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April 3, 1997

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Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Re: Docket Nos. ~~960223~~-WS and 960234-WS

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are the original and 15 copies of the Post Hearing Brief of the Citizens of the State of Florida. A diskette in WordPerfect 6.1 is also submitted.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

Stephen C. Reilly
Associate Public Counsel

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FPSC-RECORDS/REPORTING

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for increase)
in rates and service)
availability charges in Lee)
County by Gulf Utility Company)

DOCKET NO. 960329-WS

In Re: Investigation of rates)
of Gulf Utility Company in Lee)
County for possible overearnings)

DOCKET NO. 960234-WS

Filed: April 3, 1997

POST HEARING BRIEF
OF THE CITIZENS OF THE STATE OF FLORIDA

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STATEMENT OF BASIC POSITION

The utility has understated its revenue by failing to charge for reclaimed water. The utility's expenses are overstated due to transactions with its affiliates, inclusion of inappropriate and non-recurring expenses, inclusion of excessive salary expenses, and inclusion of expenses that are not properly borne by ratepayers. The utility's cost of capital is overstated because the utility included equity which should have been reflected as a contribution from an affiliated developer. The utility's rate base is overstated due to the inclusion of plant that is non-used and useful and the failure to properly recognize CIAC in rate base. Instead of a rate base increase proposed by the utility, the rates should be reduced for both the water and wastewater operations.

SYMBOLS AND CITATIONS

References to the transcript of the hearing are designated (T. page or pages). References to exhibits are designated (Exhibit __, page or pages). Also attention is drawn to certain portions of an exhibit by designating (See response to Interrogatory No. ____, page or pages of Exhibit No. ____). References to schedules are designated (See Schedules __ and __ of Exhibit _ ____).

ISSUES, POSITIONS AND DISCUSSION

ISSUE 1

Is the quality of service provided by Gulf Utility Company satisfactory?

OPC POSITION

The Citizens do not propose any penalties or reduction of Gulf's return on equity because of poor quality of service.

DISCUSSION

During the customer testimony portion of the hearing Mr. Dale Heusing complained about the quality of the water. (T. 47-48). He stated that most people in the community have had to put in water softners to soften the water and additional filtration so that faucets, fixtures and appliances do not corrode. (T. 48) He also felt that the 10,000 gallon cap established for the wastewater charge was unfair to those customers with irrigation systems. (T. 48-50) Mr. Bernard Bogner said that in past years it seemed as though plant additions to serve growth were paid for with rate increases to current customers. (T. 56) Mr. Bogner felt that growth should pay for growth rather than the current customers. (T. 60-61) Ms. Johanna Weeks stated that her water tastes bad. (T. 68) While she conceded that the water might meet governmental standards she still had to pay for filters on her faucet and refrigerator (ice maker). (T. 68)

Staff witness William Allen, with the Lee County Public Health Unit, testified that Gulf Utility's facilities and operations met the Florida Department of Health and Rehabilitative Services requirements. (T. 367-369) Staff witness Andrew Barienbrock, with the Florida Department of Environmental Protection, testified that Gulf's facilities and operations met his agency's requirements. (T. 371-373)

ISSUE 2

Does the Utility provide adequate fire flow to its entire certificated area?

OPC POSITION

Representatives from both fire Control Districts located in Gulf's service territory agree that the Utility fails to provide adequate fire flow to portions of its certificated area.

DISCUSSION

Staff witness Thomas Beard, Fire Inspector for the San Carlos Park Fire and Rescue Service District, provided substantial testimony confirming that Gulf Utility did not provide adequate fire flow to many portions of its certificated area. Mr. Beard stated that for residential areas the minimum requirement was 750 gallons per minute (gpm), and in commercial areas the fire flow required would depend upon the size of the building, but a minimum flow of 1500 gpm would be a good standard. (T. 388) Of the 619 fire hydrants in his district, 397 are served by Gulf, 56 hydrants are in commercial areas and 341 are located in residential areas. (T. 388) Thirty-five (35) of the 56 hydrants in the commercial areas did not meet required fire flow standards and 75 of the 341 fire hydrants in the residential areas failed to meet the districts' requirements. (T. 389)

Fire inspector Beard suggested that the inadequate fire flows were caused by reduced pumping pressure in the water lines. (T. 389) He said this reduced pressure can be caused by small diameter lines and build up in the water lines, or scaling, which reduces the diameter of the line. (T. 389) Inspector Beard stated that his discussion with Gulf representatives revealed that they felt they were not responsible for fire flows, but only responsible for the delivery of potable water. (T. 390) Inspector Beard provided specific examples of tests revealing inadequate fire flow in the Company's certificated area. (T. 390-391) He specifically stated that the flow being delivered to the University

was not adequate. (T. 391-392). He provided detailed information about eight buildings in the University's first phase of development. (Exhibit 28) He also complained that Gulf insisted upon being present anytime he or his men conducted fire hydrant inspections, while Florida Cities had no such requirement. (T. 391) Interestingly, Florida Cities has no fire flow problems, while Gulf Utility fails to maintain adequate flow to portions of its territory (T. 391) Gulf Utility conducts inspections of its fire hydrants without the presence of the fire inspector. (T. 751) Even though the current applicable fire code Section 10-384(5)(c), on page 10-82.2, requires the fire inspector's presence. (T. 751)

The Company's witness Mr. Elliott criticized Mr. Beard's fire hydrant inspections because he said the inspections were conducted for only 3-5 minutes rather than a duration of 10 minutes which allowed the booster pumping stations to initiate start up of the high-service distribution pumps designed to provide fire flow to the system. (T. 711-712) Inspector Beard criticized Mr. Elliott's testimony. He said fire fighters can not wait 10 minutes for proper fire flow (T. 400) Inspector Beard said the 3-5 minute inspections conducted by his personnel were proper and in accordance with the American Water Association Works Manual 17 and NFPA 291. (T. 400 and Exhibit 28) Inspector Beard added that to conduct tests as suggested by Gulf would result in property damage around the hydrant and the loss of 10,000 gallons of water for every fire flow test. (T. 401)

The Company criticized Inspector Beard's use of the Lee County Development Ordinance, Section 12 instead of the more current Section 10. (T. 709-710) However, Mr. Elliott under cross examination by Staff could not point out any material differences between the requirements of the two sections, except to say that in his opinion the current ordinance applies to only new developments and places the burden on the developer not the Utility to make adjustments to his development to meet

the fire flow requirements. (T. 746-748) Ultimately, witness Elliott admitted he hadn't really studied the two different sections and couldn't really say how they might be different. (T. 749) On the one hand the Company embraces the fire code's requirement for 1500 gpm flow to commercial buildings as a justification to receive a 1500 gpm times 4 hours credit of 360,000 gallons in its used and useful determination of water facilities, but on the other hand refuses to take responsibility for even supplying 750 gpm of actual fire flow to portions of its residential territory. This inconsistency should not escape the Commission's attention.

Staff witness Bernard Kleinschmidt, Deputy Chief of the Estero Fire Control and Rescue Service District, basically corroborated the opinions expressed by Inspector Beard. (T. 419-423) Specifically, he stated that the Company's suggestion that fire flow tests should last at least 10 minutes was contrary to the industry standards he was familiar with. (T. 726-727) He also stated that in his experiences Gulf's water system contains so much debris that in some cases a fire flow was not successful due to debris obstructions coming through the hydrants. (T. 422) In one instance in the Wildcat Run Subdivision the pressure device on the hydrant continually got clogged up with roots, wood and construction debris that was in the pipe. (T. 423) This incident occurred in lines currently in use to provide drinking water, not water lines under construction or for construction uses. (T. 423) In another test in the Breckenridge subdivision the flow coming out of the hydrant was a dark rusty color. (T. 423) For this test the hydrant flowed for 20 minutes and the water never cleared up (T. 423)

In Document Request No. 44 the Citizens asked the Company to provide fire flow testing records of the remote hydrants for the year 1995. In its response the Company stated that: "Gulf does not maintain records of fire flow testing at hydrants. Local fire departments keep those

records." Concerning the issue of fire flow the company has been less than forthright. Under cross examination Company Witness Cardey conceded that the company had fire flow tests conducted by the company and the fire departments which the Company participated in, which go back a number of years. (T. 179) After discussing this issue with the two fire departments one can understand why the Company was not more forthright.

Although the Company is asking the Commission to give it credit for supplying 1500 gpm fire flow to its entire service area (residential and commercial) it clearly fails to provide these flows to its customers, or even one half of this flow to portions of its service territory. Under cross examination by Staff the Company's operations manager, Steve Messner conceded that the Company does not provide the 1500 gpm fire flow to all of its customers. (T. 825) When asked to give an estimate of how many hydrants fail to deliver the 1500 gpm flow he could not even offer an estimate. (T. 825) Clearly, the Company has not met its burden of proof to justify charging the customers the 360,000 gallon fire flow allowance being requested in this proceeding.

ISSUE 3

Should the one million gallon reject holding tank for the Corkscrew Water Treatment Plant be included in rate base?

OPC POSITION

No. Construction of the one million gallon holding tank has not even begun. If further delays occur it could be 1998 before the facility is in service.

DISCUSSION

On December 4, 1996, at the end of the test year, when the Citizens conducted their on site inspection, the one million gallon holding tank (tank) had not been constructed. (T 247) Witness

Biddy testified that the capital investment of the proposed concentrate holding tank of \$700,000.00, as shown in Schedule A-1, Page 3 of 3, line 24, should not be included in rate base. (T. 247) He testified that the engineering, legal and administrative costs of the facility, totaling \$150,000, should also be excluded from rate base. (T. 247-248)

Under cross examination by Staff the Company's president, James Moore, conceded that the contract had not been executed authorizing the construction of this facility and that even the plans to build the building had not been finalized. (T. 128-129) While the date for commencing construction had been delayed a number of times the company still "projected" completion of the project by August, 1997. (T. 129) The Citizens suggest that considering the past delays in this project the company has failed to offer convincing evidence that this facility will be in service before 1998.

In his prefiled rebuttal testimony Company witness Elliott stated that the tank is "being constructed" as a component part of membrane treatment Skid #3 at the Corkscrew WTP. However, under cross examination witness Elliott conceded that his term "being constructed" meant that it had been permitted and that plans were being finalized for its construction. (T. 722) In fact, he admitted he was not even sure that the company had received a permit to construct the facility. (T. 723)

While the company claims it can start and complete the construction of its one million gallon reject holding tank in four months, it also claims it can't construct increments of increased capacity to existing permitted wastewater treatment facilities in less than 3 years, when asking for a margin reserve allowance. The availability of this tank for service is well outside the test year and should be excluded from rate base.

ISSUE 4

Should any adjustments be made to the chlorine contact chambers at the new Three Oaks Wastewater Treatment Plant?

OPC POSITION

While the Chlorine contact chamber at the new plant should be considered 64.63% used and useful, the chlorine contact chamber at the old plant (located at the same site) should be considered 48.48% used and useful, pursuant to class I reliability requirements.

DISCUSSION

According to Mr. Biddy's Exhibit TLB-3, page 1 of 1 the new Three Oaks WWTP, including its chlorine contact chamber should be considered 64.63% used and useful. In his prefiled direct testimony Mr. Biddy stated that he thought the new chlorine contact chamber was sufficient to serve the plant's existing capacity of .75 mgd. (T. 248) He stated that the other chamber associated with the old WWTP was not needed and should be considered held for future use. (T. 248)

Company Witness Elliott in his prefiled rebuttal testimony argued that the second chlorine contact chamber associated with the old WWTP should be considered 100% used and useful because it was necessary to assure compliance with DEP Rule 62-610 that requires class I reliability for the new plant. (T. 704) In response to this rebuttal testimony Mr. Biddy agreed to modify his recommendation, which he did with his Exhibit TLB-3.4.

