

LAW OFFICES  
**ROSE, SUNDBSTROM & BENTLEY, LLP**  
2548 BLAIRSTONE PINES DRIVE  
TALLAHASSEE, FLORIDA 32301

**ORIGINAL**

(850) 877-6555  
Fax (850) 656-4029  
www.rsbatorneys.com

CHRIS H. BENTLEY, P.A.  
ROBERT C. BRANNAN  
F. MARSHALL DETERDING  
DAVID F. CHESTER  
MARTIN S. FRIEDMAN, P.A.  
JOHN R. JENKINS, P.A.  
STEVEN T. MINDLIN, P.A.  
DAREN L. SHIPPY  
WILLIAM E. SUNDBSTROM, P.A.  
DIANE D. TREMOR, P.A.  
JOHN L. WHARTON  
ROBERT M. C. ROSE, *OF COUNSEL*  
WAYNE L. SCHIEFELBEIN, *OF COUNSEL*

CENTRAL FLORIDA OFFICE  
600 S. NORTH LAKE BLVD., SUITE 160  
ALTAMONTE SPRINGS, FLORIDA 32701  
(407) 830-6331  
FAX (407) 830-8522

REPLY TO ALTAMONTE SPRINGS

January 8, 2003

**VIA HAND DELIVERY**

Ms. Blanca Bayo  
Commission Clerk and Administrative Services Director  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399

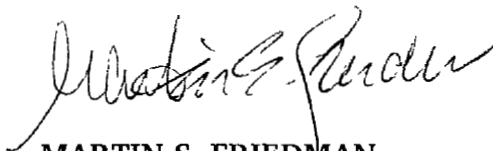
Re: Docket No. 020344-SU; Application for increase in Wastewater rates in Monroe County by Key Haven Utility Corporation  
Our File No.: 26043.10

Dear Ms. Bayo:

Enclosed is Key Haven Utility Corporation's Response to the PSC Audit Report in the above-referenced docket.

Should you have any questions concerning the enclosed, please do not hesitate to give me a call.

Very truly yours,



MARTIN S. FRIEDMAN  
For the Firm

MSF/dmp

AUS  Enclosures

CAF

CMP

COM  cc: Mr. Wayne Lujan (w/o enclosure)

CTR  Robert C. Nixon, CPA (w/o enclosure)

ECR  Mr. Clint Boutwell (w/enclosure) (via hand delivery)

GCL

OPC

MMS  Key Haven\PSC Clerk (Bayo) 05.ltr

SEC

OTH

DOCUMENT NUMBER-DATE

00244 JAN-8 2

FPSC-COMMISSION CLERK

Key Haven Utility Corporation  
Docket No. 020344-SU  
Response to Audit Report

Audit Exception No. 1: The Company agrees with the adjustment to plant in service of \$2,411.

The Company also agrees to the adjustment to accumulated depreciation (\$54,751.13), however, the Company is not sure what the auditor is recommending.

Audit Exception No. 2: The Company agrees with the adjustment.

Audit Exception No. 3: The Company agrees with this adjustment.

Audit Exception No. 4: The Company agrees with the adjustment to payroll taxes (\$-1,313) and to real estate taxes (\$1,578) for a net adjustment (increase) of \$265.

However, the Company disagrees with the adjustment to remove intangible taxes. Intangible taxes are based upon the value of the utility's net assets (in the form of stockholders equity). To the best of the Company's knowledge, intangible taxes have never been removed from this, or any other, company as a ratemaking adjustment.

Audit Exception No. 5: The Company agrees with this adjustment.

Audit Disclosure No. 1: The Company agrees with this disclosure.

Audit Disclosure No. 2: The Company agrees with this disclosure.

Audit Disclosure No. 3: The Company essentially agrees with this disclosure, however, the Company is not sure of what the auditor is proposing.

Audit Disclosure No. 4: The Company agrees with this disclosure.

Audit Disclosure No. 5: Since the amount in question relates to out of period expenses, the Company agrees to this adjustment.

Audit Disclosure No. 6: The Company included \$150 per month in its proforma adjustment to obtain gallonage data from the water company (Florida Keys Aqueduct Authority (FKAA)) not \$100 as stated in the Disclosure (12 months x \$150 = \$1,800; as shown on Schedule B-3, Line 25). See Attachment #4.

The Company submits the following as the total additional estimated cost of monthly billing that should be recognized in this proceeding. The Company presently renders bills to customers twice yearly, in the form of a coupon book containing six monthly bills for flat rate service.

