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TO: DIVISION OF RECORDS AND REPORTING

FROM: DIVISION OF LEGAL SERVICES (O'SULLIVAN PARKER, VACCARO)

RE: DOCKET NO. 960234-WS - INVESTIGATION OF RATES OF GULF UTILITY COMPANY IN LEE COUNTY FOR POSSIBLE OVEREARNINGS.

DOCKET NO. 960329-WS - APPLICATION FOR INCREASE IN RATES AND SERVICE AVAILABILITY CHARGES IN LEE COUNTY BY GULF UTILITY COMPANY.

PSC 97-0847-FOF

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Attached is a FINAL ORDER SETTING RATES AND CHARGES, with attachments, to be issued in the above referenced docket. (Number of pages in Order - 106)

see 1 + 92

MOP/TV/dp,mw

Attachment

cc: Division of Water & Wastewater (Merchant, Fuchs, Galloway, Von Fossen, Webb)

I: 960234-C.GLF

4 mailed - KAR.

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Attachments Not On Line

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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|---|---|
| In re: Investigation of rates of Gulf Utility Company in Lee County for possible overearnings. | DOCKET NO. 960234-WS |
| In re: Application for increase in rates and service availability charges in Lee County by Gulf Utility Company. | DOCKET NO. 960329-WS<br>ORDER NO. PSC-97-0847-FOF-WS<br>ISSUED: JULY 15, 1997 |

The following Commissioners participated in the disposition of this matter:

J.TERRY DEASON
SUSAN F. CLARK

APPEARANCES:

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On behalf of the Citizens of Florida.

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On behalf of the Commission Staff.

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## FINAL ORDER SETTING RATES AND CHARGES

BY THE COMMISSION:

### BACKGROUND

Gulf Utility Company (Gulf or utility) is a Class A utility which serves approximately 7,040 water and 2,435 wastewater customers in Lee County, Florida. The utility is located in a water use caution area as designated by the South Florida Water Management District (SFWMD). We last established rate base for Gulf's wastewater facilities by Order No. 20272, issued November 7, 1988, in Docket No. 880308-SU. Rate base for water facilities was last established by Order No. 24735, issued July 1, 1991, in Docket No. 900718-WU.

On June 27, 1996, Gulf filed an application for an increase in wastewater rates, approval of a decrease in water rates, and approval of service availability charges. The minimum filing requirements (MFRs) were satisfied on August 23, 1996, which was established as the official filing date pursuant to Section 367.083, Florida Statutes. The utility's requested test year for interim purposes is the historical year ended December 31, 1995. The requested test year for final rates is the projected year ending December 31, 1996.

By Order No. PSC-96-0501-FOF-WS, issued April 11, 1996, in Docket No. 960234-WS, we initiated an overearnings investigation and held $353,492 in annual water revenues subject to refund. As noted by that order, the overearnings investigation has been combined with this rate proceeding.

By Order No. PSC-96-1310-FOF-WS, issued October 28, 1996, we suspended Gulf's proposed rates, approved interim wastewater rates subject to refund, and granted the utility's request to reduce its water rates and held additional water revenues subject to refund. By Order No. PSC-96-1344-PCO-WS, issued November 14, 1996, we acknowledged the Office of Public Counsel's (OPC) intervention in these dockets. The Prehearing Conference was held on February 17, 1997. The technical and customer hearings were held on March 5 and 6, 1997 at the Elks Club of Bonita Springs in Bonita Springs, Florida. Two customer hearings were held on those dates.

## FINDINGS OF FACT, LAW, AND POLICY

Having heard the evidence presented at the hearing in this proceeding and having reviewed the recommendation of the Commission Staff (Staff), as well as the briefs of the parties, we now enter our findings and conclusions.

## STIPULATIONS

In Prehearing Order No. PSC-97-0208-PHO-WS, issued on February 24, 1997, all parties and Staff agreed the following stipulations were reasonable. We have reviewed the stipulations, which are set forth below, and find them to be reasonable, although they shall have no precedential value in any subsequent proceeding. Accordingly, the following stipulations are approved.

1. Wastewater plant in service will be reduced by $2,265 in order to correct the 13-month average balance of wastewater plant reported in the MFRs.

2. The water transmission and distribution system will be considered 100 percent used and useful because the water distribution lines are contributed.

3. The entire wastewater collection system will be considered 100 percent used and useful because the collection system is contributed.

4. Test year expenses will be reduced by $792, to remove lobbying-type expenses.

5. Test year expenses will be reduced by $235 to remove expenses related to rotary club dues.

6. Charitable contributions will not be included in operation and maintenance expenses.

7. An adjustment of $8,000 will be made to remove expenses for pond cleaning from the test year.

8. Consulting costs associated with the overearnings investigation case will be considered rate case expense and included in Gulf's documentation for requested rate case expense. Test year expenses should be reduced by $4,205 for water and $1,979 for wastewater.

9. Payroll taxes will be allocated based on the ratio of payroll costs between water and wastewater. The amounts are subject to the resolution of other issues.

10. Test year regulatory assessment fees will be computed to reflect 4.5 percent of adjusted test year revenues, resulting in adjustments of $(715) for water and $(1051) for wastewater.

11. Private fire protection rates shall be calculated in accordance with Rule 25-30.465, Florida Administrative Code.

12. For both water and wastewater refund purposes, the final revenue requirements will be adjusted to remove any ratemaking components which were not in service or not incurred during the time interim rates were in effect. These adjusted revenue requirements will be compared to the adjusted test year revenues to determine whether any refund shall be ordered. The water test year revenues shall be annualized for the two time periods using the rates prior to the water interim rate reduction and the rates subsequent to the water interim rate reduction.

13. The appropriate allowance for funds used during construction (AFUDC) rate will be based on the rate of return found to be fair and reasonable by the Commission, and pursuant to Rule 25-30.116, Florida Administrative Code. The rate will be effective January 1, 1997.

14. The cost of common equity capital shall be determined using the leverage formula in effect at the time of the Commission's decision in this case. OPC had no position as to the use of the leverage formula, but did not take issue with it in this proceeding.

15. If any plant costs related to funds received from the SFWMD's Alternate Water Supply Grants Program have been included in projected rate base, those costs shall also be included in rate base as contributions in aid of construction (CIAC). Regardless of the ratemaking treatment followed in this rate case, the grant shall be recorded as CIAC on the utility's books when received.

In no event shall the amount of CIAC exceed the amount of related plant in rate base resulting from this transaction.

QUALITY OF SERVICE

Pursuant to Rule 25-30.433(1), Florida Administrative Code, this Commission evaluates the utility's quality of service based upon the quality of the utility's product, the operational conditions of utility's plant and facilities, and the utility's attempt to address customer satisfaction. We also consider sanitary surveys, outstanding citations, violations and consent orders on file with the Department of Environmental Protection (DEP) and county health departments (HRS) or lack thereof over the preceding 3-year period.

According to Staff witness James Allen of DEP and Andrew Barienbrock of HRS, Gulf is in compliance with state and other regulatory requirements. Its water treatment plant and distribution system and wastewater collection and treatment system are in good operational order. They further testified that the utility has not been the subject of any enforcement actions.

The level of customer satisfaction which results from the utility's relations with its customers is also evaluated by a review of recent complaints and with direct customer testimony at the hearing. Approximately 100 persons attended the service hearing; eleven customers provided testimony. Five golf course representatives testified opposing the establishment of a reuse rate and six residential customers testified regarding the rate increase in general. Two customers addressed water quality related to corrosivity, hardness and taste.

Based upon our review of evidence in the record, we conclude that the quality of service provided by Gulf to its customers is satisfactory.

FIRE FLOW

In this proceeding, we reviewed the utility's provision of adequate fire flow to its service area. The utility included a fire flow component of 1500 gallons per minute (gpm) in its used and useful calculations. Two representatives from local fire departments testified that the utility did not meet adequate fire flows at all of the hydrants in the service area. The utility asserted that it was not required to meet the fire flow level set forth in local regulations, and that its own tests yielded more satisfactory results.

Utility witness Steven Messner, Operations Manager for Gulf, stated that not all fire hydrants met the utility requested 1,500 gpm. Staff witness Thomas Beard, a fire inspector for the San Carlos Fire and Rescue Service District testified that in some residential and commercial areas, the utility cannot produce 750 gpm at its fire hydrants. More specifically, he testified that 35 of 56 (62.5 percent) hydrants in commercial areas and 75 of 341 (22 percent) fire hydrants in residential areas do not meet fire flow needs for those areas.

Staff witness Bernard Kleinschmidt, employed by the Estero Fire Control and Rescue Service District as its Deputy Chief, testified that fire districts are graded by the Insurance Service Organization (ISO), an agency that classifies and rates fire departments throughout the country. The grading system is used by insurance companies to set insurance rates within the area covered by the respective departments. Both witnesses testified that lower fire flows result in added costs to construction of buildings by requiring sprinkler systems and additional fire walls to be installed. Mr. Beard testified that according to the development standards, set forth in Section 12 of the Lee County Development Code, if 750 gpm is not met, the development order will not be approved.

OPC asserted that the utilitv does not provide sufficient fire flow to its entire service area. OPC also questioned Mr. Beard regarding the requirements of the Florida Gulf Coast University (FGCU). Mr. Beard testified that according to calculations based on the Lee County Development Code, using the Hayes and Williams formula for fire flow, most of the university buildings do not come up to fire flow units. According to Mr. Beard the buildings require flows ranging from 755 gpm to 2,493 gpm. When asked how much flow is available to the university, Mr. Beard answered that several tests on the line performed in January, 1997, ranged from 1,064 gpm to 1,099 gpm. That is less than half the required flows required according to the calculations.

During rebuttal, utility witness Elliott testified that Section 12 of the Lee County Development Code relied upon by Mr. Beard had been replaced by Section 10-385 of the current development code. Mr. Elliot testified that the utility was not obligated to meet the local code because it referred to new development. He further testified that the utility was not required to retrofit the system under the new ordinance.

Mr. Elliott testified that three fire flow tests conducted by a state certified fire sprinkler contractor on January 14, 1997, yielded acceptable fire flow results. The tests were taken at the extremities of the Gulf service area. According to Mr. Elliott, the difference between the fire flow tests conducted January 14th, and those conducted by the San Carlos Fire Department, is that the duration of the test was a minimum of ten minutes, in contrast to the Fire Department's three to five minute test. Mr Elliot testified that the ten minute test permitted sufficient time for the high service distribution pumps to provide pressure.

The utility contended that the Lee County Development Code relied upon by Mr. Beard had been superseded by a new section. However, utility witness Elliot agreed that the old Section 12 and the new Lee County Development Order pertaining to fire flow were substantially the same. Section 10-385(b)(1) of the new Lee County Development Code requires 750 gpm for one and two family developments when the distance between buildings is zero to 30 feet. Section (b)(2) requires fire flows to be in accordance with the formula shown in subsection (b)(3) of the same section. Subsection (b)(4) requires a minimum flow of 500 gpm with 20 pounds per square inch (psi) residual in all cases. Section 12 had been in effect since 1983, so any construction done after that time would effectively be the same as under the new requirement.

According to Mr. Beard, the utility's ten minute duration fire flow tests were not reflective of fire department practice. Mr. Beard testified that, according to the American Water Works Association, (AWWA) Manual 17 and National Fire Protection Association (NFPA) 219, there is no requirement to leave a hydrant running 10 minutes until the pressure stabilizes. Mr. Beard testified that this could cause property damage and waste water to the extent of 10,000 gallons for each flow test. Moreover, it would not be appropriate to allow a fire to burn for 10 minutes before applying water to it.

Based on the testimony in the record from expert witnesses Beard and Kleinschmidt, who are state-certified, practicing fire officials, we conclude that Gulf does not provide adequate fire flow protection in its entire certificated service area. Gulf is therefore ordered to coordinate with representatives from the fire districts in its service area to correct low flow problems where they exist. Gulf is further ordered to report to this Commission in 6 months and 12 months, after the issuance date of this Order, detailing the corrective measures taken and the progress of the corrective action.

RATE BASE

Our calculation of the appropriate rate base for the purpose of this proceeding is depicted on Schedule No. 1, and our adjustments are itemized on Schedule No. 1-A. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion. The major adjustments are discussed below.

Corkscrew Water Treatment Plant (WTP) - One Million Gallon Reject Holding Tank

In its MFRs, Gulf requested the inclusion of a one million gallon reject water holding tank. The tank, to be used for holding reject water from the Corkscrew water treatment plant, had not been constructed, nor were contracts or construction even initiated during the utility requested test year ending December 31, 1996.

The utility cited Section 367.081(2), Florida Statutes, as authority to include the cost of the reject water holding tank in rate base. This statute provides a utility with the opportunity to request the use of a projected test year of up to twenty-four months in a rate proceeding. Gulf opted to file its rate case using a 12 month projected test year ending December 31, 1996. Gulf did not produce firm evidence of a commitment to construct the holding tank up to and including the hearing held on March 4 and 5, 1997, three months after the end of the test year. When questioned at the hearing, utility witness Moore testified that the tank had not been built and that contracts for its construction had not been signed. The utility did not have any bids for the tank's construction or a firm start/completion date for the project. Mr. Moore testified the completion time was estimated by the engineer to be four months. If the project were to be initiated in April, the estimated completion date would be August.

In its brief, Gulf argued that case law requires the Commission to include the reject holding tank in rate base, because it is a known change that will occur within a reasonable time after the test year. In support of its argument Gulf cites Gulf Power v. Bevis, 289 So. 2d 401, 405 (Fla. 1974) relying on McCardle v. Indianapolis Water Co., 272 U.S. 400 (1926), and Floridians United v. Public Service Commission, 475 So. 2d 241 (Fla. 1985). We recognize and adhere to the holdings in these cases, but these cases do not apply in this instance because the utility failed to provide evidence of a date certain for construction of the tank. In a rate case, the burden of proof is on the utility seeking a rate change. See Florida Power Corp. v. Cresse, 413 So. 2d 1187 (Fla. 1982).

We are mindful of the cost for filing any rate proceeding. Had there been at least a signed contract to construct the reject holding tank, we could have considered its inclusion in some manner. However, there is no date certain in the record as to when this tank will be built. Therefore, we conclude that the evidence does not support the inclusion of the one million gallon reject water holding tank in rate base. We note that the utility could apply for a limited proceeding when it has firm figures and dates available if it can show financial need.

New Three Oaks Wastewater Treatment
Plant (WWTP) - Chlorine Contact Chambers

The chlorine contact chambers are the final stage of wastewater treatment before disposal. Utility witness Elliott testified that the second chlorine contact chamber at the Three Oaks WWTP is a necessary element to provide the required redundancy to the online chamber as required by DEP Rule 62-610, Florida Administrative Code.

OPC questioned utility witness Elliott about the DEP redundancy rule. Witness Elliott agreed that the rule relies on a reference to Federal Environmental Protection Agency (EPA) guidelines. Mr. Elliott also agreed that the EPA guidelines require a 75 percent backup for sedimentation basins and 50 percent design flow backup for disinfection of contact basins. Mr. Elliott stated, though, that those figures applied in an ideal world. OPC witness Biddy testified that the cost of the chlorine contact chamber should be transferred to plant held for future use. In its post hearing brief, however, OPC contended that the original and new plant elements should have different used and useful percentages.

There is no precedent for the treatment proposed by OPC, nor is there any record support for different calculations for each required element. Additionally, since the cost for the chlorine contact chambers is not segregated from the total cost of the treatment facility, it is not possible to determine an amount specifically dedicated to the chambers. Chlorine contact chambers are necessarily a part of the treatment plant, recorded in Account No. 380.4. Therefore, adjustments made to Account No. 380.4, (Treatment and Disposal Equipment) will automatically apply to the contact chambers. We have addressed the appropriate used and useful percentage for this plant component below.

Old Three Oaks WWTP

The original Three Oaks WWTP is a 0.250 million gallons per day (mgd) circular steel aeration treatment plant. It has been replaced as the primary treatment plant by the new 0.750 mgd plant. Utility witness Elliott testified that the old tanks are a necessary element in the Three Oaks WWTP process to provide the required redundancy for online aeration and clarifier units according to DEP Rule 62-610, Florida Administrative Code, for Class I reliability. Mr. Elliott further testified that, upon the completion of Three Oaks Phase IV expansion, one of the old treatment tanks will be modified for use as a flow equalization basin and the second will be used for effluent storage.

OPC witness Biddy testified that the old Three Oaks WWTP is currently off line. OPC proposed that the old Three Oaks plants be considered 60.59 percent used and useful and the new plant to be 64.63 percent used and useful. There is no precedent for this type of consideration, nor did OPC provide any record support for using different percentages of used and useful for the old and new plants.

Although OPC witness Biddy testified that the old WWTP is currently off line, if the plant were actually off line there would be no used and useful consideration. Utility witness Elliott testified that the additional plant is required to meet the Class I reliability rule. It must be available for immediate use in an emergency situation. The old plant is an integral part of the system and necessary according to DEP rules requiring redundancy for Class I operation. According to Mr. Elliott, the plant was on line as recently as February of 1997.

In consideration of the evidence, we conclude that no adjustments will be made to the old Three Oaks WWTP.

Costs Associated with the Florida Gulf Coast University (FGCU)

FGCU will not open its doors to students until the Fall semester of 1997. However, the construction of the lines and other infrastructure for water and wastewater was undertaken and placed in service in the December 31, 1996 test year. FGCU will be the utility's largest customer and the largest single source of revenue in its first year of operation.

Utility witness Moore testified that the university is under construction, and actually began receiving service in December 1996. He further testified that the facilities to serve FGCU were designed by engineers contracted by the university and considered only their [FGCU] service requirements, and that the lines for the university were in place during the test year. Mr. Moore testified that the FGCU staff did not want other lines connected with the campus lines because of concern that such connections would negatively impact pressure and fire flow requirements of the university.

OPC witness Biddy expressed concern that the lines not be considered 100 percent used and useful because ultimately they will serve private developments off campus. OPC's final position stated the used and useful percentages should be no more than 24.96 percent for water and 23.15 percent for wastewater.

OPC did not provide supporting testimony or documentation for its proposed percentages. In fact, OPC witness Biddy testified that without knowing the ultimate build-out design, no reliable used and useful analysis can be performed for the water and wastewater lines. We agree with OPC that a reliable used and useful percentage on lines, based on actual demand, cannot be performed at this time.

The university is in operation and receiving service from the utility, even though there are no students present on campus. Because the record shows the lines were sized by university contracted engineers, for the university only, and constructed by the university with only the university's service requirements in mind, we conclude that all costs relating to FGCU were prudently incurred in the test year and should be included in this rate proceeding with no adjustments.

Margin Reserve

Margin reserve allows a utility to expand prudently beyond current demands to enable it to meet reasonable projected short term growth. This practice allows the utility to include a reasonable cost of expansion in its rate base without placing an unreasonable burden on current customers to pay for long term growth. It is this Commission's policy to grant a reasonable margin reserve if requested.

Utility witness Cardey testified that Section 367.111(1) Florida Statutes, provides that, "Each utility shall provide service to the area described in its certificate of authorization within a reasonable time." In order for a utility to meet its statutory responsibilities, it must have sufficient capacity and investment to meet the existing and changing demands of present and potential customers. Therefore, Mr. Cardey states that the Commission has consistently recognized margin reserve as an element in used and useful calculations.

OPC witness Dismukes testified against a margin reserve because it represents capacity to serve future customers, not current customers. OPC witness Biddy agreed that a utility must be in a position to serve changing needs of its present customers. Mr. Biddy agreed that utilizing CIAC and AFPI funds is reserved until the new customers connect to the system.

We grant a reasonable margin reserve to enable a utility to charge present customers for some of the additional capacity. For calculation of growth projections, we have utilized the linear regression analysis instead of the historical average method. See Orders Nos. PSC-96-1320-FOF-WS and PSC-97-0388-FOF-WS. Linear regression, because of the analysis of the two factors of growth and time, more reliably reflects positive or negative trends in growth than the simple historical averaging method of calculation. By tracking this relationship for several observations, a straight line can be established to reasonably predict growth by projecting out along the same path. Additional years can be added for further projections with reasonable confidence in the results.

Gulf advocated a 60 month margin reserve period for the wastewater treatment plant. Utility witness Elliot testified that an 18 month cycle is insufficient time for planning, permitting and construction for wastewater plants. Mr. Elliott further testified that according to DEP Rule 62-600.405, Florida Administrative Code, if a capacity analysis report indicates less than five years capacity remains in a wastewater facility, that planning and preliminary design of the expansion must be initiated and documented in a signed and sealed statement provided by a professional engineer and that a shorter planning time increases costs.

In consideration of the evidence, we find it appropriate to approve a margin reserve of 18 months for water treatment plants, equal to 283,773 gallons per day (gpd), and 18 months for the Three Oaks wastewater treatment plant, equal to 112,812 gpd. We find that these time frames sufficiently address future growth concerns without unduly burdening current customers. The San Carlos WWTP is 100 percent used and useful; therefore, no margin reserve will be allocated for that facility.

Used and Useful

Our analysis and findings regarding the elements of used and useful are set forth below.

Inclusion of fire flow

Gulf stated that the fire flow component of used and useful should be 360,000 gallons. This is calculated by using 1500 gpm at 20 psi for a four-hour duration as shown in the utility's MFRs. Utility witness Elliott offered two fire flow tests as proof of the utility's compliance with existing codes. The highest flow was 1,213 gpm at 20 psi. Both tests fall short of the 1,500 gpm at 20 psi listed in the MFRs.

OPC contended that if a fire flow allowance is granted, the flow should be 750 gpm because that is the only documented flow in this proceeding. OPC witness Biddy agreed that when there is a fire in this system, all of the wells, pumps and tanks are used to put out the fire.

Division 5, Fire Safety Section, of the Lee County Development Standards, admitted as Composite Exhibit 36, requires buildings spaced from zero to thirty feet to have 750 gpm available fire flow as does the code it replaced, Section 12, Fire Safety Standards Design Requirements.

As noted herein, representatives of the local fire departments in Gulf's service area testified that the utility did not meet fire flow needs in residential and commercial areas. Staff witness Beard testified that some residential area hydrants do not meet the minimum 750 gpm and further testified that there are some commercial areas that do not produce 750 gpm. Staff witness Kleinschmidt testified that single family homes are required to have a minimum fire flow of 750 gpm and fire flow in commercial areas is dictated by the type of buildings, size, spacing and use. Mr. Kleinschmidt testified that Gulf does not meet all these requirements in its service area.

If the utility requests and is granted a fire flow of 1,500 gpm at 20 psi residual pressure, that amount should be available at every hydrant. Evidence in the record indicates that Gulf either does not or cannot deliver the requested 1,500 gpm at 20 psi, at more than one fourth of their hydrants. Evidence also shows that Gulf can deliver 750 gpm at 20 psi residual pressure at most of its hydrants.

Fire flow is required by the Lee County Land Development Code. The additional capacity required by the Code must be provided by the utility. As supported by the record, Gulf does not provide the requested 1,500 gpm at 20 psi residual pressure. Therefore, while fire flow will be included in the used and useful calculations, the utility does not or cannot provide the requested fire flow to its entire service area.

We have ordered the utility to address the issue of fire flow on a going-forward basis until the flow problems are corrected. We find the appropriate fire flow allowance for Gulf to be the amount customers actually can expect to have available if needed. Therefore, we conclude that the fire flow component of used and used shall be based upon 750 gpm at 20 psi for 4 hours, or 180,000 gallons.

