

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application of ORTEGA UTILITY)	DOCKET NO. 871262-WS
CO. for rate increase in Duval County.)	ORDER NO. 20666
<hr/>	ISSUED: 1-27-89

Pursuant to Notice, a Prehearing Conference was held on January 9, 1989, in Tallahassee, before Commissioner Gerald L. Gunter, Prehearing Officer.

APPEARANCES: ALLAN G. GIMBEL, Esquire, 4981 Atlantic Boulevard, Suite 4, Jacksonville, Florida 32207
On behalf of Ortega Utility Co.

ROBERT J. PIERSON, Esquire, Florida Public Service Commission, 101 East Gaines Street, Tallahassee, Florida 32399-0850
On behalf of the Commission Staff

PRENTICE P. PRUITT, Esquire, Florida Public Service Commission, 101 East Gaines Street, Tallahassee, Florida 32399-0850,
Counsel to the Commission

PREHEARING ORDERBACKGROUND

On August 8, 1988, Ortega Utility Company (Ortega or utility) completed the minimum filing requirements (MFR's) for a general rate increase and that date was established as the official date of filing. The approved test year for this docket is the historical twelve-month period ended December 31, 1987.

Ortega has requested final rates designed to generate annual revenues of \$393,732 for water and \$489,884 for sewer. These revenues represent increases over test year revenues of \$215,109 (120%) and \$231,072 (89%) for water and sewer, respectively. Ortega proposes to implement these rates in two phases. At the end of the eight-month suspension period, the utility proposes to implement rates which are approximately ninety per cent of the requested final rates. The final rates would be implemented upon substantial completion of a number of proforma plant additions. If these proforma plant additions are not substantially completed with a thirty-month period of time, Ortega proposes that the final rates not be implemented.

A formal hearing on Ortega's application for increased rates is currently scheduled to be held February 13 through 14, 1989, in Ortega's service area.

PREFILED TESTIMONY AND EXHIBITS

Testimony of all witnesses to be sponsored by the parties has been prefiled. All testimony which has been prefiled in this case will be inserted into the record as though read after the witness has taken the stand and affirmed the correctness of the testimony and exhibits. All testimony remains subject to appropriate objections. Each witness will have the opportunity to orally summarize his or her testimony at the time he or she

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takes the stand. Upon insertion of a witness' testimony, exhibits appended thereto may be marked for identification. After opportunity for opposing parties to object and cross-examine, the document may be moved into the record. All other exhibits will be similarly identified and entered at the appropriate time during hearing.

Witnesses are reminded that on cross-examination responses to questions calling for a yes or no answer shall be answered yes or no first, after which the witness may explain the answer.

ORDER OF WITNESSES

<u>Direct</u>	<u>Appearing For</u>	<u>Issues</u>
Ray Avery	Ortega	Quality of service, financial & accounting matters
Alan W. Potter, Sr.	Ortega	Quality of service, financial & accounting matters
Alan W. Potter, Jr.	Ortega	Quality of service, financial & accounting matters
<u>Rebuttal</u>		
Mary G. Hermany*	Ortega	Response to customer testimony

* Indicates that testimony has not been prefiled.

BASIC POSITIONS

UTILITY: Ortega's basic position is that a rate increase is warranted as set forth in it's rate case application and prefiled testimony.

STAFF: Staff's basic position is that a rate increase may be warranted, but certain adjustments need to be made to Ortega's rate base and operating statements.

ISSUES AND POSITIONS

Quality of Service

1. ISSUE: Is the quality of service satisfactory?

POSITIONS

ORTEGA: The quality of service provided by Ortega Utility Company to its customers is excellent. (Potter, Sr., Potter, Jr. & Avery)

STAFF: No position at this time. Customer testimony must be considered.

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Test Year

2. **ISSUE:** Should an average test year be used?

POSITIONS

ORTEGA: No, due to the fact that much of the expansion required to meet existing regulatory requirements occurred near the end of the test year and due to the magnitude of the proforma adjustments which will occur after the end of the test year, we believe that the year end test year approach is the more accurate and appropriate in this rate case. (Avery, Potter, Jr.)

STAFF: Yes, a thirteen-month average test year ended December 31, 1987, should be used.

