Messer Vickers law  
15 firm, Mr. Ludsen could not explain to what those related. He  
16 agreed, in general, that legislative expenses should not be charged  
17 to customers. Specifically, Mr. Ludsen agreed that charges from  
18 Landers and Parsons for preparing testimony for a Senate hearing  
19 should be removed.

20 Mr. Ludsen's response to why open houses with customers, in  
21 addition to the Commission hearings, should be charged to  
22 customers was that it was a benefit to the case. If it benefitted the  
23 case, then it benefitted the customers. He did admit that those open  
24 houses were not required by the Commission.

25 ...

26 ...

27 We believe that if SSU sees a need to inform its customers or the  
28 press about the issues in the case beyond what our rules require,  
29 then those expenditures must be borne by SSU, not the customers.  
30 Accordingly, all charges related to telemarketing, public relations,  
31 uniform rate bill inserts, mailings and door hangers, cellular  
32 telephone bills and bus transportation shall be removed. Mr.  
33 Ludsen was unable to justify why a banquet or lunch was  
34 necessary and reasonable; accordingly, this amount shall be

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<sup>116</sup> Florida Public Service Commission, United Water Florida Inc., Docket No. 960451-WS PSC-97-0618-FOF-WS, May 30, 1997.

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1 removed. As agreed to by Mr. Ludsen, any legislative or lobbying  
2 charges shall also be removed.<sup>117</sup>

3  
4 This order provides an excellent analysis of the types of public relations  
5 expenses that should not be charged to customers.

6 Another order, involving United Telephone Company of Florida, also  
7 explains the Commission's policy of not requiring customers to pay for public  
8 relations and/or image enhancement advertising.

9  
10 United has included intrastate institutional or image advertising  
11 costs of \$ 848,000 in its proposed test year operating expense. The  
12 Company asserts that LECs today are facing various forms of  
13 competition and advertising is an effective tool to deal with it.  
14 United is receiving payments from UTLD to compensate for the  
15 many tangible and intangible benefits it receives from the  
16 Company. United contends that, since the ratepayer is being  
17 compensated through the payment for the value of United's name,  
18 logo and reputation, it is only fair that the ratepayer pay for the  
19 expenditures necessary to maintain this value.

20  
21 OPC does not agree with United's argument; OPC asserts that it is  
22 flawed and a misunderstanding of the UTLD docket. The  
23 compensating payment was primarily to compensate United for  
24 marketing and operation benefits derived by UTLD. OPC  
25 recommends that we continue our long-standing, well reasoned  
26 policy of assigning the costs of institutional or image advertising to  
27 the shareholder.

28  
29 We agree with OPC that institutional or image advertising benefits  
30 the nonregulated portions of the business to a greater extent than  
31 the regulated operations and that the UTLD compensating payment  
32 is for benefits already funded by the ratepayers. We will continue  
33 our policy of excluding institutional or image advertising from the  
34 cost of service.<sup>118</sup>

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<sup>117</sup> Florida Public Service Commission, Southern States Utilities, Inc. Docket No. 950495-WS; Order No. PSC-96-1320-FOF-WS, October 30, 1996.

<sup>118</sup> Florida Public Service Commission, United Telephone Company, Docket No. 891231-TL, 891239-TL; Order No. 24049, January 31, 1991.



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**Q. WHAT IS YOUR RECOMMENDATION CONCERNING THE COSTS CHARGED TO ADVERTISING EXPENSES?**

A. I recommend that the Commission disallow all of the expenses charged to advertising expenses because, as the Utility admitted, they are related to public relations functions. This amounts to \$27,738. However, as noted above, I already recommended that \$1,085 be removed from the advertising account because it was related to political contributions. Therefore, the adjustment for advertising expenses related to public relations is \$26,653.

**Q. WHAT IS THE NEXT EXPENSE ACCOUNT THAT YOU EXAMINED?**

A. I examined the expenses included in the account Miscellaneous Expenses. There are several expenses included in this account that I do not believe should be recovered from customers. The first two expenses relate to the Company paying the Monroe County Sheriff's office to serve notice to customers about the need to hook up to the Company wastewater system. During the test year the Company paid the Monroe County Sheriff's Department \$420 to hand deliver letters to KWRU customers that had not hooked up to the sewer system. (The County later refunded \$160 of this.) In addition, KWRU also paid Anderson Process Servers \$225 during the test year. In a newspaper article, it was reported that:

Sheriff Rick Roth... permanently stopped his office's practice of uniformed deputies hand-delivering business letters for private companies for \$20 a piece. Roth said he learned of the years-long practice only Wednesday, when the media questioned him about deputies delivering letters to some Stock Island residents from KW Resort Utilities....

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1 'I was uncomfortable that they were using the Sheriff's Office to  
2 add strength, ....

3  
4 Roth said Monroe County deputies hand-deliver summonses and  
5 other legal documents for the Clerk of Court, but said he didn't  
6 know his deputies were delivering non-legal items.

7  
8 'It's not worth it.' he said. 'It's setting the wrong impression.'<sup>119</sup>

9  
10 The Company's hiring of the Sheriff's office to deliver hook-up notices  
11 was excessive and appears to be an attempt to intimidate its customers. The  
12 Commission should not endorse such practices by utilities. It is counterproductive  
13 and does not comport with providing good customer service.

14 The second expense that I recommend be disallowed is a \$100 donation to  
15 the Rotary Club of Key West. As explained above, the Commission has  
16 consistently disallowed such expenses because customers should be permitted to  
17 decide which organizations they donate to, not the utility.

18 The third expense is \$61 paid to Blossoms in Paradise. It does not appear  
19 that these charges are beneficial to ratepayers.