Economies of Scale

Gulf raised the general issue of whether the Commission should consider economies of scale in general, and the specific issue of whether we should consider economies of scale in determining used and useful for the Corkscrew well field, Corkscrew water treatment plant, Skid #3 and Corkscrew reject water facilities.

We consider economies of scale, with regard to used and useful calculations, on a case by case basis when proper support is provided by the utility. The only supporting documentation presented by Gulf in this docket is that we recognized the principle of economies of scale in a rate proceeding involving Gulf Utility Company in Order No. 24735, issued July 1, 1991, in Docket No. 900718-WU.

Utility witness Cardey presented an economies of scale argument regarding Skid #3 in the Corkscrew WTP. He related economies of scale to the last increment of capacity, that being Skid #3 in the plant. Mr. Cardey testified that this Commission, in Order No. 24735, recognized economies of scale in the construction of the utility's water treatment facilities. Mr. Cardey theorized that excess capacity is related to the last increment of capacity which, in this case, is Skid #3. Under cross-examination by OPC, Mr. Cardey agreed there is no express language to that effect in the order.

In this docket, no data was presented or considered for the Corkscrew well field. We have removed the reject water holding tank from rate base because it has not yet been constructed during the test year. We have not considered economies of scale for Skid #3 in the Corkscrew WTP. When calculating used and useful percentages, we have never considered individual items such as skids as separate elements. They are considered a unit and treated as a single element. We agree with Mr. Cardey that this Commission did consider economies of scale in Order No. 24735. However the utility did not provide any testimony or documentation to support economies of scale in this case. Moreover, in the rate case referenced by Mr. Cardey, economies of scale were considered for the Corkscrew WTP building.

Nothing in the record supports this method of calculating used and useful. The Gulf WTP is considered a unit and all its parts are a whole. As we have concluded with regard to the WWTP chlorine contact chambers, the WTP plant is one entity. There is no account to provide for a separate skid just as there is none for contact chambers.

We will continue considering economies of scale in plant investment on a case by case basis with proper documentation from the utility.

Utility Land

We found facility lands 100 percent used and useful in Order No. 24735, in Docket No. 900718-WU. Gulf witness Cardey noted this finding, and testified that nothing has changed since that case. OPC witness Biddy offered no compelling testimony to the contrary. Mr. Biddy testified that the utility can expand to the ultimate design capacities of 3.0 mgd for water and 5.0 mgd for wastewater. However, these capacities were evident in the prior case when we granted 100 percent used and useful for the facility land.

We conclude that, upon reviewing the record in this proceeding, that nothing has changed since the prior case regarding the amount of land or land use. Therefore, all facility lands shall be considered to be 100 percent used and useful.

Water System Components

Gulf has two water treatment plants which are interconnected. Plant #1 is the San Carlos lime softening plant with a capacity of 2.415 mgd. Plant #2 is the Corkscrew membrane softening plant with a capacity of 1.8 mgd. Total water plant treatment capacity is 4.215 mgd.

Utility witness Cardey presented used and useful calculations in the MFRs indicating a used and useful percent for the water treatment plant of 88.2 percent. Mr. Cardey used 360,000 gallons for fire flow and margin reserve flows based on calculations which utilized artificially high equivalent residential connection (ERC) growth and flows per single family ERC. We have made several adjustments which affect these calculations.

First, we have concluded in this Order that available fire flow is 180,000 gallons, instead of the 360,000 proposed by the utility. We also find that the single family ERC flows of 396 gallons per ERC for water and 250 gallons per ERC for wastewater presented by the utility in its MFRs are too high. Current flows for single family residences should actually be 206 gallons per ERC for water and 158 gallons per ERC for wastewater. A calculation of the flow figures and ERC numbers from Schedule F-9 of Gulf's MFRs result in an ERC of 206 gallons per single family Mr. Cardey presented as his argument, economies of scale, and extended the economies of scale to the last increment of capacity, Skid #3. Mr.

Cardey also used a factor of 500 ERCs at 396 gallons per ERC from the utility's tariff, as an indicator of expected flows from the university.

OPC witness Biddy, in his used and useful calculations does not include a margin reserve, testifying that OPC's policy is to not endorse a margin reserve. By not including margin reserve, a much lower used and useful percentage of 68.43 percent results.

Our policy has been to use the sum of the average of five maximum days plus fire flow plus margin reserve minus excessive unaccounted for water divided by plant capacity. As indicated herein, the margin reserve includes an annual growth of 430 ERCs as calculated by the more reliable linear regression method. This differs from Mr. Cardey's number of 500 ERCs. We have also utilized the lower fire flow figure of 180,000 gallons. Based upon these findings, the water treatment plants shall be considered 76.15 percent used and useful.

Water Supply Wells

Gulf has two non-interconnected well fields: The San Carlos well field, which serves the San Carlos WTP and the newer Corkscrew Swamp well field, which serves the Corkscrew WTP. Eleven wells were drilled in the Corkscrew well field, of which five are equipped with pumps. Gulf claimed in Docket No. 900718-WU that all 11 wells were drilled at one time at the request of the SFWMD, which wanted to protect the integrity of the Corkscrew Swamp. The utility had only two of the 11 wells equipped with pumps in that Docket. Since then, three additional wells have been equipped with pumps.

Gulf witness Cardey testified that the Commission found the San Carlos supply and treatment plant 100 percent used and useful in Order No. 24735. He testified that the Commission included three of the Corkscrew wells in used and useful property in that same order. Our review of the order indicates that we actually included four wells in calculating used and useful. Mr. Cardey appears to request 100 percent used and useful for San Carlos independently, then combines the two for an average percentage of 88 percent.

OPC witness Biddy testified that a water utility will customarily use a "firm reliable capacity" in calculating the used and useful percentages for water wells. The firm reliable capacity excludes the largest well capacity by assuming it to be out of service. Mr. Biddy further cited Section 3.2.1.1 (Source Capacity) of the Recommended Standards for Water Works, (Ten States Standards): "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."

We utilized the method recognized by the Recommended Standards for Water Works (Ten States Standards) in our used and useful calculations for the Corkscrew well field. That method uses a percentage of the capacity required versus capacity constructed as a criteria for used and useful calculations, observing economies of scale when appropriate. The San Carlos well field has a capacity of 2.808 mgd. The San Carlos water treatment plant has a capacity of 2.4 mgd. We found all accounts associated with the San Carlos water treatment plant to be 100 percent used and useful in Order No. 24735. Mr. Cardey testified that nothing has changed since that decision. Mr. Cardey testified that the five well pumps in the Corkscrew well field each has a capacity of 500 gpm. With the largest well out of service, the well field has a total capacity of 2.88 mgd. The Corkscrew water treatment plant has a current capacity of 1.8 mgd. Dividing the 1.8 mgd capacity of the WTP by the 2.88 mgd capacity of the well field equals 62.5 percent used and useful for the Corkscrew well field.

Based on the evidence in the record, we find the San Carlos well field to be 100 percent used and useful and the Corkscrew well field to be 62.5 percent used and useful.

Water Storage

Gulf has 2.6 million gallons of storage, representing about 18 hours normal use. Average use for the system is 1.847 mgd. Utility witness Elliott testified that it is standard practice to provide emergency storage based on an assessment of risk and degree of system dependability.

OPC witness Biddy raised the issue of dead storage, which is defined as water in a storage tank which cannot be pumped out and thus, is unavailable for consumption. Mr. Elliott stated there is no dead storage to consider. He testified that Lee County requires a 24-hour production for storage in smaller systems. Mr. Elliott also testified that Gulf only has an 18-hour storage capacity whereas other systems in the area, such as the City of Cape Coral and Sanibel have five to ten days storage.

Mr. Biddy testified that the Commission granted 100 percent used and useful for storage in Order No. 24735 by utilizing one day of peak demand plus fire protection. Mr. Biddy took exception to that allowance by testifying that he believed half of the average daily flow is adequate for equalization and emergency storage, but offered no supporting documentation for his theory. Mr. Biddy also testified that no dead storage was used in his calculations.

We found in Order No. 24735 that normally a one day plant production is utilized for storage when available, and granted 100 percent used and useful for storage in that docket. The system has grown since that time and no new storage has been added. Therefore, we conclude that storage is 100 percent used and useful.

Wastewater Treatment Plants

Gulf witness Cardey testified that the wastewater treatment plants should be 100 percent used and useful. For used and useful consideration, the utility presented the two plants as one system in its MFRs. Gulf requested 118.6 percent used and useful for the two wastewater treatment plants together by calculating a growth factor of 507 ERCs at 250 gallons per single family ERC plus a growth factor for the university of 209 ERCs at 250 gallons per ERC, plus a margin reserve of 3 years times 400 ERCs times 250 gallons per ERC. On cross-examination, Mr. Cardey testified that the San Carlos and Three Oaks treatment plants are interconnected.

OPC offered calculations showing the current wastewater gallons per single family ERC experienced by Gulf are 158. Mr. Cardey did not agree with OPC. However, our calculation of these figures, using flow figures and total ERCs taken from the minimum filing requirement (MFR) schedule F-10, results in the same amount proposed by OPC: 158 gallons per single family ERC.

OPC witness Biddy offered exhibits regarding used and useful percentages at the hearing, but had no further testimony to support his position. OPC asserts that the San Carlos WWTP should be 100 percent used and useful. As to the used and useful percentage of the Three Oaks WWTP, OPC advocated a lower number due to the exclusion of a margin reserve allowance. OPC witness Dismukes testified against granting a margin reserve because it represents capacity to serve future customers not current customers. OPC witness Biddy agreed that a utility must be in a position to serve changing needs of its present customers. We have granted Gulf a margin reserve in this proceeding, and will therefore utilize it in these calculations.

The San Carlos plant is operating above capacity and therefore it shall be considered to be 100 percent used and useful. Using the 18 month margin reserve approved herein, we find the used and useful percentage for the Three Oaks WWTP to be 72.11 percent.

Adjustments Related to Lines Built for the Caloosa Group

Caloosa Trace is a development owned by the Caloosa Group, which has the same owners as Gulf. On February 20, 1990, Gulf recorded water and wastewater assets of $59,684 and $92,815, respectively, for Phase 1 and $8,430 in water assets for Unit 16, Phase 8, for the Caloosa Trace Development. Instead of a credit entry being made to the utility's CIAC, the owners were given stock in the utility in exchange for the assets.

Staff witness Kathy Welch, a supervisor in the Commission's Miami District office, sponsored the audit staff's report in the instant case. Ms. Welch testified that when developers connect to a system, the lines and hydrants are normally contributed by the developers and recorded on the books of the utility as a debit to plant and a credit to CIAC. In its response to the audit, Gulf stated that the transaction had been reviewed by its auditors and was in compliance with all rules and regulations of the Commission and generally accepted accounting principles. Nevertheless, Ms. Welch testified that the transaction should have been recorded the same as a transaction for non-affiliates transferring property to the utility.

Staff witness William Troy Rendell testified that the developer agreements between these two corporations, which are on file with the Commission, covered the development of all phases of Unit 16. Mr. Rendell testified that any contributions made by developers, including an affiliate corporation, should be booked to CIAC. Section 1(c) of the developer agreement states that any property received by the utility from the developer should be considered CIAC. Sections 1(j)&(k) indicate those water lines constructed by the developer should be considered on-site and off-site facilities, and Sections 3 and 4 of the agreement cover the installation of these facilities. Mr. Rendell testified that Gulf's tariff also required these facilities to be contributed. To do otherwise, in his opinion, would be discriminatory. He concluded that Rule 25-30.585, Florida Administrative Code, designates that, at a minimum, the cost of installing water transmission and distribution facilities and sewage collection facilities should be considered CIAC.

OPC witness Dismukes agreed with Staff's witnesses on this issue. She testified that Gulf and Caloosa had the same owners and that ownership in Caloosa was in the same proportion as the ownership for Gulf. Ms. Dismukes believed that Gulf had not provided a satisfactory reason why its developer-affiliate should be treated any differently than a non-affiliate developer. Accordingly, she advised that CIAC should be increased by $68,114 for the water operations and $92,815 for the wastewater operations, with a corresponding adjustment to reduce equity by the same amount.

Utility witness Moore testified that the transaction between the companies was very open and straight-forward. He stated that there was a substantial difference in the conditions under which the stockholders obtained service in contrast to other developers in the area. He maintained that the utility's accounting of the transaction strengthened the utility financially, benefitting customers in the long run.

Mr. Moore testified regarding customer growth and the manner in which Gulf's operations have been financed through the efforts of the shareholders and industrial development revenue bonds (IDRB). In any real estate development, he testified, some group has to generate "up-front" money and construct facilities to have capacity available to serve that growth. It is Gulf's viewpoint that it, instead of the developer, must provide this money, and the stockholder has had to absorb the losses from this up-front investment. Further, he stated that the benefits of providing this investment in capacity go to the builders in the area and that equity dictates this situation be brought into balance.

Mr. Moore stated that the stockholders have absorbed losses over several years, including losses of over $1.5 million occurred from the differences in IDRB loans and temporary investments of these government securities funds. By absorbing these losses, Gulf believes that its stockholders are providing a benefit to customers and developers, who are provided service when needed. There is a substantial difference in the service provided to the stockholders in Gulf/Caloosa and the other developers in the area. For that reason, Mr. Moore contended that no discrimination occurred in the transaction.

Mr. Moore asserted that a higher equity base benefits customers by improving the utility's ability to negotiate the refinancing of the IDRBs with lower interest rates, and by freeing $1 million of reserve funds to invest in new facilities. Although the refinancing was suspended pending the Commission's investigation into overearnings, it could lower expenses by more than $300,000 annually. The $14,800 cost to the customers of this equity transaction by Gulf/Caloosa pales in comparison to those a stronger balance sheet provide. If equity is further reduced from its already low level, Mr. Moore concluded that it would be even harder to sell bonds and attract new equity to finance construction if Gulf cannot demonstrate that it can sustain adequate earnings in the future.

Mr. Moore agreed that the customers had no part in Gulf's decision to incur more debt than necessary at the time it incurred $1.5 million in losses, and that the stockholders, not the customers, should bear those losses. He stated that if any unaffiliated developer sustained losses on obtaining more debt than was required that the developer would still have to contribute the lines.

We disagree with Mr. Moore's assessment that no discrimination between developers occurred. His first point that there is a substantial difference between the stockholder and the other unaffiliated developers brings this to light. There should be no substantial difference in the way affiliate and non-affiliate developers are treated. Further, we disagree with Mr. Moore's statement that Gulf violated no rule or regulation of this Commission. Both Rule 25-30.565, Florida Administrative Code, and the utility's tariff state that off-site lines should, at a minimum, be contributed. Neither the rule nor the tariff make any distinction between affiliate and non-affiliate developers.

While Gulf has a relatively low equity ratio, and this transaction increased its equity, it is not the appropriate mechanism to infuse equity into the utility. As evidenced by Mr. Moore's testimony, since the current owners acquired the utility, they have infused equity at various times when the stockholders deemed it necessary. Just as Mr. Moore states that the revenue impact of this equity transaction is minimal for the customers, we question whether a $160,000 equity adjustment would have such a material impact on Gulf's overall financial stability. It is logical that a greater equity infusion would be necessary to affect the long-term financial viability of a utility of this size.

We also disagree with Mr. Moore's statement that it is Gulf's responsibility to provide up-front money to affiliates or any other developers in the area. While a prudent utility should be concerned about growth potential in its territory, to extend its financial risks to the benefit of the builders in the area is inappropriate. This is clearly a developer's risk and should not be taken on by a regulated utility. This blurring of the lines between developer and utility has long been a concern of this Commission, to assure that the utility's customers pay for only those costs legitimately incurred to provide utility service. Mr. Moore has placed too much emphasis on the financial responsibility of Gulf with respect to this issue. Regardless of how these assets are recorded, Gulf still maintains the statutory responsibility of providing timely and quality service to its customers. Prudence also dictates utility service be provided in the least costly manner available.

We therefore conclude that the transaction was discriminatory and in violation of the utility's tariff and our rules and regulations. As a result, CIAC shall be increased by $68,144 for the water operations and by $92,815 for the wastewater operations. Adjustments shall likewise be made to increase accumulated amortization of CIAC by $10,855 for water and $14,145 for wastewater. Test year amortization of CIAC shall be increased by $2,106 and $2,755 for water and wastewater, respectively, and equity shall be decreased by $160,929. The utility shall adjust its books and records to correct the accounting treatment for this transaction.

<u>Adjustment to Reflect Prepaid CIAC in Rate Base</u>

Staff witness Welch and OPC witness Dismukes both suggested that prepaid CIAC associated with plant that is in service be included as on offset to rate base. Ms. Welch testified that because the utility only made a used and useful adjustment to the Corkscrew water plant, all the connections in prepaid CIAC appear to be related to plant already in service. Although the utility is not yet collecting revenue related to these contributions, it is earning a return on the assets to which the contributions relate, since the assets were considered 100 percent used and useful. Ms. Welch testified that excluding the CIAC received from FGCU, Gulf has a balance of $550,999 for water and $207,304 for wastewater. This balance was based on the general ledger balance as of August 31, 1996, which was the most current actual data available during the audit. According to Ms. Welch, the utility transferred $171,680 in water prepaid CIAC in the MFRs to used and useful CIAC, with none transferred for wastewater. She proposed that CIAC be increased by $379,319 for the water operations (net of the transfer) and by $207,304 for the wastewater operations.

On cross-examination, Ms. Welch was asked if she matched up the prepaid CIAC with existing plant. She responded that she reviewed an exhibit provided by utility witness Andrews that showed that the wastewater prepaid CIAC could be matched to individual plants that are existing and in service. Ms. Welch also testified that when she asked if any additions were needed to the wastewater plant, the utility's answer was no. With respect to the water prepaid CIAC, Ms. Welch testified that Ms. Andrews told her that she could not identify the plants to which the water prepaid CIAC related.

Ms. Dismukes testified that she reviewed the staff audit workpapers and other information provided by the utility and the information was not clear to what the prepaid CIAC related. Further, Ms. Dismukes reviewed the exhibit provided to the auditors, and the utility's response which stated that the two water plants were interconnected and the prepaid CIAC could not be identified by specific plant. She also agreed that the 13-month average balance of prepaid CIAC projected by the utility in its MFRs could be derived by taking the total balance of CIAC, including prepaids, less the 13-month averages of the water and wastewater amounts provided. The utility's MFRs did not break down the 13-month balance of prepaid CIAC between water and wastewater.

Utility witness Cardey testified that the proposals of staff and OPC witnesses on this issue are inconsistent with the legal framework of ratemaking, and the fundamentals in the MFRs. He defined a test year as the synchronization of four basic determinants in setting rates: (1) the revenues produced under the rate structure; (2) the expenses, including depreciation and taxes incurred to produce these revenues; (3) the property (rate base) that provides the service; and (4) return on said rate base. Gulf's investment in non-used and useful plant exceeds prepaid connection fees, including the $300,000 to be received in the future from the SFWMD by 21 percent. Mr. Cardey testified that the prepaid connection fees relate to future customers and Gulf's contractual obligation to meet their service requirement. Further, he testified that the treatment afforded in the MFRs is consistent with prior Commission rate orders for Gulf.

On cross-examination, Mr. Cardey testified that the prepaid CIAC relates to central or treatment plants, as opposed to lines. He added that Gulf will have to build additional water and/or wastewater plant to be able to serve the future customers which have prepaid CIAC. However, he also testified that many prepaid connections will connect onto the system in the next year to three years, which is consistent with the utility's requested margin reserve period. When asked if the utility keeps any documentation or worksheet to support that the prepaid connections are not associated with used and useful plant, Mr. Cardey responded with a general comment regarding internal accounting procedures.

In its brief, OPC argued that it is the utility's burden to prove the issues identified in a rate proceeding. In the instant case, OPC asserts, 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 except for 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, OPC argued that we should include as an offset to rate base prepaid CIAC related to both the utility's water and wastewater operations.

In its brief, the utility argued that the evidence showed that Gulf's internal accounting procedures assure that prepaid balances for both water and wastewater would not be associated with the used and useful plant already included in projected test year rate base. We disagree with Gulf's interpretation that this assurance is provided in the record. The utility asserts that it keeps separate track of the payments of prepaid CIAC to match plant and CIAC. A reasonable interpretation of this evidence would indicate that this is done for book purposes. There is no such reference in the record that such was done for the purposes of determining the prepaid CIAC associated with the projected test year rate base. The utility even admitted in its brief that no such study exists, supporting Ms. Welch's assumption that the prepaid CIAC appears to relate to plant already in service.

We agree with OPC that it is the utility's burden to show that its balance of prepaid CIAC is not related to plant included in rate base. If the utility had provided sufficient evidence to show that these prepaid fees related to plant that is non-used and useful beyond the margin reserve period or related to plant not yet constructed, the burden could have been met. Lacking any of this support, we must analyze the dollar amount of plant removed from rate base as non-used and useful and compare this with the projected balance of prepaid CIAC. This analysis is somewhat consistent with Mr. Cardey's comparison. His analysis was made on the utility's balance of non-used and useful water plant. However, as addressed herein, we have made used and useful adjustments to both the water and wastewater treatment plants, including the well fields. As such, the evidence supports making this comparison using the staff's witness's recommended amounts.

We generally agree with Mr. Cardey's definition of a test year, but we conclude that he is missing one component that should be included. Section 367.081 (2)(a), Florida Statutes, requires that this Commission set rates only on plant that has been found used and useful and that no return be allowed on contributed plant. To allow a utility to include a margin reserve in its used and useful calculation, would allow a utility to recover its investment required to be ready to serve future customers. A determination, however, should be made to ascertain that a utility that collects prepaid CIAC actually has invested in this plant. If the prepaid CIAC offsets the dollar amount of plant included in the margin reserve, and is not included as a reduction in rate base, then rates would be set on contributed plant. As such, it is necessary to compare these amounts in determining what amount of prepaid CIAC, if any, should be included in rate base.

In making this comparison, we began with Ms. Welch's balance of prepaid CIAC, based on the actual balance as of August 31, 1996. We do note, however, that this balance would be inconsistent and does not match the projected rate base and assumptions as filed by the utility in its MFRs. While the record supports the projected 13-month average of total prepaid CIAC, it is silent as to the projected breakdown between water and wastewater. Given the large difference between Gulf's water and wastewater customers, (66 percent to 34 percent, respectively), it would be inaccurate to analyze this on a total utility basis. We believe it to be a reasonable alternative to assume that the ratio of the actual balance between water and wastewater as of August, 1996, would apply to the projected balance. This estimate, however, does not take into account our decision to switch the service availability charges between water and wastewater from $800 to $550. Regardless, we conclude that this is the only reasonable alternative that the record provides to determine the split of prepaid CIAC. The projected 13-month balance in the MFRs of prepaid CIAC is $993,166.

Based on the actual balance of prepaid CIAC as of August, 1996, the ratio between water and wastewater is 64.66 percent for water and 35.34 percent for wastewater. By applying those percentages to the 13-month average balance in the MFRs, the allocated amounts are $642,207 and $350,978 for water and wastewater, respectively.

We have determined herein that the full amount of net water plant included in the margin reserve, $193,700, shall be recognized as used and useful CIAC. The remaining balance of water prepaid CIAC of $448,507 ($642,207-$193,700) shall be matched with non-used and useful plant and will not reduce rate base.

For the wastewater system, we have determined that CIAC of $594,000 will be imputed on the margin reserve. Accordingly, the estimated $350,978 in wastewater prepaid CIAC is less than the total amount of CIAC imputed on the margin reserve. Therefore, no additional adjustment to reflect prepaid wastewater CIAC is appropriate. The net amount of wastewater non-used and useful plant is $527,581, and is not funded by any remaining prepaid CIAC.