Rate Base

3. **ISSUE:** What are the appropriate used and useful percentages?

POSITIONS

ORTEGA: All items of plant are 100% used and useful. (Potter, Sr., Potter, Jr. & Avery)

STAFF: The following are the appropriate used and useful percentages:

	<u>Water</u>	<u>Sewer</u>
<u>Treatment Plants:</u>		
Blanding	100 percent	100 percent
Airport	100 percent	92.55 percent
Herlong	100 percent	100 percent
<u>Collection/Distribution System:</u>		
Blanding	76.06 percent	69.44 percent
Airport	100 percent	100 percent
Herlong	100 percent	100 percent

4. **ISSUE:** Should proforma plant be included in rate base?

POSITIONS

ORTEGA: Yes. Proforma plant in the amounts of \$306,800 for water and \$307,546 for sewer should be allowed in rate base and a return allowed at such time as they are completed. (Potter Jr., Sr. & Avery)

STAFF: No proforma plant should be allowed in rate base.

5. **ISSUE:** Are there any pending orders by any governmental agencies which would require the expenditure of significant funds not included in this rate case application?

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POSITIONS

ORTEGA: Yes, a proposed "zero discharge" order (currently being opposed in an administrative proceeding) would require the expenditure of in excess of \$1.2 million to construct an effluent outfall main from the Blanding sewage treatment plant to the St. Johns River. (Potter, Sr. & Potter, Jr.)

STAFF: Any such speculative expenditures are outside of the test year, completely outside of the contemplation of this proceeding and are, therefore, irrelevant.

6. **ISSUE:** Should proforma land costs be included in the sewer rate base?

POSITIONS

ORTEGA: A \$20,000 proforma adjustment for land for the Herlong System reaeration basin should be allowed. (Avery, Potter, Sr. & Potter, Jr.)

STAFF: No proforma additions to land should be allowed.

7. **ISSUE:** What amounts of plant, accumulated depreciation, CIAC and accumulated amortization of CIAC are non-used and useful?

POSITIONS

ORTEGA: The company does not consider that any of its plant, accumulated depreciation, CIAC, or accumulated amortization of CIAC are non-used-and useful. (Potter, Jr., Potter, Sr. & Avery)

STAFF: The following balances should be recorded as plant held for future use:

	<u>Water</u>	<u>Sewer</u>
Plant in Service	(\$166,731)	(\$104,327)
Accum. Depr.	24,593	19,512
CIAC	15,499	35,448
Accum. Amort. CIAC	<u>(3,426)</u>	<u>(7,286)</u>
Plant Held for Future Use	(\$130,065)	(\$ 56,653)

8. **ISSUE:** Should a margin reserve be included in the used and useful calculations? If so, what is the appropriate amount?

POSITIONS

ORTEGA: Yes. Twenty percent (20%) margin reserve should be included in the used-and-useful calculations. (Potter, Sr. & Avery)

STAFF: No position at this time.

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9. **ISSUE:** If a margin reserve is allowed in the used and useful calculation, should CIAC be imputed on the margin reserve?

POSITIONS

ORTEGA: No. Ortega believes that the margin reserve is essential in placing it in a ready-to-serve situation, particularly in view of the regulatory and permitting lag in seeking approvals for new construction. (Potter, Jr. & Avery)

STAFF: No. Since CIAC is prepaid by the developer and is, therefore, already included in rate base, no imputation is necessary.

10. **ISSUE:** Should construction-work-in-progress (CWIP) be allowed in rate base and if so, what is the appropriate amount?

POSITIONS

ORTEGA: Yes. CWIP should be allowed in rate base in the amount of \$10,321.00, per schedule A-3. Ortega has considered all CWIP and proforma capitol expenditures as being a part of utility plant-in-service in its presentation and it has transferred all work in progress except for the \$10,321.00 to utility plant-in-service for the purposes of this rate case. (Avery & Potter, Sr.)

STAFF: No CWIP should be included in rate base.

11. **ISSUE:** Should accumulated depreciation and depreciation expense be annualized to reflect test year and proforma plant additions?

