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December 9, 1992

Mr. Steve Tribble, Director
Division of Records and Reporting
Florida Public Service Commission
101 East Gaines Street
Tallahassee, Florida 32399-0850

HAND DELIVERY

Re: FPSC Docket No. 920199-WS

Dear Mr. Tribble:

Enclosed for filing in the above-referenced docket are the following documents:

1. Original and fifteen copies of the Posthearing Brief of Southern States Utilities, Inc.; and

2. Two disks containing a copy of the Brief entitled "Gigabrf.pt1" and "Giga .pt2" in Word Perfect 5.0.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

hank you for your assistance with this filing.

Sincerely,

Kenneth A. Hoffman

KAH/rl
Enclosures

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DOCUMENT NUMBER-DATE
14294 DEC -9 1992
FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application of Southern States Utilities, Inc. and Deltona Utilities, Inc. for Increased Water and Wastewater Rates in Citrus, Nassau, Seminole, Osceola, Duval, Putnam, Charlotte, Lee, Lake, Orange, Marion, Volusia, Martin, Clay, Brevard, Highlands, Collier, Pasco, Hernando, and Washington Counties.	Docket No. 920199-WS Filed: December 9, 1992

POSTHEARING BRIEF OF SOUTHERN STATES UTILITIES, INC.

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TABLE OF CONTENTS

	Page
I. BASIC POSITION	1
II. ISSUES	5
Issue 1	5
Issue 2	16
Issue 3	18
Issue 4	20
Issue 5	28
Issue 6	35
Issue 7	37
Issue 8	42
Issue 9	45
Issue 10	46
Issue 11	47
Issue 12	47
Issue 13	48
Issue 14	48
Issue 15	49
Issue 16	51
Issue 17	52
Issue 18	53
Issue 19	55
Issue 20	56
Issue 21	58

Issue 22 58
Issue 23 59
Issue 24 60
Issue 25 61
Issue 26 62
Issue 27 63
Issue 28 65
Issue 29 66
Issue 30 68
Issue 31 69
Issue 32 72
Issue 33 72
Issue 34 83
Issue 35 86
Issue 36 87
Issue 37 87
Issue 38 88
Issue 39 88
Issue 40 89
Issue 41 91
Issue 42 92
Issue 43 93
Issue 44 96
Issue 45 96
Issue 46 97
Issue 47 98

Issue 48 102
Issue 49 104
Issue 50 105
Issue 51 107
Issue 52 108
Issue 53 108
Issue 54 110
Issue 55 111
Issue 56 111
Issue 57 112
Issue 58 115
Issue 59 115
Issue 60 117
Issue 61 119
Issue 62 121
Issue 63 122
Issue 64 123
Issue 65 124
Issue 66 126
Issue 67 127
Issue 68 128
Issue 69 134
Issue 70 136
Issue 71 136
Issue 72 138
Issue 73 139

Issue 74 141
Issue 75 142
Issue 76 143
Issue 77 143
Issue 78 144
Issue 79 144
Issue 80 145
Issue 81 147
Issue 82 148
Issue 83 151
Issue 84 152
Issue 85 152
Issue 86 153
Issue 87 153
Issue 88 153
Issue 89 156
Issue 90 158
Issue 91 158
Issue 92 158
Issue 93 161
Issue 94 162
Issue 95 164
Issue 96 165
Issue 97 168
Issue 98 169
Issue 99 169

Issue 100 169
Issue 101 170
Issue 102 171
Issue 103 171
Issue 104 173
Issue 105 175
Issue 106 175
Issue 107 175
Issue 108 175
Issue 109 176
Issue 110 177
Issue 111 178
Issue 112 178
Issue 113 183
III. CONCLUSION 186
CERTIFICATE OF SERVICE 187

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application of Southern States Utilities, Inc. and Deltona Utilities, Inc. for Increased Water and Wastewater Rates in Citrus, Nassau, Seminole, Osceola, Duval, Putnam, Charlotte, Lee, Lake, Orange, Marion, Volusia, Martin, Clay, Brevard, Highlands, Collier, Pasco, Hernando, and Washington Counties.	Docket No. 920199-WS Filed: December 9, 1992

POSTHEARING BRIEF OF
SOUTHERN STATES UTILITIES, INC.

SOUTHERN STATES UTILITIES, INC. and DELTONA UTILITIES, INC. (hereafter referred to collectively as "Southern States" or "Company"), pursuant to Rule 25-22.056, Florida Administrative Code, and Order No. PSC-92-1265-PHO-WS issued November 4, 1992 ("Prehearing Order"), respectfully submit the following Posthearing Brief in the above-captioned docket. Southern States has presented as witnesses in this proceeding Mr. Arend J. Sandbulte, Mr. Bert T. Phillips, Mr. Forrest L. Ludsen, Mr. Scott W. Vierima, Mr. Bruce Gangnon, Mr. Gerald C. Hartman, Mr. Gary S. Morse, Mr. Charles K. Lewis, Mr. Charles L. Sweat, Ms. Helena Loucks, and Mr. Joseph P. Cresse. Southern States filed its Prehearing Statement on October 16, 1992. On November 5, 1992, following the issuance of the Prehearing Order, Southern States filed Revisions to its positions on specific issues as reflected in the Prehearing Order. Southern States hereby readopts and reaffirms the positions contained therein as further amplified in the present submission.

I. BASIC POSITION

Southern States filed its Application for Increased Water and Wastewater Rates ("Application") and Minimum Filing Requirements

("MFRs") on May 11, 1992. The official date of filing of the MFRs was established by the Commission as June 17, 1992.

Southern States' Application encompasses 90 water and 37 wastewater systems located in 19 counties throughout the State of Florida. These 127 systems constitute all but two of the Commission regulated water and wastewater systems operated by Southern States in Florida. The Marco Island water and wastewater systems were not included in this Application due to the significant amount of investment in facilities placed into service following the 1991 historic test year in this docket. Southern States has filed a separate application for its Marco Island water and wastewater systems in Docket No. 920655-WS.

Southern States requests annual revenues of $17,978,776 for water operations and annual revenues of $10,872,112 for wastewater operations. These requests represent annual increases of $5,064,353 for water operations and $3,601,165 for wastewater operations based on rates in effect on the date of submission of the Application. These revenue requirements are based on a historic test year for the twelve months ended December 31, 1991. Southern States' need for rate relief is reflected by its rates of return and returns on equity for its water and wastewater systems during the historic test year. Under rates in existence during the historic test year (prior to interim rates authorized by the Commission in this docket), Southern States would experience a rate of return for the water systems of only 3.07% (a -7.07% return on equity) and a rate of return for the wastewater systems of only

1.74% (a -10.18% return on equity). These historic test year returns have been further deteriorated following the First District Court of Appeal's affirmance of the Commission's order in Docket 920399-WS and the resulting diminution of test year revenues due to the refund of interim rates approved in that docket.

The need for rate relief has resulted, in principal part, from additional investments in water and wastewater facilities and increased operations and maintenance ("O&M") expenses which have been incurred since rate base and rates were last established (over varying periods of time) for the 127 systems. These increases in investment in water and wastewater facilities and increased operations and maintenance expenses have been prudently incurred to meet customer growth and to comply with environmental regulations.

Southern States has an excellent history of providing sufficient, high quality water and wastewater services to its customers. Based on and following the Commission's September 1988 Management Audit Report, numerous steps have been taken to transition Southern States from its prior management and operating practices, which were reflective of those practiced by small water and wastewater utilities, to a current state of highly professional management and operating departments necessary to the provision of high quality, environmentally sound water and wastewater services to the approximately 160,000 customers of Southern States. The implementation of these improved and specialized management, operating, financial, accounting, budgeting and human resources

functions and procedures provide the benefits of economies of scale to Southern States' customers and are necessary to assure the long-term provision of high quality water and wastewater services which comply with ever increasing environmental requirements. Southern States' administrative and general ("A&G"), customer service and other common costs are reasonable. These costs have been pooled with the A&G, customer service and other common costs of the recently acquired Lehigh Utilities, Inc. ("Lehigh") and reallocated to all customers served by each of the systems operated by Southern States, including Lehigh, based on number of customers. The proposed allocation based on number of customers is consistent with Commission policy and precedent and reasonable since each customer receives equal benefits from these services and would thus be asked to contribute equally to the costs.

For these reasons as well as those reflected in further detail in the MFRs and testimony and exhibits of Southern States' witnesses, Southern States maintains that the requested increase in Southern States' annual revenue requirements are justified and the rates proposed by Southern States are fair, just, reasonable and necessary to permit Southern States the opportunity to earn its requested overall rate of return of 11.57%.

As a final preliminary note, Southern States suggests that pursuant to Rule 25-22.038(5)(b), Florida Administrative Code, the Order Establishing Procedure (Order No. PSC-92-0638-PCO-WS issued July 10, 1992), at 6, and requirements imposed by the Commission at the hearing, Intervenors Citrus County and Nassau County have

waived positions on all issues. Nassau County chose not to file a prehearing statement, appear at the Prehearing Conference or appear at the final hearing. Citrus County did not file a prehearing statement nor appear at the Prehearing Conference. Citrus County appeared and participated at the hearing. However, Citrus County failed to communicate a position on any issue to counsel for Southern States as instructed by the Commission at the hearing in the event Citrus County intended to take a position on an issue in a posthearing brief. (Tr. 796.) Accordingly, Southern States has no notice of positions Citrus or Nassau Counties may take in a posthearing brief. For the foregoing reasons, the Commission should determine that Nassau County and Citrus County have waived positions on all issues in this proceeding and strike any posthearing brief filed by such parties.

II. ISSUES AND POSITIONS

QUALITY OF SERVICE

ISSUES APPLYING TO MORE THAN ONE SYSTEM

ISSUE 1: **Which systems have an unsatisfactory quality of service?**

The quality of service provided by each of the water and wastewater systems included in the docket is safe, efficient and sufficient.

Florida law requires a water and wastewater utility to provide safe, efficient and sufficient service to its customers in compliance with Florida Department of Environmental Regulation ("DER") rules and standards. Sections 367.081(2)(c) and 367.111(2), Florida Statutes. Company witness Charles L. Sweat testified that the service being rendered by Southern States on

each of the water and wastewater systems included in this docket more than satisfies these standards. (Sweat, Tr. 1218-1219, 1224-1226, 1230, 1258, 1261.) Compelling corroboration of Mr. Sweat's testimony is found throughout the record.

First, Mr. Sweat provided the Commission with customer complaint statistics for the historic 1991 test year as well as the first six months of 1992. (Sweat, Tr. 1226-1228.) The statistics confirm that during the 1991 test year only 51 customer complaints were filed against the Company which were even partially justified and, of the 91 total complaints filed, only 50 related to water or wastewater quality complaints (as opposed to billing and other similar complaints regarding administrative activities). These facts indicate that less than one in 2,000 of the customers the Company serves under Commission jurisdiction had any type of complaint against the Company which rose to the level of Commission scrutiny and was at least partially justified. (Sweat, Tr. 1227.) In the first six months of 1992, the trend of complaints was even lower (35 complaints filed with the Commission, only 18 of which were at least partially justified). (Sweat, Tr. 1227-1228.)

The scarcity of complaints against Southern States reflects the Company's consummate efforts to provide high quality water and wastewater service to its customers. (Sweat, Tr. 1228.) Even during years of undeniably poor financial performance, Southern States has continued to invest millions of dollars in capital improvements and expansions. (Sandbulte, Tr. 199, 209-210; Phillips, Tr. 336, 349-350, 365, 366; Vierima, Tr. 973-974, 976;

Sweat, Tr. 1232.) In fact, the record confirms that the Company has invested approximately $50 million in the systems included in this proceeding since the date rates last were established for each system. (Phillips, Tr. 336.)

Staff identified eight water and two wastewater systems out of the 127 systems included in this filing which Staff alleged had an unsatisfactory quality of service record. These systems were as follows: Water - Beecher's Point, Chuluota, Golden Terrace, Harmony Homes, Hermits Cove, Point O' Woods, River Park and Wootens; Wastewater - University Shores and Woodmere. Staff apparently relied primarily on the testimony of the various witnesses from DER and county regulatory agencies to identify these systems. However, reference to that testimony reveals that Staff's allegation of unsatisfactory service often is premised on the fact that a particular maximum contaminant level ("MCL") for a particular element in the water had been exceeded at some time in the past. As the record confirms, MCLs are established based on a conservative assessment of the impact of the presence of a certain level of a contaminant in water consumed by a person in a certain quantity (2 liters per day) over a seventy year period. (Ludsen, Tr. 508-509.) In contrast, a particular MCL may be exceeded for only short periods. As Company witness Sweat explained, "where there are deficiencies by DER, they are only temporary." (Sweat, Tr. 1261.) Under these circumstances, it would be totally unjustified to brand the Company's service unsatisfactory on the sole basis that an MCL was exceeded. The

inequity of such a finding is demonstrated further by the absence of any evidence which would indicate that the service provided by the Company for any of these ten (10) systems had any adverse impact either on the public health and safety or the environment. (Sweat, Tr. 1261, 1334.)

With many new standards being established each year with limited time periods for compliance, a determination of unsatisfactory service based on the sole fact that an MCL may have been exceeded at some point in the past could have disastrous results for Southern States and its customers. As indicated by Bert T. Phillips, Southern States' President, and the Company's Vice President for Finance and Administration, Scott W. Vierima, investors are well aware of the potential negative impacts of the new water quality rules and regulations on the financial well being of utilities such as Southern States. (Phillips, Tr. 345-347; Vierima, Tr. 909-911.) These and other Company witnesses also confirmed that the financial pressure imposed on Southern States as a result of these rules and regulations already have impacted the Company and its customers to the point that Southern States is a "non-investment grade" utility which cannot obtain financing without the credit support of its parent. (Vierima, Tr. 909, 913, 966-968, 972, 974-976; Exhibit 72.)

Mr. Sweat also testified that most of the deficiencies indicated by the DER and county witnesses (encompassing periods as far back as 1985 (Maher, Tr. 75)) for these ten systems have been corrected or are in the process of correction by Southern States.

The Company will address each system, <u>seriatum:</u>

<u>Water Systems</u>

<u>Beecher's Point</u>

The Company expects the sodium and chloride problems to be resolved when the system is interconnected with the City of Welaka. (Sweat, Tr. 1248.) The Company has negotiated on virtually a weekly basis with the city and an interconnect is expected in early 1993. (<u>Id.</u>) The interconnect is the most cost-effective alternative to correct the problems. (Late-Filed Exhibit 87, page 4-4.)

<u>Chuluota</u>

The DER witness identified high levels of Radium 228. Mr. Sweat confirmed that water samples were retested and compliance with Radium 228 standards were confirmed. (Sweat, Tr. 1240.) Mr. Sweat also testified that customer related complaints concerning periodic rust in the water were being resolved by ongoing replacement of the pre-existing galvanized pipe. (Sweat, Tr. 1327-1328.) In fact, Southern States currently is nearing completion of the replacement of 3,000 feet of main. As a result of these efforts, the appearance of rust is eliminated and water pressure is increased. (<u>Id.</u>)

<u>Golden Terrace</u>

The DER witness indicated that the water was exceeding the MCL for iron. Mr. Sweat explained that the Company previously used a line flushing program to reduce iron levels and a sequestering agent called "Aquameg" to sequester, rather than remove, the iron.

(Sweat, Tr. 1321-1324.)

Prior to DER rule changes, the sequestering of iron, as opposed to its removal, was all that was required. (Id.) Mr. Sweat confirmed that no rust stains result on customer clothing as long as the iron is sequestered. At this time, the Company has an agreement with DER to maintain satisfactory iron levels through a flushing program pending either installation of iron filters or interconnection of the system with the City of Inverness. The Company has determined that the interconnect is the least cost alternative and has authorized funding of the interconnect. (Id.) The City of Inverness has conceptually agreed to the interconnect. (Id.; Late-Filed Exhibit 95.) Therefore, the iron level problem identified has been temporarily resolved and a permanent solution is in progress.

Harmony Homes

Apparently, Staff's suggestion of unsatisfactory service was premised solely on a deficient residual chlorine reading during the Staff Auditor's field inspection. (Sweat, Tr. 1328.) As Mr. Sweat explained, residual chlorine levels were satisfactory both prior to and after the field inspection upon correction of a malfunctioning chlorinator. (Sweat, Tr. 1329.) Mr. Sweat explained that for a small system like Harmony Homes (approximately 60 customers), a thirty (30) minute chlorination malfunction would result in a deficient chlorine residual reading. (Id.) No evidence was introduced of deficient chlorine residuals either prior to or after the Staff field inspection. In fact, upon

correction of the malfunction, the chlorine residuals were rechecked and found to be satisfactory. (Sweat, Tr. 1329.) Therefore, there is no indication that the deficiency is of a continuing nature, which it is not.

Hermits Cove

The DER witness identified recent deficiencies in complying with the secondary MCLs for Manganese and TDS. Mr. Sweat indicated that no prior difficulties had been experienced meeting these MCLs and that the Company suspected improper lab testing. (Sweat, Tr. 1249.) Retesting is underway. (Id.)

Point O'Woods

The DER witness identified difficulties with high iron levels and a recent mishap when a sinkhole developed during drilling of a new well intended to remedy the iron and meet DER's second well requirement (Chapter 17-555, Florida Administrative Code). (Sweat, Tr. 1316.) Obviously, the forming of a sinkhole at the well site was beyond the Company's control. In addition, at the time of hearing, the well problem had been resolved (wells cleared for service and water cleared for drinking). (Sweat, Tr. 1359.) Finally, Mr. Sweat indicated that the installation of iron filters to further remedy the iron problem was caused by DER permitting delays. (Sweat, Tr. 1358.) Mr. Sweat further explained that the iron filters could not have been installed prior to resolution of the sinkhole problem because the wells had to be repumped to remove the excess sand. Otherwise, the Company would have run the risk of ruining the filters (which are expensive). (Sweat, Tr. 1320.)

River Park

The DER witness indicated that the water recently exceeded the MCL for iron. Late-Filed Exhibit 97 (page 4-5) reveals that Hartman and Associates, Inc., the Company's engineering consultant, recommends that the Company install a potassium permanganate system at a cost of approximately $50,000 to reduce the iron levels.

Wootens

The DER witness indicated that the water currently is not meeting the secondary MCLs for color, odor and turbidity. The DER witness specifically noted that some of the MCLs were exceeded prior to 1992. (Maher, Tr. 76.)

Late-Filed Exhibit 97 (pages 4-1 and 4-2) reveals that Hartman and Associates recommends that a carbon filter system be installed at a cost of approximately $5,000 and the hydropneumatic tank be replaced (at an undisclosed cost) to achieve compliance with these MCLs.

Wastewater Systems

University Shores

The DER witness indicated that the effluent had failed a bio-assay test and alleged that ponding of effluent was occurring and effluent for the percolation ponds was discharging into surface waters.

Mr. Sweat testified, without hesitation, that the ponding consisted of rainwater, not effluent. Mr. Sweat confirmed that this determination was made after actual observation of the water by the Company's plant operators and examination of its appearance

and smell. (Sweat, Tr. 1326.) Mr. Sweat also disputed the allegation regarding discharges to surface waters finding that such an event "hardly seems possible" in light of the appreciable distance from the ponds to a surface water source. (Sweat, Tr. 1239-1240.) It should be pointed out that the DER witness did not identify when the "recent" inspection took place (Dentice, Tr. 97), and that Southern States recently has made significant investments in the system's effluent facilities.

Regarding the bio-assay test, Mr. Sweat testified that DER had agreed to the performance of a re-test with additional chemical analyses to be performed. Results from the re-test were not yet available. (Sweat, Tr. 1239.) Without anything further in the record, neither Mr. Dentice's allegations nor the initial failure of a bio-assay test justify a finding of unsatisfactory service.

Woodmere

The DER witness identified no deficiencies on this system. Mr. Sweat indicated that there were six small overflows on the system in the last two years, three of which related to one pumping station. (Sweat, Tr. 1331.) Mr. Sweat confirmed that the overflows were refined in small areas and did not pose any health hazard to University Shores residents, disinfection of the area was completed promptly and the required regulatory agencies were notified. (Sweat, Tr. 1334.) Mr. Sweat further testified that the cause of the pumping station overflows apparently was old equipment which was rebuilt six years ago and now will be replaced at a cost of approximately $18,000 (for two ABS pumps and other equipment).

(Sweat, Tr. 1332.) Southern States also will be installing an automatic alarm system that will notify the Company of high water levels (Sweat, Tr. 1333) so that overflows can be avoided in the future. Mr. Sweat then confirmed that the new equipment will produce a much more reliable system. (Sweat, Tr. 1332.)

There is no evidence which indicates that six small overflows in a two year period is an inordinate number of such events. Mr. Sweat's testimony that the public health was not placed in danger as a result of these small spills remains undisputed.

Finally, Southern States urges the Commission to consider several related facts when determining whether the Company has met the standard of safe, efficient and sufficient service. Of the ten systems identified by Staff as having service quality issues, the deficiencies which allegedly support Staff's allegation no longer exist on the majority of the systems while the others are being resolved by the Company. Far from ignoring these ten systems, Southern States' investments in improvements and additions for the majority of these systems since the date rates were last established are in the range of hundreds of thousands of dollars, i.e., $6.7 million in the University Shores wastewater system (2,654 customers): $210,000 on the Hermits Cove water system (173 customers); $299,000 in the Chuluota water system (637 customers); $692,000 in the Woodmere wastewater system (1,027 customers). Therefore, Southern States could hardly be accused of neglecting these systems or ignoring alleged deficiencies.

Moreover, various Company achievements must be considered

which demonstrate the Company's efforts to provide the highest quality of service possible at the lowest reasonable cost to the customers served by each of its systems. These facts include: (1) the Company's demonstrated efforts to bring small systems acquired by the Company into compliance with DER standards (Sweat, Tr. 1231-1232) and dispute the findings of regulatory authorities which would impose uneconomic financial burdens on customers, particularly those served by our smaller systems (Ludsen, Tr. 538-541); (2) Southern States' leadership role in the water conservation movement which has been recognized at both the national and state levels (Phillips, Tr. 351-352; Sweat, Tr. 1222-1223, 1261); (3) the use by the St. John's Water Management District of Southern States' conservation plan as a model for all utilities within that water management district's jurisdiction (Sweat, Tr. 1222); (4) the use of Southern States' lead and copper rule implementation plan as the model for other utilities (and Southern States' speed in implementing the plan) (Sweat, Tr. 1222); (5) Southern States' participation in the innovative reuse of effluent to irrigate cemeteries (Sweat, Tr. 1220, Exhibit 91); and (6) the innovative spirit Southern States has fostered in its employees that resulted in the invention of a new type of loss of chlorine alarm by one of our employees which warns both our employees and residents near our water treatment facilities if chlorine escaping into the air. (Sweat, T. 1221.) Each of the ten systems identified by Staff are the beneficiaries of these efforts as well as those specifically delineated in this brief.

All of these facts provide compelling evidence that Southern States is providing satisfactory service to each of the 127 systems included in this filing.

ISSUE 2: **What adjustments should be made and what corrective action should the Commission require for those systems that are not currently meeting Department of Environmental Regulation standards?**

No adjustments are appropriate. Southern States either is in compliance or is taking the necessary steps to achieve compliance with all Department of Environmental Regulation ("DER") standards. Since safe, efficient and sufficient service is being provided to each system, no Commission ordered corrective actions are required.

Pursuant to its position stated in the Prehearing Order (Order No. PSC-92-1265-PHO-WS issued November 4, 1992), Staff recommends that "the rate increase, if granted, should be held in abeyance for those water [and wastewater] systems which are not meeting water quality standards." No Florida law authorizes the Commission to hold justified rate increases "in abeyance." Southern States is not aware of any Commission order which has held otherwise justified rate increases "in abeyance." Staff did not produce any witness to clarify the significance of "held in abeyance." Presumably, Staff is suggesting that the Commission determine the level of justified rate relief but deny Southern States recovery of such rate relief until "water quality standards" are met. The evidence in this proceeding does not present justification for such a result.

The record does not support the imposition of this egregious penalty. The record demonstrates that Southern States suffered large negative returns on equity in 1991 from its water and

wastewater operations. (Vierima, Tr. 908) (water -7.07%, wastewater -10.18%). Despite these large negative returns, the Company has continued to invest millions of dollars in its systems, including the ten alleged by Staff to be providing unsatisfactory service. (Sandbulte, Tr. 199, 209-210; Phillips, Tr. 336, 349-350, 365, 366; Vierima, Tr. 973-974, 976; Sweat, Tr. 1232.) Moreover, the record confirms that without exception, the deficiencies identified by the DER and county witnesses either had been corrected in the past or were in the process of correction by the Company. (See Company's analysis in Issue 1, supra.) As to those systems where some deficiency may remain, Company witness Sweat offered on behalf of the Company to submit periodic reports of the Company's progress in resolving the deficiency to the Commission. (Sweat, Tr. 1262.) As indicated in the Company's analysis and arguments concerning Issue No. 1, there is no evidence or even an allegation that customers, the environment or the public in general were adversely effected by the past deficiencies identified by the DER or county witnesses and only 1 in 2,000 customers made even a partially justified compliant to the Commission concerning the Company's service (either administrative or operational in nature). In light of these facts, no adjustments to the Company's return on equity is justified, and certainly the Commission would not be justified in ordering the required rate increases to be held "in abeyance" (which the Company believes would be an unlawful act). Should the Commission desire to monitor and ensure that Southern States' ongoing efforts to correct the few

remaining deficiencies continue to progress, the Commission should require Southern States to submit periodic reports to the Commission until the deficiency is corrected. Southern States should not be denied the immediate rate relief it so desperately requires in the absence of evidence of harm to customers, the environment or the public in general from the quality of water or wastewater services.

RATE BASE

GENERIC AND GENERAL PLANT ISSUES

ISSUE 3: **Should a margin reserve be included in the calculations of used and useful plant?**

Yes. Commission policy and precedents historically grant water and wastewater utilities a margin reserve in the calculation of used and useful plant in order to promote economies of scale in the construction of plant, comply with DER requirements, and permit the utility to recover a return on prudent investment necessary to meet its statutory obligation to serve.

Mr. Hartman captured the rationale supporting the Commission's policy of including a margin reserve in the calculation of used and useful plant:

> The margin reserve is the additional water and wastewater facilities necessary to meet the customer demands while additional facilities are being constructed. The Commission realizes that a utility must construct facilities beyond the needs of its current customers and has an obligation to do so, since the utility's customer base is a continuously growing and dynamic element while the construction of facilities takes a great deal of time.

(Hartman, Tr. 1389-1390.) See also, 90 FPSC Rep. 10:559 at 569 (Order No. 23660, Oct. 24, 1990):

> A water company is required to provide service to customers within its service area when they

> are ready for service. This is why a margin reserve is so important; the alternative is an inefficient utility trapped in a cycle of perpetual construction so that it can add small increments of capacity required to connect new customers.

The allowance of a margin reserve based on a utility's obligation to serve within a reasonable period of time is authorized under Chapter 367, Florida Statutes, and has been so recognized by the Commission. See, e.g., 90 FPSC Rep. 4:438, 449 (Order No. 22844, Mar. 23, 1990) and 92 FPSC Rep. 7:8, 15 (Order No. PSC-92-0594-FOF-SU, July 1, 1992).

The margin reserve is becoming ever more important due to the regulatory, financing, and construction processes that must be undertaken and the ever lengthening time frames required to bring new facilities into service. Mr. Hartman identified 38 steps that must be addressed for the addition of water supply and treatment capacity, and indicated that these steps were not all inclusive and assumed a relatively simple facility with no major delays. Based upon his professional experience, Mr. Hartman testified that in the current regulatory environment it takes a minimum of two years to bring new facilities on line. Moreover, with the adoption of DER Rule 17-600.405, Florida Administrative Code, the construction and permitting process for wastewater treatment plants is now a minimum of four years. (Hartman, Tr. 1390-1395, 1412, 1422-1429, 1563-1566.) Mr. Hartman's testimony in this regard was not refuted in any way.

The margin reserve also benefits present customers. First, inclusion of a margin reserve in a utility's rate base helps to

ensure that future customers will not overload or otherwise adversely impact the quality and safety of service provided through existing facilities. Second, the margin reserve enables a utility to time (i.e., install pipes prior to construction of roads) and size additional units of capacity to achieve lower costs and economies of scale.

In sum, because of its important customer benefits and in consideration of Southern States' obligation to serve, a margin reserve should be included in the calculation of used and useful plant. This is consistent with Commission precedent. (Hartman, Tr. 1412; see, e.g., 90 FPSC Rep. 4:438 (Order No. 22844, Mar. 23, 1990).) As in Southern Broward Utility, Inc., Order No. 22844, supra, at 449, the Office of Public Counsel ("OPC") opposes a margin reserve in this proceeding but presented no evidence to show why a margin reserve should not be included. OPC's testimony was limited strictly to its disagreement regarding the calculation of the margin reserve for various systems. (Dismukes, Tr. 1891-1896; see Issue 4.) There is no evidence of record rebutting the testimony of Mr. Hartman regarding the rationale or precedent for inclusion of margin reserves. Consequently, Southern States' request for margin reserves on specific systems as set forth in the MFRs (Exhibit 39) and discussed under Issue 4 should be included in the calculation of used and useful plant.

ISSUE 4: **What is the appropriate method for calculating margin reserve?**

*The margin reserve should be eighteen months for water treatment plants and twelve months for water distribution and wastewater collection facilities. However, the margin reserves

for wastewater treatment plants impacted by the regulatory requirements imposed under DER Rule 17-600.405, F.A.C., should be four (4) years. The Company notes that the Commission has approved a Memorandum of Understanding with DER which requires the Commission to consider and recognize the impact of this rule on their wastewater treatment plant planning and expansion.*

The Company's margin reserve calculations for applicable water and wastewater systems are presented in Schedule F-8 of the MFRs (Exhibit 39.) A narrative description of the margin reserve calculations is presented at the front of Volume II, Book 11 for water systems and Volume III, Book 6 for wastewater systems. The essential components of the calculation are as follows:

1. The use of 18 months for treatment plant and 12 months for distribution and collection lines (Hartman, Tr. 1389; Morse, Tr. 1609); and

2. The use of average growth in ERCs for the last five years including the test year (1987-1991) (Hartman, Tr. 1396; Morse, Tr. 1609).

The first component of the calculation is not at issue. The use of the 18 month (treatment) and 12 month (distribution and collection) time periods for margin reserve calculations has been accepted by the Commission in the past (Hartman, Tr. 1395) and were not opposed by any party. These time periods are not adequate to plan, design, permit and construct additional facilities to meet customer demands. (Hartman, Tr. 1422.) Mr. Hartman provided a number of persuasive arguments for greater margin periods which are not requested by the Company in the MFRs but should be applied by the Commission if the Commission deviates from established practice of using the five year historical average to project growth.

(Hartman, Tr. 1422.) For example, Section 367.081(2)(a), Florida Statutes, requires the Commission to consider the Company's investment for a period of 24 months following the historic test year in establishing final test rates. (Hartman, Tr. 1411-1412.) With respect to water supply and treatment plant, the design, construction and permitting process takes a minimum of 24 months, and wastewater treatment plant must now undergo a 4 year design, construction and permitting process under Rule 17-600.405, F.A.C. (Hartman, Tr. 1422-1429.) Accordingly, should the Commission elect to calculate margin reserves by use of the linear regression analysis advocated but not supported by Mr. Shafer or choose to use the projections of growth employed by Ms. Dismukes, a larger margin reserve period as supported by Mr. Hartman should also enter the calculation.

The second component of the margin reserve calculation is the projection of growth in ERCs. Consistent with established Commission precedent, Mr. Hartman and Mr. Morse used the average growth in ERCs for the last five years. See, e.g., 90 FPSC Rep. 4:438, supra, at 449-450; 91 FPSC Rep. 7:20, 24 (Order No. 24733, July 1, 1991). Apart from the fact that the five year average represents the standard methodology historically utilized by the Commission (Hartman, Tr. 1402-1403), there are two important reasons supporting the use of the five year average in a case such as this where there are 127 systems included in the Application of varying size which are subject to various economic and local community factors impacting growth. First, the use of the five

year average overcomes misleading recent experiences of declining growth due to the current state of the economy which may be reversed when economic conditions improve. (Hartman, Tr. 1403.) Second, the use of the five year average levelizes recently experienced declining growth rates, particularly for the large number of small systems in this Application where there is significant potential for further development within the service area, which is the case with most of the systems in this Application. (Hartman, Tr. 1403-1405.)