According to Mr. Biddy's Exhibit TLB-3.4, which is based upon the requirements of MCD-05, United States Environmental Protection Agency - Design Criteria for Mechanical, Electric, and Fluid System and Component Reliability Standards, EPA-430-99-77-001, the chlorine contact chamber to the Old WWTP should be considered 48.48% used and useful. (See Schedule TLB-3.4 of Exhibit 18) Under cross examination Company Witness Elliott admitted that Section 212.1.9 of

the EPA guideline, page 22, only requires 50% design flow backup for chlorine contact chambers (T. 734) Given this admission, and given the max month average daily flow of the new WWTP of 484,357 gallons, and given the old chlorine contact chamber's capacity of 500,000 gpd, the old chlorine contact chamber should be considered no more than 48.48% used and useful for purposes of providing Class I reliability to the new WWTP. (See Schedule TLB-3.4 of Exhibit 18)

ISSUE 5

Should any adjustments be made to the old Three Oaks Wastewater Treatment Plant?

OPC POSITION

Yes, the old Three Oaks Wastewater Treatment Plant should be considered 60.59% used and useful.

DISCUSSION

Mr. Biddy's initial recommendation was to transfer the entire old Three Oaks WWTP into plant held for future use. (T. 248) Company Witness Elliott in his prefiled rebuttal testimony argued that the old treatment plant was a necessary element of the new Three Oaks WWTP process to provide required redundancy for on-line aeration and clarifier units. (T. 704) Mr. Elliott argued that the old WWTP should be considered 100% used and useful in that it was necessary to ensure compliance with DEP Rule 62-610 requiring Class I reliability. (T. 704) In response to this testimony Mr. Biddy agreed to modify his recommendation, which he did with his schedule TLB-3.4 of Exhibit 18.

According to Mr. Biddy's Schedule TLB-3.4, which is based upon the requirements of MCD-05, United States Environmental Protection Agency - Design Criteria for Mechanical, Electric and Fluid System and Component Reliability Standards, EPA-430-99-74-001, the old Three Oaks WWTP

should be considered 60.59% used and useful. (See Schedule TLB-3.4 of Exhibit 18 and Exhibit 37) Section 212.1.5 of the EPA Standard only requires 75% design flow backup for final and chemical sedimentation basins, trickling filters, filters and activated carbon columns. (Exhibit 37) Given the maximum month average daily flow of the new Three Oaks WWTP of 484,757 gallons, given the old WWTP's capacity of 500,000 gpd, the old Three Oaks WWTP, less the old plant's chlorine contact chambers, should be considered 72.71% used and useful. (See Schedule TLB-3.4 of Exhibit 18) Unfortunately, when the company responded to the Citizen's Interrogatory No. 60 it did not break out the dollar investment in the various WWTP components, so Mr. Bidy was forced to provide an average used and useful percentage for the entire old Three Oaks WWTP, including its chlorine contact chambers, producing a combined average used and useful percentage for the old WWTP of 60.59% (average of 72.71% and 48.48%). (See Schedule TLB-3.4 of Exhibit 18)

Under cross examination Company witness Elliott admitted that DEP rule 62-610.300(1)(c), F.A.C., and the before mentioned sections 212.1.5. and 212.1.9 of the EPA publication are the appropriate guidelines to determine Class I reliability for these wastewater facilities. (T 731-732) Mr. Elliott also agreed that the guideline required 75% of the total design flow backup for final sedimentation basins and filters and 50% for the disinfectant contact basins (chlorine contact chambers). (T. 732-734)

ISSUE 6

Should the costs associated with the Florida Gulf Coast University (FGCU) be included in this rate proceeding, and what, if any, adjustments are necessary?

OPC POSITION

*No. The costs, expenses and revenue related to Florida Gulf Coast University should be

removed from the test year. In the alternative, if the water and wastewater lines are not removed from rate base they should be considered no more than 24.96% and 23.15% used and useful, respectively.*

DISCUSSION

With the exception of a water meter for construction and a water meter for a chiller unit the water and wastewater lines built to serve the University were not operational during the test year. (T. 123 and 130-131) Mr. Moore conceded that other than the meter for the chiller unit and the meter for construction purposes, the University will be open for students with the phase I buildings utilizing Utility services in the Fall of 1997. (T. 611-612) Since this service is well beyond the test year, rate base should not include any of the associated costs to serve the University. (T. 249) The associated costs are \$1,160,207.75 according to Staff's Interrogatory No. 16. (T. 249)

It is best to exclude the costs, expenses and revenues related to serving the University after mid 1997 because it is nearly impossible to establish any proper used and useful percentage to the water and wastewater lines. The initial usage of the lines, with the nine buildings of Phase I represents about 12% of the year 25 projected phased growth of the University for water services and about 11% of the year 25 projected phased growth of the University for wastewater services. (Exhibit 4) These percentages also do not take into account the use of the water and wastewater mains on Treeline before the lines enter the University's property. Ultimately, these lines will serve increasing demands on campus as well as private developments off campus, because of the private development that will occur around the campus as it grows. (T. 249)

All attempts to get the company witnesses to quantify the capacity of the lines installed to serve the University proved to be futile. After exclusive questioning the president of the Utility had no idea what the capacity of the lines were, even though he had negotiated the contract with the

University. (T. 571-577) Mr. Moore, however, did admit that the lines installed to serve the University would also serve non-University customers. (T. 612) The Company's engineering witness, Mr. Elliott, had no knowledge about the lines capacity. (T. 715-717) He said he had no knowledge about the agreement with the University and that although the Utility had engineers review the specifications, he was not one of those engineers. (T. 715-716) Although the water and wastewater mains are 12" in diameter and initially would serve only 9 buildings, he said he had not conducted a hydraulic analysis of the lines to determine their capacity and he refused to engage in speculation (T. 716-717)

In light of the limited use of these lines, well outside of the test, year and the dearth of information provided by the Company concerning their capacity, the proper regulatory treatment would be to exclude all costs, expenses and revenues associated with these lines from the rate case. By removing these costs and revenue from the test year the Commission will ensure that current customers are not burdened with paying for the non-used and useful transmission lines and collection lines installed to serve the university and other customers in the future. By excluding these costs and revenue from the test year, the Company will, in effect, be permitted to earn a return on the used and useful portion of these facilities. (T. 307- 308)

If for any reason the Commission does not exclude these lines from plant in service, these water and wastewater lines should be considered no more than 24.96% and 23.15% used and useful, respectively. These percentages are based upon a comparison of the flows from Phase I to the projected flows of the year 10 phased growth for the University, according to the contract included in Exhibit 4. These percentages also do not take into account use of the lines by private developments next to the campus.

ISSUE 7

Should a margin reserve be allowed for the water and wastewater systems, and if so, what amount?

OPC POSITION

No. Margin Reserve is for the benefit of future customers and should not be borne by current customers. If the Commission grants a margin reserve, the reserve periods should not exceed those traditionally allowed by the Commission, 18 months for treatment plants and 12 months for collection and distribution lines.

DISCUSSION

While it may be appropriate for a Utility to have reserve capacity to accommodate demands placed upon the system because of growth, it is not appropriate to make current customers pay for this reserve capacity in a margin reserve. (T. 246) It is more appropriate to collect these costs from the cost causers, namely the future customers. (T. 246) Funds to support prudently constructed reserve capacity should be collected from future customers in the form of contributions-in-aid-of-construction (CIAC), paid by customers upon connection, or prepaid, in the form of plant capacity charges, connection charges for distribution and collection mains, advances for construction collected from developers and distribution and collection lines contributed by developers. (T. 246)

Even the carrying charges for plant which is not needed to serve current customeres may be paid for by the Utility receiving guaranteed revenues from future customers. (T. 246) The Commission also permits utilities to collect an allowance for funds prudently invested (AFPI) which also reimburses the Utility for the carrying charges for non-used and useful plant. (T. 246) Collection of these contributions and prepaid fees from future customers should render a margin reserve allowance, paid by current customers, to be unnecessary. (T. 246) Gulf Utility is a good example

because in every instance, except when dealing with the Caloosa Group, the Utility requires developers to contribute all of the water and wastewater lines necessary to serve a development prior to it connecting to Gulf's system.

Under Florida's tightening environmental regulations, increasing water costs and water conservation concern, it is reasonable to believe that the water consumption and wastewater generation of existing customers will not increase. (T. 247) Therefore, the margin reserve requested by the Utility is solely for new customers. If the Commission allows margin reserve in the used and useful calculations, then it will penalize existing customers by burdening them to pay extra cost for new customers. Allowing margin reserve will further increase water and wastewater rates for the existing customers. (T. 247) High Utility rates (electric, water and wastewater) reduce customers' financial ability to obtain Utility services and that will hinder future development in the service areas. (T. 247) Therefore, the Commission should eliminate margin reserve allowance in the used and useful calculations. The Utility should recover the costs of plant additions and main extensions through other measures from new customers or developers. (T. 247)

In its filing Gulf attempts to expand its rate base by proposing longer margin reserve periods, by overstating the projected annual growth of ERC's and by overstating the gallons used by the equivalent residential connections. The F-9 and F-10 Schedules for water and wastewater treatment revealed actual historic ERC growth from 1995 to 1996 of 431 ERC's for water and 545 ERC's for wastewater. However, the Company "projected" in its F-5 and F-6 schedules that actual growth would be 607 ERC's (exclusive of the University) for water and 507 ERC's (exclusive of the University) for wastewater. When questioned about the discrepancies between these MFR schedules Mr. Cardey explained that the F-5 and F-6 schedules attempt to reflect the growth the Company

“anticipates” for the future. (T. 170) He admitted that the “effect” of the Company’s analysis of the growth it “anticipates” is to create a higher growth rate than could otherwise be supported with historic data. (T. 172) A higher growth rate will support a larger margin reserve allowance for the Utility.

Mr. Cardey also conceded that the Company used a 396 gpd water usage per water ERC in Schedule F-5 and a 250 gpd wastewater generation per wastewater ERC in Schedule F-6. (T. 176) While these figures are consistent with the Company’s tariffs, Mr. Cardey admitted that they had not been updated for eight years. (T. 176) According to the 9-27-96 revised Schedules F-9 and F-10, that are part of Exhibit 9, one can determine that the current usage for water is 206 gpd per ERC and the current usage for wastewater is 158 gpd per ERC. (T. 176-177, also See Exhibit 9) If the Commission accepts the Company’s proposal to expand the margin reserve periods, overstate the projected growth of ERC’s and to accept a per gallon usage per ERC which is greater than can be supported by current usage data, it will cause rate base and Utility rates for current customers to be unjustifiably increased.

Mr. Elliott in his prefiled rebuttal testimony argued that the purpose of DEP’s Rule 62-600.405, F.A.C., was to ensure that the company has at least a five-year margin reserve of capacity or that the expansion process is in progress. (T. 702) When Mr. Elliott was asked which it was, a five year margin reserve or an expansion process in progress, he answered that the rule “translates” to him that the company should have a five-year margin reserve. (T. 718) However, under questioning Mr. Elliott admitted that this interpretation of the rule can not be found in the literal reading of the rule. (T. 719) After further questioning, Mr. Elliott also admitted that there was nothing in Rule 62-600.405, F.A.C., which speaks to the issue of who should pay for any needed

reserve capacity. (T. 721) He admitted that really the thrust of the DEP rule was to develop a planning process to guarantee the availability of sufficient reserve capacity. (T. 720) Given these admissions it is clear the DEP rule does not even speak to, much less, mandate any reserve capacity to be paid for by current customers (margin reserve).

In his prefiled rebuttal testimony company witness Mr. Cardey argued that the margin reserve was designed to serve existing and future customers. (T. 643) He argued that the margin reserve served the changing and at times increasing needs of existing customers. (T. 643) He stated a good example of this was the Estero High School. Five years ago it had a total pupil enrollment of 1,226, and in 1996 it was 2,451. (T. 643) Under cross examination his example was challenged. He was asked if he knew how much of the increased enrollment was due to new families moving into the service area as opposed to existing families becoming larger and sending more kids to the school. He said he didn't know. (T. 663) When pressed further on the issue, he admitted that as existing schools are expanded to meet larger and larger enrollments and new schools are built, it is the result of normal community growth as opposed to existing families becoming larger. (T. 664)

In conclusion, the Commission should not grant Gulf Utility a margin reserve, or in the alternative, if a margin reserve is granted it should not exceed those traditionally allowed by the Commission, 18 months for treatment plants and 12 months for collection and distribution lines. (T. 264)

ISSUE 8

Should fire flow be included in the used and useful calculations for the water system, and if so, what is the appropriate allowance?