	<u>Annual</u>
Gallorage data charge from FCAA	\$ 1,800
Additional postage (433 customers x \$0.37 x 10 additional mailings)	1,602
Envelopes (433 customers x \$0.07/envelope x 10 additional mailings)	303
Return envelopes (433 customers x \$0.05/envelope x 12 months)	260
Invoices:	
Cost of paper (433 customers x \$0.01/bill x 12 months)	\$ 52
Remove cost of coupon books	<u>(738)</u> (686)
Additional salary (433 customers x 13 minutes per bill (Note 1) = 93.82 hours/month x 12 months = 1,126 hours/year x \$15/hr.	16,890
Present salary (\$12,000 annual less 1,800 for non-billing related work (Accounts Payable and billing customer issues)	<u>(10,200)</u> 6,690
Depreciation of software (\$700/5 years amortization)	<u>140</u>
 Total estimated annual cost of monthly billing	 <u>\$10,109</u>

Note 1 - The additional estimated time to calculate, and print 433 metered rate bills per month, stuff envelopes, post them, mail them, pick up mail, receipt payments, and calculate past due balances

Audit Disclosure No. 7: The Company disagrees with this Disclosure. The Company believes that \$525 per month is a fair price for comparable office space in Key West and, in fact, is less than what it would cost to maintain a stand-alone office.

Additionally, the utility did recognize 285-sq. ft. of space used by the utility employee. Added to that was 15-sq. ft. of storage space used in an out building to comply with Internal Revenue Service and regulatory record retention requirements.

The utility disagrees with the auditor's conclusion that the rental charge should be adjusted by 50%, for a time allocation of the Company's one office employee. The employee must be available at all times the office is open to deal with utility matters. Additionally, with the implementation of monthly billing, the bookkeeper will be working full-time on utility matters.

Finally, the utility disagrees with the stated PSC policy "When we have a lease with an affiliate, we usually use the lower of cost or market to determine the rent allocation." To use the lower of cost or market is confiscatory and presumes that because it is an affiliated transaction, it is unfair to the rate payer. As noted by the auditor, the Company provided estimates from a local realtor which substantiates the \$21 per square foot lease expense contained in the total rent and overhead charge.

The courts have found, in *GTE Florida Incorporated vs. Deason*, 642 So. 2d 545 (Fla 1994), "... the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair. If the answer is "no", then the PSC may not reject the utility position". See Attachment #5

Other Audit Matters:

1. In the initial draft of the Audit Report, Disclosure No. 5 addressed the issue of the proforma adjustment for the plant operating permit, estimated at \$7,800 with amortization of \$1,560 per year.

The final costs are attached, and total \$8,500, with amortization of \$1,700 annually. See Attachments #2 and #3.

Therefore, amortization needs to be increased \$140 per year.

2. During the course of the audit, the Company provided documentation of the management fee paid to the Company's president, Mr. A. Wayne Lujan. In addition, auditors were furnished a copy of the Management Agreement in effect since August 1994, which requires an annual payment of \$26,000. In the MFR's, only \$20,000 was paid, as the Company has not had the funds available to pay the contractual amount of the management fee.

The Company believes the 1994 amount contained in the Management Agreement is fair and reasonable, and was approved in the 1993 Rate Case. An additional \$6,000 should be recognized on a going forward basis in this rate proceeding.

Page 3

390876 1336

KEY HAVEN UTILITY CORPORATION, INC.  
 P.O. BOX 2057  
 KEY WEST, FL 30946

040194374 1 A DATE 08/29/02 \$ 7500.00 DOLLARS

PAY TO THE ORDER OF *D.E.P.*

*Security year end 2002*

FOR *Operating Limit Review*

STATE BANK OF FLORIDA  
 KEY WEST, FLORIDA BRANCH

*Andrew W. Jones*

REDACTED

CK# 1336 \$7,500.00 PAID 08/29/2002

AT

2

FL. UTIL. **ATTACHMENT #3**

**GLEN BOE & ASSOCIATES, INC.**

6807 OVERSEAS HIGHWAY

MARATHON, FL 33050

PHONE (305) 743 5111 • FAX (305) 743 5197

July 30, 2002

Wayne Lujan  
Key Haven Utility Corporation  
1104 Truman Avenue  
Key West, FL 33040

RE: Key Haven Utility Corporation  
Wastewater Treatment Plant  
Permit Renewal  
Invoice No.: 0702-08-W

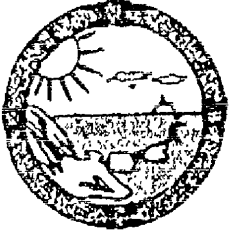
SERVICE: Prepared application packages for submittal to regulatory agencies  
as required.

