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February 12, 2002
VIA HAND DELIVERY

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Blanca S. Bayo, Director
Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Aloha Utilities, Inc.; PSC Docket No. 010503-WU
Our File No. 26038.35

Dear Ms. Bayo:

Attached in accordance with the requirements of the Commission's Prehearing Order, Prehearing Procedure Order, and updates to each, as well as the Commission's direction at hearing and the subsequent extension of time granted by Order No. PSC-02-0171-PCO-WU, are the Post-Hearing Statement of Issues and Positions and Brief to be filed on behalf of Aloha Utilities, Inc. in the above-referenced matter. I am enclosing 15 copies of each for distribution.

If you have any questions in this regard, please let me know.

Sincerely,

ROSE, SUNDSTROM & BENTLEY

F. Marshall Deterding
For The Firm

FMD/tms

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cc: Ralph Jaeger, Esq.
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Enclosures
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BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION
DOCKET NO. 010503-WU

POST-HEARING MEMORANDUM FILED ON BEHALF OF ALOHA UTILITIES, INC.

F. Marshall Deterding, Esquire
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INTRODUCTION AND BACKGROUND

In accordance with Public Service Commission (the "PSC" or "Commission") practice, Aloha Utilities, Inc. ("Aloha" or "Utility") hereby submits a detailed Post-Hearing Memorandum in response to each of the enumerated issues posed in Commission Order No. PSC-02-0016-PHO-WU.

On January 9-11, 2002, in New Port Richey, Florida, Commissioners Lila Jaber, Braulio Baez, and Michael Palecki heard testimony and received exhibits in the Application for an Increase in Water Rates in Pasco County which was filed by Aloha in Docket No. 010503-WU. The case was opened as a result of Aloha's Application for Water Rate Increase filed on August 10, 2001. The primary basis for Aloha's filing was the fact that the water demand from Aloha's existing customers exceeds, on an aggregate basis, the limitations placed upon Aloha by its Water Use Permit. Therefore, it will be necessary for Aloha to purchase water from Pasco County in order to meet those demands. The water which Aloha must purchase from Pasco County under this circumstance is currently available but is also very expensive.

An important issue in this proceeding is how much water Aloha's customers will demand during the period of time the rates requested will be in effect. Aloha's service area has been undergoing (and continues to undergo) a demographic shift by which the newer customers place a demand upon the system which far exceeds that of the historic "average" Aloha customer. The evidence in this proceeding clearly demonstrated that not only are new customers connecting to Aloha's system at a very rapid pace, but also that none of those customers will be the type of customer who connected to the system prior to ten years ago. Nor will any of those customers resemble the historic "average" Aloha customer. These customers are moving into successful high-end developments which are selling expensive homes to high income buyers who have families and whose water usage will be approximately 500 gallons per day (in stark contrast to Aloha's "older" connections or to the historic "average" customer in Aloha's system). This issue is extremely important because if the demand upon the system is underestimated or understated, Aloha will be buying water at a marginal cost above the marginal revenue to be received from its customers. As such, Aloha would not only not be able to meet its authorized rate of return, it would begin losing money very quickly if that circumstance occurred.

Also, of great concern and interest to the Commission, the Utility, and the other parties in this proceeding, is the quality of water service received by Aloha's customers. There has continuously

been much discussion over a seven-year period about the quality of the water provided by Aloha. After an unprecedented investigation in Commission Docket No. 960545-WS, which spanned more than five years, all of the evidence clearly demonstrates, and the Commission has found, that the water provided by Aloha is in conformance with all applicable standards. In this proceeding, not only were the same findings offered by all of the experts in the area, but additionally, the Utility provided detailed responses to the approximately 30 customers who testified at hearing demonstrating that the water continues to meet all standards and is clean and clear at the point-of-delivery, with no significant odors (Exhibit 37). The evidence also clearly demonstrates that the Utility is providing good customer service. While Mr. Durbin of the Commission staff provided testimony concerning the level of complaints filed against Aloha, it is clear from that evidence that the statistics contained in his testimony are at best inconclusive, if not downright misleading, because of the failure to compare the Utility to utilities in similar situations, or to recognize the effect that the ongoing processing of two rate case filings and the water quality investigation have had on the complaint levels. The Commission's own records clearly indicate that the Utility had properly handled more than 99% of the complaints filed over the last 34 months, and that the Utility has satisfactorily corrected those two cases where it was found to be in error. Based upon all of the facts presented into evidence, both the quality of the water and the quality of the customer service provided by the Utility, is at a minimum satisfactory, if not very good. The Commission's own management audit conclusions, undertaken for the purpose of investigating this issue, reached a similar conclusion.

It is not the position of any party or witness (other than Mr. Larkin's unsupported and illegal proposal) that Aloha has not shown its entitlement to a rate increase in some form or fashion. Aloha demonstrated, through the exhibits and testimony in this case, that it has no alternative other than to begin to purchase water from Pasco County to the extent water demand exceeds Aloha's Water Use Permit allocations. Aloha has also clearly demonstrated that its proposed costs and expenses, which are at issue in this proceeding, are prudent and reasonable and that no adjustment to those costs and expenses, other than adjustment for which Aloha, the Staff, and OPC have previously agreed upon, are appropriate in this proceeding.

Additional issues in this proceeding include the structure of Aloha's proposed rates, any repression of consumption that is likely to occur in this case; and how conservation programs which Aloha proposes to implement should be funded. Aloha's proposed, two-tier block rate structure is

the appropriate rate structure to implement in this case. This is the rate structure which the Southwest Florida Water Management District ("SWFWMD") ordered Aloha to implement and is also the structure which Aloha believes will achieve the best conservation results. Additionally, the evidence has demonstrated that Staff's proposed base facility charge for Aloha places the Utility unnecessarily at risk by shifting, contrary to Commission rule and policy, a substantial portion of Aloha's fixed costs into the gallonage charges. Allocation of fixed costs and variable costs between Aloha's base facility charge and gallonage rate should be in accordance with Aloha's testimony and traditional Commission practice. With regard to the implementation of conservation programs, the evidence was clear that such programs cost money, that they can only be implemented when they are fully funded, and that the SWFWMD supports funding the programs agreed to for Aloha as reflected in Exhibit SGW-2 of Exhibit 29 and Exhibit 36 through appropriate rates. To depend on the programs to "pay for themselves" at some unknown future date is counterproductive and contrary to the facts presented concerning the years each will take to be fully implemented and achieve the desired reduction in consumption; and contrary to the sound public policy that is promoted by the implementation of programs designed to decrease pressure upon water resources in that area of the State in which Aloha is situated, which is a Water Use Caution Area as designated by the SWFWMD. Finally, Aloha and the Staff appear to agree that the Water Rate Model, created by Dr. Whitcomb for the SWFWMD, is the appropriate tool to use to calculate repression of consumption in this case.

Finally, the issue of the royalty paid to a related party has been raised by the staff in this proceeding, for the first time since the Utility began that method of obtaining water more than 25 years ago. Not only has the Commission previously approved that arrangement in rate setting more than 20 years ago for an unrelated third party, but on at least two occasions in the recent years, the Commission staff has reviewed that issue, issued discovery and audit reports discussing that issue, and declined to make any adjustment. As such, any proposal to reevaluate the original basis for such an arrangement is unreasonable and plainly contrary to the facts which led to the conclusion that the royalty arrangement was the best alternative available to the Utility at the time it entered into the agreements.

In addition, Aloha has clearly demonstrated that the royalty paid is below the market value for the only other water sources available to it. In fact, Aloha's related party has agreed to provide treated water to the Utility at a price slightly below that offered by Pasco County, the only other

source of water available to the Utility, as was admitted by all persons testifying on the subject. The issue is not what level of payment the Commission should approve, but rather whether the Commission intends to approve the contract as entered into many years ago between the related parties, as it has previously in at least two rate investigations, or to require the Utility to begin purchasing all water from Pasco County, if the contract terms are violated by a Commission requirement to pay less than the contract price.

In addition to the above-referenced issues, more fully discussed in the body of this Memorandum, all of the issues tried in this proceeding as outlined in the Prehearing Order are specifically addressed herein and in accordance with the Commission's standard procedure.

DISCUSSION OF ISSUES

ISSUE 1

Is the quality of service provided by the Utility satisfactory?

