

ORIGINAL
FILE COPY

GATLIN, WOODS & CARLSON
Attorneys at Law
a partnership including a professional association

The Mahan Station
1709-D Mahan Drive
Tallahassee, Florida 32308

B. KENNETH GATLIN, P.A.
THOMAS F. WOODS
JOHN D. CARLSON
WAYNE L. SCHIEFELBEIN

TELEPHONE (904) 877-7191
TELECOPIER (904) 877-9031

August 12, 1996

RECEIVED
AUG 12 1996

Blanca S. Bayo, Director
Division of Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

HAND DELIVERY DIVISION/REPORTING

ACK _____ Re: Docket No. 951056-WS
Application for rate increase in Flagler County by Palm Coast
AFA 3 _____ Utility Corporation.

APP _____ Dear Ms. Bayo:

CAF _____ Enclosed on behalf of Palm Coast Utility Corporation, for
CMU _____ filing in the above docket, are an original and 15 copies of our
CTR _____ Post-Hearing Statement of Issues and Positions and Brief, along
EAG _____ with our Certificate of Service.

LEG 1 _____ Also enclosed is a 3 1/2" high density diskette containing the
LIN 3 _____ Post-Hearing Statement of Issues and Positions and Brief. The
software used to prepare this document is WordPerfect 5.1.

OPC _____ Please acknowledge receipt of the foregoing by stamping the
RCR _____ enclosed extra copy of this letter and returning same to my
SEC 1 _____ attention. Thank you for your assistance.

WLS Willis

OTH _____

Sincerely,
Wayne L. Schiefelbein
Wayne L. Schiefelbein

RECEIVED & FILED
AUG 12 1996
FPSC BUREAU OF RECORDS

WLS/l dv
Enclosures

DOCUMENT NUMBER-DATE
08438 AUG 12 1996
FPSC BUREAU OF RECORDS

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

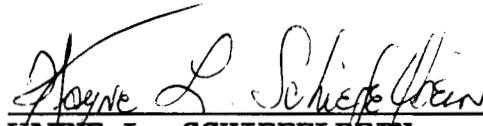
FILED

In re: Application for rate) Docket No. 951056-WS
increase in Flagler County by)
PALM COAST UTILITY CORPORATION) Filed: August 12, 1996

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that Palm Coast Utility Corporation's Post-Hearing Statement of Issues and Positions and Brief have been furnished by hand delivery to Mr. Scott Edmonds, Esquire, Division of Legal Services, Florida Public Service Commission, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, and by U.S. Mail to Mr. Richard D. Melson, Esquire, Hopping, Green, Sams & Smith, 123 South Calhoun Street, Tallahassee, Florida 32314; Mr. Stephen C. Reilly, Associate Public Counsel, Office of Public Counsel, Claude Pepper Building, Room 812, 111 West Madison Street, Tallahassee, Florida 32399-1400; and Mr. Albert J. Hadeed, County Attorney, 1200 East Moody Boulevard, #11, Bunnell, Florida 32110-9764, on this 12th day of August.

Respectfully submitted,



WAYNE L. SCHIEFELBEIN
Gatlin, Woods & Carlson
1709-D Mahan Drive
Tallahassee, Florida 32308
(904) 877-7191

Attorneys for
PALM COAST UTILITY CORPORATION

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

FILED
AUG 12 1996

In Re: Application for Rate)
Increase in Flagler County by)
PALM COAST UTILITY CORPORATION)

Docket No. 951056-WS

Filed: August 12, 1996

POST-HEARING STATEMENT
OF ISSUES AND POSITIONS
AND
BRIEF
OF
PALM COAST UTILITY CORPORATION

B. KENNETH GATLIN
WAYNE L. SCHIEFELBEIN
Gatlin, Woods & Carlson
1709-D Mahan Drive
Tallahassee, Florida 32308
(904) 877-7191

Attorneys for Palm Coast
Utility Corporation

DOCUMENT NUMBER-DATE

08438 AUG 12 96

FPSC-REGULATORY REPORTING

ISSUE 1: IS THE QUALITY OF SERVICE SATISFACTORY?

PCUC: ***The quality of service provided by Palm Coast Utility Corporation (PCUC) is exemplary.***

Compliance with all Florida Department of Environmental Protection (FDEP) regulations was established by the testimony of two FDEP officials. Water Treatment Plant No. one received the FDEP Water Treatment Operation Award in 1995, in recognition of the "effective operation and maintenance program and...commitment to maintaining and protecting the drinking water quality and treatment facilities." (T. 758) According to FDEP testimony, both water treatment plants and the wastewater system are properly permitted, and the overall maintenance of the water and wastewater treatment plants and the distribution, collection and disposal facilities is satisfactory. PCUC water meets all state and federal maximum contaminant levels for primary and secondary water quality standards. The utility monitors the organic contaminants required by FDEP and all chemical parameters are below detectable levels. Recent chemical analysis of raw and finished water suggest no need for additional treatment. The utility maintains the required chlorine residual or its equivalent throughout the distribution system. The wastewater facility meets all applicable technology-based and water-quality based effluent limitations. (T. 573-574A; 576; 756-758; Exh. 35)

Three customers testified in a complimentary manner regarding the utility's service. (T. 31; 38; 102) The few customer service concerns raised were addressed by Mr. Seidman. Contrary to Mr. Rosen's assertion, Mr. Seidman explained that customers could either mail their bill payments (95% currently do so) or drop off

payments at drop boxes located at the utility's local office and a local shopping center. PCUC will also accept payments at its local office, especially if they are related to service disconnections. (T. 896) Mr. David questioned whether PCUC hydrants actually work, since he had never seen them tested by the utility. Mr. Seidman testified that the utility engaged in regular hydrant testing and flushing, including the hydrant nearest Mr. David's residence, which had been tested 14 of the preceding 18 months. (T. 897) Ms. Soper testified about her dissatisfaction with the quality of the water. However, Mr. Seidman testified that all water quality tests conducted by the utility at the point of delivery to Ms. Soper's residence in response to her complaints (including a test performed on the day of her testimony) show full compliance with all water quality requirements. Further, none of Ms. Soper's neighbors have complained about the water. The utility has suggested that Ms. Soper contact a plumber to determine whether there may be a problem on the customer side of the meter. (T. 897-898)

The record overwhelmingly supports a determination that quality of service is exemplary.

ISSUE 2: SHOULD A YEAR-END OR 13-MONTH AVERAGE RATE BASE AND CAPITAL STRUCTURE BE RECOGNIZED FOR RATEMAKING PURPOSES?

PCUC: *Year-end.*****

Given the substantial new investment in utility plant during the test year, use of a year-end rate base would allow only the reasonable and actual cost of operations during the period when the new rates would be in effect, which will not be until the end of

1996 -- well beyond year-end 1995. Using an average test year would deny PCUC a return on about \$4.8 million out of \$7 million of 1995 additions for water and wastewater plant in service. Year-end rate base is also appropriate since the utility has annualized the revenues and incremental expenses to the year-end customers which this plant will serve. (T. 168; 229; 940; Exh. 7 (FS-1), p. 2)

While the difference between the thirteen-month and year-end rate base balances is small for the water system (Exh. 7 (FS-1), p. 1), Mr. Seidman testified that

it would be impractical to evaluate revenue requirements on a split test year basis. And it would be even more difficult to monitor the earnings of the utility or to reconcile schedules going into any future rate proceeding. The proposal for a split test year should be rejected. (T. 941)

There is no question that investment in wastewater rate base is substantially enlarged under year-end considerations. A year-end water rate base should also be accepted so that water and wastewater rates and rate base are reflective of the cost of service and are not mismatched.

ISSUE 3: WERE THE APPRAISALS FOR THE 1996 PURCHASE OF THE SPRAYFIELD SITE AND THE 1991 PURCHASE OF THE RAPID INFILTRATION BASIN (RIB) SITE PREPARED BY AN INDEPENDENT, QUALIFIED APPRAISER?

PCUC: *Yes.*****

It is uncontroverted that the two appraisals were prepared by a qualified appraiser. Mr. Spano has been an independent fee appraiser in the Greater Daytona Beach area since 1972, and his professional training and experience in this field are unassailable. (T. 798-801; Exh. 38 (CDS-1)) It is further

uncontroverted that in preparing the appraisal reports for the sprayfield and RIB site, Mr. Spano acted as an independent appraiser. As Mr. Spano testified, "(b)oth appraisals were conventional assignments requiring me as the appraiser to act in an independent manner, consistent with standard appraisal practice and in compliance with stated and subscribed to conditions of non-bias." (T. 801)

ISSUE 4: WHEN WAS THE SPRAYFIELD SITE FIRST DEDICATED TO UTILITY SERVICE, AND BY WHOM?

PCUC: *1979, by PCUC.*****

Analysis of this issue is included under Issue 5.

ISSUE 5: WHEN WAS THE RIB SITE FIRST DEDICATED TO UTILITY SERVICE, AND BY WHOM?

PCUC: *1991, by PCUC.*****

In PCUC's last rate case, the PSC examined transactions and valuations related to eighty-six (86) separate land parcels purchased by PCUC from an affiliated company, ITT Community Development Corporation (ITTCDC). The PSC found without exception, that "it was PCUC, not I[TT]CDC that actually devoted the land to public service." Order No. 22843, at p. 36. The circumstances attending PCUC's purchase of the sprayfield and RIB sites from ITTCDC are no different than for those 86 other parcels. (T. 949; Exh. 41 (FS-12), at p. 13) PCUC purchased the RIB site from ITTCDC in July, 1991 and devoted it to utility service later that year. At the time of this purchase, the land had been put to no use; it was idle and available for agriculture or development. (T. 945-946) PCUC purchased the sprayfield site from ITTCDC in 1985, but

recorded the cost at the appraised value as of 1979, the year in which PCUC first devoted the land to utility service. (T. 952)

The Uniform System of Accounts (USOA) requires that utility plant be booked at "original cost," that is, "the cost of such property to the person first devoting it to public service." (Exh. 30 (RFD-1), p. 6) Staff auditor Dodrill found that in 1968, Lehigh Portland Concrete Company sold 12,777 acres of land to "an ITT corporation Ray-Florida Company," which vast acreage included the RIB and sprayfield sites. (Exh. 30 (RFD-1), p. 12) Since "person" is generally defined by the USOA as including "any organized group of persons," Mr. Dodrill somehow concluded that "the ITT Group of Corporations" is the "person" who first devoted the two sites to utility service. (Exh. 30 (RFD-1), pp. 6-7) There is no legal entity called "the ITT Group of Corporations." (T. 946) As Mr. Seidman testified,

The amount to be recorded is the cost to the first person to "devote" the land to utility service, not just the cost to the first owner. According to Webster's dictionary, to devote is to dedicate, and to dedicate is to "set apart to a definite use." In order for ITTCDC to have set this land apart for definite use for utility service it would have had to be able to identify the parcel and know for what purpose it was going to be used. ITTCDC purchased the land circa 1968 along with thousands of other acres of land in Flagler County. It could not have known, when it purchased the land, that this specific parcel would be needed or used for utility purposes. Unless it were the party responsible for the design of the utility system, which it was not, it could not be aware of when, where, or for what purpose the utility would require land. Certainly it cannot be logically concluded that all land owned by ITTCDC, wherever located, is automatically devoted to utility service merely because there exists a related company that is a public utility. ITTCDC is not the party that placed this land in utility service, and the cost to ITTCDC is not a proper basis for the original cost of

land devoted to utility service. The only person responsible for the design of the utility system is PCUC and therefore only PCUC can be and is identified as the party devoting this land to utility service. The proper cost to be stated, in accordance with the NARUC uniform system of accounts is the original cost to PCUC. (emphasis added) (T. 947-948; Exh. 41 (FS-12) at pp. 4-5)

ISSUE 6: HOW SHOULD THE SPRAYFIELD AND RIB SITES BE VALUED?

PCUC: *At fair market value as of the date they were first dedicated to utility service.*****

The PSC has explicitly addressed the valuation of land acquired by PCUC from its affiliates in two rate cases. In 1983, the PSC reviewed land purchased by PCUC from ICDC for the utility's office building, water treatment plant, an elevated storage tank, and a sewage lift station. The purchase prices paid were supported by a market value study prepared by a professional real estate appraiser based on comparable sales of commercial property in communities near Palm Coast. While accepting the appraisals as a starting point, the PSC noted the appraised valuations were made as of 1981, while the various parcels were dedicated to utility service prior to 1981. The PSC therefore adjusted the appraised value to reflect the original cost for the year of actual dedication to service, using the GNP Implicit Price Deflator. Order No. 12174, at p. 5; Order No. 12957, at pp. 5-6.

In PCUC's last rate case, the PSC evaluated 86 utility sites purchased by PCUC from ITTCDC. Each of the appraisals for these sites was found to have been prepared by a qualified, independent appraiser, with the value of the subject parcels based upon their date of dedication to utility service by PCUC. Each appraisal excluded any improvements added after the property was first placed

in utility service. The PSC found that a review of its prior orders indicated a preference to use independent appraisals when those reports provide reasonable land values, and, ultimately, accepted the appraised values of each of the 86 parcels of property. (Order No. 22843, at pp. 31-36)

The appraisals of the sprayfield and RIB sites are consistent with the foregoing PSC decisions. Both appraisals were prepared by a qualified independent appraiser, exclude consideration of improvements, and reflect valuation as of the year the sites were first dedicated to utility service. The appraised valuations were no higher than what would have been paid in a normal arms-length transaction. (T. 809-810; 815)

Mr. Dodrill conceded that he had no "direct evidence" that PCUC paid more than an arm's length price for the sprayfield and RIB sites. (T. 692) His rejection of the two appraisals is irreconcilable with the Florida Supreme Court's holding in GTE Florida Incorporated v. Deason, 642 So 2d 545 (1994), at pp. 547-548. In that case, the Court found that the PSC had abused its discretion in disallowing certain costs arising from transactions between the utility and its affiliates, where the evidence indicated that utility costs were no greater than they would have been had the utility purchased services and supplies elsewhere:

The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated, without more.... We believe the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair.

This principle equally applies to purchases of land by a utility

from an affiliate.

ISSUE 7: SHOULD AN ADJUSTMENT BE MADE TO THE COST OF THE RAPID INFILTRATION BASIN LAND AND BUFFER SITES PURCHASED BY THE COMPANY FROM ITS AFFILIATE?

PCUC: ***No. The cost recorded is the original cost, as determined by an independent certified appraiser, to the person first dedicating the land to utility service.***

Analysis of this issue is included under Issue 8.