In total, the CIAC associated with the margin reserve for both water and wastewater is $787,700. This is $205,483 less than the total utility balance of projected CIAC of $993,183 for the 1996 test year. As a result, the reflection of prepaid CIAC as used and useful CIAC in rate base is reasonable and shall be approved, with no additional adjustments made other than those regarding margin reserve.

Imputation of CIAC on Margin Reserve

Utility witness Cardey testified that he did not impute CIAC associated with the margin reserve. He stated that the margin reserve reflects the utility's obligation to serve existing and potential customers, and it invests in central plants to meet this service obligation. Gulf has included the investment in margin reserve in used and useful investment. If CIAC were imputed, the net effect would be to negate the Utility's capital investment in plant and to have the stockholders absorb the cost of meeting the growth of the area. The 1996 test year matches gross revenues and the utility property that provides the service. Mr. Cardey believed that to impute CIAC from future customers would cause the test year to be out of synchronization.

OPC witness Dismukes testified that if margin reserve is included in the used and useful calculations, an amount of CIAC equivalent to the number of ERCs represented by the margin reserve should be reflected in rate base, in order to achieve proper matching. When determining the amount of imputed CIAC, she advocated using the proposed, interim, or final new capacity charges. The CIAC that will be collected from these future customers would serve to mitigate the impact on existing customers required to pay for plant to serve future customers.

Ms. Dismukes testified that imputation of CIAC on the margin reserve has been a longstanding policy of this Commission. She listed two orders where this practice is well documented: Order No. 20434, issued December 8, 1988 in Docket No. 871134-WS; and Order No. PSC-93-0301-FOF-WS, issued February 25, 1993 in Docket No. 911188-WS. If we do not continue to impute CIAC associated with the margin reserve, Ms. Dismukes believes it would place the risk of customer connections on the backs of current ratepayers. According to Ms. Dismukes, 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. Otherwise, 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 gives the utility an incentive to properly project future connection and it matches plant in service with CIAC. In addition, she testified that if we change our policy, we should likewise reduce the utility allowed return on equity to recognize that customers now bear this risk, not the utility's stockholders.

Ms. Dismukes also agreed on cross-examination that if prepaid CIAC has already been collected by the utility and a margin reserve is allowed in plant, any adjustment to rate base would not be an imputation but rather a reclassification of prepaid to used and useful CIAC. Regardless of whether a utility has prepaid CIAC or not, the imputation of CIAC on the margin reserve has merit. However, Ms. Dismukes testified that we should not impute or reclassify prepaid CIAC more than the amount of plant in service. She also agreed that the imputation of CIAC on the margin reserve and any reclassification of prepaid CIAC to used and useful should not overlap.

On rebuttal, Mr. Cardey testified that imputing CIAC on the margin reserve deprives the utility of a return on and a return of investment in margin reserve. He testified that the Commission has recognized the utility's obligation to meet the service needs of existing customers and anticipate the service needs within the area it serves by allowing a margin reserve. The imputation causes a mismatch of economics with the stockholder by absorbing the cost of meeting this obligation imposed on the utility.

Mr. Cardey computed what he believed to be the impact of imputing CIAC on the water operations. Based on the plant requested in the filing, his calculation reflected that the net plant in margin reserve in the water operations would be $397,330. If imputed, $412,500 in CIAC would be deducted from rate base, leaving a negative amount of $15,170. The loss of earning and loss of capital each year would be $55,893. Mr. Cardey testified that imputing CIAC as shown above ignores the utility's obligation to serve the changing demands of present and potential customers. Further, Mr. Cardey noted that his proposed treatment is consistent with Staff testimony in a proposed rule making proceeding in Docket No. 960258-WS.

In its brief, OPC argued that the utility presented no new evidence that would require this Commission to change the policy of imputation of CIAC on margin reserve. We agree with OPC in that regard. In Gulf's last water rate case, (Docket No. 900718-WU, Order No. 24735, issued on July 1, 1991), we imputed CIAC on the margin reserve. We specifically found that:

> Commission policy is that only the utility's investment in the margin reserve should be recognized in rate base and the CIAC should not, however, reduce rate base further than if no margin reserve had been allowed. Without this adjustment, the utility would be allowed to earn a return on plant that would be contributed by future customer. As its policy, Gulf collects prepaid CIAC from developers in advance of when the future customers connect to the system. As such,

> this adjustment is not an imputation but a reclassification of prepaid to "used and useful" CIAC.

In Gulf's last wastewater rate case (Docket No. 880308-SU, Order No. 20272, issued November 7, 1988), we also imputed CIAC on the margin reserve allowed in plant. We do not believe that the circumstances since those last cases have dramatically changed. The issue of imputation of CIAC on the margin reserve for this utility is unique in that Gulf maintains a balance of prepaid CIAC on a recurring basis.

The proposed rulemaking docket that Mr. Cardey referred to in his testimony has not been finalized nor has any of the testimony of that proceeding been made a part of this record. Therefore, information related to that docket will not be considered in this proceeding. We also note that our policy, as addressed in the prior Gulf rate case dockets does not impute more CIAC than the amount of plant included in the margin reserve. Even if we agreed with the plant investment included in Mr. Cardey's calculation of imputed CIAC, we would not agree that the full amount be imputed to reduce rate base further than the balance of plant included.

We conclude that the evidence in this case indicates that we should continue to apply the current practice of imputing CIAC on the margin reserve. In the water facilities this equates to $354,750, based on the 645 ERCs included in the margin reserve (18 months) multiplied by the approved $550 plant capacity charge. Because net plant included in the margin reserve is only $193,700, the amount of CIAC recognized in rate base shall be no greater. As addressed herein, the full amount of net water plant included in the margin reserve is funded by prepaid CIAC. Accordingly, no imputation is necessary, but instead, it is appropriate to reclassify $193,700 of water prepaid CIAC to used and useful CIAC for the margin reserve.

For the wastewater facilities, the gross amount of CIAC collected would be $1,594,000. This is based on the 743 ERCs included in 18 months margin reserve multiplied by the approved $800 plant capacity charge. Since the net plant included in the margin reserve of $617,496 is greater than the gross CIAC, no net-plant limit is necessary. However, the amount of prepaid CIAC for the wastewater system is projected to be $350,978. This portion of the CIAC on the margin reserve shall be reclassified from prepaid CIAC to used and useful CIAC.

In the most recent rate proceedings of other water and wastewater utilities, we imputed only 50 percent of the CIAC estimated to be collected during the margin reserve period. This policy is based on the premise that all of the CIAC related to the margin reserve will not be collected on day-one of the period, but evenly over the margin reserve period. See Order No. PSC-97-0388-FOF-WS, issued April 7, 1997; Order No. PSC-96-1320-FOF-WS, issued October 30, 1996; and Order No. PSC-96-1338-FOF-WS, issued November 7, 1996. Fifty percent of the gross CIAC for the wastewater system, stated above, is $297,000. However, since this amount is less than the amount of prepaid CIAC for the wastewater system, no imputation should be made. Instead, it is only appropriate to reclassify $350,978 of wastewater prepaid CIAC to used and useful CIAC for the margin reserve.

We conclude, therefore, that to the extent that Gulf has prepaid CIAC, those amounts shall be first recognized as used and useful to be included in rate base associated with the margin reserve. We believe that it is appropriate to reclassify $193,700 of water prepaid CIAC to used and useful CIAC for the margin reserve. For the wastewater system, we find it appropriate to reclassify prepaid CIAC of $350,978. Adjustments shall also be made to increase accumulated amortization of CIAC by $2,737 and $5,861 and test year amortization expense by $5,475 and $11,723 for water and wastewater, respectively.

Treatment of Funds Received from SFWMD's Alternate Water Supply Grants Program

According to Gulf witness Andrews, the utility requested $375,000 under the SFWMD's Alternate Water Supply Grants Program to fund the costs of constructing and installing a portion of the control system and instrumentation for monitoring flow and quality parameters at the three effluent reuse disposal sites. Ms. Andrews testified that the grant was not included in the MFRs as CIAC.

Utility witness Cardey testified that the grant was approved in the amount of $300,000, but that no money had yet been received. Mr. Cardey provided a late-filed exhibit which detailed the costs of the reuse project, where the costs are located in the MFRs and the account numbers. According to that exhibit, the project cost for the holding tank is $700,000, inclusive of transfer and pumping equipment and metering and controls. Additionally, there is a reuse line reflected at $200,000. This exhibit shows that the costs for the reuse line only were recorded in water account 339.3, at $66,667 and wastewater account 382.4, at $133,333, in December, 1996.

Our analysis of the plant accounts indicates that the costs for the reuse line were included in the utility's projections in October of 1996, not December. To determine the 13-month average of CIAC to include in rate base as an offset to the plant costs, we multiplied the water and wastewater amounts for the reuse line by three and then divided by thirteen. Accordingly, the record supports that the appropriate amount of CIAC to be included in rate base, as it relates to the reuse line, is $15,385 for water and $30,769 for wastewater. Adjustment to test year amortization and adjustments to accumulated amortization of CIAC are similarly computed, using the appropriate plant depreciation rates, and result in an increase of $142 for water and $236 for wastewater for the test year. The record supports these adjustments, as Mr. Cardey has testified that the reuse line has been constructed and was in-service in the test year.

According to the utility's brief, the amount of the reuse project costs included in rate base should be $446,090 and the dollar amount of CIAC is $185,371. According to Mr. Cardey's exhibit and the utility's position in its brief, the utility's calculation considered the holding tank, pumps, and controls associated with the project. However, the utility did not consider the reuse line.

OPC's determination of total plant costs associated with the reuse project that are included in rate base was $232,911. Since OPC has determined this amount of plant to be included in rate base, it advocates including the same amount as CIAC as an offset to rate base. OPC's calculation includes a component related to the holding tank, pumps, and controls and a component related to the reuse line, and reached the same conclusion as to the 13-month average for the reuse line.

The reject holding tank had not been constructed by the end of the test year, nor did the utility have contracts for construction, or bids or a firm start/completion date in hand as late as the date of the hearing. As stated herein, we disallowed that holding tank from rate base. We therefore cannot presently consider the inclusion of the holding tank in terms of offsetting the related CIAC, as the evidence does not support that the holding tank should be included in rate base. Therefore, we have not increased CIAC for the costs related to the holding tank.

Thus, we find that the year-end dollar amount of plant costs that should be included in rate base, related to the reuse line only, is $66,667 and $133,333 for water and wastewater, respectively. CIAC related to this plant shall be increased in the amount of $15,385 for water and $30,769 for wastewater, which reflects the 13-month average balance of plant included in rate base. Additionally, test year amortization and accumulated amortization of CIAC shall be increased by $142 and $236 for water and wastewater, respectively. As the project is completed, CIAC up to the $300,000 received shall be included in rate base as an offset to plant investment.

Adjustments to Accumulated Amortization of CIAC (AACIAC)

Gulf has been amortizing contributed property at the same rate as the related asset, but contributed cash is being amortized at a rate of 4.35 percent for water and 3.13 percent for wastewater. The utility does a true-up to come to the composite depreciation rates for total CIAC amortization. Staff witness Welch testified that the utility calculates 1) total depreciation for water divided by total plant for water and does the same for wastewater, and 2) total CIAC amortization divided by total CIAC for water and for wastewater. Next, the utility multiplies the difference in these two rates by the ending balance of CIAC and makes an adjustment to the reserve account for CIAC.

Ms. Welch testified that the audit staff performed a calculation to arrive at composite depreciation rates for 1996, using the plant at August, 1996. The composite rates exclude intangible and common plant and are 3.2 percent for water and 3.5 percent for wastewater. Further, Ms. Welch testified that the utility should be computing yearly composite rates only for the amortization of cash CIAC. Ms. Welch testified that when the utility makes the adjustment as described above, the calculation effectively changes total CIAC amortization to a composite rate and eliminates the amortization of contributed plant at the same rate as the related asset. Further, Ms. Welch testified that the utility's true-up calculation should only apply to cash CIAC.

The staff auditors computed amortization expense for the projected test year by utilizing the August, 1996 balance of CIAC. Audit staff estimated that amortization expense for water should be $351,176, which is 12,967 higher than the utility's projection of $338,209. Audit staff estimated that amortization expense for wastewater should be $282,877, which is $7,329 less than the utility's projection of $290,206.

According to Ms. Welch, the staff auditors calculated the 13-month average of AACIAC by utilizing the utility's general ledger balance of AACIAC for the period ending September, 1996. The auditor's average, when compared to the average AACIAC contained in the MFRs, resulted in a reduction to water rate base of $115,371 and a reduction to wastewater rate base of $98,456. Audit staff's computation did not include forecasted CIAC not yet recorded on the utility's books. The forecasted CIAC relates to the FGCU in the amount of $261,350 and to the force main on Corkscrew in the amount of $127,526. Ms. Welch concluded that, if the projected CIAC was amortized for the entire year, using a 13-month average, the increase would be $11,588 inclusive of water and wastewater.

The staff audit indicated that the utility should recalculate amortization on cash using yearly composite rates and that the utility should not true-up contributed property to those rates. Thus, water expenses must be increased by $12,967, and wastewater expenses decreased by $7,329. The audit staff did not calculate the corrections to AACIAC that would occur as a result of the utility's past (prior to the test year) true-up of contributed property at composite rates. As described above, audit staff only calculated an estimate of what AACIAC should be for the test period, based on the utility's general ledger balance.

Utility witness Andrews testified that the utility amortizes CIAC using a composite rate and that Gulf has been doing this for a number of years. Further, she testified that this is one of the alternative methods permitted by Rule 25-30.140, Florida Administrative Code. Ms. Andrews testified that Ms. Welch's proposal to amortize CIAC by function is a change from the utility's current permitted practice. Ms. Andrews disagreed with the underlying procedures of implementing audit staff's recommendation, and disagreed that a rate proceeding was the inappropriate forum for addressing these differences.

Ms. Andrews disagreed with audit staff on several points: audit staff used a period different from the test year; since audit staff tested the period September, 1995 through August, 1996, their assumptions are not consistent with a 13-month average required by the MFRs; and the utility requested new service availability charges for both water and wastewater, so the balance in the MFRs is different from the general ledger.

On cross-examination, witness Andrews was asked to read Rule 25-30.140, (8) (a), Florida Administrative Code, which, in part, states:

> The CIAC plant shall then be amortized either by account, function or bottom line depending on availability of supporting information. **The amortization rate shall be that of the appropriate account or function where supporting documentation is available to identify the account or function of the related CIAC plant.** Otherwise, the composite plant amortization rate shall be used. (emphasis added)

Ms. Andrews confirmed that the utility does maintain records of CIAC by function and that these records were available at the time Gulf filed this rate case. She testified that she came to work for the utility in the 1980s and that the records were not as detailed at that time. Ms. Andrews testified that, since her employment, she has been able to update CIAC records by function. However, Gulf has continued to use a composite rate when amortizing CIAC.

After reading the rule on CIAC amortization, witness Andrews could not agree that, where supporting documentation is available by function, there is no option to use a composite amortization rate. She testified that Gulf has always used composite amortization rates, including the use of such rates in preparation of the MFRs. Ms. Andrews stated, again, that this rate proceeding is not the appropriate forum to determine whether the utility has used appropriate amortization rates. She testified that after this proceeding is over, that would be the appropriate time to discuss the correct method of amortizing CIAC.

Ms. Andrews was asked, at hearing, to provide a late-filed exhibit detailing the adjustments that would be necessary to AACIAC, assuming that the Commission disallowed Gulf's use of a composite amortization rate. The late-filed exhibit did not provide an adjustment; instead, Gulf reiterated its position that it is an alternative under Rule 25-30.140, Florida Administrative Code, to use a composite amortization rate.

The audit staff clearly used the period from September, 1995 through August, 1996 in analyzing the balance of AACIAC, and did not calculate the corrections to AACIAC that would occur as a result of the utility's past (prior to the test year) true-up of contributed property at composite rates. Audit staff only calculated an estimate of what AACIAC should be for the test period, based on the utility's general ledger balance. For these reasons, the audit suggested that the utility correct the balance of AACIAC. Furthermore, the utility's late-filed exhibit did not reflect the utility's corrected balance of AACIAC, assuming that the use of a composite amortization rate was disallowed. The utility continued to advocate the position that Rule 25-30.140, (6)(a), Florida Administrative Code, gives the utility an option to amortize CIAC using a composite rate even if the plant records are available by function.

Contrary to Ms. Andrews' assertion, it is well within the purview of this rate proceeding for this Commission to determine the appropriateness of Gulf's method of amortizing CIAC and to make any adjustments, as needed. We will not ignore this issue merely because the utility has been using composite rates for a number of years and it has not been addressed until this rate proceeding. Accordingly, based on the evidence in the record, we shall make adjustments to correct test year amortization and AACIAC. These adjustments shall be based on audit staff's calculations, which relied on the data made available by the utility. This is the best information with which to make an adjustment, as the utility did not make any attempt to enter proposed adjustments into the record. Further, if the utility wishes to have AACIAC corrected to a fully-supported balance, it is not precluded from requesting that adjustment in its next filing.

Therefore, AACIAC for both the water and wastewater systems shall be reduced in the amount of $115,371 and $98,456, respectively. Additionally, test year amortization for water shall be increased by $12,967 and test year amortization for wastewater shall be decreased by $7,329.

Adjustments Related to Working Capital

Our determination of the utility's working capital involved the review of all components of the utility's test year projection, including unamortized debt discount and issuance expense, industrial development revenue bonds (IDRBs), and interest receivable. Our review and conclusions are set forth below.

Utility's Projection of Test Year Working Capital Accounts

The utility did not provide the forecast methodology for working capital in its MFRs, nor did it provide that information to the audit staff. Therefore, the audit staff generated the most current 13-month average working capital for the period from August, 1995 through August, 1996. The audited amounts were then compared to the forecasted amounts in the MFRs and the utility was requested to provide reasons or support for amounts that would change from September through December, 1996, in order to bring any discrepancies closer to the forecast. The audit of working capital indicated that Gulf's projection improperly excluded or included certain accounts in its determination of working capital.

In its brief, Gulf argued that the staff audit contains a working capital computation based on an historic period rather than the approved projected test year ended 1996. Gulf also contended that, other than requesting reasons for changes in working capital accounts for the period September, 1996 through December, 1996, no analysis was performed by staff as to the reasonableness of the working capital accounts.

Staff witness Welch testified that by auditing the period from August, 1995 through August, 1996 and then adjusting those numbers for known and measurable changes, requested from the utility, that the end result was still an audit of the projected test year ended December 31, 1996. The utility's concern that staff performed no analysis to determine the reasonableness of the working capital accounts is off-point. The audit staff chose to audit the period from August, 1995 through August, 1996 because the utility did not provide any forecast methodology, as required in the MFRs, for the working capital components. Further, when asked, the utility could not and did not provide the support for the working capital projection. Therefore, audit staff had no choice but to utilize the most recent period at the time of the audit, which was August, 1995 through August, 1996. By choosing this period, requesting any changes from the utility for the period September, 1996 through

December, 1996, and comparing the results to the projected working capital accounts, staff auditors tested the reasonableness of those projected working capital accounts.

OPC witness Dismukes advocated a negative working capital amount of $46,062. She arrived at this amount by starting with the working capital balance of $381,610 from staff's audit report. From this balance, she removed unamortized rate case expense, which she stated should be an incentive for the utility to minimize rate case expense. Next, she removed unamortized debt discount and issuance expense because it is included in the utility's cost of debt. She further decreased working capital for an additional amount of accrued interest related to the IDRBs. Finally, Ms. Dismukes increased working capital for accounts receivable and materials and supplies, in accordance with Gulf's response to staff's audit report.

Gulf contended that because OPC witness Dismukes used the working capital amount determined by staff as a basis for her analysis, her working capital determination should also be rejected. In rebuttal, Mr. Nixon testified that Ms. Dismukes did not understand the concept of an allowance for working capital. He stated that an allowance is just that, "an allowance over and above the capital investment in plant and other specifically measured rate base items". According to Ms. Dismukes' definition, current assets and current liabilities are a source of capital for rate base plant investment. Mr. Nixon stated that long-lived plant assets simply are not funded by working capital, but instead, working capital is a measurement of cash required to fund day-to-day operations.

Mr. Nixon first removed $43 which represented the 13-month average of interest earnings on the operating cash account. This adjustment corresponds to the stipulation that interest income is appropriately matched with cash balances because both are removed from the rate making equations. Mr. Nixon removed $87,686 of plant construction payables from the utility's original balance in Trade Accounts Payable. We concur with Mr. Nixon's explanation for this adjustment, that the plant assets related to the payables are included in rate base and earn a rate of return; therefore, such payables shall be eliminated from working capital. Additionally, the source of payment for construction is long-term debt, which is accounted for in the capital structure, along with customer deposits.

Mr. Nixon removed $114 of Accounts Receivable to a related party. We approve of this adjustment because receivables with a related party are normally not included in working capital; regardless, the amount is very minimal. Next, Mr. Nixon made an adjustment to increase materials and supplies by $13,150 for additional water chemicals needed to improve water quality. Mr. Nixon then removed the balance of $78,031 in the account Miscellaneous Current and Accrued Assets because it represented interest receivable on the IDRB special deposits. This interest receivable correlated to Mr. Nixon's removal of $238,739 of Accrued Interest which represented interest payable on the IDRBs. $557 remains in the Accrued Interest account after this adjustment. Mr. Nixon contended that these adjustments to interest receivable and accrued interest follow the matching concept for accounting.

Mr. Nixon removed the utility's original inclusion of $389,922 for Unamortized Debt Discount and Issuance Expense from the working capital calculation, as this account was used in the capital structure and cannot be included in both places, and its removal was stipulated by the parties. Preliminary Survey and Investigation and Clearing Accounts in the amounts of $9,895 and $2,026, respectively, were removed, as these accounts did not relate to day-to-day operations. Finally, Mr. Nixon stated that the average amount of rate case expense ultimately approved should be substituted for the projected test year balance. The projected test year balance of Deferred Rate Case Expense is $57,561; therefore, Mr. Nixon included this amount is his calculation.

We approve and agree with all of Mr. Nixon's adjustments and the conclusions drawn in his rebuttal testimony, with the exception of one statement: that the accuracy of the utility's original projections becomes irrelevant as an outcome of his analysis of the appropriate working capital allowance. The difference between the utility's original $593,611 projection and Mr. Nixon's $486,853 projection, which includes final deferred rate case expense, is considerable. The difference of $106,758 is not irrelevant, and demonstrates that some of the utility's working capital components included in the MFR projection were not appropriate, nor were some of the projections reasonable.

Nonetheless, we approve Mr. Nixon's proposed allowance for working capital and disagree with witness Dismukes' proposal. Additionally, we disapprove of her removal of deferred rate case expense as an incentive for Gulf to keep rate case expense at a low level. This is an improper mechanism to lower rate case expense.

Furthermore, it is consistent to match the unamortized expense with the allowed expense. Because the utility will not receive recovery of all rate case expense until the end of four years, disallowing the unamortized portion would deny recovery of the utility's investment.

Furthermore, Ms. Dismukes did not remove accrued interest payable from her calculation, which automatically places working capital into a negative position, even by matching such an adjustment with the removal of interest receivable. Another account which dramatically affects Ms. Dismukes' determination of working capital is Trade Accounts Payable. Again, she based her calculation on staff's audit, which reflects a balance of $209,853 for this account. Witness Nixon testifies that this balance should be $83,203. This is a significant difference which speaks for itself in terms of the negative impact on Ms. Dismukes' working capital computation. The other accounts on which Ms. Dismukes differs in her analysis are relatively immaterial when compared to those larger differences just discussed above, and do not warrant further discussion.