All of the expert witnesses who testified on the issues of quality of service agreed that the Utility is meeting all applicable environmental standards with regard to the quality of water provided. Mr. Durbin testified on behalf of the Commission staff concerning the frequency of complaints and the disposition of customer complaints and contacts by Aloha's customers. In response to cross-examination, Mr. Durbin's testimony clearly shows that the level of Aloha customer complaints received by the Commission over the past two years, are related primarily to the two rate cases that the Utility has undergone during that period of time. While Mr. Durbin's testimony is inconclusive about the complaint level of Aloha's customers as compared to the other selected utilities, because of various major factors not considered, it is clear that the Commission's own management audit staff charged with investigating management practices with relation to customer service and complaints, clearly indicates that the great majority of Aloha's customers are satisfied with the quality of service provided by the Utility. Based upon the clear evidence of record, Aloha is providing good quality of service to its customers and is striving each day to improve that service in several areas rated by Mr. Watford.

The quality of service issue and the witnesses testifying on the subject can best be broken into two separate parts: i) Quality of water provided and ii) Customer service. These will each be addressed separately below:

Quality of Water

Both Department of Environmental Protection ("DEP") witnesses clearly indicated that the Utility is in compliance with all regulatory standards administered by the DEP and EPA (TR 226 and TR 386). No expert witnesses testified to the contrary, or provided any suggestion that the quality of the water product provided by the Utility is anything less than in full compliance with the regulatory standards.

While several customers testified about concerns with the water quality, those represent less than 1/10th of 1% of the customers served by the Utility.

Representatives of Aloha visited each of the customers who registered complaints of water quality at hearing and who would allow such a visit, shortly after the hearing. The great majority of

such customers were visited. In each case, the Utility representative found the water at the point-of-delivery to be clean and clear, with no odor. This is clearly borne out by the photographs and other information in Exhibit 37. In those cases where the complaint had included concerns about discolored water in the home, the Utility representative took samples of the water inside the home as well, and found the water in all cases to be clean, clear, and odor free.

While the Utility is well aware that a small percentage of its customers have experienced a discoloration of water and expressed concerns with water quality, the DEP approved the Utility's corrosion control program 7 years ago, and that program has been deemed optimized by DEP for more than 2 years. Primarily as a result of this water issue, the Utility has been investigating alternatives available that may be able to further assist with this problem. This Commission has thoroughly investigated the quality of the water provided in Docket No. 960545-WS and found that water to be in full compliance with all regulatory standards in the Final Order No. PSC-00-1285-FOF-WS, issued in that proceeding. No evidence to the contrary has been presented in this case. As noted by Mr. Watford, the Utility will continue to review its options in hopes of finding additional technologies and procedures (other than those that have already been proposed and thoroughly discussed in prior dockets), to assist with resolving these concerns. The Utility is currently involved in a pilot study undertaken at the Commission's direction for the expressed purpose of exploring options for improving water quality in the future.

In all, the evidence clearly demonstrates that the Utility is in compliance with all environmental standards concerning water quality, and an inspection of water at each of the complaining customer's homes, clearly demonstrates that the water at the point-of-delivery is clean and clear with no odor.

Customer Service

Mr. Durbin and Mr. Watford testified concerning issues of customer service. The Utility also provided Late-Filed Exhibit No. 37, which dealt in part with water quality and in part with the customer service issues. In addition, the Commission's own management audit found a high level of customer satisfaction with the service provided by Aloha.

Mr. Durbin suggested that the number of complaints filed with the Commission related to Aloha was higher on an average per thousand customer basis than any of the ten other utilities compared. However, upon further questioning, Mr. Durbin admitted that:

1. Aloha has been involved in two rate cases and a water quality investigation during the entire period of time reviewed, and that he did not know if any of the other utilities were involved in any investigations or rate cases, much less three during the period of time analyzed (TR 928-TR 930).
2. He agreed that during the pendency of rate cases, customers are much more likely to complain to the Commission and that in fact, the customers have been encouraged to complain about Aloha in at least four separate written notices issued during the period of time covered by his analysis (TR 928-TR 931).
3. He admitted that the two rate cases and the longstanding water quality investigation that was also ongoing during the period of time analyzed, resulted in substantial media coverage and that from his experience, such coverage results in an increase in customer complaints (TR 932).
4. Mr. Durbin also agreed that generally during the pendency of a rate proceeding, complaints are increased. He agreed that his exhibits clearly showed that the complaints filed against Aloha substantially increased with the beginning of the Utility's sewer rate case, approximately 1 3/4 years ago. But for inclusion of the months during which the two rate cases processed for Aloha during 2000 and 2001, the average number of complaints per water customer shown on Schedules JRD-2 and JRD-3 of Exhibit 13, is approximately equal to the average of the other companies listed on JRD-3.
5. Mr. Durbin had done no analysis of an industry wide average for the number of complaints filed per thousand customers, to determine whether the averages calculated for Aloha were at or below the norm for the industry (TR 926).
6. Mr. Durbin agreed that to the extent a customer filed a water quality complaint while also complaining about a rate increase, there is no indication in the records of the Commission that his complaint was initiated because of a request for increased rates (TR 924).

7. Mr. Durbin made no attempt to break out complaints between those related to water and those related to wastewater, and those tabulated could have been all related to wastewater for all he knew (TR 926-TR 927).
8. Mr. Durbin admitted he made no attempt to segregate complaints between the Seven Springs system, which is the subject of this case, and the Aloha Gardens system, which is not covered by this case (TR 927).
9. Mr. Durbin agreed that in only 1% of the complaints (2 total complaints over the 34-month period covered) did the Commission find any violation of rule or tariff on the Utility's part (TR 920-TR 921). This is less than one justified complaint per year against Aloha. Mr. Watford noted that the Utility provided benefits above and beyond those required in compensation for the errors in both of those cases (TR 493).

Based upon the above discrepancies in Mr. Durbin's analysis, the only thing that can be conclusively determined from his analysis is that the Utility received a high number of complaints because of participation in rate proceedings. No comparisons whatsoever to other utilities or to the industry as a whole or those entities regulated by the Commission can be drawn from the evidence submitted, because of the substantial issues that Mr. Durbin himself admitted would significantly affect the results, but for which there was no attempt to account in his analysis.

In addition, Mr. Watford provided testimony that if complaints over the last five years were considered, that the complaint level would fall to less than three complaints per thousand customers, as an average for Aloha (TR 1354-1355). The underlying basis for this calculation is shown in SGW-4. That complaint level average is substantially lower than the average Mr. Durbin found for the 10 companies reviewed in his Exhibit JRD-3 of Exhibit 13.

Mr. Durbin also discussed the issue of the Utility's timeliness in submitting responses to customer complaints. Mr. Watford provided extensive testimony on the circumstances surrounding those complaints that were alleged to be late. However, in conclusion, Mr. Durbin found that the Utility's responses to complaints were on the whole, timely.

Based upon the evidence of record, it is clear that the Commission's most recent finding concerning the Utility's quality of water provided in Docket No. 960545-WS is fully supported and reiterated in this case through all of the expert witness testimony. That is, that the Utility is in full compliance with all environmental regulatory standards and provides water which is clean and clear

at the point-of-delivery. While a few customers at hearing continued to complain of experiencing discolored water, it is clear from the investigation undertaken, both in the prior docket and in this case, that it is a result of factors occurring within the home and that the water entering the customers' homes is clean and clear and in compliance with all regulatory standards at the point-of-delivery outside the customers' homes.

The testimony of Mr. Durbin provides no information upon which the Commission can reasonably rely in finding a failure in the area of customer service. While he provides a comparison of complaints per thousand customers that comparison totally failed to take into account many significant factors that might lead to that result, and which he openly admitted would be expected to lead to that result. The only clear information from Mr. Durbin's testimony and the responses provided by Mr. Watford, is that the Utility experiences less than one justified complaint per year and in both cases noted the Utility has not only corrected the error, but provided the customer with credits and other benefits above and beyond its responsibility under its tariff, Commission rules and statutes.

Finally, the Commission's own management audit recently undertaken at the direction of the Commissioners in order to review customer service issues, clearly demonstrates that the great majority of Aloha's water customers are satisfied with the quality of service they are receiving from the Utility. To the extent that the management audit suggested changes in the Utility's operations, the Utility has already undertaken some of those proposals, as outlined in the testimony of Mr. Watford (See also Section 3.2.3 of RCN-9, Ex.24).