ISSUE 8: SHOULD AN ADJUSTMENT BE MADE TO THE COST OF THE SPRAYFIELD LAND SITE PURCHASED BY THE COMPANY FROM ITS AFFILIATES?

PCUC: ***No. The cost recorded is the original cost, as determined by an independent certified appraiser, to the person first dedicating the land to utility service.***

The appraisals of the sprayfield and RIB site are consistent with generally accepted principles of land appraisal.

The methodology employed in both appraisals is "a straightforward comparable sales analysis in which a variety of sales of property with varying degrees of comparability are compared to the subject property and adjusted for differences where necessary to arrive at an indicated value...." (T. 806; 810)

All of the sales used in the two appraisals were between non-related parties and complied with the features of a normal, arms-length transaction. All of the comparable sales used in the two appraisals were suitable for residential development. In fact, all of the comparable sales used in the sprayfield site appraisal have been so developed since their dates of sale. (T. 808-809; 812; 814) Both appraisals reflected the concept that the value estimated should reflect the highest and best use, which was residential development. This theory of valuation

follows the reasonable person theory that an investor in

real estate, under normal circumstances, attempts to maximize its return from an investment and would thus develop, sell or buy a parcel for the form of development or use which would maximize the return to the land. Vacant parcels and the underlying land of improved parcels are virtually always valued on their highest and best use as if vacant. Estimating value based on highest and best use provides a common measure of utility and comparability. (T. 803-804; 810)

The appraisals were not based on a special utility use. Mr.

Spano explained that

(r)estricting a parcel to a very narrow range of uses could have the effect of artificially depressing values (at which an informed seller would most probably not sell.) Alternatively, if specialized site characteristics, location, proximity to other facilities, etc. dictate that a specific site is especially needed for a certain project, there is the possibility that the value could be inflated to an unrealistic level as the seller knows that the buyer must have that specific site and could thus attempt to obtain more than market value. This is one of the primary reasons for condemnation powers and standards which virtually always require that the land to be acquired be appraised on the basis of its highest and best use, using comparable sales of property with similar attributes and utility. (T. 804-805; 810)

Staff asked Ms. Dismukes and Mr. Seidman whether, from a ratemaking perspective, it is appropriate to value land transactions between related parties at their highest and best use. Ms. Dismukes merely said no, without explanation. (T. 569) However, Mr. Seidman explained that for a transaction between related parties, the cost should reflect the value to a nonaffiliate purchaser, and that is its value at its highest and best use. (T. 1046)

It was reasonable for the appraisals to use comparable sales outside of the immediate neighborhood of the subject property. As Mr. Spano testified,

Around the time of the 1990 appraisal, there were virtually no arms-length sales of potential residential development parcels such as the subject parcel and thus any search for comparable sales had, by necessity, to be expanded outside of the immediate Palm Coast core area. This is typical in appraisal data research. An appraiser normally starts with the subject property and expands his search radius until sufficient data is found, sometimes (in the case of Palm Coast) requiring incursion into neighboring counties for certain types of property such as industrial parks, mini-warehouses, and the like. (T. 813-814)

It should be noted that in the last five to ten years, there have been numerous parcels sold within a one to three-mile radius of the sprayfield and RIB site at \$30,000 to \$150,000 per acre. Mr. Spano nevertheless did not use those transactions in his appraisals, as they were not comparable sales. (T. 891-892)

The two sales "disqualified" under DOR rules are nonetheless valid comparable sales for valuing the RIB site.

As the Flagler County Appraiser, Mr. Sapp disqualified a County school site and a County jail site which were used as comparable sales by Mr. Spano in his appraisal of the RIB site. Mr. Sapp disqualified the two sales under a Department of Revenue rule that sets out specific recordkeeping and data collection requirements for purposes of ad valorem tax assessments. The rule authorizes a county property appraiser to consider for disqualification from those requirements certain types of transactions, including deeds to Counties. That Mr. Sapp disqualified those two sales for ad valorem tax assessment purposes is irrelevant to this proceeding. As Mr. Spano testified,

Sales to a governmental authority MAY IN FACT BE UTILIZED as comparable properties as long as they have been properly researched....If it is determined that the sale is an arms-length transaction, then the sale may be used

as a qualified sale for ad valorem tax calculation purposes....The simple fact that the two sales referenced in our 1990 appraisal report were sales to governmental authorities does not automatically disqualify them as useful comparable sales. It may well be that the Flagler County Property Appraiser's office does not have the manpower nor the resources to investigate such sales; however, they may still be very valid comparable sales and should be investigated further, as we have done in this particular instance. (T. 828-829)

The historical trended cost proposed by Mr. Dodrill is fundamentally flawed in the valuation of land and produces an arbitrary value.

Mr. Dodrill "trended" the per acre price of a 1968 bulk sale to a 1996 sale to re-value the sprayfield in 1979 and the RIB site in 1990. In doing so he used inaccurate acreage data, and ignored the enormous acreage differential among the parcels and the extent to which they contained unusable or environmentally sensitive land that would affect the costs of the developable areas. (T. 691; 736-737; 819-820; 822) His calculation also ignored economic conditions, available infrastructure, and a myriad of other local market considerations affecting market value at any given point in time. (T. 816-820) As Messrs. Spano and Sapp agreed, the 1996 sale is not appropriately used to revisit the 1990 value of the RIB site, since proper appraisal methodology is to use comparable sales data available during the time the appraisal is conducted. (T. 737-738; 821)

Mr. Sapp's own "comparable sales" were not comparable to the RIB site.

At hearing, Mr. Sapp unveiled his own selected "comparable sales" for the RIB site. Per acre sales prices for seven parcels in Flagler County between January, 1988 and August, 1990 were

calculated from the parcels' reported sales prices. These parcels, which range in size from 15 to 1005 acres, were sold for substantially less than the 80 acre RIB site. (Exh. 34)

Mr. Spano personally confirmed Mr. Sapp's seven sales. One parcel was sold as a dump and fill site. Most had agricultural use as their highest and best use. Another parcel was sold by estate heirs seeking to divest themselves of their interests in the property. Still another parcel was a distress sale to avoid bank foreclosure. (Exh. 39) These sales are clearly not properly considered comparable to the RIB site.

The appraised value of the sprayfield site has been included by the PSC in rate base in PCUC's last two rate cases.

As Mr. Seidman testified,

(t)he cost of the sprayfield land was accepted by the Commission at its appraised value without modification in PCUC's rate base in Docket Nos. 870166-WS and 890277-WS. The wastewater rate base schedule on page 27 of Order No. 18625 and on page 75 of Order No. 22843 reflects the recorded cost of the sprayfield land. ...Mr. Dodrill's unqualified analysis of the sprayfield costs is not a reasonable basis for reversing a transaction based on an independent appraisal which has been accepted by the Commission in the utility's last two rate cases. (T. 952-953; Exh. 41 (FS-11))

Messrs. Dodrill and Sapp and Ms. Dismukes were not qualified to render their opinions, and failed to establish the facts or data underlying those opinions.

Messrs. Dodrill and Sapp and Ms. Dismukes should be considered as lay witnesses providing opinion testimony in a field requiring special knowledge, skill, experience, training or education which they lack. Their opinions on land appraisal issues in this case are therefore irrelevant and should not be relied on by the PSC. (T. 536; 648-650) Further, while Mr. Sapp is qualified in the

field of land valuation for ad valorem tax assessment purposes, he has never performed an independent appraisal of real estate for purposes of determining value for purchase. (T. 713-714) In addition, Messrs. Dodrill and Sapp had an insufficient basis for their opinions, given their failure to review underlying appraisals of the land they purported to revalue. (T. 689-693; 725-728; 749; 751) Having failed to establish the facts or data underlying their opinions, these witnesses' opinions and references should be deemed inadmissible. In any event, their testimony should not be relied on for any findings on land valuation in this proceeding. Ms. Dismukes made no claim to having done any independent analysis of these issues; she merely adopted Mr. Dodrill's proposed adjustments. (T. 537-538) It would be highly improper to allow her testimony to serve as a conduit for otherwise inadmissible evidence.

ISSUE 9: SHOULD PLANT IN SERVICE BE REDUCED FOR THE MISCLASSIFICATION OF MAJOR REHABILITATION PROJECTS? (AUDIT EXCEPTION NO. 3)

PCUC: *No. The projects are properly classified.*****

Mr. Dodrill testified that PCUC misclassified certain repair or rehabilitation costs. He asserted that PCUC improperly capitalized \$548,416 in water and \$504,537 in sewer plant rehabilitation projects. Mr. Dodrill based this audit exception on his belief that the costs were recurring expenses. Mr. Seidman disputed this assertion, explaining that the projects in question were "not routine, ongoing, recurring events."

Each line rehabilitation and replacement project was a unique circumstance that required a response to a failure.

which affected service continuity. Each rehabilitation resulted in replacement and retirement of line segments. The costs incurred, as well as the costs of the retired property, were properly accounted for as a retirement in accordance with the uniform system of accounts. If, as Mr. Dodrill suggests, the cost of the replacement plant is expensed and the plant balances are additionally reduced by the cost of the retired units, there will be no cost on the books for these line segments. With regard to the cited projects for structural interior and exterior elevated water tanks and water plant softening basins, these are nonrecurring major rehabilitation projects that add to the life of the equipment and are properly capitalized. With regard to the cited well programs, each is specifically a capital project. The first project, costing approximately \$49,000 is for activation of a new well. The second project, costing about \$51,000 is for four new back-up diesel generators. The third project, costing approximately \$115,000 is for redrilling two wells.... The costs the company capitalized were for new wells, redrilled wells and generators. The expenses included in the test year for the ongoing, recurring, well rehabilitation program, are to restore the productivity of existing well by inspecting them, acidizing them and redeveloping the existing well areas to restore porosity. There is no conflict between the well projects that are capitalized and those that are expensed. (T. 955-957) (emphasis added)

While Mr. Dodrill believed that the costs are recurring expenses that are properly amortized, he proposed no amortization period, since he is "not an engineer." (T. 678) In fact, if the projects are deemed recurring as Mr. Dodrill suggests, estimated test year water expenses would have to be increased by \$54,000 to amortize the well projects over four years, and wastewater test year expenses would have to be increased by about \$100,000 to recognize the average level of annual sewer line replacement projects. (T. 956)

ISSUE 11: SHOULD A MARGIN RESERVE BE INCLUDED IN THE CALCULATIONS OF USED AND USEFUL?

PCUC: *Yes, as per PSC policy.*****

PCUC is required to provide "safe, efficient and sufficient service.... not... less safe, less efficient, or less sufficient than is consistent with the approved engineering design of the system and the reasonable and proper operation of the utility in the public interest." Sec. 367.111(2), Fla. Stat. This obligation to serve applies to both existing and future customers located within the utility's certificated service area. Sec. 367.111(1), Fla. Stat. Recognition of this readiness to serve is achieved by including margin reserve allowances within used and useful calculations. Margin reserve represents the investment in plant needed to meet the demands of potential customers and the changing demands of existing customers within a reasonable period of time. (T. 240)

In effect, Mr. Bidy testified that PCUC's cost of providing service for ratemaking purposes should be limited to a mechanical ratio of existing test year demands to the capacity of various system components. Mr. Bidy advocates shifting margin reserve costs to future customers only. He ignores the fact that margin reserve costs must be incurred to serve both existing and new customers. Existing customers will be present in the future when new customers are added, and both must receive adequate service. Service must be provided to all customers on a continuous basis, to meet growth and changes in demand characteristics of all customers. (T. 1062-1063; Exh. 17 (JFG-1), pp. 10-12) The investment necessary to fulfill that responsibility is appropriately recognized by margin reserve.

ISSUE 12: IF MARGIN RESERVE IS INCLUDED IN THE CALCULATION OF USED AND USEFUL, WHAT IS THE APPROPRIATE MARGIN RESERVE PERIOD?

PCUC: *As per Used and Useful Analysis.*****

With respect to the water system, PCUC used a margin reserve period of three years for the water treatment plants and 1.5 years for the wells and mains. With respect to the sewer system, PCUC used five years for the wastewater treatment plant facilities and 1.5 years for mains. PCUC's margin reserve calculations are based on a regression analysis of historical growth. (Exh. 15 (JFG-1), pp. 10-11, 16, 26, 37) These periods reflect the actual time experienced by PCUC for design, permitting and construction of the respective utility facilities.

For the membrane softening plant, Staff engineer Amaya used an 18-month period for margin reserve, for the reason that the expansion of the plant to accommodate additional membrane skids would not require more than 18 months. It should be noted that PCUC's used and useful calculations do not include the cost of expanding the plant; they are based on the cost of the existing plant, which in fact required nearly five years from design to completion. It is also conceptually improper to base the period for margin reserve for the existing plant on the period for future incremental expansions to that plant. A three-year period for water treatment plant is a reasonable average allowance to design, permit and construct such plants (with shorter periods for expansion) and to allow for regulatory lag. (T. 1064-1065)

Ms. Amaya also reduced the period for margin reserve with

respect to water and wastewater mains from 18 months to 12 months, simply stating that the shorter period is sufficient. She offered no explanation for her departure from the 18 months used by the PSC for mains in PCUC's previous rate cases. See Order No. 22843, pp. 9-10 and Order No. 18625, p. 7. It is important to recognize that the margin reserve portion of used and useful calculations is part of a rate setting/cost recovery process, and should not be viewed only in terms of permitting, design and construction. Margin reserve should always be based on a period of at least 18 months, even if Ms. Amaya believes the design, permitting and construction process takes only 12 months, given the regulatory lag with respect to cost recovery between the time a utility files for and receives rate relief. In this case, PCUC is using a year-end 1995 test year, and the regulatory lag between the end of the test year and the full year that the new rates will be in effect will exceed 12 months. (T. 1065-1066)

With respect to wastewater treatment plant and effluent disposal (excluding the effluent storage tank), Ms. Amaya used a three-year margin reserve instead of the proposed five-year margin reserve. The five-year margin reserve is appropriate in light of PCUC's actual experience with respect to design, permitting and construction of wastewater treatment and disposal facilities (T. 381; 1065-1066)

In selecting appropriate margin reserve periods, it should also be noted that the demands used in PCUC's used and useful calculations are based on demands for 1995 prior to the allowance

of margin reserve. In fact with respect to the water system, the maximum day demand was actually a 1994 demand, conservatively deemed as being applicable to the mid-point of 1995. Accordingly, before including an allowance for margin reserve, the maximum day demand for "average" 1995 should be adjusted for growth to bring that demand to a year-end 1995 demand. Thus, the margin reserve period with respect to the water treatment plant is three years for margin reserve and half a year for growth between mid-1995 and year-end 1995. The same is true with respect to the other margin reserve allowances. In other words, half a year should be added to recognize that PCUC's rate filing is based on a year-end test year, and that the demands represent mid-point 1995 demands. (T. 1066-1067)

ISSUE 13: IF A MARGIN RESERVE IS APPROVED, SHOULD CIAC BE IMPUTED ON THE ERCs INCLUDED IN THE MARGIN RESERVE?