POSITIONS

ORTEGA: Yes, accumulated depreciation and depreciation expense should be increased by \$9,792 for water and \$9,279 for sewer to reflect the annualization of test year depreciable asset additions and proforma depreciable asset additions, subject to final adjustments agreed upon. (Avery)

STAFF: Yes, accumulated depreciation and depreciation expense should be increased by \$2,122 for water and \$1,415 for sewer to reflect the annualization of test year additions. No depreciation should be allowed for proforma plant.

12. **ISSUE:** Should accumulated amortization and amortization expense related to CIAC be annualized to reflect test year additions?

POSITIONS

ORTEGA: Yes, accumulated amortization and amortization expense should be increased by \$202 for water and \$71 for sewer to reflect the annualization of test year additions. (Avery)

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STAFF: Yes, accumulated amortization and amortization expense should be increased by \$202 for water and \$71 for sewer to reflect the annualization of test year additions.

13. **ISSUE:** Should the reserve balance of accumulated depreciation and amortization of CIAC be restated for the test year due to the change to the depreciation rates prescribed by Rule 25-30.140, Florida Administrative Code?

POSITIONS

ORTEGA: Yes. Ortega agrees with this for the purposes of determining rates; however, Ortega strongly objects to either the imputation of the depreciation rates prior to the conclusion of this rate hearing or, providing the adjustments to accumulated depreciation and the accumulated amortization on CIAC are not retroactive to the computation of rate base or to the beginning of the test year. (Avery & Potter, Sr.)

STAFF: Yes, accumulated depreciation should be increased by \$6,042 for water and \$13,599 for sewer. Accumulated amortization of CIAC should be increased by \$6,871 for water and \$18,159 for sewer.

14. **ISSUE:** What is the appropriate method to calculate the working capital allowance?

POSITIONS

ORTEGA: The appropriate method of calculating the working capital allowance is the one-eighth of operation and maintenance (O & M) expense method. (Avery)

STAFF: The balance sheet approach.

15. **ISSUE:** Should deferred rate case expense be included in the working capital allowance?

POSITIONS

ORTEGA: No. If the one-eighth of O & M expense method is utilized to calculate the working capital allowance, it will not be necessary to include deferred rate case expense in working capital, however, it will have to be included as an amortization expense in the operating expenses included in this rate case. (Avery & Potter, Sr.)

STAFF: Yes, the average unamortized balance should be included in the working capital allowance.

16. **ISSUE:** What is the appropriate working capital allowance to be included in rate base?

POSITIONS

ORTEGA: The appropriate working capital allowance to be included in rate base is \$19,913 for water and \$29,870 for

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sewer, based upon the one-eighth O & M expense method.
(Avery)

STAFF: The appropriate working capital allowance is (\$13,035) for water and (\$53,892) for sewer.

17. **ISSUE:** What is the test year rate base?

POSITIONS

ORTEGA: The test year rate base is \$1,189,978 for water and \$855,293 for sewer subject to the adjustments to utility plant in service, accumulated depreciation, CIAC, and amortization of CIAC in the amounts the company has conceded in other issues. (Avery)

STAFF: A thirteen month average rate base of \$675,988 for water and \$276,787 for sewer.

Capital Structure

18. **ISSUE:** Should proforma adjustments to long- and short-term debt be allowed?

POSITIONS

ORTEGA: Yes. (Avery)

STAFF: No. If proforma plant is not incorporated in rate base, the associated debt should be excluded from the utility's capital structure.

19. **ISSUE:** What is the appropriate test year balance of debt to be used in the capital structure?

POSITIONS

ORTEGA: Per Ortega's filing, the appropriate proforma test year end debt balance is \$915,076. After giving effect to the proforma debt required to finance the proforma capital expenditures, the resulting debt to be included in the cost of capital calculations should be \$1,685,551, subject to adjustments agreed upon. (Avery & Potter, Sr.)

STAFF: The appropriate test year balance of debt is \$920,710.

20. **ISSUE:** What is the appropriate cost of long-term debt?

POSITIONS

ORTEGA: As set forth on Schedules D-1 and D-2, the appropriate cost of long-term debt is 12.32 percent. (Avery & Potter, Sr.)

STAFF: 10.91 percent.

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21. **ISSUE:** What is the appropriate cost of short-term debt?

POSITIONS

ORTEGA: As set forth on Schedules D-1 and D-2, the appropriate cost of short-term debt is 11.86 percent. (Avery & Potter, Sr.)