20 In total the amount that I recommend be removed from test year  
21 miscellaneous expenses is \$646.

22 **Q. WHAT IS THE NEXT ADJUSTMENT THAT YOU RECOMMEND?**

23 A. I recommend that the Commission adjust chemical and purchased power expense  
24 for the cost savings associated with the Company's efforts to refurbish its sewer  
25 lines. Mr. Smith explained in his testimony the significant undertaking the  
26 Company took to resleeve a substantial portion of its existing collection lines.

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<sup>119</sup> Key West Citizen, March 30, 2006, p. 1a.

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1 According to Mr. Smith, this effort was completed at the beginning of 2007 at a  
2 cost of \$600,000. Mr. Smith explained:

3 The Utility's collection system is located in an area that is subject  
4 to tidal influences and is relatively old. As such, not only has the  
5 particular location of the facilities caused its degradation, but the  
6 types of "soils" themselves and the age of the system, have  
7 resulted in substantial infiltration for years within the Utility's  
8 system. It has now reached a point where it is not only  
9 substantially impacting the ability to properly treat effluent, but  
10 also to utilize the treated effluent for reuse purposes. In addition,  
11 because the infiltration is generally high in salt content, we were  
12 told by our engineer that we could not proceed to AWT without  
13 first fixing these infiltration problems, or the AWT system would  
14 not work. Therefore, in 2006 the Utility began a project for re-  
15 sleeving a substantial portion of the existing collection system  
16 lines.<sup>120</sup>  
17

18 In response to Citizens' Interrogatory 51, the Company provided more  
19 detail on the slip lining project:

20 In October 2006 KWRU completed a slip lining of its existing  
21 Lincoln Gardens collection system which included, contractors  
22 mobilization, camera and TV reports on gravity system to be re-  
23 sleeved, slip line 6080 LF of 8 inch pipe with CIP liner, slip line  
24 620 of 12 inch LF with CIP liner, reinstatement of 158 lateral  
25 connections, 2160 LF of laterals needed to be slip lined and added  
26 or replaced 200, 4 inch clean outs w/plastic meter box and lid.  
27 Also, KWRU has a 3 year warranty on the work mentioned above.  
28 \$565,615 was the cost of the Brian Inc. slip lining project.<sup>121</sup>  
29

30 **Q. THE COMPANY INCLUDED \$600,000 OF COSTS ASSOCIATED WITH**  
31 **RESLEEING ITS COLLECTION LINES. DID IT MAKE AN**  
32 **OFFSETTING ADJUSTMENT FOR THE REDUCTION IN CHEMICALS**

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<sup>120</sup> Smith Testimony, p. 2.

<sup>121</sup> Response to Citizens' Interrogatory 51.

1       **AND PURCHASED POWER EXPENSE THAT WOULD RESULT FROM**  
2       **THIS EXPENDITURE?**

3     A.    No, it did not. Citizens requested that the Company provide a quantification of  
4       the cost savings associated with this project. Specifically, Citizens asked:  
5       “Describe and quantify all cost savings resulting from the resleeving and explain  
6       and show where these cost savings are reflected in the rate case.”<sup>122</sup>

7               In its initial response to Citizens’ Interrogatory 51, the Company stated:  
8       “Electrical and chemical costs will be lower since we are treating less wastewater;  
9       however KWRU expenses will definitely increase when we start treating to  
10       advanced wastewater treatment levels.” Citizens did not believe that the  
11       Company’s answer was responsive, so we asked the Company to supplement its  
12       response. In its supplemental response, the Company stated: “Electrical and  
13       chemical costs will be lower since we are treating less wastewater; however  
14       KWRU expenses will definitely increase when we start treating to advanced  
15       wastewater treatment levels and for the additional customers which will begin  
16       receiving service as a result of Code Enforcement.”<sup>123</sup> Citizens’ did not believe  
17       that the Company’s supplemental answer was responsive to the question of  
18       quantifying the cost savings associated with resleeving the sewer lines. In the  
19       Company’s response to Citizen’s Second Motion to Compel, the Company gave  
20       the following explanation:

21               However, by way of further response, Monroe County sought to  
22       have all wastewater treatment facilities converted to AWT by

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<sup>122</sup> Citizens’ Interrogatory 51.

<sup>123</sup> Letter from John Wharton 11-20-2007.

1 2010, and KW Resort Utilities by 2007. No cost saving analysis  
2 was performed by the Utility, since AWT Conversion is a  
3 requirement of a Monroe County Ordinances and any such analysis  
4 would have been moot. While Monroe County may or may not  
5 have performed such an analysis, the Utility believes that the  
6 environmental concerns rather than cost savings is the driving  
7 force in the Ordinances enacted.<sup>124</sup>  
8

9 Although AWT conversion was required by Monroe County, there was no  
10 requirement that the collection system be resleeved. However, it was apparently  
11 necessary in order to allow for the reuse to be used by KWGC and the Monroe  
12 County Detention Center. Regardless of what caused the resleeving of the  
13 collection system, the fact remains that chemical and electric costs will be  
14 reduced as a result of the resleeving. It would be a violation of the matching  
15 principle to include the costs of the resleeving in rate base without the offsetting  
16 reduction to expenses. Unfortunately, the Company did not make such an  
17 adjustment, nor did it attempt to do so as a consequence of Citizens' request.

18 The Commission consistently reduces chemical and purchased power  
19 expenses when a utility has excessive infiltration and inflow. Therefore, it would  
20 only be logical to reduce the same expenses when the Company has expended  
21 considerable amounts to reduce the amount of infiltration and inflow. Because the  
22 resleeving was not complete until the end of 2006, the Company's test year  
23 expenses are overstated relative to what can be expected on a going forward basis,  
24 all else being equal. Even if expenses are expected to increase due to the  
25 conversion to AWT, it is necessary to adjust test year expense to reflect the lower

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<sup>124</sup> KW Resort Utilities' Response to Citizens' Motion to Compel KWR to Respond to OPC's First Set of Interrogatories and PODs and Second Set of Interrogatories and PODs; and Motion for an Extension of Time to Prefile Testimony or Leave to File Supplemental Testimony, December 3, 2007.