Staff witness Shafer recommended the use of linear regression analysis as a "sanity check" in projecting growth for the purpose of calculating the margin reserve. (Shafer, Tr. 1175.) Mr. Shafer conceded that as a matter of past practice, the Commission has used the five year average method. (Shafer, Tr. 1184.) The evidence established numerous deficiencies with the use of linear regression analysis, particularly as applied to this case:

1. With respect to the examples of linear regression analysis reflected in the exhibits to his testimony (Exhibit 90), Mr. Shafer acknowledged that there are times when the linear regression method shows no correlation between time and growth. (Shafer, Tr. 1170, 1176-1177.)

2. Based on the examples reflected in Exhibit 90, Mr. Shafer acknowledged that there will be situations where the data points reflecting growth over the past five years will not closely correlate to the trend line derived by the use of linear regression analysis. In such circumstances, it is imperative to investigate

the specific circumstances to establish the reasons for the deviations in the trend line. However, in his experience, he has never made such investigations of specific circumstances when using the linear regression method and did not do so in this case. (Shafer, Tr. 1179-1182, 1187-1188.)

3. Mr. Shafer conceded that the five year average will avoid the extremely low correlations between time and growth which may result from the use of linear regression analysis. (Shafer, Tr. 1176.)

4. Finally, and most importantly, Mr. Shafer conceded that he had not conducted a linear regression analysis of the 127 systems in this case and therefore had no basis for comparing the results of linear regression analysis with the five year average method used by the Company to determine which method should appropriately be applied in this case. Since Mr. Shafer did not conduct and present this analysis, the Company was deprived of its due process rights to study, evaluate and cross-examine Mr. Shafer on what those results may be. (Shafer, Tr. 1188-1196.)

Apart from the substantive deficiencies with the use of linear regression analysis conceded by Mr. Shafer and discussed by Mr. Hartman (Hartman, Tr. 1452-1455), there is no record evidence to support the application of linear regression analysis to the 127 systems in this proceeding. As the Commissioners emphasized at the hearing, the Commission's decision must be based on the record evidence, and since there was no evidence presented regarding the results of the linear regression analysis, there is no evidentiary

basis to support the use of the linear regression method. (Tr. 1193-1196.)

A second alternative was presented by OPC witness Ms. Dismukes. Ms. Dismukes applied data provided by the Company which showed lower projections of growth than those reflected by the five year historical average as applied to the systems for which the Company requests a margin reserve. The source of this data was a report prepared by the Company's engineering department in March 1992 to plan for capital improvements in the next five years. This report was prepared for review at an annual meeting of the Board of Directors of Minnesota Power and Light Company, Southern States' parent company, with the primary purpose of providing projections reflecting a very conservative estimate of revenues which could be used for the purpose of obtaining capital financing. (Hartman, Tr. 1513-1514.)

During the hearing, a question arose regarding Mr. Hartman's justification for rebutting Ms. Dismukes' use of this data on the ground that the data had been provided by the Company to OPC. The question essentially came down to is this: was it credible for the Company to maintain that it compiled projections of growth for one purpose, obtaining capital financing, while using the historical average for the purpose of calculating the margin reserve? (Tr. 1513-1526.) The creditability and confirmation of the Company's position was provided by OPC's own witness, Ms. Montanaro.

Ms. Montanaro confirmed that lenders or investors who even suspect that a utility company has been presenting them with

overly-optimistic projections would be less likely to provide the utility with funds in the future. (Montanaro, Tr. 2044.) Ms. Montanaro also confirmed that lenders and investors are interested in the existing and projected financial situation of utility subsidiaries which are wholly-owned by utility parent companies as is the case with Southern States and Minnesota Power and Light Company. (Montanaro, Tr. 2044-2045.) Ms. Montanaro also confirmed that a parent company would find itself in difficulty with lenders and borrowers in terms of future financing if a wholly-owned subsidiary was overly optimistic in its financial projections. (Montanaro, Tr. 2045.) Such concerns are not limited to lenders and investors but are also the concern of the Securities and Exchange Commission. (Montanaro, Tr. 2045-2046.) Finally, Ms. Montanaro offered the following response to the following question:

> Q. (By Mr. Armstrong) This is the last question. If Southern States Utilities was to provide overly-optimistic projections of revenue increases and sales increases to its parent, Minnesota Power, upon which the parent relied when approaching investors or lenders, and those investors or lenders subsequently came back and determined or could establish that those projections were overly optimistic, wouldn't that cause some problems -- or couldn't that cause some problems, I should say -- in the future with the abilities of Minnesota Power as well as Southern States obtaining financing?
>
> A. (By Ms. Montanaro) Certainly. And I think we have seen that with other corporations that have done similar.

(Montanaro, Tr. 2046.)

The testimony of Ms. Montanaro unequivocally supports and confirms Southern States' position that the data used by Ms.

Dismukes is the type of data normally complied by utilities such as Southern States for the purpose of obtaining capital financing and is, therefore, extremely conservative in nature. The use of such data is no substitute for the type of data traditionally used by the Commission, i.e., the historical five year average, in calculating the margin reserve. For the reasons previously discussed, the data used by Ms. Dismukes does not provide the historical prospective and leveling of economic, system size related and potential growth factors discussed by Mr. Hartman in support of the five year average. (Hartman, Tr. 1403-1405.) Southern States has a statutory obligation to serve customers included in the margin reserve. The Commission should not penalize the Company through an unprecedented use of conservative growth projections compiled solely for the purpose of obtaining capital financing.

Finally, as stated by Mr. Hartman, the Commission should not arbitrarily impose a cap of 20% on the growth rate used in the calculation of margin reserves for certain small systems included in this Application when the historical average reflects that projected growth rates exceed 20%. (Hartman, Tr. 1566-1567.) Again, an arbitrary cap of 20% penalizes the Company which has no choice but to meet its statutory obligation to serve.

Accordingly, for the foregoing reasons, the evidence supports approval of the margin reserves as calculated and reflected in the MFRs and no adjustment is appropriate.

ISSUE 5: **What is the appropriate method for calculating used and useful plant?**

The appropriate method for calculating used and useful is the component method as presented in the MFRs.

The evidence establishes that the Company has justified the "component" method explained and applied in the MFRs. This method should be applied by the Commission in the calculation of used and useful plant.

The Company's "component" approach to the calculation of used and useful is explained in narrative form in Volume II, Book 11, pages 001-004 (water) and Volume III, Book 6, page 001 (wastewater) of the MFRs. (Exhibit 39.) Under this approach, the Company evaluated the used and useful percentage of each major functional component of each water and wastewater plant included in this Application. This evaluation and analysis was performed in relation to the standard engineering and design criteria as well as requirements imposed by the DER (water and wastewater) and local governments (water-fire flow requirements) applicable to each major component. (Hartman, Tr. 1415; 1552.) Mr. Hartman also addressed and supported the Company's use of fill-in lots in the calculation of used and useful distribution and collection lines, and the maximum day demand in the calculation of used and useful water treatment plant. In addition, Mr. Hartman discussed the importance of economies of scale and their impact on the used and useful analysis as well as redundancy requirements imposed by DER. (Hartman, Tr. 1413-1414; 1416-1420, 1431-1433, 1445-1446.)

Staff Positions under Issues 27-30 in the Prehearing Order,

as amended at the hearing (Tr. 1551), reflect that Staff agrees with the Company's used and useful percentages as follows:

1. Water Treatment - 73 out of 90 systems (81%);
2. Water Distribution - 81 our ot 90 systems (90%);
3. Wastewater Treatment - 36 out of 37 systems (97%); and
4. Wastewater Collection - 30 out of 37 systems (81%).

Staff presented the testimony of Mr. Chapdelaine. Mr. Chapdelaine did not conduct the used and useful analysis for any of the systems in this Application. Nor did he review the workpapers of all of the Staff engineers who performed used and useful analyses but did not present testimony in this proceeding. (Chapdelaine, Tr. 2080.)

The Commission Staff failed to present evidence in the record reflecting the basis and results of their used and useful analyses. Thus, the Company had no opportunity to respond on the record as to the appropriateness of the method used by the Staff engineers. Thus, the Company is placed at a severe disadvantage as it must draw inferences as to the used and useful methodologies applied by Staff -- since Staff failed to present its analysis in the record. This leads to a number of conclusions of significance in this case:

1. First, the Commission emphasized at the hearing that Staff has **"the burden of putting on evidence that will support their position."** [Emphasis supplied.] (Commissioner Clark, Tr. 2162.) Staff has totally and completely failed to meet its burden of supporting its used and useful percentages for the **remaining systems in dispute** since Staff presented no evidence identifying the methodology it used in calculating used and useful percentages for all 127 systems and the results of such calculations.

2. The Company, on the other hand, has met its burden of justifying the use of the "component" method. The only witness sponsored in this proceeding for the purpose of challenging the Company's methodology, Mr. Chapdelaine, testified that he had <u>no opinion</u> as to whether the Company justified its methodology:

> Q. (Mr. Hoffman) In light of Staff's agreement with the Utility's used and useful percentages on the great majority of the water and wastewater systems in this application, wouldn't you agree that the Utility has justified its methodology?
>
> A. (Mr. Chapdelaine) I don't think I really am preparead to give you an opinion yes or no on that. I just don't know, I really don't know that.

(Chapdelaine, Tr. 2099-2100.)

3. Based on Staff's agreement with the Company on the <u>vast majority</u> of <u>used and useful percentages</u>, the <u>inference</u> must be drawn (since there is no record basis for comparison presented by Staff) that the <u>vast</u> <u>majority</u> of <u>Staff engineers agree</u> with the Company's methodology for calculating used and useful plant. For example, Staff and the Company agree on the used and useful distribution/collection percentages for 90% of the water systems and 81% of the wastewater systems. The Company included fill-in lots in the calculation of these percentages. Hence, it is evident that most but not all of the Staff engineers agree with the use of fill-in lots. The same arguments apply to to the debate over the use of the single maximum day versus the average of the five highest days for calculating used and useful water treatment plant. The Company used the single maximum day. Use of the average of the

five highest days would clearly lead to a different used and useful percentage. Yet, Staff agreed with the Company on 81% of its water treatment used and useful calculations which included the use of the single maximum day. Again, the only inference that can be drawn is that most but not all of the Staff engineers agree with the Company.

4. Mr. Chapdelaine testified that the Company must justify any deviation from established Commission practice. (Chapdelaine, Tr. 2079.) As previously discussed, the Company has justified the use of the component method. Moreover, the apparent disparities in used and useful methodologies employed by the Commission Staff lead to but one conclusion -- the Commission does not have an established practice for determining used and useful plant. (Hartman, Tr. 1449.) Certainly there is no record evidence reflecting the results of a calculation of used and useful plant percentages for all 127 systems under any so-called "standard Commission practice."

Having established that the Staff's "variance in method" is the so-called "standard Commission practice", it comes as no surprise that Mr. Chapdelaine acknowledged on cross-examination that the many factors considered by Mr. Hartman and Mr. Morse in conducting their used and useful analyses are necessary, relevant inquiries, such as:

1. consideration of economies of scale, including the

construction of standard sizes for incremental plant additions;[1]

2. compliance with Commission, DER and water management district regulatory requirements in the construction and design of plant and providing service;

3. consideration of different regulatory (DER) requirements which apply to the design of different plant components and impact the timing and necessity of investment in various plant components;

4. consideration of different peak load customer service requirements used in the design of different plant components;

5. consideration of construction modifications that can either diminish or increase treatment capacity; and

6. consideration of how various plant components can compensate for each other to maximize capacity.

(Chapdelaine, Tr. 2082-2092.)

Two aspects of the Company's used and useful approach which were discussed in some detail were the Company's use of the maximum day demand for the calculation of used and useful water treatment plant and the use of fill-in lots.

The use of the maximum day demand is justified and required pursuant to standard engineering design references incorporated in Rule 17-555.330, F.A.C. (Hartman, Tr. 1416-1420.) This method also was supported by the Staff in the Company's last rate case (Hartman, Tr. 1420.) The use of the maximum day demand is

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[1]The Commission has considered economies of scale, where appropriate, in calculating used and useful plant. See, e.g., 92 FPSC Rep. 6:481, 484 (Order No. PSC-92-0563-FOF-WS, June 24, 1992; no protest filed; no consummating order issued); 92 FPSC Rep. 4:547, 550 (Order No. PSC-92-0266, Apr. 28, 1982).

justified from an engineering design standpoint since each system's supply/treatment facilities, together with storage facilities, must be capable of meeting peak demand caused by climatic conditions, seasonal population fluctuations, natural occurrences, line breaks and fire fighting. (Hartman, Tr. 1418-1420.) Further, the Commission has acknowledged that use of the maximum day demand may be appropriate so long as abnormal occurrences are removed. 91 FPSC Rep. 9:332, 343 (Order No. 25092, Sept. 23, 1991). The record in this proceeding reflects that such adjustments have been made. The development of lots is primarily influenced by actions of the developer, zoning boards and the conditions set forth in the applicable comprehensive plan. (Hartman, Tr. 1376, 1465-1466; 1554-1555.)

In preparing their used and useful calculations for the water distribution and wastewater collection facilities, Mr. Hartman and Mr. Morse also included as used and useful what are identified as "fill-in lots." The development of lots is primarily influenced by actions of the developer, zoning boards and/or the terms set forth in the applicable comprehensive plan. The Company has little control over which lots in a development are developed first which often leads to one or several vacant lots with utility lines passing in front of them. These lots are "fill-in lots." The Company's position essentially is that it should not be penalized for fulfilling its obligation to provide service to connected lots which pass fill-in lots. (Hartman, Tr. 1445-1446, 1572-1573; Exhibit 110.)

Inclusion of fill-in lots in the calculation of used and useful distriution and collection lines is appropriate and in the public interest for six reasons:

(1) there is an obligation to serve and construct facilities to each customer's point of delivery under Commission statute and rules which necessarily results in fill-in lots;

(2) the Company cannot require customers to connect to facilities passing fill-in lots;

(3) the Company has no way of recovering its investment, much less earn a return thereon except through its rates;

(4) it is more cost effective to size and install lines to serve a residential development at inception. This is particularly true of small housing developments which are not expected to be expanded beyond their initial design. In larger housing developments, such as Deltona Lakes, it is common to install the lines as each "phase" is constructed. It is not economic to install smaller lines at inception, and then go back several years later to install larger lines to accommodate the growth in the later years. As a prudent engineering/economic decision, these lines should be considered 100% used and useful;

(5) many of the systems which have fill-in lots were considered by Staff to be 100% used and useful in the Company's last rate case; and

(6) most of the water and wastewater systems in this Application could not provide service to existing customers with any less of a water transmission and distribution system or

wastewater system. (Hartman, Tr. 1445-1446; 1467, 1469, 1593-1594; Exhibit 110.) Indeed, the Commission has specifically recognized that is it is inappropriate to exclude fill-in lots from the used and useful calculation when "no less of a distribution system could serve the existing customers." 91 FPSC Rep. 1:124, 126 (Order No. 23973, Jan. 9, 1991), and 89 FPSC Rep. 7:323, 327 (Order No. 21554, July 17, 1989).[2] (See also, Cresse, Tr. 1155-1156.)

The rationale and justification supporting the calculations of used and useful plant under the Company's "component" method is supported by competent, substantial evidence of record that was not rebutted by any other evidence of record. Therefore, the Commission should apply the Company's "component" method, including fill-in lots and maximum day demand, as reflected in and supported by the MFRs and the testimony of record.

ISSUE 6: **For those systems where a margin reserve is included in the used and useful calculation, should CIAC be imputed as an offsetting measure?**

*No. The margin reserve is required because Southern States has a duty to provide service to customers when they apply. It cannot logically be argued that a system must be or even can be designed solely to serve the customers which exist on any given day. However, the imputation of CIAC unfairly penalizes Southern States because whether or not customers will actually hook on to a system is fortuitous and beyond the Company's control. Also, there is no guarantee that the CIAC levels which exist today, and thus would be utilized to compute the imputation, will not be decreased by the Commission in the future. Under such a scenario, Southern States will never be able to recover a portion of its prudently invested funds. Therefore, the imputation would be premised on two totally speculative events whereas the Company's duty to stand ready to serve customers is real and remains a

[2]Order No. 21554 was a PAA Order made final by Consummating Order No. 21707 (issued August 10, 1989).

regulatory requirement imposed on the Company under Chapter 367, Florida Statutes.*

CIAC should not be imputed as an offsetting measure to the margin reserves requested by the Company. The importance and necessity of permitting a utility to earn a return on a margin reserve is well addressed and supported by the evidence and analysis presented at Issue 3. The imputation of CIAC on the margin reserve contradicts the Commission's established policy of permitting a return on the margin reserve by eliminating that return in whole or in part. (Hartman, Tr. 464.) Further, a growing utility such as Southern States will continue to require a margin reserve to meet customer demand beyond that of the next 12 to 18 months. (Hartman, Tr. 1559.) As previously discussed under Issue 4, the realities of today's design, construction and permitting process dictate that Southern States will continue to require a margin reserve to meet customer demand for at least 24 months. Southern States will not have the opportunity to earn a return on that margin reserve of facilities necessary to serve customers beyond the conservative margin reserve period of 18 months. Hence, the Commission should ensure the opportunity to earn a return on the margin reserve requested in the MFRs by declining to impute CIAC.

Essentially, the imputation of CIAC against the margin reserve would penalize Southern States for including in rate base the plant and facilities deemed prudent and necessary by the establishment of the margin reserve. The imputation of CIAC is replete with speculation since there is no certainty as to how many future

customers will connect during the margin reserve period, when such connections may take place, or the service availability charges which will be in effect at the time of such connections. (Hartman, Tr. 1463-1464.)

As previously recognized by the Commission, the issue of whether to impute CIAC on the margin reserve is being developed through adjudication on a case-by-case basis, as circumstances warrant. There is no Commission rule requiring the imputation of CIAC on margin reserve. The decision to impute CIAC is dependent upon whether the utility establishes by record evidence that CIAC should not be imputed on margin reserve. 90 FPSC Rep. 4:438, 450 (Order No. 22844, Apr. 23, 1990.) The Company has met its burden of demonstrating the reasons why CIAC should not be imputed to the margin reserves in this Application. There is no testimony or other evidence in the record advocating the imputation of a specific CIAC imputation adjustment. The only evidence in the record supports the Commission accepting the well supporting margin reserves without any CIAC imputation.

ISSUE 7: **What is the appropriate method for allocating general plant, and are any adjustments necessary?**

The Commission should adhere to its unwavering precedent and allocate Southern States' general plant based on the number of customers served by each system. No customer benefits any more or less from the services provided utilizing general plant assets. No customer should contribute more than any other for such assets. No adjustments are necessary to general plant. No adjustments are necessary to general plant based on the allocation method used and supported by the Company.

Southern States has allocated general plant, administrative and general ("A&G") and customer costs on the basis of the number

of customers. This allocation methodology is supported by competent substantial evidence and should be approved for general plant, A&G and customer costs allocated to the 127 systems included in the Application. Testimony on this issue was offered by Mr. Ludsen on behalf of the Company and Ms. Dismukes by OPC. Ms. Dismukes suggested that the Commission consider implementation of a 50% direct labor allocation factor/50% average ERCs allocation factor in Southern States' **next rate proceeding**. (Dismukes, Tr. 1880-1882, 1925.) The grounds supporting the Company's allocation methodology based on number of customers and the deficiencies in Ms. Dismukes' proposal are set forth below:[3]

1. Ms. Dismukes questions why the Company did not use an allocation based totally on direct labor as advocated by the Company in its last rate case. (Dismukes, Tr. 1872-1874.) The reason for raising this issue is curious because she does not advocate the use of such a methodology either in this case or future rate cases. Nonetheless, Order No. 24715 issued June 26, 1991 in the Company's last rate case clearly indicates that the Commission was not satisfied with the results of a direct labor methodology and high costs allocated to some systems by use of such methodology. Indeed, the Commission found the direct labor method to be "troublesome". <u>See</u> 91 FPSC Rep. 6:509, 514.

2. Commission precedent confirms that an allocation based on customers is reasonable and consistent with the Company's prior

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[3]<u>See</u> Ludsen, Tr. 525-533, 717-718, 724-727; Dismukes, Tr. 1924.

Commission-approved rate cases. Ms. Dismukes' proposal is untested, unprecedented, and would impose an excessive burden on small systems, a result which the Commission previously indicated to be unsatisfactory in the Company's last rate case.[4] Ms. Dismukes' proposal mistakenly assumes the existence of some relationship between water usage (ERCs) and the level of the Company's general plant and A&G expenses -- no such relationship exists.

3. Allocations based on number of customers results in the same cost per customer for services whether the customer is served by a small or large system. This method permits the Company to pass along benefits of economies of scale to customers on small systems. Small systems usually are relatively more labor intensive and normally have higher rates. Allocating common costs on direct labor, or even on 50% direct labor, accentuates the assignment of higher costs to small systems and obliterates the beneficial impact of economies of scale which otherwise could be made available to such systems. Ms. Dismukes' proposal would eliminate one of the most significant benefits Southern States' size brings to its customers (recognized by Staff witness Mr. Williams) -- economies

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[4]Public Counsel's reference to 87 FPSC 12:232 (Order No. 18551, Dec. 15, 1987) does not diminish the Company's position that the Commission has historically used number of customers as the accepted methodology for allocation of total utility general plant and A&G expenses. That Order is clearly distinguishable since it did not involve an allocation of total general plant and A&G expenses but rather approved allocations for two expense items, general office equipment (based on active meters) and rent expense (based on office space of each employee and that particular employee's share of responsibilities), both of which are components of total general plant.

of scale.

4. Small systems can be very sensitive to any change in costs due to their size. Since small systems are generally more labor intensive, they are very sensitive to any fluctuations in labor charges and non-recurring or unusual events. Thus, the occurrence of such fluctuations and events may distort the allocation of general plant and common costs to small systems when the allocation is based, in whole or in significant part, on direct labor (i.e., a service line break). Allocations based on direct labor can also be distorted by the fact that regulators impose staffing requirements on water and wastewater utilities. These requirements are more extreme for the wastewater utilities and bear no direct relationship to the majority of general plant and A&G services provided to customers.

5. The use of number of customers presents a consistent methodology which can be used in future rate cases because customer growth is normally steady and gradual.

6. The direct labor allocation method would produce results contrary to Florida's goals of promoting water conservation and encouraging connections to wastewater utilities since the direct labor method would assign more costs to wastewater customers than water customers resulting in lower water rates.

7. An allocation based on customers is easily developed, quantified and verified. This method is consistent with the way the Company currently books common costs. Ms. Dismukes' proposal would be neither easy to develop nor to verify on a monthly basis

and would needlessly add complexity to future rate cases.

The evidence in this proceeding overwhelmingly supports the use of an allocation methodology based on number of customers. Apart from the substantive deficiencies in OPC's proposal, the ERC information on a company-wide basis necessary to implement OPC's proposal, which is not advocated by Ms. Dismukes for this rate case, is not included in the record. (Ludsen, Tr. 733-734.)

OPC has presented no evidence which establishes that an allocation methodology based 50% on direct labor and 50% on ERCs more accurately allocates general plant costs or A&G and customer costs to the cost causer. In other words, OPC has failed to establish how wastewater customers, who generally would bear a higher burden of general plant and A&G costs under OPC's method, cause the Company to incur greater common costs than water customers. Nor has OPC established that increased water consumption causes an increase in general plant, A&G or customer costs.

Choosing an allocation method is not an exact science. Nonetheless, the method selected should be fair and reasonable in assigning costs. (Ludsen, Tr. 528.) The customer allocation method used by Southern States clearly meets this objective, which may explain why this method is used by other water and wastewater utilities and consistently has been approved by the Commission for use by the Company in the past. Accordingly, the Commission should approve the per customer allocation method reflected in the MFRs to allocate general plant, A&G and customer costs.

ISSUE 8: **Is an adjustment necessary to allocate a portion of the Company's general plant to its acquisition efforts?**

No. Acquisition efforts represent an activity and are not a separate business unit such as water, wastewater, and gas. As such, they do not utilize the full facilities of the Company. Acquisition efforts are normally conducted by Topeka Group, Inc. and reflect minimal involvement by Southern States until such time as the acquisition is final. Acquisition efforts involve only a few individuals at Southern States and their time should be charged below the line. Therefore, any allocation would involve only a de minimus amount of space. Any such costs are offset by benefits received through reduced allocation of common costs to customers as a result of the acquisition.

OPC suggests that adjustments should be made to general plant, A&G expenses and related depreciation accounts to allocate costs for acquisition and gas sales efforts. OPC alleges that general plant, A&G expenses and related depreciation accounts should be reduced by a factor of 2.28%. (Dismukes, Tr. 1882-1884.) The 2.8% factor was developed by taking total expenses booked during the test year to possible acquisitions and possible sales-gas division in Account 166 and dividing that number by total direct labor (wages and salaries) of Southern States and Lehigh Utilities, Inc. ("Lehigh"). (Dismukes, Tr. 1883.) Ms. Dismukes offers no specific factual support for her proposed adjustment other than a general reference to the fact there is a cost of electricity for the Company's home office which could be attributed to acquisition efforts. (Dismukes, Tr. 1882-1883.) Further, her application of a 2.28% factor based on a ratio of the Company's direct wages and salaries to NARUC expense Account 166 for possible acquisitions and gas sales (Dismukes, Tr. 1883) bears no relationship whatsoever to general plant.

The substantive deficiencies in the ratio used by Ms. Dismukes to support her adjustment are reflected in the record. First, although Ms. Dismukes uses direct wages and salaries in her ratio, to the extent the Company's employees engaged in activities related to acquisitions or gas sales, virtually all of such employees would be administrative or managerial employees, not field employees. There is no rational relationship between the wages and salaries of field employees and whatever small amount of time the Company's administrative or managerial employees have spent on such efforts during the test year.

Second, Exhibit 65 reflects that costs directly attributable to acquisition efforts of approximately $15,451 are charged below the line. As Mr. Ludsen stated during the hearing, the Company's acquisition efforts are not substantial particularly when one considers that only $3,500 of direct payroll out of $10.2 million in 1991 payroll costs are attributable to acquisition efforts. Such costs were placed below the line. (Ludsen, Tr. 784-785.) Ms. Dismukes conceded on cross-examination that payroll costs related to acquisition efforts are charged below the line and that, for example, time billed by the Company's individuals on the Lehigh acquisition was billed to Minnesota Power and Light Company. (Dismukes, Tr. 1967-1970.) Hence, Ms. Dismukes' proposed adjustment as it pertains to A&G expenses would impose a double disallowance on the Company.

Third, as stated by Mr. Ludsen and acknowledged by Ms. Dismukes, acquisitions and gas sales efforts are not a business

unit within the Company. They are an activity within a unit and do not require the full use of the Company's resources as a business unit would. They do not require billing services, accounts payable, and engineering, and when such services are required, they are of a limited nature and are charged below the line. (Ludsen, Tr. 547-549, 786.)

Finally, as previously stated, the Company's total labor costs in 1991 were approximately $10.2 million and the amount charged to possible acquisitions under Account 166 was approximately $25,000.00. If any labor relates to acquisition and gas sales efforts, virtually all of such labor would be from administrative and managerial personnel, not field personnel. However, Ms. Dismukes chose to use a ratio of Account 166 expenses to the Company's labor associated with field personnel (direct labor). The substitution of the Company's total labor costs for direct labor costs in Ms. Dismukes' ratio yields a percentage factor of .2% applicable to total general plant, A&G and related depreciation accounts. The result of this substitution virtually eliminates Ms. Dismukes' proposed adjustments.

In sum, Ms. Dismukes' proposal should be rejected for the following reasons: (1) Southern States books labor associated with acquisition and sales efforts below the line, hence, Ms. Dismukes' proposed adjustment as it pertains to A&G expenses would impose a double disallowance; (2) Southern States' involvement in acquisition and sales activities and the use of general plant for such activities are immaterial; and (3) Ms. Dismukes failed to

identify any rational relationship between acquisition and sales efforts and the components used in the ratio purporting to support her proposed adjustments. (Ludsen, Tr. 549.)

For these reasons, Ms. Dismukes' proposed adjustments to general plant, A&G expenses, and related depreciation accounts for acquisition and gas sales efforts should be rejected.

ISSUE 9: **Has the Company properly allocated general plant common costs to its gas merchandising and jobbing operations?**

Yes. The gas business has been allocated costs based on the number of customers consistent with the water and wastewater business. Merchandising is an activity within the gas business and is not a business unit in and of itself, and therefore, should not be treated separately from gas. In addition, the gas business is generally over-allocated common costs because it receives allocated costs associated with regulatory requirements which do not apply to the non-regulated gas business.

Southern States incurs direct and A&G costs pertaining to the sale of gas appliances and the provision of liquid petroleum ("L.P.") gas to its L.P. gas customers. The L.P. gas business is a separate business unit within the Company. The gas merchandising and jobbing operations are activities within the L.P. gas business unit. The cost related to merchandising and jobbing operations are charged to a separate account and are incurred below the line. Common costs for general plant, A&G and customer costs expenses are allocated to the L.P. gas business based on the number of customers. The L.P. gas operations are not regulated. The L.P. gas business unit within the Company is generally over-allocated common costs because it receives allocated costs associated with regulatory requirements which do not apply to the non-regulated gas business. (Ludsen, Tr. 734-737.)

The Prehearing Order reflects that the remaining parties to the proceeding took no position on this issue pending either development of the record or receipt of discovery responses. The above-stated facts supplied by Mr. Ludsen during the hearing were not rebutted in the record. Accordingly, the record establishes that the Company has properly allocated general plant, A&G expenses and customer costs to its gas merchandising and jobbing operations, and there is no evidence of record supporting any adjustment.

ISSUE 10: **Should the provision for general plant be increased to reflect omission of common plant acquired in the Lehigh acquisition?**

Yes.

The gas operations use the same general plant facilities as the water and wastewater operations. The administrative and general and customer service functions of the gas operations, i.e., billing, customer service, management, legal, accounting, etc., are performed by the same personnel and equipment as are used to carry out the water and wastewater operations. Therefore, Public Counsel's objection to "gas plant" being allocated to water and wastewater operations is misplaced. In fact, gas operations are allocated a disproportionately large share of general plant and administrative and general and customer service expenses since the gas operations are unregulated and do not require all the administrative and general and customer services related to regulated operations, i.e., tariffs, annual reports, MFRs, comprehensive environmental regulations and extensive accounting recordkeeping as is required under the uniform system of accounts.

Accordingly, Southern States concurs with the adjustments recommended by Staff in the Prehearing Order.

ISSUE 11: **What is the appropriate method for allocating deferred income taxes related to CIAC, connection fees and CIAC gross-up provisions?**

Per the MFRs. Since the Company's deferred taxes are a net debit balance, it is appropriate to include the deferred taxes as a component of rate base. The taxes in Account 281 and Account 190 other than CIAC should be allocated on the basis of plant since they are primarily plant related items. Deferred taxes related to CIAC accounts should be allocated based on the activity in the CIAC accounts during the test year as shown on the allocation schedules in Volume I, Book 2 of 4, pages 0004 and 0021 for water systems and pages 0022 to 0030 for wastewater systems. (Exhibit 39.) The deferred taxes related to the SFAS 106 costs are allocated based on the number of customers to conform to the allocation of the SFAS 106 expense to the systems.

ISSUE 12: **Should deferred income taxes related to post-retirement benefits be included in rate base?**

Yes. The Company is collecting through rates the OPEBs net of the deferred tax expense. Since there is no current tax deductible method to fund these benefits available to the Company it is appropriate for the ratepayers to pay the carrying costs on those taxes.

Yes. The deferred taxes related to other post-retirement employee benefits ("OPEBs") as shown on the allocation schedules in Volume I, Book 2 of 4, pages 0004 to 0021 for water systems and pages 0022 to 0030 for sewer systems should be included in the rate base. (Exhibit 39.)

The deferred taxes arise because there currently is no tax deductible method of funding these benefits available to the Company. Thus, the Company will be required to pay taxes on the OPEB expense recovery even though they are being recovered net of tax from the ratepayers. Since the tax payment will be made by the Company from shareholder funds, it is appropriate for the

ratepayers to pay the carrying costs on these taxes by including the deferred income taxes in the rate base.