Based upon all of the evidence of record, it is clear and unrefuted by any competent substantial evidence that the quality of service provided by Aloha is satisfactory, both as to the quality of the water provided, and as to customer service issues, and the Commission should so find.

ISSUE 2

Should the utility's rate increase request be denied due to poor quality of service?

Mr. Larkin proposed this adjustment based upon his contention that the Utility failed to meet a "competitive service standard" for the provision of water service. Upon detailed questioning, Mr. Larkin could not, or would not, provide any quantitative or other defined basis upon which the Commission could apply his standard for judging a Utility's level of service (TR 683-TR 688). He admitted that he had done no analysis to determine the level of customer satisfaction for the customer base as a whole (TR 076); that he had done no analysis of the quality of water provided

by the Utility (TR 676); and that he based his contention that the Utility provided service below a "competitive standard" solely on the basis of the customer complaints of less than 1/10th of 1% of the Utility's customers, which he witnessed testify at hearings in this and the prior wastewater rate case (TR 677).

Mr. Larkin also admitted that there was no statute or rule that authorized the Commission to deny a rate increase based upon this undefined standard and that he knew of no cases where such a standard had previously been applied (TR 675).

Based upon all of these factors, Mr. Larkin's proposal must be rejected, not only because it is wholly undefined and unclear and based upon only anecdotal and very limited evidence, but also because it is clearly contrary to law and the Commission's responsibility to set just and reasonable rates under the provisions of Section 367.081, Florida Statutes and the underlining rules of the Commission. Therefore, this proposal can and must be rejected completely.

ISSUE 3

What is the appropriate cost of the Commission ordered pilot project to include in working capital for the Seven Springs water system?

The Commission ordered the Utility to undertake a pilot project in Order No. PSC-00-1285-WS. In two subsequent Orders, one concerning a rate investigation and one concerning interim rates in this proceeding, the Commission recognized the requirement from that prior Order and included 50% of the estimated cost of the pilot project in establishing the working capital allowance. Ms. DeRonne has proposed to only recognize 50% of the actual costs incurred through mid year 2001.

The testimony of Mr. Watford, Mr. Nixon, and Mr. Porter is clear that the pilot project is in no way finished and apparently her adjustment is based on Mr. Biddy's unfounded contention that the pilot project has come to an end. The cost for the project will substantially exceed those originally estimated, and will be expended early in 2002 under the current schedule, before rates can be implemented in this case (TR 1362-TR 1363).

Based upon the evidence of record, the Commission should include 50% of the estimated cost of the required pilot project in the working capital allowance, as per the testimony of Mr. Watford and Mr. Nixon. Mr. Watford has specifically estimated in his testimony that the actual cost will substantially exceed the estimate approved by the Commission by sometime in early 2002, in advance of the date rates will go into effect in this proceeding. As such, it is only appropriate that the Commission recognize the cost of this required pilot project in rate setting as it has already done

in two previous Orders. There is no competent substantial evidence upon which the Commission should either revisit those prior Orders, reverse its prior determination that the pilot project should continue, or find that the pilot project is not ongoing, as outlined in the testimony of Mr. Nixon and Mr. Watford. Therefore, the Commission must continue to recognize the estimated total cost of this required expenditure in working capital.

ISSUE 4

What is the appropriate working capital allowance?

As testified to by Mr. Nixon and included in the MFRs, the balance sheet approach to working capital should be utilized. The actual amount of the working capital allowance is subject to the results of conclusions reached on other issues affecting the working capital allowance and will not be discussed further here.

ISSUE 5

What is the appropriate projected rate base?

The amount of the appropriate rate base is subject to the resolution of other issues in this proceeding. However, since no parties have raised any issues concerning the rate base components in this case, other than working capital and the stipulations agreed to by all parties, the appropriate rate base is that proposed by the Utility in its filing, as sponsored by Mr. Nixon, and revised for working capital and those stipulated rate base issues.

ISSUE 6

What is the appropriate projected cost rate for variable-cost related party debt?

Other than the information provided in the initial filing by the Utility, no witnesses have provided testimony concerning related party debt cost. However, the Utility is in agreement that the Commission should utilize 2% above the Prime Rate as the appropriate cost of related party debt, in calculating the cost of capital. Since the related party debt cost is established on a semiannual basis at December 31st and June 30th, the Commission must utilize the December 31, 2001 Prime Rate for calculating that cost of debt.

ISSUE 7

What is the appropriate projected weighted average cost of capital for the projected test year ending December 31, 2001?

The overall cost of capital has not been testified to by any witness other than through the exhibits sponsored by Mr. Nixon as included within the original MFRs. As such, the weighted average cost of capital should be determined based upon the criteria established within those MFRs

and as stipulated to by the parties. The cost of equity should be calculated, based upon the leverage formula in effect at the time the Commission renders its Final Order and the cost of debt as updated, based on the conclusion reached in Issue 6.

ISSUE 8

What are the appropriate number of gallons sold for the projected 2001 test year?

The number of gallons sold for the 2001 test year has now been established by actual data supplied by Aloha to the Commission. For several years now, the SWFWMD has placed water use restrictions on the users of water throughout the entire Aloha service area (TR 1247). The SWFWMD restrictions applicable throughout the test year included restrictions, on irrigation, as well as, a number of other water uses such as washing cars, boats, sidewalks, etc. (TR 1247). The SWFWMD is currently lifting restrictions for some areas within its jurisdiction and certainly water use will rise if the SWFWMD reduces or removes the water use restrictions in Aloha's service area in the future (TR 1248). In fact, restrictions have been lifted, at least to some extent, by the SWFWMD, in areas all around Aloha's service area. Additionally, the Staff's expert witness at the time of hearing acknowledged that the Commission should adjust the test year data to properly reflect conditions in the future period for which the rates are being fixed (TR 1098). In fact, this is entirely consistent with Section 367.081(3) which requires that the Commission, in fixing rates, should consider the prudent cost of providing service during the period of time the rates will be in effect. Both Mr. Stallcup and Mr. Stewart acknowledged that their methodologies made no attempt to project what gallons per ERC will be used in Aloha's service area beyond the test year (Stewart TR 902; Stallcup TR 1116-TR 1117). However, Mr. Stallcup did express a desire to "normalize" the data he had reviewed to take into account such things as water restrictions and abnormal weather (TR 1099). Some recognition of the repression effect of aloha's recent wastewater rate increase is also appropriate (TR 1045-6). These types of adjustments to test year data to properly reflect conditions in the future period for which the rates are being fixed are entirely appropriate and should be based, at least in relevant part, on the testimony of Aloha's witnesses about the demographic shift that Aloha's service area has experienced and the effect of continuing SWFWMD restrictions on demand. Mr. Porter testified at length about the SWFWMD's restrictions and their tendency to repress demand throughout the entire Aloha service area during the test year (TR 1247-TR 1248).

Aloha's expert engineer carefully considered demographic shifts taking place in the water system which required that the water consumption projection be calculated so that such shifts would explicitly be taken into account (TR 1237). Aloha's original customers were in homes typical of those being constructed in Florida 30 years ago which were very small, often 900 square feet or less, and more than likely retirement homes with one or two persons living in them (TR 404). As the system aged, homes came online which were a little bit larger, some with pools, and some which had irrigation demands (TR 405). However, the new homes in Aloha's service area are very expensive homes, occupied by a different type of consumer, and consist primarily of homes with pools and families (TR 405). No party disputed that both the recently connected and all of the customers into the future which connect to Aloha's water system will fit into that third group (See, e.g., TR 407 and TR 819).

Mr. Porter's was the only realistic and logical projection of the amount of water per ERC per day that is likely to be used by new connections to Aloha's system. All parties agreed that the data revealed that the trend in the quantity of water used in Aloha's system has been increasing each year (TR 1244, TR882). All of the new customers to Aloha's system will come from the high water use subdivisions (which use 500 gallons/ERC/day or more) and therefore it should be a simple matter to project water consumption for the test year and for each year thereafter based on this water use and the projected average ERC growth (TR 1244-TR1245). This is the methodology used by Mr. Porter. The fact that an average of 473 new customers are projected to be added to the system in the test year was a fact undisputed by experts from the Staff and the parties (TR 1244, TR 1072, TR821).