PCUC: *No.*****

The PSC has recognized that margin reserve is essential in order for utilities to construct economically-sized facilities to meet the demands of existing and new customers. Allowing the necessary margin reserve but then reducing or eliminating it by the imputation of CIAC creates a disincentive for utilities to build economically-sized facilities. By imputing CIAC, the rates for all customers will eventually be higher because water and sewer utilities, basing their economic decisions on the PSC's rate allowances, will construct facilities which are not economically sized. (T. 242; 1071)

CIAC is not "related" to margin reserve because the costs

allowed for "margin reserve" are costs PCUC must incur to serve existing and new customers, whether or not growth expectations are realized. If growth is realized, then allowances for future growth must continue in order to serve existing and new customers in the future. (Exh. 15 (JFG-1), pp. 11-12)

Mr. Guastella refuted the assertion that imputation of CIAC is necessary to achieve a proper matching with the margin reserve. The margin reserve is based on the plant which is used and useful for year-end 1995. It is obvious that CIAC will not be received until after 1995 for the ERCs represented by margin reserve. Moreover, as new customers are added, there is then a need for yet additional margin reserve. Accordingly, the need for margin reserve in order to meet the demands of existing as well as new customers now and in the near-term future is always current, and the ERCs represented by growth or new customers is always in the future. (T. 1069-1070)

Mr. Guastella also disputed Mr. Bidy's arguments regarding AFPI:

An AFPI charge is not and should not be a mechanism to shift to future customers costs which are appropriately recovered through general rates for service. The new customers who pay a proper level of AFPI charges will also pay a proportionate level of the costs related to margin reserve when they pay general rates for service. There is no need to improperly shift costs to future customers simply to hold rates artificially low. In addition, the level of collection of AFPI charges is uncertain and spread over future periods. Accordingly, shifting costs to AFPI for margin reserve would deny PCUC its unavoidable and reasonable current cost of providing service. (T. 1063-1064)

With respect to the margin reserve and the issue of imputation

of CIAC, it makes no difference if one source of funding of utility plant is from "pre-paid" CIAC. Arrangements between a developer and potential utility customers to prepay service availability charges should not impact used and useful calculations. While CIAC is deducted from rate base in full when a potential customer actually connects to the system, it should not be deducted before there is a connected customer who is paying rates for service. The level of prepaid CIAC related to future customers is not related to margin reserve. Instead, it is simply a provision which enables the developer to offset part of the carrying costs associated with the formation of a new utility. Indeed, the PSC has recognized that carrying costs associated with the cost of utility plant for future customers (beyond the "margin reserve" plant) should be borne by future customers. Thus, the PSC established an AFPI charge to recover the carrying costs of future use ("non-used and useful") plant. While prepaid CIAC should properly be considered as an offset in calculating AFPI charges, it is not proper to use prepaid CIAC as an offset to margin reserve or any other component in a used and useful calculation. (T. 241-242; 1070-1071)

ISSUE 14: WHAT IS AN ACCEPTABLE LEVEL OF UNACCOUNTED FOR WATER?

PCUC: *Without further explanation, 12.5% is an acceptable level of unaccounted for water.*****

It is inappropriate for the PSC to "arbitrarily limit the amount of unaccounted for water to a specific percentage without looking at the specific circumstances." The PSC "should continue its policy of allowing a specific percentage without explanation, and then requiring the utility to justify amounts greater than

that." (T. 942) See Order No. 22843, at pp. 7-9 and Order No. 18625, at p. 14 (both sustaining a 13.5% allowance for PCUC).

ISSUE 15: DOES PCUC HAVE EXCESSIVE UNACCOUNTED FOR WATER AND, IF SO, WHAT ADJUSTMENTS ARE APPROPRIATE?

PCUC: *No. No adjustments are appropriate.*****

Unaccounted for water for the PCUC water system has steadily decreased since 1988. The MFRs, based on 6 months actual and 6 months projected data, show 4.68% unaccounted for water. Using 12 months of actual data, unaccounted for water totals 5.23% of water pumped. (Exh. 7 (FS-1), p. 118; Exh. 42 (FS-14)) Obviously, there is no excessive unaccounted for water.

ISSUE 16: IS THERE EXCESS FLUSHING AT PCUC'S WATER SYSTEM, AND IF SO, WHAT ADJUSTMENTS ARE APPROPRIATE?

PCUC: *No. No adjustments are appropriate.*****

PCUC's level of flushing is the amount necessary to provide safe water in conformance with state and federal water quality standards to all of its customers, wherever they are located. In addition, the amount of flushing, as a percent of water pumped, is the lowest it has been since 1989. (T. 253; 757-758; 977)

Mr. Bidy asserted that flushing water used by PCUC for water quality compliance is "extraordinarily high" and that a well designed system should use "no more than 5% water use for flushing." (T. 515) He gave no substantiation or source for his cap on flushing. The PSC should reject Mr. Bidy's arbitrary cap on flushing. It was obviously offered as another excuse to reduce rates, without consideration of the need to provide safe service to the customers and of the fact that the existing distribution system

(with the current level of flushing) is the least cost alternative. As Mr. Seidman testified, "it would be irresponsible for any utility to limit its flushing to a set amount when the circumstances warrant otherwise." (T. 979)

There is in fact no "normal rate" for line flushing. (T. 252; 482; 979) The level of flushing is significantly affected by such factors as customer density, quantity and frequency of customer use, and the age of the system. (T. 252; 979) Another contributing factor to PCUC's volume of flushing is that PCUC uses chloramine rather than chlorine to treat the water. This increases the amount of flushing necessary to maintain chlorine residuals. While residual levels are more difficult to maintain when chloramine is used as a disinfectant, treatment with chloramine is necessary to control the level of trihalomethanes pursuant to water quality standards. (T. 978-979)

PCUC's distribution system is extensive. A significant portion of that system was installed in the 1970s, at substantially lower costs than what would have been required had the system been installed gradually over time. Given the relatively small costs associated with power and chemicals related to flushing, current and future ratepayers have been receiving and continue to receive the benefits of the lower historical construction costs. (T. 252-256; T. 273-279) Accordingly, it is improper to reduce PCUC's rates because its larger distribution system requires more flushing. The rates reflect only a portion (used and useful) of the distribution system which costs less than if a smaller system

had been gradually installed. While a smaller system, installed in phases, may require less flushing, its construction cost would be higher and, as a result, rates would be higher.

PCUC's initiation of service in 1988 to the "beachside" portion of its certificated territory, east of the Intracoastal, triggered substantial increases in line flushing to maintain water quality. Between 1988 and 1995, approximately 25 miles of new lines were added, a substantial portion of which was required to provide service to the beachside and other areas. The distance to the beachside area and the sparsity of its development required increased flushing. Excluding the beachside area, flushing as a percent of total water pumped drops to about 12%. (T. 978; Exh. 42 (FS-14))

Given customer density and the size of the distribution system, flushing will always be required. As Mr. Seidman noted, PCUC "does not dictate where its customers live, but regardless of where they live, they are entitled to good quality water." (T. 979)

PCUC has taken prudent steps to minimize flushing requirements. Within the primary area of Palm Coast development it has looped the two water plants and it has looped the north and south zones. And it will also loop the beachside area. (T. 1012) As customer growth and density increases, the percentage should steadily decrease. (T. 278; 978; Exh. 42 (FS-14))

ISSUE 17: WHAT IS AN ACCEPTABLE LEVEL OF INFILTRATION AND INFLOW?

PCUC: ***For an existing system, an acceptable level of infiltration is 500 gpd/inch dia./mile of gravity mains

and service laterals. If the total unbilled flows do not exceed this amount, then inflow need not be separately addressed. A reasonable allowance for inflow is 10% of treated flows.***

Mr. Bidy proposed using the "Ten State Standard" of 200 gallons per inch of pipe diameter per mile per day in evaluating infiltration at the PCUC wastewater system. Mr. Bidy touted the guideline since its criteria are "generally used by... FDEP staff." (T. 522) Indeed, FDEP staff does recognize that as one guideline - as a design standard for newly constructed lines, also recognizing however that higher levels will be experienced over time. (T. 579, 580, 587) A careful reading of its text clearly confirms that it applies only to testing newly installed pipe. (Exh. 47; T. 610)

For existing systems, the PSC has traditionally used an infiltration allowance of 500 gallons per day per inch diameter per mile of mains and services. (T. 598, 612, 1019-1020) This is drawn from the Water Pollution Control Federation Manual of Practice No. 9.

Staff witness Amaya advocated using the EPA allowance of 40 gallons per capita per day for total infiltration and inflow. The EPA guideline is the only criteria in the record which includes an allowance for inflow. The EPA guideline provides an upper cap of allowable inflow and infiltration for existing systems. (T. 598; 609-610; 629) PCUC does not oppose use of that EPA criterion.

ISSUE 18: DOES PCUC HAVE EXCESSIVE INFILTRATION AND/OR INFLOW AND, IF SO, WHAT ADJUSTMENTS ARE NECESSARY?

PCUC: *No. No adjustments are appropriate.*****

The level of infiltration and inflow for PCUC's wastewater

system is about half of that allowed under the EPA guideline. (T. 610-612) All witnesses addressing the issue other than Mr. Biddy believed the level is reasonable. (T. 578; 599; 628)

Mr. Biddy's analysis, even as "corrected" at hearing, included fundamental flaws. He made no allowance for inflow. He used water sold to residential customers instead of total water sold, resulting in a 312,000 GPD understatement of water sold to wastewater customers and a resulting overstatement of infiltration and inflow. Further, in determining an allowance for infiltration based on footage of pipe, Mr. Biddy did not consider the footage for service laterals, another probable source of infiltration. This resulted in an understatement of the infiltration allowance of 50,504 GPD. (T. 779-780; 783-784; 981-983; Exh. 36 & 37)

PCUC's existing gravity system is close to 20 years old. In spite of the age of the system, the infiltration and inflow is almost equal to Mr. Biddy's own standards for new pipe. (T. 983)

ISSUE 19: SHOULD 20% OF FACILITY COST BE AUTOMATICALLY CONSIDERED 100% USED AND USEFUL BECAUSE OF ECONOMIES OF SCALE CONSIDERATIONS?

PCUC: *Yes. The economic benefits of economies of scale should be recognized and an acceptable method is to limit 80% of plant costs to be subject to a used and useful adjustment.*****

Construction of economically sized plants has long-term as well as short-term benefits in terms of ultimately providing a lower cost facility to serve customers in the future. (T. 612) Incentives are needed to encourage utilities to prudently construct increments of capacity expansion, as PCUC has done, instead of imprudently undersizing capacity increments to avoid exposure to

used and useful adjustments. Margin reserve allowances recognize design, permitting and construction time and regulatory lag, but not economies of scale, since margin reserve allowances are determined regardless of the size of the facilities.

PCUC proposed as one of two "prudency" allowances to limit at 80% the plant costs subject to used and useful adjustments, with 20% of the costs included in rate base regardless of the relationship of demand to capacity. (Exh. 15 (JFG-1), p. 3) This would provide ratemaking recognition of the benefits of economies of scale that both existing and future customers receive from prudently sized plant. This proposal would also put PCUC's water and wastewater systems on a more equal footing with other types of PSC-regulated utilities which are encouraged to construct economically sized systems with ample extra capacity for which no used and useful calculations are made. (T. 1069)

ISSUE 20: IS IT APPROPRIATE TO INCLUDE A FIRE FLOW ALLOWANCE IN THE CALCULATION OF THE USED AND USEFUL PERCENTAGE FOR THE WATER TRANSMISSION AND DISTRIBUTION SYSTEM, SUPPLY WELLS, AND WATER TREATMENT PLANTS?

PCUC: *Yes, as per Used and Useful Analysis.*****

In PCUC's last rate case, the PSC allowed an estimated fire demand of 2,000 GPM for a five-hour duration in its used and useful calculations for source of supply and water treatment plant. Order No. 22843, at pp. 10-11. The PSC did not use the fire demand of 6,000 GPM as peak flow for about two days actually experienced by PCUC during the 1985 forest fires. In fact, under guidelines of the National Board of Fire Underwriters (Insurance Service Office), PCUC would be required to meet a fire flow of 4,500 GPM for a ten

hour duration. (T. 1072-1073) Nonetheless, PCUC used the fire demand allowed in its last rate case in determining used and useful source of supply and treatment plant, although as the system continues to serve an increasing number of customers, a greater fire demand will be necessary. (Exh. 15 (JFG-1), p. 5) Fire flow is also included in the used and useful calculation for mains, since mains must be capable of meeting fire demand on the maximum day. In order to avoid duplication, the proposed allowance, based on the ratio of fire demand to the maximum day plus fire demand, is only applied to the portion of mains not included as used and useful in PCUC's proposed density allowance. (Exh. 15 (JFG-1), pp. 8-9)

During occurrence of actual fires, all of the utility's sources of supply and treatment facilities, as well as storage tanks, can be utilized to provide water for fire fighting. All such facilities would also be utilized to replenish the water from storage facilities during those fires. The supply wells are connected to treatment and storage facilities, rather than directly to the distribution system. Because of the configuration of the water system, fire demands which may occur throughout the service area require the utilization of all components of the system. (T. 613-614; 629-630; 1073; Order No. 22843, at p. 11) These realities have been specifically recognized by the PSC in previous PCUC rate cases. Mr. Guastella also testified that the AWWA Water Rates manual also recognizes the allocation of all such facilities in the design of fire service rates. Mr. Biddy's recommendation to

disallow fire demand for all but storage facilities, strictly relying on certain limited design criteria, ignores those realities as well as established rate setting methodology.

ISSUE 21: IS THE UTILITY'S METHOD OF CALCULATING THE MAXIMUM DAY FLOW APPROPRIATE FOR CALCULATING USED AND USEFUL PERCENTAGES FOR WATER FACILITIES?