ISSUE 13: **If the Commission adopts SFAS 106 for ratemaking purposes, what is the appropriate treatment of the unfunded liability for post-retirement benefits other than pensions?**

Southern States intends to fully fund its liability for post-retirement benefits other than pensions. For ratemaking purposes, any unfunded liability should be treated consistent with proposed Rule 25-14.012, F.A.C.

The question of how unfunded liabilities should be treated is moot since the Utility intends to fully fund its OPEBs. (Gangnon, Tr. 452.) However, to the extent it is necessary to make a determination in this case, unfunded liabilities should be treated in the manner indicated in the Commission's proposed Rule 25-14.012, Florida Administrative Code, which was approved at the Commission's August 18, 1992 Agenda Conference in Docket No. 910840-PU.

ISSUE 14: **What is the appropriate method for calculating working capital?**

Working capital should be calculated pursuant to the formula method of one-eighth of O&M expenses in accordance with (1) the Commission's MFRs and Rule 25-30.437, F.A.C., requiring an applicant to provide the information required by the MFRs, and (2) Order Nos. 21202 and 21627 issued by the Commission on May 8, 1989 and July 8, 1989, respectively, which require the use of the one-eighth of O&M method (or risk forfeiture of rate case expense associated with advocating an alternative method). This has been the Commission's policy to date. No prefiled testimony, pleading or other factual predicate has been identified which justifies deviation from Order Nos. 21202 and 21627 and the Commission policy established therein and carried out to date. Therefore, the Company is not able to address and rebut any allegation that such a deviation would be appropriate.

Working capital is identified in MFR Schedules A-17 in Volume II, Books 1-5 (water) and Volume III, Books 1-3 (wastewater) with

pro forma adjustments for incremental water and wastewater O&M expenses reflected in Volume I, Book 1 (pages 41-43, 212-216). (Exhibit 39.) As Mr. Lewis testified, these schedules and adjustments were derived by use of the formula approach, i.e., one-eighth of O&M expenses. (Lewis, Tr. 1666, 1671.) The use of the one-eighth O&M approach is consistent with Rule 25-30.437, Florida Administrative Code, and the requirement to provide the information required in the Commission's MFRs. See e.g., 92 FPSC Rep. 7:8, 16 (Order No. PSC-92-0594-FOF-SU, July 1, 1992); 92 FPSC Rep. 4:547, 556 (Order No. PSC-92-0266-FOF-SU, Mar. 28, 1992); 89 FPSC Rep. 5:174 (Order No. 21202, May 8, 1989); and 89 FPSC Rep. 7:581 (Order No. 21627, July 8, 1989). In its Prehearing Order position, OPC advocates the use of the balance sheet method. However, OPC offered no testimony, exhibits, or other evidence in support of its position. Given the unrefuted evidence of record, Commission rules, and prior precedent supporting the one-eighth O&M method and the absence of any contradictory evidence, the Commission should approve Southern States' working capital as presented in the above-referenced schedules in the MFRs.

SYSTEM SPECIFIC ISSUES (by County)

Citrus County

ISSUE 15: **Should Rosemont and Rolling Green be considered one system for ratemaking purposes, and if not, how should the rate base improvements at Rosemont be shared between the two systems' customers?**

*The Rosemont and Rolling Green systems were not interconnected until May, 1992. Southern States remains without Commission authority to treat these previously segregated systems as one system for ratemaking purposes. Southern States does not oppose doing so as long as the combined revenue requirements are

met.*

The 1991 additions for the Rosemont system reflect the cost to interconnect the Rosemont and Rolling Green systems. (Wood, Tr. 2222.) These additions include the cost of installing a new well and other equipment to provide service for the Rosemont-Rolling Green interconnection. (Id.) The interconnect between the Rosemont-Rolling Green systems was completed in 1992 and now permits both systems to meet peak demands. (Wood, Tr. 2223, 2228.) The two 4-inch wells at Rolling Green have been taken out of service and water is now supplied to Rolling Green by Rosemont. (Wood, Tr. 2223.) Prior to completion of the interconnect, the Rolling Green plant had proven unreliable, incapable of meeting peak demands, and provided insufficient water pressure. In addition, the Rolling Green plant had been losing prime on the well several times a year and was pumping sand. With the completion of the interconnect, Southern States is now able to provide a reliable, high quality, long-term source of water supply to Rolling Green. (Wood, Tr. 2223; Morse, Tr. 1628.)

The foregoing facts are unrefuted in the record. Southern States is without Commission authority to treat these previously segregated systems as one system for ratemaking purposes; however, Southern States does not oppose doing so as long as combined revenue requirements are met.

ISSUE 16: **Was the utility's decision to interconnect Rosemont and Rolling Green prudent, considering the utility could have interconnected with the City of Inverness, and, if not, what adjustments to rate base are appropriate?**

Southern States' decision to interconnect these systems was prudent.

The Prehearing Order reflects that all parties except Southern States took "no position" on this issue. Southern States' position is that the decision to interconnect Rosemont and Rolling Green was prudent. The evidence supports Southern States' position.

Based on the operational problems with the Rolling Green plant discussed under Issue 15, Southern States explored the possibility of interconnecting with the City of Inverness ("City"). (Wood, Tr. 2224.) Mr. Wood stated that the Company received a letter from the City in September of 1989. The City proposed monthly base facility and demand charges plus a one-time connection charge for each master meter (the amount of the charge depended on the size of the meter). Further, as reflected in correspondence dated May 17, 1990, the City was willing to provide Southern States with service only on a temporary basis and pursuant to various other conditions. (Wood, Tr. 2224-2225; Late-Filed Exhibit 152.)

The evidence reflects that the Company needed a long-term solution for the provision of water at Rolling Green as opposed to the temporary solution offered by the City of Inverness. Based on the comparative costs of the available alternatives, the Company concluded that the upgrade of Rosemont was the most cost effective alternative. (Wood, Tr. 2226-2229; Late-Filed Exhibit 152.) There is no evidence offered by any party disputing Mr. Woods'

conclusion.

Accordingly, the record unequivocally supports the Company's decision to interconnect Rosemont and Rolling Green as the most prudent and financially feasible alternative to provide a long-term solution to the provision of high quality water service to the customers of Rolling Green. Hence, no adjustments to rate base as a result of this decision are appropriate.

<u>ISSUE 17:</u> What is the appropriate number of ERCs to use at Sugar Mill Woods?

The appropriate number of ERCs for Sugar Mill Woods is 9,054 as was used in Docket No. 900329-WS.

The evidence reflects that there is no disagreement on this issue. Mr. Jones of COVA maintains that in the Company's last rate case, the Company agreed to a total of 9,054 ERCs to be used in the denominator of the calculation of used and useful. (Exhibit 122.) Mr. Hartman agreed and supported the 9,054 ERC total utilized in the last case as appropriate in this case for two reasons. First, the 9,054 is based on the potential number of connections in Sugar Mill Woods and the fact that most customers use a 1-inch water meter, which under the American Water Works Association ("AWWA") equivalency standards is equivalent to 2.5 ERCs. Second, the 2.5 ERC equivalency standard for 1-inch meters issued by the AWWA is on target for Sugar Mill Woods based on hydraulic analysis studies conducted on the Sugar Mill Woods system by the Post, Buckley, Schuh & Jernigan engineering firm and Mr. Hartman's engineering firm. (Hartman, Tr. 1455-1456, 1491.) Hence, the evidence unanimously reflects that the appropriate number of ERCs to use at

Sugar Mill Woods is 9,054.

ISSUE 18: **Did SSU use a higher figure (2,500 GPM) for fire protection than that provided to their engineering consultant by the Citrus County Fire Marshall?**

Southern States used the correct fire flow figure based upon Citrus County Ordinance No. 86-10.

The Commission has recognized that a utility must comply with fire flow requirements imposed by county ordinance. 92 FPSC Rep. 8:270, 276 (Order No. PSC-92-0811-FOF-WS, Aug. 12, 1992).[5] In this case, the Company used a fire flow requirement of 2,500 gallons per minute ("GPM") for a duration of five hours as required by Citrus County Ordinance 86-10 ("Ordinance"). (Hartman, Tr. 1461.) COVA alleges that fire flow requirements should be established at 1,500 GPM. COVA's position is based on a letter dated October 28, 1991 from the Citrus County Deputy Fire Marshall to Mr. Hartman's firm which states that the required fire flow for the Sugar Mill Woods "project" is 1,500 GPM. (Exhibit 122.) COVA's position lacks factual and legal merit.

From a factual standpoint, Mr. Hartman testified that the "project" referred to in this letter was a "specific little area" within Sugar Mill Woods -- not the entire Sugar Mill Woods development. (Hartman, Tr. 1502-1503.) Mr. Hartman further testified that subsequent to the October 28, 1991 letter, a representative from his firm discussed fire flow requirements for the entire Sugar Mill Woods development. Pursuant to these

[5] Order No. PSC-92-0811-FOF-WS was a proposed agency action ("PAA") order. Commission records reflect that this PAA Order was not protested and, thus, has become final.

discussions and a memorandum dated January 21, 1992 from the Citrus County Fire Marshall, Mr. Hartman's firm was advised that the Ordinance would be enforced for the entire development thereby requiring fire flow of 2,500 GPM for a duration of five hours. (Hartman, Tr. 1503; Exhibit 103.) Second, even if the Ordinance were amended today to reduce fire flow requirements to 1,500 GPM, the Company (or its predecessor) still would have built facilities following the adoption of the Ordinance in 1986 designed to meet the fire flow requirements of the Ordinance. Thus, even the hypothetical reduction of the fire flow requirement to 1,500 GPM has no impact upon the used and useful percentage of the water source of supply facilities since the Company cannot arbitrarily reduce investment made prior to the conclusion of the test year. (Hartman, Tr. 1435-1436, 1461-1462.)

From a legal standpoint, Section 5 of the Ordinance provides that alternate systems for meeting the minimum fire flow requirements under Section 5 may be approved only by the Citrus County Fire Prevention Division Chief. (Exhibit 103.) There is no evidence in this proceeding reflecting an approval of any form of exemption from the Section 5 minimum fire flow requirements by the Fire Marshal. Mr. Hartman, who investigated this matter and who would know, testified that he was not aware of any such approval. (Hartman, Tr. 1502.) Indeed, the evidence establishes that the Fire Marshal confirmed that the minimum fire flow requirements under the Ordinance would be enforced for the entire Sugar Mill Woods development. As a matter of law, the October 28,

1991 letter from the Deputy Fire Marshal is insufficient evidence of an exemption from the Section 5 minimum fire flow requirements under the Ordinance.

Accordingly, the evidence of record establishes as a matter of fact and law that fire flow requirements for Sugar Mill Woods should be based on the 2,500 GPM and five hours duration requirements required by the Ordinance and used by the Company in calculating used and useful supply wells for Sugar Mill Woods.

ISSUE 19: **Is it appropriate for SSU to deduct two 600 GPM wells instead of one when calculating used and useful?**

Yes. Southern States correctly deducted two 600 GPM wells in calculating the used and useful percentages for the water supply wells.

Sugar Mill Woods has nine wells. Mr. Hartman's unrefuted testimony is that in order to determine the reliable capacity of the Sugar Mill Woods water system, it is necessary to remove the two largest wells out of service. (Hartman, Tr. 1458-1459.)

Mr. Hartman's opinion is consistent with the findings and conclusions of the St. Johns River Water Management District and supported by the record in this proceeding. In DOAH Case No. 89-0828, et al., Final Order entered December 12, 1990, the St. Johns River Water Management District held, at 16:

> Twenty percent, the amount requested in the City's application is a reasonable and appropriate reserve in excess of the City's projected maximum daily demand.

In determining the appropriate reserve (i.e., firm reliable capacity) for Sugar Mill Woods necessary to meet the system's maximum hour demands plus fire flow requirements (Hartman, Tr.

1458), Mr. Hartman removed two of the nine wells in his calculation. This equates to approximately 20% which is the appropriate reserve established by the St. Johns River Water Management District for determining the firm reliable capacity of water supply and treatment plant. Further, it is appropriate to calculate used and useful with due consideration to both routine maintenance and mechanical failure which becomes more likely with a water system that has nine wells. (Hartman, Tr. 1459.)

There is no competent or substantial evidence supporting a determination by the Commission that only one 600 GPM well should be removed in the calculation of used and useful for Sugar Mill Woods. Accordingly, for the reasons stated, the testimony of record and precedent established by the St. Johns River Water Management District provide convincing support for the Company's calculation of used and useful water plant at Sugar Mill Woods based on the removal of two 600 GPM wells.

<u>Clay County</u>

<u>ISSUE 20:</u> **Should the No. 2 well at Keystone Heights be included in the used-and-useful calculation?**

Yes. The well currently is providing service to customers and was providing service prior to the test year. The Company has spent $9,800 to correct problems with the well and place it back in service. This investment also should be considered in this proceeding. The Company already is negatively impacted by the absence of O&M expenses associated with running this well. If the Commission goes beyond the 1991 test year to determine plant in service and adjust used and useful downward, it also must make upward adjustments.

There are three supply wells at Keystone Heights. Well No. 2 was not available for service during the test year. The well had been taken out of service in 1989 because it was pumping sand.

Used and useful was calculated by taking the two wells available for service during the test year and removing the largest well in order to determine the firm reliable capacity of the system. (Morse, Tr. 1631-1633; Exhibit 114.)

Following the performance of several studies to determine the best solution to the problem with the No. 2 well, the Company installed a 430 GPM 9 stage Peerless pump that runs at 1800 rpm. That installation was completed on April 30, 1992 at a cost of $9,800. (Exhibit 114.) Since Well No. 2 is currently in service, the Company does not object to including the No. 2 well in the used and useful calculation. This is clearly a known and measurable adjustment. However, as explained by Mr. Morse and Mr. Ludsen, and confirmed by Ms. Dismukes, if the Commission calculates revenue requirements based on known and measurable adjustments which decrease revenue requirements, it must also consider known and measurable adjustments which increase revenue requirements. (Morse, Tr. 1635, 1653; Ludsen, Tr. 556-557, Dismukes, Tr. 1919-1920; see also Gulf Power Co. v. Bevis, 289 So.2d 401, 406 (Fla. 1974).) Therefore, if the Commission includes the No. 2 well in the used and useful calculation based on known and measurable post-test year events, the Commission must also permit the Company to recover the $9,800 in actual expenses incurred in 1992 which were necessary to correct the problems with the No. 2 well and place it back in service. (Morse, Tr. 1635; Exhibit 114.)

Lake County

ISSUE 21: **Should the plant in service for Skycrest be reduced by $4,124 to eliminate a double counting error?**

Agree with Staff.

This issue was stipulated by the parties at the hearing. (Tr. 326.)

Marion County

ISSUE 22: **Should rate base for the Slat Springs water plant be reduced to reflect abandonment of plant?**

*The retirements of the Salt Springs plant are as follows:

304.200	Structures & Improvements-Source	$ 351.54
304.300	Structures & Improvements-Treatments	440.34
305.200	Collecting & Impounding Reservoir	9.27
307.200	Wells & Springs	8,367.43
309.200	Supply Mains	26.10
310.200	Power Generation Equipment	11.08
311.200	Pumping Equipment	7,692.71
320.300	Water Treatment Equipment	1,805.97
		$18,704.45

These amounts are small because the original assets belonged to the U.S. Forestry Department. The above costs reflect change outs or upgrades.

Accumulated Depreciation as of December, 1991.

304.200	Structures & Improvements-Source	$ 144.65
304.300	Structures & Improvements-Treatments	190.34
305.200	Collecting & Impounding Reservoir	.23
307.200	Wells & Springs	1,573.00
309.200	Supply Mains	2.75
310.200	Power Generation Equipment	0.00
311.200	Pumping Equipment	2,321.34
320.300	Water Treatment Equipment	3,339.00
		$7,561.31

The amount of CIAC associated with the retirement of this plant is estimated to be $3,702.50. Accumulated amortization of CIAC in the amount of $3,702.50 would also be retired. The loss which would be recognized on this retirement is $11,143.14 which should be amortized as an extraordinary retirement.*

During 1991, the Salt Springs water plant was retired and a

new plant constructed. Ms. Kimball provided unrefuted testimony that the retirement was extraordinary in nature and that any loss arising out of an extraordinary retirement should be recognized, deferred and amortized under Accounting Instruction 27 of the Uniform System of Accounts. Accordingly, in the case of the Salt Springs water plant, rate base should be reduced to reflect the extraordinary retirement of these assets and the related CIAC, depreciations and amortizations. The evidence reflects that plant in service should be credited for $18,704, accumulated depreciation should be debited for $7,561, and CIAC and its related amortization should be debited and credited, respectively, for $3,703. As a result of these entries, a loss will be recognized in the amount of $11,143 which should be deferred and amortized as an extraordinary retirement. (Kimball, Tr. 1767-1768, 2203-2204; Exhibit 146.)

Martin County

ISSUE 23: **Should those plant improvements at Fox Run not required by Order No. 21408 be included in the rate base?**

All plant improvements at Fox Run were prudent investments and should be included in rate base. These improvements include the improvements proposed by Southern States and approved by the Commission in Order No. 21408.

Pursuant to 89 FPSC Rep. 6:328 (Order No. 21408, June 19, 1989), the Commission approved the Company's proposal to correct then existing water quality problems. The Commission determined that the Company's final alternative was the most cost effective of four alternatives considered. The proposal included refurbishing three existing iron filters and installing two additional

filters, adding two high service pumps and three backwash ponds and connecting two existing tanks to the system at an estimated cost of $100,000 (using an outside contractor). 89 FPSC Rep. 6:328, 329.

Late-Filed Exhibit No. 145 reflects that the cost of completing the work as proposed in Order No. 21408 totaled $117,545 (W.O. #88-1080). The Company's response to Staff Interrogatory 178 addressed additions to Structures and Improvements -- Water Treatment Plant. As none of the required additions were booked to that specific account, the Company's response indicated that none of the additions related to those proposed in Order No. 21408.

Based on these facts, no adjustment to the Fox Run rate base is appropriate.

Putnam County

ISSUE 24: **Should the River Park No. 2 plant be included in the used and useful calculation?**

Yes. The River Park No. 2 plant is providing service to customers and was providing service prior to the test year. The Company is entitled to recover the necessary investment incurred to correct problems with this plant and place it back in service. This investment also should be considered in this proceeding. The Company already is negatively impacted by the absence of O&M expenses associated with running this well. If the Commission goes beyond the 1991 test year to determine plant in service and adjust used and useful downward, it also must make upward adjustments.

There are a total of four water supply wells and three water treatment facilities at the River Park system. In 1988, River Park Plant No. 2 including one well was removed from service due to problems with the well staying primed. This well was not in service during the test year. Accordingly, used and useful was correctly calculated by taking the three wells in service during

the test year and removing the largest well to determine the system's firm reliable capacity. No adjustment to plant in service is appropriate since the Company does not intend to retire the well and is considering reactivating the well after evaluating alternatives to correct the problem. (Morse, Tr. 1633; Exhibit 114.)

<u>ISSUE 25:</u> **What adjustments to used and useful should be made for the new equipment added to the Silver Lake Oaks system?**

Used and useful should be adjusted to reflect the additional equipment. The finished water storage tanks should be 67% used and useful and the high service pumps should be 36% used and useful.

In response to a letter dated June 6, 1990 from DER requiring the Company to meet the maximum contaminant level for iron and remove excessive air in the treated water, improvements were made in 1991 to resolve these problems pursuant to Permit No. WC54-187620 issued November 16, 1990 by DER. These improvements are included in rate base for the test year as reflected in Volume II, Book 5, page 0657, column 3 of the MFRs (Exhibit 39). However, the improvements were not considered in the used and useful calculation for Silver Lake Oaks. Based on these facts, Mr. Morse agreed with Staff that a re-calculation of used and useful for Silver Lake Oaks is appropriate. These calculations and the resulting used and useful percentages are reflected in Late-Filed Exhibit 117 and should be approved by the Commission. (Morse, Tr. 1636-1637; Exhibit 113; Late-Filed Exhibit 117.)

ISSUES APPLYING TO MORE THAN ONE SYSTEM

ISSUE 26: **Which systems for which the utility requested a margin reserve should not be allowed a margin reserve in the amount requested?**

Subject to an adjustment for the Sunny Hills system, margin reserve should be allowed per the MFRs (Schedule F-8).

The positions raised by Public Counsel have been previously addressed under Issues 3 and 4 of this Posthearing Brief. The record reflects that Staff raised margin reserve issues pertaining to the Quail Ridge, Salt Springs and Woodmere systems. Mr. Morse supported the determination of the 19 ERCs margin reserve at Quail Ridge. (Morse, Tr. 1637-1638.)

Mr. Hartman addressed the Salt Springs system. The Salt Springs system is not built-out. Although it has not experienced any growth in the past years, there are still vacant lots available and Adventure Resorts of America is considering an expansion of their existing RV park which would provide a substantial increase in the number of connected ERCs for both the water and wastewater systems. Hence, the margin reserve requested by the Company is appropriate. (Hartman, Tr. 1464-1465.)

Mr. Hartman also addressed the margin reserve for the Woodmere systems. Mr. Hartman testified that the Company's commitment report indicates that there are four current developments that either are in process or beginning to connect to the Woodmere systems. This demonstrates that the service area is not built-out, and, in Mr. Hartman's opinion, expected growth will more than likely exceed the 3.9% historical five year average indicated in the MFRs. (Hartman, Tr. 1465.)

There is no competent substantial evidence supporting a denial of the margin reserves requested in the MFRs, including those requested for the Beechers Point water and wastewater, Park Manor water and wastewater, Quail Ridge water, Venetian water and wastewater, Wootens water and Salt Springs wastewater systems. Accordingly, no adjustment to the margin reserves requested in the MFRs, as amended at the hearing for a minor downward adjustment to the Sunny Hills system (183 projected ERCs to 180 ERCs; Hartman, Tr. 1377-1378), is appropriate.

ISSUE 27: What are the used-and-useful percentages for the water treatment facilities?

Subject to an adjustment for the Marion Oaks system, the used and useful percentages should be as set forth in the MFRs.

There is no disputed issue regarding the used and useful percentages for the water treatment systems included in the Application and reflected in the MFRs with the exception of the seventeen systems set forth under Staff's position in the Prehearing Order, as amended at hearing. (Prehearing Order, at 27-28; Tr. 1551.) However, as compared to Staff' position in the Prehearing Order, the record reflects a dispute only as to two systems. With respect to the other fifteen systems referenced in Staff's Position, the Company reiterates its argument under Issue 5, specifically, Staff failed to present any evidence in support of a used and useful percentage different than that provided, explained and justified by the Company.

The first system at issue based on the record is Marion Oaks. Staff maintains in its position reflected in the Prehearing Order

that used and useful is overstated because a main break occurred on the day with maximum overflows. In recognition of this occurrence, Mr. Hartman amended the maximum day demand figure used for the calculation of used and useful supply wells by changing from a maximum day demand date of May 14, 1991 to June 16, 1992 and changing the maximum day gallons pumped from 1,885,000 gallons to 1,032,000 gallons. This resulted in a downward adjustment of the used and useful percentage for the Marion Oaks supply wells. The percentage, as amended, is 84% including the margin reserve. (Hartman, Tr. 1376.)

The other system at issue based on the record is the Sugar Mill Woods water treatment facilities. The record evidence supports Mr. Hartman's method of calculating used and useful which derived a used and useful percentage of 100%. (Hartman, Tr. 1460.) Key components of Mr. Hartman's calculation which are supported by the record are the removal of the two largest wells having capacities of 600 GPM each and fire flow requirements of 2,500 GPM and five hours duration based on Citrus County Ordinance 86-10. (See discussion under Issues 18 and 19.) Indeed, even if the Commission were to determine that the reliable well capacity at Sugar Mill Woods should be determined with the removal of only one well, this produces a 97.5% used and useful percentage which is essentially 100%. (Hartman, Tr. 1461.)

The Company's use of the "component" method for each water system's treatment facilities is justified and supported by competent and substantial evidence of record. The Company's

adjustment to the Marion Oaks used and useful percentage alleviates the issue raised by Staff. The Company's calculation of the percentage of used and useful water treatment facilities at Sugar Mill Woods is also supported by competent substantial evidence justifying the removal of the two largest wells, the use of the maximum daily demand, and the 2,500 GPM/5 hours duration fire flow requirements.

Accordingly, the Commission should approve the used and useful percentages reflected, explained and justified by the MFRs and the record evidence, as amended at hearing for the Marion Oaks system.

<u>ISSUE 28:</u> **What are the used-and-useful percentages for the water distribution systems?**

The used and useful percentages should be as set forth the MFRs.

There is no disputed issue regarding the used and useful percentages for the water distribution systems included in the Application and reflected in the MFRs with the following exceptions: Deltona Lakes, Sugar Mill, Jungle Den, Fox Run, Palms Mobile Home Park, Sunshine Parkway, Palisades, Venetian Village and Sugar Mill Woods. With respect to all of these systems except Sugar Mill Woods, Mr. Hartman's unrefuted testimony is that these distribution systems have been considered by Staff in previous cases to be 100% used and useful or are similar in terms of water distribution used and useful criteria to other systems in this Application which Staff considers to be 100% used and useful. Further, although there remain some vacant lots within these systems, like other systems in this Application considered to be

100% used and useful, the systems at issue cannot provide service to existing customers with any less of a water transmission distribution system. (Hartman, Tr. 1467.) Mr. Hartman also unequivocally rebutted Staff's contention that most of these distribution systems would be less than 85% used and useful if the Commission removed fill-in lots. (Hartman, Tr. 1579.)

With respect to Sugar Mill Woods, Mr. Hartman's analysis supports his conclusion that the water distribution system, including the margin reserve, is 50% used and useful. (Hartman, Tr. 1456.) Mr. Jones' calculation of 22% used and useful (Jones, Tr. 1746; Exhibit 122) inappropriately mixes connections and ERCs. The numerator and denominator of the calculation must use the same unit of measure and this unit of measure, consistent with the other calculations of used and useful water distribution plant, should be ERCs. (Hartman, Tr. 1491-1492; Volume II, Book 11, page 004 of Exhibit 39.)

Hence, with respect to the nine water distribution systems at issue, the evidence supports a determination by the Commission that all of such water distribution systems, except Sugar Mill Woods, are 100% used and useful. The evidence supports a determination by the Commission that the Sugar Mill Woods water distribution system is 50% used and useful.

<u>ISSUE 29:</u> **What are the used-and-useful percentages for the wastewater treatment facilities?**

*The percentages set forth in the MFRs should be adjusted upward for wastewater treatment plants which are impacted by DER Rule 17-600.405, F.A.C., and thus require a four (4) year margin reserve. The Commission's recent approval of the Memorandum of Understanding with DER in which the Commission agrees to

acknowledge and recognize the impact of Rule 17-600.405, F.A.C., requires modification of the used and useful percentages set forth in the MFRs. The resulting increase in revenue requirements should be used to set off against any downward adjustments the Commission ultimately might decide are necessary.*

Based on the evidence of record, there is only one wastewater treatment system at issue. That system is the South Forty wastewater system.

Staff alleges that the denominator of the used and useful calculation should be based on the capacity of the South Forty treatment plant. However, consistent with Commission precedent, Mr. Hartman testified that the permitted condition of the treatment facility is limited to the capacity of the spray field site for the purpose of calculating used and useful. (Hartman, Tr. 1468.) See, 91 FPSC Rep. 6:247, 250 (Order No. 24643, June 10, 1991.)[6]

In addition, Mr. Hartman noted that despite the loss of a large customer in the service area (Gold Bond Ice Cream), the cost to refurbish the 75,000 gallon per day plant to accommodate that customer was significantly less than the cost of, for example, a new 30,000 gallon per day plant to serve the other customers in the service area. The Company should not be penalized in the calculation of the used and useful percentage as a result of reduced flows due to circumstances beyond its control, particularly when the Company has acted prudently and in a cost effective manner to provide service to its customers. (Hartman, Tr. 1468-1469.)

Based on the testimony of record, the used and useful

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[6]PAA Order made final pursuant to 91 FPSC 8:444 (Order No. 24961, Aug. 22, 1991).

percentages determined by the Commission for the wastewater treatment facilities should be those set forth in the MFRs.

ISSUE 30: **What are the used-and-useful percentages for the wastewater collection systems?**

Subject to an adjustment for the Sunny Hills system, the used and useful percentages should be as set forth in the MFRs.

There is no disputed issue regarding the used and useful percentages for the wastewater collection systems included in the Application and reflected in the MFRs with the following exceptions: Deltona Lakes, Sugar Mill, Jungle Den, Fox Run, Sunshine Parkway, Venetian Village and Sugar Mill Woods wastewater collection systems. The evidence and grounds supporting the Company's position that each of these wastewater collection systems, except Sugar Mill Woods, is 100% used and useful are set forth under Issue 28 (which addresses specific water treatment systems) and apply with equal force and effect to the wastewater collection systems at issue in this proceeding. (Hartman, Tr. 1469.) Similarly, with respect to the Sugar Mill Woods wastewater collection system, the evidence and rationale supporting Mr. Hartman's 50% used and useful percentage discussed under Issue 28 applies with equal force and application to the Sugar Mill Woods' wastewater collection system which is also 50% used and useful. Likewise, the evidence and analysis under Issue 28 requires the rejection of Mr. Jones' recommendation of a 21% used and useful percentage for the wastewater collection plant. (Jones, Tr. 1746; Exhibit 122.)

Accordingly, the used and useful percentages for the

wastewater collection systems as set forth in the MFRs, and as amended at the hearing for a minor downward adjustment to the Sunny Hills system, 37 to 36% (Hartman, Tr. 1377-1378), are justified and supported by competent and substantial evidence.

ISSUE 31: **Should rate base be reduced to designate certain "future use" plant sites as non-used and useful properties?**

No.

The issue raised by Staff is whether adjustments to rate base are appropriate for the Citrus Springs, Sunny Hills, Marion Oaks, Spring Hill and Deltona Lakes utility systems[7] on the ground that certain "future use" plant sites are, in whole or in part, non-used and useful. There are essentially two issues. The first issue addresses the book value of these properties. The second issue concerns the justification for including these properties in rate base.

During the hearing, questions arose regarding the appropriate book value of specific tracts of "future use" property included in the rate bases of the above-referenced systems. The questions were based on discrepancies between amounts shown in Exhibit 112 and amounts shown in the MFRs (Exhibit 39) regarding the book value of those properties. These discrepancies have been reviewed and are addressed in Late-Filed Exhibit 121. Late-Filed Exhibit 121 corrects errors reflected in Exhibit 112 and provides explanations and reconciliations of adjustments which support the book value of

[7]This Issue was limited to these systems per the Prehearing Order.

these properties as reflected in the MFRs.

The second issue pertains to the justification for inclusion of these properties in rate base. The properties designated as "future use" on Exhibit 112 do not have assets situated on them at this time. (Morse, Tr. 1617.) Late-Filed Exhibit 116 provides specific confirmation as to the Company's intended use for each of these properties. Mr. Morse testified that these properties should be considered used and useful if they will be used sometime in the near future (five years as suggested by Staff's cross-examination of Mr. Morse, Tr. 1622-1623) and were a prudent investment at the time of original purchase. At the hearing, questions were raised with respect to the present full utilization of a few specific "future use" properties included in the rate bases of the Spring Hill and Sunny Hills systems. (Morse, Tr. 1622-1626.) Mr. Morse explained that the intended use of these properties would require further review and noted that in many cases, additional land must be purchased to cost effectively plan for additional capacity and meet DER requirements. (Morse, Tr. 1624-1626.) Based upon further review and analysis and pursuant to Staff's request, the Company submitted Late-Filed Exhibit 116 (and attached hydraulic flow analysis maps) which provides the justification for the Company's investment in these properties from a cost effectiveness, prudency and system planning standpoint:

> According to discussions with Mr. Ralph Terraro, P.E. who was the Chief Engineer for the Deltona Corporation at the time these systems were originally designed, the future use parcels in question were an integral part of the Master Plan to develop these large

systems. This is evidenced by the fact that during the design many of these parcels will supply potable drinking water as future demand warrants. As shown in the attached Hardy Cross hydraulic flow analysis, the water transmission systems were originally designed for the total buildout which includes the provision to use these parcels as the raw water supply sites. Any change in the status of these water supply sites would require that major design modifications take place on the transmission system which was sized based upon design flows from these sites. As such the Company continues to utilize these future well sites as growth warrants and will continue to develop these future utility sites as growth warrants and should therefore be permitted to earn a return on these prudent investments.