As opposed to Mr. Porter's straightforward approach, Mr. Biddy and Mr. Stewart have all offered alternative (and variably complex) methodologies which they hoped would provide a more representative estimation of the projected water consumption for the test year. These methodologies did not even attempt to project water use after the test year.

This issue is particularly important to this case because Aloha must purchase water, at a greatly elevated cost per 1,000 gallons, from Pasco County for all water quantities in excess of the present quantities allowed in the SWFWMD Water Use Permit (TR 1245). If Mr. Biddy's, Mr. Stewart's, and Mr. Stallcup's calculations produce projected water consumption values that are "tuned" for the test year and do not reflect the actual water consumption going forward, the ramifications of adopting the values estimated from those models may be profound and will seriously

economically damage the utility and/or cause the expenditure of a great deal of the rate payers money in applying for and obtaining another rate increase to correct the earlier (inaccurate) projection (TR 1245-TR 1246).

Mr. Biddy attempted to take rainfall into account in his methodology based upon his belief that the period Aloha chose to evaluate subdivision by subdivision water use (July 2000 through June 2001) was an abnormally dry period. Therefore, customers were irrigating their lawns more due to rainfall shortages. Mr. Stewart's methodology, while somewhat confusing, did not incorporate any rainfall data (TR 888). Mr. Stewart's surficially complex methodology, when stripped to its essence, is really nothing more than the last 6 years gallons per day per ERC on the system divided by 6.[1] Like Mr. Stewart, Mr. Biddy assumed that Aloha's customer water use data had been collected during an "abnormally" dry period. Yet Mr. Biddy conceded that the SWFWMD considered the period 1990-2000 to be a period of drought in Aloha's service area (TR 845) and agreed that he could not quantify how much more people irrigate during a drought period or because they have new lawns (TR 848). Perhaps more importantly, Mr. Biddy also was not able to quantify in any way, shape, or form, in what way he believes water restrictions currently imposed by the SWFWMD have affected watering (TR 851). Notably, Staff witness Stallcup did not agree with Biddy and Stewart's conclusions regarding the weather during 2000 (TR 1072-TR 1073). Mr. Stallcup was of the opinion that the weather during the years 2000 and 2001 were comparable, and that no adjustments should be made to rectify a perceived abnormal weather period (TR 1073).

Merely averaging usage on Aloha's system by some past set of years (and then assuming that usage during the test year would equal that average) was conclusively revealed to be both illogical and counterintuitive. Initially, such a methodology completely ignores the fact that there will be no more small users connecting to the system and there will be no more "average users" connecting to the system (TR 1245). All the new connections to the system will be the high end users Mr. Porter used in his methodology.[2] No amount of methodologies, whether entirely defensible or entirely indefensible, can counteract the clear evidence in the proceeding that the new customers

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[1]The counter intuitive nature of this approach is discussed later.

[2]In fact, Mr. Porter pointed out that his methodology was conservative. Logically, Mr. Porter could have only used the usage data from the three neighborhoods in which Aloha's growth is occurring, as opposed to the 12 most recent neighborhoods constructed over the last 10 years. In that case, his figure would have risen to 593 gallons/ERC/day (TR 436).

connecting to Aloha's system are not some "average" of all of Aloha's customers over some past period. There will simply not be any new connections to Aloha's system which are like the homes that initially were constructed in Aloha. There will not be any more connections to Aloha's system which are like the homes that were constructed in Aloha's system more than 10 years ago. All of the new connections to Aloha's system are going to be from the type of homes and customers which there was so much testimony about (and so much agreement between the witnesses about) which will be expensive homes, with manicured lawns, with families living in them, occupied by higher income individuals, who are likely to use more water (See, e.g. TR 1102). This change in the demographic in Aloha's territory is readily apparent from not only a tour of the area served, but also from a review of the usage patterns of the areas where Aloha has remaining connections for the future within its system (Watford Rebuttal Page 34, Exhibit 29 [SGW-8]).

In 1995, average use for the system was 246 gallons/ERC/day, in 1996 it rose to 260, in 1997 to 265, in 1998 it stayed about even, and in 1999, it increased dramatically to 276, and in the year 2000 it stayed about the same as 1999 (TR 409). This steady progression of increased water usage did not stop Mr. Stewart from reaching the conclusion that Aloha's usage would experience a bigger drop from 2000 to 2001 than for any of the years for which he had seen data (TR 887)[3]. Because of the newer homes and different consumer who is connecting to Aloha's system now, it is obvious that Aloha's usage per day per ERC will continue to rise, just as it has steadily in the past.

Mr. Porter, approaching this issue with the expertise of an engineer and unburdened by a need to depend upon arcane or overly complex econometrical theories, took certain truisms about the system and the shift in Aloha's demographic base, and has correctly extrapolated what future demands on the system are likely to be. Mr. Porter's projection should be utilized by the Commission to adjust test year data to properly reflect conditions in the future period for which the rates are being fixed.

ISSUE 9(a)

What is the appropriate projected number of purchased water gallons from Pasco County, and what is the resulting expense?

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[3]Of course, Mr. Stewart also admitted that the more data he had available to him, the lower the number he would have projected (TR 882-TR 883). In other words, if Mr. Stewart would have had 20 years worth of data, his number might have been below the average use of the system 10 years ago, etc. This despite the fact that all parties acknowledged that the usage levels in the system are climbing steadily. Thus, Mr. Stewart apparently created a methodology that the more thorough the data, the more inaccurate the projection.

Because the number of gallons sold for the 2001 test year is now known, the real question as to the appropriate projected number of purchased water gallons from Pasco County is really a question of the appropriate methodology and the appropriate adjustments that should be made on a going forward basis.

The methodology utilized to determine the appropriate projected number of purchased water gallons from Pasco County is the total gallons sold, and unaccounted for, and flushing, minus the Water Use Permit limitations.

The purchased water expense for water purchased from Pasco County should be $1,029, 519, including gallons used for flushing. This amount includes that reflected in MFR Schedule G-9, using $2.35 per 1,000 gallons instead of $2.20 per 1,000 gallons, and also that amount of "other uses" for water, including flushing, reflected in MFR Schedule F-1.

All parties agreed that it would be necessary for Aloha to begin to purchase water from Pasco County to the extent such water demand exists which exceeds the limitations of Aloha's Water Use Permit. OPC witness Biddy testified that he would support the purchase of greater quantities of water from the Pasco County Utilities Department although it is his opinion that Pasco County's rates are too high (TR 836-TR 837). His discussions with the SWFWMD had led him to believe that Aloha was unlikely to secure an increase in its withdrawal allocation from the SWFWMD prior to 2006 (TR 837). Although the Commission heard a variety of testimony about Aloha's exceedence of its Water Use Permit, Mr. Biddy agreed that whether Aloha pumps more from its present wells than that allowed by its Water Use Permit, or whether Aloha buys the water from Pasco County, there is no net effect on the water resource because those two entities are getting their water from the same source (TR 837). Mr. Biddy also agreed that if Aloha had begun to buy more water from Pasco County, so as to avoid the problem with Aloha's water use permit, that in fact, would have meant the customers would have had to start paying a higher price at an earlier time (TR 839).

The projected number of purchased water gallons from Pasco County, during the period the rates are to be in effect, should be established with due consideration to Mr. Porter's water usage projections. A more thorough discussion of this issue occurs under Issue 8.

ISSUE 9(b)

Should a provision be made to monitor whether the gallons pumped from Aloha's wells differs from the maximum permitted quantity on an annual average basis under the Water Use Permit (WUP)?

ISSUE 9(c)

What provision should the Commission make within rate setting for the potential shortfall or excess if usage by customers differs from that included in the rate setting?

Because Issues 9(b) and (c) are similar, they are combined here for the purposes of discussion. The procedure posed in Issue 9(b) was offered by Ms. DeRonne in order to ensure that the Utility did not receive some type of "windfall" as a result of continuing to pump above its permitted levels, while having recognition in rates of purchasing everything above permitted levels. Both Mr. Nixon and Mr. Watford provided responsive testimony to Ms. DeRonne's proposal, which clearly shows that not only is her proposal unprecedented, but that it falsely assumes that the Utility can precisely pump at its permitted levels; that such over pumping is in any way likely to occur; and that if there are to be monitoring situations, that this represents an appropriate case to break with longstanding Commission policy. Each of these assumptions is clearly false, based upon the testimony of Mr. Watford and Mr. Nixon. Mr. Watford noted, and the SWFWMD's own position, as stated in the Prehearing Order, clearly indicates that it will be nearly impossible for the Utility to exactly achieve the "permit limits" of the Consumptive Use Permit on Aloha's wells. Because there are daily, monthly, and yearly limits, any attempt by the Commission to utilize strict limitations on the amount of purchased water based upon those limits, must include some room for variation from the permit, which is absolutely certain to occur.