PCUC: *Yes. The maximum day utilized by PCUC contains no unusual usage.*****

The PSC has consistently used maximum day demand in prior PCUC rate cases. The maximum day demand used by PCUC in the pending case contains no unusual usage of water. Mr. Guastella analyzed the ten maximum daily flows and any unusual occurrences during those days. He selected the third highest maximum day, since the highest and second highest maximum day flows did include unusual usage. (T. 1073-1074)

ISSUE 22: SHOULD THE COMMISSION USE OPERATING PERMIT CAPACITIES INSTEAD OF CONSTRUCTION PERMIT CAPACITIES FOR THE USED AND USEFUL CALCULATIONS?

PCUC: *In this case, it is generally appropriate to use operating permit capacities. However, in this case, using the design capacity of the wastewater treatment plant produces a used and useful percentage which more appropriately reflects costs for rate setting purposes.*****

ISSUE 23: WHAT IS THE APPROPRIATE ALLOWANCE FOR EQUALIZATION AND EMERGENCY STORAGE IN THE USED AND USEFUL CALCULATION?

PCUC: *50% of maximum day flows.*****

PCUC used an allowance of 50% of the maximum day demand to provide for equalization (peak flows within the day), and reserves for emergencies (such as main breaks and unanticipated plant shutdowns). Storage facilities must also be capable of delivering water for fires (2,000 GPM for 5 hours) at any point throughout the

distribution system, as well as meeting coincidental fire demands. Accordingly, a separate allowance for fire demands should be made for each of the major storage facilities. (Exh. 15 (JFG-1); T. 1078-1079)

Ms. Amaya recommended equalization and emergency storage at 75% of the maximum day demand plus fire flow. (T. 603-604)

Mr. Biddy's recommendation to use 50% of the average daily flow fails to recognize the demands PCUC must meet under various conditions. Mr. Biddy originally allowed nothing for retention, but later changed his testimony to allow only 6%, less than actual, without providing any supporting calculation or analysis. (T. 518)

ISSUE 24: SHOULD 10% OF THE FINISHED WATER STORAGE BE TREATED AS RETENTION STORAGE?

PCUC: ***Yes. Storage tanks, ground and elevated, should not have to be drained dry in order to have their full cost recognized in rate base.***

A retention allowance of 10% of storage as unusable capacity is appropriate. (Exh. 15 (JFG-1), p. 7; T. 603-604) In considering elevated or ground storage tanks, used and useful calculations

should not be made on the basis that the utility must drain its storage tanks dry before full recognition of this cost is included in rate base. As a practical matter, the utility is simply not going to pump its ground storage facilities to the point of suction, nor is it going to permit its elevated storage facilities to empty down to the mains. (T. 247-248; 1078)

ISSUE 25: What are the appropriate methods for calculating the water source of supply, treatment plant, high service pumping, and storage used and useful percentages?

PCUC: ***As per Used and Useful Analysis.***

Source of Supply

PCUC obtains its entire water supply from 30 existing wells. The source of supply for Water Treatment Plant No. 1 ("WTP#1") is obtained from 27 wells which are dispersed over a wide area. Water Treatment Plant No. 2 ("WTP#2") obtains its water from three existing wells, with a fourth well under construction.

Used and useful is calculated according to the ratio of the maximum day demand on the system, adjusted for margin reserve and fire demand, to the combined capacity of the wells. The well capacity for WTP#1 excludes three maximum yield wells. The well capacity for WTP#2 excludes one maximum yield well, and also reflects an adjustment for additional water which must feed WTP#2 for the level of membrane concentrate produced by this process. The maximum day demand, exclusive of any unusual events, was 4.89 MGD. (Exh. 15 (JFG-1), pp. 4, 19)

Contrary to Mr. Bidy's assertions, there is no "firm reliable capacity" method with respect to used and useful calculations for source of supply. The PSC has recognized that for used and useful purposes, the capacity of PCUC's sources of supply should be adjusted to reflect the reality that some of the wells may not be on line during the maximum day. With respect to WTP#1, in PCUC's last rate case, the PSC accepted elimination of the capacity of the two highest yield wells from the total well capacity. At that time PCUC had 22 wells in service. There are now 27 wells serving WTP#1. On any given day at least one well is not in use due to monitoring requirements of the water management district. In addition, PCUC alternates the use of certain wells which have

relatively high, naturally occurring color in order to comply with color standards. While PCUC must perform periodic maintenance, it must also be prepared for unanticipated well or pump failures. On average, for the ten maximum days, there were in excess of five wells not in operation for various reasons. Now that PCUC has 27 wells, it is appropriate to recognize three wells out of service with respect to WTP#1. (T. 1059; 1076-1077)

Water Treatment Plant

The water treatment facilities include a lime-softening plant and a new membrane treatment plant. WTP#1, the lime-softening plant, has a rated capacity of 6.0 MGD, but that capacity must be adjusted for plant uses. The PSC accepted a 10% factor in PCUC's last rate case for plant uses, while directing the utility to again analyze plant uses in its next rate case. The 1994 plant use with respect to the application of lime, chlorine and lime sludge processing amounted to an annual average of 250,000 GPD, in relation to an average of 3.101 MGD of filtered water. In addition, the amount of water used for backwashing during 1994 averaged 190,000 GPD. Accordingly, during 1994 the actual average plant use for chemical processing and backwashing amounted to 14.2% of the filtered water. Plant use during the 1988 test year in the last case was 18.5% of filtered water. Consistent with the plant requirements determined in other engineering studies for PCUC, 13.3% of the capacity is properly used for plant requirements for WTP#1.

Since its last rate case, PCUC added WTP#2, which consists of

a membrane treatment process. WTP#2 has a rated capacity of 2.0 MGD and was designed so that future expansions can be installed by adding membrane units. While the membrane process does not require "plant uses," it does produce a concentrate requiring disposal. Accordingly, the plant requires 2.353 GPD of raw water in order to operate at its 2.0 MGD capacity. For used and useful purposes, the supply wells, not the plant capacity, were adjusted by PCUC to account for the concentrate.

The combined capacity of the treatment plants is 7.2 MGD, after adjustment for plant uses applicable to WTP#1. The maximum day of 4.89 MGD is adjusted for margin reserve and a fire demand of 0.6 MGD (2,000 GPM for five hours), equating to 6.427 MGD. The ratio of the demand to the capacity calculates to a used and useful percentage of 89.3%, which should be applied to the cost of WTP#2. The cost of WTP#1 remains at 100% used and useful. (Exh. 15 (JFG-1), pp. 5-7, 20; T. 241, 1059)

Neither Mr. Bidy or Ms. Amaya considered the fact that since WTP#1 had reached 100% capacity, requiring the addition of WTP#2, an adjustment should be made to recognize the integrated use of both treatment plants. Mr. Bidy simply did not address this matter. Ms. Amaya calculated used and useful for WTP#2 apparently on the assumption that it only meets water demands which exceed the capacity of WTP#1. That approach is not consistent with the actual integrated use of the treatment plants. Customer demands cannot be met by operating WTP#1 until it reaches capacity and then using WTP#2 for the balance of the demand. PCUC's analysis demonstrates

the used and useful percentage of the combined operation of the water treatment plants is 89.3%. The cost of WTP#1, however, is 100% used and useful, as should be evident from the need for the addition of WTP#2. (T. 1075)

Storage

Methodology is discussed under Issue 23 and 24.

High Service Pumping

In PCUC's analysis, high service pumps were allocated along with other plant allocations. No separate allocation was made specifically for high service pumps. Ms. Amaya used a combined capacity of all high service pumps with respect to both treatment plants. If a separate used and useful allocation is made for high service pumps, then it should be recognized that the high service pumps at each treatment plant should be allocated separately, making allowance for the highest capacity pump being out of service at each plant. (T. 1076)

ISSUE 26: WHAT IS THE APPROPRIATE METHOD FOR CALCULATING THE WASTEWATER TREATMENT PLANT AND EFFLUENT DISPOSAL USED AND USEFUL PERCENTAGES?

PCUC: *As per Used and Useful Analysis.*****

A new operating permit for the wastewater treatment and disposal systems was issued on June 28, 1996 (Exh. 27). The design capacity of the treatment plant is 4.0 MGD annual average daily flow (AADF). However, under the new permit, the permitted capacity of treatment plant is limited to the newly permitted capacity of effluent disposal facilities, which is 3.35 MGD (previously 3.4 MGD). The newly permitted effluent disposal facilities include a

sprayfield of 0.6 MGD and two RIB sites, one at 1.0 MGD and the second at 0.75 MGD (previously 1.0 MGD). Effluent for reuse by the DCDD for public access irrigation is now at an annual average rate of 1.0 MGD (previously 0.8 MGD). However, during wet weather the DCDD is committed to utilize only 0.3 MGD. The wet weather capacity is now 2.05 MGD (previously 2.3 MGD), without the 0.6 MGD sprayfield and the 0.7 MGD in DCDD dry weather capacity. (T. 580-584; Exh. 15 (JFG-1), pp. 14-15) The new permit does not impact on PCUC's used and useful calculations. PCUC had already determined that the effluent disposal facilities were 100% used and useful, based on 3.4 MGD capacity. Reducing the permitted capacity to 3.35 MGD does not change that conclusion. Further, if the newly permitted capacity of the treatment plant is considered, the used and useful percentage as proposed by PCUC would be higher. However, we propose no change.

PCUC's used and useful calculation for the treatment plant is based on the ratio of an estimated maximum 3-month demand, adjusted for margin reserve, to the capacity of the treatment plant. The wastewater flow for 1995 was calculated on the basis of water usage by sewer service customers, excluding water used for irrigation and construction. The water returned to the sewer system is based on a return factor of 85%. An allowance of 15% for infiltration and inflow was included. The calculations were made on an ERC basis. With respect to the treatment facilities, the average sewage flow was adjusted for a maximum 3-month demand using the actual ratio of the maximum 3 months to average for 1995. A similar calculation

was made for the effluent reuse facilities using a maximum month factor, because of the need for "wet weather" capacity. (Exh. 15 (JFG-1), pp. 14-15, 35-36)

The capacity of the sprayfield is 600,000 gallons per day, not the 800,000 gallons per day used by Ms. Amaya. The older RIB site has a capacity of 1.0 MGD, not the 1.3 MGD used by Ms. Amaya. It also appears that Ms. Amaya did not make an adjustment for dry weather capacity, which is not available during wet weather periods.

With respect to the effluent storage tank, Ms. Amaya performed a separate calculation, producing only a 30% used and useful percentage because she used only the sprayfield capacity (corrected to 600,000 GPD). However, Ms. Amaya failed to take into consideration the 1.6 MGD disposal at DCDD during dry weather periods when she estimated the "minimum" requirement. Correcting Ms. Amaya's proposed three-day minimum requirement would produce a minimum capacity of 6.6 million gallons, which is calculated by multiplying three times the sum of the 600,000 GPD spray field capacity plus the 1.6 MGD disposal at DCDD. Aside from Ms. Amaya's error, PCUC's actual storage requirement is not the minimum amount. An outside engineering firm performed a study for PCUC which indicated that the wet weather flow volume over a 24-day period ranges from 4.3 to 4.6 MGD, which would require significantly more than the minimum capacity when calculated over a 24-day wet weather period. PCUC's internal studies show a wet weather flow in excess of 5 MGD over a 21-day wet weather period. Because of this

significant need for wet weather storage in excess of the 6 million gallon storage tank, PCUC is seeking authorization for surface water discharges, which it now does not have. (T. 1087-1088) The fact that Ms. Amaya's estimate of the effluent storage requirement of 1.8 MG is seriously understated may be observed by comparing it to DCDD storage. DCDD has only a 0.25 MGD capacity treatment plant and 11.6 MG of storage. The engineering studies and calculations for PCUC, which has a 4.0 MGD treatment plant, clearly support a storage requirement in excess of 6.0 MG.

Ms. Amaya's use of the average annual daily flow in the calculation of used and useful for the wastewater treatment plant is inappropriate. Despite the fact that the permitted capacity of wastewater treatment plants is stated as an average annual daily flow, treatment plants must be designed to meet the maximum three-month demand. The cost of wastewater treatment plants is also, therefore, related to the design criteria for the maximum three-month demand at a minimum. PCUC cannot meet the wastewater flow demands of its customers if the capacity of the plant is limited to the average annual daily flow. Although utilities have a choice of stating the permitted capacity in terms of either annual average, maximum three months or maximum month demands, DEP nevertheless requires the expansion of plants on the basis of the three-month average daily flow. Capacity analysis reports must be submitted to DEP on the basis of the three-month average daily flows. If these reports show that the permitted capacity will be equaled or exceeded within the next five years, DEP requires that the planning

and design of the expansion be initiated. Accordingly, the cost which the utility incurs with respect to its wastewater treatment plants is based on its ability to meet the three-month average demands in relation to their permitted capacity, and the used and useful cost should be determined on a similar basis. (T. 1088-1089) Even Mr. Bidy recognized the 3-month demand for wastewater plants. (Exh. 25 (TLB-3))

ISSUE 27: WHAT IS THE APPROPRIATE METHOD FOR CALCULATING THE WATER TRANSMISSION AND DISTRIBUTION SYSTEM USED AND USEFUL PERCENTAGE?

PCUC: *****The calculation should be based on an analysis of component parts including the recognition of equivalent flows of customers expressed in ERCs.*****

Transmission and Distribution Mains

The used and useful calculation for mains is consistent with the methodology accepted in PCUC's last rate case, with a further adjustment which is necessary to recognize that in addition to general metered service, mains must also meet fire demands. (That adjustment is addressed in Issue 20.) Both transmission and distribution mains are allocated to used and useful on the basis of "density." The used and useful percentage is based on the ratio of ERCs, adjusted for margin reserve, to the total lots capable of being served. (Exh. 15 (JFG-1), p. 8)

While the distribution mains have been installed to serve 46,438 lots (excluding the DCDD and beachside), the transmission mains are not adequate to serve all such lots. Accordingly, a separate analysis of the transmission mains has been performed in order to determine, by means of an hydraulic equivalency

calculation, the percentage of the present system served by existing transmission mains. It should be noted that the cost of mains in the "beachside" area is advanced subject to refund agreements approved by the PSC. The amounts refunded in accordance with the agreements are considered 100% used and useful. (Exh. 15 (JFG-1), p.9) The refunded and unrefunded amounts are accounted for separately on the plant in service schedules within the MFRs. (Exh. 7 (FS-1), pp. 10-11)

Ms. Amaya testified that it is necessary to compare connected lots to lots available in order to compare "apples to apples." As Mr. Guastella testified, her analogy is misplaced.