> The same would be true of several parcels set aside for wastewater treatment and disposal. During the Master Plan process at inception, it was necessary to select parcels suitable for effluent disposal. Given the cost and difficulty in acquiring land that is suitable for this purpose today, the Company should be allowed to earn a return on these prudent investments.

See Late-Filed Exhibit 116.

Based on the evidence of record, the Company has justified inclusion of the "future use" properties identified in Exhibit 112 in the rate bases of the Citrus Springs, Sunny Hills, Marion Oaks, Spring Hill and Deltona Lakes systems. The Company's reliance on the Master Plan pursuant to which these systems were planned and developed is precisely the type of justification that the Commission has found to be sufficient in determining that land necessary for future use should be included in rate base. See 92 FPSC Rep. 6:594, 597 (Order No. PSC-92-0578-FOF-SU, June 29, 1992). Accordingly, no adjustment to the rate bases of the systems at issue as reflected in the MFRs (Exhibit 39) is appropriate.

However, to the extent the Commission believes an adjustment may be appropriate, such adjustment should be based on and limited to the non-used and useful percentage of plant of the specific system applied to a specific tract of land included in the rate base of such system. See, e.g., 91 FPSC Rep. 7:341, 346 (Order No. 24817, July 15, 1991) (PAA Order which was not protested); 91 FPSC Rep. 7:20, 28[8] (Order No. 24733, July 1, 1991).

ISSUE 32: What are the proper allowances for working capital?

As indicated in the Company's response to Issue No. 14, the one-eighth O&M method of determining working capital is appropriate. The Company utilized this method in this proceeding. The working capital reflected in the MFRs is appropriate.

As discussed under Issue 14, the Company's use of the one-eighth of O&M method of determining working capital is approriate and consistent with Rule 25-30.437, F.A.C., and prior orders of the Commission. The Commission should approve the Company's working capital identified in the MFR schedules (see discussion under Issue 14) subject to any adjustments to O&M expenses which are supported by competent and substantial evidence.

ISSUE 33: Should the unamortized portion of the gain on the sale of St. Augustine Shores and University Shores be included as an offset to rate base?

No, the gains on the condemnations of the non-jurisdictional St. Augustine Shores water system and the non-rate base University Shores wastewater facilities should not be applied to reduce Southern States' revenue requirements.

To avoid unnecessary duplication of substantive arguments supporting the Company's position with respect to the gains on the condemnations of the St. Augustine Shores system and the University

[8] 91 FPSC 9:13 (Order No. 24999, Sept. 3, 1991).

Shores property, the Company will address the rate base issue (Issue 33) and net operating income issues (Issues 58 and 78) together below. At the outset, the Commission should be reminded of the parties' positions as reflected by the evidence. The Company's position is that no portion of the gains realized from the condemnations should be applied to reduce the Company's revenue requirements. Public Counsel presented no evidence addressing a specific adjustment to rate base for the gains on the condemnations of the St. Augustine Shores system and University Shores property. However, Ms. Dismukes did present testimony proposing specific net operating income adjustments with respect to the gains realized on these condemnations.[9]

The unrebutted facts relating to the St. Augustine Shores condemnation as reflected by the record are as follows:

1. The St. Augustine Shores water system always has been treated on a stand alone basis for ratemaking purposes, including separate A&G and customer services. (Todd, Tr. 2160.) Southern States' remaining ratepayers contributed nothing toward the recovery of these common costs. Rates were never changed at St. Augustine Shores between the time the system was acquired by Topeka Group, Inc. in 1989 and the time the system was condemned by St. Johns County in 1991. (Sandbulte, Tr. 179; Todd, Tr. 2158-2159.)

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[9]During the cross-examination of Staff witness Todd it was apparent that Mr. Todd did not dispute the Company's rationale for retaining the gain from the condemnation of the St. Augustine Shores system. (Todd, Tr. 2156-2165.) In fact, Mr. Todd's audit report identifies several reasons why it is appropriate to permit the Company to retain the gain. (Exhibit 131 at 21.)

2. Southern States' remaining ratepayers contributed nothing to Southern States' recovery of its investment in the St. Augustine Shores water system and they bore none of the risk of any loss. (Sandbulte, Tr. 179.)

3. At the time of condemnation, the St. Augustine Shores system was regulated by St. Johns County and was not under Florida Public Service Commission jurisdiction. (Sandbulte, Tr. 179.)

4. The condemnation of the St. Augustine Shores system involved not only the sale of Southern States' assets, but also the loss of both the customers to whom service had previously been provided through those assets and the associated future stream of earnings. (Sandbulte, Tr. 179, 217.)

5. The proceeds from the condemnation of St. Augustine Shores were retained by Southern States as equity and deployed for utility purposes. No portion of the proceeds were distributed as dividends to shareholders. (Sandbulte, Tr. 180-181.)[10]

The record reflects the following pertinent facts pertaining to the University Shores condemnation:

1. The condemned University Shores wastewater facilities were placed in service in March 1986. The Commission has not

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[10]No party disputed Mr. Sandbulte's attempt to create a symmetry between the Commission's policy on acquisition adjustments and the treatment of gains from the condemnation of entire systems. (Sandbulte, Tr. 181.) Under this proposal, on the sale of a system, the rates of remaining customers would not be adjusted to reflect gains or losses absent extraordinary circumstances. (Sandbulte, Id.) No extraordinary circumstances have been demonstrated in this proceeding. In fact, no adverse impact at all on customers of the Commission regulated systems has been established. Therefore, Public Counsel's proposed adjustments should be rejected.

established a new rate base for the University Shores wastewater system since 1982 (based on a June 30, 1979 rate base). Therefore, neither the customers served by the University Shores system nor Southern States' remaining customers contributed to Southern States' recovery of its investment in the condemned wastewater facilities because they were never included in rate base. (Sandbulte, Tr. 179-180, 228-229.) Ms. Dismukes disputed Mr. Sandbulte's testimony that the University Shores property was not previously included in rate base. Ms. Dismukes based her claim on the Company's response to OPC Interrogatory No. 113. (Dismukes, Tr. 1890.) The record reflects that Ms. Dismukes misunderstood and thus mischaracterized the contents of the Company's response to OPC Interrogatory No. 113. Mr. Sandbulte quoted the Company's response in his testimony (Sandbulte, Tr. 190-191) and confirmed that the Company never indicated to any party that the condemned University Shores facilities ever were included in rate base[11] and are not presently in rate base as verified by the MFRs (Exhibit 39). (Sandbulte, Tr. 190-191, 228-229.)

2. As in the case with the St. Augustine Shores condemnation, the proceeds from the condemnation of the University Shores wastewater property were retained by Southern States as equity and deployed for utility purposes -- no portion of the proceeds were distributed as dividends to shareholders. (Sandbulte, Tr. 180-181.)

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[11]There is no evidence that the land ever was considered plant held for future use either (because it was not).

Based on these facts and Commission precedent, the condemnations of the St. Augustine Shores system and University Shores property have no regulatory implications for the Commission or Southern States' remaining ratepayers, and it is improper to make any adjustment to test year rate base or income relating to these condemnations. With respect to Commission precedent, **it must be emphasized that Southern States' remaining customers never were assessed any of the capital, A&G or operating costs associated with the St. Augustine Shores system or University Shores wastewater property.** (Sandbulte, Tr. 182.) The critical nature of these facts was acknowledged by Ms. Dismukes reliance on the rate base status of the University Shores property to justify her proposal that the gain be shared with customers.

Clearly, ownership of utility assets resides with shareholders. If there had been a loss, it is indeed questionable whether Public Counsel would now be advocating the recovery of the loss from the Company's remaining customers.[12] Moreover, where an

[12]There was some discussion in the record regarding whether the loss from a condemnation is analogous to an abandonment of utility plant. Such an analogy is a strained one for the following reasons:

1. an abandonment is an ordinary part of doing business -- a condemnation by a governmental authority is not;

2. a utility impacted by an abandonment (even one forced upon a utility by new or revised governmental regulations or some other reason beyond the Company's control) does not relinquish the right to serve customers and the abandonment only becomes extraordinary if the utility does not have sufficient reserves to accommodate the abandonment (Kimball, Tr. 2203-2204) -- condemnations are not part of the normal course of a utility's operations;

3. in an abandonment situation, the customers formerly served by the abandoned plant remain customers of the utility -- when an entire system is condemned, such as St. Augustine Shores,

entire system is condemned, the Company losses the ability to obtain returns from its investment in the system for years in the future -- against its will. (Sandbulte, Tr. 181-185.)

The arguments posed by Ms. Dismukes (Tr. 1888-1889) do not support recognition in this proceeding of the proceeds from the condemnations of the St. Augustine Shores system and University Shores property. First, the prospect of achieving economies of scale and the customer benefits therefrom through the acquisition of systems does not support the provision of a windfall benefit to customers who contributed nothing to the Company's recovery of its investment in the St. Augustine Shores system and University Shores property nor bore the risk of any loss associated with such investment. There is simply no correlation between the two issues.

Second, the mere possibility that customers may bear some portion of common costs which may previously have been borne by St. Augustine customers, does not support an adjustment. The Commission has never attributed any portion of the gain on the condemnation or even voluntary sale of utility facilities to ratepayers on this basis. This comes as no surprise since common costs such as A&G and customer expenses are a constantly moving target and primarily are a function of the total number of

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the affected customers no longer are customers of the utility; and

4. since customers remain with the utility in the abandonment situation, the utility's investment can be recovered from them -- when an entire system is condemned, no customers remain from whom the utility can recovery any losses of its investment in utility assets.

For these reasons, an abandonment is distinguishable from a condemnation and thus, the analogy is inappropriate.

customers requiring A&G and customer services. This issue was explored extensively with Ms. Dismukes on cross-examination. Ms. Dismukes confirmed that it was her position that, at worst, the condemnation of the St. Augustine Shores system would cause the ratepayers affected by this Application to bear the 1991 A&G and customer service expenses which would have been allocated to the St. Augustine Shores customers:[13]

> Q. (Mr. Hoffman) You are saying in that passage there, are you not, that the ratepayers in this case have suffered because, with the condemnation of the St. Augustine Shores system, the same level of 1991 A&G and customer service expenses will be spread over a smaller total Company customer base, the result of which would be to increase the A&G and customer service expense for the ratepayers in this Application?
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> A. (Ms. Dismukes) Well, I didn't use the word "suffered" in there, but, if you take that out, I think I can agree with you.

(Dismukes, Tr. 1947.) Upon further cross-examination, Ms. Dismukes confirmed that based on her above-stated theory, the maximum adverse impact to ratepayers affected by this Application would be the imposition of additional A&G and customer costs in a total amount of $157,844. (Dismukes, Tr. 1954-1955; Exhibit 128.) However, there is no evidence that even this level of common costs ever were allocated much less recovered from St. Augustine customers. In addition, Mr. Sandbulte pointed out that:

> if the only adverse impact on SSU's remaining

[13]Ms. Dismukes did not attempt to apply this strained "allocation" argument to the condemnation of the University Shores property since no customers were lost from this sale. (Sandbulte, Tr. 187).

customers is the allocation to them of the portion of the common costs that would have been allocated to St. Augustine Shores customers, then SSU's remaining customers can be made whole by requiring Southern States to absorb this portion of the common costs. Ms. Dismukes' rationale supports no further adjustment than that.

(Sandbulte, Tr. 188.)[14]

Third, in past proceedings where the Commission has required utilities to share a gain involving the sale of assets, as distinguished from a condemnation, the facts demonstrate that the gains were realized on the: (1) **sale of rate base assets such that** (2) **remaining ratepayers had contributed** through their rates to recovery of depreciation expenses and/or a return on the utility's investment. See Florida Power & Light Company, 81 FPSC Rep. 9:240 (Docket No. 810002-EU, Order No. 10306, Sept. 23, 1981); Gulf Power Company, 82 FPSC Rep. 2:7 (Docket No. 810136-EU(CR), Order No. 10557, Feb. 1, 1982); Tampa Electric Company, 82 FPSC Rep. 11:64 (Docket No. 820007-EU, Order No. 11307, November 10, 1982); and, Florida Power Corporation, 83 FPSC Rep. 2:148 (Docket No. 830470-EI, Order No. 13771 issued Oct. 12, 1984).

None of the above-cited decisions involved: (1) the **condemnation** of assets where (2) **remaining ratepayers had contributed nothing to the utility in the form of return on investment or depreciation expense recovery.** A review of

[14]Ms. Dismukes also failed to address the fact that the Company's customer base actually grew in 1991 (with the acquisition of Lehigh) despite the loss of St. Augustine Shores customers. This fact throws another cog into Ms. Dismukes' customer allocation justification for giving the gain to existing customers. (Sandbulte, Tr. 187.)

Commission orders reflects that the Commission has recognized this distinction **by permitting the utility to retain the gain on the sale of non-rate base assets.**[15] In the GTE Florida, Inc. decision, the Commission held:

> Because the Quad Block property was sold in 1979, it was not in the rate base when final rates were established in Order No. 10418, issued November 23, 1981. Therefore the Quad Block property never was a factor in determining final rates. For these reasons, we will make no adjustment in this proceeding concerning the sale of GTEFL of the Quad Block property.

90 FPSC Rep. 7:73, 74 (Order No. 23143, July 3, 1990) (emphasis added), consumated by 90 FPSC Rep. xvii (Order No. 23261, July 27, 1990); see also, Florida Power Corporation, 83 FPSC Rep. 2:148 (Order No. 11628, Feb. 17, 1983) (gain on sale of property allocated in part to shareholders based on ratio of number of years property not in rate base over the total years the company owned the property). If the Commission's rationale in these cases is applied in this proceeding, no adjustment to recognize the gains would be proper and Public Counsel's proposed adjustment should be rejected.

The fact that this sale involved a condemnation of an entire system provides further support for the Company's position that the gain should be retained by Southern States and its shareholders. Condemnations of entire systems are essentially a liquidation of a utility's business. In the case of a liquidation of a utility system, it is clear that any gains or losses should go to the

[15]Legal research revealed no prior Commission orders addressing the factors raised by a condemnation of rate base or non-rate base assets.

owners of the utility, in other words, the shareholders. Ms. Dismukes fails to address how the St. Augustine Shores condemnation differs from a condemnation of a single utility system which happens to be the only system owned by a particular entity. In such circumstances, no reasonable argument can be made that the owner of the condemned system can be ordered to return all gains to the former customers served by the system. Similarly, the Commission cannot authorize the former owner to look to former customers for compensation of losses the owner may have incurred as a result of the condemnation. (Sandbulte, Tr. 185.)

Staff's request for information addressing University Shores' achieved rates of return for the years 1987 through 1990 suggests that Staff may believe that such returns are relevant to a determination of whether any portion of the gain on the condemnation of the University Shores property should be shared with ratepayers. Although University Shores was not earning its authorized rate of return between 1987 and 1991 and the amount of gain from the condemnation would not compensate the Company for the difference between the actual and authorized returns during such period (Ludsen, Tr. 842; Late-Filed Exhibit No. 68; Exhibit 39), this issue is irrelevant. A utility's historical and present earnings have no bearing on the factors considered and rationale articulated by the Commission in prior orders determining whether gains on the sale of property should be shared with ratepayers. To the extent that the Commission wishes to examine such facts in this proceeding, Late-Filed Exhibit 68, lends no support to Public

Counsel's position that the gain on the condemnation of the University Shores property should be shared with ratepayers.

Moreover, Exhibit 135 demonstrates that, but for the gain from the condemnation of the St. Augustine Shores system, United Florida Utilities Corporation would have suffered a loss in 1991 of approximately $3.1 million. Exhibit 135 further reveals that Deltona suffered a loss in 1991 of approximately $154,000 and Southern States suffered a loss in 1991 of approximately $2.2 million. Thus, the combined 1991 losses of these three utilities was approximately $5.5 million prior to recognition of the gain from the St. Augustine Shores condemnation. Morever, even after the gain is considered, the combined profit of these utilities was only approximately $1.2 million. Considering combined net assets in 1991 of approximately $213 million, the 1991 financial situation of Southern States was dismal, at best. Therefore, to the extent past financial performance is relevant, the evidence establishes that the Commission must permit the gain from the condemnation of the St. Augustine Shores system to be retained by the Company.

Finally, due to the lack of factual and legal support for her proposed adjustments, Ms. Dismukes offered a brief, unsupported alternative proposal. Under this alternative proposal, if the Commission does not recognize some portion of the gains on the condemnations in the calculation of net operating income, Ms. Dismukes suggests that the associated dollars be removed from the equity portion of the Company's capital structure. (Dismukes, Tr. 1891.) There is no Commission precedent or other justification

for such a proposal. This capital rightfully belongs to the Company and its shareholders and the Company should not be penalized for devoting this capital to its other utility systems. (Sandbulte, Tr. 195.) Accordingly, there is no basis for reducing the amount of equity included in the Company's capital structure. (Sandbulte, Tr. 195-196.)

For all of the foregoing reasons, the adjustments proposed by OPC should be denied.

ISSUE 34: Should negative acquisition adjustment(s) be made to rate base?

No.

The Commission's recently reaffirmed policy concerning acquisition adjustments states that absent extraordinary circumstances, no acquisition adjustments will be recognized for ratemaking purposes. In re: Investigation of Acquisition Adjustment Policy, 92 FPSC Rep. 2:409 (Order No. 25729, Feb. 17, 1992). In addition, the party seeking implementation of an acquisition adjustment has the burden of proving that such an adjustment is justified. No party has presented any evidence rising to the level of "extraordinary circumstances" which would justify a negative acquisition adjustment concerning any of the systems in this filing.

To the contrary, the evidence demonstrates that the systems acquired by Southern States have benefitted in many of the ways identified by the Commission in Order No. 25729 to justify

retention of its policies.[16] Some of the more noteworthy benefits were identified by Company witnesses Vierima, Phillips, Sweat and Ludsen. Company witness Vierima testified that:

> During the 1/92 period SSU's financial condition deteriorated, and as a result, the support from its parent corporation, Topeka Group, was stepped up. Some of the benefits that were provided during this period included guarantees to Sun and South Trust Bank, in terms of credit support for their lines of credit; subordinations and continuing ownership agreements; credit support for the refund associated with the mega-Docket 900329.
>
> Topeka has also been an equity provider to Southern States Utilities without the overhead typically associated with equity. If SSU had been issuing equity securities on its own, the cost of shareholder services, shareholder notices, the types of costs normally associated with maintaining a shareholder body, have not been, in the past, charged to SSU.
>
> There's the implied credit support of our affiliation with the Minnesota Power group of companies. Our affiliation, Minnesota Power and Topeka have also been influential in certain transactions, market transactions. For example, the Deltona bondholder consents. Minnesota Power as a larger corporation, had previous financial relationships with some of the bondholders and was able to intervene in those activities. They have provided bridge short-term financing during a period when SSU's credit has been low, and at the time when we

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[16]Specifically, the Commission identified the following benefits to customers of small systems when acquired by larger systems: "the elimination of financial pressure on the utility due to its inability to obtain capital, the ability to attract capital, reduction in the high cost of debt due to the lower risk, the elimination of substandard operating conditions, the ability to make necessary improvements, the ability to comply with the [DER] and the Environmental Protection Agency requirements, reduced costs due to economies of scale and the ability to buy in bulk, the introduction of more professional and experienced management, and the elimination of a general disinterest in utility operations in the case of developer owned systems." 92 FPSC Rep. 2:409, 411-412.

> still had heavy construction financing requirements. They've accepted returns that are below the cost of equity for the parent corporation, and which we view as a positive in terms of patient capital. And they have provided indemnification on the current performance bonds that were required for revenues subject to refund under the multiple filings currently in progress with SSU.

(Vierima, Tr. 1033-1035.)[17]

As witnesses Phillips and Sweat testified, it was only after Southern States acquired ownership of Deltona Utilities, Inc. ("Deltona" or "DUI") that the Company was able to comply with a DER consent order by halting the discharge of effluent into Lake Monroe (at a cost in excess of $5 million) and correcting the Deltona Lakes wastewater system to 100% public access reuse. (Phillips, Tr. 337; Sweat, Tr. 1278-1281.) Surely, the prior owners of Deltona Utilities, Inc. (who were the same owners that were forced to obtain the 15.99% bonds to satisfy other debts upon which they previously had defaulted (see Application of Marco Island Utilities, 90 FPSC Rep. 12:96, 97 (Order No. 23841, Dec. 7 1990)), could not have achieved these results. Company witnesses Phillips and Ludsen identified additional benefits, including economies of scale, the capability to make bulk purchases, employee specialization, professional utility management and many others. (Phillips, Tr. 355-357, Ludsen, Tr. 520-523, 534-537.)

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[17]A further benefit identified by Mr. Vierima is the parent's demonstrated willingness to permit Southern States to defer interest payments or credit support fees when otherwise due to the parent. (Vierima, Tr. 969). The ability to secure such deferrals has assisted the Company when it has experienced cash flow problems. (Vierima, Id.)

Finally, the only transfer challenged on the record by Public Counsel was the purchase by Southern States' parent, Topeka Group, Incorporated ("Topeka") of 100% of the common stock of Deltona Utilities, Inc. (pursuant to the exercise of certain warrants in Topeka's possession). (Vierima, Tr. 934-951.) As the Commission recently acknowledged, the transfer of stock ownership does not change the rate base balance. (Lehigh Utilities, Inc., 91 FPSC Rep. 11: 514 (Order No. 25391, Nov. 25, 1991).) In addition, the record confirms that in stock transfers, such as the Deltona transfer, a determination of rate base may not even be considered in the determination of the price to be paid for utility systems such as those previously owned by Deltona. (Vierima, Tr. 935, 939, 940-951, 956-959.)[18]

For these reasons, no acquisition adjustment would be appropriate regarding the acquisition of the Deltona or any other systems in this filing.

ISSUE 35: **What are the rate bases?**

The rate bases are as set forth in the MFRs subject to any adjustments approved by the Commission.

The Commission should approve the rate base amounts identified in Volumes I, Books 1-6, Schedules A (water) and Volume II, Books 1-3, Schedule A (wastewater) of the MFRs (Exhibit 39), including the pro forma adjustments to rate base supported by Mr. Lewis

[18] A review of the warrant contained in Exhibit 7 to the Purchase Agreement provided in Late-Filed Exhibit 78 confirms that the purchase price of the stock of the Deltona Corporation utility subsidiaries upon exercise of the warrant was determined by the stockholder's equity on the date of exercise.

(Lewis, Tr. 1666-1671) and included in the above-referenced schedules of the MFRs, subject to any adjustments supported by competent and substantial evidence and/or stipulated by the prties and approved by the Commission.

COST OF CAPITAL

ISSUE 36: **Should the cost of debt capital be adjusted to reflect reduced interest rates for variable-cost debt components?**

The cost of debt capital should be adjusted to reflect either increased or reduced interest rates for variable-cost debt components as they exist at a reasonable time before the evidentiary hearings in this proceeding.

Late-filed Exhibit 87 reflects interest rates for variable-cost debt components as of November 17, 1992. These rates should be used by the Commission in calculating the Company's cost of debt capital.

ISSUE 37: **What is the appropriate cost rate for deferred investment tax credits?**

Per the MFRs. The cost rate should be the weighted cost rate of long-term debt, preferred stock and common stock.

The appropriate cost rate for the deferred investment tax credits is the weighted cost rate of long term debt, common stock and preferred stock shown on Schedule D of the MFRs because the Company has made a valid election under Section 46(f)(2) of the Internal Revenue Code.

Since a company can have only one tax method of accounting for an item, and Southern States is the surviving company, its method of merger accounting for investment tax credits is the appropriate method to use.

ISSUE 38: **What is the appropriate amount of accumulated deferred income taxes to be included in the capital structure?**

Per the MFRs. The Company's deferred taxes are a net debit balance. Such balance should be a component of rate base. Therefore, there are no deferred taxes to be included in the capital structure.

Since the Company's total net deferred income taxes is a debit balance, no deferred income taxes should be included in the capital structure. The net debit amounts allocated to each system in Volume I, Book 2 of 4, pages 0004 to 0030 (Exhibit 39), as adjusted for the resolution of other issues in this case which may impact deferred income taxes, should be included in the rate base.

ISSUE 39: **Should short-term debt be included in the capital structure?**

No. The average capital structure for the test period ended 12/31/91 did not include a short-term debt component. Therefore, the capital structure per the MFRs is appropriate. The application of projected capital costs and structure without concurrent adjustments for plant additions and expense escalation conflicts with the Commission's acceptance of a historic test year for this filing.

The testimony of Mr. Vierima clearly establishes that short-term debt was appropriately excluded from the Company's test year capital structure. Staff maintains that short-term debt should be included in the capital structure because short-term debt was included in the Company's capital structure in the pending Marco Island rate case. (Vierima, Tr. 1030.) However, as Mr. Vierima explained, the Company's short-term debt was incurred in 1992 after the conclusion of the 1991 historic test year used in this proceeding. This explains and justifies the Company's exclusion of short-term debt from the capital structure in this proceeding

and the Company's inclusion of short-term debt in the Marco Island case which is based on a projected test year ended April 30, 1993. (Vierima, Tr. 1031.)

<u>ISSUE 40:</u> **Should the cost of debt capital be adjusted to reflect a reduced interest rate for the 15.95% fixed rate on the Company's $22,500,000 of long-term mortgage bonds?**

No. This issue was decided by the court in <u>Marco Island Utilities v. Public Service Commission</u>, 566 So.2d 1325 (Fla. 1st DCA 1990) and followed by the Commission in Order No. 23841 issued December 7, 1990.

During the hearings, Southern States requested that the Commission strike this Issue and determine that Public Counsel (as well as the other parties) were collaterally estoppel from arguing the facts concerning the interest rate on the DUI bonds. The doctrine of res judicata and collateral estoppel are applicable in administrative proceedings. The Commission has articulated the doctrine between the two doctrines:

> Collateral estoppel is a corollary of the doctrine of res judicata. In a nutshell, res judicata mandates that facts already presented to and determined by a court of competent jurisdiction cannot be tried again between the same parties. The doctrine prevents parties from attempting, in a second proceeding on the same claim, to introduce evidence that might have been offered in the first proceedings but was not. Collateral estoppel prohibits the same parties from relitigating identical issues in a second action, even though the causes of action may differ.

88 FPSC Rep. 9:445, 446 (Order No. 20066, Sept. 26, 1988).

Under the doctrine of collateral estoppel, the Commission is bound by the 1990 decision of the Florida District Court of Appeals for the First Circuit which held that the Commission could not

lawfully adjust the terms of the DUI bonds (including interest payments). Issue 40, once again raised by Public Counsel, seeks the same type of adjustment. Therefore, it would not be lawful to adjust the interest rate on the bonds for ratemaking purposes.[19]

During the hearings, Public Counsel attempted to clarify this issue by indicating that the issue addresses whether Southern States "accommodated" the bond interest rate when it purchased Deltona Utilities, Inc. from Deltona Corporation, ostensibly by paying less than the market price for the utility company's common stock. (Tr. 29.) Commissioner Clark clarified the issue further for Public Counsel (and without Public Counsel's objection), indicating that the issue relates to "what did [a successor in interest] gain by taking on this significant liability; that being a high interest rate for long term debt." (Id.)

The only evidence of what Southern States "gained" as a result of this high cost debt is larger losses. As confirmed in Exhibit 135, the former Deltona Utilities, Inc. lost money in the 1991 test year which means Southern States could not cover the cost of the Deltona bonds at issue without capital infusions from other sources, namely its parent, Topeka. Contrary to the presumption in the re-definition of the issue during the hearings, high interest costs do not benefit a utility, particularly when the debt

[19]Neither Public Counsel nor any other party presented evidence concerning the proper interest rate to which the bonds should be reduced. In other words, there is no evidence of the current interest rate for long term mortgage bonds issued by a utility which is in default on its other financial instruments and otherwise generally in poor financial shape -- the situation Deltona faced when it issued the bonds.

instrument does not permit renegotiation of the interest rate nor refinancing of the debt.

Public Counsel, having raised the issue, bears the burden of proving that the interest rate on the Deltona bonds somehow affected the purchase price -- which it failed to do. Moreover, the Company reasserts that even if such a showing were made, the Commission may not lawfully adjust the interest rate payable on the bonds or the associated debt costs recoverable in the Company's rates.[20]

For the foregoing reasons, no adjustment to the interest rate on the Deltona bonds is proper.

ISSUE 41: **What is the appropriate overall cost of capital including the proper components, amounts, and cost rates?**

Per the MFRs as modified by the Company's response to Issue No. 36.

The appropriate overall cost of capital on the date of acceptance of the Application and MFRs including the proper components, amounts and cost rates associated with the capital structure are fully and accurately set forth in the D Schedules contained in Volume II, Book 7 of the MFRs (Exhibit 39) and supported by the testimony of Mr. Vierima. (Vierima, Tr. 906-907.) The final appropriate overall cost of capital should be based on the components, amounts and cost rates stated in the D

[20]As re-defined, the issue apparently is one which would impact solely the acquisition adjustment issue which was discussed in Issue 34. As the Company discussed then, the purchase price of the common stock of the Deltona Corporation utility subsidiaries primarily was based upon the level of stockholder's equity on the warrant exercise date.

Schedules subject to adjustments for: (1) the updated interest rates for variable-cost debt components (Late-Filed Exhibit 87), (2) the stipulation set forth in the Prehearing Order and approved by the Commission regarding the use of the leverage formula in effect at the time of the Agenda Conference and the 100 basis points range for the cost of equity (Tr. 16-17), and (3) any other adjustment supported by competent and substantial evidence.

NET OPERATING INCOME

GENERIC AND A&G EXPENSE ISSUES

ISSUE 42: **Should the Company's revenues be weather normalized, and, if so, what adjustments are appropriate?**

No weather normalized study has been presented by any party to this proceeding. With the diversity of systems located throughout the State, weather normalization is not meaningful since many other factors affect revenues as much if not more such as the economy, the level of rates and conservation measures.

The Utility's rates in this rate case were developed for an historic test year on the basis of stand-alone cost studies performed for each system and the caps discussed at Issues 94, 95, 96, and 101. These rates are supported by the MFR E Schedules of Exhibit 39 and the testimony of Ms. Loucks, Mr. Ludsen, and Mr. Cresse.

Weather normalization adjustments were not proposed by the Company. In addition, no witness testified in support of weather normalization, and there is no evidence of record identifying or supporting any weather normalization adjustment.

On cross-examination of Ms. Loucks, Public Counsel attempted to establish a basis for a weather normalization adjustment through the use of Exhibit 125, which presented very limited information

regarding average rainfall in 10 selected Florida cities. On its face, given the diversity of Southern States systems throughout Florida and the unpredictable nature of rainfall in this state, this Exhibit does not rise to the level of competent substantial evidence, let alone competent substantial evidence of a specific adjustment to any one or all systems. More directly, as Ms. Loucks testified, there is no evidence as to whether the Exhibit is representative of SSU's service areas, and to weather normalize there must be "very representative data." (Loucks, Tr. 1818-1819.) In addition, if there was excessive rainfall in 1991 that effected each and every system, it would affect irrigation and not domestic consumption. (Loucks, Tr. 1852.) Finally, because of the diversity and number of locations Southern States serves, the effect of high rainfall in one area may be balanced out by low rainfall in the other.

The effort to impose a weather normalization adjustment must be recognized for what it is -- unfounded. Any effort on the basis of this record would be purely speculative, drawing its inspiration from the imagination and lacking in a solid evidentiary basis. Since there is no evidence properly advocating a weather normalization adjustment, and absolutely no evidence as to a specific adjustment, none should be made.

ISSUE 43: **Is the utility's test year provision for employee wages and compensation unreasonable and, if so, what adjustments are appropriate?**

*Administrative salaries are reasonable and no adjustment is appropriate. There has been no prefiled testimony, pleading or other factual predicate identified to the Company which suggests that any portion of administrative salaries are not reasonable.

Therefore, the Company has not had the opportunity to address and rebut any allegation in such regard.*

In raising this issue, OPC takes the position that "bonus or other at-risk compensation should be eliminated from test year expenses." Prehearing Order, at 35. Public Counsel presented no specific adjustment or other testimony addressing this issue. Instead, Public Counsel attempted to establish through cross-examination of Mr. Phillips that the Company's merit incentive payroll system imposes excessive costs which do not benefit ratepayers. The testimony of Mr. Phillips unequivocally rebuts this contention.