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1 level of infiltration and inflow. Unfortunately, I have been unable to develop an  
2 appropriate adjustment at this time

3 **Q. WHAT PROFORMA ADJUSTMENT DID THE COMPANY PROPOSE**  
4 **CONCERNING THE OPERATING COSTS ASSOCIATED WITH AWT?**

5 A. Although not discussed in any detail in its filing, the Company is proposing to  
6 increase test year expenses by \$177,583 for "Adjustments to AWT Level  
7 Treatment."<sup>125</sup> This consists of \$46,518 for Purchased Power; \$112,341 for  
8 Chemicals; and \$18,724 for Sludge Hauling.

9 **Q. WHAT INFORMATION DID THE COMPANY PROVIDE IN SUPPORT**  
10 **OF THESE ADJUSTMENTS?**

11 A. There was no documentation included with the MFRs and there was only a brief  
12 discussion by Mr. Smith as to the need to increase test year expenses. The  
13 Company failed to provide any discussion of how the amount of additional  
14 expenses was derived.

15 **Q. DID CITIZENS REQUEST SUPPORTING INFORMATION FOR THESE**  
16 **PROFORMA ADJUSTMENTS?**

17 A. Yes, it did. However, the Company referred Citizens to its response to Citizens'  
18 POD 2. In this response there was a one page word document with a memo from  
19 Mr. Ed Castle to Mr. Doug Carter. This is shown on Schedule 15. The  
20 documentation supplied in this response was a Memorandum from Mr. Ed Castle  
21 to Mr. Doug Carter which contained the following:

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<sup>125</sup> MFRs, Schedule B-3.

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I have made the assumption that the flows will increase to 400,000 GPD since it looks like the trailer parks are finally going to connect. Under that assumption, the monthly budget numbers calculate out as shown below. Call me if you have questions.<sup>126</sup>

Cost Category	AWT Level Treatment
Electricity	\$15,650
Chemicals	\$13,592
Sludge Hauling	\$3,183

Interestingly, the Company's proforma adjustment assumes that the plant flows will be 400,000 GPD. This compares to test year flows of 287,000 GPD. Therefore, the Company assumptions on the level of electricity, chemicals, and sludge hauling expenses assume a higher level of flow than experienced during the test year. If the Commission were to use this assumption, there would be a mismatch between the test year proforma level of expenses and the test year level of revenue. The Company's calculations overstate the level of expense increase associated with just the conversion to AWT.

**Q. WHAT WOULD BE THE CORRECT ADJUSTMENT?**

A. The correct adjustment would only account for the increased costs associated with processing the wastewater under AWT standards—not costs associated with both AWT standards and increased flow beyond the test year.

**Q. IN YOUR EXAMINATION OF THE DOCUMENTS ASSOCIATED WITH THIS PROFORMA ADJUSTMENT DID YOU FIND ANYTHING ELSE UNUSUAL?**

<sup>126</sup> Response to Citizens' POD 2.

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1 A. Yes. As discussed earlier, the Company included a mark-up of 30% on the  
2 chemicals and sludge hauling expenses used in its proforma adjustment.  
3 Apparently, the Company believes that because these products are purchased  
4 from its affiliate, Keys Environmental, Inc., a mark-up over cost of 30% is  
5 warranted. I disagree. If the Utility were providing this service itself, there would  
6 be no mark-up over cost. There is simply no reason for this mark-up.

7 **Q. HAVE YOU ADJUSTED THE AMOUNT OF THE COMPANY'S**  
8 **PROPOSED AWT EXPENSES TO BRING THEM TO THE TEST YEAR**  
9 **FLOW LEVEL OF EXPENSES?**

10 A. Yes. I have estimated what the revised level of expenses would be if one were to  
11 use the test year flows of 287,000 GPD and I have also removed the 30% mark-  
12 up. To develop my adjustment, I used the Company's estimate and assumed that  
13 each component was a direct function of the flow level. As shown on Schedule  
14 15, I divided the proposed AWT expense amount by the 400,000 GPD assumption  
15 used by the Company to arrive at an expense amount for each category on a per  
16 GPD basis. I then multiplied this GPD amount by the test year level of flow to  
17 arrive at the amount of AWT increased expenses at test year flows. Unless this  
18 adjustment is made, there would be a mismatch between test year expenses and  
19 test year revenue. The consequence of this mismatch would be to overstate the  
20 amount of rate increase needed by the Company. As shown on Schedule 15, my  
21 adjustment amounts to \$211,517, or \$109,705 less than the Company's proposal.  
22 Removing the excessive mark-up from this adjustment reduces the proforma



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1 adjustment by another \$33,344. Therefore, the Company's proforma adjustment  
2 should be reduced by \$143,048.

3 **Q. HOW MUCH IS THE COMPANY REQUESTING IN RATE CASE**  
4 **EXPENSE?**

5 A. The Company is requesting rate case expenses of \$200,000.

6 **Q. IN YOUR OPINION, WAS THIS RATE CASE COMPLEX? AND IF SO,**  
7 **COULD YOU EXPLAIN THE CIRCUMSTANCES THAT MADE THIS**  
8 **CASE COMPLEX?**

9 A. I consider this case to be complex due to many factors, including but not limited  
10 to:

- 11 • the significant and questionable affiliate relationships of the Company;
- 12 • the Grand Jury investigation into the relationships and substantial money  
13 transfers between the Company, its numerous affiliates, and other entities;
- 14 • the fact that the Commission has not established rates since 1985 for  
15 KWRU; and
- 16 • the necessity of examining the capital investments and associated dollars  
17 for the period since the Commission last established rate base in 1985.