Neither the design or the cost of mains is based solely on the number of lots to be served. Mains are designed for required flows and pressure. The design must take into consideration residential flows with respect to some lots, as well as significantly higher flows with respect to commercial lots. The design must also take into consideration fire flow requirements. Finally, the design must also take into consideration the distances over which the mains must be extended. Thus, the cost of mains is based on the cost to meet flow and pressure requirements as well as to meet the number of lots to be served. Mr. Bidy's and Ms. Amaya's use of connected lots to total lots, which is not the basis for the design and cost of mains, to identify the used and useful cost, creates a mismatch. My use of the ratio of ERCs to lots is consistent with the design as well as the cost of mains, and has been consistently accepted by the FPSC for PCUC. (T. 1080)

Acceptance of the lot count method, with no recognition of customer density, hydraulic equivalency and fireflow, would be improper. See State v. Public Service Commission, 669 SW 2d 941, 947 (Mo. App. 1984), in which the Missouri Court held that investment in an electric line extension could not be properly excluded from rate base under used and useful theory, because

customers were served by the line and there was no evidence that any portion of the line was surplus in terms of providing service to customers who were connected to it.

Mr. Biddy's analysis is contradictory. He recognizes that water transmission and distribution systems are designed with fire flow capability, and therefore the cost of mains includes the cost for fire flow provision. On the other hand he states that it is inappropriate to use fire flow allowances in the used and useful calculation.

His testimony is also contradictory in that while he states the fire flow provision is for all existing and future customers, he also states that PCUC's proposed calculations shift more cost burden to existing customers, especially in new and sparsely developed areas. Mr. Biddy's calculations, however, do not recognize any added cost with respect to mains in order to meet fire flows, and therefore he includes no cost for existing customers with respect to fire flow.

Mr. Biddy is also incorrect when he states that Mr. Guastella added an extra 33.1% to the used and useful percentage for mains by including a fire flow allowance. In fact, in order not to duplicate the cost of mains considered used and useful, Mr. Guastella applied the 33.1% fire demand allowance only to the portion of mains not previously found to be used and useful according to his density calculation (ERCs to total lots). (T. 1081-1082)

Mr. Biddy also testified that the "lot count" method allocates the water main costs evenly to all customers, and that the lot

count method gives an equal cost share to all customers. As Mr. Guastella testified, this is inconsistent with proper rate making.

A used and useful determination establishes the cost level of investment which should be recognized in rates. Once that level of used and useful cost is established, then studies could be made to determine an allocation of costs among customer classes. Mr. Bidy has made no such cost allocation; he merely uses a ratio of lots to lots in order to exclude more of PCUC's actual costs from rate base. Moreover, all customers are charged the same basic rates for service, and their share of the costs will vary according to their usage (given similar classes of customers). Accordingly, this analysis by Mr. Bidy is irrelevant to the question of appropriate used and useful calculations. (T. 1082-1083)

The PSC has accepted Mr. Guastella's use of the ratio of ERC's to lots in PCUC's previous rate cases. (Exh. 15 (JFG-1), p. 18) Moreover, in a rate case involving Marco Island Utilities, the PSC specifically rejected the use of the ratio of lots to lots:

In determining the used and useful percentage for the water distribution and sewage collection systems, we do not believe it is appropriate to take the total number of lots with service connections and divide by the total number of lots available to calculate the used and useful percentage. When there is a mix of large condominiums and single family residences, there must be a complete evaluation of the water distribution and sewage collection systems to include the location of existing customers and the extent of the systems. (Order No. 17600, at p. 7)

Mr. Guastella's testimony that the cost of mains is not dependent solely on number of lots, but also on varying demands of residential, multi-family and commercial customers, as well as fire flow requirements, parallels the PSC's reasoning in the Marco Island order, and was not challenged. While the words lots to lots may "match," applying a lot to lot ratio to costs, as recommended by Ms. Amaya and Mr. Bidy, does not produce the used and useful

cost PCUC has incurred to meet the varying demands of its customers, as the Marco Island order recognizes.

Mr. Bidy also asserted that "the lot count method will not discourage future development as opposed to the method proposed by PCUC which will probably discourage future development." Mr. Bidy presented no evidence which would demonstrate that future development is at all affected by the difference in rates resulting from the use of proper used and useful allowances, let alone the increment of the rates which is based on used and useful mains. As Mr. Guastella testified,

it is obvious that because PCUC installed most of the mains in the early stages of this development, the total cost included as used and useful is much less than if the mains had been installed gradually over the years (because the cost of labor, material and construction costs have increased over the years). The lower embedded cost of mains coupled with used and useful adjustments have produced the lowest cost of service for this utility.
(T. 1083)

Services

The distribution system contained an average of 15,172 services in 1995, excluding beachside and multi-family customers. As in the last case, the used and useful percentage is based on the ratio of the average ERCs, adjusted for margin reserve, to the total services.

Meters and Meter Installation

Consistent with PCUC's last rate case, meters and meter installations are considered 100% used and useful.

Hydrants

Consistent with PCUC's last rate case, used and useful for

hydrants is based on the ratio of active hydrants serving one or more customers to the total hydrants. (Exh. 15 (JFG-1), pp. 8-10, 22-25) Mr. Biddy's assertion that "fire hydrants are part of the distribution system and there is no need to perform a separate used and useful analysis" indicates that he is unaware of the fact that hydrants have not yet been installed throughout the system and the cost of only the active hydrants which are all necessary to provide existing customers with fire protection have been included as used and useful. The PSC has accepted PCUC's hydrant methodology in previous cases, and it is still applicable. (T. 1084)

ISSUE 28: WHAT IS THE APPROPRIATE METHOD FOR CALCULATING THE WASTEWATER COLLECTION SYSTEM AND PUMPING PLANT USED AND USEFUL PERCENTAGE?

PCUC: ***The calculation for the collection system and pumping plant should be based on an analysis of their component parts including the recognition of equivalent flows of customers expressed in ERCs.***

Collecting Mains

Consistent with the last PCUC rate case, the collecting mains are segregated into three categories for calculating used and useful allocations: Force Main, Gravity Main and Pressure Main (pretreatment effluent pumping [PEP] system). The force mains which comprise the major manifold (carrying the combined flow from all lift stations) are considered 100% used and useful. The remaining force mains are allocated to used and useful according to the weighted used and useful percentage for lift stations. The used and useful percentage for the gravity collection mains is based on a density analysis of ERCs served (excluding customers on the PEP system and adjusted for margin reserve) in relation to

total lots served by the gravity mains. The used and useful allocation of PEP mains is based on the ratio of ERCs served by the PEP system, adjusted for margin reserve, to the total lots served by the PEP system. The cost of individual pumps is separately identified as being 100% used and useful. (Exh. 15 (JFG-1), pp. 13, 29-30)

Services

Consistent with the last PCUC rate case, services are allocated on the basis of the ERCs (excluding customers served by the PEP system, and multi-family customers) in relation to total services. (Exh. 15 (JFG-1), pp. 14, 31)

Pumping Plant

Consistent with the last PCUC rate case, each lift station was examined to estimate the 12-hour combined demand from each connected customer served by a particular lift station. An allowance has also been made for infiltration and inflow. (Exh. 15 (JFG-1), pp. 14, 32-34)

To the extent the Mr. Bidy or Ms. Amaya used the relationship of connected lots to total lots with respect to the wastewater collection system, our comments are the same as given for the transmission and distribution system under Issue 27.

In his lot count analysis, Mr. Bidy erroneously considered his used and useful analysis as an exercise which establishes equal shares of the costs for all customers. As Mr. Guastella testified,

Used and useful analyses establish the utility's cost of providing service which should be recovered through the rates resulting from this rate case. The use of lot counts is not a mechanism with which to establish equal

shares costs for all customers, individually as a class or existing compared to future. As has been recognized by the FPSC in previous cases and Ms. Amaya in this case, separate treatment with respect to gravity mains, PEP system, force mains and service lines is most appropriate for PCUC. Two of the most obvious examples relate to PEP tanks and service lines. Clearly those components may be identified with individual existing customers and should be included as entirely used and useful. (T. 1085-1086)

For pumping plant, Ms. Amaya uses a peaking factor of two, as was used in the last case. As Mr. Guastella testified,

(a)ccording to recommended design criteria with respect to the design of sewers... the peaking factor for domestic wastewater flows, with and without commercial flows and inflow and infiltration, show that a peaking factor in excess of three times average is warranted. The factor of two times used in the last case has been found to be inadequate for peak flows during the course of any given day. (T. 1086-1087)

Mr. Guastella also referred to specific studies of PCUC's largest lift stations confirming that all lift stations experience peaking factors of at least 3 times average. (T. 258) As for lift stations, Ms. Amaya conceded at hearing that she was unaware of any design criteria that would support a peaking factor other than 3.

ISSUE 29: SHOULD FACILITY LANDS BE CONSIDERED 100% USED AND USEFUL WITHOUT DETAILED JUSTIFICATION?

PCUC: *Yes.*****

Mr. Bidy's recommendation to make a used and useful adjustment to land should be rejected. The cost of land to the utility would be no smaller in order to serve just existing customers. It therefore should be considered 100% used and useful. (T. 1079; Exh. 15 (JFG-1), p. 3)

ISSUE 30: SHOULD A FACILITY BE CONSIDERED 100% USED AND USEFUL AGAIN, IF IT WAS DETERMINED TO BE 100% USED AND USEFUL IN A PREVIOUS PROCEEDING?

PCUC: ***Yes. Once the Commission has determined that a facility is 100% used and useful in serving the public, the recovery of the cost of that facility through rates should not be rescinded, regardless of whether additional capacity is installed.***

The second prudence allowance proposed in PCUC's Used and Useful Analysis is to recognize that once a facility reaches 100% used and useful, because additional capacity must be added to serve growth or meet regulatory requirements, it will remain 100% used and useful after the new capacity is added. (Exh. 15 (JFG-1), p. 3) This prudence allowance should be approved.

ISSUE 31: SHOULD NON-USED AND USEFUL ADJUSTMENTS BE MADE TO GENERAL PLANT?

PCUC: ***No. General plant is 100% used and useful.***

General Plant should be considered 100% used and useful. These costs do not fluctuate with usage, are entirely necessary to serve existing customers, or would be no smaller to serve only existing customers.

ISSUE 32: WHAT ARE THE APPROPRIATE USED AND USEFUL PERCENTAGES?

PCUC: ***As per MFRs and Used and Useful Analysis.***

ISSUE 33: SHOULD AN ADJUSTMENT BE MADE TO DEPRECIATION EXPENSE AND ACCUMULATED DEPRECIATION FOR THE RECLASSIFICATION OF THE COST OF RAPID INFILTRATION BASIN TO THE APPROPRIATE ACCOUNTS?

PCUC: ***No. The costs of the RIB are not misclassified.***

Mr. Dodrill testified that PCUC "misclassified" improvements to the newer RIB site in USOA Account 380, Treatment and Disposal Equipment. He advocated reclassification of these costs to USOA Account 354, Structures and Improvements, which account has longer guideline service lives and hence lower depreciation rates. (Exh.

As indicated in PCUC's response to the audit report,

The rapid infiltration basins (RIB) were designed and are being used for further treatment and reuse/disposal of reclaimed water. The reclaimed water is applied to the bottom of the RIBs to allow for percolating through the soil for further treatment prior to discharging to the ground water. The RIB is properly considered as treatment and reuse/disposal equipment similar to oxidation ponds, lagoons, filtering equipment, etc. which have a normal useful life of approximately 18 years, as recognized by PSC service life guidelines.

The use of rapid infiltration technology is relatively new and was not specifically envisioned in the NARUC Uniform System of Accounts. PCUC has consistently classified RIBs as treatment and disposal facilities as generally described in Account 380. We do not agree that this RIB should be treated differently and reclassified to Account 354 - Structures and Improvements. The descriptions of grading and clearing in that account, upon which the auditor relies in his workpapers, is grading and clearing "when directly occasioned by the building of a structure." There are no structures at the RIB site. Similarly, the drainage systems and landscaping relate to structure improvements. The RIB site, including any landscaping required as a buffer, is in total a functioning wastewater disposal facility, not a structure with improvements. It should remain in Account 380 and no adjustments are necessary. (Exh. 41 (FS-12), p. 8; T. 953-954)

Mr. Dodrill was unaware that the initial RIB site was booked by PCUC to Account 380 and accepted as such by the PSC. (T. 674) He agreed that while there is an element of engineering judgment in determining where such items should be booked, he did not have that expertise. (T. 674) He agreed that a rapid infiltration basin is similar in function to an oxidation pond or lagoon and a sedimentation basin, both of which are properly booked in Account 380. (T. 677-678; Exh. 32, p. 4)

The guideline depreciable life for Account 380 fairly

represents the expected life of the RIB, and neither Mr. Dodrill nor Ms. Dismukes provided any data to justify a change from this guideline rate, which is currently approved. (T. 953) Mr. Dodrill's analysis, and Ms. Dismukes' endorsement of it, ignore the actual function of the RIB site and its expected depreciable life. As such, the proposed reclassification should be summarily rejected.

ISSUE 34: SHOULD NON-USED CIAC BE INCLUDED AS A REDUCTION TO RATE BASE?

The parties have proposed a stipulation that non-used plant, non-used accumulated depreciation, non-used CIAC or non-used accumulated amortization of CIAC should not be included in rate base.

ISSUE 36: WHAT IS THE PROPER AMOUNT OF CIAC TO USE AS A DEDUCTION FROM RATE BASE?

PCUC: *As per MFRs, all of the CIAC associated with existing customers should be used as a deduction in determining rate base.*****

All of the CIAC paid by current customers has been properly accounted for and reflected in rate base as a reduction of used and useful plant. (T. 914) This methodology has been universally followed by the PSC in water and wastewater rate cases, including PCUC's prior rate cases.

ISSUE 37: SHOULD NET DEBIT DEFERRED INCOME TAXES BE INCLUDED IN RATE BASE AND IF SO SHOULD ANY ADJUSTMENTS BE MADE TO THE AMOUNT PROPOSED BY THE COMPANY?

PCUC: *Yes. No adjustments to the amounts in the MFRs are appropriate.*****

PSC Rule 25-30.433(3) requires that the used and useful portions of debit and credit deferred taxes be offset against one another for ratemaking purposes. If the net balance is a credit,

it is included in capital structure. If the net balance is a debit, it is included in rate base. In this case, the net balance is a debit. Only the used and useful portion of deferred taxes is included in rate base.