FEE: For Services \$1,000.00

Balance Due: \$1,000.00

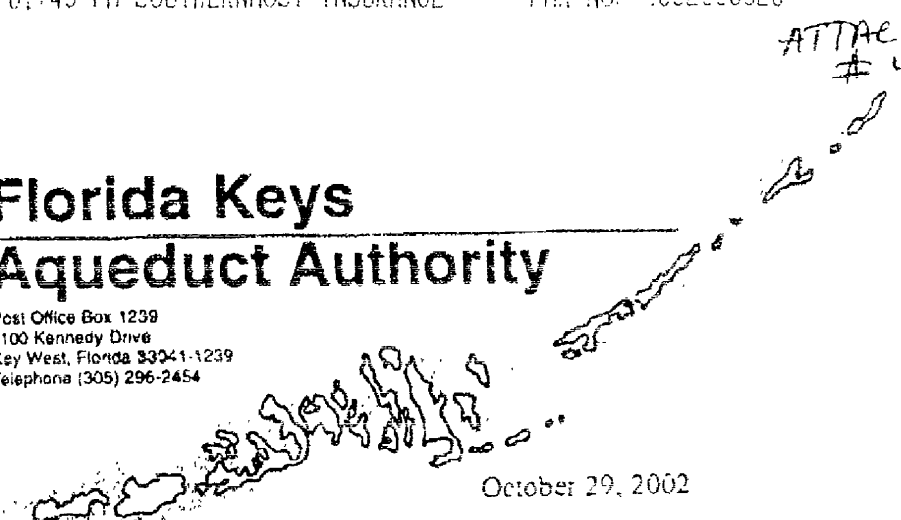
Please write Invoice No. 0702-08-W on check

*ck 1346 11/12/02*



# Florida Keys Aqueduct Authority

Post Office Box 1239  
1100 Kennedy Drive  
Key West, Florida 33041-1239  
Telephone (305) 296-2454



ATTACHMENT  
# 4

John M. Koenig, Sr.  
Chairman  
Key West

Lynn C. Mapes  
Grassy Key

Mary L. Rice  
Secretary-Treasurer  
Marathon

Linda B. Wheeler  
Key West

Harry E. Cronin  
Key Largo

Roger Braun  
Executive Director

October 29, 2002

Key Haven Utility Corporation  
A. Wayne Lujan, President  
P.O. Box 2067  
Key West, FL 33045

Re: Monthly consumption data report charge

Dear Mr. Lujan:

This letter is confirming the monthly cost of \$150.00 for the Florida Keys Aqueduct Authority to provide a consumption data report to the Key Haven Utility Corporation for your customers on Key Haven.

To date, the Florida Keys Aqueduct Authority has provided one data report to the Key Haven Utility Corporation for a rate study and the cost was \$150.00 which has been paid.

If I can be of further assistance to you, please call 296-2454 ext. 231

Sincerely,

Luanne Malgrat  
Director of Administration

Attachment #5

LEXSEE 642 So. 2d 545

GTE FLORIDA INCORPORATED, Appellant, v. J. TERRY DEASON, etc., et al.  
Appellee.

No. 82,003

SUPREME COURT OF FLORIDA

642 So. 2d 545; 1994 Fla. LEXIS 1000; 19 Fla. L. Weekly S 362

July 7, 1994, Decided

**SUBSEQUENT HISTORY:**

[\*\*1]

Released for Publication September 22, 1994.

**PRIOR HISTORY:**

An Appeal from the Public Service Commission.

**COUNSEL:**

Thomas R. Parker, James V. Carideo, Joe W. Foster, Kimberly Caswell and M Eric Edgington. Tampa, Florida, for Appellant.

Robert D. Vandiver, General Counsel and David E. Smith, Director of Appeals, Florida Public Service Commission. Tallahassee, Florida; and Jack Shreve, Public Counsel and Harold McLean, Associate Public Counsel, for the Citizens of the State of Florida. Tallahassee, Florida, for Appellees.