OPC POSITION

Fire flow provision should be included in the used and useful calculation of finished water storage but not for the supply wells, treatment plants or distribution mains. The fire flow allowance should be 750 gpm because that is the only documented fire flow filed in this proceeding.

DISCUSSION

The delivery of a required fire flow is dictated by many components in a water distribution system, including high service pumps, distribution storage tanks, water mains, etc. (T. 249) Because of economic concerns, for many systems fire flows are provided partially by high service pumps and partially by elevated storage. It is not cost effective to use source of supply and treatment plant to meet instantaneous demands, such as peak hourly flows and fire flows. (T. 250) For this reason, the Citizens did not included fire flow in their used and useful calculation for source of supply or water treatment plant.

Both of the Utility's engineering witnesses ultimately agreed that instantaneous demands like fire flow and peak hour demands should not be included in the design basis for treatment plants. Witness Elliott stated: "Instantaneous demands like fire flow and peak hour demands are included in the design basis for water storage and high service pumping systems, not plant treatment process capacities." (T. 709) Under cross examination Witness Cardey agreed that plant treatment processes should not be designed to meet fire flow and peak hour demands. (T. 667) He went on to say that while for small systems that might not be true, it would be true for a system the size of Gulf's. (T. 667-668) Despite the contrary sworn testimony of both Utility engineering witnesses the Utility is still seeking a fire flow allowance in the used and useful determination for their water treatment facilities.

Gulf currently has a total of 2.6 million gallons of storage, which seems adequate for the fire flow requirement and peak hour demands. (T. 250) Therefore the Citizens have included fire flow in the used and useful calculations for finished water storage. (T. 250) See Schedule TLB-2 in Exhibit 18 for details. However, the amount of the allowance must be limited to the documented fire flow that is consistently and uniformly supplied to the service territory. See the considerable discussion concerning the amount and adequacy of the fire flows being supplied by Gulf Utility under issue 2. There are portions of Gulf's territory that are unable to consistently receive the residential fire flow of 750 gpm. Despite this deficiency the Citizens recommend to give the Utility a 750 gpm times 4 hours, or a 180,000 gallon, fire flow allowance in the used and useful calculation for finished water storage. (T. 270 and 285)

ISSUE 9

Should economy of scale be considered by the Commission in determining whether facilities are used and useful in the public interest?

OPC POSITION

No, all existing and future customers should evenly share the facility costs.

DISCUSSION

See discussion of issue 10 relating to economy of scale considerations in determining the used and useful percentage for the Corkscrew Well Field, Corkscrew Water Treatment Plant, skid #3 and Corkscrew reject water facilities.

ISSUE 10

Should the Commission recognize economy of scale in determining used and useful for the Corkscrew Well Field, Corkscrew Water Treatment Plant, Skid #3, and Corkscrew reject

water facilities (page 167 and page 9, lines 11 and 12 of MFRs)?

OPC POSITION

All facilities should be designed and constructed in the most cost effective sizes to take advantage of any economy of scale. However, the benefits of any economy of scale should be shared by all current and future customers.

DISCUSSION

Company Witness Cardey in his prefiled direct testimony stated: "The Commission in Order No. 24735 recognized economics of scale in the construction of the Company's water treatment facilities, and this principal has been extended to the construction of Skid #3 at the Corkscrew treatment plant which will go into service in December 1996." (T. 138) However, under cross examination Mr. Cardey conceded that the Commission's Order No. 24735 made no determination concerning the used and useful percentage of either Skid 2 or Skid 3. (T. 181) In his prefiled Direct Testimony Witness Cardey goes on to state: "Under this theory (of economy of scale), the excess capacity is related to the last increment of capacity, which in this case is Skid #3 " (T. 138) Again, under cross examination Mr. Cardey conceded that he could not find any "exact words" in Order No. 24735 which would support such a proposition concerning economy of scale analysis in determining the used and useful percentage for the membrane skids. (T. 181)

Witness Cardey also claimed that Order No. 24735 recognized economy of scale in determining the used and useful percentage for the well fields. (T. 184) However, under cross examination he admitted that Order No. 24735 found that 7 of the 11 wells were determined to be non-used and useful. (T. 184)

ISSUE 11

Should all facility lands be considered 100% used and useful, and if not, what are the

appropriate used and useful percentages?

OPC POSITION

***No. Used and useful calculations should be performed to justify the 100% used and useful allocation for facility lands. The appropriate used and useful percentages for combined water treatment facility land is 67.16% and for combined wastewater treatment facility land is 66.96%.**

DISCUSSION

The Commission should not automatically grant 100% used and useful on facility lands without complete analysis. (T. 253) Every system has different sizes of facilities and lands. The current demands and available facilities are also unique between systems. These factors all dictate the facility usage. Therefore, a used and useful assessment is necessary for every facility land because all facility lands are part of the system. (T. 253) Facility lands are designed and used to serve the whole system, including new and existing customers. It is unfair to burden existing customers for the whole facility land cost needed to serve total build out. (T. 253)

San Carlos WTP is built out in its facility site based on the Citizens' field inspection. (T. 253) According to Gulf's operation manager's explanation, San Carlos wastewater treatment plant (WWTP) can not be expanded because of the Class I reliability requirement and inadequate open space. However, facility land adjustments should be made to Corkscrew WTP and Three Oaks WWTP because there is ample space to expand for the ultimate design capacities of 3.0 MGD and 5.0 MGD respectively. (T. 253)

After Citizens' engineer, Mr. Bidy reviewed the site plans provided in Citizens' Production of Documents Request No. 46, he made his used and useful determinations of the Corkscrew WTP and resulting combined WTP facility lands as well as for the Three Oaks WWTP and resulting

combined WWTP facility lands. The resulting used and useful percentages were 51.98% for Corkscrew WTP, 100% for San Carlos WTP with a 67.16% combined used and useful percentage for water treatment facility lands, and a 57.40% for Three Oaks WWTP, 100% for San Carlos WWTP with a 66.96% combined used and useful percentage for wastewater treatment facility lands. (See Schedules TLB-2 and TLB-3 of Exhibit 18)

Company witness Messner conceded that the Three Oaks WWTP's current capacity is 750,000 gpd, and that ultimately a plant designed to process 6 million gpd of wastewater will be located on the same site. (T. 817-818) In his prefiled rebuttal testimony company witness Messner stated: "By way of background, the Commission in the 1991 rate case (Order No. 24735) found the land to be 100% used and useful." (T. 803) Under cross examination witness Messner admitted that he was unaware of any expressed language in Order No. 24735 which held that the facility lands were 100% used and useful, but that the plant itself, at that time, was 100% used and useful and no adjustment was made to facility lands. (T. 818-819) Under cross examination witness Messner also conceded that there would be two additional storage tanks constructed at the Corkscrew WTP site. (T. 820-821) He, however, could not confirm if the Utility still intended to build the administration building, which was depicted in a site plan provided to the Citizens in response to its Document Request No. 46. (T. 821)

ISSUE 12

What is the appropriate method and resulting used and useful percentages for the water system components?

OPC POSITION

*For water treatment the average of 5 maximum daily flows of the maximum month divided

by the total plant capacity results in a 68.43% used and useful percentage. The water lines are contributed and require no analysis. See issues 13 and 14 for water supply and storage.*

DISCUSSION

The appropriate method for determining the used and useful percentage for water treatment facilities is to divide the average of the 5 maximum daily flows of the maximum month by the total plant capacity. (See Schedule TLB-1 of Exhibit 18) It is not cost effective nor appropriate to include instantaneous demands like fire flows or peak hour demands in the calculation. (See Schedule TLB-1 of Exhibit 18) Although the company proposes to include a 360,000 gallon fire flow allowance in its used and useful calculation for water treatment, neither of the Company's engineering witnesses support its inclusion. (T. 667-668 and 709)

At the hearing it was revealed that the Company was adding on average 57,600 gallons of raw water per day to its average daily production of 1.8 million gpd of membrane water at its Corkscrew WTP. (T. 813-815) This blending of raw water with membrane water effectively increases the capacity of the Corkscrew WTP. This increase in capacity should be taken into account when calculating the plant's used and useful percentage. As a result of this additional information the Citizens proposed used and useful percentage for the Corkscrew WTP is reduced from 28.26% to 27.39%, with the combined water treatment plant percentage being reduced from 69.36% to 68.43%.

ISSUE 13

What is the appropriate method and resulting used and useful percentages for water supply wells?

OPC POSITION

*The appropriate method is "Average of 5 Maximum Daily Flows of the Maximum Month divided by Total Well Capacity." The resulting used and useful percentage is 46.82%

DISCUSSION

Gulf did not perform a complete used and useful analysis for the water supply wells. (T. 251) The Utility's analysis was only based upon "activation or inactivation" for its used and useful determination, which neglects potential excess capacities of supply wells. (T. 251) The used and useful analysis should consider the capacity of each well and treatment demands. When calculating treatment demands for the Corkscrew Water Treatment Plant (WTP), an additional 15% of demand from the raw water supply should be considered for reject concentrate. (T. 251)

Customarily a water Utility will use a "firm reliable capacity" in calculating the used and useful percentages for water supply wells. The firm reliable capacity excludes the largest well capacity by assuming it to be out of service. (T. 251) When there are more than ten wells, the largest two wells are assumed to be out of service. The combined capacity of the remaining supply wells is the "firm reliable capacity." (T. 251)

However, when storage or high service pumping facilities are available, the "firm reliable capacity" method is not applicable. According to Section 3.2.1.1 Source capacity of *Recommended Standards for Water Works*:

"The total developed groundwater source capacity shall equal or exceed the design maximum day demand and equal or exceed the design average day demand with the largest producing well out of service."

This design criteria should be used to calculate used and useful percentage for supply wells. (T. 251) For the above reason, the "firm reliable capacity" method should not be applied to supply wells where the water system is also equipped with storage and high service pumping facilities. Gulf also has a one million-gallon booster station along the US Highway 41 to supply demands from the customers.

(T. 252)

Pursuant to the Company's response to the Citizen's Interrogatory No. 53 the total capacity of the San Carlos well field is 2.808 million gpd. The average of 5 maximum daily flows of the maximum month from the San Carlos WTP is 2.415 million gpd, making the San Carlos well field 86% used and useful.

Pursuant to the Company's response to the Citizens' Interrogatory No. 53 the total capacity of the Corkscrew Well Field is 3.6 million gpd. The average of 5 maximum daily flows of the maximum month from the Corkscrew WTP is 508,727 gpd, making the Corkscrew Well Field 16.25% used and useful. The proper used and useful percentage for the weighted and combined well fields is 46.82%.

Under cross examination Company witness Cardey admitted that only 5 of the 11 wells located in the Corkscrew Well Field are even equipped with pumps. (T. 192) Further, Mr. Cardey admitted that the company had no plans in the next 18 months to activate any of the 6 inactive wells.

(T. 193)

ISSUE 14

What is the appropriate method and resulting used and useful percentages for water storage?

OPC POSITION

The appropriate method is "Half Average Daily Flow plus Fire Flow Storage, divided by the Total Storage Capacity." The resulting used and useful percentage is 63.15%, assuming 750 gpm fire flow is provided.

