ORIGINAL

FLORIDA CITIES WATER COMPANY

FT. MYERS & BAREFOOT BAY DIVISIONS

WATER AND WASTEWATER OPERATIONS

REBUTTAL TESTIMONY OF GARY BAISE

TO

DIRECT TESTIMONY

OF

Hugh Larkin, Jr. and Patricia W. Merchant

DOCKET NO. 971663-WS

Q: Please state your name and business address.

A: Gary H. Baise, Baise, Miller & Freer, P.C., 815 Connecticut Avenue, N.W., Suite 620, Washington, D.C. 20006-4004.

Q: By whom are you employed and in what capacity?

A: I am a partner in the law firm of Baise, Miller & Freer, P.C.

Q. Have you filed testimony in this case?

A. Yes. I filed direct testimony in this case.

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this testimony is to refute certain positions of OPC witness Hugh Larkin, Jr. and Patricia W. Merchant, PSC witness.

Q. On page 4, line 22 of his testimony, Mr. Larkin is discussing his position that legal costs should not be recovered from rate payers, testifying as follows:

"The reasoning underlying this basic principle is that management must be held responsible for its actions. It must follow those laws regardless of their conclusion as to the fairness or economic reasonableness of the requirements of the law. If regulation allowed the recovery of fines and penalties and/or any related costs from ratepayers, clearly, management and stockholders would be shielded from the affects of their actions. They could operate with impunity knowing that as a general principle they could recover any penalty or fine and related costs from ratepayers. Clearly, in a competitive environment they would not recover such costs. To the extent that the Commission shifts the costs of the violations - whether penalty or legal fees incurred in litigation over penalties - from the Company to the ratepayers, it holds the Company harmless from such violations frustrates the purpose of the Clean Water Act." Is Mr. Larkin correct, please explain?

A. Mr. Larkin concludes that if FCWC can shift the cost of violations in terms of legal fees to the rate payers, that holds the company harmless from such violation, which frustrates the purpose of the Clean Water Act. The amount of attorneys' fees would not be admissible as evidence in a CWA enforcement action;

Accordingly, the Court would have no authority to consider legal costs. The CWA does not address the issue of whether penalties or legal fees are to be paid by shareholders or ratepayers. Therefore, under the CWA there is no basis to support Mr. Larkin's policy argument that the purpose of the CWA is frustrated by shifting legal fees to ratepayers. It is apparent that Mr. Larkin does not understand the framework of the Clean Water Act (CWA) nor has he studied the many court cases involving the CWA. At $25,000 per day per violation and criminal sanctions of many years imprisonment, violators of the CWA are subject to some of the most severe civil and criminal penalties imposed by federal environmental laws. Clearly, violations of the CWA can result in the financial ruin of companies and individuals and the imprisonment of a company's officers and employees. Generally, in civil cases such as that brought against FCWC under the CWA, the legal expenses are very small compared to the potential liability associated with the allegations. To conclude, as Mr. Larkin apparently has, that the prospect of recovery of legal expenses associated with the defense of allegations of violations of the CWA represents a disincentive to comply is without basis and is not consistent with the

history of enforcement of the CWA. Until the Court ruled in this case there was never any consideration on my part that FCWC would be in a position to seek recovery of its legal fees in its rates.

Q. On page 5 of his testimony, starting with the answer on line 15 - Mr. Larkin says "... that neither the EPA, DOJ or the federal Judge was ever aware that the company might shift the expenses of litigation to its customers" Mr. Larkin then quotes from the deposition transcript of FCWC President, Mr. Allen, dated November 13, 1995. He concludes his answer on page 7, lines four through twelve are as follows: "Thus, Mr. Allen indicated that FCWC's seeking to include expenses associated with this litigation was "highly unlikely." While Mr. Allen hastened to add that he was no expert regarding whether the expenses could be recovered through the rate making process, the matter was apparently not raised again. It is reasonable to conclude that the DOJ and the federal Judge were under the reasonable impression that the violator - FCWC - like any other violator - would be liable for whatever penalty and expenses arose from this litigation. It is also reasonable to assume that the Court and the DOJ were aware that the Company was incurring substantial litigation expenses, and that its ability

to pay any penalty would be lessened to that extent." Would you please respond to Mr. Larkin's answer?