The debit deferred taxes are associated with taxes on CIAC, while credit deferred taxes are primarily associated with timing differences between book and tax depreciation. Therefore, the used and useful adjustment for the debit deferred taxes is proportionate to that for CIAC, while the adjustment for credit deferred taxes is proportionate to used and useful plant. (T. 170-171; Exh. 7 (FS-1), pp. 1, 2, 6-8)

ISSUE 38: SHOULD ANY ADJUSTMENTS BE MADE TO PLANT IN SERVICE RELATED TO PERCOLATION PONDS THAT WERE TAKEN OUT OF SERVICE OR GENERAL PLANT DUE TO THE COMPANY PROVIDING OPERATION AND MAINTENANCE SERVICES TO NON-PCUC WATER AND WASTEWATER SYSTEMS?

PCUC: *No.*****

Perc Ponds:

OPC raised this issue subsequent to the prehearing conference but did not pursue it at hearing. Perhaps this was because OPC had reviewed PCUC's response to OPC Interrogatory 85, which noted the continuing use of the ponds as part of the FDEP-required onsite stormwater management system. See also Exhibit 1, pp 10-11 and accompanying Grading and Drainage Plan. In the absence of any cross-examination elicited by OPC, the sole record discussion of the ponds was by Mr. Guastella, who confirmed that the ponds "are retained, not retired, but...not used for service to the Dunes or for effluent at this point." (T. 366) No adjustment is therefore

warranted.

General Plant

No adjustment to general plant is necessary or appropriate due to the company providing operation and maintenance services to non-PCUC water and wastewater systems. Since no additions were made to general plant to provide O&M services to non-PCUC systems and since the amount of general plant would be no smaller if PCUC did not provide O&M services to non-PCUC systems, no adjustments are necessary. The record clearly establishes that non-PCUC systems receiving service from PCUC pay the direct labor expense for those services (Exh. 44).

ISSUE 39: WHAT PROVISION FOR WORKING CAPITAL SHOULD BE INCLUDED IN RATE BASE?

PCUC: ***A zero working capital allowance should be approved.***

In accordance with PSC Rule 25-30.433(2), working capital was calculated using the balance sheet approach. On that basis, the calculation results in a numerically negative amount. Consistent with longstanding PSC policy, PCUC therefore included a zero working capital in rate base. (T. 171)

The PSC should reject Ms. Dismukes' recommendation to include a negative working capital to offset debit deferred taxes. As Mr. Seidman testified,

(t)he Commission has required PCUC, a class A utility, to calculate working capital using the balance sheet approach. Under the balance sheet approach, current assets are matched against current liabilities. MFR Schedule A-17 shows the calculation of working capital using the balance sheet approach. Net debit deferred taxes are not a component of working capital since they clearly are long term assets related to tax timing

differences of CIAC and depreciation and are amortized generally over the life of related assets. The Commission more clearly acknowledges this distinction in its rule for the calculation of working capital for Class B and C utilities. That rule, which authorizes the calculation of working capital as one-eighth of O&M expenses, specifically requires the offsetting of debit deferred taxes against credit deferred taxes as a calculation separate from working capital, under a separate subparagraph. Beyond that, the inclusion of a negative working capital at all in rate base violates the intent of making working capital a rate base component. Its intent is to recognize that a utility has an ongoing need for liquid assets to pay its current payables. A zero working capital fails to recognize that need and is penalty enough; a negative working capital further reduces the cost basis of long term assets upon which the utility is entitled an opportunity to earn. (T. 937-938; 172)

ISSUE 40: WHAT ARE THE APPROPRIATE RATE BASE AMOUNTS?

PCUC: ***Fall-out issue.***

ISSUE 42: SHOULD CIAC BE INCLUDED AS A COMPONENT OF THE COST OF CAPITAL?

PCUC: ***No. CIAC should not be included in capital structure. There is no precedent for Public Counsel's proposal, which is contrary to long-standing ratemaking principles.***

Analysis is included under Issue 43.

ISSUE 43: SHOULD PREPAID CIAC BE INCLUDED IN THE UTILITY'S CAPITAL STRUCTURE?

PCUC: ***No. CIAC should not be included in capital structure. OPC's proposal is unprecedented and contrary to long-standing ratemaking principles. Further, as recognized by the PSC, prepaid CIAC is non-used. Neither prepaid CIAC, nor any other non-used component, should be included in rate base or cost of capital.***

In PCUC's last rate case, the PSC rejected OPC's contention that nonused CIAC should be included in capital structure as cost-free capital, noting the absence of any precedent for such treatment. Order No. 22843, at pp. 48-50. In the pending case,

through the testimony of Ms. Dismukes, OPC resurrects this proposal.

As Mr. Seidman testified, Ms. Dismukes' adjustment violates utility regulatory accounting principles and is without precedent in Florida or any other jurisdiction.

Her proposal is contrary to the concept developed and consistently applied in Florida, namely to treat CIAC as an offset to plant in service in rate base. CIAC has not been treated as part of the utility's capital structure. NONUSED CIAC is not and should not be an offset to used plant in rate base, but Ms. Dismukes' proposal effectively does just that. It is contrary to any regulatory philosophy with which I am familiar to consider NONUSED components in determining the revenue responsibility of current customers. Ms. Dismukes' proposal to make NONUSED CIAC a part of capital structure results in a discriminatory mismatch of funds by crediting CIAC from future customers against the cost of serving current customers. (T. 907)

Ms. Dismukes has made no showing to overturn longstanding precedent of offsetting plant with CIAC in determining rate base, nor has she provided any justification to include CIAC, whether used or nonused, in the cost of capital, or to include nonused components in rate base or the capital structure. As Mr. Seidman noted, in fact, Ms. Dismukes wants CIAC treated both ways. She recognizes used CIAC as a deduction in determining rate base and at the same time recommends nonused CIAC to be a part of the cost of capital with respect to that rate base. (T. 907-908)

In PCUC's last rate case, the PSC observed that the utility had a significant investment in nonused facilities. Ms. Dismukes points out that in this case it has a smaller investment in nonused facilities. This is no reason to include nonused CIAC as capital.

All it shows is that investment in nonused plant has been reduced as additional customers have connected to the system over the seven years that have passed since the last rate case. Regardless, the Commission does not set rates for nonused facilities. It sets rates for used facilities. That's what rate base is - the investment of the utility in property used and useful in the public service. This is a fundamental ratemaking concept, universally accepted, and is the requirement under Chapter 367, Florida Statutes. Whether the utility has a large, small or no investment in nonused facilities is of no consequence. (T. 908-909)

In fact, the relationship of capital to rate base has improved considerably since PCUC's last rate case. In the last PCUC rate case, capital exceeded rate base by \$12.2 million. In this case, capital only exceeds rate base by \$2.1 million. However, if OPC's proposals to reduce used and useful, reduce margin reserve, impute CIAC against margin reserve, and the like are adopted, rate base will be reduced and the gap between rate base and capital will increase. (T. 909) And while PCUC has made progress in matching capital more closely to rate base, Ms. Dismukes' proposal would distort the relationship beyond any reasonable limits. By including non-used CIAC as a component of capital, Ms. Dismukes' ends up with a capitalization of \$50,608,040 against a rate base of \$33,854,171. (Exh. 26 (KHD-1), Schedule 2). This is most telling.

Through her Schedule 3, Ms. Dismukes attempted to show the relationship of nonused CIAC to nonused plant, and specifically that nonused CIAC is greater than nonused plant. This schedule does not appear to recognize all nonused components nor does it include any means of reconciling those components to the balance sheet and capital structure to ensure that all components are accounted for. PCUC calculated all the investment in used and

nonused assets and reconciled it with the year-end capital structure. (Exh. 41 (FS-6)) All components are accounted for. This analysis shows that net nonused CIAC is not in excess of net nonused plant. (T. 911)

Ms. Dismukes also incorrectly assumed that all prepaid CIAC is applicable to the wastewater system. Although all prepaid CIAC is recorded in one CIAC wastewater subaccount, prepaid CIAC does, in fact, include prepayments turned over to PCUC for both water and wastewater. The reason these amounts are not broken out is that funds are turned over to PCUC from the developer in lump sums and the components are not identified until a customer requests service. At that time, the customer's prepayments are specifically identified. Accordingly, neither the MFRs nor Exhibit 41 (FS-6) show water and wastewater prepayments separately. (T. 911-912)

Exhibit 41 (FS-6) also shows that in addition to an investment in nonused plant, net of nonused depreciation, the utility also has an investment in nonused deferred tax debits. When all accounts are reconciled, PCUC has a net investment of some \$2,000,000 in nonused assets. This means nothing as it affects the determination of rates. All it reveals is a difference in the timing of the construction of the assets that will be used to eventually serve the total built-out system and the collection of CIAC to be used to offset a portion of that total built-out cost. As Mr. Seidman testified,

Palm Coast is platted for some 46,000 lots, but presently serves just under 12,000 customers. Additions will have to be made to the water transmission system, the wastewater PEP system and incremental additions will be

necessary for water supply and storage capacity and wastewater treatment and disposal capacity. PCUC has filed, under separate docket, a request to increase its service availability charges (SAC) because the current SAC level will not produce net CIAC equal to 75% of net plant even at the next buildout horizon. Since PCUC strives to prudently phase in its supply, treatment and disposal facilities to match need, a considerable amount of plant will be necessary to serve at buildout. (T. 913)

Ms. Dismukes also attempted to show that PCUC had no investment in nonused plant by examining the guaranteed revenue agreement with ICDC. Under that agreement, ICDC currently makes payments to PCUC of approximately \$1,000,000 per year to cover costs associated with nonused plant. Ms. Dismukes concluded that PCUC did not have any nonused plant that was not being recovered through nonused CIAC. (T. 535) However, Mr. Seidman effectively rebutted her testimony by pointing out that she severely understated the investment in nonused plant and the associated costs by incorrectly portraying the calculations performed under the agreement, excluding some capital costs that made up part of the nonused plant components, and incorrectly applying the wrong used and useful methodology. (T. 918) In addition, Ms. Dismukes took no notice of the safety provision in the agreement that prevents PCUC from a double recovery of its costs. (Exh. 43) Mr. Reilly tried to show that the O&M expense recovered through the agreement was excessive because the PSC only disallowed \$26,000 as nonused O&M in the last case, a figure Mr. Seidman accepted, subject to check. (T. 1005) Mr. Seidman has checked Order No. 22843 from the last case and found that Mr. Reilly had misinterpreted the order. The PSC adjusted the nonused O&M in the

MFR for an additional \$26,000, bringing the nonused O&M in the last case to a total of \$503,607 (Compare Order No. 22843, pp. 53-54, 80-82; see also Docket No. 890277-WS, Exh. 3, Schedule B-1 & B-2).

If Ms. Dismukes' proposal were to be adopted, the cost of serving current customers would be understated and their rates would be subsidized by the utility's shareholders. This would have been obvious had Ms. Dismukes proposed to treat nonused CIAC as a deduction from rate base, as this Commission requires used CIAC to be treated, rather than proposing to treat it as a component of capital. Mr. Seidman explained that,

All of the CIAC paid by current customers of PCUC has been properly accounted for and is reflected in rate base as a reduction of used & useful plant. Only the CIAC paid by current customers is used and useful and only used and useful CIAC, or any used component for that matter, is considered in determining rate base. If Ms. Dismukes' proposed adjustment were properly reflected it would show up as a line item called "nonused CIAC" on the rate base schedule. But it would be offsetting used and useful plant since there cannot be any nonused plant in rate base for it to offset. Since a nonused component, be it CIAC or otherwise, is not allowed in rate base, Ms. Dismukes elected to add nonused CIAC to the capital structure where the revenue impact is theoretically the same, but where the violation of accepted ratemaking treatment is not so obvious. (T. 914)

Exh. 41 (FS-6) illustrates the effect of Ms. Dismukes' proposal on PCUC. Ms. Dismukes' adjustment would allow PCUC to earn on only \$26.3 million of its \$37.4 million of rate base. The amount available for a return on equity, under Ms. Dismukes' proposal, would only be sufficient to provide a 6.02% return, even though, under the leverage formula, PCUC should be allowed the opportunity to earn 11.10%. If all of Ms. Dismukes' adjustment is applied only to wastewater rate base, the effective rate of return

on the equity portion of wastewater rate base is reduced to a negative 0.74%.

Mr. Guastella testified that,

it is important to recognize that "non-used CIAC" or "prepaid CIAC" is not contributions in aid of construction, nor is it attributable to existing customers or used and useful investment in accordance with FPSC policy or rules. Instead, the dollars associated with what has been dubbed non-used CIAC or prepaid CIAC represent dollars collected in accordance with agreements between developers and real estate purchasers. While developers may or may not transfer those dollars to a utility as part of the funding of non-used and useful plants, developers also incur enormous costs to create and subsidize new water and sewer utilities during their growth years. With respect to Palm Coast, I estimate that the carrying costs incurred by the developer since 1980 amount to approximately \$60 million. If any rate making consideration were to be given to non-used CIAC, then the developer's carrying costs to create this utility would also have to be given consideration. Accordingly, an entirely different method would have to be created to replace the FPSC's existing policies and rules with respect to rate setting for developer-related water and sewer utilities. (T. 1097-1098)

However, as noted by Mr. Guastella,

The FPSC's policies with respect to service availability charges, levels of CIAC and used and useful analyses have been applied for too many years to now change direction. While each of those specific policies and components may be improved upon, the inter-relationship of all of them with respect to the appropriate regulation of water and sewer utilities cannot change so significantly as to begin to introduce such foreign elements as is being recommended by Ms. Dismukes. (T. 1098)

ISSUE 44: WHAT IS THE APPROPRIATE COST OF DEBT?

PCUC: ***As per MFRs, the appropriate cost of long-term debt is 7.24% and the appropriate cost of short-term debt is 7.73%.***

Mr. Dodrill testified that PCUC's outstanding debt "may be impaired" because of the parent company's unconditional guarantee of such debt. (Exh. 30 (RFD-1) p. 33; T. 681) However, under

cross-examination, Mr. Dodrill agreed that the purpose of a guarantee was to reduce the risk of nonpayment and provide a basis for a lower or enhanced rate, that the guarantee by a parent like ITT would reduce the interest rate, and that in actuality, PCUC's debt, instead of being impaired, is enhanced by the guarantee. (T. 680-682) A parent guarantee has always been part of all debt issued to PCUC. The benefit of this arrangement is clear. No adjustment to PCUC's cost of debt is appropriate. (T. 959-961; Exh. 41 (FS-12) at p. 18)

ISSUE 45: WHAT ARE THE APPROPRIATE ADJUSTMENTS TO INVESTMENT TAX CREDITS (ITCs) AND THEIR COST RATE, IF ANY, AND WHAT IS THE RESULTING BALANCE?