STAFF: 10.91 percent.

22. **ISSUE:** What is the correct deferred tax balance?

POSITIONS

ORTEGA: \$15,597. (Avery)

STAFF: No position at this time.

23. **ISSUE:** What is the correct investment tax credit (ITC) balance?

POSITIONS

ORTEGA: \$17,851. (Avery)

STAFF: No position at this time.

24. **ISSUE:** Should ITC's be amortized over the remaining lives of the related assets on a prospective basis?

POSITIONS

ORTEGA: No. (Avery)

STAFF: Yes.

25. **ISSUE:** What is the overall rate of return?

POSITIONS

ORTEGA: As set forth on Schedule D-1, the appropriate return on rate base is 12.33 percent, subject to adjustments agreed upon. (Avery & Potter, Sr.)

STAFF: 11.50 percent.

Net Operating Income

26. **ISSUE:** Should the utility's proposed proforma adjustments to salary and associated expenses for three Class C operators be allowed?

POSITIONS

ORTEGA: Yes. A Class C operator is required for each wastewater treatment facility within Duval county per City

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of Jacksonville Environmental Protection Board Rule.
(Potter, Jr., Avery & Potter, Sr.)

STAFF: No adjustment is appropriate.

27. **ISSUE:** Should salaries and wages be annualized to reflect the effect of several utility personnel changing from a contract to a salary basis?

POSITIONS

ORTEGA: O & M expenses should be increased to reflect the full cost, including taxes and benefits, of all personnel who previously performed services on a contractual basis but who are now employees of Ortega Utility Company. Ortega has not analyzed these amounts as yet. Therefore, it is not in a position to agree with the amounts set forth in Staff's position. (Potter, Sr. & Avery)

STAFF: Yes, O & M expenses should be increased by a net amount of \$1,376 for water and \$8,096 for sewer.

28. **ISSUE:** What is the appropriate balance of rate case expense for this case?

POSITIONS

ORTEGA: The appropriate balance of rate case expense is \$91,200, as set forth in Schedule B-3, page 3 of 4 and in Schedule B-15(a) and B-15(b). (Avery & Potter, Sr.)

STAFF: \$78,136.

29. **ISSUE:** Over what period should rate case expense be amortized?

POSITIONS

ORTEGA: Rate case expense should be amortized over five (5) years unless the proforma capital expenditures are disallowed, in which case rate case expense should be amortized over two (2) years. (Avery & Potter, Sr.)

STAFF: Rate case expense should be amortized over five years.

30. **ISSUE:** How should a \$5,637 gain on the disposition of utility property be treated?

POSITIONS

ORTEGA: Yes, since this is a non-recurring item, it should not be considered when evaluating future revenues required to cover operating costs and a fair return on Ortega's investment. (Avery, Potter, Sr.)

STAFF: It should be amortized over a five-year period.

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31. **ISSUE:** Should the costs associated with litigation regarding the utility's certificated area be included in test year expenses?

POSITIONS

ORTEGA: Yes, the adversarial position of the City of Jacksonville makes continuing legal expenses probable. (Potter, Sr., Potter, Jr. & Avery)

STAFF: No, these costs should be deferred and amortized over a five-year period. One-fifth of these amounts, or \$3,045 for water and \$1,764 for sewer, should be allowed as test year expenses. The remaining four-fifths, or \$12,181 for water and \$7,057 for sewer, should be included as a deferred debit in the working capital allowance at the average unamortized balance.

32. **ISSUE:** Should O & M expenses be reduced based upon a benchmark analysis?

POSITIONS

ORTEGA: No, Ortega operates three (3) utility systems 30 miles apart and O & M expenses for personnel and transportation are greater than if only one system were operated. Ortega does not believe the benchmark analysis is appropriate. (Avery & Potter, Sr.)

STAFF: Until final O & M expense balances are determined, a benchmark analysis cannot be completed.

33. **ISSUE:** What are the appropriate depreciation expenses?

POSITIONS

ORTEGA: As set forth on Schedules B-1 and B-2, the appropriate depreciation expense, net of CIAC, is \$31,704.00 water and \$18,348.00 sewer, subject to adjustments agreed upon. (Potter, Sr., Potter, Jr. & Avery)

STAFF: The appropriate used and useful depreciation expenses, net of CIAC amortization, are \$29,468 for water and \$14,036 for sewer, based upon the guideline rates incorporated in Rule 25-30.140, Florida Administrative Code.