We have addressed all of the components of working capital, the MFR projected balance, and witness Nixon's adjustments and final working capital allowance. In accordance with the evidence in the record and our analysis, we find that an adjustment shall be made to reduce the utility's working capital allowance by $106,758, to be prorated as a reduction to water of $64,178 and a reduction to wastewater of $42,580.

Unamortized Debt Discount and Issuance Expense

In its filing, the utility included unamortized debt discount and issuance expense of $389,922 in the working capital calculation. When audit staff performed its audit of the working capital forecast, they included $394,954 for this account in arriving at net working capital. Audit staff also reported that they were able to trace the accounts that comprise unamortized debt discount and issuance expense to the utility's cost of capital schedule, which means that these accounts were included in two places in the MFRs. All parties agreed that unamortized debt discount and expense could not be included in rate base and in cost of capital; therefore, it should be removed from working capital.

Utility witness Nixon provided extensive rebuttal testimony on the appropriate working capital allowance. His allowance does not include unamortized debt discount and expense. Thus, the contention between the parties became a question of the appropriate dollar amount that should be removed. However, subsequent to the hearing, Gulf filed a letter on March 17, 1997, stipulating that this account was included in arriving at the cost of debt in the cost of capital. Therefore, Gulf argued that working capital should be reduced by $389,922, according to utility witness Nixon's working capital determination.

Unamortized debt discount and expense cannot be included in rate base and in cost of capital; therefore, the amount shall be removed from the working capital calculation contained in the MFRs We have accounted for unamortized debt discount and expense in our prior discussion regarding the removal of the utility's working capital allowance.

<u>Adjustment to the Projected Balance of Accrued Interest for the Industrial Development Revenue Bonds (IDRBs)</u>

In the utility's filing, $239,296 was included as the balance in the accrued interest account. According to the Staff audit, the utility adjusted this amount to $269,790 in response to staff's analysis of the working capital calculation. All parties agreed that the appropriate balance should be $269,790.

Mr. Nixon testified that Gulf's interest payable is not funded by the operating cash account. Instead, cash is deposited into a special account from which the interest is paid. Mr. Nixon removed the balance of special deposits from his determination of working capital. Therefore, in keeping with the matching principle, Mr. Nixon also proposed removing the balance of accrued interest from the working capital calculation. Mr. Nixon testified that, conversely, if interest on the IDRBs was paid from the operating account then the balance of accrued interest should remain in the working capital computation. Because this is not the case with Gulf, he advocated removing accrued interest in order to be properly matched with the elimination of the special deposits which fund the interest payments.

OPC witness Dismukes agreed with the utility as to the balance for accrued interest. However, she did not analyze the matching of the cash deposits, which fund the utility's interest payments, to the accrued interest account.

We find that the conclusions drawn by witness Nixon in his rebuttal testimony are valid and well supported. Because we have removed interest receivable from the working capital calculation, it follows that accrued interest must also be removed. Accordingly, while an adjustment should be made to the balance of accrued interest, it shall nonetheless be excluded from the working capital calculation in keeping with the matching principle.

Interest Receivable

The utility included $78,031 as the balance of Miscellaneous Current Assets. This account represents interest receivable on special deposits related to the IDRBs. We have found that the record supports the exclusion of accrued interest on the IDRBs from the working capital computation, so long as such an adjustment is offset with the exclusion of interest receivable. According to Mr. Nixon, such an offset achieves proper matching of assets with liabilities. Likewise, OPC agreed that interest receivable should not be included in the working capital calculation. Accordingly, interest receivable shall be excluded from the working capital allowance.

Working Capital - Conclusion

We have made a composite adjustment downward to the utility's projected balance of $593,611 for working capital in the MFRs. Our adjustments to the components discussed herein result in a decrease of $106,758 to the projected amount. Therefore, we approve working capital in the amount of $486,853. This amount was calculated using the balance sheet approach in accordance with Rule 25-30.433(2), Florida Administrative Code. The working capital allowance shall be prorated $293,966 to water and $192,887 to wastewater.

Rate Base Summary

Based on the adjustments made herein and the use of a thirteen-month average, we find rate base to be $3,449,029 for water and $3,164,213 for wastewater.

## COST OF CAPITAL

Our calculation of the appropriate cost of capital is depicted on Schedule No. 2. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without further discussion. The major adjustments are discussed below.

Credit Accumulated Deferred Income Taxes

In its filing, the utility reported that credit accumulated deferred income taxes included in the capital structure were $1,517,923. This amount was prorated, along with the other sources of capital, to equal the utility's requested rate base. There was no testimony or cross-examination on this issue. We have made adjustments to rate base as well as the dollar amount of equity included in the capital structure, as discussed in this Order. We find that no adjustments to credit accumulated deferred income taxes are necessary and the utility's projected balance shall be approved.

Appropriate Cost of Capital

The overall cost of capital is based on the utility's projected 13-month average capital structure, as impacted by the adjustment to equity associated with lines contributed from the Caloosa Group. The parties stipulated that the cost of common equity should be based on the leverage formula in effect at the time of our decision in this proceeding. Using the utility's adjusted equity ratio, the cost of equity is 11.88 percent, with a range of 10.88 percent to 12.88 percent. The resulting overall cost of capital is 9.20 percent. The range of the overall cost of capital is 9.12 percent to 9.28 percent.

NET OPERATING INCOME

Our calculations of the appropriate net operating income is depicted on Schedule No. 3-A for the water system, and on Schedule No. 3-B for the wastewater system. Our adjustments are itemized on Schedule No. 3-C. Those adjustments which are self-explanatory or which are essentially mechanical in nature are reflected on those schedules without futher discussion. The major adjustments are discussed below.

Operating Revenues

Test Year Gallonage and Revenue Projections

Consistent with our decision to include the costs, expenses and revenues associated with FGCU in this rate proceeding, the appropriate water and wastewater gallons for FGCU must be determined.

Consumption projections for the university were included in the utility's MFRs and set forth in the special service availability agreement addressed later in this Order. The consumption projections were calculated based on number of students, faculty and staff, and considered the academic calendar and enrollment. However, we have adjusted the consumption figures in the utility's filing, to 206 gpd per ERC for water and 158 gpd per ERC for wastewater. Applying these amounts to the associated number of ERCs for the university would result in lower projected gallons, which in turn would result in a higher gallonage charge. Further, lower projected gallons would lower the revenue requirement, which ultimately could put the utility in an overearnings posture.

Until actual flows can be documented through meter readings, the projections set forth in the utility's MFRs are acceptable: 15 million gallons for water, and 10.6 million gallons for wastewater. Therefore, although we have lowered the general ERC projections made in Gulf's filing, we will make no change to the utility's projections for the university.

Miscellaneous Service Revenues

When both water and wastewater miscellaneous revenues exist, a utility may record the total either as water or wastewater miscellaneous revenues. For this docket, the utility included miscellaneous revenues in total as water miscellaneous revenues. We approve the utility's methodology of recording and amount of miscellaneous revenues in its MFRs. No adjustment is necessary to this account.

Reuse Revenues

Gulf did not have a tariffed charge for the provision of reuse, and did not include any projections for reuse in its projected revenues. Because we have determined the appropriate reuse rate to be zero, no adjustment to test year revenue is necessary on this point.

<u>Interest Income Recorded Below the Line</u>

OPC witness Dismukes contended that the utility has booked interest income below the line related to cash included in the working capital allowance. Ms. Dismukes arrived at this adjustment after reviewing the utility's response to an OPC interrogatory, which confirmed that the operating account included in the working capital calculation earns interest. Utility witness Nixon testified that Gulf's operating account earns a modest amount of interest which he removed in arriving at net working capital. In fact, Mr. Nixon's working capital calculation removed from cash all interest bearing money market accounts and the 13-month average of the interest earnings from the operating account.

Mr. Nixon's testimony on working capital provided a revised number from that contained in the utility's filing. The filing had included the 13-month average of the interest earnings on the operating account. OPC contended that, in utility's witness Andrews' rebuttal testimony, the utility agreed with Ms. Dismukes' adjustment.

We do not believe that Ms. Andrews agreed with OPC's adjustment, but instead erred in her testimony. Mr. Nixon's rebuttal testimony addressed each component of the utility's requested working capital allowance. Based on this evidence, we find it appropriate to remove the interest from the operating account in arriving at working capital, which negates the need for adjusting interest income above the line. Accordingly no adjustment will be made to move interest income above the line, as this would result in improper matching.

<u>Adjustments to Projected Test Year Salaries and Benefits</u>

According to utility witness Cardey, the Caloosa Group is a land development utility and an affiliate to the utility with the same owners as Gulf, and the same proportionate interests. Namely, 80 percent is owned by Russell B. Newton, Jr. and 20 percent is owned by James W. Moore. According to Mr. Cardey, some of Gulf's employees provide general supervision and accounting services to Caloosa. Those employees participate in selling lots and in the homeowners' association of Caloosa Trace, plus administration of the Caloosa-owned office building. Five employees provide services to both companies: the President (Mr. Moore); the Chief Financial Officer (Ms. Andrews); the Assistant to the CFO (Ms. Babcock); the Administrative Manager (Ms. Rivers); and the Administrative

Assistant (Ms. Gravel). According to the audit report, each of these employees are paid directly from Caloosa for the services they provide.

Mr. Cardey testified that in analyzing the payroll of Caloosa he first made a determination of the services Gulf provided to Caloosa, then reviewed the time required by each person who performed the service. He stated that two people maintain the books and perform record keeping at an estimated nine hours per month. One person handles the selling of lots and does administrative work for the homeowners' association, at an estimated 16 hours per month. Additionally, Mr. Moore and his secretary spend an estimated 5 percent of their time each on administrative duties related to Caloosa. Mr. Cardey stated that he used current payroll costs for each employee and added payroll taxes and health insurance cost to come up with an estimate of what Caloosa should have paid in salaries. His calculation was approximate to the $12,142 paid to Gulf's employees by Caloosa. Since the five employees are paid directly by Caloosa, Mr. Cardey determined that no salary expense allocation to Caloosa was needed, as his estimate is approximate to what was actually paid.

OPC witness Dismukes advocated an adjustment to the salaries of Gulf's employees that provide services to both the utility and to Caloosa. She demonstrated that the hourly rate for those employees that perform services for Gulf is considerably higher than the hourly rate for services performed on behalf of Caloosa. Ms. Dismukes testified that the hourly rates charged should be the same for both Gulf and Caloosa. In order to achieve this, Ms. Dismukes reallocated the salaries charged to Caloosa based upon the combined hourly rate of Caloosa and Gulf. Ms. Dismukes utilized the information contained in a document which includes the Earnings and Deductions reports for Caloosa from September, 1995 to August, 1996. These reports detail the earnings for each of the five employees for the period, including a column for the hours worked during the period.

To ensure that both the utility and its affiliate are paying the same amount per hour for the services of Gulf's employees, Ms. Dismukes reallocated total Gulf plus Caloosa salary for each of the employees based upon the total number of hours worked for each entity during a year. Ms. Dismukes' analysis assumed that Mr. Moore is the only one of the five employees who provides services to Caloosa above the standard 2,080 hours per year that he works for Gulf. Additionally, Ms. Dismukes' analysis assumed that the remaining of the shared employees work for Caloosa within the parameter of a 40-hour work week. By taking each employee and combining the salaries expense for Gulf and Caloosa and then dividing by the respective hours worked by each employee for both entities, Ms. Dismukes arrived at one combined hourly rate which she stated is appropriate to use in determining the salary for each entity. She used this new combined hourly rate and multiplied it by the number of hours taken for each employee from the Earnings and Deductions reports to determine the salary that should have been paid by Caloosa. Based on this difference, she then reallocated some of Gulf's salaries expense to Caloosa. The result of this calculation for each of the five employees was an adjustment to reduce Gulf's requested salaries expense by $8,947.

Staff witness Welch testified that the percentage of Caloosa payroll to total Caloosa and Gulf payroll during the last audit was 12.67 percent, while the most recent payroll register reflected Caloosa payroll at 2.13 percent of total payroll. According to staff's audit report, Audit Disclosure No. 3, in analyzing the differences, the audit staff reviewed the Caloosa Earnings and Deductions reports and the pay shown to arrive at an hourly rate. The conclusion drawn in the audit report is that the hourly rates used for Caloosa and Gulf appear to be very different.

In rebuttal, utility witness Cardey testified that he was the only witness who reviewed the services that Gulf's employees provide to Caloosa. The result of his direct analysis was that the present salaries paid to Gulf employees by Caloosa are reasonable. Mr. Cardey testified that neither staff nor OPC made a study of the work performed or the time spent by the personnel involved.

Gulf also cited Sunshine Utilities v. Public Service Commission, 624 So. 2d 306, 312 (Fla. 1st DCA 1993), in which the Court found that in a rate case, "the best way to allocate employee expenses was actual time." Gulf alleged that witness Cardey allocated employees' time for both Gulf and Caloosa based on actual time expended in work for each entity.

Page 23 of Audit Disclosure 3 reflects differences found in the hourly rates between Gulf and Caloosa employees. The staff witness's calculation for Caloosa's hourly rates was taken directly from Caloosa Earnings and Deductions reports provided to the auditors by the utility. The Earnings and Deductions reports provide the basis for the staff witness's proposed adjustments. Ms. Dismukes, like the audit staff, utilized the information contained in the Caloosa Earnings and Deductions reports to analyze the difference in pay rates between Gulf and Caloosa employees.

It is not clear, however, what period Mr. Cardey used to analyze payroll costs or how he actually came up with percentages for time worked, other than subjectively arriving at a percentage just by talking to the employees. Witness Cardey's percentages found in his exhibit range from 2 percent to 10 percent. Mr. Cardey found one person who spent 10 percent of her time on Caloosa-related business, the administrative person who spent 16 hours per month, as mentioned above. This percentage does correlate to the calculated percentage from the Earnings and Deductions report for this same employee. However, Mr. Cardey's determination of 5 percent for Mr. Moore does not correlate. The report for Mr. Moore reflects that he spends approximately 12.5 percent of his time on Caloosa-related business. Similar analyses can be done for all of the related employees and percentage differences can be found, but Mr. Moore's is the greatest difference.

During cross-examination, Mr. Cardey testified that the Earnings and Deductions reports do not represent the hours that employees work for Caloosa. He testified that the salaries were set in 1988, that the hours were set for computer payroll purposes, and that an individual review of employees' hours are necessary.

Mr. Cardey has not provided a solid basis on which we can determine the reasonableness of the Caloosa salaries. Contrary to his assertion, both staff and OPC witnesses utilized documents provided by the utility as a basis for their respective analyses. Both attempted to arrive at a fair hourly rate by utilizing the best information available, that being the Earnings and Deductions reports for the Caloosa Group for the most recent period of September, 1995 to August, 1996.

We find Mr. Cardey's explanations and analysis regarding this issue to be insufficient. It is irrelevant that the salaries were set in 1988; if logic dictates that salaries should be increased each year for Gulf, so should the salaries for Caloosa. Thus, the utility has not satisfied its responsibility of burden of proof.

Based upon our review of the testimony and documentation, we find that the percentages arrived at by witness Cardey are too subjective and shall not be used as a benchmark for the appropriateness of salaries paid by Caloosa. Instead, we find the most reliable information to be the Caloosa Earnings and Deductions reports, which is a reflection of actual time.

It is logical that in order to determine the appropriate percentage of time that each employee spends on Caloosa-related business, one would reference a record such as the Earnings and Deductions reports. By dividing the salary for the period by the total number of hours worked, this reflects an hourly rate. Taking the total number of hours worked and dividing them by 52 weeks in a year reflects an approximate number of hours worked per week. Further, dividing these hours per week by a 40-hour work week reflects the percentage of time worked, on average, for Caloosa. Accordingly, based on the record and our analysis, salaries expense shall be reduced by $5,905 for water and $3,042 for wastewater in order to properly allocate Caloosa-related payroll back to Caloosa. Corresponding adjustments to benefits associated with Caloosa payroll and payroll taxes are addressed herein.

Vice President's Salary and Benefits

The utility projected $49,608 in salary expense for Mr. Randall Mann, the Vice-President of Gulf. Mr. Mann does not physically work at the utility's location in Estero, Florida. Instead, he conducts his duties from Jacksonville, Florida, where he also works for another utility and lives full-time. During cross-examination, Mr. Moore stated that Mr. Mann has worked for Gulf for approximately 10 years. However, when asked if Mr. Mann worked full or part-time for this utility in Jacksonville, Mr. Moore did not know, nor was Mr. Moore certain of Mr. Mann's position. Further, Mr. Moore testified that he does not know how Mr. Mann spends his days, but that Mr. Mann is available to the utility when he is needed.

According to Staff witness Welch, during the course of the audit, Mr. Mann was asked to provide a letter which would confirm how much time he spends on utility business. The staff auditors received a list of Mr. Mann's responsibilities with a statement from the utility that "The amount of time spent per week on these various duties varies considerably depending on the needs of the company."

In its brief, the utility cites Metropolitan Dade Co. W&S Bd. v. Community U. Corp., 200 So. 2d 831, 832-833 (Fla. 3rd DCA 1967), wherein the Court held that a regulatory commission in ruling upon the reasonableness of an executive salary allowance must base its ruling on evidence establishing individual duties and activities and the complexity of those duties. In support of this argument, the utility also cited the following three cases: Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276 (1923); Sunshine Utilities of Central Florida, Inc. v. Florida Public Service Commission, 624 So. 2d 306 (Fla. 1st DCA 1993); and Florida Bridge Co. v. Bevis, 363 So. 2d 799 (Fla. 1978). We agree with the evidentiary requirements set forth in the foregoing cases. However, Gulf has the burden of establishing the individual duties, activities, and the complexity of Mr. Mann's duties. See Florida Power Corporation v. Cresse, 413 So. 2d 1187 (Fla. 1982). In the present case, Gulf did not fully meet its burden of proof.

During discovery, the utility responded to a request for an estimate of the time that Mr. Mann devotes to utility business by stating that Mr. Mann does not submit time records and is paid on a salary basis. On cross-examination, Mr. Moore explained that the utility was not able to obtain an hourly estimate, because Mr. Mann was unavailable. OPC contended that if Mr. Mann was truly available to the utility when needed, as testified by Mr. Moore, Gulf should have been able to obtain time records from Mr. Mann.

Mr. Moore testified during cross-examination that Mr. Mann is compensated based upon the value of his services. Mr. Mann holds a Master's Degree in Business Administration, is a Certified Public Accountant, and a Chartered Financial Analyst. He is responsible for various management-level accounting, financial, and tax matters. According to Gulf, Mr. Mann participates in all utility borrowings and related financing negotiations, and testified in Docket No. 940418, Southwest Florida Capital Corporation v. Gulf Utility, which involved issues related to CIAC.

OPC witness Dismukes testified that Gulf did not prove the reasonableness of the salary paid to Mr. Mann. Based upon her review of Mr. Mann's duties, she estimated that Mr. Mann should spend approximately 10 hours per week, or 520 hours per year on utility-related matters. Ms. Dismukes proposed that Mr. Mann's hourly salary be based on the mid point between Mr. Moore's and Ms. Andrews' salary, or $35.00 per hour. Thus, she advocated a salary of $18,200 per year, with a reduction to test year expenses of $30,234.

Although the utility has not fully met its burden of proof as to the reasonableness of Mr. Mann's salary, we do not find Ms. Dismukes' recommendation to be entirely reasonable. If Mr. Mann were paid on a contractual basis for the services he provides, his rate would be much higher. Witness Nixon, for example, is a partner in his firm and commands a rate of $140 per hour. Considering Mr. Mann's credentials, he would likely command a similar rate.

Even though an estimate of hours has not been provided by the utility, logic dictates that the hours worked per week by Mr. Mann, on utility business, averages out over the year. However, some daily record or journal of utility-related activities must be maintained by Mr. Mann.

The utility could not adequately support the amount requested for Mr. Mann's salary, and could not provide a time estimate for him. If a utility is requesting recovery of this magnitude of expense, it should certainly be able to provide all reasonable means of validating its position. Gulf has not done so. The utility has not clarified whether Mr. Mann works 40 hours per week or less than 40 hours per week for the utility, nor provided an estimate of Mr. Mann's time, despite having sufficient time to do so. The evidence in the record suggests that Mr. Mann is not a full-time employee of Gulf, since he also works for a utility in Jacksonville, where he lives. We therefore conclude that the record supports an adjustment to Mr. Mann's salary.

Mr. Mann's responsibilities as vice president are more similar to the responsibilities of a contractual services person than to those of a regular employee. Given the value of his services, which is based on his expertise and qualifications, Mr. Mann should undoubtedly be sufficiently compensated. We are concerned with how to measure Mr. Mann's time spent on utility-related business, as the utility has failed to provide this support.

The only support in the record on which to make an adjustment is the testimony of Ms. Dismukes, and we have relied on her analysis to the extent of her estimate of hours worked per week. We believe that Ms. Dismukes' estimate of 10 hours per week, or 520 hours per year, is fair based on the fact that Mr. Mann does have another job in Jacksonville. However, we do not agree with the hourly rate that Ms. Dismukes has used. A vice president with the responsibilities, expertise, and qualifications of Mr. Mann should be compensated at an hourly rate similar to the president of the utility. There is not much of a difference between the level of responsibilities of the president and vice president of Gulf; although, it is certain that each one has their own responsibilities.

We find it appropriate to use an hourly rate of $49, which is approximately the adjusted hourly rate of Mr. Moore. An estimated 520 hours per year at $49 per hour yields an annual salary of $25,480, on a part-time basis. Thus, Mr. Mann's salary shall be reduced to $25,480. The difference between Mr. Mann's adjusted test year salary and final, approved salary is a $22,954. Test year expenses shall be reduced by this amount, prorated $15,150 to water and $7,804 to wastewater. Additionally, the utility is hereby ordered to maintain records of Mr. Mann's daily, utility-related activities, on a going-forward basis.

Adjustments to Salary Expense for Pay Increases

According to OPC witness Dismukes, the projected 1996 pay increases range from 6.5 percent to 9.6 percent for Gulf's officers and managers. Ms. Dismukes states that, according to the utility, salary increases were 5 percent in 1992, 4 percent in 1993, 5 percent in 1994, and 4 percent in 1995. According to Ms. Dismukes, the overall budgeted increase was 6.5 percent; however, the increases vary by employee. Ms. Dismukes prepared a schedule which shows the percentage increases for the employees at issue, and indicates that some individuals actually exceed the 6.5 percent overall increase. Based on the trend of salary increases in the past, Ms. Dismukes supported reducing salaries expense for a 5 percent increase which results in a reduction to test year expenses of $7,416.

On rebuttal, utility witness Moore testified that Gulf's salaries expense compares favorably to nine other utilities that operate in Lee County. Referencing an annual salary survey conducted by Pine Island Water Company, he stated that Gulf's 1995 wages were about 12 percent lower than the average for the other utilities. Mr. Moore further testified that Gulf was attempting to narrow the gap between Gulf's salaries and those of the nine other utilities. Mr. Moore believed that the issue should be whether Gulf has excessive payroll costs and whether the utility is operating efficiently, not what salary levels are or what the increases might be.

During cross-examination, Mr. Moore admitted that his salary, the salary of Mr. Mann (Vice President), and the salary of Mr. Messner (Operations Manager) were not included in the salary survey discussed in his rebuttal testimony. The apparent reason for not including the above salaries is that there were no comparable positions in the survey. Mr. Moore agreed that with two exceptions, Gulf's employees have fewer years of service than the average of the other companies. He also agreed that in many instances Gulf's employees have less than one-half the years of service of the other companies' average. Mr. Moore admitted that one of Gulf's maintenance mechanics was categorized as a maintenance supervisor which, if categorized appropriately, would have shown that this person's salary was 42 percent higher than the average.