Ms. DeRonne's basis for proposing that the Commission continue to monitor this Utility for any pumpage of water above the permit levels is based simply on her contention that this is an expense fully within the control of the Utility. Mr. Watford clearly notes that the likelihood of the Utility exceeding its permitted levels from its wells is very small, given the substantial threats of fines that the SWFWMD will claim are due under the Consent Agreement, if the Utility continues in such exceedences after the Commission approves rates in this proceeding. Mr. Watford also noted that there is really no difference between a proposal to monitor this issue and any number of other issues that the Commission could hold a case open for, simply because the expenses are within the control of the Utility (TR 1382-TR 1384). This does not constitute a sound basis for establishing a true-up or other method by which the Commission should implement a monitoring program over rates and charges.

While the Utility has not proposed that the Commission would implement a monitoring program for any purposes, to the extent the Commission chooses to do so, it must do so for the purposes of monitoring to ensure that the Utility does not find itself in a substantial loss position

because consumption by customers deviates substantially from the regressed figures inherent in rate setting, under the Water Rate Model 2001. If actual consumption levels deviate substantially from the "average" projection which the Commission utilizes in setting rates, the Utility will likely find itself in a substantial loss position, because of the high cost of purchased water. To the extent the Commission does propose to implement a monitoring program for the Utility, it should also monitor the much more likely shortfall in rates that may result because of the unique, highly subjective, and volatile rate setting methodologies proposed to be utilized by the Commission in this case and grant an increase in rates should they occur (TR 1383-TR 1385).

Ms. DeRonne admitted that she provided no additional expense recognition for the costs related to the reporting and monitoring in the compliance program she proposed (TR 756). Mr. Watford estimated that the cost of such reports would be $10,000 per year, and must be considered in rate setting if any reporting requirements were imposed (TR 1385).

Therefore, based upon the clear evidence of record, Ms. DeRonne's proposal is not only unprecedented in its scope but also she provides no sound basis for such a first time substantial deviation from longstanding policy in these circumstances. In any case, it is clear from the testimony of Mr. Watford and the Consent Agreement entered into between the SWFWMD and Aloha (Exhibit 36) that there is absolutely no incentive for the Utility to exceed its Water Use Permit, as such exceedences will result in substantial and immediate fines from the SWFWMD. To the extent the Commission ultimately determines that some continued monitoring is appropriate (outside the mechanisms already available through Annual Report reviews), the issue which should be addressed with regard to that continued monitoring is the substantial possibility of a shortfall in revenues resulting from usage by customers deviating in any material amount from the levels projected by use of the Water Rate Model 2001 and the repression inherent therein. To the extent that there is any continued monitoring, that potential for inaccurate projections is the only situation that presents a unique set of circumstances which might justify such a unique monitoring proposal. However, the Utility is willing to accept any reasonable establishment of rates as final and pursue such matters in a future docket, to the extent shortfalls occur.

ISSUE 10

Should projected chemicals and purchased power be adjusted?

Witness DeRonne proposed a reduction to chemicals and electricity, based upon the fact that the Utility would begin purchasing substantial additional quantities of water from Pasco County,

replacing water previously obtained from its own wells. Mr. Porter provided testimony on this issue and noted that the Utility would not be reducing expenses for chemicals and electricity, but because of repumping and the changes in differences in the chemical makeup of Pasco County's water, and the need to continue chlorination and also treat Pasco County water to include the corrosion inhibitor used by the Utility, such costs would actually increase above those for the test year. Mr. Porter provided testimony concerning the specific reasons for the increase in chemicals and purchased power, in response to Ms. DeRonne's general proposal (TR 1286-TR 1287). Mr. Nixon addressed the issue of adjustments to those expenses based upon customer growth and inflation, which Ms. DeRonne had specifically excluded. As noted by him, it is illogical to assume that such costs are not affected by such factors and to exclude them simply because no increases occurred in 18 months, is unreasonable (TR 1176 /L18-19). Ms. DeRonne admitted that she did not review all expense categories to see if experience with other expenses suggested a higher inflation adjustment was appropriate (TR 757-TR 758). Her basis for adjustment is therefore inherently flawed and biased.

Based upon these factors, no adjustments should be made to the chemical and power expenses as proposed by the Utility. The proposals by Ms. DeRonne to exclude costs based upon the fact that the Utility will be purchasing water is unfounded, based upon the unrebutted testimony of Mr. Porter. Additionally, Mr. Nixon's testimony clearly demonstrates that such costs are subject to inflation and customer growth increase factors and that those factors should therefore be included.

ISSUE 11

Should an adjustment be made to employee salaries and wages for open positions?

Ms. DeRonne testified on behalf of OPC in support of an adjustment to salaries and wages of Utility employees for positions that were open or unfilled just after the end of the test year. However, at hearing Ms. DeRonne agreed that to the extent those positions were filled at the salary levels which were proposed by the Utility and no other positions had become vacant, that she would not disagree with their recognition in rate setting (TR 747) or to adjustments in employee benefits, which are entirely dependent upon her proposed adjustments to those positions (TR 748). Mr. Watford provided testimony at hearing, which explained the need for each of those employees. He also noted that all positions are currently filled, with the exception of the Utility Director position (TR 1409). In addition, he noted that the Utility would be filling the last remaining position of Utility Director in very short order, and before the time rates would go into effect.

Therefore, based upon Ms. DeRonne's agreement that to the extent the positions had been filled and that no other positions had become vacant, combined with the testimony of Mr. Watford to that effect, all of the costs of those positions must be recognized in rate setting on a going forward basis.

ISSUE 12

Should an adjustment be made to employee salaries and wages to correct the annualized salary of the utility operations supervisor?

Based upon an agreement at hearing, the parties have stipulated Issue 12 to reduce salary expense by $21,268 for an allocation error.

ISSUE 13

What adjustments should be made to pension expense?

All parties agreed at hearing that an adjustment to increase pension expenses by $40,509 was necessary in order to correct an error and to reflect the additional liability obligations. In addition, as noted in the testimony of Mr. Nixon, the new employee benefits percentage to be applied to all employees' salaries is 22.10%. This results in an additional increase in benefit expense of $10,580 (RCN-10 of Exhibit 24).

No party, other than Mr. Nixon, provided any testimony on this issue. As such, the Commission should find that these adjustments, as proposed by Mr. Nixon, are appropriate.

ISSUE 14

Does the utility have excessive unaccounted for water, and if so, what adjustments should be made?

Aloha does not have excessive unaccounted for water and therefore no adjustments should be made. OPC witness Biddy stated in his testimony that he calculated unaccounted for water by subtracting the quantity of water sold to customers from the total water pumped and purchased by the Utility. This is an incorrect method for determining unaccounted for water (TR 1277). The water used by the Utility in operating the system (such as treatment plant loss or water main flushing) is not "unaccounted for" (TR 1277). Even Mr. Biddy agreed that his unaccounted for water calculation included water that was used in treatment loss and flushing (TR 854). Subtracting water used by the Utility in operating its system from the water pumped and purchased when calculating "unaccounted for water" is not only the calculation accepted by the Commission but it is the calculation used by utilities when determining this percentage for submission in the Annual Report to the Commission (TR 1277).