A. Mr. Larkin is simply incorrect and apparently has not thoroughly reviewed the record nor does he understand the provision of the CWA which sets forth the factors courts are to consider in assessing penalties. First, at deposition, neither Mr. Gerald Allen, FCWC's President nor Mr. Bradtmiller, FCWC's Executive Vice President, ruled out the prospect of attempting to recover legal expenses through rates. Second, if the department of Justice had wanted to bring this matter to the Court's attention it could have done so through its direct examination of Mr. Gerald Allen, but it did not choose to do so or through testimony presented by any other FCWC witness. Third, the matter of how FCWC proposed to recover part or all of the legal expenses associated with its defense (even if it knew at the time) was not a matter included in the six factors which the CWA specifies for consideration by courts in assessing penalties. Therefore, the matter was not relevant to the Court's deliberations or findings in FCWC's case.

Q. Mr. Larkin's answer starting on line 18, page 12 and ending on line 18, page 13 sets forth his understanding of environmental law and regulation by

the EPA and DEP. Is his understanding correct? Please explain.

A. Mr. Larkin indicates that it is his "understanding" that neither the DEP nor EPA orders companies to add large system improvements. Again, Mr. Larkin is incorrect. The agencies take an active role in regulating wastewater treatment works. The CWA gives the EPA ample authority to specify remedial action and it often does so in the form of consent orders and permit conditions. It is true the company may decide what type of equipment or what brand of equipment to put into place but the fact is the requirement is such that EPA or DEP is ordering the company through the permit and the administrative order process to install the improvements. An example is EPA Administrative Order No. 89-109 and NPDES certification worksheet ((see Exhibit ____ (MA-9) and Exhibit _____ (MA-7)) which directed FCWC to construct the treatment and other facilities necessary to relocate the effluent outfall and meet specific water quality standards. In addition, EPA has a tool that may order companies to construct supplemental environmental projects in order not to be subjected to additional fines. Therefore it is not accurate to suggest that all EPA does is to determine whether the company is or is not in

compliance with the law.

The CWA is a complex law subject to multiple interpretations and to conclude, as Mr. Larkin has, that it is a simple matter of the regulatory agency finding "the utility is or is not in compliance with the requirements of the law" is an oversimplification. It is indeed true that the agencies may allege that a company is in violation of the law and penalties therefor. It is up to courts to determine indeed whether there is a violation of the law. In many cases there may be a "technical" violation of the law and the courts may find penalties as low as $1 a day or slightly more as in the case of FCWC where many of the fines were only $10 a day compared to the agency's ability to charge or attempt to obtain $25,000 a day.

Mr. Larkin implies that the company's own engineers can work out any differences regarding compliance. FCWC pursued such course. With respect to all three wastewater facilities for which the DOJ ultimately alleged violations, the first step FCWC took was to have its engineers engage the DEP and EPA in an effort to assure that these facilities were in compliance and if not in compliance, to take the action necessary to bring them into compliance. In fact, all issues pertaining to both Barefoot Bay and

Carrollwood were satisfactorily resolved with both the EPA and DEP and the issues pertaining to Waterway Estates were satisfactorily resolved with the DEP, prior to the DOJ's allegations. It was not until the EPA wanted to pursue the Waterway Estates issue, notwithstanding the DEP's satisfaction with FCWC's action and the outcomes, and referred the matter to the DOJ was any appreciable legal work necessary. Furthermore, the amount of legal work necessary was increased substantially when the DOJ initiated an investigation of all of FCWC's wastewater facilities and finally amended its complaint in March 1995 to include the Carrollwood and Barefoot Bay facilities.

Q. Beginning at line 21, page 13 and ending at line 19, page 14, Mr. Larkin purports to explain certain aspects of the litigation and the Court's findings and the penalties imposed. Are his characterizations complete and accurate?