18 **Q. PLEASE DESCRIBE THE AMOUNT OF DISCOVERY CITIZENS**  
19 **PROPOUNDED TO KWRU.**

20 A. Due to the extensive nature of this case and the fact that it has been over 20 years  
21 since the Company's last rate case, Citizens requested additional interrogatories  
22 and PODs. The Commission granted 300 interrogatories and 150 PODs to

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1 Citizens in its “Amended Procedural Order.”<sup>127</sup> To date, Citizens has propounded  
2 249 interrogatories and 115 PODs, including all subparts, in four separate sets of  
3 discovery. At the time this testimony was filed, the Company had responded to  
4 the first three sets. In addition, the Company, OPC, and Staff participated in  
5 depositions on November 27 and 28.

6 **Q. HAS THE OFFICE OF THE PUBLIC COUNSEL ENCOUNTERED**  
7 **DIFFICULTY WITH THE COMPANY’S RESPONSES TO DISCOVERY**  
8 **THAT WOULD INCREASE RATE CASE EXPENSE?**

9 A. Yes. The Company has repeatedly disregarded the Commission’s procedural  
10 orders and has provided responses to Citizens’ discovery that were both late and  
11 non-definitive. Because of the Company’s lack of responsiveness to its discovery,  
12 Citizens has had to resort to filing three motions to compel concerning its first and  
13 second sets of discovery.

14 **Q. PLEASE EXPLAIN HOW THE COMPANY HAS DISREGARDED THE**  
15 **COMMISSION’S PROCEDURAL ORDERS.**

16 A. On September 17, Citizens filed its First Set of Interrogatories and First Request  
17 for Production of Documents. As a result of the Commission’s Amended  
18 Procedural Order, on September 27, Citizens filed its Amended First Set of  
19 Interrogatories and First Request for Production of Documents. At that time  
20 Citizens also provided to the Company a copy of the Amended First Set of  
21 Interrogatories and Request for Production of Documents that contained the

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<sup>127</sup> Order PSC-07-0786-PCO-SU First Order Revising Order Establishing Procedure; Order Granting in Part and Denying in Part OPC’s Motion to Permit Additional Interrogatories and PODs; and Order Granting in Part and Denying in Part the Utility’s Motion for Protective Order.

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1       strikeouts and edits. On October 5, Citizens filed its second set of discovery.

2               On October 8, the Company filed its Request for Extension of Time,  
3       Request for Clarification, and Objection to OPC's Amended First Request for  
4       Production of Documents and First Set of Interrogatories. Citizens responded on  
5       October 15, by filing its Response to KW Resort's Request for Extension of Time,  
6       Request for Clarification, and Objections to OPC's Amended 1st Request for  
7       PODs and 1st Set of Interrogatories and Citizens' Motion to Compel.

8               The Commission issued its Second Amended Procedural Order on  
9       October 25, addressing discovery disputes and amending the procedural dates of  
10      the proceeding.<sup>128</sup> In the Second Amended Procedural Order, the Commission  
11      approved the agreement reached between Citizens and the Company whereby  
12      Citizens allowed the Company four extra days to file its responses to the  
13      uncontested portion of the initial discovery, if the Utility agreed to allow Citizens  
14      four extra days in which to file its testimony and exhibits. KWRU was to submit  
15      responses to Citizens' initial set of discovery for which there was no objection on  
16      October 26. Further, the Second Amended Procedural Order provided that all  
17      contested discovery would be responded to by November 1. In addition, the  
18      Company was ordered to provide all information that is in its possession, custody,  
19      or control; state in its responses instances where information could not be  
20      provided because no such costs or charges exist; and provide information on

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<sup>128</sup> Second Order PSC-07-0851-PCO-SU Revising Order Establishing Procedure; Granting in Part and Denying in Part K W Resort's Request for Extension of Time, Request for Clarification, and Objection to OPC's Amended 1st Request for PODs and 1st Set of Interrogatories; and Granting in Part and Denying in Part OPC's Motion to Compel.

1 expenses as far back as 2002.

2 On October 26, KWRU filed its responses to the uncontested portion of  
3 Citizens' initial discovery; however, many of these responses were not complete.  
4 Although the Company filed responses to Citizens' First Set of PODs by the  
5 agreed upon date, every answer to the PODs (1-62) contained the statement, "The  
6 documents will be produced to the extent that they exist." No documents were  
7 provided on that date.

8 Additionally, 27% of the responses to Citizens' First Set of Interrogatories  
9 had problems. There were seven subparts of the Interrogatories that received no  
10 response. In addition, answers to 19 different interrogatory subparts indicated that  
11 documents responsive to the interrogatory would be produced in the POD  
12 responses, but no references were given as to the specific POD providing the  
13 response. As mentioned earlier, the documents in response to the PODs were not  
14 provided as well. Another 19 of the responses were non-definitive or incomplete.  
15 Therefore, on October 31, OPC filed a Motion to Compel KW Resort Utilities  
16 Corp. to Respond to OPC's First Set of Production of Documents and Request for  
17 Extension of Time to File Prefiled Testimony.

18 The Utility had 38 days to respond to Citizen's First Set of Production of  
19 Documents. KWRU failed to provide any reason why the documents requested  
20 had not been produced, nor did the Utility contact OPC indicating that its  
21 responses would be late. After deliberations between the Company and OPC, the  
22 Company finally provided the documents on November 6, and on November 7 the

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1 Company delivered further documents in response to OPC's PODs 50 and 60 and  
2 Interrogatory 78(k).

3 As the Company's response to OPC's motion indicates, it did not provide  
4 the documents as Citizens requested, but chose to rely on its interpretation of the  
5 Florida Rules of Civil Procedure and instead allow an inspection of the documents  
6 at its place of business. On November 8, the Commission found in its "Third  
7 Amended Procedural Order" that if the Company was not going to honor  
8 Citizens' instructions, it should have contacted OPC to work out other  
9 arrangements.<sup>129</sup> Citizens and Staff were also granted an extra three days to file  
10 their testimony and exhibits due to the Company's delay in producing the  
11 documents.