DISCUSSION

As previously discussed the Citizens believe it would be appropriate to include a fire flow

allowance of 180,000 gallons in the used and useful calculation for finished storage. When the system is furnishing fire flow, a half day average daily flow (ADF) storage is appropriate. That volume is more than adequate for peak hour demand storage compared with 20 to 25% ADF mentioned in the AWWA M32. (T. 252) The excess storage can be considered as a provision for emergency storage. The one day ADF storage criteria used in the "Ten-States Standards" was reduced to one half day because design flow of the maximum daily flow (MDF) is used for supply wells, treatment plant and high service pumps. (See Schedule TLB-1 of Exhibit 18)

The Citizens included no additional emergency storage because it is an owner's option. Total capacity is used, retention storage is not applicable to elevated storage tanks and there is no documented dead storage. (See Schedule TLB-1 of Exhibit 18)

In his prefiled rebuttal testimony Company witness Elliott states that: "It is a standard practice to provide emergency storage based upon an assessment of risk and degree of system dependability" (T. 706) Under cross examination Mr. Elliott conceded that there were no studies, documents or standards which the Company utilized to assess the system's dependability when arriving at Gulf's recommended emergency storage allowance. (T. 743-744) The Company's witness, Mr Elliott, concurred with the Citizens' Witness, Mr. Bidy, in the conclusion that there was no dead storage allowance applicable for this Utility. (T. 745-746)

ISSUE 15

What is the appropriate method and resulting used and useful percentages for the wastewater treatment plant?

OPC POSITION

***The appropriate method is the "average daily flow of the maximum month or annual average**

daily flow divided by the total plant capacity," depending upon the FDEP permits. San Carlos WWTP is 100% used and useful. Three Oaks WWTP is 64.63% used and useful.*

DISCUSSION

The permitted capacity of the San Carlos WWTP is 218,000 gpd, based upon the annual average daily flow of the plant. The estimated annual average daily flow of the plant in 1996 is 219,151, making it 100% used and useful. The permitted capacity of the Three Oaks WWTP is 750,000 gpd, based upon the average daily flow of the maximum month of the plant. The estimated average daily flow of the maximum month in 1996 is 484,757 gpd, making it 64.63% used and useful. The combined and weighted used and useful percentage for both plants is 72.60%.

Both the Public Counsel and the Utility utilize the same percentage of used and useful for effluent disposal as was used for wastewater treatment. (T. 673)

ISSUE 16

What are the appropriate used and useful percentages for the water and wastewater facilities?

OPC POSITION

See issues 12-15.

DISCUSSION

See discussion for issues 12-15.

ISSUE 17

Are adjustments necessary to increase CIAC and decrease equity for lines built for the Caloosa Group (Audit Disclosure 1)?

OPC POSITION

Yes, CIAC should be increased by \$68,144 for the water operations and by \$92,815 for the wastewater operations. Appropriate adjustments should likewise be made to accumulated amortization of CIAC and amortization expense. Equity should be decreased by \$160,929.

DISCUSSION

In February 1990, Gulf recorded \$68,114 of water assets and \$92,815 of wastewater assets on its books associated with assets constructed by Caloosa Group, Inc. In exchange for the assets, Gulf issued common stock to the shareholders of Caloosa Group, Inc. The shareholders of Gulf and Caloosa are the same and they own the same proportionate share of each company. It is typical for a developer to construct and donate their lines and hydrants to the utility's system. The assets are recorded on the books of the Company and an equal amount of CIAC is also recorded on the books. The net result is no impact on rate base. This is the Company's policy with all developers, except its affiliate Caloosa Group, Inc. Gulf claims that its treatment of these affiliate transactions is appropriate because it was a routine business transaction in February 1990 where common stock was issued for \$160,928 of assets. It was straightforward. It violated no law or rule. (T. 291- 292) The Company also suggests that its stockholders have borne losses associated with the utility operations and specifically the interest payments on the IRDB which exceeded the interest earned on the money not used. This according to Mr. Moore, justifies the utility's unusual accounting of these assets. Mr. Moore suggests that these losses create a "substantial difference in service provided the stockholders in Gulf/Caloosa and the other developers in the area."(T. 543- 544) Mr. Moore however, failed to tell the Commission that Gulf borrowed \$10,000,000 in 1988, yet it was not required to borrow this much money. (T. 578) Furthermore, on cross-examination, Mr. Moore conceded, the amount of the IRDB issued by the utility was a decision made by the utility not customers.(T. 579) Likewise, Mr.

Moore admitted that the losses sustained because of these bonds were the result of management decisions not customer or developer decisions. (T. 579- 580)

The Company has not provided any reasonable explanation of why the Utility did not require its affiliate-developer to contribute the property as it requires other developers. The Company has not provided a satisfactory explanation of why the Commission should permit the Company to treat its affiliate-developer more favorably than unaffiliated developers. The effect of the Company's transaction is to increase rate base and the overall cost of capital — both of which increase rates to customers. The Commission should reject the Company's accounting treatment of this transaction.(T 293) The Commission should adopt the recommendations of Ms. Dismukes and Mr. Rendell and reduce the equity component of the capital structure by \$160,928. In addition, the Commission should increase CIAC included in rate base by the same amount.(T. 293)

ISSUE 18

Are adjustments necessary to reflect prepaid CIAC as used and useful in rate base?

(Audit Disclosure 8)

OPC POSITION

Yes, to the extent that the associated plant is included in rate base. In the absence of a showing by the utility that the plant related to prepaid CIAC is not included in rate base, CIAC should be increased by \$379,319 for water operations and by \$207,304 for wastewater operations.

DISCUSSION

Staff witness Welch and the Citizens' witness Dismukes both recommend that prepaid CIAC associated with plant that is in service be included as an offset to rate base. (T. 309 and 454-455) Ms. Dismukes testified that she reviewed the Staff audit workpapers and other information provided by

the utility and it was not clear to what the prepaid CIAC related. (T. 349-350)

Ms. Welch testified that she had an exhibit prepared by Carolyn Andrews, of the utility, that showed which wastewater treatment plants prepaid CIAC relates to and that wastewater prepaid CIAC can be matched to individual plant that are existing and in service. (T. 480-481) Ms. Welch also testified that she asked if any additions were needed to the plant and the answer was no.(T. 481) With respect to the water prepaid CIAC, Ms. Welch testified that Ms. Andrews told her that she could not identify which plants the water prepaid CIAC related to. (T. 480)

It is the utility's burden to prove the issues identified in a rate proceeding. In the instant case, the utility has failed to meet its burden. Both Ms. Dismukes and Ms. Welch testified that they had requested information to determine if prepaid CIAC related to plant in service, and with the exception of wastewater prepaid CIAC which is related to plant in service, the utility did not provide the data necessary to make such a determination. Accordingly, in the absence of proof to the contrary, the Commission should include as an offset to rate base prepaid CIAC related to both the utility's water and wastewater operations. Accordingly, CIAC should be increased by \$379,319 for the water operations and by \$207,304 for the wastewater operations.

ISSUE 19

If a margin reserve is approved, should CIAC be imputed on margin reserve, and if so, what amount?

OPC POSITION

Yes.

DISCUSSION

As Ms. Dismukes testified, if margin reserve is included in the used-and-useful calculations,

then, to achieve a proper matching, an amount of CIAC equivalent to the number of equivalent residential connections (ERCs) represented by the margin reserve should be reflected in rate base. When determining the amount of imputed CIAC, the Commission should use the proposed, interim, or final new capacity charges. The CIAC that will be collected from these future customers would at least serve to mitigate the impact on the existing customers resulting from requiring them to pay for plant that will be utilized to serve future customers. (T. 315-316)

Imputation of CIAC on margin reserve has been a longstanding policy of this Commission. The Commission's practice of imputing CIAC on margin reserve is well documented in Order No. 20434 and Order No. PSC-93-0301-FOF-WS. The Company has presented no new evidence that would require the Commission to change its policy. If the Commission were to change its policy as suggested by the Company, it would place the risk of customer connections on the backs of current ratepayers. The risk that future customers connect to the system, as projected by the utility in its margin reserve calculations, should be borne by stockholders, not customers. This is a risk that the utility is compensated for in its allowed return on equity. If the Commission were to change its policy, the utility would not only be provided with an opportunity to overearn, it would create a significant incentive for the utility to over project customer growth for margin reserve purposes. Imputation of CIAC on margin reserve provides the utility with an incentive to properly project future connection and it matches plant in service with CIAC. In addition, if the Commission changes its policy it should likewise reduce the utility allowed return on equity to recognize that customers now bear this risk not the utility's stockholders. (T. 316-317)

ISSUE 20

What is the dollar amount of plant costs included in rate base, and what dollar amounts

should be included in rate base as CIAC, related to funds received from the South Florida Water Management District's Alternate Water Supply Grants Program?

POSITION

The total plant costs associated with the reuse funding project included in rate base is \$232,911. Since the Company will receive \$300,000 in funding, \$232,911 of the funds to be received from the water management district should be included as an offset to rate base, as CIAC.

DISCUSSION

Ms. Dismukes testified that according to the Company's response to Staff's Interrogatory 37, Gulf Utility requested funding under the South Florida Water Management District's Alternative Water Supply Grants Program in the amount of \$375,000 for the preservation of potable water through the development of alternative sources of irrigation water. On November 14, 1996, the Governing Board of the District approved a grant of \$300,000. (T. 308) Exhibit 10, showed the estimated construction cost for the grant request by Gulf Utility to the South Florida Water Management District. According to Exhibit 10 the project consists of four general component which are the one-million-gallon per day holding tank, transfer and pumping equipment, reuse site, blending station and the extension of the reuse main. Mr. Cardy testified that the costs of some of the elements to be funded by the \$300,000 grant were included in the test year rate base. (T. 196) Staff counsel requested as a late-filed exhibit identification of costs and amounts included in the MFRs associated with the reuse project funding. Exhibit No. 11 described in general where the costs were included in the MFRs.

An analysis of the information presented in Exhibit No. 11 and the MFRs indicates that \$232,911 of plant related to the reuse funding project was included in rate base. This analysis was

conducted as follows. Exhibit No. 11 indicates that \$700,000 of the holding tank was included in the MFRs. However, page 9 of the MFRs shows that only \$186,757 of the holding tank, transfer and pumping and metering and control were considered used and useful and included in rate base. With respect to the reuse line, Exhibit No. 11 showed that \$200,000 was included in the MFRs. Exhibit No. 11 also states that the amounts were recorded in their accounts in December 1996. However, a review of the MFRs, specifically page 16 for the water operation and page 22 for the wastewater operations shows that the \$66,667 related to water was recorded in account 339.3 in October 1996. (This was determined by subtracting the balance in account 339.2 of \$182,636 in September 1996 from the balance of \$249,303 in October 1996. The difference is \$66,667, indicating that the amount was recorded in October 1996, not December as stated in Exhibit No. 11.) Similarly, the \$133,333 for wastewater was recorded in account 382.4 in October 1996. (This was determined by subtracting the balance in account 382.4 of \$381,297 in September 1996 from the balance of \$514,630 in October 1996. The difference is \$133,333, indicating that the amount was recorded in October 1996, not December as stated in Exhibit No. 11.) Given that the amounts were recorded in October 1996, the 13-month average included in rate base would be \$15,385 for the water portion of the reuse line and \$30,769 for the wastewater portion of the reuse line. Thus, totaling the amount for the holding tank and related equipment and the reuse line indicates that \$232,911 of the reuse funding plant was included in the test year rate base. Since the Company will receive these funds, and a portion of the cost is included in rate base, \$232,911 of the funds to be received from the water management district should be included as an offset to rate base, as CIAC.

ISSUE 21

Are adjustments necessary to Accumulated Amortization of CIAC to amortize cash

contributions using yearly composite rates? (Audit Exception 2)

OPC POSITION

Yes. Accumulated Amortization of CIAC in rate base should be decreased by \$115,371 for the water operations and by \$98,456 for the wastewater operations. Similarly, the CIAC amortization expenses should be increased by \$12,967 for the water operations and decreased by \$7,329 for the wastewater operations.

DISCUSSION

Staff witness Welch testified that the Company has been inappropriately calculating the amortization rate and methodology for CIAC. (T. 444-446) Likewise, Ms. Dismukes agreed with Ms. Welch and recommended that the Commission adjust the amortization of CIAC and the accumulated balance of CIAC to reflect the Commission policy as stated in Rule 25-30.140, F.A.C. (T. 309) On cross-examination, Ms. Dismukes agreed with Staff counsel that the methodology employed by the utility was incorrect and that it does not comport with the Commission's rule. Specifically, the rule only allows for composite amortization (as used by the utility) when it can not be separated by function. (T. 328) The utility however has the records and records its CIAC by function. (T. 872) Accordingly, it should amortize its CIAC and account for accumulated CIAC in accordance with the Commission's rule.