Under the Company's merit incentive payroll system, employees are evaluated and placed within one of five categories depending on their prior year's performance. Those categories are outstanding/excellent, fully capable, marginally satisfactory, and unsatisfactory. Fully capable and outstanding/excellent employees receive merit increases of 3.5% of their base salaries. Outstanding/excellent employees also receive a 2% (of base salary) incentive adjustment. A marginally satisfactory employee may receive a nominal raise of 1% as well as a reprimand. Under the Company's program, these evaluations are made on an annual basis so that, for example, there is no guarantee that an outstanding employee who earns the 2% lump sum incentive adjustment for 1990 performance will again earn the same lump sum incentive adjustment for 1991 performance. (Phillips, Tr. 399-402; Late-Filed Exhibit No. 35; Exhibit 40, Ludsen Prefiled Rebuttal Exhibit FLL-8.)

Exhibit 23 and Late-Filed Exhibit No. 35 reflect that in 1991,

55 out of 450 employees, or approximately 12.22%, were determined to be outstanding or excellent thereby entitling them to the total increase of 5.5%. Approximately 80% of the Company's employees were determined to be fully capable and therefore entitled to the 3.5% merit increase. Hence, in 1991, the great majority of the Company's employees received merit increases lower than the 4.12% 1991 level of inflation and only approximately 12% were paid the additional 2% lump sum incentive adjustment. In addition, there are ten employees in upper level positions with the Company who are eligible for additional compensation under the Company's Incentive Compensation Plan. The level of the bonus, if any, depends on the employee's position and the achievement of a number of corporate goals by the Company. (Phillips, Tr. 412-422; Exhibit 23; Late-Filed Exhibit 35.)

In sum, the evidence reflects that Southern States has implemented a merit incentive payroll system designed to provide continuing quality of performance incentives to its employees which results in a higher quality of service and efficiencies for the Company's customers. (Phillips, Tr. 399-400.) There was no evidence otherwise presented in the record that the Company's administrative salaries or the level of merit increases and incentive adjustments which must be earned by employees are unreasonable. Accordingly, no adjustment to employee wages and compensation as reflected in the MFRs is appropriate.

ISSUE 44: **What is the appropriate method for allocating administrative and general expenses?**

The allocation of A&G expenses based on customers is appropriate for the following reasons: (1) it is the method invariably used by the Commission in all prior Southern States and, to the Company's knowledge, other water/wastewater utilities rate proceedings; (2) no customer will contribute more than any other customer; (3) customer usage (ERCs) has no impact on the levels of A&G expenses; (4) direct labor is distorted by DER staffing requirements (rules and permits) as well as the unusual occurrences, i.e., line breaks, which may require additional personnel or overtime in the test year; (5) economies of scale are recognized whereas an allocation in the manner advocated by Public Counsel obliterates such economies; and (6) the other reasons presented in the Company's evidence.

The Company's analysis of the evidence concerning Issue 7 demonstrates the reasonableness of the allocation of general plant expenses on the basis of customers. The evidence and rationale supporting the customer allocation method for allocating general plant expenses apply with equal force to A&G and customer costs. There is no competent or substantial evidence which would justify the Commission's rejection of the customer allocation method for allocating these common costs. Accordingly, Southern States adopts its Issue 7 position (and the analysis and arguments raised therein) for Issue 44. Based thereon, the Commission should approve the allocation of A&G and customer costs on the basis of customers.

ISSUE 45: **Is an adjustment necessary to allocate a portion of the Company's administrative and general expenses and general plant depreciation expense to its acquisition efforts?**

*No. Acquisition efforts represent an activity and are not a separate business unit such as water, wastewater and gas. As such, they do not utilize the full facilities of the Company. Acquisition efforts are normally conducted by Topkea Group, Inc. and reflect minimal involvement by Southern States until such time as the acquisition is final. Acquisition efforts involve only a

few individuals at Southern States and their time should be charged below the line. Therefore, any allocation would involve only a de minimus amount of space. Any such costs are offset by benefits received through reduced allocation of common costs to customers as a result of the acquisition.*

The Company's analysis of the evidence under Issue 8 demonstrates that the record does not support any adjustment to the Company's administrative and general expenses and general plant depreciation expense due to acquisition efforts. The evidence and grounds supporting the Company's position pertaining to OPC's proposed adjustments to general plant and related depreciation accounts apply with equal force to OPC's proposed adjustments to administrative and general expenses and general plant depreciation expense. There is no competent or substantial evidence supporting OPC's proposed adjustments to A&G expenses and general plant depreciation expense due to acquisition efforts. Accordingly, the Company adopts its Issue 8 position (and the analysis and arguments raised therein) for Issue 45. Based thereon, the Commission should reject OPC's proposed adjustments to A&G expenses and general plant depreciation expense due to acquisition efforts.

<u>ISSUE 46:</u> **Has the Company properly allocated administrative and general expenses to its gas merchandising and jobbing operations?**

Yes. The gas business has been allocated costs based on the number of customers consistent with the water and wastewater business. Merchandising is an activity within the gas business and is not a business unit in and of itself, and therefore, should not be treated separately from gas. In addition, the gas business is generally over-allocated common costs because it receives allocated costs associated with regulatory requirements which do not apply to the non-regulated gas business.

The Company's analysis of the evidence concerning Issue 9 demonstrates that the Company has properly allocated administrative

and general expenses to its gas merchandising and jobbing operations. The evidence and rationale supporting the Company's allocation of general plant to its gas merchandising and jobbing operations apply with equal force to administrative and general expenses. There is no competent or substantial evidence which would justify an adjustment to the Company's allocation of administrative and general expenses to its gas merchandising and jobbing operations. Accordingly, Southern States adopts its Issue 9 position (and the analysis and arguments raised therein) for Issue 46. Based thereon, there is no evidence of record supporting an adjustment to the Company's allocation of its administrative and general expenses to its gas merchandising and jobbing operations as the record reflects a proper allocation of such expenses.

ISSUE 47: **Are adjustments necessary for expenses charged to the Company by the Topeka Group, Inc. and Minnesota Power and Light Company?**

No.

During the test year, Southern States paid credit support fees to Topeka Group, Inc. in the amount of $54,236.94. (Late-Filed Exhibit 79.) The MFRs also reflect that the Company allocated travel costs (based on number of customers) of $17,508 incurred in 1991 for the travel of Minnesota Power/Topeka and Southern States' employees between Southern States' home office in Apopka and Minnesota Power/Topeka's home office in Duluth, Minnesota. (Late-Filed Exhibit 81.) OPC maintains that an adjustment is necessary to these expenses. OPC presented no specific adjustment or other record evidence addressing this issue. The testimony of

Mr. Vierima reflects that these expenses were prudent and provide benefits to ratepayers.

Due to Southern States' poor 1991 and year-to-date 1992 financial results, the Company has been unable to obtain debt financing from commercial banks or other lending institutions on a stand-alone basis. (Vierima, Tr. 909; Exhibit 72.) Since Southern States lacks sufficient stand-alone financial capacity to secure significant debt or credit obligations, Southern States has been required to secure credit support through such instruments as guarantees and indemnifications from its parent, Topeka Group, Inc. (Vierima, Tr. 965-966.) For example, Sun Bank required Topeka to guarantee the $2.8 million letter of credit posted by the Company with the Commission as security pending its appeal of its last rate case. (Vierima, Tr. 971-972; Late-Filed Exhibit 79.) Topeka's charge to Southern States was only one-half of 1% of the principal amount. Sun Bank also refused to issue Southern States a letter of credit on the Collier County Industrial Development Revenue Bonds without credit support and a credit guarantee from Topeka. (Vierima, Tr. 967; Late-Filed Exhibit 79.)

The financial indicators for Southern States presently indicate that its credit capacity is classified as "noninvestment grade credit" which simply means that lenders are reluctant to issue debt or extend credit to Southern States without the financial support of Topeka. Southern States presently lacks the financial capacity to go into the capital markets and secure debt without such support. (Vierima, Tr. 974-975.) There is no record

evidence that the credit support fees paid by the Company to Topeka are excessive. Indeed, the Company's relationship with Topeka has enabled the Company to pass along numerous financial benefits to ratepayers. For example, Topeka has been an equity provider to Southern States without the overhead costs typically associated with issuing equity on a stand-alone basis. The implied credit support of the Minnesota Power Group of companies was also influential in securing the necessary bondholder consents to complete the merger with Deltona Utilities, Inc., which, as acknowledged by Ms. Dismukes (discussed infra), provides numerous benefits to ratepayers. In addition, much of the short term debt funding provided by Topeka to Southern States are at rates well below those available on the open market, particularly when one considers that Southern States' noninvestment grade credit would require it to borrow at 250 to 400 basis points above comparable maturity treasury securities for senior secured debt. (Vierima, Tr. 976, 1033-1034.)

Hence, the record reflects that Southern States is the beneficiary of significant financial benefits due to its relationship with Topeka and Minnesota Power, particularly in light of Southern States' present inability to secure debt or credit on a stand-alone basis. There is no evidence that the level of credit support fees paid by Southern States to Topeka are unreasonable or excessive. Moreover, these expenses will be recurring in nature until such time as financial indicators used by lenders, such as interest coverages and cash flow, improve dramatically and lenders

are comfortable extending debt and credit to Southern States at reasonable rates without credit support. (Vierima, Tr. 974.) For these reasons, there is no competent substantial evidence supporting any adjustment to the credit support fees paid by Southern States to Topeka.

With respect to the travel costs between Apopka and Minnesota, Late-Filed Exhibit 81 reflects that approximately 84% of these costs were associated with travel by Minnesota Power/Topeka employees to Apopka. As stated by Mr. Vierima, the Company has analyzed these costs and found them to be cost efficient and beneficial to ratepayers:

> Q. (Mr. Armstrong) Did Southern States perform any analysis of the costs and benefits of using Minnesota Power and Topeka personnel, who are located in Minnesota, to perform certain functions, versus the use of independent third parties who may be located in Florida?
>
> A (Mr. Vierima) We estimate that for an average visit of the Minnesota Power employee on any given function, that for a typical two-week stay, including travel costs, for a degreed individual with many years of utility experience, that the average cost, including the travel cost, would range from 40 to $45 an hour. That includes the fact that these employees typically worked longer hours and on weekends, those types of things, when they do work for SSU. Our experience has been that that rate is comparable for those qualifications, plus the fact that these individuals are familiar with SSU; that these qualifications compare to what we would pay for similar qualified people, locally, is at least comparable, if not less.

(Vierima, Tr. 1035-1036.)

The evidence reflects that the travel costs of Minnesota Power/Topeka employees to Apopka are cost efficient, justified and provides benefits to ratepayers. Further, there is no evidence reflecting the approximate $2,800 (Late-Filed Exhibit 81) of travel costs associated with the travel of Southern States' employees to Duluth is unreasonable or excessive. Therefore, no adjustment to these travel costs is appropriate.

ISSUE 48: **What is the appropriate allowance for rate case expense?**

The rate case expense requested by the Company in this proceeding, including legal, accounting and consulting fees as well as mailing, copying and other costs, is approximately $10,000 per system. There is no way that this extraordinary low level of expenses per system could have been achieved if each system were filed individually. The Company is aware of no litigated rate proceeding in which rate case expense is anywhere near this low figure. Recovery of the total amount of rate case expense requested by the Company, as adjusted for the amount of rate case expense actually incurred, is appropriate.

Pursuant to Late-filed Exhibit No. 71, Southern States currently estimates rate case expenses for the 127 system filing to average approximately $10,000 per system. (See also Ludsen, Tr. 882.) Southern States is aware of no litigated rate proceeding where total rate case expense, on a per system basis, was as low as only $10,000. The record reflects that Southern States actually reduced the legal expenses in this 127 system filing from the level of legal expenses incurred in Docket No. 900329-WS, which involved only 34 systems. (Ludsen, Tr. 878.) When Exhibit 41 and Late-Filed Exhibit 71 are compared to the Company's projections of rate case expense in the MFRs, it is apparent that the Company was able to achieve this extraordinarily

low expense level by performing as much of the required work as possible in house. (Ludsen, Tr. 882.) Examples of the Company's efforts in this regard include the use of in house personnel to prepare the MFRs (to the maximum extent possible) and conduct rate engineering studies such as margin reserve and used and useful (except where the use of Mr. Hartman was more efficient due to his recent performance of these studies on the 34 systems filed in Docket No. 900329-WS), the hiring of an in house attorney engaged primarily in rate case litigation (Ludsen, Tr. 883), and the in house copying of hundreds of thousands of documents (perhaps more than a million) rather than contracting such copying out.

In the hundreds of pages of invoices provided by the Company to substantiate rate case expense, a few misclassified or inaccurate billings were discovered. Adjustments were made to correct these inaccuracies in the Company's late-filed exhibits. (See, e.g., Late-Filed Exhibits 69 and 70.)[21]

The record is otherwise devoid of evidence which would indicate that the level of Southern State's rate case expense was unreasonable or imprudently incurred. The Commission should approve Southern States rate case expense in the amount of $1,305,399, subject to a true-up of projected expenses. (Late-

[21] No services of outside personnel were used to respond to Commission Staff's alleged MFR deficiencies with the exception of certain minimal legal services provided by Messer, Vickers in the amount of $1,914.00. (Late-Filed Exhibit 69.) Even these costs are prudent and should be recoverable since the determination of "deficiencies" often is a matter of interpretation and Staff actually rescinded one of the alleged "deficiencies" as a result of Company counsel's intervention, thereby avoiding additional rate case expense.

Filed Exhibit 71.)

ISSUE 49: **Should the utility's proposed pro forma adjustments to customer accounting and administrative charges due to acquisition of Lehigh Utilities be approved?**

The adjustment represents the roll-in of actual customer account and A&G expenses of Lehigh on an annualized basis after reductions for costs eliminated after the acquisition of Lehigh. No adjustments are appropriate.

The Company initially notes that OPC took "no position at this time" in the Prehearing Order on this Issue. Prehearing Order, at 39. For the same reasons previously articulated under the Company's Basic Position pertaining to Citrus County's failure to provide notice of its positions, OPC has waived its position on this Issue.

The only testimony on this Issue was provided by Mr. Lewis. Mr. Lewis testified that a pro forma adjustment was made to add back and reallocate the A&G expenses previously allocated to Lehigh during the period October through December, 1991. The purpose of this adjustment was to permit the Company to allocate a full twelve months of A&G costs rather than only three months. The impact of this adjustment was $70,082 (water) and $24,238 (wastewater). An adjustment was also made to reflect the estimated annualized Lehigh A&G expenses. This was necessary since Lehigh was not acquired until June 30, 1991. Thus, the Company did not have twelve months of experience with Lehigh as part of Southern States' family of utilities. The impact to the systems in this case is $125,226 (water) and $43,310 (wastewater), respectively. (Lewis, Tr. 1675-1676.)

The unrebutted testimony of Mr. Lewis supports and justifies

the Company's pro forma adjustments to customer accounting and A&G expenses due to the acquisition of Lehigh. Accordingly, no adjustment is appropriate.

ISSUE 50: **Should the Commission allow the utility's $1,435,469 pro forma adjustment for post-retirement benefits, and, if not, what adjustments are appropriate?**

The Commission should permit Southern States to recover the entire amount of FASB 106 expenses requested. These amounts are $679,550 for water and $235,025 for wastewater per Schedule B-3 of the MFRs subject to an adjustment of 18.02% applicable to each expense item which should be excluded from the calculation of net operating income and capitalized and included in rate base. See Issue 54. The Company agrees to fully fund its FASB 106 expenses. The failure to provide for these expenses will negatively impact the Company's ability to obtain the lowest cost financing since investors and lenders will be confronted with significant unfunded liabilities in the absence of such recovery.

The expenses for OPEBs included in the B-3 schedules of the MFRs are premised upon the Commission's adoption of SFAS 106, which is more fully addressed in the analysis and argument concerning Issues 51, 52, 111 and 112. On the basis of SFAS 106 and the Company's thorough consideration and adoption of the Current Plan shown in the Milliman and Robertson, Inc. Actuarial Report (Gangnon, Tr. 455, 477; Exhibit 38), the cost of OPEBs identified in MFR Schedule B-3 (Exhibit 39) is $679,550 for water and $235,025 for wastewater. (See also Exhibit 38, Gangnon Late-Filed Deposition Exhibit 6.) However, the Company agrees that 18.02% of these expenses should be capitalized and included in rate base. (Exhibit 38, Gangnon Late-Filed Deposition Exhibit 4; Exhibit 66; Gangnon, Tr. 478-480; Ludsen, Tr. 835-836.)

Staff has raised the issue (but presented no testimony or other evidence) of the appropriate level of the Company's OPEB

expenses. As Mr. Gangnon stated during the hearing:

> The level of benefits that were offered to the employees (came) after careful consideration of the management and the Medical Plan Board of Governors. The level of benefits and the costs having been considered by management as part of an overall compensation package needed to attract and retain quality employees. The benefits appear to be in line with the other OPEB benefits offered by other Florida companies that I'm aware of.
>
> The Commission has adopted SFAS 106 in the case of United Telephone, Florida Power, without reduction or change to their substantive plan amounts. Not allowing the recovery of the OPEBs in accordance with the SFAS 106 may force the Company to reduce these benefits when other utilities are not forced to do so, which could cause us to lose qualified people and have a harder time attracting them.
>
> If we do not recover these costs and continue the benefits levels and fund them to retain our employees, this would divert credit capacity when we are straining existing capital sources to fund plant additions, improvements and modifications.
>
> Also, the growth of the OPEB liability if we don't fund would create uncertainty on the part of the Company's creditors and investors, which would be used to determine the interest rates and equity return expectations resulting in higher financing costs.

(Gangnon, Tr. 455-456.)

The Company has been and will continue to contain costs so that it will be able to provide quality service at reasonable rates. The OPEB expenses are known costs that will be incurred prior to rates becoming effective in this docket. The expenses are based on a sound actuarial study. (Exhibit 38, Gangnon Late-Filed Deposition Exhibit.) The results of the Milliman and Robertson,

Inc. Actual Report were derived from a number of carefully researched and informed decisions, made in consultation with independent experts, to select appropriate assumptions and produce reasonable results. (Gangnon, Tr. 451-453.) The Company is always looking at alternatives; however, there are no present plans to reduce either the kinds or level of post-retirement benefits offered to the Company's employees. (Gangnon, Tr. 451-452.) As indicated by Mr. Gangnon, the Company must consider the benefits it offers to employees carefully and is ever mindful that there is only a small pool of experienced utility professionals both at the managerial and operational levels from which the Company can draw its employees to maintain and improve the quality of service provided by the Company. Therefore, the benefits offered must consider more than dollars and cents -- the Company must consider its ability to attract and retain qualified, knowledgeable utility employees who can assist the Company in providing the highest quality service possible.

To conclude, apart from the Company's stipulation that 18.02% of the OPEB expenses identified in the MFRs should be capitalized and included in rate base, there is no competent substantial evidence justifying a reduction to the OPEB expenses reflected in the MFRs.

ISSUE 51: **Does FASB 106 require SSU to incur any expense which it would otherwise (i.e., in the absence of FASB 106) not incur?**

No. The adoption of SFAS 106 will not change the ultimate amount of OPEBs but will impact the period in which the expenses are incurred, i.e., such expenses will be accrued when services are performed.

There is no dispute as to this issue. Both Mr. Gangnon and Ms. Montanaro agree that the adoption of SFAS 106 will not change the ultimate amount of OPEBs but will impact the period in which the expenses are incurred, i.e., such expenses will now be accrued under SFAS 106 when services are performed. (Gangnon, Tr. 461; Montanaro, Tr. 2035; Exhibit 22, Montanaro Deposition at 33.)

ISSUE 52: **Are SSU's alleged OPEB obligations certain enough to justify recovery of expenses related thereto?**

Yes, because such expenses were calculated in accordance with SFAS 106 and this methodology has been adopted by the Commission for the purpose of providing reliable or sufficiently certain estimates of such expenses.

This Issue is thoroughly addressed under Issues 50 and 112 and the factual and legal grounds supporting the Company's position in those Issues are incorporated herein by reference.

ISSUE 53: **Is the transition adjustment a request to recover expenses incurred in prior periods?**

No. The change to the accrual method of accounting is to match the OPEB expenses with the related employee services. The fact that a transition obligation arises due to the change from pay-as-you-go to the accrual method is not a recovery of costs which should have been recovered in a past case. In fact, the costs would be recovered in the future under the cash method.

The evidence supports the Company's position on this Issue. In considering this Issue, the Commission must bear in mind that the Company has been applying the pay-as-you-go/cash method of accounting for OPEBs in the past and will begin implementation of the SFAS 106 accrual method of accounting in January, 1993. (Gangon, Tr. 446.) With this distinction in mind, the question is whether the transition or accumulated benefit obligation ("APBO") represents a request to recover expenses incurred in prior periods.

The answer is no.

Ms. Montanaro stated in her testimony that the APBO assigns costs of prior periods to current ratepayers. (Montanaro, Tr. 1987.) Ms. Montanaro did not state that the APBO assigns costs incurred in prior periods to current ratepayers. This is because under the cash method of accounting utilized by the Company, the APBO portion of the OPEBs pertaining to prior periods were **earned by employees of the Company, but not incurred for accounting purposes under the cash method of accounting.** Since the APBO portion of the OPEBs requested in this proceeding were never incurred for accounting purposes in the past, there is no basis for the position that the Company should have sought to recover these expenses in past rate cases.

In addition, the Commission should recognize that OPC is essentially taking the primary deficiency in the pay-as-you-go method and attempting to use it as an argument against the use of SFAS 106. As Mr. Gangnon stated:

> Under the pay-as-you-go method, there is no direct matching of customers who pay the costs and the customers on whose behalf the costs are incurred, i.e., a customer who first received service in 1991 will be assessed OPEBs paid to an employee who may have retired in 1991.

(Gangnon, Tr. 453-454.) The Commission should presume that OPC did not raise this "prior periods" issue for the purpose of establishing deficiencies in Ms. Montanaro's arguments in support of the continued use of the pay-as-you-go method for ratemaking purposes. Yet, this is precisely the result if one accepts OPC's

position on this Issue.

Accordingly, and for the reasons stated, the APBO does not represent a request to recover expenses incurred in prior periods.

ISSUE 54: **If the Commission approves the accrual method for post-retirement benefits, should that portion of benefits related to construction be removed?**

Yes, these costs should be capitalized as part of rate base.

The Company and Staff agree that 18.02% of the requested OPEB expenses should be capitalized. (See Exhibit 66.) All other parties took no position. The Issue is whether the 18.02% of such expenses should be included in rate base. The unrebutted testimony of the Company justifies inclusion of the 18.02% of OPEB expenses in rate base.

As Mr. Gangnon testified and as previously discussed under Issue 50, the Company will subject itself and its ratepayers to increased financing costs and loss of the ability to attract and retain quality employees if it is not permitted to fully recover its requested OPEB expenses. (Gangon, Tr. 455-456.) Staff questioned the rationale for including 18% of the OPEB expenses in the 1991 test year rate basis on the ground that OPEBs were not actually accrued in 1991 due to the Company's use of the cash method of accounting. Mr. Ludsen fully responded to this concern. Mr. Ludsen testified that these expenses should be included in rate base because rates must be established for the future and such rates should permit the Company to recover 100% of its requested OPEB expenses through allowable expenses and rate base. (See also, Gangnon, Tr. 478-480.) These expenses should be included in rate

base as a lump sum entry and allocated to the systems included in this Application based on number of customers. (Ludsen, Tr. 835-836.)

The Company's OPEB expenses are known and measurable. The fact that 1991 construction costs did not include any provision for OPEBs under SFAS 106 comes as no surprise since the Company will not implement SFAS 106 until January, 1993. Hence, based on the record, the Commission is fully aware that 18.02% of OPEBs in 1993 will be capitalized. Accordingly, for the reasons stated by Mr. Gangnon and Mr. Ludsen which are unrefuted in the record, the Commission should include 18.02% of the Company's requested OPEB expenses in rate base and allocate such costs to the rate basis of the systems included in this Application based on the number of customers.

<u>ISSUE 55:</u> **If the Commission approves the accrual method for post-retirement benefits, should pay-as-you-go expenses be removed?**

Yes.

At the hearing, the parties stipulated to Staff's position as set forth in the Prehearing Order, at 42. The stipulation was approved by the Commission. (Tr. 17, 326.)

ISSUE 56: **Should the Commission allow the utility's 3.63% escalation factor for operating and maintenance expenses other than payroll and rate case expense, and, if not, what adjustments are appropriate?**

*Yes. By the time final rates are established in this proceeding, the level of costs for which Southern States seeks escalation will be approximately fifteen 15) months old. The requested escalation would be available to the Company but for the dire financial circumstances facing the Company which required a general rate increase. Since the Commission's indexing provision itself constitutes a recognition of the existence of inflation, the

indexing adjustment should not be denied to the Company.*

The test year in this proceeding is a historic 1991 test year. A final rate order will not be issued until March 8, 1993. Thus, approximately fifteen months will have passed since the date the expenses considered in this proceeding were incurred before Southern States will be able to recover even its 1991 level of expenses. As witness Ludsen testified, without application of the requested indexing factor, Southern States "will forever have lost the ability to recover the additional expenses associated with the Commission's recognized indexing factor since March 31, 1992." (Ludsen, Tr. 546.) Mr. Ludsen further explained that Southern State's proposed escalation factor was premised on Commission Order No. PSC-92-0136-FOF-WS in Docket No. 92005-WS (which was issued on March 31, 1992) which recognizes the existence of inflation. (Ludsen, Tr. 545-546.) The Company further relied upon the wealth of data (including various United States Government indicators) examined by the Commission in Docket No. 920005-WS to confirm that inflation has and will continue to impact Southern States in 1992. (Id.)

In contrast to this evidence, no other party presented any evidence that the Company's request was unreasonable. The Company's request for an escalation factor should be approved.

ISSUE 57: **Should the Commission allow the utility's 5.00% increase to payroll expense, and, if not, what adjustments are appropriate?**

*The 5% increases to payroll should be approved without adjustment. The Company's actual payroll increase was 5.34%. The increase did not consist of an across the board 5% increase but rather merit increases (evaluated on a case by case basis), step

adjustments (lowest grade employees hired at below market salaries and gradually brought up to market levels), and licensing adjustments (i.e., obtaining operator licenses or upgrading licenses). These adjustments contribute to the Company's ability to provide the highest quality service to our customers by ensuring a highly qualified, experienced, licensed workforce. There has been no prefiled testimony, pleading or other factual predicate identified to the Company which suggests that any portion of the 5% increase was unreasonable or imprudently made. Therefore, the Company has not had the opportunity to address and rebut any allegation in such regard.*

The Company's MFRs include a 5% escalation rate for payroll expenses booked to Accounts 601/701 and 603/703. (Lewis, Tr. 1677.) The Company's request should be approved. There is no affirmative testimony nor other competent or substantial evidence of record supporting any other escalation rate. Moreover, actual 1992 payroll increases exceeded the 5% increase requested by the Company.

Mr. Ludsen identified five separate grounds supporting the 5% increase. First, the Company's salary levels are below market. (Ludsen, Tr. 552-553.) Second, as confirmed by the Company's experience with the Marco Island systems, where 13 operators were lost to the Collier County utility division in the past due to salary disparities, it makes no sense to hire employees and train them only to lose them to other utility providers once they have been trained and qualified. (Ludsen, Tr. 553.) There could be no more persuasive evidence than this that competitive salaries are necessary to attract and retain quality employees. Third, the Company's actual payroll increase since the test year and through July 30, 1992 is 5.34%. (Ludsen, Tr. 552; Exhibit 40, FLL-8.) Therefore, if any adjustments were justified in the record it would

be an increase in the Company's projected payroll by an additional .34%. Fourth, of the total increase of 5.34%, only 3.3% related to merit increases (Ludsen, Tr. 554.) Fifth, the balance of the increase is related to equity, step and licensing adjustments. Equity adjustments are provided to employees only after the Company has confirmed that salaries previously offered to certain employees were not competitive with salaries being paid by other businesses, particularly utility providers, as in the Marco Island example above. (Ludsen, Tr. 552-554; Exhibit 40, FLL-8.) The step adjustments exist for secretarial and clerical employees who are hired at below market rates and, if performance is satisfactory, are stepped up in salary in three increments over an 18 month period. (Id.) Licensing adjustments are provided to encourage employees, particularly field employees, to enhance their training and improve their skills by taking skills courses and obtaining additional service-related licenses. (Id.) The provision of these adjustments has proven very effective in motivating employees to achieve their full potential -- a motivation which ultimately serves to enhance the Company's quality of service. (Ludsen, Tr. 553.)

In addition, Exhibit 40 (FLL-8) provides several reliable and reputable utility industry-specific studies reflecting utility (and specifically water utility) data confirming industry payroll increases in the 5.0 to 5.2% range. (Ludsen, Tr. 554.)

To conclude, there is no evidence of record substantiating any alternative payroll expense level which appropriately could be

applied in this case. The record demonstrates the reasonableness of the Company's actual payroll increases, confirms that the Company's salary policy promotes high quality service and enables the Company to retain qualified personnel, and establishes that the Company's requested payroll increase is consistent with payroll increases in the water industry. For all of the foregoing reasons, the Commission should approve the Company's requested payroll increase.

<u>ISSUE 58:</u> **Should the gain realized upon sale of the St. Augustine utility system be considered in determining operating revenues for the systems in this proceeding?**

No, the gains on the condemnations of the non-jurisdictional St. Augustine Shores water system and the non-rate base University Shores wastewater facilities should be retained by Southern States and should not be applied to reduce Southern States' revenue requirements for the reasons stated in Mr. Sandbulte's rebuttal testimony.

The evidence and legal argument supporting the Company's position are set forth in the discussion under Issue 33 and are incorporated herein by reference.

<u>ISSUE 59:</u> **Should the costs associated with the merger of the SSU companies be removed from the test year results?**

No. The cost associated with the merger of the Southern States group of affiliated companies were incurred as a normal cost of continuing efforts on the part of the Company to maintain and enhance operating efficiency. Uniform recognition of a singular corporate entity by customers, employees, suppliers, regulators and creditors creates an environment conducive to control of operating costs and standardization of services. Combining corporate activities is also expected to improve access to financial markets (after obtaining rate relief) in view of an expanded collateral pool and uniformity of debt covenants.

OPC proposes an adjustment of $7,247. (Dismukes, Tr. 1989.) The primary reasons offered in support of the adjustment are that

the merger costs are non-recurring and that benefits have not been derived in the test year. (Dismukes, Tr. 1898-1899.) OPC's position is without merit.

First, there is no evidence in support of Ms. Dismukes' conclusion that Southern States's merger costs are non-recurring. Second, Ms. Dismukes could not identify any Commission precedent which would support her position that savings from the merger must be recognized within the test year to permit the inclusion of merger expenses in the Company's revenue requirements. Indeed, Ms. Dismukes acknowledged that she had recommended an adjustment in this proceeding arising out of the consolidation and closing of Company business offices based on a belief that there would be savings outside of the test year. (Dismukes, Tr. 1928.)

Ms. Dismukes also acknowledged that the consolidated Company provides efficiencies consistent with a single corporate identity, a single set of financial statements, a single set of general ledgers, a single auditor auditing one set of financial statements, and lower utility rate case expenses. In addition, Ms. Dismukes admitted that the merger eliminates the customer confusion regarding the various names of the former affiliates of the Company. (Dismukes, Tr. 1929-1934.) Because of the customer benefits that have and will be provided to customers as a consequence of the merger, no adjustment to remove the merger costs is appropriate.

ISSUE 60: Should common expenses be reduced to reflect projected savings due to consolidation or closing of customer service offices?

No. These cost savings are not known and quantifiable and are not certain to result in a reduction of expenses but may help to reduce future increases. In addition, these expenses fall outside the historic test year and will, in the short run, be partially offset by other non-test year conversion costs such as records and supplies conversion. If downward adjustments outside the test year are to be made, then upward adjustments must also be made. For example, the annual costs associated with the new Marco Island office ($33,000.00) was not included in the expenses in this filing. In addition, the Company has not included projected annual capital additions of $20 million as well as projected increased costs for such items as testing, sludge hauling, and postage related to combined monthly billing in this filing. In addition, the Company has no less than 25 additional authorized and required positions which it has been unable to fill due to austerity related financial constraints.