The calculations of Mr. Nixon in Aloha's MFR's was 10%, based on the fact that this is the acceptable limit for unaccounted for water use by the Commission for many years and also based upon Mr. Nixon's belief that the unaccounted for water shown on Schedule F-1, Page 100 of the MFR indicated two months where Aloha sold more water than it had pumped and purchased (TR 1173). Aloha's unaccounted for water is 10.2% in the first 9 months of 2001. While the Staff has taken the position that this is an excess of .2% and therefore that both purchased power and chemicals should be reduced by .2%, no adjustment is appropriate and the Staff proposed adjustment is immaterial. *Application of GDU, Port Malabar Division*, Docket No. 800376-WS; Order No. 10672 (1982). Additionally, in the case of *Meadowbrook Utility System*, Docket No. 850062-WS, Order No. 17304 (1987), the Commission rejected OPC's position that any amount over 10% unaccounted for should be considered excessive water loss, and found that an allowance of 10% for unaccounted for water is not representative of a system in which a large part of the system exceeds 15 to 20 years of age. The Commission therein noted that an article published by the *American Water Works Association* stated "Systems having 10%-15% unaccounted for water are generally agreed to be performing well, and distribution system losses of 10%-20% are considered reasonable". In that case, the Commission determined that 19% unaccounted for water was not excessive and that therefore there was no need to adjust expenses accordingly. Finally, the Water Management District's expert witness testified that the Water Use Permit holds Aloha to a 12% unaccounted for water standard and that the District accepts that there is a range of acceptable unaccounted for water from 10-15% (TR 637).

ISSUE 15

Should an adjustment be made for related-party purchased water transactions?

The staff of the Commission proposed to make an adjustment to a royalty fee paid by Aloha to two related parties, for the rights to extract raw water. Based upon the testimony of Mr. Fletcher, the staff proposed to reduce this charge to the $.10 per thousand gallons agreed to between the Utility and an unrelated third party approximately 27 years ago, and approved by the Commission in a rate case approximately 23 years ago.

Mr. Watford and Mr. Nixon offered testimony, both on the historical perspective of why the Utility entered into this agreement with related parties, and as to why it was and is the best alternative available to the Utility, for obtaining needed water supply. This issue can be broken down into two basic areas of discussion. These are: i) historical perspective for why the Utility has

entered into the agreement and why it was the best alternative available to the Utility then and now; and ii) Market Value - the legal basis for review of this related party transaction. These are discussed separately below:

Historical Perspective

Aloha entered into an agreement with the unrelated third party (Mitchell) in 1974, to pay $.05 per thousand gallons for the right to withdraw water from the Mitchell property. In 1977 and 1978, an "emergency situation" arose in the area surrounding Aloha, whereby many of the utilities in the area were forced to purchase at least 80% of all water from the Pasco Water Authority, which later became owned by Pasco County (see Commission Order Nos. 6823, 7111, 8453, 7494, 8530, 8667, and 8967). As such many, if not most utilities in the area, became solely dependant upon bulk purchases from the County as their water source. In fact, this occurred for Aloha's own Aloha Gardens system, which has a territory to the West of Seven Springs. To meet the continuing growth and water needs of Aloha's customers in the Seven Springs system, the management chose instead to enter into agreements with two related parties in 1977 and 1978, to obtain water resources through pumping of wells, rather than interconnect and purchase of bulk water.

In addition, as noted by Mr. Nixon, the Utility was in rather dire financial straits during the period of time when this need for additional water resources occurred. As such, as he noted, the Utility probably could not have had the money to buy the land, or put in the facilities at that time (TR 1212).

The Utility's last full file and suspend rate proceeding was completed in 1980 on remand from the Florida Supreme Court. The Commission approved rates in that case, including recognition of the royalty paid to the unrelated third party. Since that time, the Utility has reported the related party purchases in Annual Reports each and every year, with no comment or suggestion for change by the Commission or its staff. In fact, the Utility has undergone three recent rate investigation and limited proceeding audits in which the issue was discussed and reviewed, and during which no adjustment was ever proposed (Docket Nos. 960545-WS, 970536-WS and 980245-WS). Not until the completion of the most recent rate investigation docket, just prior to the filing of the MFRs in this proceeding, has the Commission ever proposed to make an adjustment to this or in any way criticize this arrangement. The auditors, less than two years ago in fact, concluded that the arrangement was in the best interest of the Utility and its customers.

Based upon all of the evidence of record, it is clear, from the testimony of Mr. Nixon, Mr. Watford and Mr. Fletcher (TR 998, L/18-TR 1000, L/5 and TR 1212, L/3-20), that the Utility was in poor financial shape at the time it entered into the agreements with the related parties; the water resources situation was already being termed "an emergency" by the PSC in several of its Orders; and the Commission had recently approved, without comment, Aloha's entering into a royalty arrangement with an unrelated third party. Given the new locations that the Utility's service area growth directed, the Utility entered into similar arrangements with the related parties to utilize well sites nearer the direction of growth at that time. This arrangement was clearly the Utility's best option at the time, based upon the great weight of evidence. Buying property and constructing facilities was neither a prudent choice nor financially feasible for this Utility at that time.

Market Value

Under the provisions of the Florida Supreme Court case, *GTE Florida, Inc. v. Deason, 642 So. 2d 545 (Fla. 1994)*, the Court established that the standard to use in evaluating affiliate transactions is whether those transactions exceed the going market rate or are otherwise inherently unfair. On the one hand, Mr. Fletcher believes that the market for raw water is established by the price paid to Mitchell, based upon the 1975 agreement, as well as the related party agreements (TR 992 L/2-9, TR993 L/12-15).

At the same time, Mr. Fletcher suggests that there is no market price for treated water, because the only option is the County. However, Mr. Fletcher understood that Aloha's related party had also offered to sell water to Aloha at a price very similar to the County price (TR 994 L/20-23). Such a distinction between treated and raw water markets is wholly unexplained and wholly illogical. If the related party and Mitchell make up a basis for determining market price for raw water, then clearly the County and a related party offering to sell treated water can make a reasonable basis for determining market price for treated water as well. In any case, Mr. Fletcher repeatedly admitted that Mitchell and the related parties, together, constitutes a reasonable basis for determining the market price of raw water.

Mr. Fletcher first tried to draw a comparison to the Florida Cities Water Company case, where a royalty had been allowed based upon the potential use of up to 149 acres. Mr. Fletcher agreed that the Florida Cities comparison involved no consideration of the substantial cost of the facilities versus the cost of the land. In the Florida Cities Water Company case, the royalty included only a right to

use land as the Utility was required to construct all facilities utilized by the Utility. In the case of Aloha, all of the original well and pump facilities were installed by and are owned by the related party. Mr. Fletcher admitted he had no idea what the relationship of the cost of facilities was to the cost of the land (TR 969-TR 970).

Mr. Fletcher attempted to draw three key distinctions between the Mitchell Agreement and the agreements with the related party: i) the escalation clause; ii) the cancellation provisions; and iii) the allowance for a plant site.

As to the escalation clause, it was clearly established by Mr. Nixon that the amount that the related party has escalated the royalty has been below the time value of money since that agreement was entered into (TR 1182-TR 1183 and RCN 13 of Exhibit 24). The combined discount rate for the time value of money would clearly represent a higher increase in that cost than has been imposed by the related party under this escalation clause. In addition, as noted in the testimony of Mr. Nixon and Mr. Watford, circumstances surrounding the water shortage in 1978 drastically increased the need for the Utility to find a reliable water source and also to some extent, minimize the risk inherent in constructing and maintaining a single or permanent well site. Mr. Fletcher agreed that he had taken none of these things into account (TR 1000-TR 1002).

Secondly, Mr. Fletcher noted the cancellation provision, which is present in the related party agreements, but not in the Mitchell Agreement. Mr. Fletcher's comments suggest that this represented a decrease in the value of the related party agreements. Again, as noted by Mr. Nixon and Mr. Watford, the circumstances surrounding the water supply situation in Pasco County had changed dramatically by 1977 and 1978, when the related party agreements were entered into. It was also agreed to by Mr. Fletcher, that the cancellation provisions have had no effect on the Utility's ability to obtain water in the 24 years that those related party agreements have been utilized (TR 979). Mr. Watford noted another provision in both the related party and Mitchell Agreement that posed a much more likely cause for what would effectively result in cancellation of Aloha's right to extract water from the Mitchell property (TR 1436-TR 1438). He testified that because of Mitchell's agricultural business this "first right" provision was much more likely to be invoked by Mitchell than the two related parties.