The utility suggests, through witness Andrews, that the composite is an option. However, as she conceded on cross-examination, it is not an option if the utility has the records to account for it by function. (T. 874) During cross-examination, Ms. Andrews was requested to provide as a late-filed exhibit the adjustments to CIAC amortization and accumulated amortization assuming the Commission did not approve of the utility's use of a composite amortization rate. (T. 876-877) Ms. Andrews agreed to provide the requested information (T. 877) However, late-filed exhibit 50, did

not provide what was requested, it only reiterates the utility's position that the numbers in the MFRS are correct. Accordingly, since the utility failed to comply with the Staff's request, the best available information to put the utility's test year accounts in accordance with the Commission's rule is the testimony of Ms. Welch and Ms. Dismukes. Accumulated amortization of CIAC should be decreased by \$115,371 for the water operations and by \$98,456 for the wastewater operations. Similarly, the CIAC amortization expenses should be increased by \$12,967 for the water operations and decreased by \$7,329 for the wastewater operations. (T. 309)

ISSUE 22

Is the utility's method of projecting its test year working capital accounts reasonable, and what, if any, adjustments are necessary?

OPC POSITION

No. Working capital should be adjusted as reflected on Ms. Dismukes schedule 17, Exhibit 19.

DISCUSSION

The Commission should adopt the working capital recommended by the Citizens' witness Dismukes. Ms. Dismukes started with the working capital calculation contained in the Staff's audit, under Audit Exception No. 5 (Exhibit 24) and made adjustments thereto. Ms. Dismukes testified that according to the Staff's audit, it generated a 13-month average working capital calculation using the period August 1995 through August 1996. Staff also requested that the Company provide reasons why the amounts would change from September through December. Ms. Dismukes started with the working capital balance of \$381,610 shown in the Staff's audit and made adjustments to bring the working capital requirement to an average 13-month projected amount for the period ending

December 1996. The first adjustment she made removes from the working capital calculation the unamortized rate case expense. This adjustment provides the Company with an incentive to minimize rate case expense. While the utility is allowed to recover the full amount of its rate case expense, the unamortized balance does not earn a return. Unless the Commission provides the utility with an incentive to minimize rate case expense, ratepayers will always bare the full cost of these expenses, which are often difficult to evaluate for reasonableness. The second adjustment recommended by Ms. Dismukes removes \$394,954 for unamortized debt discount and expense which is reflected in the Company's cost of debt. Accordingly, it should not be included in working capital. The third adjustment increases working capital for the accrued interest on Industrial Revenue Bonds. According to the Company, its projected 13-month average accrued interest is \$269,790, or \$18,128 less than the Staff's calculation. Ms. Dismukes used the estimate provided by the Company and increased working capital accordingly. The fourth and fifth adjustments are similar in that they increase working capital for accounts receivable and materials and supplies, as projected by the Company. As shown on Schedule 17 of Exhibit 19, the working capital amount that Ms. Dismukes recommends is negative \$46,062. (T. 310-311)

Although the Commission has not in the past included negative working capital in rate base, there is no reason not to. Ms. Dismukes provided testimony that a negative working capital requirement merely means that the utility has other sources of noninvestor supplied capital that are used to support the operations of the Company. It does not mean that the utility does not have a working capital requirement. This requirement, however, is being met by other sources of cost-free capital and these sources are in excess of the Company's working capital needs. If a negative working capital is not included in rate base, the utility will be permitted to earn a return on cost-free sources

of capital. If the Commission does not include a negative working capital in rate base, it will effectively provide the Company with an opportunity to overearn. (T. 311)

The appropriateness of including a negative working capital in rate base was recently addressed by Commissioner Deason in a dissent to Order No. PSC-96-1338-FOF-WS concerning Palm Coast Utility Corporation:

I respectfully dissent from the majority's application of Rule 25-30.433(2), Florida Administrative Code, regarding the calculation of a working capital requirement for this company. Application of the balance sheet method yields a negative working capital requirement. Absent a demonstration that there are circumstances that require the negative balance to be ignored, the plain language of the rule is that the balance sheet method shall be used. Although it could even be argued that the rule leaves no room for departure from strict application of the balance sheet methodology, I am not urging that reason and common sense be abandoned in application of a ratemaking tool. Rather I would urge that the burden of proof be left squarely on the company to justify a modification of the balance sheet method.

Zeroing out the negative balance of working capital in water and wastewater industries has been a common practice of this Commission. My understanding is that it has its roots in practicality and the proper recognition of the going-forward operations of a company. The simple application of the formula of current assets minus current liabilities can mask affiliate subsidies that do not represent the stand-alone operations of a utility. For that reason, a zero balance has been used where, for example, accrued interest equal to two-thirds of non-working capital rate base resulted from years of unpaid parent loans resulting in a negative working capital. In such a case where the company's rates were being set on a stand alone basis, it was deemed appropriate to recognize that the past losses would not be continuing. Order No. 17366, issued April 6, 1987, in Docket No. 850031-WS, in re Application of Orange-Osceola Utilities, Inc. for increased water and sewer rates in Osceola County. See also, Order No. 12350, issued August 10, 1983, in Docket No. 820073, in Re Application by Seacoast Utilities, Inc., for an increase in the water and sewer rates to its customers in Palm Beach County, Florida.

Despite the frequency of zeroing a negative working capital calculation, I do not believe that the practice rises to the level of a blanket Commission policy. Rather, the intent behind the Commission's working capital policy is to place the burden on the utility to prove its entitlement to a working capital allowance other than the one yielded by the balance sheet method.

The concern that I wish to express here is that the record does not clearly reflect that the company in this case has met its burden of showing that a basis exists for zeroing out the negative working capital. Even should the circumstances exist which would allow the company to meet its burden, the order should be clear that the Commission's practice is one that creates a rebuttable presumption that Class A utilities' working capital requirements will be calculated pursuant to Rule 25-30.433(2). Only upon a showing that the negative working capital requirement is generated by factors which are not sustainable on a stand alone basis should the presumption be overcome and a zero balance be utilized. (Order No. PSC-96-1338-FOF-WS, Pp. 100-101)

For the reasons addressed above, as well as the reasons explained by Commissioner Deason, the Commission should include in rate base a negative working capital amount of \$315,852. (See issue 25, for the calculation of the recommended amount of negative working capital)

ISSUE 23

Should unamortized debt discount and issuance expense be included in the working capital calculation (Audit Exception 5)

OPC POSITION

Stipulated.

DISCUSSION

It is the Citizens' understanding that the utility agreed to stipulate this issue to the Staff's position and the Citizens' position after the hearings were complete. Under these circumstances, the Citizens will not brief this issue.

ISSUE 24

Is an adjustment necessary to the projected balance of accrued interest for the Industrial Development Revenue Bonds (IDRBs) included in the working capital calculation? (Audit Exception 5)

OPC POSITION

Yes, working capital should be decreased by \$30,494 to adjust the projected balance of accrued IDR interest.

DISCUSSION

See discussion under issue number 22.

ISSUE 25

Should interest receivable be included in the working capital calculation? (Audit Exception 5)

OPC POSITION

No.

DISCUSSION

The utility included interest receivable in its working capital request. The most recent projected balance by the utility is \$269,790. (T. 448) As Ms. Welch testified, the Commission has historically excluded from working capital interest-bearing accounts from working capital. (T. 447-448) Accordingly, the Commission should exclude from working capital the amount of \$269,790 which was the amount included by Ms. Dismukes in her calculations which are addressed under issue 22. Making this adjustment produces a negative working capital amount of \$315,852.

ISSUE 26

What is the appropriate allowance for working capital?

OPC POSITION

Negative working capital of \$315,852 should be included in rate base.

DISCUSSION

Refer to issues 22, 23, 24, and 25 for a discussion of the appropriate working capital amount.

ISSUE 27

What are the appropriate rate base amounts?

OPC POSITION

The final amount of rate base is subject to the resolution of other issues.

COST OF CAPITAL

ISSUE 29

What is the appropriate weighted average cost of capital including the proper components, amounts, and cost rates associated with the capital structure for the 1996 projected test year?

OPC POSITION

The appropriate overall cost of capital is 9.22%. The proper components, amounts, and cost rates associated with the capital structure can be found in Schedule 2 of Exhibit 19.

DISCUSSION

Refer to issue 17 for a discussion of the appropriate adjustments to the utility's capital structure.

NET OPERATING INCOME

ISSUE 32

If a reuse rate is approved, and the rate is greater than \$0, should test year revenues be adjusted?

OPC POSITION

Yes. The Commission should increase test year revenue by \$87,668 to reflect the sale of reclaimed water at \$.25 per 1,000 gallons during the dry season and to reflect a credit of \$.05 during the wet weather season.

DISCUSSION

Refer to issue 55 for a discussion of the appropriate reuse rate to set for Gulf Utilities, Inc.

ISSUE 33

Should any adjustments be made to include in test year income, interest income recorded below the line?

OPC POSITION

Yes. Test year income should be increased by \$4,000 to reflect interest income earned on cash included in the Company's working capital allowance.

DISCUSSION

Ms. Dismukes recommended that the Commission include above the line for ratemaking purposes \$4,000 of interest income earned on cash included in the Company's working capital request. Ms. Dismukes testified that in response to OPC's Interrogatory 37, the Company indicated that its operating account was included in working capital and that this account earns interest. Since the cash is included in working capital, it is only reasonable to include the interest income above the line for ratemaking purposes. (T. 305) The utility agreed with Ms. Dismukes adjustment in its rebuttal testimony. (T. 844) Accordingly, the Commission should increase test year income by \$4,000.

ISSUE 34

Are any adjustments necessary to the projected test year salaries, benefits and payroll taxes for employees that provide services to both Gulf and the Caloosa Group (Audit

Disclosure 3)?

OPC POSITION

Yes. Gulf's salaries should be reduced by \$8,947 to reflect the higher salary paid to employees when they work for the utility instead of its affiliate Caloosa. Appropriate adjustments should likewise be made to employee benefits and payroll taxes.

DISCUSSION

Gulf Utility employs persons that perform work for both the utility and Caloosa Group, Inc. an affiliated developer. Ms. Dismukes testified that the hourly rate charged for services performed on behalf of Gulf Utility is considerably higher than the hourly rate charged for services performed on behalf of Caloosa. For example, the equivalent hourly rate of Mr. Moore when he performs services for the Company is \$49.04, whereas the hourly rate charged to Caloosa is \$22.69. Similarly, Ms. Andrews's hourly rate for work performed at Gulf Utility is \$25.66, however, for Caloosa the hourly rate is only \$16.70. As shown on Schedule 6 of Exhibit 19, the hourly rates charged to the Company are much higher than the hourly rates charged to Caloosa. Ms. Dismukes testified that it appears that Caloosa is receiving a windfall at the expense of ratepayers. In other words, the regulated utility operations are absorbing a disproportionate share of the total payroll costs of Caloosa and Gulf Utility. (T. 299-300)

Ms. Dismukes reallocated the salary charged to Caloosa based upon the combined hourly rate of Caloosa and Gulf Utility. This ensures that both companies are paying the same amount per hour for the use of Gulf Utility's employees. For example, the combined hourly rate for Mr. Moore is \$46.11. Using Mr. Moore's estimate that he spends five hours per week working for Caloosa, Ms. Dismukes reallocated the salary charged to Caloosa using an hourly rate of \$46.11 as opposed to the \$22.69 per hour actually charged or paid. (T. 300)

The reallocation calculated by Ms. Dismukes produced a reduction to the utility salary paid to Mr. Moore of \$6,088. Similar calculations were performed for each of the employees of Caloosa based upon the hours that they devote to the utility operations versus Caloosa's operations. In total Ms. Dismukes recommended that \$8,947 be removed from the Company's test year payroll expense to properly account for the salary expense charged to Caloosa. (T. 300)

Mr. Cardey suggests in his rebuttal testimony that Ms. Dismukes allocation is inappropriate. (T. 649-650) However, as demonstrated on Exhibit 32, the data used by Ms. Dismukes to determine the hourly rate paid to employees while working for Caloosa, came directly from Caloosa and is the payroll register for the period September 1995 through August 1996. (T. 596, Exhibits 19 and 32) Contrary to the utility's claims, the Commission should adopt the recommendations of Ms. Dismukes as they were based upon objective data provided by the utility, not the subjective analysis performed by Mr. Cardey. Accordingly, the Commission should reduce Gulf's test year salaries by \$8,947.