In its post hearing filing, the utility argued that the evidence in the record establishes the reasonableness of Gulf's salary increases and that no abuse of discretion in utility management has been shown to exist. In support of this argument, the utility cited the following four cases: Metropolitan Dade Co. W&S Bd. v. Community U. Corp., 200 So. 2d 831, 832-833 (Fla. 3rd DCA 1967); Southwestern Bell Telephone Co. v. Public Service Commission of Missouri, 262 U.S. 276 (1923); Sunshine Utilities of Central Florida, Inc. v. Florida Public Service Commission, 624 So. 2d 306 (Fla. 1st DCA 1993); and Florida Bridge Co. v. Bevis, 363 So. 2d 799 (Fla. 1978).

In the Sunshine and the Metropolitan Dade cases, the Court stated: "If any comparisons with the salaries paid by other utility companies are to be made, the comparisons must at least be based on showing of similar duties, activities, and responsibilities in the person receiving the other salary." (Sunshine, 624 So. 2d 306 at 311 and Metropolitan Dade, 200 So. 2d 831 at 833). Based on the record, the salary survey does not support the evidentiary requirements set forth in the foregoing cases.

The salary survey is not a valid comparison to Gulf's salaries, in that Gulf's positions are not all comparable and at least one position was inappropriately categorized. Further, the years of service of Gulf's employees vary greatly from the average in the survey. We conclude that the most appropriate gauge of reasonable and prudent salary increases is to look at past salary increases. We approve the rationale set forth by OPC witness Dismukes and find it appropriate to reduce salaries expense for a

5 percent increase in the test year. Accordingly, we find it appropriate to reduce salaries expense by $7,416, prorated $4,895 to water and $2,521 to wastewater.

Annual Lease Charged by Caloosa Group

Utility witness Moore testified that in approximately November, 1995, Gulf moved its administrative offices into a 3,931 square foot space within a new building owned by its affiliate, Caloosa. This space represents approximately one-third of the entire space in the building. The Lee Memorial Health System (the hospital), an independent third party, has a lease with Caloosa for the remainder of the office space. Gulf's annual lease amount is $47,172, which is 3,931 square feet at $12 per square foot. Sales tax on the lease is $2,830 per year and common maintenance expenses are estimated at $9,828 per year.

Staff's Audit Disclosure No. 4, sponsored by Staff witness Welch, addressed Gulf's lease with Caloosa. The report stated that if no proven outside market exists for affiliate rental property, a cost basis is used to determine the appropriate lease amount. To illustrate, the audit staff calculated what the lease amount would be at cost and compared that to the current amount. The calculation took the building plus the land and multiplied this total by the allowed rate of return. Depreciation expense, assuming the standard 40-year life, was subtracted from the utility's return on investment in the building and land. This number was then multiplied by the percentage of space that the utility occupies in the new building, producing the rent using a cost basis. When compared to the current market value lease amount, the cost basis was approximately $20,762 lower.

Caloosa's lease with the hospital is a five-year lease for 6,460 square feet at $12 per square foot. The lessee is also required to pay a proportionate share of operating expenses and is given a $15 per square foot improvement allowance. The utility provided the auditors with a report from a real estate broker which concluded that the appropriate market rental rate for smaller tenants would be $15 per square foot, inclusive of taxes and common maintenance expenses. The audit report stated that Caloosa is currently charging $14.50; however, an analysis of other similar office space shows gross rent after adjustments ranging from $11.76 to $15.47 per square foot.

In rebuttal, Mr. Moore testified that the utility moved its administrative operations because Gulf had outgrown the old space and needed to provide a more easily accessible location for customers. Mr. Moore stated that Gulf was unable to finance a new office because of the utility's other capital demands related to plant expansion. He also stated that an independent appraiser substantiated the rental charge as being the market rate. He testified that there was no suitable office space available in the area to lease from a third party.

Mr. Moore testified that it was management's judgement that the new office space with the lease was the most economical method of serving Gulf's customers. He pointed out that most of the remaining two-thirds of the building was rented at a charge comparable to that being paid by Gulf, which justifies the reasonableness of the rental charge. He further pointed out that the report prepared by the real estate appraiser was done independently for the bank which ultimately financed the building. Mr. Moore quoted the conclusion of the report as follows: "After considering comparable rentals, it is our opinion the market rent for the subject property is between $10.00 and $12.00 per square foot on a triple net basis."

OPC witness Dismukes proposed an adjustment for the difference between the lease currently charged to Gulf and the present value of a levelized lease payment, based upon a 40-year life and a discount rate of 9.22 percent. Ms. Dismukes testified that the lease is not an arm's-length transaction. Therefore, she tested the reasonableness of this lease payment by comparing it to what the lease payment would be over the life of the building using a cost of capital of 9.22 percent, which is reasonably close to the utility's requested cost of capital of 9.25 percent.

Ms. Dismukes' concluded that the levelized lease payment over the life of the building would be $64,826, based on the original cost of the building to Caloosa. As Gulf occupies 33.71 percent of the building, Ms. Dismukes multiplied the $64,826 by that percentage to arrive at the lease payment that would apply to Gulf. The levelized lease payment would be $21,853, compared to the amount currently being charged of $47,152. Taking into consideration the allocation of rental expense back to Caloosa, Ms. Dismukes suggested that test year expenses be reduced by $26,182.

It is the utility's position that to make an adjustment to the lease amount paid by Gulf would be contrary to the Supreme Court's decision in GTE Florida Incorporated v. Deason, 642 So. 2d 545 (Fla. 1994). In that ruling, the Court stated:

> We do find, however, that the PSC abused its discretion in its decision to reduce in whole or in part certain costs arising from transactions between GTE and its affiliates, GTE Data Services and GTE Supply. The evidence indicates that GTE's costs were no greater than they would have been had GTE purchased service and supplies elsewhere. The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated, without more [citation omitted]. We believe the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair. If the answer is "no," then the PSC may not reject the utility's position. The PSC obviously applied a different standard, and we thus must reverse the PSC's determination of this question. (Id. at 547-548) [Citations omitted]

Ms. Welch did not render an opinion on Audit Disclosure No. 4. She only included information within that disclosure that would be helpful in analyzing the reasonableness of the lease paid by Gulf. During cross-examination, she stated that there are different ways to look at the reasonableness of the lease. She stated that when an affiliate transaction is involved, the policy has normally been to use the lower of cost or market. She further testified that if an outside market exists, the market value is allowed; however, that does not necessarily mean that management made a prudent decision in this case. Ms. Welch stated that we should consider whether the utility could have found another building, or whether the utility could have built the building.

The report prepared by the independent appraiser, working for the lending bank, is a solid basis upon which to test the reasonableness of Gulf's lease with Caloosa. As stated above, both Gulf and the hospital pay $12 per square foot, not inclusive of taxes and common maintenance expenses. It is a logical conclusion that the hospital would also have sought the most reasonable cost per square foot when searching for space to lease. If the $12 per square foot was not the going market value, it is doubtful that a not-for-profit hospital would be paying such a charge. Mr. Moore has supported the utility's management decision to lease from Caloosa, as outlined above, and has made it clear that the utility simply does not have the credit to borrow what it would need to build its own structure.

Based on the independent appraiser's report, we conclude that the $12 per square foot charge that Gulf is paying to Caloosa is at market value. Further, a third party is leasing the remainder of the office space for $12 per square foot. To make an adjustment to the lease would be inconsistent with the Court's decision in GTE v. Deason, as outlined above. Accordingly, we shall make no adjustment to the annual lease amount charged to Gulf by Caloosa.

Common Maintenance Expenses Related to the Building Lease

Audit Disclosure No. 4 noted that the maintenance costs that are paid with Gulf's lease are estimated and a portion may be refunded based on actual costs. The estimated common maintenance expenses that Gulf pays total $9,828 for the test year. Common maintenance expenses include insurance, property taxes, electric, lawn care, and garbage collection. The staff auditors tested the reasonableness of these estimated expenses by annualizing total maintenance costs for the seven months ended July 31, 1996. The first seven months of 1996 were used because this information was known and measurable at the time of the audit. To annualize, total costs were divided by seven and then multiplied by twelve. Real estate taxes and insurance were then added to this annualized number to produce total estimated expenses of $18,474 related to the building. As Gulf occupies 33.71 percent of the building, the utility's share of the estimated expenses is approximately $6,228. Comparing the auditors estimate of $6,228 to the projected amount of $9,828 indicated that the MFRs were overstated by approximately $3,600. The Staff audit recommended that expenses should be reduced by this amount and prorated $2,376 to water and $1,224 to wastewater.

The utility did not rebut the adjustment to common maintenance expenses associated with the lease. However, Gulf argued that the adjustment is not based on the projected test year because the expenses for the first seven months of 1996 were annualized. Further, the utility stated that common maintenance expenses are billed to Gulf at cost and that no adjustment is necessary.

OPC witness Dismukes agreed with audit staff's adjustment to reduce expenses by $3,600 for the overstatement in the MFRs. In its brief, OPC agrees with the testimony of Ms. Welch, and arques that there is no reason to believe that the last four months of the test year will be any different than the first seven.

The record fully supports reducing the common maintenance expenses associated with the lease. The utility's position, in its brief, that the expenses are billed to Gulf at cost, is irrelevant; the utility's projection of $9,828 is overstated in comparison to the $6,228 estimated by audit staff. Audit staff logically tested the reasonableness of the projection by annualizing known expenses and making a comparison to that projection. We find it appropriate to annualize the seven months that are known and measurable, because expenses of this nature would not change dramatically for the remaining five months of the year.

Based on the record, we believe that audit staff's estimate of common maintenance expenses associated with the lease is the best reflection of what these expenses should have been for the projected test year. We do not believe that the utility has supported its higher projection of expenses. Even though a portion of the expenses may be refunded based on actual costs, it seems appropriate that the projection should be as close as possible to what actual costs have been year-to-date. Accordingly, we approve an adjustment to reduce test year expenses by $3,600. This adjustment represents the difference between audit staff's estimate and the projection contained in the MFRs. The adjustment shall be prorated as a reduction of $2,376 to water and a reduction of $1,224 to wastewater.

Allocation of Expenses to the Caloosa Group

We have also considered the allocation of expenses related to employees who provide services for both companies. Staff witness Welch testified that Caloosa is currently charged $50 per month for the use of Gulf's computer system to process payroll, the general ledger, and minimal accounts payable. Caloosa is also charged $50 per month for office rent and supplies. The $1,200 per year charge is credited by Gulf to materials and supplies, administrative and general, and miscellaneous expense accounts.

Utility witness Cardey allocated overhead costs to Caloosa based on the total square footage of offices and the customer accounting and collecting area. He took the square footage of the offices of the five employees who provide services to Caloosa and multiplied that number by the percentage of time each employee worked for Caloosa. Next, he took that square footage as a percentage of total office, customer accounting, and collecting square footage, which gave him an allocation factor of 2.8 percent. He used the 2.8 percent to allocate rent, security, cleaning, power, office supplies, and pest control expenses. This calculation reflects approximately $2,000 compared to the $600 that Caloosa currently pays for these items. Mr. Cardey then analyzed Caloosa's reimbursement for monthly use of Gulf's computers and determined that the additional $600 per year charge for this was reasonable. In total, Mr. Cardey found $2,600 to be appropriate as reimbursement to Gulf from Caloosa for the costs listed above.

OPC witness Dismukes allocated shared expenses based on three different allocation factors. First, she allocated health insurance and IRA benefits for the five employees that work for both companies based upon their Caloosa salary relative to their total Caloosa plus Gulf salary. Next, she allocated rent, office supplies, computer depreciation, and other business and administrative expenses based upon total payroll for Caloosa relative to total payroll for Caloosa plus Gulf. Third, she allocated Mr. Moore's car expenses based upon his Caloosa salary relative to his total Caloosa plus Gulf salary. Next, she compared the total of her calculations to the $1,200 per year currently being reimbursed by Caloosa. Ms. Dismukes' schedule contained a footing error, which caused her adjustment to be inappropriately reflected. As adjusted, Ms. Dismukes' total adjustment to test year expenses was $9,372, allocated $6,186 to water and $3,186 to wastewater.

Staff witness Welch testified that for the most recent pay period, the audit staff calculated the percentage of Caloosa payroll to total Caloosa plus Gulf payroll at 2.13 percent. Next, audit staff determined expense items related to employees who perform tasks for both companies for the year September, 1995 to August, 1996. Audit staff allocated these expenses at the 2.13 percent payroll ratio and compared the calculation to the $1,200 per year currently being reimbursed by Caloosa. Audit staff's calculations result in a recommended decrease to projected expenses of $6,276, prorated accordingly between water and wastewater.

Ms. Welch testified that by using the payroll ratio method, the resulting adjustment may be understated because the allocation basis used is total utility payroll while many of the expenses relate to Mr. Moore, who should probably be allocated on an individually higher basis than on a total utility basis. However, the audit used a payroll basis to allocate expenses because a more appropriate allocation method could not be determined.

In rebuttal, utility witness Cardey contended that using total payroll of both Gulf and Caloosa to make allocations is in error because total Gulf payroll contains the salaries of a plant operator, meter readers, and others that have nothing to do with the Caloosa payroll issue. During cross-examination, Mr. Cardey agreed that allocating employee benefits based on direct payroll would be an appropriate method, versus allocating based on square footage. He would not agree that direct payroll for Mr. Moore would be an appropriate method of allocating Mr. Moore's car expenses. It appears that Mr. Cardey's argument is with only those allocation factors which contain Caloosa payroll over total Caloosa plus Gulf payroll. That would include Ms. Dismukes' allocation factors for rent, office supplies, business and administrative expenses, and computer depreciation. Mr. Cardey did not offer an alternative method of allocating these expenses, other than his method based on square footage. Since his allocation factor of 2.8 percent, discussed above, considered the percentage of time that the five employees spend on Caloosa-related business, and because we have not utilized the percentages he advocated for common payroll expenses, we have not used his factor in this matter, either. We also note that his allocation factor is higher than the allocation factor of 2.62 percent used by Ms. Dismukes and the factor of 2.13 percent used by the audit staff.

The allocation methodology used by Ms. Dismukes is appropriate given the nature of these expenses. Further, if these expenses were allocated using the ratio of Caloosa payroll over payroll for only those employees of Caloosa plus Gulf, this would result in a higher allocation factor of 8.85 percent, according to Ms. Dismukes' analysis. It is unclear to staff why the utility has taken such issue with these allocation factors.

We find that the evidence supports Ms. Dismukes' expense allocations based upon three different allocation factors, as outlined herein. Accordingly, after consideration of the adjustments to rent and business and administrative expenses made herein, we shall make a reduction to Gulf's requested test year expenses of $9,236: a decrease of $6,096 to water and $3,140 to wastewater.

Directors Fees

For the test year, directors fees total $18,000: $4,500 for Russell Newton, Jr.; $4,500 for William Newton; and $9,000 for Russell Newton, III. According to Staff witness Welch, while these amounts were included in the audit for informational purposes, staff had no opinion regarding these amounts.

OPC witness Dismukes proposed an adjustment to directors fees based on her review of the Board of Directors Meeting Minutes, which indicated that not all of the directors attend the meetings. She stated that in 1996, only Russell Newton, Jr. attended all three meetings. William Newton attended only one, and Russell Newton, III attended two of the three meetings. In 1995, Russell Newton, Jr. again attended all three meetings. William Newton and Russell Newton, III attended only one of the three meetings.

Ms. Dismukes advocated reducing two-thirds of the fees for William Newton, since he attended only one meeting in both of the years analyzed. Further, she advocated reducing the fees paid to Russell Newton, III, first by one-half because she does not believe that he should be paid twice as much as the other directors. Next, she further reduced the fees for Russell Newton, III by one-third, based on his attendance at two of the three meetings in 1996. Witness Dismukes' adjustments to directors fees would reduce test year expenses by $9,000. She stated that further adjustments could certainly be made at the discretion of the Commission, as not much is discussed at the meetings.

Utility witness Moore testified that directors have potential liabilities in exercising their responsibilities and that it is common practice to pay non-employee directors a fee for their services. He testified that, while the directors may not attend every meeting, they are very active in meetings amongst themselves and management. According to Mr. Moore, the fees are reasonable given the size of the utility, the needs of the utility, and the directors' responsibilities.

We find that it is appropriate for a Class A utility to have a Board of Directors, unless the evidence demonstrates otherwise. The record indicates that the Board of Directors for Gulf is acting in a prudent manner and that the fees are reasonable. We do not find that the record supports Ms. Dismukes' suggested adjustments, because she has looked only to the minutes of the meetings to make her recommendation. Ms. Dismukes did not consider the work that the directors might perform outside of the business conducted at directors' meetings. It is logical to conclude that directors conduct their responsibilities in a variety of ways. Therefore, we find that the directors fees are reasonable given the size of the utility and the directors' responsibilities. Accordingly, no adjustments shall be made to directors fees.

Lift Station Coating

Gulf has numerous manholes and lift stations in its wastewater collection system. The utility has a preventive maintenance program to assure proper operation of the system. OPC disagreed with a portion of the expenses by claiming that it is a non-recurring expense.

OPC witness Dismukes testified that Gulf indicated it did not incur any cost to coat lift stations in 1993, 1994, or 1995, but that it did incur lift station repair costs of $11,919 in 1994 and $6,980 in 1995. It did not, however, incur these costs in 1993. Ms. Dismukes advocated reducing the lift station expense by $10,500, due to this expense being non-recurring.

Gulf witness Messner testified that Gulf has 42 lift stations and more than 600 manholes. The maintenance of these facilities is included in the requested $21,000. Mr. Messner testified that to relate the allowance proposed by OPC witness Dismukes would allow just $250 per lift station per year. Mr. Messner testified that it is not possible to maintain adequate and safe service to Gulf's customers without adequate maintenance expenditures. Mr. Messner offered a cost breakdown of lift station repairs that averages $1,500 to $2,000 per station per year. This cost does not include coating costs of $8,000 each for the three planned per year to be coated. Mr. Messner testified that there must be routine annual preventive maintenance to prevent damage to the lift stations.

The records indicates that Gulf has $18,000 to $24,000 per year scheduled in coating costs, not including the regularly scheduled maintenance of the lift stations and manholes. Based on evidence in the record, we find the expenses and repair schedule outlined by Gulf to be reasonable, and no adjustment shall be made.

Charitable Contributions

According to Audit Exception No. 3, charitable contributions totaling $1,910 ($1,270 for water and $640 for wastewater) were included by the utility in accounts 675.8 and 775.8, miscellaneous expenses, for the audited period of September, 1995 to August, 1996. The miscellaneous expense accounts are above-the-line accounts, which would be included in the utility's test year projections. Staff witness Welch testified that Commission Rule 25-30.115(1), Florida Administrative Code, requires that water and wastewater utilities maintain accounts and records in conformity with the 1984 National Association of Regulatory Utility Commissioners (NARUC) Uniform System of Accounts (USOA) adopted by the National Association of Regulatory Utility Commissioners. The USOA prescribes that "donations for charitable, social, or community welfare purposes" should be charged to Account 426, Miscellaneous Non-Utility Expense, a below-the-line account. Accordingly, Ms. Welch concluded that these expenses should be reclassified to the below-the-line expense account.

On cross-examination of utility witness Andrews, OPC pointed out a correlation between the utility's 19^6 budgeted expenses and the miscellaneous expense projections contained in the MFRs. Ms. Andrews was referred to a schedule of adjustments to operating income contained in the MFRs. Ms. Andrews agreed that miscellaneous expenses listed on this page total $71,289. Next, Ms. Andrews was referred to a breakdown of these miscellaneous expenses provided by the utility in response to a MFR deficiency letter. She agreed that the $71,289 miscellaneous expense projections included $3,200 for a customer survey. Next, OPC referred Ms. Andrews to a copy of Gulf's 1996 budget. Here, OPC pointed out that the utility's 1996 budget for miscellaneous expenses totals $71,289 and contains $3,200 for charitable and political contributions. OPC matched every other item in the utility's budget to the MFRs, except charitable and political contributions. OPC suggested that the charitable and political contributions are being covered up in the MFRs as expenses related to a customer survey.

Utility witness Andrews testified that charitable contributions were not included in test year expenses. She stated that the survey was estimated at approximately $3,200, that it was performed in the latter part of 1996, and that the results were provided to OPC. The utility contends that no adjustment is necessary to remove charitable contributions from test year expenses.

Although the utility has included charitable contributions in above-the-line accounts, we do not believe that the dollar amount for such contributions has been included in test year expenses. The customer survey was conducted by the utility and the results were provided to the parties. Additionally, the costs associated with conducting the survey are the subject of a separate audit finding. We therefore do not find any credence to OPC's position that the $3,200 expense projection for the customer survey was a disguise for charitable contributions. No adjustment shall be made to remove charitable contributions from test year expenses, as none are listed in the MFRs under miscellaneous expenses. However, we shall require the utility to reclassify charitable contributions to a below-the-line account in accordance with Rule 25-30.115(1), Florida Administrative Code.

Golf Outings and Gift Basket Expenses

OPC witness Dismukes proposed an adjustment to remove from test year expenses $780 related to golf outings and gift baskets. Ms. Dismukes revised her testimony at the hearing to a reduction of only $185. The utility argued in its brief that these sort of expenses are not included in the test year projections and, therefore, no adjustment is necessary.

It is unclear as to what Ms. Dismukes' suggested adjustment is based upon, although it may be based on the data obtained from Mr. Moore's travel and entertainment expense reports, which contain items such as golf outings and gift baskets. We have addressed local business and entertainment expenses separately. While we agree with Ms. Dismukes that it is not appropriate to include expenses for golf outings and gift baskets in test year projections, we have addressed the removal of such costs later in this Order. While we note that the utility did not rebut this issue, and there is nothing in the record to prove that the expenses are not included in test year projections, we shall make no adjustment in this regard.

Unanticipated Expense

The utility included $1,000 in unanticipated expenses in its MFRs for contractual services for treatment-operations, prorated $660 to water and $340 to wastewater. The utility also included $4,000 of unanticipated expenses in the miscellaneous expense account, prorated $2,640 to water and $1,360 to wastewater.

Ms. Dismukes advocated the removal of expenses which the utility has characterized as "unanticipated". In her opinion, this is not an appropriate category of expenses for a test year, and it is the utility's burden to prove the reasonableness of its projected expenses, including all expenses that it anticipates. Therefore, she advocated disallowing all unanticipated expenses. Her proposed adjustment related to the miscellaneous expense account is net of an allocation to Caloosa of 2.62 percent. In total, Ms. Dismukes proposed that expenses be reduced by $4,895, which represents a $3,231 reduction to water and a $1,664 reduction to wastewater.

Utility witness Andrews testified that the utility must allow for unanticipated expenses that occur annually in the normal course of business and which are not specifically itemized in the utility's budget. She explained that the utility had to hire a safety consultant to manage the utility's safety program, which is necessary in order to meet OSHA standards. During cross-examination, Ms. Andrews agreed that it would be difficult to ascertain that the category of unanticipated expenses did not include non-utility related expenses.

The utility has demonstrated that the category of unanticipated expenses relates to valid, utility-related business expenses. The inclusion of $5,000 in unanticipated expenses is nothing more than a padding of the total requested expenses. The purpose of the projected test year is for the utility to include its best estimates of costs that will be prudently incurred. It is not acceptable to include in projections a category of expenses which are not identified, but are included as a safety net for costs which may or may not occur in the future.