**JUDGES:**

GRIMES, C.J., and OVERTON, SHAW, KOGAN and HARDING, JJ., and McDONALD, Senior Justice, concur.

**OPINIONBY:**

PER CURIAM

**OPINION:**

[\*546] PER CURIAM.

We have on appeal a decision by the Florida Public Service Commission relating to rates or service of telephone utilities. We have jurisdiction. Art. V, § 3(b)(2), Fla. Const.; § 364.381, Fla. Stat. (1993).

In 1992, GTE Florida Incorporated asked the Public Service Commission (PSC) to approve a telephone rate increase in gross annual revenues of \$ 110,997,618, later

revised downward to \$ 65,994,207. After hearings, the PSC denied the request and reduced revenues by about \$ 14,500,000.

GTE Florida filed a motion for reconsideration. The [\*\*2] PSC took up the motion in a meeting lasting less than an hour. At this point the PSC decreased the negative revenue requirement by about \$ 831,000 to \$ 13,500,000.

Ten million dollars of the total reduction arose from GTE's use of Statement of Financial Accounting Standards 106 ("SFAS 106"), which embodied expenses GTE Florida claimed in connection with certain post-retirement benefits. GTE contended that the \$ 10,000,000 reduction was improperly based on the PSC's unsupported opinion of GTE Florida's 1994 financial conditions, rather than the established 1992 test year and the 1993 rate year contained in the record.

The PSC disallowed some of the cost of services supplied by GTE Data Services, an affiliate of GTE Florida. As grounds, the PSC held that the transaction with the affiliate was not "arms length" and therefore was subject to greater scrutiny. Specifically, the affiliate would only be entitled to cost plus a reasonable return, which was set at 11.25 percent. The evidence showed, however, that GTE Data Services charged GTE Florida rates equal to or less than those charged to nonaffiliates.

The cost of supplies purchased from GTE Supply was disallowed for the same reason. [\*\*3] The PSC found that the relationship with GTE Supply provided substantial benefits, however, and allowed a greater return to GTE Supply. The evidence showed that GTE Supply sold commodities to GTE Florida at a discount of about 2.5 to 3 percent lower than the cost to nonaffiliates.

The PSC also based its order on a calculation of GTE Florida's capital structure, which the corporation disputes. The calculation involved a wholly owned subsidiary, GTE Communications, which sells deregulated offerings. The PSC reduced GTE Florida's capital structure by 100 percent of the equity value of GTE Communications. GTE



Florida contended that the reduction should have been adjusted to represent proportionately its own sources of capital, which include forms of debt such as bonds.

Regarding SFAS 106, our research has disclosed that this relatively new accounting standard n1 has created some confusion throughout the nation. In simple terms, SFAS 106 establishes a new "accrual" method of accounting for costs associated with post-retirement benefits other than pensions [\*547] (PBOPs), replacing the earlier "pay-as-you-go" accounting method. Under the accrual method, PBOP costs are deemed "paid" for financial [\*\*4] accounting purposes as each employee earns them rather than when the PBOPs are actually paid to employees after retirement. Thus, SFAS 106 essentially is a change in the timing at which PBOP costs are used to offset company profits for accounting purposes. However, this change can have dramatic results. In 1991, International Business Machines' switch to SFAS 106 had an estimated accounting effect of \$ 2.26 billion. Reva Steinberg et al., *Accounting for Post-Retirement Benefits: Part II*, 8 Prentice Hall Insights 29 (1991).

n1 SFAS 106 was formally adopted by the Financial Accounting Standards Board in December 1990.

SFAS 106 has generated diverse responses by ratemaking authorities throughout the nation. Some such authorities apparently have adopted the accrual method of accounting for ratemaking purposes with little if any change. E.g., *Iowa Adopts Accrual Method for PBOPs*, 131 Pub. Util. Fort. 51 (1993). Other jurisdictions have rejected it in whole or in part. E.g., *Arizona Sticks with Cash Accounting [\*\*5]*, 132 Pub. Util. Fort. 54 (1994). This apparently includes the Federal Communications Commission in at least one case involving telephone carriers, *FCC Rejects PBOP Accounting Change*, 131 Pub. Util. Fort. 60 (1993).