ISSUE 35

Are any adjustments necessary to the vice president's salary and benefits (Audit Disclosure 13)?

OPC POSITION

Yes. The vice president's salary should be reduced by \$30,234. Appropriate adjustments should likewise be made to employee benefits and payroll taxes.

DISCUSSION

The utility is requesting that the salary of Mr. Mann, Vice President of Gulf, in the amount of \$49,608 be recovered from ratepayers. (T. 117) Mr. Mann does not maintain an office at the utility site, but instead has an office in Jacksonville where he is employed by Timucuan--an investment

advisory firm. (T. 115 and 301) Although Mr. Moore has known Mr. Mann for 10 years, when questioned concerning Mr. Mann's employment with Timucuan, Mr. Moore did not know if Mr. Mann was an owner or employee of this firm or if he was full-time or part-time. (T. 115) During cross-examination by the Citizens' counsel, Mr. Moore admitted that Mr. Mann does not keep records of the time he spends on utility business. On two separate occasions, the Company was requested to provide an estimate of the hours Mr. Mann devoted to the Company. (T. 301-302 and 117-118) In response to OPC's Interrogatory 41, Exhibit 6, which asked the Company to provide an estimate of the time Mr. Mann (and others) devoted to the utility operations for the years 1995 and 1996, the Company stated that "Mr. Mann does not submit time records and is paid on a salary basis. The amount of time he spends each week on his various duties varies considerably depending on the needs of the Company." (T. 117-118 and Exhibit 6) A similar response was given to the Staff auditors when they conducted their audit of the Company books. (T. 302) When asked if it would be correct to infer from the utility's response that it was not even possible to estimate the time Mr. Mann spent on the utility business, Mr. Moore stated: "I don't think I could without consultation, you know, trying to figure it out with him. I mean, we could probably come to some number." When questioned again by the Citizens' counsel that the interrogatory asked for precisely that, Mr. Moore responded: "Yes. He wasn't available. I mean, it's not that we are trying to — I'm not trying to be — but we haven't kept time records, and it would be just that, an estimate." (T. 118) Despite Mr. Moore's characterization that Mr. Mann is "available to us when we need him", he was not available to provide an estimate of the time he spends on utility operations for the 30-days the discovery was outstanding and apparently the 117 days since the interrogatory was propounded. (T. 116 and 119)

As is evident from the above discussion, Mr. Moore knows relatively little about how much time Mr. Mann spends on the utility's business. It is virtually impossible for the Commission to judge the reasonableness of Mr. Moore's salary without the knowledge of how much time he spends on the utility's business. For example, assume Mr. Mann spends on average 2 hours per week for 52 weeks working on utility business. At a salary of \$49,608, this would equate to an hourly rate of \$477, or an equivalent annual salary of \$992,160—clearly an excessive amount.

Ms. Dismukes examined the list of duties performed by Mr. Mann for the utility. These included reviewing certain accounting matters like preparation of PSC annual reports, financial statements, budgets, and cash flow statements. In addition, in conjunction with the president, Mr. Mann performs such functions as long-term financial planning, long-term debt management, and setting tax policies. In addition to these types of duties, Mr. Mann also prepares the tax M-1 schedule and other related schedules for state and federal tax returns and other special projects as directed by the Board of Directors. (T. 302)

Ms. Dismukes testified that the Company has not proven the reasonableness of the salary paid to Mr. Mann. Although other employees of Gulf Utility maintain time records, there is no such requirement for Mr. Mann, despite the apparent variable nature of the work he performs. Based upon a review of the duties Mr. Mann performs, Ms. Dismukes estimated that he should, on average, spend 10 hours per week on utility business, or 520 hours per year. At an hourly rate of \$35.00 per hour, which is roughly the mid point between the hourly rates paid to the president and the Chief Financial Officer, Ms. Dismukes recommended that the Commission allow a salary for Mr. Mann of \$18,200. (T.302) The Commission should either disallow Mr. Mann's salary in its entirety, due to the utility's failure to provide relevant information and sustain its burden of proof, or adopt the

recommendations of Ms. Dismukes and reduce test year expenses by \$30,234. (Schedule 7 of Exhibit 19)

ISSUE 36

Should any adjustments be made to salary expense for excessive pay increases?

OPC POSITION

Yes. Salaries should be reduced by \$7,416 to remove excessive pay increases from the test year.

DISCUSSION

The Company is projecting pay increases ranging from a high of 9.6% to a low of 6.5% for its officers and managers. (Schedule 7 of Exhibit 19) According to the Company's response to OPC's Interrogatory 11, salary increases in the past were 5% in 1992, 4% in 1993, 5% in 1994, and 4% in 1995. The Company budgeted a 6.5% overall increase in 1996, but increases can vary per employee. (T. 301) Ms. Dismukes testified that the Company has not demonstrated that a 6.5% increase in employee salaries is reasonable. In many instances the salary increases for the officers and managers of the Company exceed the 6.5% overall increase budgeted for the test year. In the past, the percentage increases have been between 4% and 5%. Since the utility did not justify the proposed salary increases included in its budget, Ms. Dismukes used a 5% increase to adjust the salaries of the Company's officers and management employees. Adjusting 1995 salaries for a 5% increase in 1996, reduces test year expenses by \$7,416. (T. 301)

ISSUE 37

Is the annual lease amount charged to Gulf by Caloosa Group reasonable and if not, what adjustments are necessary (Audit Disclosure 4)?

OPC POSITION

No. Test year expenses should be reduced by \$26,182 for the lease of office space from Caloosa by Gulf.

DISCUSSION

In 1996, Gulf Utility entered into a lease agreement with its affiliate developer Caloosa Group, Inc. to lease 3,931 square feet of office space. Because this is an arrangement between affiliates and is not an arm's-length transaction it is important for the Commission to test the reasonableness of the price charged Gulf Utility. Citizens' witness Dismukes tested the reasonableness of the lease payment by comparing it to what the lease payment would be over the 40-year life of the building using the actual cost of the building as a surrogate for a market-based price. Exhibit 19, Schedule 5, showed that the levelized lease payment over the life of the building would be \$64,826. Since Gulf Utility occupies 33.71% of the building, \$64,826 was multiplied by 33.71% to arrive at the amount Gulf Utility should pay--\$21,853. This compares to the amount being charged the Company of \$47,152. After accounting for the allocation of rental expense to Caloosa, Ms Dismukes calculations show that Gulf Utility is being charged \$26,182 more than it essentially would have cost the utility and its ratepayers if Gulf had built the building, not Caloosa. (T. 298-299)

In contrast to the testimony of Ms. Dismukes, Mr. Moore states that the lease payment paid to Caloosa is reasonable because it is "comparable" to what the other two-thirds of the building is rented for. According to Mr. Moore, in May 1996 the Lee Memorial Health System entered into a five year lease with Caloosa Group with an annual rental amount of \$77,520.00, or \$12 00 per square foot. The maintenance cost is \$1.50 per rentable square foot. (T. 547 and 551.) Mr. Moore also suggests that the lease amount charged to the utility is reasonable because it falls within the \$10 00

to \$12.00 per square foot rental estimate provided by an appraiser. (T. 550.)

In judging the reasonableness of the rental rate charged to the utility by its affiliate the Commission must follow the standard set forth in *GTE Florida Incorporated v. J. Terry Deason, et al*, Appellee No. 82003; Supreme Court of Florida; July 7, 1994, wherein the Supreme Court stated: "The mere fact that a utility was 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 "

While the utility suggests that the rental rate charged Lee Memorial Health System and the appraisers report supports the reasonableness of the charge to Gulf Utility, Ms. Dismukes testified that she did not believe that the market comparisons that had been done support the lease rate charged to the utility. (T. 351) In this regard, Ms. Dismukes testified that the lease with the hospital had not been entered into the record, although it easily could have been done by the utility. In addition, Ms. Dismukes pointed out that utility made substantial leasehold improvements to the building which effectively raises the cost per square foot to \$14.69. In addition Ms. Dismukes testified that the maintenance cost charged the health system is \$1.50 per square foot where as the maintenance cost charged to the utility is \$2.50 per square foot. In addition, Ms. Dismukes noted that there could be a variety of things that may be different between the health system and the utility lease which have not necessarily been accounted for if one looks strictly at the cost per square foot of the leases. (T. 352)

In addition, Ms. Dismukes indicated that one method of examining the market value is to examine what would it have cost the utility to build the building According to Ms Dismukes it would have cost the utility roughly \$236,000 to build the office which it now rents (T. 353-354) The

adjustment proposed by Ms. Dismukes compares the lease rate charged by Caloosa to what it would have cost the utility and its ratepayers had the building been built by the utility instead of its affiliate-- which has the same stockholders as the utility. (T. 355-356.)

Other factors should also be considered by the Commission when evaluating the reasonableness of the lease. First, as Ms. Dismukes pointed out and as Ms. Andrews agreed, the utility made \$52,856 of leasehold improvements to the building. \$10,571 of these costs are included in test year expenses. (T. 859-860, Exhibit 46) Since the lease is only for a period of five years, if the utility does not renew the lease, these improvements, which will have been paid for by ratepayers will become the property of Caloosa, not the utility.

Second, Gulf Utility agreed to rent the office space before construction of the building had begun. (T. 598) This significantly reduced the risk to Caloosa of building the office, yet there is no discount offered to the utility for agreeing in advance to lease 1/3 of the proposed office space (T. 598)

Third, Mr. Moore negotiated the lease on behalf of both Caloosa and the utility. Mr. Moore is a 20% stockholder of both the utility and Caloosa. (T. 598) Since Caloosa is a Subchapter S corporation, all profits of this company are distributed to its stockholders. (T. 592) Consequently, the higher the lease paid by Gulf Utility, the higher the profits to Caloosa which are proportionately distributed to Mr. Moore. Under these circumstances, Mr. Moore could not have objectively negotiated the lease on behalf of the utility.

Fourth, as Ms. Welch pointed out, the Commission should consider the prudence of the utility's decision. According to Ms. Welch, while a comparison to the health system shows a market value for this particular property, it does not show that the company using that space is prudent or

that it was a good management decision. (T. 466) Clearly, based upon the comparison made by Ms. Dismukes and Ms. Welch, it would have been substantially cheaper for the utility to build the office space rather than lease it from Caloosa. For these reasons and consistent with the GTE Supreme Court decision, the Commission should remove from test year expenses \$26,182.

ISSUE 38

Are any adjustments necessary to the common maintenance expenses associated with the building lease (Audit Disclosure 4)?

OPC POSITION

Yes. Common maintenance expenses should be adjusted to reflect the actual amount that will be paid during the test year. As of July 1996, the amounts in the test year were overstated by \$3,600.

DISCUSSION

According to the testimony of Ms. Welch, the maintenance costs charged to Gulf are estimated and a portion may be refunded based upon actual costs. Ms. Welch compared the expenses incurred for the first seven months of 1996 to the amount charged to the utility and concluded that test year expenses are overstated by \$3,600. (T. 452-453) Since there is no reason to believe that the last four months of the test year will be any different than the first seven months, the Commission should reduce test year expenses by \$3,600.

ISSUE 39

Are adjustments necessary to allocate additional administrative and general expenses, including rent, office supplies, miscellaneous business and administrative expense, vehicle expense and computer depreciation to the Caloosa Group (Audit Disclosure 3)?

OPC POSITION

Yes. Test year expense should be reduced by \$7,445 to reflect administrative and general expenses that have not been properly charged to Caloosa.