We agree with witness Dismukes' adjustment, with the exception of the small amount that she allocated to Caloosa. This allocation is not necessary, and may have been confused by the witness with another issue. Moreover, by applying her allocation factor in this adjustment, a small amount of unanticipated expenses would remain in the test year.

Accordingly, all unanticipated expenses shall be removed from the projected test year expenses. The total unanticipated expenses are $5,000, which shall be prorated as a reduction to water and wastewater in the amount of $3,300 and $1,700, respectively.

Amortization of the San Carlos Water Line Project

According to staff's Audit Disclosure No. 5, as of December, 1993, the utility had recorded $11,827 of engineering costs for the San Carlos waterline project in a deferred account. The utility recently added $17,773 to this account for additional costs. The account was projected to be amortized over 5 years at an annual expense of $8,184. Originally, the utility described this project as construction work in progress. During the last audit, when asked why the costs had not been charged to construction work in progress as part of the water line costs, the utility responded that it had not yet received approval from the county for the installation of the line, nor was the county going to require mandatory hook-ups. Upon further questioning, the utility responded that the project was being abandoned because the county would not require mandatory hook-ups.

OPC contended that these costs have not been demonstrated to be prudent. In its brief, OPC questioned why the charges were incurred in the first place if the utility had to wait on the county to require mandatory hook-ups, and that the determination should have been made by Gulf prior to expending funds on the project. Therefore, OPC advocated reducing test year expenses for the amortization of project costs.

Contrary to OPC's assertions, we conclude that the record supports the utility's uncertainty regarding the county's requirement for mandatory hook-ups. The utility acted with prudence in planning and expending funds for this project. The utility is required by Section 367.111(1), Florida Statutes, to provide service within a reasonable time frame from the time that a customer requests service. Gulf was anticipating the future needs of the utility.

Utility witness Moore confirmed that this project has been abandoned. According to Rule 25-30.433 (8), Florida Administrative Code, nonrecurring expenses shall be amortized over five years, unless a shorter or longer period can be justified. We find a five-year amortization period to be appropriate, as it relates to this project. However, according to the numbers in Audit Disclosure 5, the annual amortization should be $5,920 instead of $8,184. Therefore, an adjustment shall be made to reduce test year amortization for the water system by $2,264.

Customer Satisfaction Survey

Staff witness Welch testified that the costs associated with the customer survey were included in the utility's test year projections and that this is the first time the utility has conducted such a survey. The costs totaled $9,744 and are allocated $6,431 to water and $3,313 to wastewater. Ms. Welch provided information regarding this costs, but did not offer an opinion as to whether the survey costs should be included in test year expenses.

OPC asserted in its brief that the customer survey expenses appeared to be a disguise for charitable contributions, as discussed herein. Accordingly, OPC stated that the customer survey expenses should be removed from test year expenses.

Ms. Andrews testified that the survey was conducted in the late summer of 1996, in order to gauge customer's opinion on quality of service and improvements. The utility's believed that the survey should be done at least annually as an ongoing effort to assure a satisfactory level of service to its customers. Further, as noted herein, the utility stated that there is no connection between the $3,200 cost of the survey and charitable contributions.

It is important for a utility to be aware of its customers' opinions regarding the services provided by the utility, and a survey is a legitimate method for Gulf to determine those opinions. We note that there are no quality of service concerns associated with this proceeding, nor have there been any such concerns in the past that have come to our attention. Gulf should be commended for the level of service that it is able to provide to its customers.

However, because there are no quality of service concerns in this proceeding, we do not believe that the survey is necessary on an annual basis. Considering Gulf's record of good customer service, it seems that a survey could be conducted every five years and still be effective and informative. If the utility wishes to receive feedback from its customers on a more frequent basis, it could achieve the same results by including a note or questionnaire in the monthly bill. For these reasons, we shall allow the costs associated with the survey, but the costs shall be amortized over five years, in accordance with Rule 25-30.433, (8), Florida Administrative Code. Thus, test year expenses shall be reduced by $5,145 for water and $2,650 for wastewater to reflect that the $9,744 in projected expenses have been amortized over a five-year period.

Preliminary Survey Costs for FGCU

According to Audit Disclosure No. 11, there were two invoices for engineering costs related to FGCU that were charged to the contractual services expense account instead of being capitalized as part of the university. The costs were related to the preliminary survey for the university.

Utility witness Andrews explained that the charges on the invoices must be broken out in order to determine that only a small portion related to the university. Since the utility did not break out the charges for audit staff, Ms. Andrews believed that audit staff made an innocent error. She stated that there was one charge for $100 that was expensed which related to the university. Staff witness Welch agreed with Ms. Andrews that the audit staff made an error, and agreed to delete that portion of the audit. Therefore, we shall make no adjustment in this regard.

Local Business and Entertainment Expenses

According to the staff audit, test year expenses included $1,868 for business meals and $120 for entertainment related to Mr. Moore. The descriptions on business meals include, *iter alia*: discussing health insurance plans; trusts and investments; engineering services; and waterline projects. The entertainment expense was for drinks while discussing the San Carlos waterline project and a golf outing to discuss the cost of insurance. Staff witness Welch rendered no opinion on these expenses.

Mr. Moore did not rebut the information, nor did witness Andrews or witness Cardey. On cross-examination, Mr. Moore was asked to explain various expenses of his related to business meals and entertainment. The travel, meal, and entertainment expense reports for Mr. Moore from October, 1994 through mid-October, 1996 indicated numerous expenses: rounds of golf and lunches to discuss insurance and capital projects; drinks for board members prior to a board meeting; meals to discuss security for the Caloosa-owned office building, vehicle purchases, and the development of property that would be in the utility's service area; for gift baskets for vendors. The meal expense items discussed with Mr. Moore ranged from $6 per person up to $50 per person.

Mr. Moore was asked to explain why customers should pay for meal expenses for business associates and their spouses in order to discuss business. In quite a few instances, Mr. Moore agreed that the business he discussed with his associates could have been conducted at his office or at the offices of his associates. However, Mr. Moore testified that his expenses are legitimate business expenses. He also testified that it is cost efficient to have meals with people where business can be discussed and the utility is not being billed an hourly rate for services. Further, Mr. Moore testified that, in bringing people together over a meal, the objective of cooperation among the parties is accomplished. The utility's position, in its brief, is that no adjustment is necessary to remove any of Mr. Moore's business expenses.

In its brief, OPC contended that Mr. Moore spent considerable resources and money on entertaining his associates and vendors. OPC pointed out that while Mr. Moore may believe it is customary to entertain spouses of business associates, it is inappropriate and should not be borne by ratepayers. OPC contended that, in many instances, the per person cost of a meal was extravagant and not a legitimate business expense. As such, OPC proposed that we disallow 50 percent of all of Mr. Moore's projected test year entertainment expenses. OPC suggested that 50 percent should be disallowed, as this is the policy followed by the IRS for deductible items for tax purposes. OPC believed that such an adjustment would be an incentive for the utility to hold down its meal and entertainment expenses, and advocated a $3,250 reduction to test year expenses.

We reviewed the travel, meal, and entertainment expense reports and conclude that, in many instances, the business could have been discussed at the utility or at the offices of Mr. Moore's associates. It is not appropriate to entertain spouses of business associates, even though this may be customary in a private utility, because ratepayers should not have to bear this non-utility expense. Additionally, we find Mr. Moore's meal and entertainment expenses to be sometimes excessive, on a per person cost basis.

While we agree with OPC that Mr. Moore's meal and entertainment expenses are considerably high and that some are not legitimate, we do not find OPC's 50 percent adjustment based on the IRS's rules for deductible expenses to be appropriate. It is not a matter of whether an expense is deductible; rather, the issue is whether the expenses are legitimate, utility-related expenditures.

Mr. Moore's total reimbursable expenses for the most recent 12-month period of October, 1995 through mid-October, 1996 was $12,104. For the same period, we calculated expenses related to meals and entertainment to be $2,670. Next, we took total expenses related to meals and entertainment divided by total reimbursable expenses, which indicates that 22 percent of his expenses are related to meals and entertainment. We performed the same calculation for the period of January through December, 1995 expenses, and found that 33 percent of Mr. Moore's total business expenses related to meals and entertainment for that period.

We realize that some allowance should be approved for meals and entertainment which would occur in the normal course of utility business. The record is not clear as to what a legitimate amount would be. Additionally, the record does not support the utility's position that no adjustment needs to be made, nor did utility provide rebuttal on this issue. While some allowance should be made for legitimate meals related to travel, some adjustment should be made to Mr. Moore's expenses that are either non-utility or extravagant in nature.

The record is not clear as to the contents included in the utility's $6,500 projection for Mr. Moore's travel and other business expenses, or what percentage of this projection is related to meals. Therefore, it is difficult to make a correlation between the projection in the MFRs and the total dollar amount of expenses for the 1995 and 1996 periods, described above. Lacking a more precise alternative, we find it appropriate to reduce Mr. Moore's projected travel and other business expenses by 25 percent. We arrived at this percentage by considering our calculations above, which demonstrate that 22 percent and 33 percent of total business expenses related to meals and entertainment for 1995 and 1996, respectively. This 25 percent adjustment allows for an 8 percent (33 percent minus 25 percent) allowance for meals included in our calculation which would relate to legitimate travel, as travel expenses are not at issue. Based on the evidence in the record, this is the most appropriate way to make an adjustment for those expenses of Mr. Moore's that we believe to be extravagant or non-utility related.

Applying the 25 percent reduction to the $6,500 projection in the MFRs yields a decrease of $1,625 to test year expenses. Accordingly, we shall reduce test year expenses by this amount, prorated $1,072 to water and $553 to wastewater.

Rate Case Expense

The utility projected rate case expense of $122,479 in its MFRs, with an allocation of $80,836 to water and $41,643 to wastewater. Utility witness Moore provided an updated rate case expense estimate of $220,000, in his rebuttal testimony, which includes an estimate to complete, and expenses associated with the overearnings investigation in accordance with an approved stipulation. This amount results in annual amortization expense of $36,300 and $18,700 for water and wastewater, respectively.

On cross-examination, utility witness Moore corrected the utility's final request for rate case expense to indicate that the total costs related to Mr. Nixon's estimate to complete should be $38,153. Mr. Moore stated that the increase in rate case expense over the original estimate in the MFRs was due to OPC's intervention. Further, Mr. Moore explained that due to the extensive lines of questioning by OPC and the nature of the testimony required, it was necessary for the utility to bring in expert witnesses. Mr. Moore stated that Gulf chose not to file a Proposed Agency Action (PAA) case because it was advised that the case would likely result in a hearing.

In its brief, OPC argued that the utility's requested increase in rate case expense, about 80 percent over the original estimate, was unsupported. OPC argued that intervention is routine in dockets that are initially set for hearing, and therefore, Mr. Moore's explanation was inadequate and not compelling. OPC also argued that the utility did not act prudently in that it estimated rate case expense without anticipating the intervention of Public Counsel. Therefore, OPC contended that we should only allow rate case expense in the amount that was originally requested, $122,479.

We find that the utility's request for rate case expense is fully supported by the documentation provided. Based on our review of the supporting documentation, we find that the costs incurred were reasonable and prudent. Further, considering the fact that this case began as an overearnings investigation, and the costs associated with the investigation are added to rate case expense, it seems reasonable that costs are somewhat higher.

We agree with OPC that the utility and its consultants could have projected for OPC's intervention. However, we do not believe this forms the basis for denying the recovery of additional rate case expense. Projections for rate case expense are somewhat different from other expense projections in that it is difficult to determine the extent to which consultants will be needed to defend the utility's positions. Rate case expense can sometimes vary dramatically from the projection in the MFRs, without being caused by utility imprudence. The prudence of the overall rate case expense must be evaluated on a case-by-case basis. In this case, we believe that Gulf acted prudently in defending its positions related to this proceeding.

Based upon our review of the record we will not make any adjustments to the utility's requested rate case expense. Accordingly, we approve a provision of $220,000 for rate case expense, resulting in an increase of $97,521 over the amount requested in the MFRs. The four-year amortization results in additional test year rate case expense of $24,380, prorated $16,091 and $8,289 to water and wastewater, respectively.

Test Year Depreciation Expense

According to the staff audit, the utility's projection for depreciation expense was understated because retirements were booked against this account. When an asset is retired, it should only be adjusted against the accumulated depreciation account. The utility had also used an incorrect rate in its calculation of depreciation for the proforma for the Corkscrew addition. Staff witness Welch testified that in order to correct the depreciation expense projection, the audit staff utilized Gulf's depreciation rates and plant as of August, 1996. Depreciation on fully depreciated plant was removed and the net was then compared to the utility's forecast. The audit included the detailed calculation, which results in audit staff's adjustment to increase depreciation expense for water by $102,236 and wastewater by $46,689.

Utility witness Andrews testified that all parties are using the same depreciation rates, but not the same investment in assets being depreciated. She explained that in December, 1995, Gulf put into service the Three Oaks WWTP and that the projections include 12 months of depreciation. Ms. Andrews testified that the audit staff's analysis of the period September, 1995 through August, 1996, erroneously omitted the 2 months of October and November, 1995, for the depreciation on Three Oaks WWTP. Therefore, Ms. Andrews calculated an adjustment to depreciation expense. Her adjustment also included corrections for retirements inappropriately booked by the utility, which is in agreement with staff's audit. Ms. Andrews advocated an adjustment to increase depreciation expense for water by $78,338 and to increase wastewater by $42,770. Her testimony also suggested an adjustment to accumulated depreciation for water and wastewater in the amount of $87,458 and $42,770, respectively.

OPC witness Dismukes initially agreed with audit staff's adjustments on this matter, but later amended her testimony because she believed that, with the exception of how the retirements are treated, this is a fall-out issue.

We agree with Ms. Andrews that the audit staff's adjustment related to the Three Oaks WWTP was incorrect because a full twelve months of depreciation was not included in the calculation. All parties agreed on the adjustment to correct for retirements inappropriately booked against the depreciation expense account. Accordingly, the record shows that the only adjustments necessary are to correct for the retirements and the Three Oaks WWTP, as outlined above. Therefore, we approve an adjustment to increase depreciation expense for water and wastewater in the amount of $78,338 and $42,770, respectively. Also, a matching adjustment shall be made to increase the 13-month average accumulated depreciation on water and wastewater plant in the amount of $44,416 and $21,385, respectively. Although Ms. Andrews' adjustment was on a year-end basis, a 13-month average is appropriate in order to be consistent with the averaging methodology required in the MFRs.

Income Tax Expense

The Income Tax information in the MFRs was based on the 1995 historic test year and the projected test year ended December 31, 1996. In the MFRs, the utility requested income tax expenses of $85,449 and $0 for water and wastewater, respectively. It is unclear as to how the utility's amounts in its briefs were determined, as they are not in the MFRs or other evidence in the record. We find no evidence in the record to support a specific adjustment to income tax expense, other than those made as a result of changes made to rate base, capital structure or operating income before taxes. As a result of our findings made herein, the appropriate income tax expense shall be $107,436 for water and $(49,542) for wastewater, before any revenue increase.

Test Year Operating Income

Based on the adjustments made herein, test year operating income before any provision for increased (or decreased) revenues shall be $462,919 for water and $213,021 for wastewater. This represents an achieved rate of return of 13.42 percent and 6.73 percent for water and wastewater, respectively.

## REVENUE REQUIREMENT

Based upon our review of the utility's books and records and the adjustments made herein, we find the appropriate annual revenue requirements for Gulf to be $2,051,020 for water and $1,435,940 for wastewater. This will allow the utility the opportunity to recover its allowed level of expenses and to earn a 9.20 percent rate of return on its investment in rate base.

## RATES AND CHARGES

A comparison of the utility's original rates, interim rates, requested rates, and final approved rates is shown on Schedules Nos. 4-A and 4-B. Our specific findings as to the utility's rates and charges are set forth below.

Public Fire Protection Charge

The utility's tariff provides for a public fire protection charge of $55.00 per year per hydrant payable on a quarterly basis. An additional clause in the utility's tariff provides that:

> The Company will maintain the fire hydrant and will use diligence to see that pressure is maintained at each hydrant; however, the Company will not be responsible for any damage or liability caused by or attributed to low pressure in the lines or at the hydrant. This charge shall not apply where there is a

> maintenance contract satisfactory to the Company making the fire district responsible for the maintenance of fire hydrants.

The public fire protection charge is in place to provide customers with the option of maintaining the fire hydrants through the utility or through another source. According to Staff witness Kleinschmidt, there is an agreement between Gulf and the Estero Fire Control and Rescue Service District which places the responsibility of maintaining fire hydrants on the Estero fire district. In order to maintain an ISO rating, which is a grading system used by insurance companies which rates fire departments throughout the U.S., the fire department must provide a maintenance program or contract an outside agency. He testified that in the past, maintenance programs have been cost prohibitive, and that most fire districts have chosen to provide the service in-house. Staff witness Beard, of the San Carlos Park Fire and Rescue Service District, provided similar testimony.

Section 367.081(2)(a), Florida Statutes, requires us to set rates which are just, reasonable, compensatory and not unfairly discriminatory. The record indicates that the public fire protection charge meets that statutory criteria. As such, the current charge shall remain unchanged in the utility's tariff. Should the situation ever arise where a fire department or another customer must depend on the utility for maintaining the fire hydrants in their district, a charge should be in place in the utility's tariff.

Reuse Rate

Gulf presently provides reclaimed water at no charge to four golf courses/developments. The utility has no tariff provisions regarding reuse, and did not specifically address any issues related to reuse in its initial filing other than to note that it was its sole source of effluent disposal. None of Gulf's witnesses addressed reuse in their direct testimony.

While not recommending a specific charge, Staff witness Xanders provided a range of factors to be considered in determining whether reuse rates should be approved, and if so, at what level. These factors included the utility's alternatives for effluent disposal, the customers' alternative water sources and the cost of these alternatives, the contents of the reuse agreements, reuse rates within the area and the utility's ability to secure additional customers.

Staff witness Scott Burns, Director of Water Use with the SFWMD, provided an overview of the district's rules and efforts to promote reuse. The District's water 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 it demonstrates that its use is either not economically, environmentally or technically feasible. However, according to witness Burns, the applicant's determination of feasibility is considered final, and the conclusions are not independently reviewed by District staff. In fact, the District does not have any standards to determine the economic feasibility of requiring golf courses to take reuse.

OPC witness Dismukes agreed that golf course irrigation is beneficial to Gulf and its customers but noted that it is also beneficial to the golf courses. She testified that since Gulf operates in a Water Resource Caution Area, the SFWMD closely monitors the need for water use permits and associated withdrawals. She noted that since Gulf is presently providing reuse to three golf courses and has a contract for the fourth, it is unlikely that the golf courses could prove that the provision of reclaimed water is not technically or environmentally feasible. Further, she stated that the SFWMD should find that a reasonable rate for reclaimed water is economically feasible. Accordingly, she initially proposed a rate of $.25 per thousand gallons for reuse.

In rebuttal, Utility witness Moore provided the utility's position on setting a rate for reuse. Gulf disposes 100 percent of its effluent through golf course irrigation and presently has contractual agreements with four golf courses which allow it to dispose of effluent at no charge on those properties. With the exception of the 1996 River Ridge agreement, all other agreements have been in place since the 1980's. According to Mr. Moore, no charge is appropriate since the golf courses are not customers but, instead, an integral part of the wastewater treatment process. Through contracts with these properties, Gulf believes it has in place the lowest cost alternative to dispose of its effluent. These agreements provide that Gulf can dispose of all its effluent, even during the rainy season, with the golf courses being responsible for constructing both off-site and on-site lines and providing effluent storage meeting DEP standards. Mr. Moore asserts that through this relationship with the golf courses, Gulf and its wastewater customers have avoided the cost of the portion of the reuse system paid for by the golf courses. Mr. Moore stated that the cost of the reuse system should be considered solely as effluent disposal costs and included in the wastewater rates as would the effluent disposal costs of any other utility.

Mr. Moore expressed concern over the impact a positive reuse charge would have on its present operations, in that the golf courses may declare their contracts void or sue the utility. According to Mr. Moore, the existing reuse users may decrease their consumption to avoid costs, and prospective customers may avoid accepting reuse or limit contractually the amount they would accept. This would place Gulf in the position, on a daily basis, of being unable to dispose of its effluent in the quantities it has historically delivered to its present sites. This could lead to a temporary moratorium on new wastewater service and a need to develop alternate methods of disposal.

While the golf courses did not intervene in this docket, all four provided testimony during the customer service hearing. All of the golf courses presently taking reclaimed water from Gulf have no-charge contracts. They testified that they would modify the amount of water taken if a reuse charge were implemented. Specifically, two golf courses indicated that they would not take effluent in the wet season, when irrigation is not needed, if a charge were implemented. Additionally, the golf courses stated that consideration should be given for both the on-site and off-site investment they have made in order to accept reuse. For example in 1994, the San Carlos Golf Club (San Carlos) invested $140,000 to upgrade its effluent holding ponds in order to be able to accept reuse. The Vines Country Club (Vines) spent at least $100,000 to construct the effluent line from the utility to its holding ponds. The Country Creek Golf and Country Club (Country Creek) paid for the line from the utility to its holding pond and incurred significant expense in lining its holding ponds. They suggested that decisions to accept reuse and pay for the off-site lines and on-site improvements were based upon reuse being provided at no charge.

In its brief, OPC stated that using fresh water, instead of reuse, would appear to cause two of the golf courses to exceed their present permitted withdrawals. Additionally, OPC argued that Gulf was unable to explain why other utilities in the area were able to charge for reuse and that reuse at $.25 per 1,000 gallons is reasonable compared to the $2.01 charge for potable water. This is the basis for OPC advocating a charge for reuse. However, in consideration of the utility's concern over wet weather storage and to offer an incentive for golf courses to take effluent during wet weather, OPC modified its original rate proposal to include a $.05 credit to the golf courses during the wet weather months of June through September.

Gulf is totally dependent upon the golf courses as its sole means of effluent disposal. The three golf courses presently receiving reuse all have active Water Use Permits allowing them to provide all or a portion of their irrigation needs through wells or surface withdrawals. Presently, with the addition of the River Ridge Property in late 1996, Gulf is able to utilize its plants at full capacity and dispose of all of its effluent. Therefore, the record indicates that Gulf has in place an effective means of effluent disposal. At issue is weighing the impact a charge for reuse would have on effluent disposal versus the benefit to the wastewater customers of the revenue derived from a positive reuse rate. The reuse customers have indicated that if a charge were imposed, they would cut back on their usage. While the reuse customers have alleged they would take reduced flows, a key point is whether through existing reuse contracts and the policy of the SFWMD, customers would be able to reduce flows.

Gulf's agreements with the San Carlos, Country Creek and the Vines contain provisions relating to minimum and maximum amounts Gulf can dispose of on the respective properties. All three properties have incurred expense in paying for off-site lines and designing effluent storage facilities meeting DEP standards. Based upon this investment, it is unlikely that any of the golf courses would cease using reuse. However, we recognize that the level of reuse flows may be reduced. Because the above contracts have no contingency regarding a charge, the golf courses could declare the existing agreements void and renegotiate minimum and maximum flows to limit their irrigation expense.

To meet their irrigation needs, the golf courses may need to increase their fresh water withdrawals which would involve the SFWMD. Witness Dismukes stated that if SFWMD uses an objective measure of economic feasibility it should find that a reasonable reuse rate is economically feasible. However, determination of economic feasibility is left to the applicant, not the District. According to witness Burns of SFWMD, the applicant's determination of feasibility is considered final, and the conclusions are not independently reviewed by District staff. In fact, the District does not have any standards to determine the economic feasibility of requiring golf courses to take reuse. Therefore, the golf courses may indeed decrease their use of reclaimed water.