This Issue demonstrates OPC's inconsistency in defining a "known and measurable" adjustment. The evidence reflects that OPC's definition of a "known and measurable" adjustment tends to fluctuate depending on whether the adjustment increases or decreases revenue requirements.

Ms. Dismukes proposes an adjustment of $70,024 based on potential savings from the closing and consolidation of customer service offices. (Dismukes, Tr. 1900-1901.) On cross-examination, Ms. Dismukes stated that in order for a proposed adjustment to be "known and measurable", it must be based, in whole or in part, on an event which has already occurred so that historic data is available to measure the adjustment. She added that "known and measurable" adjustments also include adjustments which are annualized based on, for example, six months of historical results. (Dismukes, Tr. 1918-1919.) Under Ms. Dismukes' very own definition, her proposed adjustment under this Issue is not "known

and measurable". Indeed, Ms. Dismukes acknowledged that she could not identify what the Company's savings to date have been for the closing and consolidation of the customer service offices. (Dismukes, Tr. 1927.)

The potential of cost savings in one area of customer service expenses do not translate into an overall reduction of such expenses. (Ludsen, Tr. 537.) Under Ms. Dismukes' definition of a "known and measurable" adjustment, her proposed adjustment for the consolidation and closing of customer service offices falls outside the classification of a "known and measurable" adjustment and is, indeed, too speculative to be included by the Commission in the calculation of revenue requirements. However, should the Commission determine that Ms. Dismukes' adjustment is appropriate, then it must, as stated by Ms. Dismukes, consider "known and measurable" adjustments for increases in expenses. (Dismukes, Tr. 1919-1920.) Both Mr. Ludsen and Ms. Dismukes agreed that the Company's expected increase in mailing costs of $45,500 which will be incurred if the Commission approves the Company's proposed uniform monthly billing cycle for each billing system in this proceeding, constitutes a "known and measurable" adjustment. (Ludsen, Tr. 537-538; Dismukes, Tr. 1923-1924.)

To conclude, Ms. Dismukes' definition of a "known and measurable" adjustment impeaches and discredits her proposal that the Commission reduce the Company's common expenses as reflected in the MFRs for projected savings due to consolidation or closing of customer service offices. Therefore, no adjustment is

appropriate. However, if the Commission determines that all or a portion of Ms. Dismukes' proposed adjustment is appropriate, the evidence unequivocally establishes that the Commission must also permit the Company to recover $45,500 in expected increased mailing costs should the Commission approve the Company's proposal for a uniform monthly billing cycle.

ISSUE 61: Should the Commission reduce the expense allowed for remittance processing to reflect anticipated savings, on a going-forward basis, as a result of in-house processing?

No.

Public Counsel witness Dismukes acknowledged that to justify an adjustment to revenue requirements changes in the level of expenses must be "known and measurable", that is, based in whole or in part on historic data available to measure the adjustment. (Dismukes, Tr. 1929-1934.) Public Counsel did not present any evidence of historic data which could confirm whether the "anticipated" savings ever actually materialized. For this reason alone, Public Counsel's proposed adjustment should be rejected.

Company witness Ludsen also presented evidence demonstrating that adjustments for "anticipated" savings in the future are not proper. Mr. Ludsen explained as follows:

> I must note that Staff's pre-hearing statement of issues in this proceeding identifies a number of issues which Staff has chosen not to address in testimony or any other evidentiary form. As a result, the Company is unable to address or rebut any such evidence and unless witnesses are designated by Staff to support a position on such issues, our right to cross-examine evidence contrary to that being presented by us effectively would be denied. We also must note that certain issues

identified by staff and various portions of the testimony of Public Counsel's witnesses address proposed out of period adjustments. The significance of these proposed adjustments is that each adjustment would result in a reduction of the Company's requested revenue requirements. Both Staff and Public Counsel ignore a myriad of facts which confirm that the Company's post December 31, 1991 revenue requirements exceed those requested in this proceeding. The Company believes that if the historic test year is to be ignored by the Commission, changes in investment levels and operations which confirm an increase in the Company's revenue requirements must be considered by the Commission as well as the changes indicated by Public Counsel and Staff which might decrease such requirements. These O&M type increases which the Company has incurred after 1991 include, but are not limited to: additional testing costs for 23 new contaminants, additional costs associated with sludge stabilization and hauling, and other additional costs since the conclusion of the test year. Staff and Public Counsel's proposed adjustments for "anticipated" savings, if they are to be considered at all, must be offset against "anticipated" increases in the Company's expenses which include the payroll associated with approximately 25 new positions authorized to be filled, yet which remain vacant due to our current dire financial situation. Southern States firmly believes that these positions, which are primarily field positions, must be filled as soon as possible if we are to continue to be able to render high quality service to our customers. Assuming the overall average Company salary of $22,000 were provided to these 25 employees, the Company's anticipated increase in payroll would be $550,000. In addition, the MFRs do not reflect actual plant in service investment made by the Company to date. These actual investments are known and quantifiable by system and therefore are more appropriate for consideration in the Commission ratemaking decision than "anticipated" savings or speculative decreases in costs which may occur in the future as proposed by Staff and Public Counsel.

(Ludsen, Tr. 555-557.)

In addition, Company witness Kimball presented evidence which establishes that the Company made additional investments and incurred additional expenses which would more than offset the "anticipated" savings as a result of the changes in remittance processing. (Kimball, Tr. 1768-1771.) All of these facts must be considered before an adjustment to revenue requirement to reflect "anticipated" savings can be justified.[22] In light of these facts, no adjustments can be made unless the Commission also increases the Company's revenue requirements to reflect "anticipated" cost increases and known investments in plant placed into service in 1992 and currently providing service to our customers (many of which are identified in this brief).

ISSUE 62: Should the Commission reduce postage costs to reflect savings to perform postage services in-house?

No. See Southern States' position in response to Issue 60 regarding closing of customer offices. In addition, the Company is proposing monthly billing which will increase the annual costs for postage, bills and envelopes by an estimated $45,000.00.

Based on the record evidence discussed under Issue 60, if the Commission determines that an adjustment is appropriate to reflect

[22]Staff counsel indicated to Ms. Kimball that Staff's assessment of the reduced level of "anticipated" savings even after Ms. Kimball's rebuttal, was approximately $25,000. (Tr. 2213-2214). Ms. Kimball disputed Staff's numbers reaffirming that additional potential A&G costs would be incurred by Southern States associated with converting to uniform monthly billing cycles and a reduction in the credits received from Sun Bank may also result. (Kimball, Tr. 1769-1770, 2214-15) may also result. Ms. Kimball succinctly stated her problem with the proposed adjustment as follows: "I really believe it is improper to be removing expenses from a historical test year, that -- its just not substantiated. We've got a lot of expenses that are not in here, and this is just picking one piece and looking at it very narrowly." (Kimball, Tr. 2214).

reduced postage costs due to the performance of postage services in-house, the Commission must permit the Company to recover additional "known and measurable" costs for postage, bills and envelopes of $45,000 which will be incurred if the Commission approves the Company's proposal to implement a monthly billing cycle for all systems included in this Application.

ISSUE 63: **What is an acceptable level of unaccounted-for water?**

Despite Commission precedent referring to industry standards which confirm that a 15% level of unaccounted for water is acceptable, the Commission has steadfastly held to a 10% standard. The standard would be more reasonable at 15%. Age, geological and hydrologic conditions and other pertinent factors must be given consideration in any determination of unaccounted for water.

The Commission has recognized accepted industry standards as the basis for its non-rule policy on unaccounted-for water. For example, in past orders dealing with the unaccounted-for water issue, the Commission has cited articles published by the American Waterworks Association and recognized that:

> Systems having 10 to 15 percent unaccounted-for-water are generally agreed to be performing well, and distribution system losses of 10 to 20 percent are considered reasonable.
>
> Also, page 10 of the AWWA Manual M8 states: The proper amount of unaccounted-for-water in any given system is a function of that system alone, and A fair average of unaccounted-for-water might be 10-20 percent for fully metered systems with good meter maintenance programs and average condition of service. See Meadowbrook Utility Systems, Inc., Order No. 17304, at 21 (March 19, 1987).[23]

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[23]As Mr. Sweat testified, Southern States recently has made significant modifications to its meter maintenance program which have resulted in decreasing levels of unaccounted for water on the Company's systems. (Tr. 1215-1216).

Staff Exhibit 94, which contains a portion of the AWWA manual, also confirms that "the proper amount of unaccounted for water in any given system is a function of that system alone. It might range in a fully metered system from as much as 35% to as little as 5%." (Sweat, Tr. 1355.) Mr. Sweat further explained that the level of "excessive" unaccounted for water must be "weighed on an individual system taking [sic] into consideration age, types of meters, types of material, et cetera. We know of a number of cases that Meadowbrook, Order No. 17304, was allowed 20% unaccounted-for water. The reason being was the age of the system. Marion County, Martin County -- excuse me, Sailfish, 15% unaccounted-for water. Marion County, Southern States Utilities, Order No. 21322, 17% and 16%. Reasons, age." (Sweat, Tr. 1356.) Mr. Sweat further identified lightning and soil conditions as factors effecting unaccounted-for water levels. (Sweat, Tr. 1357-1358.)

In light of the Commission's recognition of AWWA standards as the appropriate guideline for its own standard, and the AWWA's adherence to a finding that systems with 15% unaccounted for water levels are considered to be performing _well_ and unaccounted for water levels of 20% are _reasonable_, it is proper for the Commission to modify its standard to 15% unaccounted for water.

ISSUE 64: **Should interest income earned on utility deposits made by Southern States be moved above the line for ratemaking purposes?**

No. Ratepayers do not pay a return on utility deposits nor are they included in the determination of working capital. Therefore, any interest earned on investor capital should be treated below the line.

OPC presented no affirmative testimony in support of its position on this Issue. The unrefuted testimony of Mr. Vierima establishes that interest income earned on the Company's utility deposits should remain below the line.

Mr. Vierima testified that ratepayers do not provide the funds which are provided by the Company to various utilities as deposits for utility services provided to the Company. These funds are not part of the Company's working capital and, hence, are not recovered from ratepayers. Therefore, there is no basis for OPC's assertion that the interest earned on these deposits should be transferred above the line for the benefit of ratepayers. (Vierima, Tr. 1028-1029.) Public Counsel's premise that the interest income earned on utility deposits should be transferred above the line is based on a presumption of facts absent from the record, specifically, the use and results of the balance sheet approach to the calculation of working capital and the appropriate treatment of utility deposits under such approach. Based on the unrefuted testimony of Mr. Vierima and the absence of record evidence supporting OPC's position, no adjustment is appropriate.

ISSUE 65: **Should an adjustment be made to remove chamber of commerce dues and other public relations expenses from the test year?**

No.

The only specific dues identified in the record as being potentially subject to adjustment were state and local chamber of commerce dues and expenses and membership dues in the Florida Public Relations Association ("FPRA"). Ms. Dismukes proposed a

reduction to the Company's O&M expenses of $1,882 attributable to these dues. (Dismukes, Tr. 1904-1905.) Since these memberships are not for public relations or image building purposes, but rather for the benefit of customers, they should not be excluded.

Mr. Phillips identified the numerous benefits and savings afforded to ratepayers by virtue of the Company's membership in state and local chambers of commerce. For example, due to the Chamber's opposition to 1991 legislative proposals to levy a 10 cents/1,000 gallons tax on water utility services, the Company's customers were saved a minimum of $1.2 million in 1991. (Phillips, Tr. 360; 369.) The Florida Chamber of Commerce is also active in health care and workers' compensation issues. These efforts serve to control costs which would ultimately be borne by ratepayers. (Phillips, Tr. 360-361.) Similar benefits are achieved at the local level through local chambers of commerce since county boards also have the authority to enact rules and ordinances which can increase the Company's cost of doing business and, ultimately, the rates charged to the customers for service. (Phillips, Tr. 361.) In sum, the Company's membership in state and local chambers of commerce provide a cost effective means of opposing state and local tax proposals and provide the Company with a cost efficient voice in opposition to health care, health insurance, and workers' compensation proposals which present the potential of increasing the cost of service. (Phillips, Tr. 370.) Finally, as explained by Mr. Phillips, the distinction between the Company's membership and participation in state and local chambers of commerce and

traditional lobbying activities is that in the vast majority of cases, the chambers' activities focus on controlling the cost of doing business which benefits the Company's customers. (Phillips, Tr. 371; 385-386.)

The FPRA memberships also benefit customers. The Company has very limited public relations activity. The two Company employees who participate in the FPRA receive training in communications skills and public speaking. These skills in turn are used to improve the dissemination of information, including formal presentations, to customers regarding such issues as conservation, xeriscaping, service, billing and rates. (Phillips, Tr. 393-395.)

Based on the evidence of record, the Company has justified its memberships in the chambers of commerce and the FPRA. Accordingly, OPC's proposed adjustment of $1,882 should be denied.

ISSUE 66: **Should an adjustment be made to the Company's membership dues?**

Yes, agree with Staff.

There is no evidence of record supporting an adjustment beyond the $3,137 set forth in Staff's position in the Prehearing Order, at 47. Specifically, there is no evidence identifying a specific adjustment or supplying any basis for an adjustment to the Company's membership dues in professional associations allegedly based on lobbying activities of such associations. Hence, the Commission should limit the adjustment to the Company's membership dues to $3,137.

ISSUE 67: **Should an adjustment be made to reduce the Company's test year bad debt expense?**

The level of bad debt expense is .6% which is consistent with industry standards. In addition, the levels of bad debt expense identified by Ms. Dismukes for M&M Utilities and Deltona Gas are allocated numbers based on total company bad debt experience and do not reflect actual bad debt expenses for these systems. In addition, the $20,000 of bad debt expense related to the Citrus Sun Club Condominium Association does not reflect an incremental bad debt expense since it has been on the Company's books for several years. Public Counsel's proposed adjustment regarding Citrus Sun Club constitutes an attempt to pick and choose between expense items despite the fact that historical bad debt expense levels confirm the reasonableness of the Company's bad debt test year expense levels for designing rates for the future.

The Company's level of bad debt in the 1991 test year was only .6% of revenues. The undisputed testimony of Company witness Kimball confirms that this level of bad debt expense is a very reasonable amount given industry averages, Southern States's system demographics and the state of the economy. (Kimball, Tr. 1759.)

Public Counsel witness Dismukes alleges that the level of bad debt expenses should be reduced, primarily based on three sets of events which Ms. Dismukes alleges should decrease the level of bad debt expense in the future. (Dismukes, Tr. 1906-1907.) However, as Company witness Kimball testified, Ms. Dismukes proposed adjustments are without merit.[24] Specifically, Ms. Kimball stated as follows:

> The allocation of bad debt expense based on number of customers is a prime example of where it is improper to select one situation and

[24]Ms. Dismukes indicated that the 1991 bad debt expense may have been impacted by a change in 1991 of the prior methodology for determining the bad debt reserve. (Dismukes, Tr. 1906). Ms. Kimball testified that this was not correct. The same methodology for determining the bad debt reserve was used in 1990 and 1991. (Kimball, Tr. 1757).

remove it from the calculation for the reserve and ignore situations where treatment perhaps would go the other direction. When reserve requirements are analyzed, it is done on a total company basis, not system by system. The resulting expense charged to the system is based on that system's balance of accounts over 60 days past due as a percent of the total. If we were to look on a customer by customer basis, we would find frequent cases where customers owe us large amounts of money which we never recover. Moreover, customers who may repay the Company for outstanding sums owed constantly are replaced by other customers who do not pay their bills.

(Kimball, Tr. 1759.)

For these reasons, as well as the facts identified by Ms. Kimball in the record refuting Ms. Dismukes' assessment of the three series of events which allegedly would reduce the Company's bad debt expenses in the future (Kimball, Tr. 1757-1759.) Public Counsel's adjustment should be rejected.

ISSUE 68: **Should an adjustment be made to reduce the Company's test year legal expenses?**

No. Theoretically, any legal expenses for any specific project are non-recurring. The project ultimately will end. However, this does not refute the fact that the Company must incur legal expenses each year for a myriad of reasons. Recovery of these expenses should not be denied absent an evidentiary showing that the level of these expenses is not reasonable. No party has presented any evidence of this nature.

Public Counsel's witness Dismukes alleges that Southern States should be denied recovery of certain legal costs incurred during the test year because they are non-recurring. (Dismukes, Tr. 1896-1899) (merger costs). Ms. Dismukes disputes the recoverability of other legal costs because they relate, at least in part, to situations where the Company may have been fined by DER or a county regulatory authority. (Dismukes, Tr. 1907-1908.)

Company witness Vierima addressed Ms. Dismukes' allegations of the non-recurring nature of certain legal expenses in a succinct and compelling manner. Mr. Vierima states as follows:

> The fact that costs may not recur on an annual basis does not justify a complete denial of a utility's recovery of the costs. Under Ms. Dismukes' apparent theory of recoverability, Southern States could never recover legal costs, costs associated with professional studies or the like since these costs invariably are incurred on a project by project basis. Since all projects have a beginning and an end, all such projects and their related costs theoretically are "non-recurring". However, this fact does not render the costs non-recoverable. Rather, the Commission must recognize that the Company will incur legal expenses and expenses associated with professional studies each year and these expenses are an ordinary cost of doing business. No adjustments are justified to these expenses, in total, unless a party demonstrates on the record either that individual items comprising these expenses were imprudently incurred or that the level of such expenses was unreasonably high. No party has made such a showing in this proceeding. The Commission should reject Ms. Dismukes' proposed adjustment. In addition, Southern States does not agree that merger costs are non-recurring. The Company intends to merge Lehigh Utilities, Inc. into Southern States prior to the end of 1992, if possible and expects the incurrence of similar costs on a continuing basis as long as Southern States remains active in acquiring new systems. It is highly unlikely that the costs associated with such mergers (including legal costs) would be less than $11,000 in any given year.

(Vierima, Tr. 923-924.)[25]

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[25]Public Counsel's attempt in its prehearing statement to identify legal costs incurred in relation to the sale of the Sahdowbrook system to homeowners as non-recurring costs fails for lack of justification in the records as well as Public Counsel's failure to demonstrate that the cost was not reasonable, imprudently incurred or impossible to replace in future years with

Staff witness Todd also confirmed that it is prudent to analyze a particular category of cost for years prior to the test year to form an opinion as to whether the level of a certain type of expense is recurring or non-recurring. (Todd, Tr. 2153.) For instance, Mr. Todd testified that an average level of relocation costs incurred over a four year period may be a proper yardstick for making an estimate of the future levels of such expenses (Todd, Tr. 2156) -- presumably, regardless of the fact that the number or location of the employees to be relocated assuredly will change. However, Ms. Dismukes presented no analysis in this proceeding of the Company's legal costs in prior years. Neither Public Counsel nor any other party presented any evidence that the allegedly "non-recurring" costs were imprudently incurred or that the level of such costs were unreasonably high. Therefore, the Commission should reject Public Counsel's unsubstantiated allegations of non-recurring legal costs.

Public Counsel also suggests that the Commission should deny Southern States' recovery of legal costs associated with defending the Company's interests in enforcement actions which result in fines. Company witness Ludsen demonstrated that the disallowance of such costs could have unintended harmful results on ratepayers. Mr. Ludsen explained as follows:

> To deny Southern States recovery of legal expenses incurred to oppose DER allegations of violations would deny the company recovery of legitimately incurred costs of operating its systems. Southern States, like all water and

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similar costs.

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wastewater utilities, both public and private, must be able to defend its interests when violations of laws and rules are alleged by an administrative agency such as the DER or the EPA. Yet Ms. Dismukes proposes that the Company, and presumably all utilities, be denied recovery of legal expenses required to present its defenses. Ms. Dismukes also would make the denial of recovery a blanket denial on one condition -- that a fine is paid. The denial of such costs would have a chilling effect on the Company's desire to dispute violations alleged by DER, which would be to our customers' detriment. Ms. Dismukes' experience, as identified in Appendix I to her testimony, reveals no dealings with DER and no familiarity with DER violations or the DER enforcement process. Knowledge of how DER operates is critical to the Commission's determination of the lack of merit of this adjustment. For example, Southern States has been notified by DER that our Fern Terrace system is in violation of a DER rule requiring an additional well for systems serving more than 350 people and that a fine is forthcoming. Southern States opposed DER's allegation and has submitted a wealth of information including census data and other information concerning the population served by the Fern Terrace system which indicates that the population served is less than 350. The sole purpose for the Company's efforts is to persuade DER that less than 350 people are served and thus an additional well source is not required. In this way, we hope to be able to forego the imposition of the costs required for an additional well on our 123 customers at Fern Terrace. The Company informed DER that the imposition of such costs would raise the rates to a level which would be much less affordable for them. However, to date, DER has denied our requests for a finding that we serve less than 350 persons and rejected as insignificant the economic impact that an additional well will have on our customers. The Company faces fines as a result of our efforts. Should the Company simply have admitted to a violation, paid a fine and made the relatively large investment in a well despite our belief that the DER rule did not apply and the investment would negatively impact our customers? If legal fees incurred to oppose such violations are not

> recoverable, such might be the result.
>
> The Commission also should be aware that the Company has not admitted to any violation associated with the DER or EPA fines paid in 1991. Consent orders often are entered because it is economical to do so since DER and EPA are noteworthy for their intransigence and litigation obviously is expensive to pursue. Therefore, it would be improper for the Commission to assume (as Ms. Dismukes' apparently has) any "guilt" on the Company's part simply because fines are paid when no such admission of guilt has been made by the company.
>
> For these reasons, it would not be proper for the Commission to deny Southern States' recovery of legal expenses associated with contesting DER or EPA alleged violations.

(Luden, Tr. 538-541.)

Finally, Staff witness Todd alleged that Southern States should be denied recovery of certain legal costs incurred during a Commission investigation (at Public Counsel's request) of its acquisition adjustment policy. (Exhibit 131.) Specifically, Mr. Todd disputed the Company's legal costs associated with research into the acquisition adjustment policies of other states. (Exhibit 131, page 22.) Mr. Todd made no allegation that the costs were imprudently incurred or unreasonably high.[26] Rather, Mr. Todd suggested (through Exhibit 131) that "these legal fees may be non-utility and perhaps should not be borne by the general body of Southern States ratepayers. Legal fees such as these appear only to benefit the shareholders in that the effect on the customers

[26]In fact, Mr. Todd admitted that Southern States has been fairly active in the acquisitions area in the past and it was logical that Southern States would participate in the proceeding. (Todd, Tr. 2125-2126).

would only be increased pressure towards higher rates." Id.

The Company is aware of no precedent which would permit the denial of reasonable, prudently incurred expenses for the sole reason that the expenses would apply pressure towards higher rates. Following Mr. Todd's logic, the Company could be denied recovery of rate case expenses, increased income tax expenses, a return on additional plant investment, etc., simply because the recovery of these costs would result in "increased pressure towards higher rates."[27] Moreover, the Commission's final order in the acquisition adjustment policy proceeding (Order No. 25729) refutes Mr. Todd's allegation that higher rates result from the Commission's existing policy. In fact, Mr. Todd acknowledged that Order No. 25729 reveals that "[t]he customers of the acquired utility are not harmed by this policy because, generally, on acquisition, rate base has not been changed, so rates have not changed. Indeed, we think the customers receive benefits which amount to a better quality of service at a reasonable rate." (Exhibit 134, page 3 (emphasis added).)

Finally, it is noteworthy that during the hearings, the Commissioners asked two Company witnesses, Sandbulte and Phillips, if they were familiar with the regulatory practices of other states regarding the issues raised in this proceeding. Exhibit 131 also contains a copy of Southern States' response to a Staff audit

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[27]Commissioner Clark and Mr. McLean (counsel for OPC) also engaged in an enlightening discussion concerning hypothetical costs which might be incurred by a utility to respond to allegations of an overearning situation -- a situation not even fathomable to the Company at this time. (Tr. 763.)

request concerning the legal research at issue which response states as follows:

> Legal research of this nature is often persuasive, and perhaps just as often, required, to convince the Commission that its policies are consistent with not only the law but also the policies of other jurisdictions. Please note that Public Counsel also conducts such research as confirmed in the testimony of its witnesses in the Lehigh rate case in which precedent established by the Federal Communications Commission is cited by Public Counsel in support of one of Public Counsel's positions in that docket. To disallow the Company's recovery of these types of legal costs would be arbitrary and would permit Public Counsel to perform this research, at taxpayer (including our ratepayers) expense, while depriving the Company of recovery of such cost. Finally, given the Company's dire financial situation, disallowance of such costs possibly would prohibit the Company's ability to perform such research -- to the detriment of the Commission (which should be provided both sides of an issue) as well as the Company.

(Exhibit 131 at 24-25.)

For the foregoing reasons, no adjustment to Southern States 1991 test year legal expenses has been justified on the record. Both Staff's and Public Counsel's proposed adjustments should be rejected.

<u>ISSUE 69:</u> **Should an adjustment be made to reduce the Company's test year aircraft expenses?**

No. The Company does not consider a presentation to the Commission at an Internal Affairs Conference to be lobbying. This is an ordinary cost of doing business in a regulated industry. Denial of recovery of such costs would have a chilling effect on legitimate and proper communications between the regulator and the regulated. Appropriate communication is critical to the rendition of high quality utility service to our customers.

OPC maintains that test year expenses should be reduced by $3,200 for expenses associated with the Company's presentation to

the Commission at an Internal Affairs Conference in December, 1991. As Mr. Ludsen stated, the Commission's determination on this Issue depends on whether the Company's presentation is considered a "lobbying" effort. (Ludsen, Tr. 709.)

The Company's presentation at the Internal Affairs Conference was informational in nature and intended to allow the Commissioners the opportunity to meet Mr. Sandbulte, the Chairman, President and Chief Executive Officer of the Company's parent company, Minnesota Power and Light Company, and to provide Mr. Sandbulte with the opportunity to present Minnesota Power's and Southern States' plans for and commitments to quality service in the State of Florida. (Ludsen, Tr. 714.) This presentation was made at a public meeting. This was not a "closed-door" conference of the type normally associated with lobbying activities. Further, the presentation was not directed to any specific issue as is normally the case with a lobbying activity. Nor was there any attempt by Mr. Sandbulte to convince the Commission to take a particular position on any issue as would normally be the case with a lobbying activity. (Ludsen, Tr. 716.)

Appropriate communication between utilities and regulators is critical to the rendition of high quality service to customers. The Commission should not establish an onerous precedent by classifying a presentation of the type made by Mr. Sandbulte at the Internal Affairs Conference as a "lobbying" activity. For these reasons, no adjustment to the Company's test year aircraft expenses is appropriate.

ISSUE 70: **Should an adjustment be made to advertising expenses?**

Yes. In adjustment to 1991 test year expenses of $5,468 associated with advertising related to the gas business can be made. (Tr. 2183.)

ISSUE 71: **Should an adjustment be made to remove expenses associated with professional studies and contractual services?**

No. The Company does not consider professional studies to be non-recurring for the same reasons and under the same rationale applicable to legal expenses. The determining factor should be whether the level of expenses for professional studies is reasonable. Professional studies are an ordinary cost of doing business and the Company would be taken to task if it did not conduct such studies, i.e., customer surveys and OPEB actuarial studies. The Company has amortized the cost of the survey performed by Cambridge Reports and anticipates conducting future studies. With respect to organizational development, this is an on-going cost related to effective inter-departmental relations, communications and coordination, as well as effective functional work designs to achieve Company goals in the most efficient manner possible.

Based on the Prehearing Order, at 50-51, there are three expense items at issue. The first expense item is the $18,156 cost of the customer survey performed by Cambridge Reports of Massachusetts. Ms. Kimball articulated the customer benefits achieved from this survey and how the survey enhanced quality of service and facilitated responses to customer complaints. (Kimball, Tr. 2209.) In response to Staff's position that the expense is non-recurring, Ms. Kimball verified that a similar survey will be conducted in 1993. (Kimball, Tr. 2208.)

The second expense item pertains to test year expenses associated with the Milliman and Robertson, Inc. actuarial report. (Exhibit 38, Gangnon, Late-Filed Deposition Exhibit.) OPC maintained that expenses associated with the actuarial report

should be removed on the ground that such expenses are non-recurring. (Dismukes, Tr. 1914.) Ms. Dismukes provided no evidentiary basis for her conclusion that studies performed by independent actuaries for the purpose of establishing the appropriate level of OPEBs are non-recurring. Indeed, on cross-examination, Ms. Dismukes conceded that studies by independent actuaries of the appropriate level of the Company's OPEB expenses are: (1) a prudent business expense, (2) necessary for the Company to try to justify to the Commission the appropriate level of OPEB expenses necessary to attract and retain quality employees, and (3) necessarily recurring in nature because the Company would be less than prudent if it did not constantly review the level of OPEBs it provides to its employees for such things as medical and dental insurance and life insurance. (Dismukes, Tr. 1940-1941.)[28] Based on Ms. Dismukes' admissions regarding the prudency and recurring nature of this expense, OPC's proposed adjustment of $8,141 (Dismukes, Tr. 1942) is unsupported by the evidence and should be rejected.

The third and final expense item pertains to organizational development costs paid by the Company to Minnesota Power. Ms. Dismukes' proposed adjustment of approximately $7,000 (Prehearing Order, at 51; Dismukes, Tr. 1942) is arbitrary and without any factual basis. Essentially, Ms. Dismukes maintains that some arbitrary percentage of organizational development costs is non-

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[28]Ms. Dismukes' claim that the Company agreed that such studies are non-recurring in nature (Dismukes, Tr. 1942) is totally unsupported by the record.

recurring because there were start-up costs associated with the organizational development process. (Dismukes, Tr. 1943.) The facts as reflected by the record demonstrate, however, that the Company has incurred a consistent level of organizational development costs (1990 - $12,000; 1991 - $14,000; and annualized 1992 - $13,368) which, as stated by both Ms. Kimball and Staff witness Mr. Todd, is a clear indication that such costs are recurring. (Kimball, Tr. 2205-2206; Todd, Tr. 2147.) Ms. Kimball acknowledged that the organizational development costs recognized by the Commission for ratemaking purposes in this proceeding should be limited to the 1991 dollar amount (Kimball, Tr. 2206-2207.)

Based on the record, there is no basis to impose an adjustment to the Company's expenses associated with the Cambridge Reports customer survey study nor the Milliman and Robertson, Inc. actuarial report. Organizational development costs should be limited to the 1991 dollar amount.

ISSUE 72: **Should an adjustment be made to remove expenses associated with the Price Waterhouse audit of the employee savings plan?**

No. The proposed adjustment is arbitrary and is not known and measurable.

Ms. Dismukes proposes an adjustment of $3,800 to remove a portion of expenses associated with the Price Waterhouse audit of the employee savings plan. This amounts to one-fourth of Price Waterhouse's labor charges for these audits. (Dismukes, Tr. 1914-1915.) The alleged basis for her adjustment is that a portion of the test year charge is non-recurring. (Dismukes, Tr. 1915.) Ms. Dismukes fails to disclose how she arrived at her conclusion that

25% of the Price Waterhouse charges will not recur. Ms. Dismukes acknowledged on cross-examination that she did not rely upon any data in reaching her conclusion that 25% of these expenses are non-recurring. (Dismukes, Tr. 1935.)

Ms. Dismukes' proposed adjustment is not "known and measurable" as she has defined that term. (Dismukes, Tr. 1918-1919.) She acknowledges that she used no historic data to derive her projection that 25% of these expenses will be non-recurring. (Dismukes, Tr. 1935.) Ms. Dismukes also agreed with Mr. Vierima that there is no certainty that the Price Waterhouse audit fee will be substantially less in future years particularly since there may be different individuals assigned by Price Waterhouse to conduct the audits and the scope of the audits may expand from year to year. (Dismukes, Tr. 1936-1937; Vierima, Tr. 924-925.) OPC's proposed adjustment is not known and quantifiable, is admittedly arbitrary, and is clearly based on unsubstantiated speculation rather than known and measurable facts. For these reasons, OPC's proposed adjustment to reduce test year expenses by $4,780 should be rejected by the Commission. (Vierima, Tr. 925.)

ISSUE 73: Should an adjustment be made to remove test year relocation expenses?

No. Relocation expenses in 1991 were the lowest since 1988 and are representative of future relocation costs. Unsubstantiated speculation as to the Company's future levels of relocation expenses is not an appropriate basis for an adjustment.