DISCUSSION

As explained under other issues, Caloosa Group, Inc. is a land development company and is an affiliate of Gulf Utility. Five of Gulf Utility's employees, the President, the Chief Financial Office, the Assistant to the CFO, the Administrative Manager, and the Administrative Assistant, provide services to both companies. These employees' salaries are paid separately for the work that they do at each company. In addition, Gulf Utility charges Caloosa \$50 per month for use of Gulf Utility's computer system and \$50 a month for supplies and office rent. Although Caloosa pays for the time Gulf's employees work for Caloosa, none of the benefits paid by Gulf are allocated or charged to Caloosa. In addition, there are two other expense categories where none of the costs have been charged or allocated to Caloosa. These include car expenses of Mr. Moore (President) and business and conference expenses of Mr. Moore as well as other general and administrative expenses. According to the testimony of Ms. Dismukes, it is not fair to charge all of these expenses to the regulated utility operations of Gulf Utility. Ms. Welch also questioned the lack of any allocation of these expenses to Caloosa. Clearly, some of these expenses should be allocated to Caloosa as the employees of Gulf Utility provide services to both. By charging only the regulated utility operations for these expenses, the nonregulated operations receive a windfall. Certainly, if Caloosa were a stand alone entity it would incur benefit expenses on behalf of its employees as well as other administrative and general expenses. (T. 296-297)

Ms. Dismukes developed three allocation factors to assign these costs between Caloosa and the utility. First, she allocated health insurance costs and IRA benefits for the five employees that work for both companies based upon their Caloosa salary relative to their total Caloosa and Gulf Utility salary. Second, she allocated office supplies, rent expense, computer depreciation, and other business expenses and administrative expenses based upon Caloosa's total payroll to the total payroll of Caloosa and Gulf Utility. Third, she allocated Mr. Moore's car expenses based upon his Caloosa salary to his total Caloosa and Gulf Utility salary. As shown in Exhibit 19, Schedule 4, this produced an allocation of expenses to Caloosa of \$10,472. After subtraction of the \$1,200 charged to Caloosa by the utility, a net adjustment of \$9,272 is indicated. (T. 325) The utility has failed to demonstrate why the expenses which Ms. Dismukes recommends be allocated to Caloosa should be provided essentially free of charge. Accordingly, the Commission should adopt the recommendations of Ms. Dismukes and Ms. Welch and reduce test year expense by \$9,272. (T. 297-298, 325)

ISSUE 40

Are any adjustments necessary to Gulf's requested level of directors' fees (Audit Disclosure 2)?

OPC POSITION

Yes. Test year expenses should be reduced by \$9,000 for excessive fees paid to the board of directors.

DISCUSSION

Test year expenses include directors' fees of \$18,000; \$4,500 for Mr. Russell Newton, Jr., \$4,500 for Mr. William Newton, and \$9,000 for Mr. Russell Newton, III. Ms. Dismukes testified that a review of the Board of Director's Meeting Minutes indicates that not all of the directors attend the

board meetings. In particular, during 1996, only Russell Newton, Jr. attended all three meetings. William Newton attended only one of the three meetings, and Russell Newton, III attended two of the three meetings. A similar pattern is shown for 1995. In 1995, Russell Newton, Jr. was the only director to attend all three meetings. William Newton and Russell Newton, III attended only one of the three meetings. (T. 306) The utility has provided no evidence that the board of directors fees it proposes to collect from ratepayers are reasonable. Mr. Moore, in his rebuttal testimony merely states that they are reasonable given the size of the company, its construction and financing programs and their responsibility. The utility has the burden of proving the reasonableness of expenses included in the test year. A mere suggestion, by the President of the utility, does not meet this burden. The utility did not explain why all of the Board members do not attend all meetings and why such practices are reasonable or typical. Likewise, the utility did not explain why Mr. Russell Newton, III should be paid twice what the other Board members are paid. Under the circumstances, the Commission should adopt the recommendations of Ms. Dismukes and remove from test year expenses two-thirds of the fees for William Newton, since he has only attended one of three meetings. The Commission should also remove one-half of the directors fee paid to Russell Newton, III since the utility failed to demonstrate that it was necessary or reasonable to pay him twice as much as the other members. In addition, one-third of these reduced fees should be disallowed since Mr. Newton, III attended only two of the three meetings. As shown on Schedule 9 of Exhibit 19, the adjustments Ms. Dismukes' recommends reduce test year expenses by \$9,000. Ms. Dismukes further testified that the Commission would be justified in removing all Board of Directors fees since, a review of the meeting minutes indicate that little is discussed and there is no significant input made by the board members. (T. 306-307)

ISSUE 41

Should any adjustment be made to remove expenses for lift station coating from the test year?

OPC POSITION

Yes. Test year expenses should be reduced by \$10,500 to remove nonrecurring expenses.

DISCUSSION

The Company's MFRs show that the Company budgeted \$21,000 for lift station coating and repairs in 1996. The Citizens' witness Dismukes recommended that the Commission reduce these expenses by \$10,500, based upon the utilities response to OPC's Interrogatory 28. In this response the utility indicated that it did not incur any cost to coat liftstations in 1993, 1994, or 1995, but that it did incur liftstation repair costs of \$11,919 in 1994 and \$6,980 in 1995. It did not, however, incur these costs in 1993. Since the amount included in the test year is nonrecurring in nature, or is not an expense that will be incurred in every year, Ms. Dismukes recommended that the Commission amortize the total over five years and then allow annual repair costs of \$6,300 ($\$11,919 + \$6,890$ divided by 3 years) The Commission should adopt the recommendations of Ms. Dismukes and reduce test year expenses by \$10,500. (T. 304)

ISSUE 42

Are adjustments necessary to remove charitable contributions from operations and maintenance expenses? (Audit Exception 3)

OPC POSITION

Yes. \$3,200 of charitable contributions included in the Company's budget should be removed from test year expenses.

DISCUSSION

The Company's 1996 budget included \$3,200 for charitable contributions. However, when the Company put the budgeted figures into the MFRs, it substituted a label for the charitable contributions to read customer survey. (T.860-866, Exhibit 47-48.) The Citizens are not convinced that the mere changing of the label of the \$3,200 included in the budget from charitable contributions to customer survey, warrants the inclusion of the \$3,200 in test year expense. Accordingly, the Citizens recommend that the Commission remove from test year expenses \$3,200 associated with either a customer survey or charitable contributions.

ISSUE 43

Should any adjustments be made to remove from test year expenses golf outings and gift basket expenses?

OPC POSITION

Yes. Test year expenses should be reduced by \$185.

DISCUSSION

Ms. Dismukes recommended that the Commission remove from test year expenses \$185 associated with golf outing and gift baskets. Ms. Dismukes reasoned that such expenses are not appropriate to recover from ratepayers. (T. 305) While Mr. Moore, believed such expenses to be prudent, the Citizens must vehemently disagree. Mr. Moore suggests that golf outings are a way to bring together individuals and discuss business and that as such they should be considered legitimate business expenses. (T. 93 and 96) Yet, when questioned why such meetings could not have been arranged in his office or the office of his associates, Mr. Moore admitted that the meetings could have taken place in Mr. Moore's office or the office of his golf partners. (T. 96) In one instance, Mr.

Moore admitted that one of the golf foursome had no business purpose for being part of the golf outing, but merely filled out the group. (T. 95) The Citizens do not believe that golf outings and related meals are appropriate to pass along to ratepayers. The business which took place, if any, during these outings could have been easily taken place at no cost in Mr. Moore's office. Furthermore, the persons for which Mr. Moore so graciously paid for a round a golf are his vendors and there should be no need to wine and dine these individuals. (T. 95-96) For these reasons the Commission should disallow \$185 of Mr. Moore's business and entertainment expenses which are related to golf outings.

ISSUE 44

Should the Commission include budgeted "unanticipated" expenses in the test year?

OPC POSITION

No. These expenses, in the amount of \$4,895, should be removed from test year expenses.

DISCUSSION

The utility included in its projected test year expenses \$4,895 associated with "unanticipated" expenses. Ms. Dismukes recommended that the Commission exclude these costs because it would not be good policy for the Commission to allow such nondescript expenses to be included in a projected test year. Furthermore, Ms. Dismukes testified that the Company has the burden of proving the reasonableness of its projected expenses, including all expenses that it anticipates. Unanticipated expenses appear to be nothing more than an additive above and beyond reasonably expected expenses. (T. 304) Since there is no designation associated with these "unanticipated" expenses, the Commission can not legitimately evaluate their reasonableness or prudence. Accordingly, the Commission should disallow \$4,895 of test year expenses.

ISSUE 45

Are adjustments necessary to remove amortization of the San Carlos water line project (Audit Disclosure 5)?

OPC POSITION

Yes. These costs have not been demonstrated to be prudent. Test year amortization should be reduced by \$8,184.

DISCUSSION

Staff witness Welch testified that the Company deferred costs associated with the San Carlos water line project and is projecting into the test year an amortization expense of \$8,184. According to Ms. Welch, the utility was questioned about these charges and the amortization in an earlier audit and the utility indicated that the costs were being deferred until approval from the county for installation of the lines or mandatory hook-up. In the instant docket the Staff auditor, Ms. Welch again asked about these charges and was informed that the project was abandoned because the County Commission would not require mandatory hook-ups. (T. 453) The utility has failed to demonstrate that the charges and related amortization are reasonable. One must question why the charges were incurred in the first place if the utility would not install the line unless the County Commission required mandatory hook-ups. This determination should have been made by the utility prior to expending any funds on the project. Accordingly, in the absence of documentation that the costs were prudently incurred, the Citizens recommend that they be excluded from test year expenses.

ISSUE 46

Is an annual customer satisfaction survey necessary, and what, if any, adjustments are appropriate to test year expenses (Audit Disclosure 10)?

OPC POSITION

Customer survey expenses appear to be a disguise for charitable contributions and should therefore be removed from test year expenses.

DISCUSSION

Refer to issue 42 for a discussion of this issue.

ISSUE 47

Are adjustments necessary to remove expensed costs related to preliminary survey charges for FGCU (Audit Disclosure 11)?

OPC POSITION

Yes, it appears that Contractual Services-Engineering should be reduced by \$1,029 for water and \$310 for wastewater and recorded in construction work in progress.

DISCUSSION

This is an issue identified by the Staff. The Citizens will defer to the Staff for an analysis of this issue.

ISSUE 48

Are adjustments necessary to remove local business and entertainment expenses for Gulf's president (Audit Disclosure 15)?

OPC POSITION

Yes. Excessive and unreasonable business meals and entertainment expenses should be removed from test year expenses.

DISCUSSION

Exhibits 5 and 7 show that Mr. Moore, president of Gulf Utility, spends considerable resources and money on entertaining his associates and vendors. On numerous occasions, Mr Moore

entertained business associates and their spouses. Mr. Moore believes that it is customary to entertain the spouses of business associates, and he apparently believes that these costs should be paid for by ratepayers. The Citizens disagree! Not only does Mr. Moore routinely entertain spouses of associates, his meal expenses are quite extravagant--in many instances exceeding \$25.00 per person for a dinner. (T. 107-114, Exhibits 5 and 7)The Citizens do not believe that such extravagant bills for meals and the cost of a meal for a spouse are legitimate business expenses that should be borne by ratepayers. The Citizens recommend that the Commission disallow 50% of all of Mr. Moore's entertainment expenses due to their excessive nature. In addition, this is the policy followed by the IRS. Only 50% of meals and entertainment expenses are deductible for income tax purposes.(T. 114) The Citizens believe that by following the policy of the IRS, the Commission will give the utility an incentive to hold down its meal and entertainment expenses. Likewise ratepayers will not be burdened with Mr. Moore excessive spending habits. Accordingly, the Citizens recommend that \$3,250 be disallowed from test year expenses. (Exhibit 47)

ISSUE 49

What is the appropriate provision for rate case expense?

OPC POSITION

The Citizen believe that the Commission should hold the utility to its initial estimate of rate case expense of \$122,479.