The parties have proposed a stipulation that Cost-Free Investment Tax Credits should be increased by \$125,569, resulting in a year-end balance of \$2,391,641 before reconciliation to rate base.

ISSUE 46: WHAT IS THE APPROPRIATE CAPITAL STRUCTURE FOR RATEMAKING PURPOSES?

PCUC: *PCUC's stand-alone capital structure is appropriate.*****

Mr. Dodrill suggested that because of the parent guarantee, PCUC's outstanding debt is in essence outstanding debt of the parent and that therefore the parent's capital structure should be considered in this case. Under cross-examination, Mr. Dodrill conceded that in each of the previous rate case orders where a capital structure is explicitly identified, PCUC's stand-alone capital structure was used and that it is the PSC's preference to use a utility's stand-alone capital structure where it is reasonable. He further acknowledged that PCUC's equity ratio in the pending case is substantially lower than in previous cases,

which results in a lower cost of capital. Ultimately, he conceded that it is in fact reasonable to use PCUC's stand-alone capital structure. (T. 682-684) The record clearly supports continuation of the long-standing PSC policy to use PCUC's stand-alone capital structure. (T. 961-963; Exh. 41 (FS-12), at p. 18)

ISSUE 47: WHAT IS THE APPROPRIATE WEIGHTED AVERAGE COST OF CAPITAL INCLUDING THE PROPER COMPONENTS, AMOUNTS, AND COST RATES ASSOCIATED WITH THE CAPITAL STRUCTURE FOR THE TEST YEAR?

PCUC: *As per Schedule D-1, as modified to include the effect of imputing ITCs [Issue 45] and giving full weight to customer deposits.*****

ISSUE 48: WHAT ARE THE APPROPRIATE PROJECTED NUMBER OF WATER AND WASTEWATER BILLS AND CONSUMPTION TO BE USED TO CALCULATE REVENUE FOR THE PROJECTED TEST YEAR AND TO CALCULATE RATES FOR WATER AND WASTEWATER SERVICE?

PCUC: *The year end number of bills and consumption should be used for both water and wastewater.*****

ISSUE 49: SHOULD AN ADJUSTMENT BE MADE TO THE AMOUNT OF MISCELLANEOUS REVENUE TO BE INCLUDED IN THE 1995 PROJECTED TEST YEAR?

PCUC: *No. When using a projected test year, it is inappropriate to pick one line item and update it to the actual amount.*****

Ms. Dismukes' proposal to adjust Miscellaneous Revenues from the proposed amount to the actual test year amount should be summarily rejected. The pending rate application is based on a 1995 test year, using for all line items, 6 months actual and 6 months projected data. It is inappropriate to pick one line item and update it to the actual amount. (T. 922)

ISSUE 50: SHOULD AN ADJUSTMENT BE MADE TO THE AMOUNT OF 1995 WATER REVENUE RECEIVED FROM HAMMOCK DUNES?

PCUC: *No. The 1995 water revenue from Dunes has already been normalized in the MFRs to reflect its ongoing consumption pattern.*****

Water consumption for Hammock Dunes (as for all customers) has been calculated to reflect anticipated levels under normal, ongoing conditions. The Dunes' actual level of consumption in the first half of 1995 is not expected to recur because it has substantially reduced its needs for flushing. In the summer of 1995, the Dunes completed installation of a booster station to maintain chlorine levels without resorting to high levels of flushing. The full effect of the operational changes is reflected in consumption for the period May 1995 to April 1996. Future consumption is expected to be in the range of actual consumption shown for that period. (T. 423-424; 923-924; Exh. 22; Exh. 41 (FS-8) No further adjustment should be made to reflect normalized usage.

ISSUE 51: SHOULD ADJUSTMENTS BE MADE FOR NON-UTILITY INCOME AND REVENUE RECORDED ON THE COMPANY'S BOOKS?

PCUC: ***No. Non-utility income should not be moved above the line for ratemaking purposes. It is not income associated with serving the utility's customers and the customers do not incur any cost related to that income.***

Aqua Tech Utility Services Corp., a subsidiary of PCUC, provides operating and/or maintenance services to four non-PCUC systems. In effect, Ms. Dismukes proposed increasing PCUC's operating revenues by the gross revenues received for these services and the net income received by Aqua Tech. Ms. Dismukes used an erroneous income figure for one of the systems. More importantly, the services performed for the four systems "by PCUC" are the services performed by Aqua Tech, and the net income to PCUC and the revenues of Aqua Tech are one and the same, except for \$2,046 in miscellaneous non-utility income. Ms. Dismukes'

adjustment double counts and would erroneously increase operating revenues twice for the same services. (T. 921) In addition, as Mr. Seidman testified,

(t)he income for these services are properly booked as nonutility income because they arise from services not related to the utility owned facilities providing service to PCUC customers. The services are performed by PCUC personnel, but the expenses for these personnel, including allocated overheads, are already excluded from the O&M expenses charged to ratepayers by reflecting them in Account 690, Services (net), on MFR Schedules B-5 and B-6. Including this income on a gross or net basis overstates the revenues received for utility services and understates the revenue requirement properly assessable to utility customers. (T. 921-922; Exh. 44)

ISSUE 52: SHOULD NON-USED AND USEFUL ADJUSTMENTS TO O&M EXPENSES BE MADE?

PCUC: *No. All appropriate adjustments are already reflected in the MFRs.*****

Consistent with the last two PCUC rate cases, an analysis of the operating departments for used and useful was performed. (Exh. 7 (FS-4). As Mr. Seidman explained,

It is quite unusual for a utility to perform a used and useful analysis of its operating departments. The Commission has always recognized that O&M expenses are composed in general of variable, not sunk costs and that operating costs are typically geared to serve only current customers even though large amounts of plant may be non-used and useful for ratemaking purposes. However, several rate cases ago, PCUC recognized that because it was closely associated with the developer, in the early stages of development some of its employees would be devoting time for planning, record keeping and maintenance associated with developing the community in general and maintaining non-used plant. This is the third rate case in which an analysis has been performed and, judging from its results, it will probably be the last. As the summary of the analysis shows on Schedule B-3-O&M, the amount of "non-used" operating department expenses is now down to less than ten percent. Only the expenses related to maintaining the distribution and collection mains still show non-used amounts of any significance. The analysis methodology is consistent

with that used in previous rate cases. (T. 177)

Ms. Dismukes makes adjustments that affect the used and useful percentages for seven departments, but some of those adjustments are the fallout result of OPC's own composite calculations, which exclude any margin reserve. Ms. Dismukes also takes issue with PCUC's reliance upon used and useful factors based on actual employee interviews for certain top level PCUC management positions rather than reliance on a calculation based on a lot ratio, asserting that this is a deviation from the methodology used in previous cases. Mr. Seidman refuted this assertion.

In this case and in each of the previous cases for which an analysis of O&M expenses was prepared, the evaluation of used and useful was based on employee interviews. Based on the input from these interviews, choices were made as to the best means of reflecting used and useful for each employee and/or department. Based on interviews in prior cases, it was decided the lot ratio calculation best reflected the amount of time necessary for management personnel to deal with long term development related issues. Current interviews reveal that the utility is operating in a more mature stage. Based on those interviews I concluded that the lot ratio calculation no longer reflected time spent and I, therefore, elected to rely on the best estimates of the specific personnel as to the time they devoted directly to near term utility operations. In my opinion, Ms. Dismukes' proposal would understate that time and the related costs. (T. 925-927)

ISSUE 55: SHOULD AN ADJUSTMENT BE MADE FOR AFFILIATE CHARGES?

PCUC: *No. The \$21,201 contract service charge is reasonable for the service provided. These services were provided by affiliates in previous PCUC rate cases and accepted by the PSC. All other services provided through affiliates (medical, pension and insurance services, and payroll and computer processing costs) are cost-based and reasonable.*****

PCUC included in its test year expenses a \$21,201 administrative service charge from ITT (\$16,961 after adjustment

for used and useful). This is a charge made by ITT for the availability of expertise at the parent level. In prior PCUC rate cases, the PSC allowed the ITT administrative service charge requested in this proceeding, as a part of used and useful O&M expenses. The services provided by ITT include corporate administrative, legal, accounting and tax expertise. The services are not necessarily person specific, although they can be. Rather they are made available through administrative, corporate and financial policies, auditing and tax guidelines and advice, health and safety programs, and insurance management and counsel for workers compensation claims. (T. 929)

ITT charges its subsidiaries an administrative service fee that ranges between .25% and 1.0% of their revenues. (Exh. 46) This is the same fee basis included in and accepted in previous PCUC cases. Mr. Seidman explained that

PCUC was charged the lowest fee - .25% of revenues. It is not a charge for any allocated portion of any individual's payroll expense, but... is for a multitude of services. PCUC represents a very small portion of consolidated ITT revenues - approximately \$8 million out of \$11 billion for all subsidiaries. The annual fee to PCUC of \$21,000 would compare to over \$280 million in fees charged to all subsidiaries if all were charged just the minimum fee. There is no information regarding subsidiary fees and ITT employees that could be used to test the reasonableness of the charge. The test of reasonableness should be whether PCUC could receive these services from another source for \$21,000 per year. We contend that this is a reasonable expense, one that the Commission has allowed as a reasonable expense in all previous cases and one that it should continue to allow. (T. 930-931)

PCUC also seeks recovery of allocated affiliate costs for medical, pension and insurance services, and payroll and computer processing

costs. All these allocated expenses are amply documented, cost based and otherwise reasonable. (Exh. 7 (FS-3), Sec. 1) Ms. Dismukes nonetheless recommended disallowing the \$10,564 PCUC pays ITTCDC for accounts payable processing services. Mr. Seidman effectively rebutted this adjustment, stating

PCUC clearly receives accounts payable processing services from ITTCDC. Ms. Dismukes recommends the expense be disallowed in its entirety because it has not been justified. Even if Ms. Dismukes is not satisfied with the cost justification, the services obviously have some cost associated with them. However, cost justification is evident from the comparison of last year's cost with this year's cost. Last year, PCUC employed one person to handle accounts payable processing at an annual expense of \$23,706 including benefits. This year, PCUC is paying ITTCDC \$1,000 per month or \$12,000 annually for this service. (T. 931-932)

Ms. Dismukes' proposed disallowance of affiliate charges and allocated costs is irreconcilable with the Florida Supreme Court's holding in GTE Florida Incorporated v. Deason, 642 So. 2d 545 (1994). There is no showing that these transactions exceed the going market rate or are otherwise inherently unfair.

ISSUE 56: SHOULD ANY ADJUSTMENTS BE MADE TO TRUE-UP THE 6-MONTHS OF BUDGETED TEST YEAR EXPENSES TO ACTUAL?

PCUC: * No. All MFR line items are six month actual and six month projected for 1995. It would be improper to true-up just one group of costs - expenses. Although actual data can be useful in assessing the viability of projections, truing up would involve restating the whole application with unaudited information.*****

ISSUE 57: SHOULD AN ADJUSTMENT BE MADE TO PERSONNEL SERVICES EXPENSES?

PCUC: *No. An adjustment of \$5,667 for nonrecurring costs may be appropriate.*****

Ms. Dismukes proposed two adjustments to the expenses for personnel services. The first adjustment is to express the percent

used and useful as a composite for all other departments. PCUC has proposed that the expenses for personnel services be 100% used and useful, because the cost of providing the service remains the same regardless of whether a portion of any individual's time might be adjusted for used and useful. This is not a case of cost allocation as suggested by Ms. Dismukes, but rather a recognition that the costs incurred by this department will be incurred regardless, and should be recovered through rates.

Ms. Dismukes' second adjustment, the purpose of which is to remove nonrecurring charges, is calculated incorrectly. She deducts payroll taxes from the departmental O&M expense when they had not been included in O&M expenses in the MFRs, and some recurring employee benefits. As shown in Exh. 41 (FS-9), her adjustment is overstated by \$10,369 assuming her composite used and useful adjustment is recognized. If the Commission recognizes that Dept 0775 expenses are 100% used and useful, as we propose, her adjustment is overstated by \$17,716. (T. 927-928)

ISSUE 58: SHOULD THE MISCELLANEOUS EXPENSE ADJUSTMENT FOR NON-RECURRING LEGAL FEES REFLECTED ON DISMUKES SCHEDULE 16 BE MADE?

PCUC: *No. The legal expenses are reasonable and recurring in their total amount.*****

Ms. Dismukes recommended an adjustment for a nonrecurring legal expense. Mr. Seidman responded that, although the specific charges from the specific law firm may not recur, legal expenses of that magnitude most likely will recur. It should also be noted that the total legal expense projected for 1995, including the amount contested by Ms. Dismukes, is already less than what would

be expected if measured against the combined increase in customer growth and CPI since the last authorized level. (T. 936)

ISSUE 59: SHOULD ANY ADJUSTMENTS BE MADE TO ADMINISTRATIVE AND GENERAL EXPENSES DUE TO THE COMPANY PROVIDING OPERATION AND MAINTENANCE SERVICES TO NON-PCUC WATER AND WASTEWATER SYSTEMS, TEST YEAR EXPENSES TO REFLECT ACTUAL EXPENSES, TEST YEAR EXPENSES TO REMOVE EXPENSES INCURRED THAT WERE ASSOCIATED WITH THE DIVESTURE OF PCUC, OR TEST YEAR LEGAL EXPENSES?

PCUC: *No.*****

A & G

The services are performed by PCUC personnel, but the expenses for such personnel, including allocated overheads, are already excluded in the MFRs from the O&M expenses charged to ratepayers, by reflecting them as credit amounts in Account 690, services (net). (T. 922; Exh. 7 (FS-1), pp. 43-59; Exh. 44)

Divestiture

No adjustment is necessary or appropriate because test year expenses are already adjusted to exclude from the test year revenue requirement costs related to any possible divestiture or sale of PCUC. Such costs are included in Account 636 - Third Party Costs, and specifically removed from the test year expenses to be recovered through rates. (Exh. 7 (FS-1), p. 56a)

Update to actual expenses

This rate case is based on six months actual and six months projected expenses for the 1995 test year. Although actual data can be useful in assessing the viability of the projections, an "update" would involve restating the entire application with unaudited information. In any event, such information is not in

the record.