12 In the meantime, the Company filed supplemental responses to Citizens'  
13 First Set of Interrogatories 16 and 28 on November 1, and filed its responses to  
14 Citizens' Second Set of Interrogatories and PODs on November 6.

15 After evaluating the Company's responses to its first and second sets of  
16 discovery, on November 13, Citizens sent the Company an email attempting to  
17 work out further discovery disagreements directly with the Company rather than  
18 filing an additional motion to compel. A copy of this email and attachment are  
19 included hereto as Schedule 16. The email requested the Company to respond by  
20 close of business the next day. On November 14, Citizens were informed that  
21 because the Company's attorney Mr. Wharton was ill, an internal KWRU

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<sup>129</sup> Third Order PSC-07-0901-PCO-SU Revising Order Establishing Procedure; Granting in Part and Denying in Part OPC's Motion to Compel and Request for Extension of Time to File Prefiled Direct Testimony.

1 conference call would be set up for November 15 to address the issues. After not  
2 hearing from KWRU on November 15, OPC called KWRU on November 16 to  
3 determine the status of the overdue discovery.

4 On the afternoon of Friday, November 16, Citizens were told that KWRU  
5 would actually meet internally on Monday, November 19 and respond to OPC on  
6 November 20. On November 20, KWRU produced some documents responsive to  
7 Citizens' discovery, but it did not produce all the required information. As a  
8 result, the outstanding responses to Citizens' First Set of Interrogatories and  
9 PODs were 31 days late, and the outstanding responses to Citizens' Second Set of  
10 Interrogatories and PODs were 21 days overdue. Therefore, Citizens had no  
11 alternative but to file its Motion To Compel KW Resort Utilities Corp. to  
12 Respond to OPC's First Set of Interrogatories and PODs and Second Set of  
13 Interrogatories and PODs; Motion for an Extension of Time to Prefile Testimony  
14 or Leave to File Supplemental Testimony on November 26.

15 In its motion, OPC detailed those discovery requests that were deficient  
16 and the reasons thereof. In addition, Citizens brought to the Commission's  
17 attention both the Company's failure to provide affidavits for the interrogatories  
18 and identify those persons responding to each interrogatory as instructed, and its  
19 failure to follow the Commission's Procedural Order to provide some sequential  
20 identification of the documents it provided in response to OPC's PODs. The  
21 following day, the Company filed supplemental responses to Citizens'  
22 Interrogatories 26(b), 34(e), and 34(f). The Commission issued its Fourth

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1 Amended Procedural Order on December 5, addressing Citizens' concerns,  
2 ordering KWRU to provide further responses by December 10 and granting  
3 Citizens and Staff seven additional days to file their testimony and exhibits.<sup>130</sup>

4 **Q. DO YOU AGREE WITH THE COMPANY'S COMPLAINT THAT THE**  
5 **AMOUNT OF DOCUMENTS REQUESTED BY CITIZENS HAS BEEN**  
6 **EXCESSIVE?**

7 A. No. The Company would have the Commission believe that this rate case is  
8 simple. However, as I explained in my testimony earlier, there are numerous  
9 issues that must be addressed. Therefore, given the complexity of this case, I do  
10 not believe the number of documents requested was excessive.

11 **Q. DO YOU BELIEVE RATEPAYERS SHOULD BEAR THE COST OF THE**  
12 **DEFICIENCIES IN THE COMPANY'S DISCOVERY?**

13 A. No, I do not. These costs should be borne by the Company's stockholders not  
14 ratepayers.

15 **Q. ARE THERE OTHER PROBLEMS WITH THE COMPANY'S**  
16 **REQUESTED RATE CASE EXPENSE?**

17 A. Yes. Citizens are recommending a rate decrease. There was no need for the  
18 Company to file for a rate increase for its wastewater operations. Therefore, all of  
19 the Company's requested rate case expense should be disallowed.

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<sup>130</sup> Fourth Order PSC-07-0970-PCO-SU Revising Order Establishing Procedure; Granting in Part and Denying in Part OPC's Motion to Compel K W Resort to Respond to Discovery Requests; for all Discovery for which OPC's Motion to Compel is Granted, Utility to Respond by 12/10/07; Granting in Part and Denying in Part OPC's Request for Extension of Time to File Prefiled Direct Testimony; Denying OPC's Motion to File Supplemental Testimony.

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1    **Q.    IS THERE PRECEDENT FOR DISALLOWING RATE CASE EXPENSES**  
2       **IN FLORIDA?**

3    A.    Yes, the Florida Public Service Commission has disallowed rate case expenses on  
4       many occasions because it has found them to be imprudent. The Commission's  
5       decisions on this issue are set forth in Order No. PSC-02-0593-FOF-WU. In that  
6       order, it addressed Order No. PSC-98-1583-FOF-WS, issued November 25, 1998,  
7       in Docket No. 971663-WS, where Florida Cities Water Company was seeking  
8       recovery of court costs (and the rate case expense associated with the docket  
9       filing). In that case the Commission found that the incurrence of rate case expense  
10      was imprudent and denied the utility's request for recovery. Also, in Order No.  
11      PSC-96-1320-FOF-WS, issued October 30, 1996, in Docket No. 950495-WS, the  
12      Commission denied legal rate case expense of \$25,000 incurred for what it  
13      deemed an imprudent appeal of an oral decision on interim rates. In addition, in  
14      Order No. 18960, issued March 7, 1988, in Docket No. 861338-WS, the  
15      Commission determined that expenditures for misspent time were imprudent and  
16      reduced the requested rate case expense by \$32,500. Finally, in Order No. PSC-  
17      02-0593-FOF-WU, issued April 30, 2002, the Commission found: "As discussed  
18      above, it is the utility's burden to prove that its requested costs are reasonable.  
19      We find that filing combined water and wastewater rate cases would have resulted  
20      in material cost savings, and the customers should not be made to pay because  
21      Aloha incurred imprudent rate case expense."