Mr. Fletcher agreed that there was no written agreement between Pasco County and Aloha for bulk water. When asked whether the County could cancel and refuse service to the Utility at any time (without a 30 day notice), Mr. Fletcher suggested that he had discussed the matter with

Mr. Doug Bramlett of the County Utility staff, and Mr. Bramlett said they would not do so without "extraordinary circumstances." When pressed to define "extraordinary circumstances," Mr. Fletcher admitted he did not know what was meant by that, or how Mr. Bramlett defined that. Mr. Fletcher also admitted he had no idea whether Mr. Bramlett would be the person to make the decision, or who would make the decision about if and when the County could discontinue service. He also agreed he was aware of no rule, tariff, or ordinance of the County which placed conditions on the County's ability to discontinue service at any time, and had done no research into the County's ability to do so (TR 982-TR 983).

Finally, Mr. Fletcher suggested the Utility has the alternative of relocating its wells, and could "explore the opportunity of transferring the withdrawal allocation limits" to other areas within the Seven Springs water system (TR 984). However, upon further questioning, he admitted he did not know whether they could obtain approval for such proposal and agreed that the Utility would have to go to the DEP and the SWFWMD, to obtain approval for moving those wells. He also agreed that the SWFWMD witness did not offer any opinion as to the likelihood of such approval (TR 985-TR 987). Mr. Fletcher further agreed that the Utility would incur the cost of engineering permitting, drilling, and equipping the new plants and wells and he admitted he had no idea about the likelihood of gaining such approval, or the cost of making such a move (TR 986-TR 987). Mr. Watford provided testimony on this issue and specifically noted previous failed attempts to move wells and the extreme difficulty the Utility had encountered, thereby clearly making this possibility not only expensive, but extremely unlikely (TR 1369).

In each and every case, Mr. Fletcher admitted that the only alternatives available to the Utility immediately, if it could no longer receive bulk raw water service from the related party, would be to obtain treated water service from the County at a substantially higher price (TR 988).

Mr. Nixon and Mr. Watford noted the substantial change in circumstances that occurred between the negotiation of the Mitchell Agreement, and the related party agreements. Mr. Watford noted that under Paragraph 8 of the Agreement, Mitchell or the related parties could utilize water resources to the exclusion of Aloha and that utilization of that provision to Aloha's detriment, was substantially more likely to occur with Mitchell than by the other entities, thereby rendering that provision much more risky with regard to the Mitchell Agreement.

The facts and circumstances surrounding the Mitchell Agreement and the related party agreements for raw water clearly indicate that a major change in the importance of obtaining a

reliable source for raw water, without incurring substantial expense for land which might be rendered unusable because of salt water intrusion, which was extremely prevalent at that time. The extent of such danger is described as an "emergency situation" in numerous Commission Orders from approximately the same time as the Utility was in negotiations with the related party for the water extraction rights.

The Utility has a written agreement with the related party and, as Mr. Watford noted, the alternative the Commission has to acceptance of that agreement is that the related party could force the Utility to discontinue extraction of water from several of its current well locations and instead, as Mr. Fletcher agreed, the only alternative available to the Utility would be to obtain bulk treated water from Pasco County at a substantially higher cost.

In conclusion, the agreements with the related parties cannot be viewed, either in isolation or directly compared to, the Mitchell Agreement. A review of the history surrounding those related party agreements clearly shows that the royalty arrangement was, at the time entered into, the best alternative Aloha had for water supply, given both resource and financial considerations. A review of those same factors today also clearly shows that the royalty arrangement with the related parties continues to be in the best interests of Aloha and its customers. The only alternative available to the Utility constitutes market value for the right to extract water. All parties agreed that the purchase of bulk treated water from Pasco County at a substantially higher price is the only alternative available to the arrangements with the related parties. As such, the existing agreement and the existing rate is a reasonable one when judged in conformance with the legal standard outlined in Florida Supreme Court case on point. Any adjustment to the agreement or to the rate charged under that agreement constitutes a breech of those agreements and, as such, endangers the Utility's water source and will likely result in substantial increases in purchased water cost to the Utility and therefore, its customers. The alternative available to the Utility constitutes what defines the market value for the right to extract water. As such, the existing Agreement and the existing rate is a reasonable one. Any adjustment to it endangers the Utility's water source and may result in substantial increases in purchased water costs from Pasco County.

ISSUE 16

What is the appropriate amount of rate case expense?

The Utility presented the estimated cost of processing this rate case in its MFRs, and updated that information in its rebuttal testimony and in a late-filed exhibit to the deposition of Mr. Nixon

requested by the Commission staff. The total of the latest estimate should be recognized in rate setting. Only two issues have arisen concerning rate case expense. The first is the proposal by Mr. Larkin that all rate case expense be disallowed because of his contention that the Utility should have combined this case with the wastewater rate case filed in early 2000. Both Mr. Nixon and Mr. Watford provide extensive testimony in response to Mr. Larkin's assertion.

Mr. Nixon first notes that at the time that the wastewater rate case was filed Aloha had no basis for requesting an increase in water rates. This is borne out by the fact that the Commission was investigating the water rates for the water system at that time, had recently denied any recognition of rate relief in a limited proceeding for the water system, and had literally within weeks of the filing of this water rate case issued a Final Order finding that no rate increase was justified, based upon historic data for the water system (TR 1166). Mr. Nixon explains in detail why these ongoing cases clearly demonstrate that the Utility would not have received favorable recognition of a water rate case filed at the time the wastewater rate case was necessitated. Mr. Nixon also notes that the Utility attempted to process the water rate increase as a limited proceeding, but was turned down by the Commission (TR 1188-TR 1189). In addition, Mr. Nixon noted that even if the Utility could have filed this rate case sooner (if such an increase that was sufficient to cover the cost now proposed to be incurred at the behest of the SWFWMD), it would simply have meant that the Utility's customers would have received a rate increase a year or two sooner, to the benefit of no one (TR 1168). Mr. Watford provided similar testimony and reached the same conclusion, that only the customers would have suffered, even if the Utility were able to do so. He too noted that recent Commission rulings on the specific subject of the water system earnings clearly show that the Utility could not have justified a rate increase at the same time the wastewater rate increase was necessitated. For these reasons, Mr. Larkin's unprecedented and ill-conceived proposal to adjust rate case expense must be rejected.

While not made an official position by any party, it was apparent from some of the questions raised by the Commission staff that they believe the Utility cost in processing a revised request for interim rates should not be recognized in rate setting. Mr. Nixon addressed this issue and noted that the Utility should not and could not have known, until after the original filing was submitted, that the Commission would not grant the interim rate increase requested, based upon the historic test year originally utilized for requesting interim rates. Just weeks before the full filing of the rate case (including the request for interim relief), the Utility believed it could support an increase in interim

rates based upon the historic test period originally proposed. The Commission staff in its recommendation to the Commission in mid 2001 had in fact itself determined that the Utility would likely be underearning for the year 2001 (TR 1224-TR 1225) and based upon adjustments worked up through the Utility's analysis of the historic test year ended December 31, 2000, the Utility believed it could support an interim increase of $133,000 (TR 1225). Therefore, it is not appropriate to adjust rate case expense for the minor amount of additional rate case expense incurred in revising the interim test year request.

Based upon the evidence of record, rate case expense has been challenged on only two issues. The first, the proposal by Mr. Larkin to completely eliminate rate case expense, is not only unprecedented and unreasonable, it is based upon assumptions about the Utility's ability to have filed the water rate increase with the wastewater rate increase request (filed approximately two years ago), which are wholly without foundation. Clearly, Commission actions in the intervening two years, finding at least twice that the Utility was earning a reasonable rate of return, if not overearning, clearly demonstrate the fallacy of Mr. Larkin's proposal. In addition, questions raised by staff that the cost of preparing the second interim request were unreasonable, are not grounded in fact, based upon the circumstances that existed at the time of the Utility's filing. For these reasons, the evidence clearly demonstrates that the rate case expense, as proposed by the Utility in its most recent update, must be recognized in its entirety and considered in rate setting.

ISSUE 17

What conservation programs, and associated expenses, are appropriate for this utility at this time?