We recognize that golf courses are businesses and a charge for reuse creates an economic incentive to take less effluent. Based upon total irrigation needs and the limitation of present water use permits, it is not clear to what extent reuse consumption could be immediately decreased. The three existing permits are all up for renewal in December of 1997. The golf courses could then determine that reuse was not economically feasible and thereby increase their fresh water withdrawals. This would obviously have a serious impact on Gulf's ability to dispose of its effluent.

Gulf's fourth and most recent reuse agreement is with the River Ridge development. This agreement was executed in 1996 and provides that the utility may ultimately dispose of up to 1.5 million gallons per day of effluent. River Ridge has applied for a water use permit which is presently under review by The SFWMD. As with the other agreements reuse is to be provided at no charge. However, this agreement differs from the other reuse agreements in that it specifies there may be a future charge for reuse and the utility, not the customer, paid for the line to bring effluent to the development. Gulf has stated that it was "up against the wall" for immediate additional disposal capacity and constructed the line to achieve that goal. Because the River Ridge property will not be developed for at least a year, it did not need effluent for irrigation. Pursuant to the agreement, Gulf constructed the effluent line and River Ridge constructed holding ponds, prior to development, to accept the effluent. This is a temporary holding area until the development is complete and lines are constructed to irrigate the golf course. Therefore, River Ridge is presently receiving and storing effluent, but not using it for irrigation. Since the benefit of reuse to the property is irrigation, River Ridge is in effect a disposal site at this time. As with pricing effluent in wet weather when it is not needed by the golf courses, a positive charge at this time would create a disincentive to accept reuse.

First and foremost, Gulf is a water and wastewater utility. A reuse rate should not negatively effect the primary operation of the utility. In determining whether a reuse rate should be implemented in this docket, the primary factor is the impact a rate would have on the ability of the utility to dispose of its present and future effluent. Because Gulf has no alternative means of effluent disposal, it is dependent upon a cooperative relationship with neighboring golf courses. As noted by the utility, prior to the River Ridge agreement, it was unable to operate its Three Oak plant at full capacity due to limited disposal capacity. The River Ridge agreement was needed to dispose of incremental flows which could not be taken at the other sites. Therefore, we infer that existing sites are at their permitted capacity. Due to anticipated customer growth, Gulf continues to look for additional sites. As previously discussed, based upon present SFWMD rules as well as the testimony of witness Burns, both existing and future reuse sites may unilaterally determine if reuse is economically feasible. If a positive rate is approved in this docket, any existing reuse customer could limit their usage because of that economic constraint or choose not to take reuse. Due to the dependency of the utility on reuse and the ability of reuse users to limit their usage, we find that the potential negative impact of a reuse rate on Gulf's ability to dispose of its effluent outweighs the benefit to the wastewater customers of shifting some of the reuse costs to the end users.

While the reuse revenue would lessen wastewater rates, we believe that wastewater customers will and have been the beneficiary of decreased wastewater disposal costs. Through its relationship with the golf courses, Gulf has not incurred the cost of land or construction of its own storage facilities and has been able to utilize transmission mains, storage facilities and irrigation systems paid for by the golf courses. Gulf has been able to dispose of all of its effluent even during the wet season. Due to problems disposing of its effluent in wet weather, Lee County, as a safety valve, has an agreement where it will pay a neighboring utility to take its effluent. Witness Burns, Director of Water Use with SFWMD testified that it has been his experience across his district that golf courses will utilize their wells if the cost of effluent exceeds the cost of using their wells. We find it appropriate to approve a zero rate based on the absence of tighter SFWMD guidelines which strictly limit fresh water irrigation and which require implementation of reuse.

Accordingly, Gulf shall file a reuse tariff sheet listing customers served and indicating the zero rate. As indicated by witness Xanders, a zero rate in the tariff indicates that this Commission has considered and approved a zero rate. Because our conclusion is based upon a combination of existing factors which are subject to change, Gulf is hereby placed on notice that this issue will be revisited in its next wastewater rate case. Furthermore, any future reuse agreements and a justification of the proposed rate must be filed with the Commission for approval.

Allocation of Reuse Revenue Requirement

Section 367.0817(3), Florida Statutes, acknowledges that water customers benefit from the water resource protection afforded by reuse and gives this Commission latitude to consider whether a portion of the cost of reuse should be borne by water customers. On rebuttal, Gulf witness Moore agreed that every water user which uses the aquifer benefits by reuse.

Staff witness Xanders provided the only testimony directly related to this issue. She noted that quantifying the benefits to water customers is a judgement call. However, in attempting to quantify reuse benefits, we may consider the additional cost to implement reuse over alternative methods of disposal. Since the lower cost alternative could provide adequate effluent disposal, the additional cost of reuse could be identified as costs incurred for conservation and protection of the water supply and recovered, in part, through water rates. We may also consider cost avoidance by water customers due to reuse. For example, if using reuse should reduce the demand for potable water, water facilities may not need to be expanded and this cost could be avoided. Specific to Gulf, its Corkscrew Water Treatment Plant is a low pressure membrane treatment facility which must dispose of concentrate created in the treatment process. Presently, the concentrate is blended with effluent from Gulf's Three Oaks Wastewater plant and sprayed on the golf courses. By being able to dispose of this reject water, Gulf has been able to avoid the cost of a $2.5 million deep well. Obviously this is to the economic benefit of the water customers.

These are generic methods which may be used to quantify the benefits of reuse to water customers, however, none appear to be applicable to this utility. Gulf has disposed of all its effluent through reuse since 1982. It is its only method of effluent disposal. The record supports our conclusion that reuse is the lowest cost disposal alternative. Therefore, there is no additional cost which could be considered solely for resource protection. As to cost avoidance, since none of the golf courses use potable water from Gulf which would be replaced by reuse, reuse would not decrease demand to Gulf's water system. Also, it appears that the cost of the deep well is being delayed as opposed to being avoided. Mr. Moore testified that there is little doubt that the deep well will be required, probably at the time the plant is next expanded, which could be as early as 1997. It is also not clear at this time if the deep well would be used only for reject water or if it could be dual permitted to also accept effluent. It would not be appropriate to increase water rates based upon this avoided cost when water customers may be solely responsible for the cost of the deep well in the near future.

However, the fact remains when reuse is used to fill the irrigation needs of golf courses, water customers benefit because the use of reclaimed water helps to preserve ground water supplies for potable water needs. Witness Xanders testified that if reuse is the only disposal alternative or we are unable to precisely quantify benefits, these factors should not be an obstacle to allocating some reuse cost to water customers. Absent specific quantification, this allocation becomes a judgement call. Our judgement is guided by additional criteria, which include the average usage of water customers, the level of water rates, the magnitude of the water and wastewater increases, and the need to send a stronger price signal to achieve water conservation.

Because the magnitude of the wastewater increase is moderate and water rates are decreasing slightly, we do not conclude that there is a need for a stronger conservation signal. Average monthly residential usage is approximately 7,000 gallons and even with the decrease the water gallonage charge is still approximately $2.00. While there are undeniable benefits to the water customers, we recognize that clear standards have not been established to recognize these benefits. Therefore, conclusions reached on similar criteria may differ as experience is gained through different cases. In this matter, we do not believe that the evidence supports a compelling reason to merit a "pure judgement" allocation to water customers. Therefore, no portion of the reuse revenue requirement shall be allocated to water customers and recovered through water rates at this time.

Master Meter Influent Service Rate

By Order No. 21450, issued June 26, 1989, in Docket No. 890110-SU, we set an excess influent consumption charge for two master metered wastewater customers whose wastewater flows exceed their water flows, Coach Light Manor and Mariner's Cove. Mr. Moore testified that the excessive infiltration situation described in the order will exist as long as no further repairs to the system are made. To his knowledge, no repairs have been made to either mobile home park since the issuance of that order. Based on this evidence, we recognize that an infiltration problem still exists for these two master-metered wastewater customers, resulting in the need for continuing the master meter influent service rate.

Pursuant to Order No. 21450, at page 3, the gallonage charge was calculated for the master metered wastewater customers at 4 percent above the gallonage charge for general service customers. The total charge for these customers consisted of a gallonage charge (as stated above) per 1,000 gallons of influent for all wastewater flows, in addition to the existing base facility charge.

The appropriate base facility charge related to the customer's meter size along with a gallonage charge rate four percent above the general service wastewater gallonage rate will insure equitable treatment of all wastewater customers in the system. No testimony was presented to the contrary. In consideration of the foregoing, the gallonage charge shall be $4.21 per 1,000 gallons as indicated on Schedule No. 4B, for the master meter influent customers.

Water and Wastewater Rates

The utility requested permanent rates designed to produce water revenues of $2,139,422 and wastewater revenues of $1,671,070. According to the utility's MFRs, the requested revenues represent a decrease in water revenues of $155,935 or 6.79 percent and an increase in wastewater revenues of $366,340 or 28.07 percent. Pursuant to the adjustments made herein, we find that the rates shall be designed to recover annual operating water revenues of $2,016,245 and annual operating wastewater revenues of $1,435,940.

While the allocation of revenue requirement was not at issue in this case, utility witness Andrews testified that an allocation was assigned based on number of customers served. We conclude that a more accurate method of allocation should be used when designing rates. Therefore, the approved rates have been allocated consistent with Commission practice, based on a fixed cost versus variable cost basis.

When calculating the base facility and gallonage charges, we must consider the portion of the revenue requirement which is to be recovered through service rates. Miscellaneous revenues along with guaranteed revenues and reuse revenues are generated through sources other than the service rates. Therefore, when calculating base facility and gallonage charges, miscellaneous revenues along with guaranteed revenues and reuse revenues are excluded from the revenue requirement so that the utility is not collecting these revenues twice. For this utility, only miscellaneous revenues are excluded from the revenue requirement since no guaranteed revenues or reuse revenues apply.

Further, the miscellaneous revenues have been excluded in their entirety from the water revenues only rather than from both water and wastewater revenues. Therefore, while the water revenue requirement is $2,051,045, the rates are designed to allow the utility the opportunity to recover $2,016,245, which is a reduction to the revenue requirement of $34,800, the amount of miscellaneous revenues.

The utility's tariff provides that whenever both water and sewer service are provided, only a single charge is appropriate unless circumstances beyond the control of the Utility require multiple actions. The miscellaneous revenues were included in total by the utility as water miscellaneous revenues. It has been our practice to allow a utility to record miscellaneous revenues in this way when water and wastewater miscellaneous charges exist.

Consistent with the utility's request, we approve a 20 percent differential between the residential and general service wastewater gallonage charges. This differential recognizes that approximately 20 percent of the water used by residential customers is used for purposes such as irrigation and is not collected by the wastewater systems.

The utility shall file revised tariff sheets and a proposed customer notice to reflect the appropriate rates pursuant to Rule 25-22.0407(10), Florida Administrative Code. The approved rates shall be effective for service rendered on or after the stamped approval date on the tariff sheets pursuant to Rule 25-30.475(1), Florida Administrative Code, provided the customers have received notice. The rates shall not be implemented until proper notice has been received by the customers. The utility shall provide proof of the date notice was given within 10 days after the date of the notice.

Statutory Four-Year Rate Reduction

Section 367.0816, Florida Statutes, requires that the rates be reduced immediately following the expiration of the four-year period by the amount of rate case expense previously authorized in the rates. The reduction will reflect the removal of water and wastewater revenues associated with the amortization of rate case expense and the gross-up for regulatory assessment fees, which is $145,200 and $71,548. The removal of rate case expense will result in the rates set forth on Schedules Nos. 5-A and 5-B.

The utility shall file revised tariffs no later than one month prior to the actual date of the required rate reduction The utility also shall file a proposed customer notice setting forth the lower rates and reason for the reduction. If the utility files this reduction in conjunction with a price index or pass-through rate adjustment, separate data shall be filed for the price index and/or pass-through increase or decrease, and for the reduction in the rates due to the removal of the amortized rate case expense.

Refunds of Water Revenues and Interim Wastewater Increase

We have approved the stipulation that, for both water and wastewater refund purposes, the final revenue requirements shall be adjusted to remove any ratemaking components which were not in service or not incurred during the time interim rates were in effect. These adjusted revenue requirements are compared to the adjusted test year revenues to determine whether any refund is appropriate. The water test year revenues will then be annualized for the two time periods using the rates prior to the water interim rate reduction and the rates subsequent to the water interim rate reduction.

By Order No. PSC-96-0501-FOF-WS, issued April 11, 1996, we initiated an overearnings investigation and held $353,492, or 16.92 percent, in annual water revenues subject to refund. Pending the resolution of the investigation, we ordered Gulf to undertake a surety bond, letter of credit or escrow agreement in the amount of $179,203, which represents a six-month time frame, plus interest. The overearnings investigation was combined with this rate proceeding.

Gulf requested interim and final revenue decreases of $141,709 (6.67 percent) and $155,935 (6.79 percent), respectively, for the water system. For wastewater, Gulf requested interim and final wastewater increases of $256,885 (22.98 percent) and $366,340 (28.08 percent), respectively. Staff witness Rendell testified that the utility did not request interim water rates, but instead requested that its proposed final rates be effective simultaneously with its proposed interim wastewater rates.

By Order No. PSC-96-1310-FOF-WS, issued October 28, 1996, we approved an interim wastewater rate increase and water rate reduction, with additional water revenues held subject to refund. For wastewater, we approved a revenue requirement of $1,288,391 for interim purposes. This resulted in an annual increase of $170,821 or 15.29 percent. For the water system, we calculated an interim revenue requirement of $1,796,651, which resulted in decreased revenues of $329,920 or a negative 15.51 percent. We determined that we could not make a final determination regarding the potential overearnings of the water system at the time of interim. Therefore, we approved the utility's proposed final rates, which generated annual revenues of $1,982,871 on an interim basis, pending the determination of the appropriate final water rates in this case. The difference between the annual revenue reduction implemented by the utility ($1,982,871) and the approved interim revenue requirement ($1,796,651) is $186,220. This amount equated to 9.39 percent of the revenues collected during the interim period to be held subject to refund. Mr. Rendell testified that the tariff sheets containing the interim water and wastewater rates were approved on November 1, 1996.

Mr. Rendell testified that water revenues should be annualized for both periods reflecting the different rates that were in effect. For the first period, April 11, 1996 through November 1, 1996, he advised calculating the revenue based upon the appropriate billing determinants for the projected 1996 test year at the rates in effect as of October 31, 1996. For the second period, November 1, 1996, through the effective date of the final rates, the revenue should be calculated based upon the appropriate billing determinants for the 1996 projected test year at the lower water rates as of November 1, 1996. We note that no parties have disputed this methodology, and accordingly have calculated $2,221,539 in annualized water revenues for the first period. For the second period, we have calculated $2,071,243 in annualized revenues. To be consistent, we also recalculated the wastewater interim revenues using the projected test year billing determinants. This results in annualized revenues for wastewater of $1,442,084.

Additionally, Mr. Rendell testified that adjustments made in the rate case test period that do not relate to the period that interim rates were in effect should be removed. Examples of such adjustments would be plant in service which was not in service during the interim collection period but will be in service after the final rates go into effect, and expenses that will be recovered only after final rates are established, such as rate case expense, should also be removed. Mr. Rendell further testified that after these items are removed, we should then calculate a revised revenue requirement for the interim period using the same data used to establish final rates. This was also stipulated by the parties, and we have therefore applied this methodology.

To establish the proper refund amount, we calculated a revised interim revenue requirement utilizing the same data used to establish final rates. Rate case expense was excluded, because it was not an actual expense during the interim collection period. Based on the record, there are no other items that should be removed to determine the revised revenue requirement for refund purposes. Accordingly, we calculate the revised revenue requirement for the interim collection period to be $2,013,093 for water and $1,480,228 for wastewater.

The annualized water revenue requirements for both the first and second interim periods exceed the adjusted final revenue requirement for water. In order to determine the appropriate refund percent, miscellaneous revenues have been excluded. Therefore, we calculate refund percentages for water of 12.30 percent for the period prior to the interim decrease and 4.70 percent for the period subsequent to the interim decrease. Compared to the restated interim revenue requirement, the revised revenue requirement for wastewater exceeds interim revenues and no wastewater refund is necessary.

Section 367.082(4), Florida Statutes, holds that refunds shall not be in excess of the amounts held subject to refund. The refund amounts above are less than the amounts held subject to refund; therefore, no limitation is necessary and the full percentages shall be made. For the period April 11, 1996, to October 31, 1996, the utility shall refund 12.30 percent of the water revenues collected during this time frame. From November 1, 1996, the utility shall refund 4.70 percent of the water revenues collected during this time frame until the effective date of the final water rates. The refunds shall be made with interest as required Section 25-30.360(4), Florida Administrative Code. Further, the utility shall submit the proper refund reports pursuant to Rule 25-30.360(7), Florida Administrative Code, and must treat any unclaimed refunds as CIAC in accordance with Rule 25-30.360(8), Florida Administrative Code.

Service Availability Charges

Pursuant to Section 367.101, Florida Statutes, this Commission shall set just and reasonable charges and conditions for service availability. The utility requested that the plant capacity charges for the water system be reduced from $800.00 to $550.00 per ERC and that the plant capacity charges for the wastewater system be increased from $550.00 to $800.00 per ERC. By Order No. PSC-96-1310-FOF-WS, we suspended the utility's proposed service availability charges.

The utility's contribution level is currently within the minimum and maximum level as required by Rule 25-30.580 (1)(a) and (b), Florida Administrative Code. Based on historical data provided in the utility's application, average growth is calculated to be 430 connections per year for the water system, and 495 connections per year for the wastewater system. We have also considered FGCU as part of the utility's growth. If this growth continues, the water plant will reach full capacity in approximately 11 years, while the wastewater plant will reach full capacity in approximately 4 years.

Based upon our review of the record, we agree with the utility's calculations regarding the plant capacity charges. The plant capacity charge for the water system shall be decreased from $800 per ERC to $550 per ERC. The plant capacity charge for the wastewater system shall be increased from $550 per ERC to $800 per ERC. The appropriate service availability charges are set forth in Schedules 6-A and 6-B.

Allowance for Funds Used During Construction (AFUDC)

We have approved the parties' agreement that the appropriate AFUDC rate should be based on the rate of return found to be fair and reasonable, and pursuant to Rule 25-30.116, Florida Administrative Code. Further, the rate shall be effective January 1, 1997. We have approved an overall cost of capital of 9.21 percent. Applying the above mentioned rule, the monthly discounted rate shall be 0.766839 percent.

Special Service Availability Agreement

While the utility included costs, expenses and revenues related to FGCU in its filing, it had not previously provided any signed agreement for service between the utility and the university for our review. In order to give FGCU consideration in this docket, we recognized that the special service availability agreement should be signed and filed with this for our review. Mr. Moore's supplemental direct testimony included the special service availability agreement. Upon review of the special service availability agreement, we find the document to be in compliance with the utility's tariff and our rules. We therefore approve the agreement as filed.

CLOSING DOCKET

This docket shall be closed after the time for filing an appeal has run, upon our staff's verification that the utility has completed the required refunds with interest and the proper revised tariff sheets and customer notice have been filed by the utility and approved by staff. Further, the utility's escrow account can be closed upon our staff's verification that the refund has been completed.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that the application by Gulf Utility Company for an increase in wastewater rates and a decrease in water rates is hereby approved as set forth in the body of this Order. It is further

ORDERED that each of the findings contained in the body of this Order is hereby approved in every respect. It is further

ORDERED that all matters contained herein, whether set forth in the body of this Order or schedules attached hereto are, by reference, expressly incorporated herein. It is further

ORDERED that the stipulations set forth in the body of this Order are hereby approved. It is further

ORDERED that the rates and charges approved herein shall be effective for service rendered on or after the stamped approval date of the revised tariff sheets, in accordance with Rule 25-30.475, Florida Administrative Code, provided the customers have received notice. It is further

ORDERED that prior to the implementation of the rates approved herein, Gulf Utility Company shall submit a proposed customer notice explaining the rates and charges and reasons therefor. It is further

ORDERED that Gulf Utility Company shall provide proof of the date that notice was given within 10 days after the notice was made. It is further

ORDERED that, prior to the implementation of the rates and charges approved herein, Gulf Utility Company shall submit and have approved, revised tariff sheets. The revised tariff sheets shall be approved upon our staff's verification that they are consistent with this Order and that the proposed customer notice is adequate. It is further

ORDERED that in its reuse tariff sheet Gulf Utility Company shall list the customers being served and shall indicate the zero rate. Gulf Utility Company shall file any future reuse agreements and a justification of the proposed reuse rate with the Commission. It is further

ORDERED that Gulf Utility Company shall coordinate with representatives from the fire districts in its service area to correct low flow problems where they exist. It is further

ORDERED that Gulf Utility Company shall report to this Commission six months and twelve months after the issuance date of this Order, detailing the corrective measures taken and the progress of the corrective action regarding the utility's fire flow. It is further

ORDERED that Gulf Utility Company shall adjust its books and records to correct the accounting treatment for stock exchanged for assets from the Caloosa Group. It is further

ORDERED that Gulf Utility Company shall maintain records of Vice President Randall Mann's daily, utility-related activities, on a going-forward basis. It is further

ORDERED that the rates approved herein shall be reduced at the end of the four-year rate case expense amortization period. Gulf Utility Company shall file revised tariff sheets no later than one month prior to the actual date of the reduction and shall also file a customer notice. It is further

ORDERED that Gulf Utility Company shall make refunds of a portion of the water revenues collected pursuant to the overearnings docket and the interim order, with interest, as set forth herein. It is further

ORDERED that Gulf Utility Company shall submit a refund report pursuant to Rule 25-30.360(4), Florida Administrative Code, and must treat any unclaimed refund as CIAC pursuant to Rule 25-30.360(8), Florida Administrative Code. It is futher

ORDERED that the service agreement between the Florida Gulf Coast University and Gulf Utility Company is hereby approved. It is further

ORDERED that this docket shall be closed administratively after the time for filing an appeal has run, upon our staff's verification that Gulf Utility Company has completed the required refunds with interest and the proper revised tariff sheets and customer notice have been filed by the utility and approved by staff. It is further

ORDERED that the utility's escrow account can be closed upon our staff's verification that the refund has been completed.

By ORDER of the Florida Public Service Commission, this 15th day of July, 1997.

BLANCA S. BAYÓ, Director
Division of Records and Reporting

By: Kay Flynn
Kay Flynn, Chief
Bureau of Records

( S E A L )

MOP/TV

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing or judicial review of Commission orders that is available under Sections 120.57 or 120.68, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing or judicial review will be granted or result in the relief sought.

Any party adversely affected by the Commission's final action in this matter may request: 1) reconsideration of the decision by filing a motion for reconsideration with the Director, Division of Records and Reporting, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, within fifteen (15) days of the issuance of this order in the form prescribed by Rule 25-22.060, Florida Administrative Code; or 2) judicial review by the Florida Supreme Court in the case of an electric, gas or telephone utility or the First District Court of Appeal in the case of a water and/or wastewater utility by filing a notice of appeal with the Director, Division of Records and reporting and filing a copy of the notice of appeal and the filing fee with the appropriate court. This filing must be completed within thirty (30) days after the issuance of this order, pursuant to Rule 9.110, Florida Rules of Appellate Procedure. The notice of appeal must be in the form specified in Rule 9.900(a), Florida Rules of Appellate Procedure.