Still other jurisdictions have permitted some utilities to fully recover SFAS 106 costs, while requiring other utilities to "phase in" the change. *Maryland PSC Keeps Its Word & Approves PBOP Phase-In*, 131 Pub. Util. Fort. 44 (1993). Some state utilities commissions have announced their intention of providing greater scrutiny over costs associated with SFAS 106 because of uncertainties surrounding it, and others have stated they may adopt an accrual method different from SFAS 106. *PBOP Rulings Continue*, 131 Pub. Util. Fort. 46 (1993). At least one state has required a utility company to defer SFAS 106 expenses

until future rate cases, in light of higher-than-usual company profits. *High Earnings Cover SFAS 106 Costs*, 132 Pub. Util. Fort. 46 (1994).

Partly because of the obvious confusion created by SFAS 106 in the ratemaking context, we cannot say we fault the PSC for exercising some degree of caution. While unsupported statements may have been made about [\*\*6] GTE's future earnings, we find that an independent basis supports the PSC's determination regarding SFAS 106: the uncertainties still associated with the accrual method of accounting for PBOPs in ratemaking. n2 Several other jurisdictions have expressed some doubt whether SFAS 106 is even appropriate in the context of ratemaking. In light of these uncertainties, the PSC is well within its discretion to proceed with some caution in changing over to the accrual method for ratemaking purposes. We so hold. n3 In fact, we believe the PSC would be within its discretion to entirely reject SFAS 106 for ratemaking purposes in light of the doubts surrounding such use. n4

n2 Accordingly, we do not find any violation of the test-year standard.

n3 Of course, future decisions of the PSC remain reviewable as provided by law.

n4 We also reject GTE's argument that its constitutional rights have been violated and its property illegally confiscated. A somewhat controversial change in accounting standards hardly gives rise to a constitutional right to have the benefit of those standards in ratemaking. This especially is true since any such "right" could not possibly have existed before the standards were changed in 1990, and since other jurisdictions have completely rejected those same standards in the ratemaking context. For the same reason there is no illegal "confiscation" of GTE's property. We also do not believe that any adjustments to the accrual method in future rate cases will violate the prohibition against retroactive ratemaking provided those adjustments do not retroactively leave a utility in a worse position than was established in prior rate cases, and provided they also do not impair existing contractual obligations in a manner prohibited by constitutional law. See *Southern Bell Tel. & Tel. Co. v. Florida Public Serv. Comm'n*, 453 So. 2d 780 (Fla. 1984).

[\*\*7]

We do find, however, that the PSC abused its

discretion in its decision to reduce in whole or in part certain costs arising from transactions between GTE and its affiliates, GTE Data Services and GTE Supply. The evidence indicates that GTE's costs were no greater than they would have been had GTE purchased services and supplies elsewhere. [HN1] The mere fact that a utility is doing business with an affiliate does not mean that unfair or excess profits are being generated. without [\*548] more. Charles F. Phillips, Jr., *The Regulation of Public Utilities* 254-55 (1988). We believe the standard must be whether the transactions exceed the going market rate or are otherwise inherently unfair. See id. If the answer is "no," then the PSC may not reject the utility's position. The PSC obviously applied a different standard, and we thus must reverse the PSC's determination of this question.

Finally, GTE complains that the PSC's determination of GTE's equity structure was faulty because it removed 100 percent of the value of an unregulated subsidiary, GTE Communications. GTE notes that other states in somewhat similar cases have required a pro rata reduction and have rejected 100 percent removal. [\*\*8] E.g., *State ex rel. Utilities Comm'n v. Public Staff-North Carolina Utilities Comm'n*, 322 N.C. 689, 370 S.E. 2d 567 (N.C. 1988).

On this point, we must affirm the PSC. The PSC order in this case notes that GTE's investment in GTE

Communications has the effect of increasing the parent company's business risk, which in turn requires an increase in its equity ratio. This means the parent's revenue requirements will be greater. There is adequate record support for these conclusions.

Were we to allow only a pro rata reduction based on the parent's sources of capital, this would not necessarily eliminate all of the increased costs likely to be borne by the rate payers as a result of GTE's riskier nonregulated investment. Accordingly, we believe the PSC is within its discretion in ordering a 100 percent removal, to eliminate any possibility that rate payers will shoulder any portion of the cost of the nonregulated investment. As the PSC noted, rate payers should only be required to pay for the cost of the regulated enterprise: local exchange service.

The order below is affirmed in part and reversed in part, and this cause is remanded to [\*\*9] the PSC for further actions consistent with this opinion

It is so ordered.

GRIMES, C.J., and OVERTON, SHAW, KOGAN and HARDING, JJ., and McDONALD, Senior Justice, concur.