Test year legal expenses

OPC cross-examined Mr. Seidman on a multitude of test year legal expenses, with no regard for their materiality. (T. 193-202; Exh. 8) Legal expenses for "CIAC Payment by Installment" were related to PCUC's successful efforts to obtain PSC approval for allowing qualifying customers to finance payment of their service availability charges. (T. 195; see Order No. 95-0577-FOF-WS) Legal expenses for review of draft developer agreements were examined and there is nothing in the record to support any adjustment to these modest but necessary amounts. Legal expenses were also incurred for PCUC's successful efforts to obtain PSC approval of agreement for service to the County Airport. (T. 199; see Order No. 96-0565-FOF-WS (4/30/96)) The only remaining aspect of test year legal expenses highlighted by OPC that is arguably material is that incurred in connection with preparation of the application for increased service availability charges filed concurrently with the instant rate case application. As Mr. Seidman points out, the service availability charge application was a necessary part of completing this rate application, given PSC policy to review service availability charges in its consideration of any rate application. (T. 1038) The PSC reviewed and changed PCUC's service availability charges as a part of the rate case in Docket No. 810485-WS (Order No. 12957, p. 20) and Docket No. 840092-WS (Order No. 14174, p. 3). In addition, Schedule E-10 of the MFRs (Exh. 7 (FS-1), p. 110-111) requires that the proposed

service availability charges be included if a change is requested. This requirement can only be met by completing the schedules utilized in an application for increased service availability charges. And as Mr. Seidman stated, he would have had to have done a review of the service availability charges to complete his work in this docket, whether or not PCUC applied for an increase. (T. 1038)

ISSUE 60: WHAT IS THE APPROPRIATE AMOUNT OF RATE CASE EXPENSE?

PCUC: *\$419,248.*****

It has been essential for PCUC to retain highly qualified experts in order to establish the cost of service for its complex utility operations. The high degree of expertise provided the record with a complete and accurate presentation based on proper rate setting and economic principles and practices. PCUC submitted thorough documentation of the rate case expense incurred and projected to complete the case through issuance of the post-hearing order. (Exh. 41 (FS-13A and 13B)) The substantial level of this expense is to a significant extent the result of the unrestrained discovery efforts of OPC and the number of complex issues and related theories which are contrary to recognized rate-setting standards. Every conceivable aspect of the PCUC water and wastewater operations was vigorously challenged in this case. OPC and Staff witnesses advocated reversal of several longstanding PSC policies and generally accepted rate-setting practices through adjustments which, if adopted, would cumulatively result in an enormous reduction in existing rates and revenues, thereby

endangering the future financial viability of the utility. It was therefore absolutely critical for PCUC to provide extensive expert testimony to refute extensive errors and ill-conceived theories, and to provide both the analytical and theoretical bases otherwise lacking, in order for the record to contain sufficient information for the PSC to make a truly informed decision. PCUC should therefore be allowed its fair and proper expenses for presenting its case to the PSC.

ISSUE 61: ARE ADJUSTMENTS NECESSARY TO PROPERTY TAXES FOR NON-USED AND USEFUL PLANT ADJUSTMENTS?

PCUC: *No, all appropriate adjustments for used and useful are included in the MFRs.*****

ISSUE 62: WHAT ARE THE APPROPRIATE ADJUSTMENTS TO THE PROVISION FOR INCOME TAXES, INCLUDING THE APPROPRIATE FEDERAL TAX RATE, THE PARENT DEBT ADJUSTMENT, THE INTEREST RECONCILIATION ADJUSTMENT, THE ITC INTEREST SYNCHRONIZATION ADJUSTMENT AND ADJUSTMENTS FOR OTHER NOI ADJUSTMENTS?

PCUC: *As per MFRs.*****

The appropriate federal tax rate for PCUC is 35%. While PCUC files its income tax return as part of the ITT consolidated return, in PCUC's workpapers for the consolidated return and in its calculations for ratemaking purposes, its taxable income is determined on a stand-alone basis. The marginal tax rate applicable to PCUC is 35%, the same as for ITT. (T. 934)

Ms. Dismukes testified that since the PSC treats PCUC on a stand-alone basis for tax purposes, a marginal rate of 34% should apply. Mr. Seidman responded as follows:

I would agree if the Commission truly treated PCUC on a stand alone basis, but it does not. The Commission takes advantage of the consolidated relationship by requiring PCUC to make a parent debt adjustment to interest expense

for ratemaking purposes. Based on the income level proposed in the MFR, the revenue requirement difference between a 34% tax rate and a 35% tax rate is \$47,000. But, the parent debt adjustment saves the ratepayers \$499,000 in revenue requirements. The net parent debt tax savings of \$452,000... is only possible because of the consolidated relationship. If the Commission were to ignore the consolidated relationship to justify a stand alone 34% tax rate, it follows that it should also ignore the parent debt adjustment that is only possible because of consolidation. (T. 934-935)

An updated parent debt adjustment to reflect the reorganization of ITT and PCUC's new parent, ITT Industries, Inc. was provided. (Exh. 14)

ISSUE 64: WHAT ARE THE TEST YEAR OPERATING INCOME AMOUNTS BEFORE ANY REVENUE INCREASE?

PCUC: *Fall-out issue.*****

ISSUE 65: WHAT ARE THE REVENUE REQUIREMENTS?

PCUC: *Fall-out issue.*****

ISSUE 66: IN LIGHT OF SECTION 367.0817, FLORIDA STATUTES, SHOULD ANY REVENUE REQUIREMENT ASSOCIATED WITH REUSE BE ALLOCATED TO THE WATER CUSTOMERS OF PCUC?

PCUC: *No.*****

ISSUE 67: SHOULD A NEW CLASS OF EFFLUENT SERVICE BE APPROVED AND, IF SO, WHAT ARE THE APPROPRIATE RATES, IF ANY, FOR EFFLUENT SERVICE?

PCUC: *Yes, as per Effluent Reuse Rate Analysis.*****

PCUC submitted an Effluent Reuse Rate Analysis in support of its proposal of a rate of \$0.67 per 1000 gallons. The proposed rate is calculated on the basis of an allocation of PCUC's proforma wastewater operations for the test year, including allocated costs associated with only certain facilities which are necessary to handle wet weather conditions: the 0.75 MGD RIB (previously 1.0 MGD) and the 6 million gallon effluent storage tank. These

facilities are necessary to provide effluent reuse water for irrigation purposes and to meet wet weather effluent flow conditions. The analysis does not include an allocation of the investment and expenses associated with the collection and treatment of wastewater. Under the proposed rate, the DCDD, the sole existing customer, is projected to take an average of 800,000 gpd of effluent reuse water, producing \$195,640 of annual revenues. (T. 243; Exh. 15 (JFG-2))

In 1995, the annual average of effluent reuse water provided by PCUC to DCDD was about 1.0 MGD. While it is not known whether this is a representative level, implementation of a rate to what is now provided to DCDD at no charge would likely reduce consumption, based upon the "mini-elastic" nature of the commodity. (T. 372-373; 458-461) Thus, the use of 800,000 GPD as projected remains the best estimate for the test year, and best matches other projections of test year revenue requirement components.

PCUC's 6 MGD storage facility is required to provide equalization to the DCDD to maintain effluent quality, and generally to provide wet weather storage for PCUC. (T. 305) The effluent storage and RIB disposal facilities are part of an integrated system which meets the needs of both the general body of wastewater ratepayers and DCDD. Accordingly, the cost of those facilities should be used to establish an effluent rate that recognizes a fair sharing of cost between the wastewater ratepayers and DCDD and the value of the service to DCDD. (T. 306-307)

That the rate is not based on incremental cost is irrelevant.

Rates are generally set on the basis of average cost, regardless of the absence of any incremental cost of service. (T. 388-389) As Mr. Guastella testified,

Although PCUC did, in fact, incur costs for the six million gallon storage facilities primarily as a means of providing service to DCDD, an effluent reuse rate should not be based on incremental costs. Rate setting is basically an averaging process. Similar classes of customer all pay the same rates for service. For example, residential customers closer to the source of supply do not pay less for water than customers far from the source of supply. Existing customers do not pay less for water than new customers despite the fact that the cost of facilities today are higher than in the past. (T. 1092-1093)

When asked by Staff whether there was a standard as to which costs should be allocated or how to allocate those costs, Mr. Guastella testified,

I believe unlike the rest of the utility industries, the effluent rates are relatively new, and I don't think there's been the volumes of cases and preceden[ts] established that has developed a consistent way of looking at effluent reuse and related rates and charges that would be appropriate. I think it's kind of an evolving rate setting technology. (T. 376)

DCDD referred to Mr. Guastella's testimony in a withdrawn rate case, in which he had developed an effluent rate based on a sharing of incremental costs. DCDD asked Mr. Guastella whether he agreed with the "principle" that effluent rates should represent a sharing of incremental costs, Mr. Guastella responded that

(t)here could be instances and cases where an incremental cost is used to develop an effluent rate. But with the current state-of-the-art of development of rates, I don't think that holds as a principle where one decision in one case or one statement in one document has then established forever, and meets all of the various circumstances that you may have and which this Commission may yet to see in terms of the provision of effluent service. (T. 391)

This principle can be illustrated by assuming that a customer is connected to an existing main and the utility does not have to add plant, employees or any significant expense to provide service. Although there is no significant incremental cost to serve that customer, the customer would properly be required to pay the same rate as other customers. (T. 1093)

Given the DCDD's argument that the absence of any incremental cost should equate to no effluent rate, it is interesting to note certain prior dealings between the parties. Under their 1994 agreement, the DCDD provided temporary assistance to PCUC by making available 1 MGD of wet weather storage for up to 7 days. DCDD did not construct any additional facilities to provide that service, nor did it otherwise incur any incremental capital costs in connection therewith. Nonetheless, DCDD charged PCUC for the right to dispose of the effluent and to lease the storage. The charge was considered reasonable by DCDD, given DCDD's investment in the facilities, which would have been made whether service was provided to PCUC or not. (T. 430-432)

Consistent with PSC policy, an effluent rate should not exceed the cost of alternatives for irrigation water. While the upper limit could be PCUC's raw water rate, consideration of the value of service alone could justify consideration of the costs to DCDD to install its own water facilities (or to increase its bulk water allocation from PCUC through payment of substantial capacity charges). From strictly a value of service perspective, the proposed rate is a reasonable mid-point. (T. 1092)

In any event, as Mr. Guastella testified, DCDD's position that there should be no effluent rate is extreme in that

it does not recognize the value to all effluent customers or to the state due to the availability of effluent reuse. The other extreme would have been the allocation of all costs of the wastewater collection and treatment facilities to effluent reuse, justified on the basis that there would be no effluent reuse available to DCDD if PCUC did not collect and treat wastewater. My study is not based on an incremental cost analysis, nor is it based on a fully allocated cost analysis. I have allocated only effluent reuse facilities which are necessary to handle wet weather conditions. Moreover, I have spread those costs over all effluent not just the estimated effluent purchases by DCDD. Accordingly, I believe that the effluent reuse rate establishes a reasonable economic balance among the parties and is consistent with water conservation concerns of the responsible state regulatory agencies. (T. 1093-1094) (emphasis added)

DCDD would have the PSC focus only on incremental costs, and thereby ignore the actual costs PCUC must incur in owning and operating an integrated wastewater utility system, without which DCDD would have to find more costly irrigation water. DCDD would have the PSC ignore the fact that all of PCUC's wastewater customers share in the actual cost, even if there was no incremental cost to serve them. DCDD seeks sympathy because the effluent rates per 1,000 gallons it currently charges its customers may increase (at most) from 35¢ to \$1.02 for the golf course and from 70¢ to \$1.37 for residential use. DCDD, however, is apparently indifferent to the fact that PCUC's wastewater customers, without which there would be no additional effluent available to DCDD, have been paying \$3.60 per 1,000 gallons for irrigation water, before any rate increase, in order to pay their share of the cost of service.

The proposed effluent rate results in the lowest cost to DCDD's customers for effluent despite the fact that DCDD paid for the facilities to bring the effluent to DCDD from PCUC's plant and to further treat the effluent. PCUC's proposed effluent rate of \$0.67 per 1,000 gallons is only about half the proposed bulk rate DCDD would pay for water, and obviously less than any other alternative water supply DCDD could have found. (T. 424-429)

DCDD would also have the PSC conclude that effluent treated to "secondary" standards has no value. However, the record demonstrates that PCUC's proposed rate provides DCDD with, by far, the lowest cost irrigation water despite DCDD's own investment in its facilities.

Mr. Guastella used his rate setting expertise to develop an effluent rate which is most appropriate for the circumstances of PCUC. It reflects a balance of cost sharing and value of service. Moreover, his testimony identified the rate-setting principles and methodology that will be useful to the PSC in this case, and in other cases as different circumstances evolve. Mr. Guastella's recommendation benefits DCDD with a rate which reflects only a partial cost sharing and also benefits PCUC's wastewater customers, not stockholders, with an offset to the general wastewater revenue requirement.

ISSUE 68: WHAT IS THE APPROPRIATE BULK WATER RATE FOR PCUC?

PCUC: *As per MFRs.*****

PCUC determined its proposed bulk water rate by applying the same across-the-board percentage increase to the current bulk rate

that it applied to its other water rates. The DCDD is the only customer that pays the bulk water rate. That rate is lower than the general service rate for a comparable meter size. The differential reflects DCDD payment of advance capacity charges and applicable gross-up, which essentially refunded 100% of PCUC's investment in water treatment capacity necessary to serve the DCDD. Therefore, the rate does not reflect recovery of depreciation or return on investment and the like. (T. 214-217; 409-410; see Order No. 21606)

ISSUE 69: WHAT ARE THE APPROPRIATE WATER AND WASTEWATER SERVICE RATES FOR PCUC?

PCUC: *As per MFRs.*****

ISSUE 70: WHAT ARE THE APPROPRIATE AMOUNTS 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?

PCUC: *Fall-out issue.*****

ISSUE 71: 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?

PCUC: *Fall-out issue.*****

ISSUE 72: WHAT ARE THE APPROPRIATE ANNUAL AND MONTHLY DISCOUNTED RATES, AND THE EFFECTIVE DATE FOR AFUDC?

PCUC: *The appropriate annual rate is the rate of return determined in this proceeding. The monthly discounted rate should be that determined in accordance with Rule 25-30.116(3)(a), F.A.C. The effective date is the date the Final Order in this case takes effect.*****