**GULF UTILITY COMPANY**
**SCHEDULE OF WATER RATE BASE**
**TEST YEAR ENDED 12/31/96**

**SCHEDULE NO. 1-A**
**DOCKET 960329-WS**

| | DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENT | ADJUSTED TEST YEAR PER UTILITY | COMMISSION ADJUSTMENT | COMMISSION ADJUSTED TEST YEAR |
|---|---|---|---|---|---|---|
| 1 | UTILITY PLANT IN SERVICE | $16,700,337 | $1,794,445 | $18,494,782 | ($700,000) | $17,794,782 |
| 2 | LAND & LAND RIGHTS | $200,372 | $0 | $200,372 | $0 | $200,372 |
| 3 | NON-USED & USEFUL COMPONENT | ($193,954) | ($881,535) | ($1,075,489) | $187,475 | ($888,014) |
| 4 | ACCUMULATED DEPRECIATION | ($4,173,672) | ($93,220) | ($4,266,892) | ($23,103) | ($4,289,995) |
| 5 | CIAC | ($12,220,685) | $0 | ($12,220,685) | ($277,199) | ($12,497,884) |
| 6 | AMORTIZATION OF CIAC | $2,942,325 | $0 | $2,942,325 | ($101,637) | $2,840,688 |
| 7 | ADVANCES FOR CONSTRUCTION | ($4,885) | $0 | ($4,885) | $0 | ($4,885) |
| 8 | WORKING CAPITAL ALLOWANCE | $358,144 | $0 | $358,144 | ($64,179) | $293,965 |
| 9 | RATE BASE | $3,607,982 | $819,690 | $4,427,672 | ($978,643) | $3,449,029 |

GULF UTILITY COMPANY
SCHEDULE OF WASTEWATER RATE BASE
TEST YEAR ENDED 12/31/96

SCHEDULE NO. 1-B
DOCKET 960329-WS

| DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENT | ADJUSTED TEST YEAR PER UTILITY | COMMISSION ADJUSTMENT | COMMISSION ADJUSTED TEST YEAR |
|---|---|---|---|---|---|
| 1 UTILITY PLANT IN SERVICE | $14,282,349 | $0 | $14,282,349 | ($2,265) | $14,280,084 |
| 2 LAND | $473,626 | $0 | $473,626 | $0 | $473,626 |
| 3 NON-USED & USEFUL COMPONENT | $0 | $0 | $0 | ($1,145,078) | ($1,145,078) |
| 4 ACCUMULATED DEPRECIATION | ($2,978,837) | $0 | ($2,978,837) | ($21,385) | ($3,000,222) |
| 5 CIAC | ($9,060,383) | $0 | ($9,060,383) | ($474,562) | ($9,534,945) |
| 6 AMORTIZATION OF CIAC | $1,976,074 | $0 | $1,976,074 | ($78,214) | $1,897,860 |
| 8 ADVANCES FOR CONSTRUCTION | $0 | $0 | $0 | $0 | $0 |
| 11 WORKING CAPITAL ALLOWANCE | $235,467 | $0 | $235,467 | ($42,579) | $192,888 |
| RATE BASE | $4,928,296 | $0 | $4,928,296 | ($1,764,083) | $3,164,213 |

**GULF UTILITY COMPANY**
**ADJUSTMENTS TO RATE BASE**
**TEST YEAR ENDED 12/31/96**

**SCHED. NO. 1-C**
**DOCKET 960329-WS**
**PAGE 1 OF 1**

| EXPLANATION | WATER | WASTEWATER |
|---|---|---|
| **PLANT IN SERVICE** | | |
| 1 To remove the projected cost of the reject holding tank | ($700,000) | $0 |
| 2 To correct transposition error to wastewater plant in rate base (Stip #1) | 0 | (2,265) |
| Total | ($700,000) | ($2,265) |
| **NON-USED AND USEFUL** | | |
| To reflect net non-used and useful adjustment | $187,475 | ($1,145,078) |
| **ACCUMULATED DEPRECIATION** | | |
| 1 To remove the projected cost of the reject holding tank | $21,313 | $0 |
| 2 Correct error to test year depreciation rate used | (44,416) | (21,385) |
| Total | ($23,103) | ($21,385) |
| **CIAC** | | |
| 1 CIAC for lines which should have been contributed by Caloosa Group | ($68,114) | ($92,815) |
| 2 Reflect prepaid and/or impute CIAC on the margin reserve | (193,700) | (350,978) |
| 3 Impute CIAC for grant from SFWMD (Stip #15) | (15,385) | (30,769) |
| Total | ($277,199) | ($474,562) |
| **ACCUM. AMORT. OF CIAC** | | |
| 1 CIAC for lines which should have been contributed by Caloosa Group | $10,855 | $14,145 |
| 2 Reflect prepaid CIAC on the margin reserve | 2,737 | 5,861 |
| 3 Impute CIAC for grant from SFWMD (Stip #15) | 142 | 236 |
| 4 To decrease for utility's use of a composite rate on total CIAC amort. | (115,371) | (98,456) |
| Total | ($101,637) | ($78,214) |
| **WORKING CAPITAL** | | |
| To reflect 13-month average adjusted working capital using the balance sheet approach. | ($64,179) | ($42,579) |

**GULF UTILITY COMPANY**
**CAPITAL STRUCTURE**
**TEST YEAR ENDED 12/31/96**

**SCHEDULE NO. 2**
**DOCKET 960329-WS**

| DESCRIPTION | TOTAL CAPITAL | SPECIFIC ADJUSTMENT (EXPLAIN) | PRO RATA ADJUSTMENT | CAPITAL RECONCILED TO RATE BASE | RATIO | COST RATE | WEIGHTE COST |
|---|---|---|---|---|---|---|---|
| **PER UTILITY 1996 - YEAR END** | | | | | | | |
| 1 LONG TERM DEBT | $8,668,424 | $0 | ($1,673,070) | $6,995,354 | 74.77% | 10.63% | 7.95% |
| 2 SHORT-TERM DEBT | $75,360 | $0 | ($14,969) | $60,391 | 0.65% | 11.01% | 0.07% |
| 3 PREFERRED STOCK | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 4 COMMON EQUITY | $1,077,293 | $0 | ($208,021) | $869,272 | 9.29% | 11.88% | 1.10% |
| 5 CUSTOMER DEPOSITS | $205,735 | $0 | $0 | $205,735 | 2.20% | 6.00% | 0.13% |
| 6 DEFERRED INCOME TAXES | $1,517,923 | $0 | ($292,707) | $1,225,216 | 13.10% | 0.00% | 0.00% |
| 7 DEFERRED ITC'S-ZERO COST | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 8 DEFERRED ITC'S-WTD. COST | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 9 OTHER | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 10 TOTAL CAPITAL | $11,544,735 | $0 | ($2,188,767) | $9,355,968 | 100.00% | | 9.25% |
| **PER COMMISSION 1996 - 13-MONTH AVERAGE** | | | | | | | |
| 11 LONG TERM DEBT | $8,668,424 | $0 | ($3,699,499) | $4,968,925 | 75.24% | 10.63% | 8.00% |
| 12 SHORT-TERM DEBT | $75,360 | $0 | ($32,162) | $43,198 | 0.65% | 11.01% | 0.07% |
| 13 PREFERRED STOCK | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 14 COMMON EQUITY | $1,077,293 | ($160,929) | ($391,085) | $525,279 | 7.95% | 11.88% | 0.94% |
| 15 CUSTOMER DEPOSITS | $205,735 | $0 | $0 | $205,735 | 3.12% | 6.00% | 0.19% |
| 16 DEFERRED INCOME TAXES | $1,517,923 | $0 | ($657,280) | $860,643 | 13.03% | 0.00% | 0.00% |
| 17 DEFERRED ITC'S-ZERO COST | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 18 DEFERRED ITC'S-WTD. COST | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 19 OTHER | $0 | $0 | $0 | $0 | 0.00% | 0.00% | 0.00% |
| 17 TOTAL CAPITAL | $11,544,735 | ($160,929) | ($4,770,563) | $6,603,780 | 100.00% | | 9.20% |

Staff Specific Adjustments
A) Reduce equity for lines which should have been contributed by Caloosa.

| | LOW | HIGH |
|---|---|---|
| RETURN ON EQUITY | 10.88% | 12.88% |
| OVERALL RATE OF RETURN | 9.12% | 9.28% |

**GULF UTILITY COMPANY**
**STATEMENT OF WATER OPERATIONS**
**TEST YEAR ENDED 12/31/96**

**SCHEDULE NO. 3-A**
**DOCKET 960329-WS**

| | DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENT | ADJUSTED TEST YEAR PER UTILITY | COMMISSION ADJUSTMENT | COMMISSION ADJUSTED TEST YEAR | REVENUE INCREASE | REVENUE REQUIREMENT |
|---|---|---|---|---|---|---|---|---|
| 1 | OPERATING REVENUES | 2,295,357 | (155,935) | $2,139,422 | $155,935 | $2,295,357 | ($244,337)<br>-10.64% | $2,051,020 |
| | OPERATING EXPENSES: | | | | | | | |
| 2 | OPERATION AND MAINTENANCE | 1,307,395 | 0 | 1,307,395 | (34,995) | 1,272,400 | | 1,272,400 |
| 3 | DEPRECIATION | 165,417 | 0 | 165,417 | 59,268 | 224,685 | | 224,685 |
| 4 | AMORTIZATION | 6,977 | 0 | 6,977 | 0 | 6,977 | | 6,977 |
| 5 | TAXES OTHER THAN INCOME | 227,672 | (7,017) | 220,655 | 255 | 220,910 | (10,995) | 209,915 |
| 6 | INCOME TAXES | 0 | 29,383 | $29,383 | $78,083 | $107,466 | ($87,807) | $19,660 |
| 7 | TOTAL OPERATING EXPENSES | 1,707,461 | 22,366 | $1,729,827 | $102,611 | $1,832,438 | ($98,802) | $1,733,636 |
| 8 | OPERATING INCOME | $587,896 | ($178,301) | $409,595 | $53,324 | $462,919 | ($145,535) | $317,383 |
| 9 | RATE BASE | $3,607,982 | | $4,427,672 | | $3,449,029 | | $3,449,029 |
| 10 | RATE OF RETURN | 16.29% | | 9.25% | | 13.42% | | 9.20% |

**GULF UTILITY COMPANY**
**STATEMENT OF WASTEWATER OPERATIONS**
**TEST YEAR ENDED 12/31/96**

**SCHEDULE NO. 3-B**
**DOCKET 960329-WS**

| | DESCRIPTION | TEST YEAR PER UTILITY | UTILITY ADJUSTMENT | ADJUSTED TEST YEAR PER UTILITY | COMMISSION ADJUSTMENT | COMMISSION ADJUSTED TEST YEAR | REVENUE INCREASE | REVENUE REQUIREMENT |
|---|---|---|---|---|---|---|---|---|
| 1 | OPERATING REVENUES | 1,304,730 | 366,340 | $1,671,070 | ($366,340) | $1,304,730 | $131,210<br>10.06% | $1,435,940 |
| | OPERATING EXPENSES | | | | | | | |
| 2 | OPERATION AND MAINTENANCE | 859,570 | 0 | $859,570 | ($24,673) | $834,897 | | $834,897 |
| 3 | DEPRECIATION | 170,257 | 0 | $170,257 | ($22,223) | $148,034 | | $148,034 |
| 4 | AMORTIZATION | 3,594 | 0 | $3,594 | $0 | $3,594 | | $3,594 |
| 5 | TAXES OTHER THAN INCOME | 132,610 | 16,485 | $149,095 | ($14,795) | $134,300 | $5,904 | $140,204 |
| 6 | INCOME TAXES | 0 | 32,706 | $32,706 | ($61,822) | ($29,116) | $47,152 | $18,036 |
| 7 | TOTAL OPERATING EXPENSES | 1,166,031 | 49,191 | $1,215,222 | ($123,513) | $1,091,709 | $53,057 | $1,144,765 |
| 8 | OPERATING INCOME | $138,699 | $317,149 | $455,848 | ($242,827) | $213,021 | $78,153 | $291,174 |
| 9 | RATE BASE | $4,928,296 | | $4,928,296 | | $3,164,213 | | $3,164,213 |
| 10 | RATE OF RETURN | 2.81% | | 9.25% | | 6.73% | | 9.20% |

GULF UTILITY COMPANY
ADJUSTMENTS TO OPERATING INCOME
TEST YEAR ENDED 12/31/96

SCHED. NO. 3-C
DOCKET 960329-WS
PAGE 1 OF 1

| | EXPLANATION | WATER | WASTEWATER |
|---|---|---|---|
| | **OPERATING REVENUES** | | |
| | Remove requested final revenue increase/(decrease) | $155,935 | ($366,340) |
| | **OPERATION & MAINTENANCE EXPENSE** | | |
| 1 | Reallocate salaries to Caloosa Group | ($5,905) | ($3,042) |
| 2 | To reduce salary increase to 5%. | (4,895) | (2,521) |
| 3 | To reallocate common maint. expenses for lease to Caloosa Group | (2,376) | (1,224) |
| 4 | Reallocate additional A&G, vehicle, computer, etc. to Caloosa Group | (6,096) | (3,140) |
| 5 | To remove projection for unanticipated expenses | (3,300) | (1,700) |
| 6 | Correct 5-year amortization of San Carlos water line project | (2,264) | 0 |
| 7 | To amortize costs associated with customer survey | (5,145) | (2,650) |
| 8 | To reduce president's meals and entertainment costs | (1,072) | (553) |
| 9 | To reflect adjusted rate case expense amortization | 16,091 | 8,289 |
| 10 | To remove lobbying expenses (Stip #4) | (523) | (269) |
| 11 | To remove Rotary dues (Stip #6) | (155) | (80) |
| 12 | To remove pond cleaning expenses (Stip #7) | 0 | (8,000) |
| 13 | Add consulting expenses to rate case expense (Stip #8) | (4,205) | (1,979) |
| 14 | To reduce vice president's salary | (15,150) | (7,804) |
| | Total | ($34,995) | ($24,673) |
| | **DEPRECIATION EXPENSE-NET** | | |
| 1 | To correct test year depreciation expense | $78,338 | $42,770 |
| 2 | To adjust for non-used and useful depreciation expense | 1,620 | (57,608) |
| 3 | CIAC for lines which should have been contributed by Caloosa Group | (2,106) | (2,755) |
| 4 | Reflect prepaid CIAC on the margin reserve | (5,475) | (11,723) |
| 5 | Impute CIAC for grant from SFWMD (Stip #15) | (142) | (236) |
| 6 | To adjust ty amort. exp. for use of composite rates for CIAC amort. | (12,967) | 7,329 |
| | Total | $59,268 | ($22,223) |
| | **TAXES OTHER THAN INCOME** | | |
| 1 | RAFs on revenue adjustments above | $7,017 | ($18,465) |
| 2 | Reallocate payroll taxes | (6,047) | 2,741 |
| 3 | Correct test year regulatory assessment fees | (715) | (1,051) |
| | Total | $255 | ($14,795) |
| | **INCOME TAXES** | | |
| | To adjust to test year income tax expense | $76,083 | ($61,822) |

UTILITY: GULF UTILITY COMPANY
COUNTY: LEE COUNTY DIVISION
DOCKET NO. 960329-WS

Schedule 4A

WATER RATE SCHEDULE

Monthly Rates

| RESIDENTIAL, MULTI-FAMILY, & GENERAL SERVICE | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge | | | | |
| 5/8"x3/4" | $8.45 | $7.88 | $7.88 | $7.77 |
| 3/4" | $12.68 | $11.82 | $11.82 | $11.66 |
| 1" | $21.13 | $19.70 | $19.70 | $19.43 |
| 1-1/2" | $42.26 | $39.38 | $39.38 | $38.85 |
| 2" | $67.61 | $63.02 | $63.02 | $62.16 |
| 3" | $135.21 | $126.03 | $126.03 | $124.32 |
| 4" | $211.27 | $196.92 | $196.92 | $194.25 |
| 6" | $422.54 | $393.85 | $393.85 | $388.50 |
| Gallonage Charge, per 1,000 gallons | $2.16 | $2.01 | $2.01 | $1.93 |

| IRRIGATION & PUBLIC AUTHORITY | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge: | | | | |
| 5/8"x3/4" | $8.45 | $7.88 | $7.88 | $7.77 |
| 1" | $21.13 | $19.70 | $19.70 | $19.43 |
| 1-1/2" | $42.25 | $39.38 | $39.38 | $38.85 |
| 2" | $67.61 | $63.02 | $63.02 | $62.16 |
| 3" | $135.21 | $126.03 | $126.03 | $124.32 |
| 4" | $211.27 | $196.92 | $196.92 | $194.25 |
| Gallonage Charge, per 1,000 gallons | $2.16 | $2.01 | $2.01 | $1.93 |

| PRIVATE FIRE PROTECTION | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge: | | | | |
| 1" | $7.04 | $6.56 | $6.56 | $1.62 |
| 1-1/2" | $14.08 | $13.12 | $13.12 | $3.24 |
| 2" | $22.54 | $21.01 | $21.01 | $5.18 |
| 3" | $45.07 | $42.01 | $42.01 | $10.36 |
| 4" | $70.42 | $69.37 | $69.37 | $16.19 |
| 6" | $140.85 | $131.29 | $131.29 | $32.38 |
| 8" | $225.35 | $210.05 | $210.05 | $51.80 |
| 12" | $605.64 | $564.52 | $564.52 | $139.21 |

| TYPICAL MONTHLY BILL COMPARISONS | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| - Residential Usage (gallons) - | | | | |
| 3,000 | $14.93 | $13.91 | $13.91 | $13.56 |
| 5,000 | $19.25 | $17.93 | $17.93 | $17.42 |
| 10,000 | $30.05 | $27.98 | $27.98 | $27.07 |

UTILITY: GULF UTILITY COMPANY
COUNTY: LEE COUNTY DIVISION
DOCKET NO. 960329-WS

Schedule 4B

**WASTEWATER RATE SCHEDULE**

**Monthly Rates**

| RESIDENTIAL | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge | | | | |
| All Meter Sizes | $14.48 | $16.73 | $16.48 | $16.00 |
| Residential Gallonage Charge, per 1,000 gallons | $3.07 | $3.55 | $4.23 | $3.37 |
| Wastewater Gallonage Cap - 10,000 gallons | | | | |

| GENERAL SERVICE, MULTI-FAMILY, & PUBLIC AUTHORITY | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge: | | | | |
| 5/8"x3/4" | $14.48 | $16.73 | $16.48 | $16.00 |
| 1" | $36.20 | $41.82 | $41.19 | $40.01 |
| 1-1/2" | $72.39 | $83.62 | $82.37 | $80.02 |
| 2" | $115.85 | $133.83 | $131.81 | $128.03 |
| 3" | $231.68 | $267.64 | $263.61 | $256.05 |
| 4" | $362.01 | $418.19 | $411.89 | $400.08 |
| 6" | $724.01 | $836.39 | $823.78 | $800.17 |
| Gallonage Charge, per 1,000 gallons (No Maximum) | $3.68 | $4.25 | $5.08 | $4.05 |

| MASTER METER INFLUENT SERVICE | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| Base Facility Charge: | | | | |
| 5/8"x3/4" | $14.48 | $16.73 | $16.48 | $16.00 |
| 1" | $36.20 | $41.82 | $41.19 | $40.01 |
| 1-1/2" | $72.39 | $83.62 | $82.37 | $80.02 |
| 2" | $115.85 | $133.83 | $131.81 | $128.03 |
| 3" | $231.68 | $267.64 | $263.61 | $256.05 |
| 4" | $362.01 | $418.19 | $411.89 | $400.08 |
| 6" | $724.01 | $836.39 | $823.78 | $800.17 |
| Gallonage Charge, per 1,000 gallons (No Maximum) | $3.84 | $4.25 | $5.29 | $4.21 |

| TYPICAL MONTHLY BILL COMPARISONS | Rates Prior to Filing | Commission Approved Interim | Utility Requested Final Rates | Commission Approved Final Rates |
|---|---|---|---|---|
| - Residential Usage (gallons) - | | | | |
| 3,000 | $23.69 | $27.38 | $29.17 | $26.11 |
| 5,000 | $29.83 | $34.48 | $37.63 | $32.85 |
| 10,000 | $45.18 | $52.23 | $58.78 | $49.70 |

UTILITY: GULF UTILITY COMPANY
COUNTY: LEE COUNTY DIVISION
DOCKET NO. 960329-WS

Schedule 6A
Water

**Schedule of Rate Decrease After Expiration of Amortization Period for Rate Case Expense**

| RESIDENTIAL, MULTI-FAMILY, & GENERAL SERVICE | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge | | |
| 5/8"x3/4" | $7.77 | $0.19 |
| 3/4" | $11.66 | $0.30 |
| 1" | $19.43 | $0.49 |
| 1-1/2" | $38.85 | $0.97 |
| 2" | $62.16 | $1.55 |
| 3" | $124.32 | $3.09 |
| 4" | $194.25 | $4.83 |
| 6" | $388.50 | $9.67 |
| Gallonage Charge, per 1,000 gallons | $1.93 | $0.03 |

| IRRIGATION & PUBLIC AUTHORITY | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge: | | |
| 5/8"x3/4" | $7.77 | $0.19 |
| 1" | $19.43 | $0.49 |
| 1-1/2" | $38.85 | $0.97 |
| 2" | $62.16 | $1.55 |
| 3" | $124.32 | $3.09 |
| 4" | $194.25 | $4.83 |
| Gallonage Charge, per 1,000 gallons | $1.93 | $0.03 |

| PRIVATE FIRE PROTECTION | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge: | | |
| 1" | $1.62 | $0.04 |
| 1-1/2" | $3.24 | $0.08 |
| 2" | $5.18 | $0.13 |
| 3" | $10.36 | $0.26 |
| 4" | $16.19 | $0.40 |
| 6" | $32.38 | $0.81 |
| 8" | $51.80 | $1.29 |
| 12" | $139.21 | $3.40 |

UTILITY: GULF UTILITY COMPANY
COUNTY: LEE COUNTY DIVISION
DOCKET NO. 960329-WS

Schedule 5B
Wastewater

**Schedule of Rate Decrease After Expiration of Amortization Period for Rate Case Expense**

| RESIDENTIAL | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge | | |
| All Meter Sizes | $16.00 | $0.24 |
| Residential Gallonage Charge, per 1,000 gallons | $3.37 | $0.04 |
| Wastewater Gallonage Cap - 10,000 gallons | | |

| GENERAL SERVICE, MULTI-FAMILY, & PUBLIC AUTHORITY | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge: | | |
| 5/8"x3/4" | $16.00 | $0.24 |
| 1" | $40.01 | $0.61 |
| 1-1/2" | $80.02 | $1.22 |
| 2" | $128.03 | $1.95 |
| 3" | $256.05 | $3.89 |
| 4" | $400.08 | $6.09 |
| 6" | $800.17 | $12.18 |
| Gallonage Charge, per 1,000 gallons (No Maximum) | $4.05 | $0.05 |

| MASTER METER INFLUENT SERVICE | Commission Approved Final Rates | Commission Approved Decrease |
|---|---|---|
| Base Facility Charge: | | |
| 5/8"x3/4" | $16.00 | $0.24 |
| 1" | $40.01 | $0.61 |
| 1-1/2" | $80.02 | $1.22 |
| 2" | $128.03 | $1.95 |
| 3" | $256.05 | $3.89 |
| 4" | $400.08 | $6.09 |
| 6" | $800.17 | $12.18 |
| Gallonage Charge, per 1,000 gallons (No Maximum) | $4.21 | $0.05 |