The Utility and the SWFWMD agree that those conservation measures agreed to between SWFWMD and Aloha should be recognized in rate setting. The testimony of Mr. Watford and Exhibit 36 showed the nature of the conservation measures to be undertaken. Mr. Watford's SGW-2 of Exhibit 29, is identical to the conservation measures outlined in Exhibit 36 (The Consent Agreement). No party took exception to any of the specific measures ordered by the SWFWMD and agreed to by Aloha. Mr. Stallcup suggested that the conservation measures might "pay for themselves." Commission Staff Exhibit 23 suggested some decrease in costs for purchased water, because of water conservation which might occur with several of the conservation measures proposed. This document itself clearly showed that such savings would not occur for many years, while the cost would be immediate. Ms. Sorensen for the SWFWMD stated that while some of the conservation measures could be implemented immediately, others would typically require pilot study

first, and could require two to twenty years to implement (TR 1147 and TR 1149). She also noted that realizing the beneficial effects of a program in terms of reduced water usage, will have a lag even after implementation is complete (TR 1148 and TR 1150). A failure to recognize all of the conservation program costs therefore is confiscatory and plainly contrary to the timing of benefits clearly outlined, even in the documents submitted by the staff as Exhibit 23.

Based upon the agreement between the SWFWMD and the Utility as to the conservation measures to be undertaken and their cost, the Commission should recognize the full cost of the conservation measures outlined in SGW-2 of Exhibit 29 as appropriate costs which must be fully considered in rate setting. To the extent there is any significant savings that occurs from implementation of the conservation measures in future years, the Commission can review those savings through the Annual Report and earnings review oversight process, which is normally utilized for that purpose. To attempt to immediately recognize in rate setting any significant portion of the conservation of water beyond the 5% proposed by Aloha in the MFRs, and which may occur from full implementation of these measures is unreasonable and contrary to sound regulatory principals. This is clear, based upon staff's own exhibit and upon logic, as well as the clear testimony of Mr. Watford. For these reasons, the entire cost of the conservation measures must be included in rate setting, in its entirety, without adjustment. The evidence of record clearly supports no other conclusion.

ISSUE 18

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

The appropriate amount of test year operating income, before any revenue increase, is subject to the resolution of other issues in this proceeding.

ISSUE 19

What is the appropriate revenue requirement?

The appropriate amount of test year operating income, before any revenue increase, is subject to the resolution of other issues in this proceeding.

ISSUE 20

What is the appropriate rate structure for this utility?

The Utility has originally proposed, within its MFRs, an including block rate structure with two separate tiers. This is acceptable to the SWFWMD and formed the basis for the information submitted in the MFRs. The Commission staff has apparently taken the position that a three tiered

rate structure should be utilized. While there is some disagreement about the appropriate structuring of this inclining block rate structure, apparently the SWFWMD, the staff, and the Utility agree that an inclining block rate structure should be implemented under the circumstances.

The calculations made by Mr. Nixon computed two-block inclining rates using the traditional Commission approach. Mr. Nixon modeled his rates using the SWFWMD's Water Rate model developed by Dr. Whitcomb (TR 1189).

The appropriate base facility charge should be calculated per Commission rule and practice. As a PSC staff member explained to customers in attendance at the request of the chairman, the base facility charge is that charge at which the PSC normally places fixed cost, and the gallonage charge is that charge where the PSC normally places variable costs (TR 1108). PSC Witness Stallcup acknowledged the concern that if too much of the fixed charges are recovered in the gallonage charges, Aloha may run a risk of not being able to cover its fixed costs (TR 1110). Mr. Stallcup recognized that as a valid concern (TR 1110). Mr. Stallcup also acknowledged that in his opinion the question of how much should be shifted from fixed to gallonage charges is a question that really cannot be answered until the final revenue requirement numbers are established (TR 1110-TR 1111). However, Mr. Stallcup recalled that Aloha's actual fixed charges are at around 46%, yet acknowledged that under Staff's proposed rate calculation, 25% of total costs would be in the base facility charge, and 75% in the gallonage charge (TR 1111). Mr. Stallcup acknowledged that if 25% of Aloha's costs are built into the base facility charge, and Aloha's fixed costs are 46%, then not all of Aloha's fixed costs are in the base facility charge (TR 1113). Conceptually, Mr. Stallcup agreed that the more a utility's fixed charges are in the gallonage charge, that the more the relative risk to the Utility increases (TR 1115).

Mr. Nixon's base facility charges were based on 38% and 35% recovery of the revenue requirement (for each of the two-blocks which Aloha proposes to use to structure its rates) (TR 1189). It was Mr. Nixon's opinion that the 25% allocation of revenue to the base facility charge recommended by the Staff was insufficient to cover Aloha's fixed costs, which represent 46% of the requested revenues in this case (TR 1189). Rule 25-30.437(6), Florida Administrative Code, provides that "The base facility charge incorporates fixed expenses of the utility and is a flat monthly charge. This charge is applicable as long as a person is a customer of the utility, regardless of whether there is any usage." Although Mr. Stallcup indicated that the word "incorporate" only required a consideration of <u>some</u> of the fixed cost elements in the base charge, it was Mr. Nixon's

opinion that not only was the Staff's recommendation contrary to the above-reference Rule, but that the proposal puts Aloha at risk for recovery of its fixed costs, given the high marginal cost of Pasco County water and the Staff's initial projection of gallons, which puts them back at a consumption level per ERC experienced in 1996. (TR 1190) Mr. Nixon opined that this was particularly risky when Aloha can document that all of the customers on a going forward basis will use approximately 500 GPD/ERC. (TR 1190) It was Mr. Nixon's opinion that the BFC proposed by Aloha, which actually recovers slightly more than 40% of the total revenue requirement, is also appropriate because it was derived from Dr. Whitcomb's recommendation to the SWFWMD (TR 1191). In Mr. Nixon's opinion, it is one thing for utility owners to risk earning a rate of return on their investment, but quite another to risk shortfalls in revenue to cover fixed costs, and in this case, the high marginal costs of purchased water from Pasco County (TR 1191). The risk that a company should break even should be minimal, especially when rates are being established in a rate proceeding such as this one (TR 1191).

ISSUE 21

Is repression of consumption likely to occur, and, if so, what is the appropriate adjustment and the resulting consumption to be used to calculate consumption charges?

Repression of consumption is likely to occur in this case. The resulting adjustment in the resulting consumption to be used to calculate consumption charges should be calculated using Dr. Whitcomb's Water Rate model. Mr. Stallcup testified that, in his opinion, it was appropriate to use the Water Rate model to "sanity check" Staff's calculations in this case, using marginal costs as opposed to average costs (TR 1107). Mr. Stallcup also opined that he would defer to Dr. Whitcomb on the decision of what constitutes an appropriate price elasticity in utilization of the model (TR 1108).

Aloha agrees that the Water Rate model is the appropriate model for use by the Staff in determining repression of consumption. Notably, Dr. Whitcomb testified that it was appropriate to also consider the repression effects of the recent wastewater case (TR 1045-6).

ISSUE 22

What are the appropriate monthly rates for service?

The appropriate monthly rates for service are subject to the resolution of other issues in this proceeding. To the extent this issue deals with either calculation of rates and charges and inclusion of fixed versus variable cost in each category or upon use of the inclining block rate structure proposed, that has been discussed in Issue 20 hereof.

ISSUE 23

What are the appropriate service availability charges for the Seven Springs water system?

No change in service availability charge has been imposed in this case. While the Utility is not adverse to a change in service availability charges, those charges are being considered in a separate Commission docket, currently pending. As soon as the Utility has more detailed information about the cost that will be incurred on a going forward basis for increased water treatment, it will provide estimates of the cost to be incurred and estimate an appropriate service availability charge to be authorized on a going forward basis. As such, no further discussion of this issue is necessary or appropriate in this proceeding. Any suggestion that an increase in service availability charges may be used to meet a revenue requirement to which a utility is entitled by law, is plainly contrary to law, longstanding Commission and general regulatory philosophy.

ISSUE 24

Should this docket be closed?

Yes. After recognition and approval of the additional rates requested by Aloha Utilities, Inc., the Commission should close this docket.

CONCLUSION

Based upon the competent and substantial evidence presented by Aloha and reflected in the record in this proceeding; the lack of credible evidence to the contrary; the often specious and conclusiory opinions of OPC's witnesses; and upon consideration of the record as a whole; applicable Florida law; and applicable precedents of this Commission; Aloha's application for increase in its water rates in Pasco County; and the specific rates and other determinations requested therein; should be granted by this Commission.

RESPECTFULLY SUBMITTED this 12th day of February, 2002, by:

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of both the Statement of Issues and Positions and the foregoing have been furnished via U.S. Mail or (*) Hand Delivery to the following on this 12th day of February, 2002:

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