DISCUSSION

The utility is requesting rate case expense in this docket of \$251,000. However, there was an error in the calculation of rate case expense concerning the fees of Mr. Nixon. Accordingly, the total requested by the utility should only be \$219,000. (T. 583) When the utility filed its MFRs, it

showed an estimated rate case expense of \$122,479. It now asks customers to pay 80% more than its original estimate. The Citizens find this increase shocking and unsupported. While Mr. Moore blames the intervention of OPC for this increase, this can hardly be an adequate explanation. (T. 587-588) It is quite routine for the Office of the Public Counsel to intervene in dockets that are set straight for hearing. While Mr. Moore suggests that his consultants would have made estimates based upon no intervention by OPC, this shows his misunderstanding of the regulatory process. (T. 590) If as Mr. Moore claims, his consultants and attorneys are professional and know the business, it would have been only prudent for them to anticipate that OPC would intervene since this docket was not a PAA and was set for hearing. (T. 590) To do otherwise, would be imprudent, especially since the consultants and attorneys hired by Mr. Moore, have all been involved in this process for many years. The Citizens do not find Mr. Moore's explanation for an 80% increase in rate case expense compelling. To the contrary, the Citizens believe that if the utility, its consultants, and its attorneys know that customers will foot the bill, there is NO incentive to hold down rate case expense. This case was not complex compared to many cases processed by the Commission Rate case expense of \$219,000 is excessive given the noncomplex nature of this proceeding. The hearings were completed in less than two days! The Citizens believe that the Commission should send a message and only allow the amount that was originally requested in the MFRs of \$122,479.

ISSUE 50

What adjustments are appropriate to test year depreciation expense? (Audit Exception

6)

OPC POSITION

*Adjustments appear necessary to remove retirement adjustments incorrectly made and to

remove depreciation expense on any additional non-used and useful plant adjustments.*

DISCUSSION

This is an issue identified by the Staff. The Citizens will defer to the Staff for an analysis of this issue.

ISSUE 52

What is the test year operating income before any revenue increase?

OPC POSITION

*The test year operating income amounts are subject to the resolution of other issues *

REVENUE REQUIREMENT

ISSUE 53

What is the appropriate revenue requirement?

OPC POSITION

*The revenue requirements are subject to the resolution of other issues *

RATES AND RATE STRUCTURE

ISSUE 55

Should the Commission determine a reuse rate in this proceeding, and if so, what is the appropriate rate?

OPC POSITION

*Yes. The reuse rate should be set at \$.25 per 1,000 gallons during the dry months and a credit of \$.05 per 1,000 gallons should be given to the golf courses during the wet weather months.

DISCUSSION

The Company disposes of its wastewater effluent by providing reclaimed water to golf courses

(San Carlos Golf Course, Vines County Club, and Villages of County Creek). Rather than selling reclaimed water to these customers, Gulf provides this service free of charge. In response to Staff Interrogatory 30, Gulf explained:

Gulf has always disposed of effluent by golf course irrigation because it was and is the least cost method available. If charges are imposed effluent become less attractive to developers and the Company could be forced to use much more expensive disposal methods such as deep well injection or evaporation/percolation ponds.

The Citizens agree that effluent disposal by way of spray irrigation is beneficial to the Company and its customers, but it must be recognized that it is also beneficial to the golf courses.

The Company operates in a water caution area. Consequently, the South Florida Water Management District will closely monitor the need for consumptive use permits and the associated withdrawals. Thus, while the golf courses to which Gulf provides reclaimed water have consumptive use permits, it remains questionable whether or not they could be renewed. The South Florida Water Management District's consumptive use permit rules require an applicant for a new permit, permit renewal, or permit modification to show that the applicant "makes use of a reclaimed water source unless the applicant, in any geographic location demonstrates that its use is either not economically, environmentally or technically feasible; or in areas not designated as Critical Water Supply Areas pursuant to Chapter 40E-23, F.A.C., the applicant demonstrates reclaimed water is not readily available." In its Basis for Review of Water Use Permit Applications, the South Florida Water Management District describes the review process in areas of special water concern: "allocation of water shall be restricted or denied for irrigation purposes when reclaimed water is available and is economically, technically and environmentally feasible." (T. 293-295)

The utility argues that no charge should be imposed upon the golf courses for their taking of

reclaimed water. (T. 556-557.) The utility claims that if a charge was imposed existing golf courses would take as little reuse water as possible, prospective reuse sites would avoid or delay entering into reuse agreements, and Gulf would have difficulties disposing of its effluent. (T. 557.) While Gulf claims it could not dispose of its effluent if a charge were imposed, Gulf was unable to adequately explain why other utilities in the area are able to charge for reclaimed water. For example, Lee County charges \$.21 per 1,000 gallon during the dry season and \$.04 per 1,000 gallons during the rainy season. Florida Cities Water Company charges \$.21 per 1,000 gallon for all effluent disposed of on golf courses. (T. 295-296) Recently, the Commission approved a \$.25 per 1,000 gallon reclaimed water rate for Aloha Utilities, Inc. which operates in Pasco County. (Order No. PSC-97-0280-FOF-WS) Likewise, the Company did not explain why it recently was able to enter into a reuse agreement with River Ridge golf course which provided among other things that the golf course would take as much 1,500,000 gpd of effluent at a rate that could be imposed by the Commission. (Exhibit 31) The environment under which the Company initially entered into its reuse agreements no longer exists. Water has become more scarce and Floridians are recognizing that water should be conserved. Reuse provides a valuable means of conserving potable water resources. (T. 294)

All of the golf courses which now take reclaimed water from the utility testified that they would "shut off" their valves if they were charged for reclaimed water (T. 12-46) Clearly it is in the best interests of the golf courses to make such threats. It is certainly cheaper to operate a golf course when it costs almost nothing to irrigate their turf. However, for some of the golf courses, it appears that such a threat could not be fulfilled because they would exceed the consumptive use permits if they did not take reclaimed water from the utility. For example, the San Carlos golf course would have to increase their permitted amount of withdrawals if they ceased taking effluent from the utility. (T.

22) Likewise the Vines would exceed its permitted amount of withdrawals if it did not take reclaimed water from the utility. The Vines witness testified that they take 200,000 gpd from the utility and that this represents roughly 40% of their irrigation needs. Thus, the Vines uses a total of 500,000 gpd to irrigate their golf course of which 200,000 gpd comes from the utility and 300,000 gpd comes from surface waters. (T. 27) However, they are only permitted to withdraw 244,000 gpd. (T. 555) It would appear that this golf course is exceeding its permitted withdrawals and that it must take the reclaimed water from the utility in order to meet its irrigation needs. While the Vines witness suggested that it could use a recharge well that is currently not operational, it had done no analysis of the cost getting that well operational and in use. (T. 32) Furthermore, without an increase in permitted withdrawals the golf course could not use the well as it already appears to be exceeding its permitted withdrawals.

In addition to these factors, none of the golf courses had examined what it might cost them if they were charged for reclaimed water. (T. 21-22 and 31-32) Considering the vast amounts of water that these golf courses use to irrigate their turf, 554,800,000¹ gallons of water per year, which is equivalent to serving 4,343² residential customers at 350 gallons per day, a fee of \$.25 per is clearly reasonable. (T. 21, 27, and 43) Consider, for example, the total these three golf courses would be charged for reclaimed water would be between \$48,363 to \$65,599 depending the amount of

¹ During the hearing the golf courses indicate that they use the following amounts of water to irrigate their golf courses: San Carlos 620,000 gpd, Vines 500,000 gpd, Villages 400,000 gpd, for a total of 1,520,000 gpd, or 554,800,000 gallons per year.

² A typical residential customers uses 350 gallons per day, or 127,750 gallons per year. Dividing 127,750 into 554,800,000 gallons used by the golf course produces the equivalent of serving 4,342 residential customers in a year.

reclaimed water they actually take³. This seems like a drop in the bucket when one considers that residential customers would pay between \$388,835 to \$535,458⁴ to use this much water. (Schedule 3 of Exhibits 19, T. 21, 27, and 43) The golf courses would pay one-eighth of what a residential customer would pay.

During the hearing Commissioner Clark raised the issue of would it be reasonable to offer an incentive for the golf courses to take reclaimed water during the wet weather season. (T. 365) Ms. Dismukes agreed that such a structure would be entirely reasonable. (T. 365) Under the circumstances, the Citizens believe that if a charge is imposed during the dry season of \$.25 per 1,000 gallons it would be reasonable to offer a credit during wet weather. This should largely ameliorate the utility's concerns about wet weather storage. The Citizens would suggest that a credit of \$.05 per 1,000 gallons be offered to the golf courses for taking effluent during the wet weather season. In summary, the Citizens recommend that a charge of \$.25 per 1,000 gallons be imposed during the months of October through May and that a credit of \$.05 per 1,000 gallons be paid to the golf courses for taking effluent during the months of June through September. There should be no reason why the golf courses would not be willing to take this effluent during the wet weather months since their sites are already equipped for this purpose. Accordingly, they should be more than willing to

³ During the hearing the golf courses indicated that they take the following reclaimed water: San Carlos 150,000 gpd, Vines, 200,000 gpd, Villages 180,000 gpd, for a total of 530,000 gpd or 193,450,000 gallons per year. (T. 21, 27, and 43) At \$.25 per 1,000 gallons this amounts to \$48,363. Exhibit No. 19, Schedule 3, which was based upon the actuals takes of reclaimed water for 1995, these three golf courses took 266,397,000 gallons per year. (Schedule 3 of Exhibit 19.) At \$.25 per 1,000 gallons this amounts to \$65,599.

⁴ At 193,450,000 gallons per year times \$2.01 per 1,000 gallons the total charge would be \$388,834. (T. 21, 27, and 43) At 266,397,000 per year times \$2.01 per 1,000 gallons the total charge would be \$535,458.

take the effluent during the wet weather months if they receive revenue for this service.

Using the data presented on Ms. Dismukes Exhibit 19, Schedule 3, and pages 155 and 156 of the MFRs, under this proposal the revenue that should be imputed into the test year is \$87,668³.

ISSUE 58

What are the appropriate water and wastewater rates?

OPC POSITION

The final rates are dependent upon the resolution of other issues.

ISSUE 60

What are the appropriate amounts of refunds, if any, for water revenues held subject to refund and the interim wastewater increase?

OPC POSITION

The refund should be calculated based upon the methodology presented in the testimony of Staff witness Rendell. The amount is subject to the resolution of other issues.

³ Pages 155 and 156 of the MFRs show that the utility disposes of 31% of its effluent from its wastewater treatment plant and reject water from its water treatment plant during the wet weather months of June through September. (For wastewater, for the months of June through September the utility treated 60,497,000 of effluent out of a total for the year of 195,775,000. Dividing 60,497,000 by 195,775,000 indicates that 31% of the total effluent disposed of is during the wet weather months. Similar calculations for water show that 31% of the water sold is during the wet weather months. 196,520,000 divided by 626,229,000 equals 31%. There is no reason to believe that the reject water that is mixed with the effluent would be any different that the ratio of water sold during these months.) Applying this ratio to the total gallons disposed of on the golf courses as depicted on Exhibit 19, Schedule 3 of 558,397,000 indicates that during the wet weather months, Gulf would need to dispose of 173,103,070 of effluent. At a credit of \$.05 per 1,000 this would result in an expense of \$8,655 to the utility and revenue to the golf courses of \$8,655. During the dry weather months Gulf disposes of 69% of its effluent on the golf courses, or 385,293,930 gallons. At a charge of \$.25 per 1,000 gallons this would produce revenue of \$96,323, for a net revenue impact of \$87,668.

**CERTIFICATE OF SERVICE
DOCKET NOS. 960329-WS AND 960234-WS**

I HEREBY CERTIFY that a correct copy of the foregoing has been furnished by U.S.

Mail or *hand-delivery to the following parties on this 3rd day of April, 1997

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A handwritten signature in black ink, appearing to read "Stephen C. Reilly", is written over a horizontal line.

Stephen C. Reilly
Associate Public Counsel