A. No. First, Mr. Larkin does not discuss the Original and Amended Complaints, the numerous motions and rulings of the Court prior to trial, the factors considered by the Court, and the penalties imposed relative to the penalties claimed by the DOJ at various stages of the proceedings leading up to the trial. Through these omissions Mr. Larkin brings into

focus only a few small parts of the total picture, including the following:

(1) In its original complaint, the DOJ was claiming penalties to $32,375,000 later amended claiming penalties to $104,325,000. After pre-trial rulings by the Court throwing out almost half of the alleged violations, the DOJ claimed penalties during the first day of trial to $53,450,000. These rulings were in response to motions filed by FCWC. In its post-trial memorandum, the DOJ proposed penalties in the amount of $4,861,500 for FCWC and a similar amount for Avatar. In its final ruling, the Court found penalties in the amount of $309,710. To put all of these claims into perspective, the penalties imposed by the Court were less than one percent of the maximum amount claimed under the Original Complaint, less than one-half percent of the maximum amount claimed under the Amended Complaint, slightly over one-half percent of the maximum amount claimed at the beginning of the trial and 6.37% of the penalty amount suggested in the DOJ's post-trial memorandum.

(2) It is virtually impossible to avoid a liability determination under the Clean Water Act inasmuch as it is called a strict liability statute. Therefore, every exceedance of a CWA permit is a violation. An

example would be any time you are running 56 mph in a 55 mph speed limit zone you are in violation of the law and should therefore be technically fined. If you're running more than 20 mph over a 55 mph speed limit, you may even be charged with reckless driving. The fact is, both policy and courts exercise a great deal of discretion. The same is true with the Clean Water Act. It was clear in this case that the Court found that even though there were technical violations, the mitigating factors set forth in the Clean Water Act (including the fact that none of the violations had resulted in environmental harm) were applied fully supported the conclusion that the penalty should be minuscule.

Q. Beginning on page 15 and concluding on page 16, line 4, Mr. Larkin sets forth his interpretation of the nature of the DOJ prosecution and FCWC's demand of recovery of legal costs from the government. Do you agree with Mr. Larkin's interpretation? Please explain.

A. No. First, regarding the nature of the DOJ prosecution, I firmly believe that anyone who thoroughly studies the record in this case will conclude that the prosecution was without merit. This conclusion is based on my twenty-eight years

experience as a practicing attorney in the area of federal environmental law. In fact, I believe the case would have been settled before the trial and before significant legals costs had been sustained by FCWC had proper supervision been afforded by a person with sufficient experience in the CWA.

Second, notwithstanding the Court's ruling regarding recovery of legal expenses by FCWC from the DOJ, it is appropriate to review the Court's Order (Exhibit ____ (GHB-101)). The "bad faith" standard is extremely confining. To prevail, it must be shown that the government undertook the litigation "vexatiously, wantonly, or for oppressive reasons." The fact that the government's action was unreasonable, without merit, or unwise is not in itself adequate to demonstrate bad faith as defined by the law. It is implicit in the Court's language in its ruling against FCWC regarding FCWC's contention that it was a "prevailing party" that the Court agreed with FCWC from a fundamental perspective but was bound by case law. The Court said, "[T]he United States contends that since a judgement was returned in its favor on its claims against the Defendant Florida Cities, [that] Florida Cities is hereby precluded from being a Sec. 2412(a) `prevailing party'. The Court

agrees with Plaintiff's analysis and, grudgingly (emphasis added), with its conclusion." See page 11, Exhibit ____ (GHB-101). Another noteworthy conclusion of the Court can be found on pages 12 and 13 of this exhibit, "[W]hile the history and purpose of Rule 68 and 28 U.S.C. Sec. 2412(a) militate strongly for an award of costs to Florida Cities, the Procrustean doctrine of sovereign immunity precludes such." It is my opinion that the relationship between the penalties sought by the DOJ and those imposed by the Court (cited above) when combined with the Court's language in its order pertaining to the recovery of costs by FCWC clearly supports the proposition that many of the DOJ's actions in this case were without merit.

Q. Beginning at line 3, page 10, of the prefiled testimony of Patricia W. Merchant, she states that "[A]ny allowed costs should only be recovered from the North Ft. Myers, Barefoot Bay and Carrollwood customers." Were the legal efforts, and accordingly legal expenses, associated with FCWC's defense limited to these wastewater systems?

A. No. Following the filing of the Original Complaint, the DOJ launched an investigation of all of FCWC's wastewater systems and considerable effort was devoted during the period beginning in early 1994 and the

filing of the Amended Complaint on March 30,1995 to this investigation and the discovery associated therewith. FCWC's wastewater systems are located in Collier, Lee, Brevard, Sarasota and Hillsborough Counties.

Q. Does this conclude your testimony?

A. Yes.