34. **ISSUE:** What is the appropriate amount of amortization expense for limited term assets?

POSITIONS

ORTEGA: Providing that proforma plant is included, the appropriate amortization amount on limited term assets including rate case amortization is \$17,120.00 water and \$20,720 sewer. (Avery & Potter, Sr.)

STAFF: No amortization expense should be allowed for limited term assets.

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35. **ISSUE:** Should proforma personal and real property taxes associated with proforma plant be allowed?

POSITIONS

ORTEGA: Yes, proforma personal and real property taxes associated with proforma plant additions should be allowed. (Avery & Potter, Sr.)

STAFF: No. If proforma plant is not incorporated in rate base, the associated personal and real property taxes should be excluded from test year expenses.

36. **ISSUE:** Should taxes other than income taxes be adjusted to reflect the early payment discount lost on real estate and personal taxes, due to a postponement of payment?

POSITIONS

ORTEGA: No, taxes other than income taxes should not be adjusted to reflect the discount lost as a result of the payment not being made during the discount period. (Potter, Sr. & Avery)

STAFF: Yes, taxes other than income taxes should be reduced by \$310 for water and \$768 for sewer.

37. **ISSUE:** Should taxes other than income taxes be adjusted to reflect the effect of the annualization of salaries and wages on payroll taxes?

POSITIONS

ORTEGA: Yes, once the proper annualization of salaries and wages is determined the payroll taxes should be adjusted accordingly. (Avery & Potter, Sr.)

STAFF: Yes, taxes other than income taxes should be increased by \$2,103 for water and \$3,333 for sewer.

38. **ISSUE:** What is the correct amount of income tax expense?

POSITIONS

ORTEGA: \$6,958 for water and \$5,039 for sewer, for a total of \$11,997. (Avery)

STAFF: No position at this time.

39. **ISSUE:** What is the test year net operating income?

POSITIONS

ORTEGA: The test year operating income should be \$146,962 for water and \$105,629 for sewer, subject to adjustments agreed upon. (Avery)

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STAFF: Test year net operating income is \$1,832 for water and (\$24,300) for sewer.

Revenue Requirement

40. **ISSUE:** What are the total revenue requirements?

POSITIONS

ORTEGA: Based on the test year presentation, the total revenue requirements should be \$393,732 for water and \$489,884 for sewer, subject to adjustments to be agreed upon. (Avery)

STAFF: The total revenue requirements are \$275,558 for water and \$330,543 for sewer.

Rates

41. **ISSUE:** Should the utility be required to meter unmetered duplexes in the Herlong System?

POSITIONS

ORTEGA: No, in order to meter the 45 duplexes substantial new construction of water distribution system in this area would be required and that cost is not cost effective. (Potter, Jr., Potter, Sr. & Avery)

STAFF: No position at this time.

42. **ISSUE:** Is Ortega entitled to a rate increase for water and sewer service based upon the results of its operations for the historical test year?

POSITIONS

ORTEGA: Yes. (Avery)

STAFF: No position at this time.

43. **ISSUE:** Should rates associated with proforma capital expenditures be implemented prior to the completion of such capital expenditures and on what basis should Ortega's requested second-phase rates be established?

POSITIONS

ORTEGA: No. Ortega has asked for a special three-phase implementation of rates as follows: (1) a portion of the rates would be implemented as interim rates; (2) the complete rates on existing plant in service are requested to be implemented upon expiration of the eight month rate case dead line, and; (3) the final rates are requested to be implemented upon completion of proforma capital expenditures which Ortega commits to complete within 30 months of the official filing date of this rate case application. (Potter, Sr., Potter, Jr. & Avery)

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STAFF: No, because proforma plant should not be included.

44. **ISSUE:** If the Commission approves the inclusion of proforma plant, should the Commission also include the additional revenues and expenses associated with the phase-in?

POSITIONS

ORTEGA: Yes. (Avery, Potter, Sr.)

STAFF: No position at this time.