The evidence is undisputed that the Company incurred $58,788 in relocation expenses during the test year. (Dismukes, Tr. 1916.) Ms. Dismukes proposes an adjustment of $22,000 based, again, on her

belief that a portion of the 1991 test relocation expenses are non-recurring. The evidence convincingly rebuts Ms. Dismukes' contention. The evidence reflects that actual relocation expenses incurred in 1989 through 1991 were $191,402 (1989), $85,532 (1990) and $58,788 (1991 test year). (Dismukes, Tr. 1916; Ludsen, Tr. 545.) Late-Filed Exhibit 63 prepared by Mr. Ludsen reflects total estimated 1992 relocation expenses of $55,910. The veracity of the estimate of relocation expenses for 1992 is self-evident since the document is based on 10 months of year-to-date actual expenses and known expenses which will be incurred in November and December of 1992. The average of the Company's relocation expenses from 1989 through 1992 is approximately $98,000.

Staff witness Mr. Todd stated that an appropriate yardstick for measuring future costs under FASB 71 is to base such estimates on the average of the costs experienced over the prior four years. (Todd, Tr. 2156.) Based on Mr. Todd's opinion, the more appropriate estimate of future relocation expenses based on FASB 71 is that such expenses will increase rather than decrease as alleged by Ms. Dismukes. The fact that the Company's relocation expenses in 1991 are lower than those experienced in prior years comes as no surprise. As Mr. Todd explained, a Company such as Southern States which has experienced negative returns on equity would limit relocation expenses because it is a discretionary item of expense. (Todd, Tr. 2153.) Finally, the total of $55,910 in relocation expenses anticipated for 1992 extinguishes Ms. Dismukes' argument that approximately 37% of the Company's 1991 relocation

expenses are non-recurring.

For these reasons, OPC has failed to justify by competent substantial evidence that any adjustment to the relocation expenses requested by the Company and included in the A&G expenses of the MFRs is appropriate.

SYSTEM SPECIFIC ISSUES (by County)

Citrus County

ISSUE 74: **Should an adjustment be made to reduce property taxes at Sugar Mill Woods?**

Yes. Property taxes at Sugar Mill Woods should be reduced $33,063 due to the inadvertent inclusion of this out of period amount in the MFRs. No further adjustment is supported by the record.

Ms. Kimball acknowledged in her testimony that 1991 test year expenses should be reduced by $33,063 due to the inadvertent inclusion of this out of period amount in the MFRs. (Kimball, Tr. 1762.) Mr. Jones of COVA maintained that a further adjustment is appropriate on the ground that the 1990 and 1991 property taxes paid in the test year "went unchallenged by the utility." (Jones, Tr. 1747.) Ms. Kimball refuted this contention in its entirety. Ms. Kimball established that in 1990, the Company's efforts proved successful in persuading the Citrus County Property Appraiser to remove non-used and useful transmission lines from the total assessed property value proposed by the Citrus County Property Appraiser. The exclusion of this property reduced proposed 1990 property taxes from $228,125 to $174,656, or a reduction of $53,469. These efforts, of course, provided benefits to ratepayers in 1991 as well since the Property Appraiser excluded non-used and

useful transmission lines from the 1991 assessed value of the Sugar Mills Woods property. (Kimball, Tr. 1765-1766; Exhibit 123, JKK-4.) In addition, the Company made further efforts to reduce the 1990 property taxes by attempting to persuade the Citrus County Property Appraiser that there should be an appropriate offset for CIAC in deriving the assessed value of the property consisent with the methodology used in other counties. However, these efforts proved unsuccessful. (Kimball, Tr. 1783.) Finally, there is no record evidence of a present or anticipated refund of 1990 property taxes paid by the Company.

For these reasons, apart from the $33,063 referenced above, no adjustment is appropriate to reduce property taxes at Sugar Mill Woods as reflected in the MFRs.

Duval County

ISSUE 75: **Is an adjustment necessary to the purchased water expense of Beacon Hills.**

No.

OPC proposes an adjustment of $14,925. The proposed adjustment is based on the failure of Jacksonville Suburban Utilities Corporation ("JSU") to properly read the Beacon Hills' water meter which resulted in the underbilling of Southern States for purchased water from the period of August 27, 1987 through January 17, 1991. The $14,925 was paid by the Company to JSU in December, 1991. (Dismukes, Tr. 1912.)

The Commission should reject this proposed adjustment. As Ms. Dismukes acknowledged in her testimony, the underbilling was solely the fault of JSU. The Company was required to remit the

underbilled amount based on JSU's tariff and Commission rules regarding back billing. (Kimball, Tr. 1760.) There is no testimony of record that the Company was negligent in its payment for water to JSU and the Company should not be penalized for the negligence or mistakes of JSU. Ms. Kimball proposed a fair resolution of this issue by recommending that the amount of the back billing be amortized and reflected in rates over a three year period which is approximately the period during which the underbilling occurred with the unamortized portion of these expenses included in the Beacon Hills rate base. (Kimball, Tr. 1760.) The Commission should approve Ms. Kimball's proposal.

Marion County

ISSUE 76: **Is an adjustment necessary to reduce property taxes associated with Marion Oaks property held for future use.**

No.

At the hearing, the parties stipulated to OPC's proposed reduction of $4,477. The stipulation was approved by the Commission. (Tr. 17, 326.)

Martin County

ISSUE 77: **Should the cost of the reuse feasibility study for Leilani Heights be amortized over five years instead of being expensed in the test year?**

Reuse studies are performed pursuant to governmental requirements and are on-going in nature and, therefore, the costs should be expensed.

At the hearing, the parties stipulated that test year expenses for the Leilani Heights wastewater operation should be reduced by $10,150. (Tr. 2198; Wood, Tr. 2230.)

Orange County

ISSUE 78: **Should test year NOI be increased for the gain on the sale of University Shores properties?**

No, the gains on the condemnations of the non-jurisdictional St. Augustine Shores water system and the non-rate base University Shores wastewater facilities should be retained by Southern States and should not be applied to reduce Southern States' revenue requirements for the reasons stated in Mr. Sandbulte's rebuttal testimony.

The evidence and legal argument supporting the Company's position are set forth in the discussion under Issue 33 and are incorporated herein by reference.

Volusia County

ISSUE 79: **Should the $14,326 test year expense in the Jungle Den system to televise and repair wastewater collection lines be amortized?**

The work performed is expected to be performed every three (3) years. The expense should be amortized over three (3) years.

OPC proposes to exclude these expenses from the Company's test year operating expenses on the ground that such expenses are non-recurring. (Dismukes, Tr. 1915-1916.) Ms. Dismukes failed to provide any specific reasons supporting her conclusion that the cost of the repairs for the Jungle Den system allegedly are non-recurring. Instead, Ms. Dismukes maintains that Ms. Kimball acknowledged that these costs are non-recurring in her deposition. (Dismukes, Tr. 1915-1916.)

Ms. Kimball testified on rebuttal that Ms. Dismukes mischaracterized her deposition testimony. Ms. Kimball stated with no uncertainty that she did not testify in her deposition that the 1991 charges at issue for the Jungle Den system should be removed from test year expenses. (Kimball, Tr. 1761.) Public Counsel

chose not to challenge Ms. Kimball's statements on cross-examination.

Further, Ms. Kimball and Mr. Lewis provided undisputed testimony that it is appropriate to amortize these costs over three years with the unamortized balance included in the Jungle Den rate base. As explained by Ms. Kimball and Mr. Lewis, these were prudent expenses and similar repair work will be performed in the future as an ordinary and necessary cost of maintaining the Jungle Den system. (Lewis, Tr. 1730; Kimball, Tr. 1761-1762.)

The record is devoid of evidence supporting Public Counsel's assertion that these expenses are non-recurring. Based on the testimony of Ms. Kimball and Mr. Lewis, this expense should be amortized over three years and the unamortized balance included in the Jungle Den rate base.

ISSUES APPLYING TO MORE THAN ONE SYSTEM

ISSUE 80: **Which systems have excessive unaccounted-for water and what adjustments are appropriate as a result?**

No systems have excessive unaccounted for water and no adjustments are appropriate.

Staff alleged that the following nine (9) systems have excessive unaccounted for water levels: Beecher's Point (35.1%), Interlachen Lakes Estates (23.3%), Keystone Heights (15.6%), River Grove (42%), Saratoga Harbor (14.9%), Kingswood (24.9%), Oakwood (12.3%), Palisades (27.3%) and Stone Mountain (52.7%). In its prehearing statement, Staff recommended that purchased power and

chemical costs be reduced for these systems.[29]

As explained by Company witness Hartman, "unaccounted for water is an ambiguous term and a precise determination of what are excessive unaccounted for water levels is no less difficult to decipher." (Hartman, Tr. 1436.) Mr. Hartman continued:

> If the system is having a problem with leaking transmission and distribution pipes, which is typically considered unaccounted for water, the true test of whether the amount of lost water is excessive should be determined by a cost/benefit analysis (examining the cost of repairing the line versus paying the additional costs of pumping and treating the lost water). In some situations, it is more cost effective to improve the leakage situation, and in other situations, it is better to continue to pump water. Replacement of transmission and distribution lines and the follow-up restoration of pavements, landscaping, etc., is capital intensive and in many situations it is not practical to correct the problem. In these situations, the Company should not be penalized for unaccounted for water levels above 10%.

(Hartman, Tr. 1436-1437.)

Company witness Sweat, as well as the Company's F-1 schedules (Exhibit 39), also explained that other factors such as system age, types of meters, meter malfunctions, lightning strikes, soil conditions, etc., all can contribute to high levels of unaccounted for water. (Sweat, Tr. 1355-1358.) For instance, the F-1 schedules for River Grove, Kingswood and Stone Mountain indicate

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[29]In addition to the adjustments to purchased power and chemical costs, Public Counsel's prehearing statement suggests that used and useful levels for these systems also be reduced. The Commission has rejected similar suggestions by Public Counsel. See Order No. 92-0811-FOF-WS (issued 8/12/92) (no protest filed) (adjustment to used and useful for excessive infiltration is not proper); 90 FPSC 9:278, Order 23511 (issued 9/18/90) (same).

that the high levels of unaccounted for water for those systems may be attributed to malfunctioning meters. The F-1 schedule for the Oakwood system indicates that the high level of unaccounted for water is attributable to the existence of galvanized and black iron pipe which is deteriorating as well as leaks in the main joints. (See also, Sweat, Tr. 1345.)

Given all of these considerations, no adjustment to the chemical or purchased power costs for these systems is appropriate.

ISSUE 81: **Which systems have excessive infiltration and what adjustments are appropriate as a result?**

Based on the allowable design criteria, the level of infiltration for all systems is acceptable.

In its prehearing statement, Staff suggests that the Jungle Den and Palm Port systems may have excessive infiltration. Late Filed Exhibit No. 99 requested by Staff demonstrates that from January through October, 1992, the Company experienced infiltration of only 3.8% on the Jungle Den wastewater system. Exhibit 99 states as follows:

> The wet well at the pumping station at the Jungle Den complex was recessed and also had a non-water tight cover. In Spring of 1992 the Company performed work which raised the neck of the wet well and changed out the cover (lid) to a water tight type. This has drastically improved the infiltration problem at this site.
>
> In August 1992 work by Citrus Pipeline of Citrus County was let to raise the wet well and valve box on Ram Island, and the infiltration problem at this site has been corrected.
>
> As can be seen by the above figures, infiltration had been kept to a minimum until heavy rains in September and October. At this time our District Supervisor discovered that Volusia County had disturbed a manhole on Alice

Drive during some road work. We believe that the infiltration problem in September and October was a combination effect of heavy rains and the disturbing of the Alice Drive manhole by the County.

These facts demonstrate that the money invested in 1991 by Southern States to improve its Jungle Den facilities (approximately $15,000) resulted in a drastic reduction of any pre-existing infiltration problem and no adjustment to the Company's revenue requirements for the Jungle Den wastewater system is justified. (<u>See</u> Sweat, Tr. 1349.)

The record is devoid of evidence which would justify a determination that the level of infiltration on the Company's Palm Port wastewater system is excessive. For this reason no adjustment to the Company's revenue requirements is appropriate for this system.[30]

<u>ISSUE 82:</u> **Should property taxes be reduced in relation to corresponding used and useful adjustments to plant?**

No, not as proposed by OPC.

The Company does not believe any adjustment is appropriate. There has been no direct correlation established by any party between used and useful adjustments and the level of property taxes assessed against the Company (Ludsen, Tr. 577) or even between the

[30]Public Counsel suggests that the Commission adjust the non-used and useful levels for the Jungle Den and Palm Port wastewater systems if infiltration is found to be excessive. As indicated in the Company's analysis and arguments concerning Issue 80, the Commission has rejected prior requests by Public Counsel for this type of an adjustment. Public Counsel has presented no evidence which would justify such an adjustment in this proceeding. Therefore, the Commission should reject Public Counsel's proposed adjustment.

property values used for tax assessment purposes and the values in the MFRs. (Ludsen, Tr. 573.) Also, the Company must pay its property taxes each year and there is no guarantee, AFPI or otherwise, that the Company can recover these prudently incurred operating expenses. (Ludsen, Tr. 574.) However, to the extent the Commission deems some adjustment is appropriate, the adjustment should be limited to $89,517. Ex. 40.[31]

As explained by Company witness Ludsen,

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[31]Mr. Ludsen's Exhibit 40 (as revised) indicates that the maximum adjustment would be $116,150. However, Company witness Kimball confirmed that in 1990 the Company successfully convinced the Citrus County Property Appraiser to remove 40% of the non-used and useful plant from the county's assessed plant value, thus reducing the Company's 1990 property tax bill. (Kimball, Tr. 1776, 1783.) If this fact incorporated into Mr. Ludsen's Exhibit 40, the appropriate adjustment for the Citrus County systems would reflect non-used and useful property taxes in column 8 as follows:

<u>Water:</u>

Apache Shores - $197;
Citrus Springs Utilities - $10,525;
Crystal River Highlands - $0;
Golden Terrace - $2;
Gospel Island Estates - $23;
Oak Forest - $66;
Pine Ridge Utilities - $974;
Point O'Woods - $33;
Rolling Green - $11;
Rosemont - $11;
Sugar Mill Woods - $7,260;

<u>Wastewater</u>

Apache Shores - $105;
Citrus Springs Utilities - $2,552;
Point O'Woods - $437;
Sugar Mill Woods - $18,441.

Thus, the maximum adjustment to property taxes indicated in Column 8 of Exhibit 40 to reflect non-used and useful plant for all sytems would be $89,517, not $116,150.

> Ms. Dismukes properly quotes the Company's response to commission Staff's interrogatory no. 27 wherein the Company noted that it is highly unlikely that there is any direct correlation between the non-used and useful percentage and the amount of property taxes assessed against the plant. Indeed, any correlation which could be fabricated would be merely fortuitous. This fact is confirmed by Ms. Dismukes' quotation of the example we provided in an interrogatory response. In our example, the Commission determines that a 1 mgd plant is 75% used and useful. Ms. Dismukes was unable to identify any correlation between the 25% reduction in taxes recoverable by the Company (which she proposes), and the level of taxes which the Company otherwise would have been required to pay if the plant were a .75 mgd plant. After discussion with the Company's internal engineers as well as Mr. Hartman, who also is testifying on the Company's behalf in this case, I am confident that there is significantly less than a 25% difference in the costs of constructing a 1 mgd plant versus a .75 mgd plant. The construction cost differential would be closer to 10%. Therefore, it follows that property taxes paid for a .75 mgd plant would not be 25% lower than property taxes paid for a 1 mgd plant but rather something closer to 10% lower. Second, application of the non-used and useful percentage to systems located in Citrus, Collier, Hernando, Lee, Marion, Volusia and Washington counties would not be proper since these counties do not tax, in whole or in part, non-used and useful property.

(Ludsen, Tr. 541-542.)[32]

The impact of Mr. Ludsen's testimony is reflected in Exhibit 40 which reduces Public Counsel's proposed adjustment to avoid an impermissible double counting (where counties already exclude a

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[32]On cross-examination, Mr. Ludsen explained that his argument primarily is an economies of scale argument. (Ludsen, Tr. 573-578). The validity of this argument is corroborated by the cost curves presented by the Company's engineering expert, Mr. Hartman, in Exhibit 101. (Ludsen, Tr. 542.)

portion of non-used and useful property from assessed value) and to better reflect the less than one to one relationship (if any, relationship exists at all) between non-used and useful property and the valuation of utility plant for property tax purposes. (Ludsen, Tr. 543.) The reasonableness of Mr. Ludsen's modifications to Public Counsel's proposed adjustment remains unrefuted in the record. In fact, Public Counsel witness Dismukes agreed with Mr. Ludsen that a finding of 25% non-used and useful plant does not translate directly into a 25% reduction in property taxes. (Dismukes, Tr. 1944.)

For the foregoing reasons, the Commission should reject the proposed adjustment to property taxes. In the alternative, the adjustment should be limited to $89,517.

ISSUE 83: **Should test year expenses for property taxes be reduced due to appraisals of Deltona Utilities and United Florida properties?**

No.

The record confirms that it is unlikely that appraisals of property for ratemaking or booking purposes in and of themselves will result in reduced property taxes. As explained by Ms. Kimball, "no adjustment or provision is appropriate as a result of the write-down of land values. The utility does not report its booked value for land to the County Assessor's Office. The counties perform their own appraisal on parcels of land owned by the utility and arrive at their own assessed value. This value could, theoretically, be greater or less than the value recorded on the books." (Kimball, Tr. 1766; see also, Tr. 1766-1767;

Exhibit 123.) Moreover, Ms. Kimball's undisputed testimony and exhibits reveal that county tax assessors use a variety of methods to determine property taxes, including the use of system revenues. (Tr. 2186, Late-Filed Exhibit 138; see also Ludsen, Tr. 569-571.) No evidence was presented which would permit quantification, much less confirm the apparently presumed inevitability, of reduced Company property tax liabilities as a result of the appraisals. The Company cannot be placed into the untenable position of having to disprove that which other parties have only presumed, without justification, might occur in the future i.e., a reduction in property taxes due to reduced land values for ratemaking and booking, not tax, purposes. For these reasons, no adjustment is appropriate.

ISSUE 84: **What is the appropriate provision for test year income taxes?**

This is a fall-out number.

The appropriate income tax expense is $986,448 for water as shown in Exhibit 39, on line 10 of Schedule B-1 in Volume I, Book 1 of 4, page 0084 and $493,851 for wastewater as shown on line 10 of Schedule B-1 in Volume I, Book 1 of 4, page 0249, adjusted for the resolution of other issues in the case which impact tax expense.

ISSUE 85: **Should ITC amortization be above-the-line and in what amount?**

Per the MFRs. ITC amortization should be above-the-line. The amount of amortization should be $27,862 for the water systems and $24,812 for the wastewater systems.

The ITC should be above the line because the Company made an

election under Section 46(f)(2) of the Internal Revenue Code. $27,862 should be allocated to water and $24,781 should be allocated to wastewater as shown on Schedule C-1, line 4.

<u>ISSUE 86:</u> **Is a parent-debt adjustment appropriate, and, if so, what is the proper amount?**

The Company has included the parent-debt adjustment in the MFRs and no adjustment is appropriate.

Yes, a parent debt adjustment is appropriate and should be calculated using the methodology in Exhibit 39 on Schedule C-1/A in Volume II, Book 7 of 11 and allocated as shown on pages 004 to 0030 in Volume I, Book 2 of 4. The $140,162 allocated to water and $124,816 allocated to wastewater on the above schedules are appropriate subject to resolution of other issues which may affect the rate base or capital structure of the Company.

<u>ISSUE 87:</u> **Is an ITC interest synchronization adjustment appropriate, and, if so, what is the proper amount?**

Yes. The proper amount is shown on Schedule B-16 for each system.

An interest synchronization adjustment is appropriate since the Company has made the election under Section 46(f)(2) of the Internal Revenue Code. The amount is $146,911 as shown on Line 15 of Schedule C-3 subject to resolution of any item which impacts the capital structure.

<u>ISSUE 88:</u> **Has the Company properly included reuse revenue in the test year revenue?**

No adjustment to test year revenue is appropriate other than the $9,308 which should be imputed for effluent sales from the Deltona Lakes system.

The parties agree to the $9,308 adjustment relating to the known and quantifiable future revenues from sales of effluent from

the Company's Deltona Lakes wastewater system to the Deltona Lakes Golf and Country Club. (Sweat, Tr. 1258.) No other adjustment is appropriate.

In its prehearing statement, Public Counsel alleges that further adjustments should be made in the form of Commission imputations of rates for all effluent agreements previously entered by the Company. Public Counsel presented no evidence which supports the proposed imputation. Such a redetermination, and subsequent imputation, of rates would violate the long established principle of utility ratemaking that the prudency or reasonableness of a utility decision must be determined considering the facts and circumstances confronting the utility at the time the decision was made. Florida Power Corporation v. Public Service Commission, 456 So.2d 451, 452 (Fla. 1984). In other words, the Commission may not analyze the reasonableness of the Company's (or its predecessors') decision to enter the effluent agreements using 20/20 hindsight.

Public Counsel offered no affirmative evidence that it was imprudent either for the Company (or its predecessors) to enter the effluent agreements or to provide effluent without charge.

In contrast, the record is replete with evidence confirming that the Company's (or its predecessors') agreements to provide effluent for irrigation purposes, without exception, were for the benefit of both the Company and its customers and the least costly (or only available) method of disposing of the effluent at the time. (Tr. 1270, 1279, 1284, 1293, 1300, 1301, 1307.) Considering these facts, the Company's customers already have benefitted

whether or not a charge is collected for the reuse effluent. (Sweat, Id., 1302.)

Several further points must be made. First, Mr. Sweat testified that several of the agreements existed prior to Southern States' ownership. (Tr. 1266, 1269.) Second, Mr. Sweat confirmed that Southern States consistently has negotiated the best agreements possible given the fact that the golf courses and cemeteries had their own irrigation facilities, consumptive use permits, etc., and were not required to take the Company's effluent. (Sweat, Tr. 1260, 1278-1284, 1308-1309)[33] Third, on examination by Staff Counsel, Mr. Sweat confirmed that if the Commission were to attempt to impute a rate on the existing agreements, the effluent user could choose to reduce or even terminate its use, resulting in hardships on the Company, as well as its customers as new, more expensive means of disposing of effluent would be required. (Sweat, Tr. 1310-1311.) Fourth, Public Counsel provided no evidence by which the Commission allegedly could determine a suitable rate for each effluent agreement and, thus, deprived the Company of its right to rebut such evidence and cross-examine its sponsor. Therefore, the record is devoid of evidence either justifying the imputation of rates for the effluent agreements or identifying costs or facts upon which the Commission could determine the rates which it would be just and

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[33]There was some confusion in the record regarding Southern States' status as "lessee" under the cemetery effluent agreement. (See Sweat, Tr. 1297 and discussion at Tr. 1299.) Southern States, as the "lessee" under the agreement, controls the amount of effluent delivered to the cemetery.

reasonable to impute. Public Counsel's proposal should be rejected.

ISSUE 89: **Should revenues be imputed for water estimated as attributable to unmetered or stuck meters?**

The Company believes an adjustment of this nature is without precedent. No evidence has been presented by any party which explains the rationale for such an adjustment.

The record is devoid of any evidence identifying a proposed rationale for an imputation of the type suggested in this issue. Therefore, Southern States did not have an opportunity to rebut such evidence or cross-examine the person who might have advocated such a position. For this reason alone, no imputation is justified.

In addition, Company witness Sweat testified that the Company has an established process for identifying stuck meters and changing stuck meters at the earliest date possible. (Sweat, Tr. 1341; see also Loucks, Tr. 1829.) This process includes the preparation of monthly zero usage reports, visual inspection of meters where no consumption is reported by field personnel, identification of stuck meters and change out, all on a regular basis. (Sweat, Id.)

Mr. Sweat confirmed that meters will eventually slow down or get stuck as they age -- a fact confirmed by experience, logic and any AWWA manual on the subject. (Sweat, Tr. 1338, 1339.) In other words, in the absence of virtually an annual meter change out program (an operational and economic impossibility), stuck or slow meters will always exist and, consequently, revenues will be lost for the associated consumption. Finally, Mr. Sweat testified that

Southern States recently implemented a comprehensive meter program that will cover all aspects of this issue and result in the testing and replacement, where necessary, of all meters over a seven (7) year period. (Sweat, Tr. 1339.)

Company witness Loucks further explained that Southern States will use the estimate of consumption to backbill commercial customers (for up to a twelve (12) month period) and that such billing appears in the Company's billing analysis submitted in this proceeding upon which rates will be established. (Loucks, Tr. 1829.) However, the Company does not backbill residential customers. (Loucks, Tr. 1830.) As explained by Ms. Loucks, stuck residential meters generally are discovered more quickly for residential customers than commercial customers as a result of differing billing cycles. Id. Moreover, unlike commercial customers, residential customers are more likely to be only part time inhabitants of their Florida residences. (Sweat, Tr. 1341.) Therefore, it is logical that attempts to assess estimated bills on residential customers based on assumptions of slow or stuck meters would be met with a sharply increased level of disputes with customers concerning usage, and risk customer dissatisfaction.

These facts verify that Southern States has acted and is acting diligently to identify, test and change slow and/or stuck meters. Neither Mr. Sweat's or Ms. Louck's testimony was refuted. In light of these facts, the suggestion that revenues should be imputed against the Company's revenue requirements, presumably based on an estimate of unmetered consumption for stuck residential

meters is not justified in the record and should be rejected.[34]

ISSUE 90: **What is the adjusted operating income amount before any revenue increase?**

Per the MFRs.

The Commission should approve the adjusted operating income amount set forth in and supported by the MFRs in Exhibit 39, subject to any adjustments pursuant to stipulations of the parties and/or adjustments supported by competent and substantial evidence.

REVENUE REQUIREMENT

ISSUE 91: **What are the systems' revenue requirements?**

Fall-out number.

All parties agree that the revenue requirement is a fall-out calculation subject to the resolution of other issues.

RATES AND CHARGES

GENERIC ISSUES

ISSUE 92: **Should SSU's final rates be uniform within counties, regions, or statewide?**

If uniform rates are to be established, the benefits of such a rate structure could best be achieved only on a statewide basis. Neither County geographical boundaries nor the Company's own "regional" boundaries would recognize the factors previously identified as being critical to a proper uniform rate structure. The statewide rates could be developed using one of two methods: (1) rate "bands" where systems falling in certain bands based upon cost of service and other pertinent factors would be considered together; and (2) a statewide rate for standard and advanced treatment processes.

Southern States' rate proposal in this case is not for uniform rates, but rather for modified stand alone rates. To the extent

[34]The Company receives revenue from commercial customers based on estimated usage. (Loucks, Tr. 1829.) Therefore, no revenue imputation would be appropriate, i.e., a double-counting would result.

the Commission wishes to deviate from the Company's proposed rate design and implement some type of uniform rate structure, this issue poses whether such uniform structure should be implemented on a county, regional, or statewide basis.

Southern States did not request a uniform rate structure in this case because the Company recognized that it had both time and cost constraints that compelled the Utility to focus first on the needed rate relief for the 127 systems. (Ludsen, Tr. 562.) Moreover, neither the Company nor any other party has submitted any evidence of record specifically requesting adoption of uniform rates. (Ludsen, Tr. 562; Williams, Tr. 2054.) However, by capping rates, establishing a base facilities and separate gallonage charge for all systems, and capping wastewater gallonage charges, the Company has laid the groundwork for the eventual statewide uniform rates. (Ludsen, Tr. 564, 844; Cresse, Tr. 1119; Williams, Tr. 2053-2054.) The benefits of a properly designed uniform rate structure include rate stability, less erratic rate changes, less accounting and ratemaking costs, the minimization of rate shock, and a recognition of the benefits of common ownership and management. (Cresse, Tr. 1120; Williams, Tr. 2051.)

While uniform rates are not part of the Company's proposal nor advocated for implementation in this case, the evidence indicates they are desirable for long-term implementation. (Ludsen, Tr. 564; Cresse, Tr. 1120; Williams, Tr. 2054.) As for how a uniform rate structure might be implemented, Mr. Williams very generally acknowledged that county-wide rates already exist

for some systems and regional rates may be possible based upon Southern States' three organizational regions. (Williams, Tr. 2052-2053.) However, neither of these approaches recognizes the differences in treatment technologies, customer base, utility size, consumption levels, or service availability charges that must be considered in developing a successful uniform rate structure. (Ludsen, Tr. 850-851; Williams, 2054, 2058-2059.) For this reason, the most desirable uniform rate structure would be statewide in application.

The specific implementation of a statewide rate can be developed based upon two approaches. First, Mr. Ludsen testified that the Company's preferred structure would be based upon standard and advanced treatment facilities. (Ludsen, Tr. 852.) Mr. Williams testified that a single statewide rate with a surcharge for advanced treatment would be simple to administer and consistent with prior Commission practices, such as the Commission has approved for Jacksonville Suburban Utilities. (Williams, Tr. 2052.) Mr. Cresse acknowledged that it may be "more fair" to develop statewide rates on this basis. (Cresse, Tr. 1121.)

The other statewide alternative would be banded rates. As Mr. Cresse testified, this may actually be more of an interim step towards a single statewide rate or advanced/standard rate structure. (Cresse, Tr. 1119-1120.) As Mr. Ludsen explained, this approach is not the Company's preferred structure since based upon the limited consideration undertaken, there is no single factor that has evolved that would be the underlying basis for the bands.

(Ludsen, Tr. 850-851.)

In the final analysis, the parties agree that adoption of statewide rates should be implemented gradually. The proposed rate structure makes the first important step in this direction. Additional measures at this time are not appropriate or supported by the record.

<u>ISSUE 93:</u> **Should systems with advanced water or wastewater treatment have a surcharge added to their rates if uniform rates are approved?**

Whether a system is served by advanced water or wastewater treatment facilities should be considered in the rate structure analysis if statewide rates are to be implemented. Under the Company's preferred statewide rate, additional costs of serving these systems should be reflected in the gallonage rate and base facility charge.

The issue of surcharges for advanced treatment is subject to the resolution of Issue 92 and the type of statewide rate structure that might be adopted. However, all of the evidence is in agreement that any statewide rate structure must specifically evaluate the costs and effects of advanced treatment facilities on rates. (Ludsen, Tr. 852; Cresse, Tr. 1121; Williams, Tr. 2053.) As Mr. Ludsen testified, reverse osmosis ("RO") treatment generally runs in the $4 to $5 range per 1,000 gallons. On the other hand, some small systems may have rates higher than an RO facility. (Ludsen, Tr. 854.) Thus, the Commission could blend all rates or separately recognize advanced costs in the final rates, depending upon the overall ratesetting objectives and the impact of the resulting final rates. (Ludsen, Tr. 854-855.)

ISSUE 94: **Should SSU's proposal that customer bills be capped at $52 for water and $65 for wastewater for 10,000 gallons for water usage be approved?**

Yes, the caps are appropriate, and the Commission should also recognize that few customers would pay the maximum rate since, generally speaking, average consumption in those systems would be less than 10,000 gallons.

This Issue involves the use of $52.00 for water and $65.00 for wastewater for 10,000 gallons for water as a basis for determining the rates that would otherwise be indicated by the Company's stand-alone cost of service study. (Cresse, Tr. 1118.) This proposal would cap rate increases for 31 systems, with the resulting revenue deficiency being allocated first the 10 systems where rate reductions are indicated by the stand-alone cost of service study and the balance of the deficiency being allocated to the other 86 systems at a uniform 1.9% increase. (Cresse, Tr. 1117-1118; Exhibit 88.) Under this proposal, water customers who use more than 10,000 gallons would still pay for whatever usage they have. (Cresse, Tr. 1045.) The separate 10,000 gallon cap for wastewater service is separately addressed at Issue 101. The revenue deficiency make-up is addressed at Issue 95. Thus, the sole question for this Issue is whether this cap is appropriate.