22



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1 **IX. Staff Audit Adjustments**

2  
3 **Q. HAVE YOU ALSO MADE ADJUSTMENTS TO THE COMPANY'S**  
4 **REVENUE REQUIREMENTS BASED UPON STAFF'S FINAL AUDIT**  
5 **REPORT?**

6 A. Yes, I have. Staff filed its final audit report of KWRU on October 29, 2007.  
7 Staff's audit resulted in 19 findings. In two instances, finding AF-6 Retirements  
8 Related to Plant Proforma, and AF-8 CIAC, Staff's findings had no effect on the  
9 Company's filing. In the case of nine findings, I concur with Staff's findings and  
10 adopt their adjustments to the Company's revenue requirements. These include  
11 audit findings: AF-1 Cost Study; AF-5 Offset to Land Entry; AF-7 Accumulated  
12 Depreciation; AF-9 Temporary Cash Investments; AF-12 Office Expense; AF-13  
13 Non-recurring Expenses; AF-15 Insurance – General Liability; AF-18 Permit  
14 Fees for AWT; and AF-19 Beachcleaner Rental.

15 **Q. WOULD YOU EXPLAIN EACH OF THESE IN GREATER DETAIL?**

16 A. The first of these adjustments is AF-1 Cost Study. The last rate case order used a  
17 test year of December 31, 1983, long before the current owner took over through  
18 a stock purchase. Staff was not able to obtain supporting documentation for  
19 \$2,137,961 of plant additions from 1984 to 1997. Unless the Company is able to  
20 produce documentation in support of this amount, I recommend that the  
21 Commission accept Staff's calculations which result in a reduction to average rate  
22 base of \$972,446.53 and a reduction to depreciation expense of \$10,523.

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1 Staff AF- 5 Offset to Land Entry resulted in a reduction to average plant of  
2 \$152,255, a reduction to average accumulated depreciation of \$71,274 and a  
3 reduction to depreciation expense of \$6,765. This adjustment resulted from a  
4 correction to an adjustment proposed by the Company.

5 Staff AF-7 Accumulated Depreciation resulted from the Company's  
6 inconsistent implementation of Rule 25-30.140, F.A.C. I accept Staff's finding  
7 that average accumulated depreciation should be increased by \$251,681, average  
8 accumulated amortization should be increased by \$99,481 and depreciation  
9 expenses increased by \$16,021.

10 Staff AF-9 Temporary Cash Investments stated "The Commission has  
11 always excluded interest earning temporary cash investments from the working  
12 capital because they already earn a return and to add a return on rate base is  
13 duplicating that."<sup>131</sup> I agree with Staff that the 13-month average Working Capital  
14 in rate base be reduced by \$168,265.

15 In AF-13, the audit Staff found that Account 736-Contractual Services-  
16 Other had an expense of \$1,290 to strip and wax the Utility's office trailer floor.  
17 Amortizing this one-time non-recurring expense over five years results in an  
18 annual amortization of \$258 and a deferred amount of \$1,032. Therefore, test  
19 year expenses should be reduced by \$1,032.

20 Staff AF-15 Insurance – General Liability concerned the Utility's  
21 inclusion of insurance finance charges in Account 757-Insurance. As Staff noted  
22 in its report:

---

<sup>131</sup> Staff Audit, p. 26.

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1 Commission policy has been to reduce operating expenses for  
2 interest incurred due to late payments, on the grounds that the  
3 expense is avoidable and that the Commission should not condone  
4 the incurrence of unnecessary expenses. The Commission has  
5 stated that it is inappropriate to require customers to pay for an  
6 avoidable cost which should be borne by the utility owners. (Order  
7 No. 2 1 137, Docket No. 87 1 262-WS7 issued April 27, 1989)<sup>132</sup>  
8

9 I agree with Staff's determination that Account 757 be reduced by \$701  
10 attributable to these charges.

11 Staff AF-17 concerned the annual expense of \$2,400 the utility recorded in  
12 Account 736-Contractual Services-Other allocated from Key West Golf Club for  
13 use of a golf cart for the Utility at \$200 per month. According to the Staff's  
14 auditors the invoiced amount paid by Key West Golf Club to Yamaha for March  
15 2006 is \$6,034 for 85 golf carts. The invoiced amount for one golf cart for this  
16 month is \$71. I agree with Staff that the Utility should pay its affiliate no more  
17 than the market cost of the golf cart rental. As \$71 times 12 equals \$852,  
18 expenses in Account 736 should be reduced by \$1,548.

19 Staff AF-18 Permit Fees concerned the Utility's recording of \$9,000  
20 payable to the Florida Department of Environmental Protection. Of this total,  
21 \$2,250 was for a permit renewal for the Company's class V injection wells and  
22 \$3,000 for the renewal application review. I agree with Staff that these permit  
23 renewal fees should be amortized over 5 years. The resulting increases of \$576 to  
24 average plant in service, \$52 to average accumulated depreciation, \$104 to

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<sup>132</sup> Ibid. p. 32.

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1 depreciation expense, and a reduction of \$7,950 to taxes other than income are  
2 shown on my Schedule 1.

3 Finally, Staff AF-19 Rental of Beachcleaner found that \$11,825 charged  
4 to Account 742 - Rental of Equipment should have been capitalized as the charges  
5 were applied to the purchase price of the equipment. I accept Staff's adjustments  
6 of an increase of \$910 to average plant in service, an increase of \$493 to  
7 accumulated depreciation, an increase of \$986 to depreciation expense, and a  
8 decrease of \$11,825 to operating expenses.