45. **ISSUE:** Should the utility's service availability charges be modified to comply with Rule 25-30.580, Florida Administrative Code?

POSITIONS

ORTEGA: Yes, Ortega Utility Company plans to file a service availability case following completion of this rate case. (Potter, Sr. & Avery)

STAFF: No position at this time.

46. **ISSUE:** What rates are appropriate for this utility?

POSITIONS

ORTEGA: The appropriate rates for this utility are those set forth in Schedule E-1, pages 1 of 2 through 2 of 2, subject to the adjustments to be agreed upon. (Avery, Potter, Sr.)

STAFF: No position at this time. These numbers will fall out from the various adjustments and calculations made in this case.

Miscellaneous

47. **ISSUE:** Does the utility maintain its books and records in accordance with the NARUC Uniform System of Accounts as prescribed by Rule 25-30.115, Florida Administrative Code?

POSITIONS

ORTEGA: Ortega does not precisely comply with the NARUC System of Accounts and has not practiced monthly close out of its records. Additionally, the test year operating costs of Ortega Utility Company do not reflect adequate personal costs to comply with monthly close out. Future compliance with the NARUC System of Accounts and monthly close out will be practiced, however, Ortega needs additional revenue consideration for this additional accounting cost if such efforts are ordered. (Potter, Sr. & Avery)

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STAFF: No, the utility does not use the prescribed NARUC account numbers. It should be ordered to maintain its books on a monthly basis and convert its Chart of Accounts to the NARUC Chart of Accounts. The utility may provide a list of the account numbers and subdivisions of accounts which it uses and a reconciliation of such numbers and subdivisions with the account numbers and titles prescribed by the NARUC Chart of Accounts.

STIPULATIONS

The company and Staff agree to the following:

1. The appropriate balances of land, other than proforma land, to be used in determining rate base are \$10,840 for water and \$115,629 for sewer.
2. The balances of CIAC are understated due to the utility's failure to make certain adjustments required under Order No. 7671. CIAC should be increased by \$10,305 for water and by \$22,185 for sewer.
3. Accumulated depreciation for water is understated due to a \$10,700 well installed in 1978 being included in the cost of land. Accumulated depreciation should be increased by \$2,541 for water.
4. Accumulated amortization of CIAC is understated due to the utility's failure to make certain adjustments required under Order No. 7854. Accumulated Amortization of CIAC should be increased by \$1,062 for water and by \$1,637 for sewer.
5. The balance of accumulated amortization of CIAC is understated for the years 1976 through 1987, based upon an adjustment made in Order No. 7671 to increase CIAC, and should be increased by \$3,092 for water and \$6,656 for sewer.
6. The appropriate return on equity is 14.35 percent, based upon the current leverage formula adopted in Order No. 19718.
7. Test year O & M expenses should be increased by \$729 for water and \$1,086 for sewer to reflect a 1987 price index adjustment acknowledged in Order No. 18981.
8. Ortega should be required, prospectively, to provide additional documentation on receipts for cash purchases. For cash purchases of materials and supplies a notation of the type of item purchased and the job number or system designation should be noted on the receipt. For cash transportation purchases (gas or miscellaneous parts), the vehicle tag number should be noted on the receipt.
9. Ortega should be required to change from a minimum charge rate structure to a base facility charge rate structure.
10. Ortega should be required to charge all customers on a uniform basis, charging the base facility charge in advance and the gallonage charge in arrears.

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EXHIBITS

<u>Witness</u>	<u>Proffered By</u>	<u>Exhibit No.</u>	<u>Description</u>
Avery, Potter, Sr. & Potter, Jr.	Ortega	1	Ortega's MFRs

Staff did not prefile any testimony or exhibits, but reserves the right to introduce exhibits for the purpose of cross-examination.

Based upon the foregoing, it is

ORDERED by Commissioner Gerald L. Gunter, as Prehearing Officer, that this Prehearing Order shall govern the conduct of these proceedings as set forth below unless modified by the Commission.

By ORDER of Commissioner Gerald L. Gunter as Prehearing Officer, this 27th day of JANUARY, 1989.

 GERALD L. GUNTER, Commissioner
 and Prehearing Officer

(S E A L)

RJP

 /s/ *Steve Tribble*
 STEVE TRIBBLE, Director
 Records and Reporting