The development of the cap was premised upon discussions among Mr. Cresse, Mr. Ludsen and Ms. Loucks regarding overall rate design issues and objectives. (Cresse, Tr. 1122.) The data available indicated that the weighted average bill for residential customers at 10,000 gallons is $17.39 for water and $32.92 for wastewater service. Applying their extensive ratemaking experience, the Company's witnesses admittedly made a judgment call in picking the

$52 and $65 figures, which are approximately three times and two times the weighted average water and wastewater charges. (Cresse, Tr. 1046.) Mr. Cresse then conducted a "sanity check" to determine whether these rates were unreasonable in light of the alternatives of private wells and septic tanks. This investigation indicated that the proposed rates did not encourage the use of alternative sources or discourage new customers from taking utility service, two vital ratemaking considerations.

On the other hand, use of these rates will help meet numerous Company objectives, examined more fully at Issue 96. But most importantly, this cap helps to minimize rate shock, continues encouragement for the acquisition of small systems, and recognizes the economies of scale a large utility can offer to customers. (Cresse, Tr. 1045-1046.) It is, quite simply, "in the best long term interest of all customers." (Cresse, Tr. 1045.)

The use of informed judgment, as was undertaken here, is what ratemaking is all about. Rarely do rates recover 100% of the revenue requirements from each class. (Cresse, Tr. 1047.) Indeed, for the water/wastewater industry, just as in the electric and telephone industries, the utility must serve all customers whether the service area is mature or developing. (Cresse, Tr. 1048.) Proper ratemaking is application of judgment to all of the available information, something this Commission undertakes in virtually every rate case. (Cresse, Tr. 1047.) For these reasons, these rate caps should not be characterized as cross-subsidization, since as Mr. Cresse explained, all ratepayers involved here are

monopoly ratepayers receiving the same services -- it's simply a discretionary rate design issue. (Cresse, Tr. 1090.)

Clearly the competent substantial evidence of record establishes the benefits of rate caps on all customers and the minimal impact on other customers. On the basis of this evidence, the proposed rate caps should be approved.

ISSUE 95: **How should the revenue deficiencies caused by the utility's proposed cap on bills at 10,000 gallons be recovered?**

Revenue deficiencies caused by the proposed "cap" on bills should be recovered as proposed by the Company.

The rate caps evaluated at Issue 94 produce a revenue deficiency of approximately $775,000. (Cresse, Tr. 1049; Exhibit 88.) Southern States has proposed that this revenue deficiency be made up first by not increasing the rates to the customers of those 10 systems whose rates would decrease on a stand-alone basis. This would recover $365,000 of the deficiency. (Cresse, Tr. 1068.) The remaining $410,000 would be made up from the other 86 systems through a uniform 1.9% increase applied to the cost of service study rates. (Cresse, Tr. 1068, 1117-1118.) This would be an average increase of 36 cents per month. (Cresse, Tr. 1069.) The positive benefits associated with the capping plan addressed at Issue 94 equally support adoption of the proposed allocation of the revenue deficiency created by such plan.

There is no competent substantial evidence of record challenging the Company's proposal to freeze rates for the 10 systems and increase stand-alone rates to the other 86 systems. Again, this overall approach minimizes rate shock to the systems

capped while providing a minimal impact on all other customers. As Mr. Williams testified, the ease of operation and administration and the reduced administrative costs of a single utility exceed any adverse consequences of capping and allocating the deficiency. (Williams, Tr. 2063.) Over the long term, several hundred systems combined for ratemaking purposes mitigate dramatic rate increases for all customers. (Ludsen, Tr. 535; Williams, Tr. 2064.)

The only alternative raised by the evidence is the idea of allocating the $410,000 to the 86 systems on a straight dollar basis instead of the proposed 1.9% method. (*See*, Exhibit 89.) Mr. Cresse acknowledged that it would be reasonable to implement an alternative based upon dollars if the revenues remain constant. (Cresse, Tr. 1133.)

On the basis of the evidence of record, the Company's proposed allocation should be adopted, although the Exhibit 89 alternative would be acceptable.

ISSUE 96: **Should the Commission adopt the utility's proposed rate structure, and, if not, what is the appropriate rate structure?**

Yes. The Company's proposed rate structure is designed to achieve reasonable rates for all customers. The proposed rate caps result in a minimal subsidy of approximately 1.9% of certain water and wastewater customers. This level of subsidy is significantly below subsidies frequently encountered in utility ratemaking. The Company hopes to encourage growth on the systems benefitting from the proposed rate caps which, if achieved, would reduce or even eliminate even this minimal subsidy in the future.

The overall rate structure is presented in Exhibit 39, the MFR E Schedules, and the testimony of Ms. Loucks, Mr. Ludsen, and Mr. Cresse. Southern States' proposed rate structure is stand alone rates with a cap, with the revenue deficiencies associated

with that cap being allocated to other systems, as is discussed at Issue 95. (Cresse, Tr. 1044; Williams, Tr. 2059.) This structure is fair, just, and reasonable for all customers. (Cresse, Tr. 1044-1045.)

Southern States set forth four objectives for designing rates that have been met in the proposed rate design:

First, the opportunity to attract capital. This result is inherent in recovering the Company's revenue requirements. (Loucks, Tr. 1802.)

Second, rates should be close enough to the allocated unit costs of the customer (the base facilities charge) and the commodity (gallonage) components. (Loucks, Tr. 1802-1803.) As for use of base facilities charges and gallonage charges, Southern States is proposing both rate elements for all customers based upon a standard methodology. (Ludsen, Tr. 844.)

Third, there should be reasonable continuity in rates. (Loucks, Tr. 1804.) Rate continuity ultimately proved to be less important in this case because of the lack of consistency in the original rate design of a mny systems and the absence of rate case for some systems for a number of years. (Ludsen, Tr. 844.)

Fourth, rates should avoid complexity and be easy to administer. (Loucks, Tr. 1803.) This has been accomplished by establishing a uniform monthly billing cycle, elimination of block rates, a uniform wastewater cap at 10,000 gallons, and the overall residential caps of $52 for water and $65 for wastewater. (Loucks, Tr. 1804.)

The essential fact underlying these objectives and the ultimate rate design proposed and supported by the evidence is the overall customer benefits resulting from the provision of service by a large, integrated utility. Public policy, and certainly the Commission's actions, have been to encourage the acquisition of smaller systems by larger providers. (Williams, Tr. 2063.) A single large utility provides operating efficiencies, service benefits, greater regulatory compliance, and lower administrative and regulatory costs. (Ludsen, Tr. 535; Williams, Tr. 2063.) Indeed, the specific rate cap part of the Company's rate design discussed at Issue 95 helps to minimize rate shock and recognizes Southern States' economies of scale while still leaving the resulting rates lower than those that would result on a true stand-alone basis. (Cresse, Tr. 1045-1046.)

To remain viable, utilities must plan for the long term and not merely base decisions on short term needs or desires. Southern States' proposed rate design is in the long term best interest of all ratepayers. (Cresse, Tr. 1045.) Since the fundamental rate design is premised upon stand-alone rates as modified by the caps and deficiency adjustments evaluated in Issues 94 and 95, there is no meaningful negative effect from this rate design while numerous customer benefits. Based upon the competent substantial evidence of record supporting the proposed rate design and the lack of alternative evidence, the Company's proposed rate design should be approved.

ISSUE 97: **Should conservation rates be implemented for systems in critical use areas with excessive water consumption and if so, how should the conservation rates be structured?**

No. If conservation rates are implemented it should not be done on a system-by-system basis but rather on a company-wide basis after some form of uniform rates have been implemented and after an analysis has been conducted on the impact of conservation rates on consumption. Currently, we have conservation embedded in our proposed rate structure through the use of a gallonage charge and base facility charge.

Southern States did not propose conservation rates and none should be adopted. While some Southern States systems are in critical use areas, the Company recognizes the overall importance of conservation, and the Company participates in educational efforts and is recommending a base facility charge for all systems. (Ludsen, Tr. 845-846.) However, no conservation rates should be implemented without first conducting studies to support such rates. (Ludsen, Tr. 845.) For example, increases on gallonage charges can disappropriately impact full-time versus part-time residents. (Ludsen, Tr. 846.) In addition, an increase in the gallonage charge, such as a uniform $1 per 1,000 gallon minimum, may have no conservation effect on some users. (Ludsen, Tr. 848.) Finally, a uniform $1 per 1,000 gallon minimum may not necessarily produce any surplus to mitigate other rate increases since, if such a conservation rate is working properly, there will not be any surplus revenues.

Mr. Williams correctly points out that reallocation of revenue requirements to the gallonage charge and/or an increase in the gallonage charge can have conservation consequences for the St. Johns Water Management District systems. (Williams, Tr. 2056.)

However, without a propr analysis, which is not present in the record, there is no basis to support actions other than those included within the company's filing.

ISSUE 98: **Should private fire protection rates be calculated by dividing the approved base facility charges for each comparable meter size by 1/3?**

Yes.

The calculation of private fire protection rates is supported by Exhibit 39, MFR Schedule E-2, and the testimony of Ms. Loucks on behalf of Southern States. No party disputed this methodology and there is no other evidence of record opposing or otherwise discussing this subject. Accordingly, rates for private fire protection as stated in the MFRs have a proper evidentiary basis and should be approved.

ISSUE 99: **Should a private fire protection rate be approved for lines less than 4" in diameter?**

Yes.

Southern States has only two customers who take private fire protection on lines less than 4" in diameter, which is used for sprinkler service. (Loucks, Tr. 1832, 1843.) The Company has proposed rates for this service. There is no evidence of record supporting a determination that these customers should receive this service for no charge. Accordingly, the rates proposed by the Company should be approved.

ISSUE 100: **Should the residential wastewater base facility charge be increased by the American Waterworks Association factors?**

Southern States does not oppose the elimination of the proposed factoring. However, rates must be adjusted to meet the Company's revenue requirements if the factoring is eliminated.

Southern States does not oppose the elimination of the proposed factoring. However, rates must be adjusted to meet the Company's revenue requirements if the factoring is eliminated. (Loucks, Tr. 1802-1803, 1812; Exhibit 39, MFR E Schedules.)

ISSUE 101: **Is a wastewater gallonage cap of 10,000 gallons appropriate for all systems, and, if not, what is (are) the appropriate cap(s)?**

Southern States has proposed a 10,000 gallon cap. Southern States does not oppose a lower cap if the Commission believes a lower cap is prudent. However, the Company anticipates that establishing a lower cap will increase the gallonage charge and result in increased customer dissatisfaction.

The development of the proposed 10,000 gallon wastewater cap was fairly straightforward. The 10,000 gallon level was premised on the fact that the average statewide consumption is between 9,000 and 10,000 gallons per customer per month. (Ludsen, Tr. 563.) No party disputed this data nor submitted any evidence indicating less of a statewide average, although admittedly some systems actual usage will be greater or less. (Ludsen, Tr. 562.)

The purpose of the cap was not disputed -- it recognizes that at a certain level high water consumption is mostly likely for irrigation purposes and not returned to the wastewater system. (Loucks, Tr. 1834-1837.) Currently, Southern States has system caps of 6,000, 7,000, 8,000, and 10,000 gallons, but the weighted average is about 10,000 gallons. (Loucks, Tr. 1835.) Use of a single cap for all systems also contributes to administrative efficiency. (Ludsen, Tr. 563.) A reduction in the cap from the proposed 10,000 gallon level would result in higher gallonage charges. (Ludsen, Tr. 562.) On the basis of the unrefuted

evidence regarding the weighted consumption average and the fact that rates would be higher under a lower gallonage cap, the evidence of record supports the adoption of the 10,000 wastewater gallonage cap.

ISSUE 102: **Should the wastewater gallonage charges be calculated assuming 80% of water sold to residential customers and 96% of water sold to general service customers is returned to the wastewater systems?**

The Company is not aware of any factual predicate which would justify this assumption. The wastewater gallonage charge should be established at the levels set forth in the MFRs.

The Company's wastewater gallonage charges were developed based upon the cost of service study performed for each system and the 10,000 gallon cap that is the subject of Issue 101. (Loucks, Tr. 1800; Exhibit 124.) These rates are expressed in Exhibit 39, the MFR E Schedules, and the supporting testimony of Ms. Loucks.

Ms. Loucks acknowledged on cross-examination that the Commission has previously utilized the 80 and 96 percentages. (Loucks, Tr. 1838.) However, she further explained that no study has been performed and submitted in this docket evaluating, let alone supporting, application of such percentages to Southern States. In light of the absence of any competent substantial evidence on behalf of the 80/96 percentages, the only proper evidentiary basis for the wastewater rates is that proposed by the Company.

ISSUE 103: **Should SSU be required to file a service availability case for all its systems?**

No. The Company will likely be filing a service availability case within the next one to two years, and there is no need to file one sooner.

A service availability case was not filed with this rate case due to time and cost constraints and the fact that inclusion of a service availability case would have significantly delayed this rate case filing and the necessary rate relief required by Southern States to meet its service obligations. (Ludsen, Tr. 855.) However, once this rate case is concluded, the Company is planning on submitting a service availability case within the next one to two years. (Ludsen, Tr. 856.)

The concern for a service availability case arises principally if the Utility were to implement some form of uniform statewide rates. (Ludsen, Tr. 857.) Since the current service availability rates already have been determined to be fair, just, and reasonable, a change in such rates may be appropriate if there was a major change in rate design such as uniform statewide rates. (Ludsen, Tr. 857; Cresse, Tr. 1140-1141; Williams, Tr. 2054.) However, even adoption of uniform statewide rates, which are not being proposed, can still preceed an evaluation of service availability charges. As Mr. Ludsen testified, service availability charges are not the main driver in whether rates are high or low, and it would likely take 8 to 10 years before a change in service availability charges would begin to have an impact on rates.

In conclusion, since uniform statewide rates are not proposed for this case, there is no immediate need to order a service availability charges case. Any move to uniform statewide rates needs to be undertaken in steps. As a part of this process, the

Company will file a service availability case in the next one to two years unless ordered to do so sooner by the Commission. Thus, there is no need to immediately order such a filing.

ISSUES APPLYING TO MORE THAN ONE SYSTEM

ISSUE 104: What are the appropriate rates for reuse of reclaimed water for each of SSU's systems?

The only systems where effluent sales take place are: Deltona Lakes (Deltona Golf and Country Club) and Florida Central Commerce Park. The charge collected for Deltona Lakes is 6 cents per 1,000 gallons over the twenty year life of the Agreement. The charge for Florida Central Commerce Park is 12 cents per sprinkler head. No other sales occur. Contracts for effluent reuse also exist on the University Shores, Point O'Woods, Amelia Island and Deltona Lakes (Glen Abbey Golf and Country Club) systems. No charge is provided for in these contracts. The Commission must remember that effluent reuse is still in the pioneering stage and Southern States is a staunch advocate and provider of significant levels of reuse. However, recipients of reuse have not been required to accept reuse water, particularly where sufficient water is available to such recipients from their own wells. No incentive existed for accepting our reuse water. It would not be appropriate for the Commission to now impose charges or attempt to impute revenues where contracts do not permit Southern States to collect such charges, particularly in the absence of any established policy or precedent from this Commission.

The appropriate rates for reclaimed wastewater are those reflected in the MFR schedules (Exhibit 39) and supported by the unrefuted testimony of Mr. Sweat.

According to Mr. Sweat, discharge of reclaimed wastewater is increasingly becoming the preferred method of disposal due to increased water source limitations and the need to recharge Florida's aquifer. (Sweat, Tr. 1225-1226.) As is clear from the extensive cross-examination of Mr. Sweat regarding each of the reuse situations employed by Southern States, each situation has its own unique facts and circumstances. Situations where the property owner may pay for the treated wastewater often involve a

rate at the customer's avoided cost. (Sweat, Tr. 1276.) On the other hand, other systems may not involve direct financial compensation to the Company, but any of these land use arrangements provide other benefits. For example, without use of the property, the Company would have to purchase property at a cost to ratepayers. (Sweat, Tr. 1270.) Moreover, in the present environment, the Utility is without the authority to compel the landowners to take the treated water.

Public Counsel would like for Southern States to collect charges in each instance. The Company would like to collect charges. However, it is not always possible to collect charges -- such rates would clearly result in the refusal to take the treated water.

The evidence in this case demonstrates that the Company and its customers benefit from each of the reuse agreements currently in effect, and, without such alternatives, Southern States would incur substantial costs to develop alternative means of disposal. Indeed, some of the existing arrangements have previously been considered and approved by the Commission. (See 90 FPSC Rep. 9:278 (Order No. 23511, Sept. 18, 1990); 89 FPSC Rep. 6:481 (Order No. 21449, June 26, 1989). It would make no sense for the Commission to encourage reuse then impose rates that would defeat such reuse. Accordingly, the appropriate rates are those in the MFRs except for the adjustment to Deltona Lakes as a known and measurable out-of-test year adjustment. (Sweat, Tr. 1258.)

ISSUE 105: **What adjustments, if any, to the Bills and Gallons identified in Schedules No. E-2A of the MFRs are appropriate?**

No adjustment is appropriate. There has been no prefiled testimony, pleading or other factual predicate identified to the Company which suggests that any adjustment to the Bills and Gallons identified in Schedules No. E-2A of the MFRs is appropriate.

The bills and gallons identified in MFR Schedules E-2A of Exhibit 39 are supported by the testimony of Ms. Loucks. (Loucks, Tr. 1800.) Other than the weather normalization adjustment, examined and rejected at Issue 42, there is no competent substantial evidence of record supporting any adjustments. Accordingly, the evidence of record supports the approval of the bills and gallons identified in MFR Schedule E-2A of Exhibit 39.

ISSUE 106: **What are the appropriate final rates?**

Fall-out number.

All parties agree that the final rates are a fall-out calculation subject to the resolution of other issues.

ISSUE 107: **What is the appropriate amount by which rates should be reduced four years after the established effective date to reflect the removal of the amortized rate case expense as required by Section 367.0816, Florida Statutes?**

Fall-out number.

All the parties agree that the final rates after amortization of rate case expenses are a fall-out calculation subject to the resolution of other issues.

ISSUE 108: **In determining whether any portion of the interim increase granted should be refunded, how should the refund be calculated, and what is the amount of the refund, if any?**

*The evidence of record justifies the requested rate relief. Therefore, no refund of interim rates is appropriate since the

proposed final revenues exceed the revenues derived from the interim rates.*

Based upon the evidence of record and the analysis associated with other issues, the rate relief requested by Southern States in Exhibit 39 (MFRs) should be approved. In such situation, or any situation where rates from final revenues exceed total revenues from interim rates, no refund of interim rates should occur.

OTHER OR MISCELLANEOUS ISSUES

ISSUE 109: **Should the Commission adjust the utility's proposed allowance for funds prudently invested (AFPI) charges?**

No.

The Commission has developed AFPI rates to help the Utility recover the carrying charge of the cost of the plant, depreciation, determined to be non-used and useful, and, if requested, property taxes. (Lewis, Tr. 1719.) For Southern States, these costs are identified and supported by Exhibit 39, MFR Schedule 39 and the testimony of Mr. Morse and Mr. Lewis. The utility used a combined treatment and collection facilities rate. (Lewis, Tr. 1710-1711.) Separate charges for these would not be unreasonable, but splitting out such rates would be more administratively complex and that might be less equitable. (Lewis, Tr. 1112.) In addition, the Company used a gross plant calculation to recover the accumulated depreciation since Southern States has not previously had AFPI rates. (Lewis, Tr. 1718-1723.) If there had already been an AFPI charge, net plant would be acceptable. (Lewis, Tr. 1723.)

As for potential adjustments to AFPI, Mr. Lewis acknowledged that changes in capital charges, used/useful percentages, and

property taxes may also impact AFPI requiring certain adjustments. (Lewis, Tr. 1708.) These are essentially fall-out calculations to the extent there are adjustments from those represented in the MFRs. In addition, Mr. Lewis acknowledged an adjustment that should be made for prepaid used and useful in the AFPI calculation.

There is no evidence of record refuting the AFPI calculations posed by the Utility or the appropriateness of the combined rate or gross plant. Accordingly, except for the adjustment for prepaid used and useful, and subject to fall-out calculations on capital charges and used/useful percentages, the proposed AFPI rates should be approved.

ISSUE 110: **Should the Commission adjust the utility's proposed allowance for funds used during construction (AFUDC) calculation?**

No.

The Company's AFDUC rate is calculated on Southern States' cost of capital and ties to the D Schedules in the MFRs, except per the Commission's rules investment tax credits have been excluded. (Lewis, Tr. 1727, Exhibit 39.) Mr. Lewis acknowledged if the return on equity or interest rate on debt were lower than those listed in the MFRs, the AFDUC Rate should be adjusted. (Lewis, Tr. 1728.)

On the basis of the competent substantial evidence of record, there is no evidence supporting any adjustment in the AFDUC rates as presented in the MFRs except as there may be a fall-out calculation based upon decisions on other issues. Subject to such fall-out calculations, on the basis of the record, the proposed

AFDUC rates thus should be approved.

LEGAL ISSUES

ISSUE 111: **Do the pronouncements of the Financial Accounting Standards Board legally compel the Commission to any specific accounting methodology for ratemaking procedures under Florida Statutes?**

No. Although the Commission is not compelled to adopt SFAS 106, it has in fact adopted the accrual accounting principles of SFAS 106 for ratemaking purposes in recent orders. The issue is not one of legal compulsion but rather whether SFAS 106 expenses are prudently and necessarily incurred. The Company believes these costs are prudently incurred and should be recovered from customers.

By its terms, the pronouncements of the Financial Accounting Standards Board ("FASB") govern the preparation of external financial reports. Based upon the positions of the parties in the Prehearing Order, the parties appear to agree that the Commission is not legally bound to adopt SFAS 106 for ratemaking purposes. Nonetheless, as discussed in Issue 112, the Commission has consistently determined in recent rate cases that it is appropriate to adopt SFAS 106 for ratemaking purposes. Hence, the Commission's focus in this proceeding should be on whether any evidence has been presented which would justify deviation from the Commission's current policy. Southern States maintains that no such evidence has been presented. Further, as previously discussed in Issue 50, the level of expenses which Southern States requests be recovered for are reasonable, prudent to incur and should be recovered from ratepayers.

ISSUE 112: **May the Commission substitute SFAS 106 as the standard by which it judges whether Company expenses are incurred, and if incurred, whether reasonably incurred?**

No. However, the Commission should apply the accrual accounting principles of SFAS 106 for ratemaking purposes consistent with its recent orders. Such principles are consistent with the ratemaking goal of requiring current ratepayers to pay for benefits earned and accrued and services provided by current employees. The Commission has recently applied the SFAS 106 method for recovering expenses for other post-employment benefits in recent rate cases. No reason exists to deviate from the Commission's policy in this rate case. The remaining question is whether such costs or projected costs are prudently and necessarily incurred. The Company believes these costs are prudently incurred and therefore should be recovered from ratepayers.

This Issue basically asks whether the Commission should use SFAS 106 for ratemaking purposes. This issue has already been answered. In Order No. 24178 issued February 28, 1991 for Central Telephone Company of Florida,[35] Order No. PSC-92-0708-FOF-TL issued July 24, 1992 for United Telephone Company of Florida,[36] and the recent Florida Power decision in Docket No. 910890-EI (final order has not been issued), the Commission has found that SFAS 106 is an appropriate standard by which to judge whether utility expenses are incurred and, if incurred, reasonably incurred. The rationale supporting the Commission's adoption of SFAS 106 in these other cases applies with equal force and relevance in this rate case.

In the arguments advanced by OPC against the use of SFAS 106, OPC has not been able to deny the one basic feature of SFAS 106 that justified its adoption in these other rate cases and compels its adoption here: "SFAS 106 allows the recognition of a future liability for current employees of [the Utility] providing services to today's customers." 92 FPSC 7:555, 590 (Order No. PSC-92-0708-

[35]See 91 FPSC 2:707, at 738.

[36]See 92 FPSC 7:555, at 589-90.

FOF-TL, July 24, 1992) (emphasis added). As OPC witness Victoria Montanaro acknowledged during her deposition, for ratemaking purposes, current ratepayers should shoulder current costs. (Exhibit 22, at 26.) As the Commission has already recognized, SFAS 106 better correlates these costs and benefits. (Gangnon, Tr. 444-445, 453-454.)

SFAS 106 was issued in response to the growing unrecognized liability of businesses which provide medical care, dental care, life insurance and other benefits (other post-employment benefits or OPEBs) to existing retirees and current employees who will one day retire. (Gangnon, Tr. 445.) SFAS 106 recognizes that OPEBs are a form of deferred compensation whose costs should be recognized over the active service life of the employee in order to properly match and assess the full cost of providing services with the period in which the benefits were earned. (Gangnon, Tr. 450, 453.) OPC does not dispute these basic facts. (Gangnon, Tr. 453; Montanaro, Tr. 1999, 2022.)

At her deposition, Ms. Montanaro acknowledged that "from a cost causation and benefits received standpoint, all costs charged to ratepayers of a person who is retiring should have been paid while that person was working." (Exhibit 22, at 25.) Yet, OPC urges the Commission to continue with the pay-as-you-go approach under which an employee might work for the Company for 30 years, accruing benefits and costs associated therewith, with no ratemaking recognition of the cost of those benefits until after the employee retires. Under this method, costs which should have

been assessed to ratepayers when an employee was actively and beneficially providing services are reserved to be paid by ratepayers after the employee has retired. (Gangnon, Tr. 453-454.)

Aside from the adverse financial impact of not accruing properly for such costs (Gangnon, Tr. 451, 456-458), it is fundamentally unfair to future ratepayers to expect them to bear this entire burden.

In the past, pay-as-you-go was accepted because retiree benefits constituted a relatively minor cost and the perceived difference between cash and accrual accounting was not considered material. With the medical cost inflation which has been prevalent over the past decade, ignoring this liability under the pretense of immateriality is no longer appropriate. These costs have simply outgrown the "immaterial" label to the point that the Company, and indeed the entire business community, has been forced to come to terms with this issue and recognize it on the books in the same manner in which it recognizes pension and other deferred compensation costs. (Gangnon, Tr. 449-450.)

The arguments raised by OPC in opposition to use of SFAS 106 do not support its rejection:

First, OPC offered no evidentiary support for the mere allegation that SFAS calculations are inherently unreliable. As utility witness Gangnon testified, the calculations employed "are the result of a number of carefully researched and informed decisions, made in consultation with independent experts, to select appropriate assumptions and produce reasonable results." (Gangnon,

Tr. 453.) As the Commission has recognized, estimates of costs are traditionally applied to other important elements examined in a rate case. 92 FPSC Rep. at 7:589. Like depreciation rates based on estimates of useful life, the Commission has the authority to adjust OPEB expenses which prove to be excessive. (See discussion of depreciation expense forecasts in Ms. Montanaro's deposition, Exhibit 22, at 34-35.) Further, as recognized by the Commission, "SFAS 106 contains a mechanism to encompass changes in the underlying assumptions and plan terms." 92 FPSC Rep. at 7:589.

Second, OPC's reference to alleged inequities resulting from the collection of transition costs from current customers is less than persuasive evidence to justify denial of the recovery of such costs since even under the Company's current pay-as-you-go method, there is no direct matching of customers who pay the costs and customers who received service while the costs were being accrued. Under SFAS 106, there is a direct matching of the current costs portion of the OPEBs. Even with respect to the transition costs for the portion of OPEBs relating to the accumulated post-retirement benefit, SFAS 106 provides a better matching of costs and service since such costs were incurred to provide service to both former as well as present customers. (Gangnon, Tr. 453.)

Third, OPC offered no substantiation for its allegation that the Company will reduce OPEBs in the future. After full consideration by the Company's management and a Medical Plan Board of Governors, the Company determined that the present level of OPEBs was necessary to attract and retain qualified employees.

(Gangnon, Tr. 452, 455.) While the Company has and will continue to employ cost containment measures, there are no current plans to reduce either the kinds or levels of OPEBs.[37] (Gangnon, Tr. 451-452.) Finally, the Company has committed to funding OPEBs in 1993. (Gangnon, Tr. 446, 452.) Therefore, Ms. Montanaro's suspicions are without foundation. (Gangnon, Tr. 452.)

In summary, application of SFAS 106 for ratemaking purposes will ensure that Southern States' cost of service is more accurately aligned with the provision of service. OPC failed to present any arguments not previously considered by the Commission which would justify the Commission's deviation from its established precedent. Accordingly, SFAS 106 should be used for determining whether expenses are incurred, and if incurred, whether reasonably incurred.

ISSUE 113: **Does SSU's requested recovery of the transition adjustment violate the prohibition against retroactive ratemaking?**

No. The inclusion of Southern States's requested SFAS 106 expenses will not violate the prohibition against retroactive ratemaking as this term is interpreted under Florida law. Since the final rates derived from this proceeding will be applied only on a prospective basis following the effective date of such rates, there will no violation of the prohibition against retroactive ratemaking.

A portion of the OPEB expenses which the Company seeks to recover in this proceeding consists of the transition or

[37] Ms. Montanaro acknowledged in her deposition that the Company's commitment to fund the OPEB liability removed her objection to the use of SFAS 106 for ratemaking purposes for recovery of the current service costs. This amounts to approximately 50% of the total OPEB costs which the Company seeks to recover in this proceeding. (Exhibit 22, at 42).

accumulated benefit obligation ("APBO".) The APBO represents OPEBs which were earned by employees of the Company over prior periods but the expenses for such OPEBs were never incurred due to the use of the cash ("pay-as-you-go") method of accounting. With the implementation of the accrual method of accounting for OPEBs under SFAS 106, the APBO must now be recognized for financial reporting purposes. OPC questions whether the recovery of the APBO violates the prohibition against retroactive ratemaking. OPC's position is without merit. As it has in recent cases (see discussion under Issue 112), the Commission should include the APBO in the OPEB expenses used to establish rates in this proceeding.

The prohibition against retroactive making means that rates established by the Commission must be applied prospectively - not retroactively. Westwood Lake, Inc. v. Dade County, 264 So. 2d 7, 12 (Fla. 1972); City of Miami v. , 208 So. 2d 249, 260 (Fla. 1968). Simply put, "[r]ates are fixed for the future rather than for the past . . . ." Gulf Power Company v. Bevis, 289 So. 2d 401, 404 (Fla. 1974). An example of how the Florida Supreme Court has applied this principle is instructive.

In City of Miami v. FPSC , supra, the court held that the Commission lacked statutory authority to issue retroactive ratemaking orders for Southern Bell and Florida Power and Light. In both utilities' rate proceedings, the Commission adopted a historic test year covering October 1, 1963 through September 30, 1964. Subsequently, the Commission ordered final rate reductions for both companies effective prospectively. The City argued that

the rate reductions should have been applied retroactively to the beginning of the test year, October 1, 1963, with appropriate customer refunds. The court found that such action would constitute unlawful retroactive ratemaking.

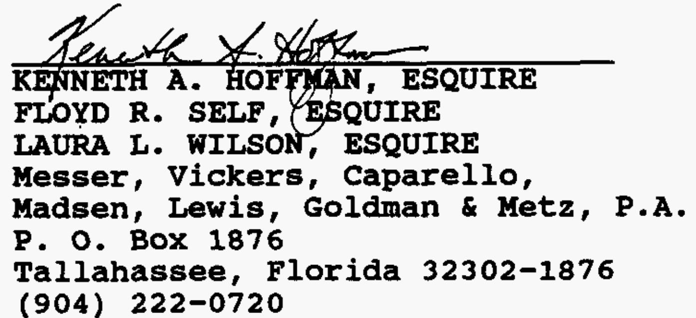
The contradictions in Public Counsel's positions are readily apparent. As she has in prior rate cases, Ms. Montanaro urges the Commission to continue using the pay-as-you-go method for ratemaking purposes. Under the pay-as-you-go method, all expenses represent OPEBs earned in prior periods. Hence, if the Commission were to accept OPC's "retroactive ratemaking" argument with respect to the APBO, it would have to determine that Ms. Montanaro's entire thesis in support of the continued use of the pay-as-you-go method violates the prohibition against retroactive ratemaking. Although the pay-as-you-go method is clearly deficient from an accounting and ratemaking standpoint, as previously discussed in this brief and determined by the Commission, there is no basis to conclude that its application would also violate the prohibition against retroactive ratemaking.

In this case as in previous cases before the Commission, the establishment of final rates based on OPEBs earned but not incurred in prior periods does not violate the prohibition against retroactive ratemaking. It is prospective ratemaking based on expenses that the Commission has determined to be sufficiently known and measurable for the ratemaking process.

III. CONCLUSION

For the foregoing reasons, Southern States request the Commission to enter a Final Order granting the rate relief requested in the Company's MFRs and supported by evidence.

Respectfully submitted,



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