9 **X. Revenue Requirement**

10  
11 **Q. WOULD YOU PLEASE EXPLAIN THE REVENUE REQUIREMENT**  
12 **THAT RESULTS FROM THE ADJUSTMENTS THAT YOU ARE**  
13 **PROPOSING?**

14 A. Schedule 1 of my exhibit sets forth each of the adjustments that I recommend. As  
15 shown on this Schedule, the revenue requirement impact of these adjustments  
16 produces a rate reduction of \$827,062. This compares to the Company's requested  
17 rate increase of \$601,684.

18 **Q. DOES THIS COMPLETE YOUR TESTIMONY PREFILED ON**  
19 **DECEMBER 17, 2007?**

20 A. Yes, it does.

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**APPENDIX I**

**KIMBERLY H. DISMUKES**

**QUALIFICATIONS**

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**Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

A. I graduated from Florida State University with a Bachelor of Science degree in Finance in March, 1979. I received an M.B.A. degree with a specialization in Finance from Florida State University in April, 1984.

**Q. WOULD YOU PLEASE DESCRIBE YOUR EMPLOYMENT HISTORY IN THE FIELD OF PUBLIC UTILITY REGULATION?**

A. In March of 1979 I joined Ben Johnson Associates, Inc., a consulting firm specializing in the field of public utility regulation. While at Ben Johnson Associates, I held the following positions: Research Analyst from March 1979 until May 1980; Senior Research Analyst from June 1980 until May 1981; Research Consultant from June 1981 until May 1983; Senior Research Consultant from June 1983 until May 1985; and Vice President from June 1985 until April 1992. In May 1992, I joined the Florida Public Counsel's Office, as a Legislative Analyst III. In July 1994 I was promoted to a Senior Legislative Analyst. In July 1995 I started my own consulting practice in the field of public utility regulation.

**Q. WOULD YOU PLEASE DESCRIBE THE TYPES OF WORK THAT YOU HAVE PERFORMED IN THE FIELD OF PUBLIC UTILITY REGULATION?**

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- A. Yes. My duties have ranged from analyzing specific issues in a rate proceeding to managing the work effort of a large staff in rate proceedings. I have prepared testimony, interrogatories and production of documents, assisted with the preparation of cross-examination, and assisted counsel with the preparation of briefs. Since 1979, I have been actively involved in more than 180 regulatory proceedings throughout the United States.

I have analyzed cost of capital and rate of return issues, revenue requirement issues, public policy issues, market restructuring issues, and rate design issues, involving telephone, electric, gas, water and wastewater, and railroad companies. I have also examined performance measurements, performance incentive plans, and the prices for unbundled network elements related to telecommunications companies. In addition, I have audited the purchased gas adjustment clauses of three gas companies and the fuel adjustment clause of one electronic company in the State of Louisiana.

**Q. WHAT IS YOUR EXPERIENCE CONCERNING COST OF CAPITAL?**

- A. In the area of cost of capital, I have analyzed the following parent companies: American Electric Power Company, American Telephone and Telegraph Company, American Water Works, Inc., Ameritech, Inc., CMS Energy, Inc., Columbia Gas System, Inc., Continental Telecom, Inc., GTE Corporation, Northeast Utilities, Pacific Telecom, Inc., Southwestern Bell Corporation, United Telecom, Inc., and U.S. West. I have also analyzed individual companies like Connecticut Natural Gas Corporation, Duke Power Company, Idaho Power Company, Kentucky Utilities Company, Southern New England Telephone Company, and Washington Water Power Company.

**Q. HAVE YOU PREVIOUSLY ASSISTED IN THE PREPARATION OF TESTIMONY CONCERNING REVENUE REQUIREMENTS?**

- A. Yes. I have assisted on numerous occasions in the preparation of testimony on a wide range of subjects related to the determination of utilities' revenue requirements and related issues.

I have assisted in the preparation of testimony and exhibits concerning the following issues: abandoned project costs, accounting adjustments, affiliate transactions, allowance for funds used during construction, attrition, cash flow analysis, conservation expenses and cost-effectiveness, construction monitoring, construction work in progress, contingent capacity sales, cost allocations, decoupling revenues from profits, cross-subsidization, demand-side management, depreciation methods, divestiture, excess capacity, feasibility studies, financial integrity, financial planning, gains on sales, incentive regulation, infiltration and inflow, jurisdictional allocations, non-utility investments, fuel projections, margin reserve, mergers and acquisitions, pro forma adjustments, projected test years, prudence, tax effects of interest, working capital, off-system sales, reserve margin, royalty fees, separations, settlements, used and useful, weather normalization, and resource planning.

Companies that I have analyzed include: Alascom, Inc. (Alaska), Arizona Public Service Company, Arvig Telephone Company, AT&T Communications of the Southwest (Texas), Blue Earth Valley Telephone Company (Minnesota), Bridgewater Telephone Company (Minnesota), Carolina Power and Light Company, Central Maine Power Company, Central Power and Light Company (Texas), Central Telephone Company (Missouri and Nevada), Consumers Power Company (Michigan), C&P Telephone Company of Virginia, Continental Telephone Company (Nevada), C&P Telephone of West Virginia, Connecticut Light and Power Company, Danube Telephone Company

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(Minnesota), Duke Power Company, East Otter Tail Telephone Company (Minnesota), Easton Telephone Company (Minnesota), Eckles Telephone Company (Minnesota), El Paso Electric Company (Texas), Entergy Corporation, Florida Cities Water Company (North Fort Myers, South Fort Myers and Barefoot Bay Divisions), Florida Power and Light, General Telephone Company (Florida, California, and Nevada), Georgia Power Company, Jasmine Lakes Utilities, Inc. (Florida), Kentucky Power Company, Kentucky Utilities Company, KMP Telephone Company (Minnesota), Idaho Power Company, Louisiana Gas Service Company, Oklahoma Gas and Electric Company (Arkansas), Kansas Gas & Electric Company (Missouri), Kansas Power and Light Company (Missouri), Lehigh Utilities, Inc. (Florida), Mad Hatter Utilities, Inc. (Florida), Mankato Citizens Telephone Company (Minnesota), Michigan Bell Telephone Company, Mid-Communications Telephone Company (Minnesota), Mid-State Telephone Company (Minnesota), Mountain States Telephone and Telegraph Company (Arizona and Utah), Nevada Bell Telephone Company, North Fort Myers Utilities, Inc., Northwestern Bell Telephone Company (Minnesota), Potomac Electric Power Company, Public Service Company of Colorado, Puget Sound Power & Light Company (Washington), Sanlando Utilities Corporation (Florida), Sierra Pacific Power Company (Nevada), South Central Bell Telephone Company (Kentucky), Southern Union Gas Company (Texas), Southern Bell Telephone & Telegraph Company (Florida, Georgia, and North Carolina), Southern States Utilities, Inc. (Florida), Southern Union Gas Company (Texas), Southwestern Bell Telephone Company (Oklahoma, Missouri, and Texas), Sprint, St. George Island Utility, Ltd., Tampa Electric Company, Texas-New Mexico Power Company, Tucson Electric Power Company, Twin Valley-Ulen Telephone Company (Minnesota), United Telephone



Company of Florida, Virginia Electric and Power Company, Washington Water Power Company, and Wisconsin Electric Power Company.

**Q. WHAT EXPERIENCE DO YOU HAVE IN RATE DESIGN ISSUES?**

A. My work in this area has primarily focused on issues related to costing. For example, I have assisted in the preparation of class cost-of-service studies concerning Arkansas Energy Resources, Cascade Natural Gas Corporation, El Paso Electric Company, Potomac Electric Power Company, Texas-New Mexico Power Company, and Southern Union Gas Company. I have also examined the issue of avoided costs, both as it applies to electric utilities and as it applies to telephone utilities. I have also evaluated the issue of service availability fees, reuse rates, capacity charges, and conservation rates as they apply to water and wastewater utilities.

**Q. WHAT FUEL AUDITS HAVE YOU CONDUCTED?**

A. I have conducted purchased gas adjustment audits of Louisiana Gas Company for the period 1971-2000, CenterPoint Energy Entex for the years 1971 through July 2001, and CenterPoint Energy Arkla for the years 1971 through December 2001. I have also audited the fuel adjust clause of Entergy Gulf States, Inc. for the period 1995-2004.

**Q. HAVE YOU TESTIFIED BEFORE REGULATORY AGENCIES?**

A. Yes. I have testified before the Arizona Corporation Commission, the Connecticut Department of Public Utility Control, the Florida Public Service Commission, the Georgia Public Service Commission, Louisiana Public Service Commission, the Missouri Public Service Commission, the Public Utilities Commission of Nevada, the Public Utility Commission of Texas, and the Washington Utilities and Transportation Commission. My testimony dealt with revenue requirement, financial, policy, rate

design, fuel, cost study issues unbundled network pricing, and performance measures concerning AT&T Communications of Southwest (Texas), Cascade Natural Gas Corporation (Washington), Central Power and Light Company (Texas), Connecticut Light and Power Company, El Paso Electric Company (Texas), Embarq (Nevada), Florida Cities Water Company, Kansas Gas & Electric Company (Missouri), Kansas Power and Light Company (Missouri), Houston Lighting & Power Company (Texas), Lake Arrowhead Village, Inc. (Florida), Lehigh Utilities, Inc. (Florida), Louisiana Gas Service Company, Jasmine Lakes Utilities Corporation (Florida), Mad Hatter Utilities, Inc. (Florida), Marco Island Utilities, Inc. (Florida), Mountain States Telephone and Telegraph Company (Arizona), Nevada Bell Telephone Company, North Fort Myers Utilities, Inc. (Florida), Southern Bell Telephone and Telegraph Company (Florida, Louisiana and Georgia), Southern States Utilities, Inc. (Florida), Sprint of Nevada, St. George Island Utilities Company, Ltd. (Florida), Puget Sound Power & Light Company (Washington), and Texas Utilities Electric Company.

I have also testified before the Public Utility Regulation Board of El Paso, concerning the development of class cost-of-service studies and the recovery and allocation of the corporate overhead costs of Southern Union Gas Company and before the National Association of Securities Dealers concerning the market value of utility bonds purchased in the wholesale market.

**Q. HAVE YOU BEEN ACCEPTED AS AN EXPERT IN THESE JURISDICTIONS?**

**A.** Yes.

**Q. HAVE YOU PUBLISHED ANY ARTICLES IN THE FIELD OF PUBLIC UTILITY REGULATION?**

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- A. Yes, I have published two articles: "Affiliate Transactions: What the Rules Don't Say",  
Public Utilities Fortnightly, August 1, 1994 and "Electric M&A: A Regulator's Guide"  
Public Utilities Fortnightly, January 1, 1996.

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**ACKNOWLEDGEMENT**

**DATE:** December 17, 2007

**TO:** Stephen Burgess/Office Of Public Counsel

**FROM:** Ruth Nettles, Office of Commission Clerk

**RE:** Acknowledgement of Receipt of Confidential Filing

This will acknowledge receipt of a **CONFIDENTIAL DOCUMENT** filed in Docket Number 070293 or, if filed in an undocketed matter, concerning Portions of Direct Testimony of Kimberly H. Dismukes, and filed on behalf of Office Of Public Counsel. The document will be maintained in locked storage.

If you have any questions regarding this document, please contact Marguerite Lockard, Deputy Clerk, at (850) 413-6770.

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